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Pacta Sunt Servanda and State Promises to Foreign Investors Before Bilateral Investment Treaties: Myth and Reality

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Abstract

In their 1959 proposal to build a new international legal order founded upon principles of human dignity, Professors Myres McDougal and Harold Lasswell admonished international legal scholars to continuously reappraise the suitability and necessity of existing international legal institutions, taking due notice of the "myths" on which current arrangements are based and justified.' The aim of this Article is to take McDougal and Lasswell's admonition seriously in analyzing one of the persistent myths that serves to explain and to justify bilateral investment treaties ("BIT"s) that form the backbone of the modern system of international investment law. The author's aim is simply to establish that developing countries enjoy significant flexibility to exit the BIT system-if they come to the conclusion that BITs are, on net, undesirable-without harming their ability to make binding commitments to investors on a case-by-case basis through investment contracts, supported by international arbitration. In Part I, the author first briefly describes the modern BIT regime. The author then summarize and discuss the most important extant theoretical study of BITs and the source of the myth challenged here. Part II presents the mythic account of BITs. Part III analyzes the extensive jurisprudence of international arbitral tribunals in the pre-BIT era, which the author defines as the period prior to the 1990s. This jurisprudence demonstrates that international tribunals reliably expressed support in the abstract for the principle of pacta sunt servanda, and that they reliably awarded investors meaningful compensation for violations of the principle. Part IV discusses why the permanent sovereignty movement failed to make state promises unenforceable. Part V summarizes the Article's main points and responds to four potential objections. Part VI concludes.

PACTA SUNT SERVANDA AND STATE PROMISES TO FOREIGN INVESTORS BEFORE BILATERAL INVESTMENT TREATIES: MYTH AND REALITY

*Jason Webb Yackee**

I. *INTRODUCTION*

In their 1959 proposal to build a new international legal order founded upon principles of human dignity, Professors Myres McDougal and Harold Lasswell admonished international legal scholars to continuously reappraise the suitability and necessity of existing international legal institutions, taking due notice of the "myths" on which current arrangements are based and justified.[1] The aim of this Article is to take McDougal and Lasswell's admonition seriously in analyzing one of the persistent myths that serves to explain and to justify bilateral investment treaties ("BIT"s) that form the backbone of the modern system of international investment law.

The myth is the notion that, prior to the explosion of popularity of BITs in the early 1990s, developing countries were free to break their promises to foreign investors with legal impunity. In the mythic account, developing countries succeeded in destroying the principle of *pacta sunt servanda*, or "promises shall be kept," through a series of United Nations General Assembly ("UNGA") resolutions related to the establishment of "perma-

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1. Myres S. McDougal & Harold D. Lasswell, *The Identification and Appraisal of Diverse Systems of Public Order*, 53 AM. J. INT'L L. 1, 13 (1959). McDougal and Lasswell's essay was but one early entry in the vast opus that would become known as the New Haven School of International Law and that would evolve into modern pluralist approaches to international law. For a critical review of McDougal and Lasswell's framework, see generally Richard A. Falk, *Casting the Spell: The New Haven School of International Law*, 104 YALE L.J. 1991 (1995). On pluralist theories of international law, see generally Paul Schiff Berman, *A Pluralist Approach to International Law*, 32 YALE J. INT'L L. 301 (2007); William W. Burke-White, *International Legal Pluralism*, 25 MICH. J. INT'L L. 963 (2004).

nent sovereignty over natural resources."[2] BITs are popular, desirable, and perhaps even natural and necessary, the mythic account suggests, because they serve to reestablish the principle. Reestablishment is important, because investors will not invest if they believe that the country hosting their investment will breach promises upon which the investor has relied. Once reassured by BITs that developing countries will not be able to break their promises with impunity, foreign investors will be more likely to invest. And developing countries, by thus credibly committing to live up to their word, will benefit from the resulting flow of new investment, upon which their continued economic development depends.[3]

My main argument is that, contrary to the myth, a long line of international jurisprudence demonstrates that state promises to foreign investors have been strongly presumptively enforceable as a matter of consistent international law and practice. This line of jurisprudence begins in the 1930s and consolidates in the 1970s with the great oil arbitrations, in which international tribunals, charged with resolving legal claims arising from petroleum concession nationalizations in Libya and Kuwait, forcefully rejected extravagant claims by certain developing countries that foreign investment contracts could be freely breached as a matter of sovereign right.

This jurisprudence demonstrates that could an investor show to the satisfaction of a neutral, authoritative decision-maker—typically, an international arbitral tribunal—that a state had breached a promise to the investor, the investor would al-

2. *See infra* notes 50-51 and accompanying text.

3. However, empirical evidence that foreign direct investment ("FDI") is developmentally helpful is mixed. Some scholars suggest that increased FDI can be developmentally harmful under certain circumstances. *See* Theodore H. Moran et al., *Conclusions and Implications for FDI Policy in Developing Countries, New Methods of Research, and a Future Research Agenda*, *in* DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENT? 375, 377 (Theodore H. Moran et al. eds., 2005). Empirical evidence that bilateral investment treaties ("BIT"s) increase foreign investment is also mixed; my own studies suggest that the treaties do not lead to increased investment. *See generally* Jason Webb Yackee, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?*, 42 LAW & SOC'Y REV. 805 (2008) [hereinafter Yackee, *Bilateral Investment Treaties*]; Jason Webb Yackee, *Do BITs Really Work? Revisiting the Empirical Link between Investment Treaties and Foreign Direct Investment*, *in* THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS 379 (Karl P. Sauvant & Lisa E. Sachs, eds., 2009).

most certainly be awarded meaningful compensation. BITs have had little or even nothing to do with the widespread and long-standing acceptance of this rule of presumptive enforceability.[4]

This Article's argument is important because it suggests that developing countries need not to embrace BITs as part of their strategies to attract foreign investment. The BIT system has recently provoked a great deal of criticism and worry, as observers digest the still unfolding experience of Argentina, which faces many billions of dollars in international arbitral claims resulting from its policy response to a severe economic crisis in 2002.[5] While BITs, by providing investors with guaranteed access to international arbitration and to particular causes of action in the event of a breach of promise, do undoubtedly support the enforcement of state promises to investors, they are not necessary to render state promises enforceable. To a great extent, their protections are simply redundant to those that already exist in the form of strong international arbitral support for contractual obligations.[6] In other words, the currently predominant international legal arrangement for protecting foreign investments from breaches of state promises is neither as natural nor as necessary as it is sometimes portrayed to be.

This Article remains largely neutral on the important question of whether BITs are, on net, good or bad, or desirable or undesirable, as a matter of public policy. My aim is simply to establish that developing countries enjoy significant flexibility to exit the BIT system—if they come to the conclusion that BITs are, on net, undesirable—without harming their ability to make binding commitments to investors on a case-by-case basis through investment contracts, supported by international arbitration.

This Article's methodology is informally empirical, focusing on the published awards of international arbitral tribunals charged with resolving contract-related disputes between foreign investors and host states—that is, focusing on what Wolfgang Friedmann calls the "individualising application of . . . guide-

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4. *See also* Yackee, *Bilateral Investment Treaties, supra* note 3, at 812.

5. *See generally* R. Doak Bishop & Roberto Aguirre Luzi, *Investment Claims: First Lessons from Argentina, in* INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW 425 (Todd Weiler ed., 2005).

6. *See infra* Part III.

posts by impartial arbiters to concrete and unique situations . . . ."[7] It is not fruitful to consider whether the principle of *pacta sunt servanda* somehow can be said to exist or not to exist as a universal principle residing in the abstract ether of customary international law, separated from the context of concrete cases.[8] What matters is whether in actual cases neutral, authoritative decision-makers claim that, and act as if, state promises to investors are legally binding. This they do, and they have done it reliably for many years, regardless of the presence or absence of BITs.[9]

The Article proceeds as follows. Part II presents the mythic account of BITs. Part III analyzes the extensive jurisprudence of international arbitral tribunals in the pre-BIT era, which I define as the period prior to the 1990s. This jurisprudence demon-

7. WOLFGANG FRIEDMANN, THE CHANGING STRUCTURE OF INTERNATIONAL LAW 199 (1964).

8. Because my analysis privileges actual arbitral decisions, I do not discuss in any detail the various abstract doctrinal debates between publicists about the normatively proper contours of *pacta sunt servanda* as an international legal principle governing state contracts, or of how to properly classify the legal regime applicable to state contracts, or the like. However, it is worth noting that a thorough review of those debates supports my basic contention here: that the right of states to unilaterally terminate or modify their contractual obligations with investors is subject to important limitations, the most important of which is to provide the investor with meaningful compensation in the event of breach. *See* John A. Westberg & Bertrand P. Marchais, *General Principles Governing Foreign Investment as Articulated in Recent International Tribunal Awards and Writings of Publicists*, *in* 1 WORLD BANK GROUP, LEGAL FRAMEWORK FOR THE TREATMENT OF FOREIGN INVESTMENT 135, 161-62, 165 (1992) (providing a review of relevant doctrinal debates, and finding that while most publicists "do not appear to support the unqualified application of the principle of sanctity of contract, or that of *pacta sunt servanda*, to State Contracts," nonetheless the "prevalent view . . . is that the right of the State to amend or terminate a State Contract is not absolute and . . . may be made subject to limitations," including the limitation that the public interest in termination be "essential" or "preeminent" and made in "good faith" and that the investor be compensated).

9. I am not the first to analyze the subject of *pacta sunt servanda*'s place in international investment law. Professor Thomas Wälde, a distinguished scholar and practitioner of international investment law, has written a number of important articles addressing or touching upon the subject. *See generally*, Abba Kolo & Thomas W. Wälde, *Renegotiation and Contract Adaptation in International Investment Projects: Applicable Legal Principles and Industry Practices*, 1 J. WORLD INVESTMENT 5 (2000); Thomas W. Wälde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 215 (1996). My analysis is largely compatible with Wälde's own, and owes many debts to his work, though, in my view, parts of his analysis risk giving the reader a mistaken assumption that arbitral practice is less uniform and less favorable as to the general enforceability of state promises than the cases actually suggest. For another valuable and broader study, see generally NAGLA NASSAR, SANCTITY OF CONTRACTS REVISITED: A STUDY IN THE THEORY AND PRACTICE OF LONG-TERM INTERNATIONAL COMMERCIAL TRANSACTIONS (1995).

strates that international tribunals reliably expressed support in the abstract for the principle of *pacta sunt servanda*, and that they reliably awarded investors meaningful compensation for violations of the principle. Part IV discusses why the permanent sovereignty movement failed to make state promises unenforceable. Part V summarizes the Article's main points and responds to four potential objections. Part VI concludes.

II. PACTA SUNT SERVANDA *& BITS: THE MYTH*

In this Part, I first briefly describe the modern BIT regime. I then summarize and discuss the most important extant theoretical study of BITs and the source of the myth challenged here.

A. *Brief Introduction to BITs*

The rapid diffusion of BITs is one of the most remarkable recent developments in modern international law. Developing countries have now signed thousands of the treaties, the vast majority since the early 1990s.[10] Most of these BITs contain a common suite of core substantive and procedural provisions designed to promote and protect foreign investment.[11] These core provisions typically include promises of highly vague but clearly pro-investor standards of treatment, such as promises that investors will be treated "fair[ly] and equitab[ly]," or treated on a most-favored-nation basis, or treated as well as domestic investors.[12] Of particular relevance to the mythic account of BITs, most of the treaties also contain promises of "adequate" compensation if the investor's property is expropriated or nationalized, and many contain so-called "umbrella clauses"—express affirmations of the principle that states should live up to their promises to investors.[13] Most modern treaties couple these substantive

10. The literature on BITs is, not surprisingly, growing rapidly. For helpful descriptive overviews of the treaties, and of trends in BIT signings, see generally RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES (1995); UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, BILATERAL INVESTMENT TREATIES (1988); UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, BILATERAL INVESTMENT TREATIES 1959-1999 (2000); UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, BILATERAL INVESTMENT TREATIES IN THE MID-1990s (1998).

11. *See* DOLZER & STEVENS, *supra* note 10, at 97-118 (discussing the core provisions of BITs); Jason Webb Yackee, *Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties*, 33 BROOK. J. INT'L L. 405, 415-16 (2008) (discussing the same argument).

12. *See* Yackee, *supra* note 11, at 416.

13. On the history of the umbrella clause and an analysis of recent arbitral juris-

promises with guaranteed access to international arbitration that investors can invoke in the event the host state breaches its BIT obligations.[14]

The ubiquity of BITs and the potential expansiveness of the vague causes of action that they provide to investors have led to an explosion of international investment arbitration. The International Centre for the Settlement of Investment Disputes ("ICSID") is an arbitral facility affiliated with the World Bank and is frequently granted jurisdiction over BIT-based investment disputes.[15] Over the first twenty years of ICSID's existence, from 1966, the year the ICSID Convention[16] entered into force, through 1986, investors registered just twenty-one investment disputes with the ICSID; in contrast, from 1987 through July 30, 2008, a comparable length of time, investors have registered 248 disputes.[17] In total, ICSID has concluded 162 arbitration proceedings,[18] and 124 ICSID arbitrations are currently pending.[19] Certain developing countries have been particularly exposed to BIT-based litigation. Most dramatically, since 2000, Argentina has faced over forty ICSID arbitrations, totaling approximately US$16 billion in claims by investors allegedly harmed by Argentina's currency devaluation and associated policy responses to a

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prudence applying it, see generally Thomas W. Wälde, *The "Umbrella" Clause on Investment Arbitration—A Comment on Original Intentions and Recent Case*, 6 J. WORLD INVESTMENT & TRADE 183 (2005).

14. *See* Yackee, *supra* note 11, at 423-33.

15. *See* Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention]. Investors may also gain access to International Centre for the Settlement of Investment Disputes ("ICSID") arbitration through an ICSID arbitration clause in a contract, or through a state's consent to ICSID arbitration contained in a municipal investment law. BITs are not necessary for an investor to arbitrate an investment dispute before an ICSID tribunal. *See* Yackee, *supra* note 11, at 447, 451. As the cases discussed *infra* illustrate, many contract-based investment disputes are also litigated before the International Chamber of Commerce ("ICC").

16. ICSID Convention, *supra* note 15.

17. Concluded cases are available at Int'l Ctr. for the Settlement of Inv. Disputes [ICSID], List of Concluded Cases (Apr. 24, 2009), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListConcluded [hereinafter ICSID, *List of Concluded Cases*], and pending cases are available at ICSID, List of Pending Cases (Apr. 24, 2009), http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&action Val=ListPending [hereinafter ICSID, *List of Pending Cases*].

18. *See* ICSID, *List of Concluded Cases*, *supra* note 17.

19. *See* ICSID, *List of Pending Cases*, *supra* note 17.

severe economic crisis in the early 2000s.[20]

The rise of investment arbitration, and Argentina's travails in particular, have led to a corresponding rise in discontent with the BIT system.[21] Scholars have argued that inconsistent decisions by arbitral tribunals threaten the legitimacy of the system,[22] that BITs give foreign investors an unfair competitive advantage over domestic investors,[23] that international arbitration under BITs is biased in favor of investors,[24] or that it wrongly impinges upon regulatory sovereignty,[25] among other criticisms.[26] Criticism is likely to further intensify as investors use BITs to mount increasingly ambitious challenges to government policies in highly sensitive issue areas.[27] For example, investors are currently suing South Africa over its Black Economic Empowerment legislation, which aims to counteract the historical legacy of apartheid by increasing black participation in the economy.[28] Investors are also increasingly using BITs, or their equivalent in-

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20. *See* Bishop & Luzi, *supra* note 5, at 425. For Argentina's ICSID cases, see List of Concluded Cases and List of Pending Cases, *supra* note 17.

21. *See* Yackee, *supra* note 11, at 459-60.

22. *See generally* Susan D. Franck, *Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005).

23. *See, e.g.*, Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30, 129 (2003) (addressing the North American Free Trade Agreement specifically).

24. *See* GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 167-75 (2007); Olivia Chung, Note, *The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration*, 47 VA. J. INT'L L. 953, 958, 960 (2007). The note critiques BITs as "unequal," "vague," imposing "burdensome restrictions on sovereignty," and as leading to "inequitable and excessive arbitral awards." *Id.* at 957, 959, 963, 965.

25. *See, e.g.*, Robert Stumberg, *Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 491, 492-95 (1998) (discussing the "sovereignty tradeoffs" posed by investment treaties, and arguing that the failed attempt to construct a "multilateral agreement on investment" represented a "depart[ure] from the fundamental values of federalism in the U.S. Constitution").

26. M. Sornarajah provides a brief overview of the most important critiques. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 259-68 (2004).

27. *Cf.* Joshua Robbins, *The Emergence of Positive Obligations in Bilateral Investment Treaties*, 13 U. MIAMI INT'L & COMP. L. REV. 403, 404-05 (2006) (noting that the BIT system has "given rise to a growing number of rather creative claims by investors" and providing examples).

28. *See* Luke Eric Peterson, *European Mining Investors Mount Arbitration over South African Black Empowerment*, INVESTMENT TREATY NEWS (Int'l Inst. for Sustainable Dev., Winnipeg, Can.), Feb. 14, 2007, at 2, *available at* http://www.iisd.org/pdf/2007/itn_feb14_2007.pdf (discussing a lawsuit alleging South Africa's Black Economic Em-

vestment chapters in free trade agreements ("FTA"s) like the North American Free Trade Agreement ("NAFTA"), to advance claims against states that would be considered quixotic, if not farcical, if brought under most domestic legal systems. For instance, a U.S. investor has recently filed a formal notice of intent to sue Canada under the investment chapter of NAFTA after the Canadian Prime Minister reneged on a campaign pledge to oppose raising taxes on Canadian energy income trusts.[29] For a U.S. equivalent, and to get a sense of how quixotic, one need only imagine a lawsuit by a Canadian investor seeking damages from the U.S. government for the first President Bush's breach of his ill-advised "read my lips: no new taxes" pledge.[30]

B. *The Mythic Account of BITs*

The sheer number of investment treaties, that they have given rise to interesting and novel legal claims, and that arbitral tribunals formed under them are now among the most important generators of authoritative pronouncements on international law,[31] have attracted the attention of social-scientifically minded scholars of international law, who have sought to explain and justify the treaties' popularity.

Professor Andrew Guzman's 1998 article "Why [Less Developed Countries] Sign Treaties That Hurt Them" provides the single most influential theoretical analysis of the treaties to date.[32] Guzman's theory has been favorably cited and applied in the law and economics,[33] international business,[34] political sci-

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powerment legislation "violates the terms of investment protection treaties concluded by South Africa with Italy and Luxembourg").

29. For relevant documents, see NAFTA Trust Claims, http://www.naftatrustclaims.com (last visited Apr. 19, 2009), a propagandistic website established by an aggrieved U.S. investor and containing links to incriminating YouTube videos of the prime minister promising at a news conference not to change the tax regime.

30. For a transcript of the entire speech, see American Rhetoric: George H.W. Bush—1988 Republican National Convention Acceptance Address, http://www.americanrhetoric.com/speeches/georgehbush1988rnc.htm (last visited Apr. 19, 2009).

31. As noted above, ICSID currently has 124 cases pending, *see supra* text accompanying note 19; the International Court of Justice ("ICJ"), which decides international disputes between states, has just fifteen, *see* Pending Cases in the International Court of Justice, http://www.icj-cij.org/docket/index.php?p1=3&p2=1 (last visited Apr. 24, 2009).

32. Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998).

33. *See* Anne van Aaken, *Perils of Success? The Case of International Investment Protection*, 9 EUR. BUS. ORG. L. REV. 1, 13 n.44 (2008) (citing Guzman and presenting an

ence,[35] and development economics literatures.[36] Given its influence, and that it is the primary source of the myth that BITs are necessary to establish an international legal principle of *pacta sunt servanda*, it is worth reviewing his argument in some detail.

For Guzman, one of the major potential impediments to increased foreign investment in the developing world is the possibility that developing country governments will change their policy regimes in ways that are harmful to the profitability of foreign investment.[37] The possibility of adverse changes of policy is especially problematic for foreign investors operating in sectors in which the investment, once made, is difficult to redeploy outside of the host state.[38] For example, an investor in a mining operation cannot easily move the mine's ore, or even the heavy equipment that services the mine, in the event that the country hosting the investment decides to raise the royalty rate that the investor must pay for the privilege of operating the mine. Because redeployment of fixed assets is costly, the investor may have no choice but to accept the adverse policy change, even if the change violates the terms and conditions that the investor reasonably expected to govern the investment at the time the investor decided to invest.

One of the challenges faced by developing countries that wish to attract investment is to credibly guarantee to investors

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argument similar to his that the main function of BITs "is to make the commitment of the host State credible"); Ryan J. Bubb & Susan Rose-Ackerman, *BITs and Bargains: Strategic Aspects of Bilateral and Multilateral Regulation of Foreign Investment*, 27 INT'L REV. L. & ECON. 291, 292 (2007) (describing Guzman's discussion as "seminal" before "build[ing] on and critiqu[ing]" Guzman's model).

34. *See* Louis T. Wells, *Protecting Foreign Investors in the Developing World: A Shift in US Policy in the 1990s?*, *in* INTERNATIONAL BUSINESS AND GOVERNMENT RELATIONS IN THE 21ST CENTURY 421, 444 n.24 (Robert Grosse ed., 2005) (describing Guzman's theory as "well-argued").

35. *See* Zachary Elkins, Andrew T. Guzman & Beth A. Simmons, *Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000*, 60 INT'L ORG. 811 (2006) (testing statistically an implication of Guzman's theory).

36. *See* Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, 33 WORLD DEV. 1567, 1569-70 (2005).

37. Guzman refers to this problem as one of "dynamic inconsistency," under which a "preferred course of action, once undertaken, cannot be adhered to without the establishment of some commitment mechanism." Guzman, *supra* note 32, at 658.

38. Assets that are difficult to redeploy outside of a given relationship are often referred to in the economics literature as having a high degree of "asset specificity." *See, e.g.*, Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 526 (1983).

that the policies governing their investment will not be changed in ways that violate the investor's initial expectations. As A.A. Fatouros notes in his classic 1962 study of "Government Guarantees to Foreign Investors," for many investors

> some assurance as to the future is needed. 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 . . . . In the case of most underdeveloped countries today . . . it is impossible to predict with confidence that conditions of stability and security will exist during the period of dynamic change ahead. Thus arises the need for legal guarantees, to be given by the state or states concerned to foreign investors. The guaranteeing states have to commit themselves as to the future, to promise that certain measures are not going to be taken, that certain others will continue to be taken, or that the investor will be compensated for any loss due to changes in such measures.[39]

These government guarantees might take the form of provisions in municipal legislation or, quite frequently in the natural resources sector, in which investments are both difficult to redeploy and often politically sensitive, in the form of formal contracts between the host state and the foreign investor.[40]

To Guzman, the popularity of BITs is explained largely as a response to successful efforts by developing countries, acting collectively through the UNGA in the 1950s, 1960s, and 1970s, to destroy rules of customary international law that supported the enforceability of these guarantees. In his story, developing countries used a series of UNGA resolutions related to the movement to establish "permanent sovereignty over natural resources" as an international legal principle, and culminating in the 1974 Charter of Economic Rights and Duties of States[41] ("CERDS"), to attack and eliminate the so-called "Hull Rule" of customary international law.[42] Developed countries have long argued that custom required that investors should always and with no exceptions receive "prompt, adequate, and effective" compensation

39. A.A. FATOUROS, GOVERNMENT GUARANTEES TO FOREIGN INVESTORS 63 (1962) (internal citations omitted).

40. *See id.* at 69-128, 232-301.

41. G.A. Res. 3281 (XXIX), U.N. A/RES/29/3281 (Dec. 12, 1974) [hereinafter CERDS].

42. *See* Guzman, *supra* note 32, at 644-51.

where the foreign investor's property has been taken (e.g., expropriated or nationalized) by the host government.[43] This alleged rule of custom was originally articulated by U.S. Secretary of State Cordell Hull in response to Mexico's 1938 nationalization of the petroleum industry,[44] and since that time the U.S. government has insisted that the customary rule is and always has been that "prompt, adequate and effective" compensation (which I refer to in shorthand below simply as "adequate" compensation) is always required.[45]

What "adequate" compensation is supposed to entail in practice is not always entirely clear, but commentators typically suggest that it means "full"[46] or "just"[47] compensation that fairly reflects the market value of the property taken. This is the approach taken in modern U.S. BITs, which affirm that adequate compensation is always due in the event of expropriation, and which typically clarify that adequate compensation means "fair market value."[48] In the investment contract setting, we can also usefully think of adequate compensation as somewhat analogous to what contract law scholars typically refer to as "expectation damages"—the principle that if a legally enforceable promise has been breached, the victim is entitled to be placed in the position he would have occupied had the promise been fully performed.[49]

Developing country challenges to the U.S. position were mild at first, to say the least. A two-paragraph 1952 UNGA resolution on the "right freely to use and exploit their natural wealth

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43. Property Rights: General Considerations, 3 Hackworth DIGEST § 288, at 658-59.

44. *See id.*

45. *See* Guzman, *supra* note 32, at 645 n.19 (discussing U.S. statutory incorporation of the Hull Rule).

46. *See* Frank G. Dawson & Burns H. Weston, *"Prompt, Adequate and Effective": A Universal Standard of Compensation?*, 30 FORDHAM L. REV. 727, 737-38 (1962).

47. *See* Georg Schwarzenberger, *The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary*, 9 J. PUB. L. 147, 161 (1960).

48. Kenneth J. Vandevelde, *The Bilateral Investment Treaty Program of the United States*, 21 CORNELL INT'L L.J. 201, 232 n.208 (1988). Even the precision that "market value" requires does not solve all potential ambiguities and problems in actual application to concrete cases. In many circumstances the expropriated property (such as a long-term concession agreement to extract a particular natural resource) will not have an identifiable market value, because no true market for such concessions exists to provide the appropriate reference price. In those cases, the adjudicator will likely enjoy considerable discretion in determining the particular level of compensation that is adequate.

49. Guzman, *supra* note 32, at 680.

and resources" introduced the concept of permanent sovereignty, without defining it, as an "inherent" "right of peoples" and "recommend[ed] all Member States to refrain from acts, direct or indirect, designed to impede the exercise of the sovereignty of any State over its natural resources."[50]

Resolution 626 was followed ten years later by the most important UNGA resolution on permanent sovereignty, Resolution 1803.[51] In Article 4, a near-unanimous Assembly, including the United States, adopted language declaring that investors "shall be paid *appropriate* compensation . . . in accordance with international law" where their property—including, by inference, their contract rights—has been taken, and that disputes over compensation "should be made through arbitration or international adjudication" where the investor and state have so agreed.[52]

The use of the word "appropriate" rather than "adequate" was a semantic though not necessarily substantive concession to developing countries. The fact that Article 4 stated the standard as "appropriate . . . in accordance with international law" gave developed countries ample space to make the highly plausible argument that Article 4 was fully compatible with the Hull Rule, as the "appropriate" amount of compensation was "adequate" compensation, as international law required.[53]

Just as importantly, Article 3 of Resolution 1803 affirmed

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50. G.A. Res. 626 (VII), U.N. Doc. A/2361 (Dec. 21, 1952). The United States opposed Resolution 626 because it failed to contain any "indication that states which take private property should recognize the rights of private investors under international law." James N. Hyde, *Permanent Sovereignty over Natural Wealth and Resources*, 50 AM. J. INT'L L. 854, 854 (1956).

51. G.A. Res. 1803 (XVII), U.N. Doc. A/5217 (Dec. 14, 1962). For a discussion of Resolution 1803's drafting history, see Karol N. Gess, *Permanent Sovereignty over Natural Resources: An Analytic Review of the United Nations Declaration and its Genesis*, 13 INT'L & COMP. L.Q. 398 (1964). For a comprehensive list of permanent sovereignty-related United Nations General Assembly ("UNGA") resolutions and other U.N. decisions, see NICO SCHRIJVER, SOVEREIGNTY OVER NATURAL RESOURCES: BALANCING RIGHTS AND DUTIES app. 1 (1997).

52. G.A. Res. 1803, *supra* note 51, ¶ 4 (emphasis added).

53. *See* Gess, *supra* note 51, at 427-28 (noting the position of the United States and Ireland that "'appropriate compensation' could only mean [adequate compensation]; the term 'appropriate' . . . was merely descriptive and had no technical or qualitative meaning," a position affirmed by Chile, the author of the draft language); Stephen M. Schwebel, *The Story of the U.N.'s Declaration on Permanent Sovereignty over Natural Resources*, 49 A.B.A. J. 463, 466 (1963); Robin C.A. White, *A New International Economic Order*, 24 INT'L & COMP. L.Q. 542, 545 (1975) (Resolution 1803 "embodied" the "developed nation's view"). *But see* Henry Landau, *Protection of Private Foreign Investments in Less Developed Countries—its Realities and Effectiveness*, 9 WM. & MARY L. REV. 804, 811-12 (1968)

that host state promises to investors were legally binding,[54] and Article 4 articulated the right of investors and host states to agree to settle compensation disputes through international adjudication. This latter declaration was particularly significant, as international adjudicators were more likely than the host state's municipal courts or authorities to take the view that promises to investors should indeed be upheld, and that "appropriate" compensation for breach was, generally speaking, something approximating full compensation.

Resolution 1803, despite its articulation of an ostensibly pro-developing–country international legal principle of "permanent sovereignty," thus represents, as Gess argues,

> [A] positive reaffirmation of four basic principles of international law:
> 1. That compensation must be paid in the event of a lawful taking of rights and property;
> 2. That such compensation must be paid in accordance with international law . . . ;
> 3. That investment agreements between States and private parties have a binding effect;
> 4. That arbitration agreements between States and private parties have a binding effect.[55]

Guzman argues that these reaffirmations were, in effect, overturned or superseded by the UNGA's 1974 adoption, over strong developed country protests, of CERDS.[56] CERDS was the

(suggesting that the developed countries' preferred interpretation of "appropriate" as "adequate" was not shared by developing countries).

54. Article 3 of G.A. Res. 1803 reads:

> In cases where authorization is granted, the capital imported and the earnings on that capital *shall be governed by the terms thereof*, by the national legislation in force, and by international law. The profits derived must be shared in the proportions freely agreed upon, in each case, between the investors and the recipient State, due care being taken to ensure that there is no impairment, for any reason, of that State's sovereignty over its natural wealth and resources.

G.A. Res. 1803, *supra* note 47 (emphasis added); *see also* Landau, *supra* note 53, at 813-14.

55. Gess, *supra* note 51, at 448. Gess further summarizes Resolution 1803 as "affirming the rule of *pacta sunt servanda*." *Id.* This is not to say that Resolution 1803 contains no important ambiguities. In particular, the resolution never defines "permanent sovereignty." More technically, and as Landau points out, the resolution fails to clarify the precise relationship between public international law principles that might govern contractual relations and potentially relevant municipal law. *See* Landau, *supra* note 53, at 813-14.

56. *See* Guzman, *supra* note 32, at 650-51; CERDS, *supra* note 41.

culmination of developing country efforts to establish a New International Economic Order ("NIEO").[57]

For present purposes, the most relevant provision of CERDS is Article 2, which declares that

> Each State has the right . . . [t]o nationalize, expropriate, or transfer ownership of foreign property, in which case appropriate compensation *should* be paid . . . taking into account . . . all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that other peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.[58]

The use of the permissive "should" rather than the obligatory "shall" of Resolution 1803 might suggest that, at least as CERDS is concerned, "appropriate" compensation for expropriation is not necessarily required in all circumstances. Note that Article 2 also asserts that the host state "shall" decide what amount of compensation, if any, is appropriate, and that such decision shall be made under municipal (and presumably not international) law applied by municipal courts (and presumably not by international adjudicators who might be more willing to hold that promises should be kept, and full compensation paid when they are not). More generally, CERDS is notable because its purported scope of application extends to "all . . . wealth, natural resources, and economic activities."[59] The inclusion of "wealth" and "economic activities" was intended to signal that permanent sovereignty principles were not only applicable to the natural resources sector (which had been the explicit and largely exclusive focus of the permanent sovereignty movement up to that point), but were also supposedly applicable to eco-

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57. On 1974 Charter of Economic Rights and Duties of States ("CERDS") as part of the New International Economic Order ("NIEO"), see generally Gillian White, *A New International Economic Order?*, 16 VA. J. INT'L L. 323 (1976). Other NIEO-related UNGA resolutions include: G.A. Res. 3202 (S-VI), U.N. Doc. A/RES/3202 (May 1, 1974); G.A. Res. 3201 (S-VI), U.N. Doc. A/RES/3201 (May 1, 1974); G.A. Res. 3171 (XXVIII), U.N. Doc. A/RES/3171 (Dec. 17, 1973) [hereinafter Permanent Sovereignty].

58. CERDS, *supra* note 41, art. 2 (emphasis added).

59. *Id.*

nomic activities involving foreign investors in all other sectors of the economy.

In Guzman's view, the NIEO resolutions "thoroughly undercut" the notion that "adequate" compensation must be paid under international law for expropriation, nationalization, or, by extension, breaches of state promises to investors.[60] As he puts it,

> Essentially, CERDS puts the host country government in full control and places the investor at the mercy of that government.
>
> . . . [T]he Hull Rule . . . was no longer a rule of customary international law.
>
> . . . The international rules governing . . . investment were entirely uncertain and individual states were in a position to determine what constituted appropriate compensation.[61]

For Guzman, the rise of BITs in the 1990s thus suggests a paradox: after destroying the Hull Rule of adequate compensation in the 1970s, many developing countries were now reaffirming their support for the rule by signing BITs that explicitly provided for the payment of adequate compensation in the event of expropriation.[62] Guzman explains this arguably paradoxical behavior by reference to cartel theory. In his view, developing countries succeeded through their U.N. efforts in creating a legal cartel, consisting of no international legal protection for foreign investors that collectively benefited developing countries.[63] As long as most or all developing countries supported the cartel, foreign investors would have no choice but to invest under unfavorable international legal rules if they chose to invest at all.[64] As with economic cartels, however, members of the U.N. legal cartel faced incentives to defect from the collective regime by offering investors, through BITs, guarantees of more favorable treatment, including guarantees of "adequate" compensation, because defecting countries might expect to capture a greater

60. Guzman, *supra* note 32, at 649.

61. *Id.* at 650-51.

62. *See id.* at 642. Many but not all BITs guarantee "adequate" compensation for expropriation; some of the treaties use words such as "just" to describe the requisite standard. *See* DOLZER & STEVENS, *supra* note 10, at 97-118 (describing the typical content of BITs, including provisions on compensation for expropriation).

63. *See* Guzman, *supra* note 32, at 678.

64. *See id.*

share of available foreign investment.[65]

There are a number of questionable aspects to Guzman's story. I will briefly mention four before addressing the fifth, the main focus of the Article.

First, Guzman seems to assume that the Hull Rule was actually incorporated into customary international law, and thus was available to be destroyed by CERDS. However, incorporation was and remains a highly contested issue among legal scholars, many of whom argue quite plausibly that customary international law has never fully reflected the Hull formulation.[66] Second, Guzman seems to assume that the various UNGA resolutions, and particularly CERDS, can be said to have created upon passage meaningfully binding customary international law. But in fact there is great uncertainty as to the conditions under which UNGA resolutions may be said to create new, binding international law,[67] and there are, to my knowledge, no serious

65. *See id.*

66. Whether a rule of customary law exists is said to depend on whether there is a widespread state practice in which states act in a certain way out of a sense of legal obligation (*opinio juris*). *See* IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 7 (1990). Much of the debate about whether the Hull Rule currently reflects or ever reflected customary law has focused on identifying instances of expropriation of foreign-owned property, and analyzing whether the amount of compensation paid, if any, seems to reflect the "full" value of the investor's loss. Dawson and Weston provide an early survey of compensation practice, and conclude that the payment of adequate compensation is "[f]ar from being a 'rule' of international law" and that "the demand for . . . 'adequate' . . . compensation would appear to be little more than a preference assumed [by investors and their home governments] for bargaining purposes—an element of legal mythology to which spokesmen pay ritualistic tribute and which has little meaning in effective policy." Dawson & Weston, *supra* note 46, at 757. Later surveys of lump-sum settlements of investor-state disputes suggest that the compensation paid is often less than "full" compensation, though the extent to which these settlements may be properly viewed as indicative of customary international law remains debated, as diplomatic settlements may lack the *opinio juris* said to be required of customary law formation. *See* SCHRIJVER, *supra* note 51, at 192-93; *see also* Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT'L L. & BUS. 327, 359 (1994) ("The argument that the 'prompt, adequate, and effective formula' is traditional international law finds little support in state practice or authoritative treatises and monographs."). *See generally* Samuel K.B. Asante, *International Law and Foreign Investment: A Reappraisal*, 37 INT'L & COMP. L.Q. 588 (1988); Richard B. Lillich & Burns H. Weston, Comment, *Lump Sum Agreements: Their Continuing Contribution to the Law of International Claims*, 82 AM. J. INT'L L. 69 (1988).

67. For extensive citations to various participants in the debate over the legally binding nature of UNGA resolutions, see Robert B. Von Mehren & P. Nicholas Kourides, *International Arbitrations Between States and Foreign Private Parties: The Libyan Nationalization Cases*, 75 AM. J. INT'L L. 476, 524 nn.177-79 (1981). As Schrijver notes, "[i]t is no longer a source of great controversy that certain categories of U.N. resolutions can

academic arguments that CERDS might have met those conditions—whatever they may be.[68] Third, Guzman also ignores the ambiguous relationship between CERDS and early UNGA permanent sovereignty resolutions, particularly Resolution 1803. Resolution 1803 was favorably "recall[ed]" by the UNGA as late as 1973,[69] no subsequent UNGA resolution expressly claims to renounce Resolution 1803's pro-investment principles, and it is not clear that the Charter can or should be read as overturning whatever international legal effect Resolution 1803 might have had. And fourth, Guzman overly discounts the tremendous shift in economic ideology that took place in the developing world in the two decades between the passage of CERDS and the explosion of interest in BITs in the 1990s—a shift from widespread acceptance of dependency theory, which emphasized the need to control foreign investment, to the neo-liberal Washington Consensus, with its emphasis on removing barriers to investment and eliminating opportunities for control.[70] Once we recognize this ideological shift, the behavior of developing countries in the two periods becomes much less inherently paradoxical.

But the most troublesome aspect of Guzman's argument, and the one that is the main focus of this Article, is Guzman's supporting assertion that by destroying the Hull Rule, developing countries thereby established an international legal regime

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have legal effects beyond their status as mere recommendations," and the idea that UNGA resolutions might at a minimum provide evidence of customary international law—as opposed to creating it from whole cloth in a quasi-legislative fashion—is widely accepted. SCHRIJVER, *supra* note 51, at 372. That said, whether particular UNGA resolutions actually do have "legal effects beyond their status as recommendations" is unclear, and must be determined on a case-by-case basis using uncertain criteria.

68. The best view of CERDS, and probably the only supportable view, is that it represented the legal "aspirations" of certain developing countries, rather than embodying new law itself. *See* A.O. Adede, *A Profile of Trends in the State Contracts for Natural Resources Development Between African Countries and Foreign Companies*, 12 N.Y.U. J. INT'L L. & POL. 479, 547 (1980) ("These UN resolutions, although not legally binding as such, are the vehicles through which developing countries have clearly expressed the prevailing attitude of a large section of the international community toward certain aspects of customary international law . . . ."); Charles N. Brower & John B. Tepe, Jr., *The Charter of Economic Rights and Duties of States: A Reflection or Rejection of International Law?*, 9 INT'L L. 295, 300-01 (1975). Adede is generally sympathetic to these "attitudes," but he repeatedly emphasizes that the U.N. resolutions "are not binding," but rather provide a "guide . . . to the negotiations of modern contracts . . . ." *Id.* at 567.

69. *See* Permanent Sovereignty, *supra* note 57, ¶ 5.

70. *See generally* Jason Webb Yackee, *Are BITs Such a Bright Idea? Exploring the Ideational Basis of Investment Treaty Enthusiasm*, 12 U.C. DAVIS J. INT'L L. & POL'Y 195 (2005).

in which they could breach promises to foreign investors with impunity, and in which they had no means of credibly guaranteeing *not* to breach their promises with impunity—in other words, a regime in which the principle of *pacta sunt servanda* had no meaningful force, and could not have any meaningful force. Guzman leaves no doubt as to his argument on this point, and, as the primary source of the myth, it is worth quoting him at length:

> International law [after CERDS] . . . does not provide a way for a host country to make credible and binding commitments to an investor. The mechanisms for the enforcement of a contract between a state and a private firm is [sic] at best extremely weak and at worst altogether non-existent. The precise status of such contracts is the subject of ongoing debate in the field of public international law and is far from being settled . . . . [T]here is no consensus that a contract with a host, by itself, offers a firm any additional protections under international law. Furthermore, even if protections exist in theory, the investor cannot be sure that they will be enforced by an arbitral tribunal or that the host will accept the decision of a tribunal if the firm obtains a favorable ruling. The fact that such agreements cannot be relied upon with any confidence implies that it is not possible for a state, even if it enters into an agreement, to make its commitment fully credible.
>
> The protections afforded to contract rights are so uncertain under international law that it is reasonable to model investor behavior under the assumption that these rights are of little or no value to the investor. More importantly, because these protections are unreliable, international law does not allow the host to make credible contractual commitments. This inability to make credible contractual commitments under international law explains why the debate over the protections afforded by customary international law was so important. Until the rise of BITs, there were few legal constraints, beyond those provided by customary law, on the behavior of host countries toward foreign investors. Thus, if the international community concluded that customary law did not require . . . adequate . . . compensation upon the taking of property, there would be no way for investors to achieve these protections.[71]

71. Guzman, *supra* note 32, at 659-60; *see also id.* at 678-79.

The value of BITs, in this view, lies not simply in reestablishing a duty to pay adequate compensation for expropriation, narrowly construed, but primarily in the fact that the treaties "lead to a world in which contracts between firms and host states are binding."[72] The treaties are essential because they "allow investors and hosts to establish binding and enforceable contracts . . . by permitting the host state to bind itself to a particular course of action before the investment takes place."[73] Indeed, Guzman claims that after CERDS, BITs were the *only* way of reestablishing the ability of developing countries to offer credible guarantees to investors. As Guzman says, "without BITs . . . it was impossible for any single country to 'defect' from the [CERDS] agreement—thus the 'cartel' of [least developed countries] was extremely stable."[74]

As I show in the next Part, these claims are highly misleading. What is important to emphasize at this point is that Guzman's claims, though misleading, have had great impact on the field of BIT studies. His theory has been accepted, unquestioned, by a number of prominent BIT scholars to support the notion that BITs are necessary to enable developing countries to provide investors with credible guarantees, and that investors, for that reason, care deeply about the treaties and take the presence or absence of BITs decisively into account when deciding where, and whether, to invest. Thus Neumayer and Spess, in a widely circulated empirical study of the effects of BITs on aggregate-level flows of foreign investment, rely heavily on Guzman's theory of BITs to support their finding that countries that sign BITs can expect to receive huge amounts of additional foreign investment.[75] Their empirical finding of huge causal effects makes sense only if it really is true that, absent BITs developing countries have no means of providing investors in risky sectors of the economy with effective guarantees.

Likewise, Ryan Bubb and Susan Rose-Ackerman have recently published a formal model that purports to show that developing countries are in theory collectively better off entering into BITs; while their model challenges certain aspects of Guz-

72. *Id.* at 679.

73. *Id.* at 687.

74. *Id.* at 678.

75. *See generally* Neumayer & Spess, *supra* note 36.

man's own account,[76] it also explicitly adopts Guzman's argument that prior to BITs international law did not admit the enforceability of state promises to investors. As Bubb and Rose-Ackerman say, "under customary international law, contracts between private investors and states are of dubious enforceability . . . . [BITs] have emerged to fill this lacuna of international law by providing [a principle of] *pacta sunt servanda*."[77]

The upshot of these various mythic arguments is to suggest that developing countries that wish to receive foreign investment have little or no flexibility to reject the BIT regime. If we really believe that, absent BITs, the investor is necessarily and unavoidably "at the mercy" of the host state government, and that the host state government can do nothing to credibly guarantee the investor that its promises will be kept, then any state that wishes to attract foreign investment would indeed be well-advised to enter into BITs. But as I show in the next Part, developing countries are perfectly capable of offering credible guarantees to investors on a case-by-case basis, as necessary to attract specific investments, without the need to enter into BITs.

III. PACTA SUNT SERVANDA *AND BITS: THE REALITY*

In this Part I analyze the long and consistent body of international jurisprudence supporting the idea that state promises to investors are presumptively enforceable. I first define what I mean by an international legal principle of *pacta sunt servanda*. I then discuss the pre-CERDS cases supporting the principle. I conclude the Part by discussing the many post-CERDS cases rejecting the notion that CERDS permits host states to breach their promises to investors. As the Part illustrates, some of the strongest statements in support of the principle of *pacta sunt servanda* came out of the great oil arbitrations of the 1970s—the same time period during which, according to Guzman, interna-

76. *See generally* Bubb & Rose-Ackerman, *supra* note 33. In Guzman's view, BITs leave developing countries worse off collectively than they were under the CERDS regime. *See id.* at 292. The main aim of Bubb and Rose-Ackerman's article is to show that it is possible, given certain assumptions, to model developing countries as collectively better off with BITs. I take no position here on this particular question.

77. *Id.* at 291-92. They also assert that "[u]nder traditional international law [meaning pre-BIT international law], states are the only subjects that can enter into binding agreements; agreements between non-state entities such as multinational corporations and states are generally not enforceable." *Id.* at 296 n.13.

tional law absolutely failed to recognize a duty to compensate investors for promissory breach. By the late 1970s and early 1980s, it should have been perfectly clear to anyone who cared to look that, as long as an investor had access to a neutral, authoritative adjudicator, the investor would almost certainly be awarded meaningful damages in the event that a developing country breached its promises. CERDS, in other words, very quickly proved to have absolutely no effect on the willingness of international tribunals to treat state promises to investors as presumptively enforceable in principle and in practice.

A. *Defining* Pact Sunt Servanda

As an initial matter it is desirable to specify what I mean by the principle of *pacta sunt servanda.*[78] I do *not* mean an unduly rigid and formalistic principle under which states must, in any and all circumstances, strictly obey to the letter promises they make to investors no matter what the content of those promises, no matter how severely circumstances have changed, or no matter what dire effects obeisance might have on the state's operations or existence.[79] As R.Y. Jennings puts it:

It is wrong to suppose that *pacta sunt servanda* must apply *tout*

78. The dictionary definition is that "agreements and stipulations . . . must be observed." BLACK'S LAW DICTIONARY 1140 (8th ed. 2004). Lowenfeld offers a less doctrinaire and rigid view of the principle as he sees it existing as part of an international *lex mercatoria*: "[c]ontracts should prima facie be enforced according to their terms (pacta sunt servanda)." Andreas F. Lowenfeld, *Lex Mercatoria: An Arbitrator's View*, *in* LEX MERCATORIA AND ARBITRATION 71, 89 (Thomas E. Carbonneau ed., 1998) (paraphrasing Michael Mustill, *The New* Lex Mercatoria*: The First Twenty-five Years*, *in* LIBER AMICORUM FOR THE RT. HON. LORD WILBERFORCE 149, 174-76 (Maarten Bos & Ian Brownlie eds., 1987)). Lowenfeld, following Mustill, adds a number of complementary and qualifying principles, particularly that contracts should be upheld in "good faith," that states should not be permitted to escape contractual obligations by denying their own capacity to make binding obligations, and that unforeseen difficulties in performance give rise to a duty upon both parties to negotiate in good faith to modify the contract. *Id.*

79. In contrast, Asante suggests that *pacta sunt servanda* means that "agreements must be kept at all costs." Samuel K.B. Asante, *The Concept of Stability of Contractual Relations in the Transnational Investment Process*, *in* LEGAL ASPECTS OF THE NEW INTERNATIONAL ECONOMIC ORDER 234, 241 (Kamal Hossain ed., 1980). Asante is sympathetic to the efforts of developing countries to create the NIEO, and it is clear from his discussion that he advances such a rigid definition of *pacta sunt servanda* largely to be better able to reject it as "blind" and simplistic and "lack[ing] of sophisticat[ion]." *Id.* at 243. In other words, his definition is a straw man, and as he goes on to note, "[e]qually, a bold assertion of an unqualified sovereign right to unilaterally abrogate or modify [investment contracts] . . . cannot provide a viable basis for a meaningful economic relationship between a host government and a transnational corporation." *Id.*

> *court* in all cases or in none. No mature law of contract is absolute, and few principles of law are to be understood without qualification . . . . Is it not likely that the true position is that the principle functions, as it does in the case of treaties, as a presumption: a presumption leaning against the existence of any right of unilateral termination; but which, like all presumptions, may in some cases be successfully rebutted? Thus understood it may be found both to fit readily into the pattern of existing law and to explain it.[80]

Following Jennings, we can say that a principle of *pacta sunt servanda* exists on the international level, if, except in limited circumstances, neutral and authoritative decision-makers tend to hold, as a matter of whatever law or laws they find to apply to the state promises at hand, that those promises should be kept, with meaningful compensation to be paid to the investor if they are not.[81] This means that states may on some occasions escape liability for breaching their promises if a relevant defense is determined to be applicable as a matter of law, such as the defense of "necessity" that has been at the center of a number of recent investment arbitrations,[82] or of *force majeure*,[83] or that a contract is void as *ultra vires*,[84] or if fundamental circumstances have changed in some meaningful way.[85] But in practice, there are

80. R.Y. Jennings, *State Contracts in International Law*, 37 BRIT. Y.B. INT'L L. 156, 177 (1961).

81. For an example of an international arbitration (involving foreign trade rather than foreign investment) that nonetheless provides a good illustration of the importance of guaranteeing arbitrator neutrality, see generally Martin Domke, *The Israeli-Soviet Oil Arbitration*, 53 AM. J. INT'L L. 787 (1959) (criticizing as unfair and impartial an award rendered against an Israeli company by three Soviet arbitrators in a dispute over the Soviet seller's contractual obligation to obtain licenses for the export of oil).

82. *See, e.g.*, William W. Burke-White, *The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System*, 3 ASIAN J. WTO & INT'L HEALTH L. & POL'Y 199, 207 (2008). *See generally* Jorge E. Viñuales, *State of Necessity and Peremptory Norms in International Investment Law*, 14 LAW. & BUS. REV. AM. 79 (2008).

83. *See, e.g.*, Susan Rose-Ackerman & Benjamin Billa, *Treaties and National Security*, 40 N.Y.U. J. INT'L L. & POL. 437, 450 n.53 (2008).

84. *Cf.* Emmanuel Gaillard, *Introductory Note* to *France: Court of Cassation Decision in* Southern Pacific Properties Ltd. Et Al. v. Arab Republic of Egypt, 26 I.L.M. 1004, 1004 (1987) (discussing the French court's refusal to enforce an ICC arbitration award against Egypt on the ground that the government official who signed the contract consenting to arbitration did not have official authority to do so).

85. This, of course, is the principle of *rebus sic stantibus*, which exists as the yin to *pacta sunt servanda*'s yang. *See* ADAM SAMUEL, JURISDICTIONAL PROBLEMS IN INTERNATIONAL COMMERCIAL ARBITRATION: A STUDY OF BELGIAN, DUTCH, ENGLISH, FRENCH, SWEDISH, SWISS, U.S. AND WEST GERMAN LAW 243 (1989) ("Pacta sunt servanda is one of the principal rules of the lex mercatoria. It is true that it may be tempered by the

few examples of the successful invocation of any exceptions to what has been a consistent and strong presumption that state promises to investors should be upheld, with meaningful compensation paid if they are not.

This definition of *pacta sunt servanda* is also flexible enough to include other legal labels or legal theories that neutral, authoritative decision-makers might use to justify promissory enforcement—equity, estoppel, unjust enrichment, the protection of acquired rights, and so on—the invocation of which can be expected to have effects equivalent to the recitation and application of the phrase *pacta sunt servanda* itself. The importance is not the citation of any particular magic words, but the application in practice of legal principles, however labeled, that support the basic notion that promises should be kept.

B. *The Pre-CERDS Cases*

In the years prior to World War II, it was unusual to find international tribunals adjudicating disputes between states and foreign investors. This was because of significant doctrinal doubt as to whether private parties were properly considered to be subjects of international law capable of directly bringing claims before international tribunals,[86] and because the institutional infrastructure supporting international commercial arbitration more generally was still in its infancy.[87] Instead, the legal institution of diplomatic protection provided the main interna-

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principle of rebus sic stantibus, but that is the case, to varying degrees, in most municipal laws."); Hasan S. Zakariya, *Changed Circumstances and the Continued Validity of Mineral Development Contracts, in* LEGAL ASPECTS OF THE NEW INTERNATIONAL ECONOMIC ORDER, *supra* note 79, at 263, 265.

86. Thus the literature on "international arbitration" of the period focuses almost exclusively on international arbitration as a means of settling disputes between governments, not as a means of settling disputes between governments and private actors. *See, e.g.*, Thomas Willing Balch, *"Arbitration" as a Term of International Law*, 15 COLUM. L. REV. 590, 601 (1915) (defining international arbitration as "International Courts and International judges chosen to function temporarily so as to pass judgment in the light of the Law of Nations upon some designated case of difference between two or more Nations . . . ."). *See generally* Henry S. Fraser, *A Sketch of the History of International Arbitration*, 11 CORNELL L.Q. 179 (1926) (reviewing the history of international arbitration, back to ancient Greece and Rome, as a history of interstate dispute settlement).

87. *See generally* Heinrich Kronstein, *Business Arbitration: Instrument of Private Government*, 54 YALE L.J. 36 (1944) (reviewing the growth of international commercial arbitration as the "new and separate law of national and international commercial groups"); Arthur Nussbaum, *Treaties on Commercial Arbitration: A Test of International Private-Law Legislation*, 56 HARV. L. REV. 219 (1942).

tional mechanism for enforcing the investor's legal rights against the host state,[88] and there are a number of examples from this early period of international tribunals enforcing state contracts in state-versus-state proceedings.

Thus we have the *Aboilard* award, in which Haiti was ordered to pay a substantial indemnity for its breach of a concession agreement with a French investor;[89] the 1899 *Antioquia Railroad* award, in which a British investor was awarded damages for Colombia's breach of a railway construction contract;[90] the 1900 award in the case of *Robert H. May*, in which Guatemala was found to have breached its own railway construction contract;[91] the 1897 *Chéribon Steamship* case, in which a tribunal awarded a large indemnity to France for Chile's non-execution of a con-

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88. *See* Edwin M. Borchard, *Contractual Claims in International Law*, 13 COLUM. L. REV. 457, 457 (1913) (noting that "[d]iplomatic protection is often invoked by citizens of one country in cases arising out of contracts entered into with . . . a foreign government"); *cf.* Alexander P. Fachiri, *International Law and the Property of Aliens*, 10 BRIT. Y.B. INT'L L. 32 (1929) (reviewing the most important international claims against host governments for compensation under international law for expropriation of investor property; all of the cases discussed involve espousal of the claim by the investor's government). For a highly interesting discussion and critique of the institution of espousal (or diplomatic protection) for foreign investment during the interwar years, see generally EUGENE STALEY, WAR AND THE PRIVATE INVESTOR: A STUDY IN THE RELATIONS OF INTERNATIONAL POLITICS AND INTERNATIONAL PRIVATE INVESTMENT (1935).

89. Aboilard, 11 R. INT'L ARB. AWARDS 77 (1905). The tribunal based its award on the principle of the investor's "legitimate expectations" (*attentes légitimes*), a principle that continues to inform arbitral jurisprudence under BITs. *Id.* at 80; *see also* Int'l Thunderbird Gaming Corp. v. Mexico, 6 ASPER REV. INT'L BUS. & TRADE L. 419, ¶ 147 (UNCITRAL 2006), *available at* http://ita.law.uvic.ca/documents/ThunderbirdAward.pdf (discussing legitimate expectations as "relat[ing] . . . to a situation where a [state's] conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure . . . to honour those expectations could cause the investor (or investment) to suffer damages.").

90. *See* H. LA FONTAINE, PASICRISIE INTERNATIONALE 1794-1900: HISTOIRE DOCUMENTAIRE DES ARBITRAGES INTERNATIONAUX 544, 551-52 (1902).

91. *See* PAPERS RELATING TO THE FOREIGN RELATIONS OF THE UNITED STATES, WITH THE ANNUAL MESSAGE OF THE PRESIDENT TRANSMITTED TO CONGRESS 648 (1902). The tribunal based its award upon its holding that:

> [t]he law of Guatemala . . . establishes, like those of all civilized nations of the earth, that contracts produce reciprocal rights and obligations between the contracting parties and have the force of law in regard to those parties; that whoever concludes a contract is bound not only to fulfill it, but also to recoup or compensate (the other party) for damages and prejudice which result . . . and that such compensation includes both the damage suffered and the profits lost.

Id. at 673. This appeal to "civilized" law is echoed in the post-World War II awards discussed *infra* notes 99-106 and accompanying text.

tract with a French ship owner to transport immigrants;[92] or the *Oliva* award, arising out of the Venezuelan Arbitrations of 1903, in which the umpire awarded the Italian investor reliance damages for Venezuela's breach of a cemetery concession.[93] The 1930 award in *Shufeldt's Case* is another important early example. The Guatemalan legislature had passed a decree annulling the U.S. investor's contract to extract chicle gum. The sole arbitrator held that Guatemala had an equitable duty under international law, founded upon the investor's reliance on Guatemala's earlier recognition of the validity of the contract, to provide indemnification.[94]

The famous *Lena Goldfields* arbitration of 1930 serves as a rough marker of the beginning of a new era, in which foreign investors would have the right and the ability to pursue their international legal claims against foreign governments directly on

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92. The Chéribon Steamship case (Chile v. France) is briefly noted in W. EVANS DARBY, MODERN PACIFIC SETTLEMENTS INVOLVING THE APPLICATION OF THE PRINCIPLE OF INTERNATIONAL ARBITRATION 63 (1904). Darby indicates that the award was never published. *See id.*

93. Oliva had obtained a concession to construct a large pantheon in a Caracas cemetery. He was expelled from Venezuela before construction had begun. The umpire held that:

> It is not to be inferred . . . that Venezuela has the right, either directly or indirectly, to break the concession, or that no recovery therefore should be allowed against it. A nation, like an individual, is bound by its contract, and although it may possess the power to break it, is obliged to pay the damages resultant upon its action.

JACKSON H. RALSTON, VENEZUELAN ARBITRATIONS OF 1903, S. DOC. NO. 316, 58th Cong., 781, 787 (1904). Because Oliva's lost profits from the contract were too speculative to be accurately determined, the umpire awarded Oliva the "amount expended to obtain" the concession "plus a reasonable allowance for the time lost by the claimant in connection therewith." *Id.*

94. *See Decision of the Arbitrator in Claim by The United States of America on Behalf of P. W. Shufeldt Against the Republic of Guatemala*, 24 AM. J. INT'L L. 799 (1930) [hereinafter Shufeldt's Case]. The sole arbitrator held that,

> The Government of Guatemala having recognized the validity of the contract for six years and received all the benefits to which they are entitled under the contract, and allowed the cessionary to go on spending money on the concession, is precluded from now denying its validity . . . .
>
> It is perfectly competent for the Government to enact any decree and for any reasons they see fit; but where such a decree, based even on the best of grounds, works injustice to an alien subject, the Government ought to make compensation for the injury inflicted, and cannot invoke any municipal law to justify their refusal to do so.

Id. at 800. The arbitrator's reasoning is analogous to the notion of "promissory estoppel" reflected in Section 90 of the Restatement (Second) of Contracts. *See generally* Edward Yorio & Steve Thel, *The Promissory Basis of Section 90*, 101 YALE L.J. 111 (1991).

their own behalves.[95] The case involved a British concessionaire's challenge to the Soviet Union's repudiation of a mining concession that granted Lena "exclusive rights of exploration and mining over certain vast areas of territory" for up to fifty years.[96] The *Lena* award contains path–breaking statements on the procedural law of international arbitration,[97] though for us the important holding is the substantive one, a holding that Nussbaum characterizes as uninteresting and unworthy of significant comment,[98] but which, for that unworthiness, is interesting here: the tribunal found that in repudiating the contract the Soviet Union had unjustly enriched itself. The tribunal awarded the company GB£13 million (US$65 million at then-prevailing exchange rates), an amount which Veeder rightly characterizes as "enormous"[99] and which implicitly included compensation for Lena's lost profits, as Lena had only invested US$20 million in the enterprise.[100]

Notably, the *Lena* tribunal based its decision on "general principles of law" common across domestic legal systems that es-

95. *See generally* Arthur Nussbaum, *The Arbitration Between the Lena Goldfields, Ltd. and the Soviet Government*, 36 CORNELL L.Q. 31 (1950). *Lena* is not, however, the only pre-World War II example of a true investor-state international arbitration. In the 1930s the Radio Corporation of America ("RCA") successfully arbitrated breach-of-concession claims against both China and Czechoslovakia. *See generally* Czechoslovakia v. Radio Corporation of America, 30 AM. J. INT'L L. 523 (1936); Radio Corporation of America v. China, *id.* at 535. In the Czechoslovakia award, the tribunal noted that "in public law the sentence *pacta sunt servanda* will also apply, just as public interest requires stability as regards any arrangement legally agreed upon," and that a state could conceivably repudiate a contract with an investor only upon (the hypothetical) showing that "public interests of vital importance would suffer if the agreement should be upheld under the rules of ordinary civil law." *Id.* at 531.

96. *See* Nussbaum, *supra* note 91, at 44-45. The *Lena* award is unpublished, but Nussbaum provides a partial translation and an important commentary. V.V. Veeder provides interesting historical detail in *The* Lena Goldfields *Arbitration: The Historical Root of Three Ideas*, 47 INT'L & COMP. L.Q. 747 (1998). The novelty of an award rendered by a private citizen, for the benefit of a private citizen, against a sovereign state is illustrated by a contemporaneous article in the newsweekly *Time*, which, with apparent skepticism, asked, "[w]ould Russia obey this order? Could two private citizens successfully command a Great Power? How did they ever get to thinking that they could?" *Millions for Lena?*, TIME, Sept. 15, 1930, at 23, *available at* http://www.time.com/time/magazine/article/0,9171,788474,00.html.

97. *See generally* Veeder, *supra* note 96.

98. Nussbaum, *supra* note 91, at 41. As Nussbaum says, "[b]reach of contract and unjust enrichment, bases of the Lena claims, have long been recognized as legitimate causes of action under the various systems of law, including international law." *Id.*

99. Veeder, *supra* note 92, at 748.

100. *See Millions for Lena*, *supra* note 92, at 23.

tablished unjust enrichment as a cause of action, rather than exclusively on Soviet law.[101] This innovation—looking to "general principles" to support contract enforcement—has proved remarkably influential in international arbitral practice, as it allows tribunals to cite widespread domestic legal support for the sanctity of contractual obligations in order to justify enforcing state contracts involving nationalized property.

The pre-war trend of strong arbitral support for *pacta sunt servanda* continued to strengthen in the years immediately following World War II. Two cases in particular are worth discussing in detail, though they are concerned exclusively with interpreting the oil concessions at issue and not with any purported right of the state to breach them.[102]

In *Petroleum Development (Trucial Coast) Ltd. and the Sheikh of Abu Dhabi* (1952), Lord Asquith, acting as sole arbitrator, held that a petroleum concession granting the company exclusive rights to search for and exploit petroleum resources in the land and territorial waters of Abu Dhabi did not extend to Abu Dhabi's continental shelf.[103] The award is of scholarly interest primarily for its discussion of the then-new continental shelf doctrine; for our purposes the main interest is that Lord Asquith's holding—for the Sheikh and against the investor—presumes without discussion that the contract is enforceable according to

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101. Nussbaum, *supra* note 91, at 50-51.

102. Two other post-World War II cases are also worth briefly mentioning, as they suggest how respect for a state's contractual obligations can be convincingly rooted in basic, foundational principles, such as the principle of "good faith." In the *Alsing* award (which involved international trade rather than investment), Greece was alleged to have breached a long-term contract with a Swedish match company to supply matches to the Greek government and the government's default on related loan obligations. *See* Stephen M. Schwebel, *The Alsing Case*, 8 INT'L & COMP. L.Q. 320 (1959). The award is notable for the umpire's forceful statement that the contract "is subject to the general principles of the law of contracts" and "must be interpreted according to the norms of private law and by the application of the principles of good faith." *Id.* at 333. In the event, the umpire ruled in Greece's favor, in part on the match contract's *force majeure* clause, *id.* at 340-41, and in part on a theory of assumption of risk, *id.* at 344-45. Similarly, in a 1957 award an ad hoc tribunal convened under an arbitration clause in a 1932 contract held that Yugoslavia had a "good faith" duty to compensate a French railway investor for losses incurred as a result of Yugoslavia's devaluation of its currency. *See* Société Européene d'Études et d'Entreprises v. Yugoslavia, 24 I.L.R. 761, 765-66 (1956).

103. *In the Matter of an Arbitration Between Petroleum Development (Trucial Coast) Ltd. and the Sheikh of Abu Dhabi*, 1 INT'L & COMP. L.Q. 247, 260 (1952) [hereinafter *Abu Dhabi*].

its written terms, as interpreted in light of "principles rooted in the good sense and common practice of the generality of civilised nations—a sort of 'modern law of nature'" rather than in light of any particular body of municipal law.[104] This basic notion is essentially that which was pioneered by the *Lena* tribunal—that state contracts with investors could or should be governed, at least in part, by "general principles of law," both to interpret the particular contract at issue, and to support their enforcement against state claims of a sovereign right to breach.[105]

Likewise, in *Ruler of Qatar v. International Marine Oil Company, Ltd.*,[106] the referee was asked, pursuant to an arbitration clause in the concession agreement, to decide a question of contract interpretation involving the concession's payment provisions. There was some question as to whether the concession was valid under Islamic law, which the referee, who was familiar with Lord Asquith's *Abu Dhabi* award,[107] deftly avoided by finding it inconceivable ("I cannot think . . .") that the Ruler of Qatar would have intended Islamic law to govern the contract if the result would be to render the transaction unenforceable.[108] Instead, the parties must have intended the contract to be governed by "principles of justice, equity and good conscience," principles which rendered the question of contract enforceabil-

104. *Id.* at 251.

105. The idea of "general principles of law as recognized by civilized nations" that can provide a body of law to resolve international disputes is codified in Article 38 of the Statute of the Permanent Court of International Justice and in Article 38 of the Statute of the International Court of Justice. *See* Statute of the Permanent Court of International Justice, art. 38, Dec. 16, 1920, 6 L.N.T.S. 391; Statute of the International Court of Justice, art. 38, 59 Stat. 1060 (1945). The *Abu Dhabi* award's invocation of general principles was quickly "quoted, with emphatic approval and as representing a major advance" by many eminent scholars of international law, including Jessup, McNair, and Mann. *See* FRIEDMANN, *supra* note 7, at 193 n.14. The resort to general principles of law to decide disputes over international concession agreements was driven in part by the perceived need to fill lacunae in public international law, which, because of its development primarily as a tool to resolve diplomatic disputes between states, did not necessarily contain rules easily applicable to disputes falling outside of public international law's traditional scope of application. As Friedmann observes, international tribunals strongly resist declining to decide disputes because of a lack of determinable law (*non liquet*), and the notion of general principles provides them with a flexible and effective away around a *non liquet* disposition. *See id.* at 189 n.3.

106. 20 I.L.R. 534 (1953).

107. *See id.* at 544.

108. *See id.* at 545.

ity moot.[109]

By modern standards the *Qatar* and *Abu Dhabi* arbitrations, as well as the concession agreements underlying them, are rather primitive,[110] with contemporaneous commentators unsure as to how the awards should fit into a system of international adjudication that had up to then primarily involved disputes between states rather than between a state and a private actor. This uncertainty is reflected in Sir Hersch Lauterpacht's note to the *Qatar* award, in which he observed that the award "is not an international arbitration in the accepted meaning," but had been included in his *International Law Reports* anyway "as being of interest for the increasing number of arbitrations between Governments and private companies and individuals."[111]

As arbitral decisions dealing with state contracts grew more common, they also became more sophisticated, building upon the foundational notions of the *Lena* award to firmly establish as a matter of legal practice that state contracts, including their arbitration provisions, were enforceable as a matter of whatever law was found to be applicable.

The well-known 1958 *ARAMCO* award is reasonably viewed as the first truly modern published award that builds upon this earlier precedent to firmly support the principle of *pacta sunt*

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109. *See id.*

110. The concessions illustrate the kinds of extremely one-sided concessionary agreements, entered into under conditions of significant inequality of bargaining power and covering vast swathes of territory for long periods of time, that the permanent sovereignty movement was primarily aimed at overturning. For example, the agreement in *Abu Dhabi* was entered into by an "absolute . . . monarch" whose reign was supported by a British protectorate and who governed his country under a "purely discretionary" and "primitive" system of justice. *Abu Dhabi*, *supra* note 99, at 247, 250-51. The region's inhabitants were "primitive [and] poor" and, until oil was discovered, the economy "depended mainly" on gathering pearls. *Id.* at 247. The concession granted a single organization—Petroleum Development, a consortium of the world's leading oil companies—exclusive rights to search for, produce, and dispose of petroleum resources across the entire territory for a period of seventy-five years. *See id.* at 247-49. This arrangement was renegotiated in the government's favor—and without resort to nationalization—in the late 1960s and early 1970s. *See* MANA SAEED AL-OTAIBA, PETROLEUM AND THE ECONOMY OF THE UNITED ARAB EMIRATES 45-46 (1977).

111. *Ruler of Qatar*, 20 I.L.R. at 547. As F.A. Mann suggests, Lauterpacht's hesitancy in publishing the awards seems to reflect his uncertainty as to whether the *lex arbitri* (or arbitral law) governing investor-state arbitrations was public international law or the municipal law of the seat of arbitration or of some other state. *See* F.A. Mann, *State Contracts and International Arbitration*, 42 BRIT. Y.B. INT'L L. 1, 8-9 (1967).

servanda against a claim of sovereign prerogative to breach.[112] Saudi Arabia had entered into a long-term concession agreement with a multinational oil consortium that provided, among other things, for the consortium's exclusive right to transport oil produced from its concession.[113] Some years later, Saudi Arabia signed a contract with a company run by shipping magnate Aristotle Onassis, providing Onassis with a thirty-year "right of priority" to transport Saudi oil.[114] The basic issue before the tribunal, which was convened under an arbitration clause in the ARAMCO concession, was essentially an issue of contract interpretation: did the concession grant ARAMCO the exclusive transportation rights that were later improperly given to Onassis?[115] But during the proceedings Saudi Arabia raised the more fundamental argument that, because the contracts underlying the dispute were "acts accomplished in the exercise of its sovereignty," the arbitral tribunal had no authority to decide the legality of the "consequences of such acts," and that it retained the sovereign power to regulate oil transportation as it saw fit.[116] The tribunal held that it had jurisdiction to decide the dispute, as signing the concession contract—which expressly emphasized "that the Parties intend to respect all their mutual obligations and that neither of them ever entertained the thought that they would not be bound"—was *itself* an "exercise of its sovereignty" that must be enforced.[117] As the tribunal noted, it could not "accept the view that questions affecting the exercise of the sovereign rights of a State are, by their nature, incapable of being the subject matter of arbitration," as a "considerable body of international decisions" indicated that promises to arbitrate disputes with private actors were fully enforceable.[118]

The tribunal proceeded to apply the now-familiar "general

112. Saudi Arabia v. Arabian American Oil Company (ARAMCO), 27 I.L.R. 117 (1958).

113. *Id.* at 117-18.

114. *Id.* at 118.

115. *Id.* at 145.

116. *Id.* at 149-50.

117. *Id.* at 152; *see also* Alfred Verdross, *The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses*, *in* SOUTHWESTERN LEGAL FOUNDATION, INTERNATIONAL AND COMPARATIVE LAW CENTER, SELECTED READINGS ON PROTECTION BY LAW OF PRIVATE FOREIGN INVESTMENTS 117, 130 (1964) ("[A] sovereign power, lacking that capacity [to bind itself by contract], is inconceivable, the competence to bind itself being the very essence of sovereignty.").

118. *Saudi Arabia*, 27 I.L.R. at 152.

principles of law" (citing the *Lena* award) to the substance of the dispute, though it primarily relied on the text of the contract as the appropriate "fundamental law" to be applied.[119] And here the tribunal provided a powerful statement in support of the principle that state contracts were binding, a statement that would generate numerous echoes in later arbitral jurisprudence:

> The Tribunal holds that the Concession has the nature of a constitution which has the effect of conferring acquired rights on the contracting Parties. By reason of its very sovereignty within its territorial domain, the State possesses the legal power to grant rights which it forbids itself to withdraw before the end of the Concession . . . . Nothing can prevent a State, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the concessionaire irretractable rights . . . . [The breach of such rights will] engag[e] its responsibility.[120]

The *ARAMCO* award powerfully illustrated that arbitral tribunals were very likely to accept jurisdiction over disputes involving host states and foreign investors—despite claims of "sovereignty"—and to hold that state contracts were binding—again, despite claims of "sovereignty." The award also confirmed the willingness of tribunals to look beyond the host state's municipal law to identify contract-supporting rules, either by applying "general principles" or by applying "international law" as such, especially where the contract at issue contained a choice of law clause indicating the applicability of such sources of law. George Ray, ARAMCO's general counsel, well-stated the award's implication as supporting the "centuries" old and "generally accepted principles" of "*ad hoc* contract and *pacta sunt servanda.*"[121]

The modern trend toward arbitral enforcement of state contracts was further confirmed by the 1963 award in *Sapphire International Petroleum Ltd. v. National Iranian Oil Company ("NIOC").*[122] A small Canadian petroleum company had entered into a joint venture arrangement with NIOC in which the Canadian company promised to invest US$18 million in petroleum exploration and development in exchange for a twenty-five per-

119. *Id.* at 168.

120. *Id.*

121. George W. Ray, Jr., *Some Reasons for the Binding Force of Development Contracts Between States and Foreign Nationals*, 16 BUS. LAW. 942, 943 (1961).

122. 35 I.L.R. 136 (1963).

cent stake in any profits realized over the twenty-five year duration of the concession.[123] The relationship ran into immediate trouble, with NIOC and the Iranian government raising numerous unfounded complaints about Sapphire's performance. After attempts by Sapphire to work out these differences, the company initiated *ad hoc* arbitration in accord with Article 41 of the contract.[124] The Iranian government refused to participate in the proceedings,[125] and the sole arbitrator issued a thoroughly reasoned award in Sapphire's favor, finding that Iran had breached its obligation, expressly laid out in the contract but also independently recognized as a "general principle[ ] of law, based upon reason and upon the common practice of civilized countries," to act in "good faith and good will" in its dealings with Sapphire.[126] On the issue of whether state promises to investors should be recognized as binding, with breaches subject to a duty to compensate, the sole arbitrator left no doubts: "it is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual undertakings must be respected. The rule *pacta sunt servanda* is the basis of every contractual relationship."[127]

Iran's breach meant that Sapphire was entitled to damages, "the object [of which] is to place the party . . . in the same pecuniary position that they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion."[128] This rule of expectation damages was "simply a direct deduction from the principle of *pacta sunt servanda,* since its only effect is to substitute a pecuniary obligation for the obligation which was promised but not performed."[129] This meant that Sapphire was entitled to "the expenses incurred in performing the contract" and the "net profit which the contract would have produced."[130] Because the ultimate profitability of the concession was highly uncertain, the Sole Arbitrator decided the compensation issue *ex aequo et bono,* awarding Sap-

123. *Id.* at 139; *id.* at 189 (the duration of the concession).

124. *Id.* at 161.

125. *Id.* at 164.

126. *Id.* at 172-73, 179, 181.

127. *Id.* at 181.

128. *Id.* at 185-86.

129. *Id.* at 186.

130. *Id.*

phire a total of just over US$2.6 million on Sapphire's US$600 thousand reliance loss.[131]

The *ARAMCO* and *Sapphire* awards appear to be only the most visible of a potentially substantial body of pre-CERDS arbitral decisions enforcing state contracts. Unfortunately the precise details of these cases are not publicly known, but they seem clearly to support Jean-Flavien Lalive's 1964 observation that "it is a fact that the desire of [legal] security of the foreign company or investor will be met, to a certain extent at least, by the insertion of an arbitration provision" into the investment contract.[132] Many of these arbitrations took place under the auspices of the International Chamber of Commerce ("ICC"), a private and well-respected arbitral institution headquartered in Paris. ICC

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131. *Id.* at 189-90.

132. Jean-Flavien Lalive, *Contracts Between a State or a State Agency and a Foreign Company*, 13 INT'L & COMP. L.Q. 987, 991 (1964). Maurice Bourquin, writing four years earlier, also shared Lalive's view of the utility of arbitration for securing the performance of state "economic development agreements" with foreign investors. *See* Maurice Bourquin, *Arbitration and Economic Development Agreements*, 15 BUS. LAW. 860 (1960), *reprinted in* SELECTED READINGS ON PROTECTION BY LAW OF PRIVATE FOREIGN INVESTMENT 99, 109 (Southwestern Legal Foundation ed., 1964) (referring to arbitration as the "key" to the system of guaranteeing the "execution of agreements" with investors). Lalive's qualification ("to a certain degree at least") refers to the possibility that arbitration would prove to be no more "flexible," no less "costly," and no "quicker than the normal judicial process." Lalive, *supra*, at 991. Lalive also mentions the potential problem of award enforcement. *Id.* This latter problem has been largely solved by the widespread adoption of the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards. 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 [hereinafter New York Convention]; *see* Susan Choi, *Judicial Enforcement of Arbitration Awards under the ICSID and New York Conventions*, 28 N.Y.U. J. INT'L L. & POL. 175 (1996). Developing countries also recognized the effectiveness of international arbitration at supporting the enforceability of their promises to foreign investors—hence Saudi Arabia's passage in 1963 of a law, in reaction to the *ARAMCO* award, forbidding government instrumentalities from entering into arbitration agreements with foreign investors, and Algeria's "lack of confidence in international arbitration" in post-independence era—as did investors and their legal advisors. ABDUL HAMID EL-AHDAB, ARBITRATION WITH THE ARAB COUNTRIES 78, 77-8 & 561 (1999); *see also* Fred C. Pedersen, *Expropriation in International Law: Strategies of Avoidance and Redress*, 10 U. TOL. L. REV. 73, 122 (1978) ("the investor should endeavor to reach an accord with the host state on the settlement of disputes, for instance on arbitration (possibly under rules of the ICC in Paris). This would greatly ease the burden on the investor in the event of an expropriation (by avoiding the necessity for numerous suits by the investor either to recoup the debt or to encourage settlement) and it might actually deter expropriation since the host state would be almost assured that it would be held liable for some amount of compensation."); Thomas Wälde, *Negotiating for Dispute Settlement in Transnational Mineral Contracts: Current Practice, Trends, and an Evaluation from the Host Country's Perspective*, 7 DENV. J. INT'L L. & POL'Y 33, 56 (1977) (noting the utility of arbitration clauses for investors).

arbitrations are confidential unless the parties to a dispute decide otherwise. But in a 1965 survey of ICC practice, Karl-Heinz Bökstiegel noted that "many contracts between states and private firms" contained ICC arbitration clauses,[133] and that, since the first state contract dispute was submitted to the ICC in 1922, "a whole series" of state-contract cases had actually been submitted to the ICC for resolution, with almost all states complying with the resulting awards.[134] The lesson that Bökstiegel draws is that the ICC's success at resolving state contract disputes "can be regarded as providing further evidence for the thesis that the principle of '*pacta sunt servanda*' of international law today applies not only to agreements between states, but also to contracts between states and private enterprises."[135]

B. *The Libyan Trilogy*

Bökstiegel's conclusion is further supported by a number of arbitral decisions issued contemporaneously with and just after the UNGA's adoption of CERDS, as some host states began to more boldly challenge the notion that their contracts with foreign investors were binding. The most influential of these awards arose out of high-profile nationalizations of petroleum concessions in Kuwait and Libya. These great oil arbitrations forcefully demonstrated the utility of international arbitration for resolving foreign investment disputes, and for resolving them consistently in the foreign investor's favor. Indeed, Yves Dezalay and Bryant Garth credit these arbitrations with promoting the

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133. Karl-Heinz Bökstiegel, *Arbitration of Disputes between States and Private Enterprises in the International Chamber of Commerce*, 59 AM. J. INT'L L. 579, 580 (1965). *See generally* EL-AHDAB, *supra* note 128 (discussing a 1985 study of Algeria's contacting practice that found a reference to ICC arbitration in ten out of seventeen state contracts).

134. *See* Bökstiegel, *supra* note 129, at 581, 583. As Yves Derains, then Secretary of the ICC's Court of Arbitration, noted in his 1973 article, by that time it had become widely accepted as a matter of international commercial custom ("*usages*") that states could bind themselves to arbitrate disputes with private parties. Yves Derains, *Le Statut des Usages du Commerce International Devant les Juridictions Arbitrales (À la lumière de l'expérience de la Chambre de Commerce Internationale) [International Commercial Custom before Arbitral Tribunals (In Light of the Experience of the International Chamber of Commerce)]*, 1973 REVUE DE L'ARBITRAGE 122, 144-45 (1973) (Fr.). Derains cites as an example ICC Case 1939, which involved a claim by an Italian company against an African state organization. *Id.* The tribunal held that the "international public order is forcefully opposed" to the idea that a state entity could rely on an arbitration clause to induce the private party's contractual reliance, and then could, when a dispute arose, seek to claim its own promise to arbitrate to be void as a matter of municipal law. *Id.*

135. *See* Bökstiegel, *supra* note 129, at 586.

dramatic growth of the ICC's international arbitration business, as investors came increasingly to realize the great value of removing international commercial disputes from the reach of domestic legal regimes.[136]

The Libyan trilogy—three awards, each issued by a different sole arbitrator, interpreting nearly identical contracts in regard to nearly identical sets of facts and arriving at similar holdings in favor of the foreign investors—provide unimpeachable evidence that state contracts with investors remained meaningfully enforceable despite the permanent sovereignty resolutions.[137] Indeed, the awards illustrate that the UNGA resolutions had no impact on the willingness of international tribunals to enforce

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136. YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 75, 83-85, 101 (1998). As the authors note, "[t]he petroleum disputes were founding acts. They made arbitration known and recognized." *Id.* at 75. One of the consequences of this greater recognition was an increased reliance by investors on lawyers to draft and negotiate complex contracts. *See id.* at 92; *see also* John H. Barton & Barry E. Carter, *International Law and Institutions for a New Age*, 81 GEO. L.J. 535, 543 (1993) (describing the Libyan oil arbitrations as demonstrating the efficacy of the New York Convention at encouraging state parties to settle investment disputes). More generally, the Libyan trilogy of cases, like the earlier *ARAMCO* and *Lena* awards, provided subsequent tribunals with a powerful source of persuasive precedent in favor of a robust principle of *pacta sunt servanda*. *See* Catharine A. Rogers, *The Vocation of the International Arbitrator*, 20 AM. U. INT'L L. REV. 957, 1000-01 (2005) (describing how arbitral decisions can become "transformed into . . . substantive rule[s]" as awards are "reported, elaborated and then incorporated . . . into the literature," thereby "forming non-binding but highly persuasive rules to guide future tribunals."); *see also* Elf Aquitaine Iran v. National Iranian Oil Co., 11 Y.B. COMM. ARB. 97, 101 (1986) (citing the *Lena* and *ARAMCO* awards for the position that "[a] State 'is bound by its obligations under international agreements and concessions' in accordance with the principle of *pacta sunt servanda*," and holding that Iran could not escape a contractual arbitration clause by unilaterally canceling the underlying concession).

137. Wälde and Ndi make the curious argument that two of the three Libyan oil cases "cast doubt[ ] on the extent to which" arbitrators would enforce contractual "stabilization clauses," in which the host state promises not to unilaterally change legislation or regulations in ways which harm the investor's interests. Wälde & Ndi, *supra* note 9, at 246. It is true that the *LIAMCO* award, cited *infra* note 135, and the *TOPCO* award, cited *infra* note 137, contain language supporting the position, as Wälde and Ndi put it, that "stabilization clauses cannot prevent a unilateral change of terms and conditions by the government." Wälde & Ndi, *supra* note 9, at 246. However, and as discussed later in this section, both awards forcefully make the point that unilateral changes, even if not legally prevented, will give rise to a right to meaningful compensation for the breach. For this reason, the two awards cannot reasonably be read as evidence of international legal uncertainty over the general enforceability of state promises to investors, as Wäelde and Ndi's article might be read to imply.

state promises, even at the height of the permanent sovereignty movement.

The awards involved claims by the Libyan American Oil Company ("the *LIAMCO* award"),[138] the British Petroleum ("BP") Exploration Company (Libya) Ltd. ("the *BP* award"),[139] and the Texaco Overseas Petroleum Company ("the *TOPCO* award")[140] against the Libyan government for breaches of the companies' concession contracts. The Libyan government had nationalized the companies' assets and repudiated the associated contracts, providing no compensation. The repudiations were in apparent violation of so-called "stabilization" clauses in each of the contracts, and through which Libya had expressly promised not to change the legal framework in ways adverse to the investors' interests.[141] The concessions contained arbitration clauses, which the companies invoked. Libya refused to participate in the proceedings, sending a letter to the President of the International Court of Justice, who, under the arbitration clauses, was empowered to nominate sole arbitrators. In the letter Libya invoked notions of permanent sovereignty to claim that the legitimacy of the nationalizations could only be addressed by its own tribunals.[142] That Libya refused to present such arguments to the tribunals themselves suggests that it had little confidence that the arbitrators would find the arguments persuasive. And indeed they did not.[143] The common point of all three awards is a ringing endorsement of the principle of *pacta sunt*

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138. Libyan Am. Oil Co. v. Gov't of the Libyan Arab Republic, April 12, 1977, 20 I.L.M. 1 (1981) [hereinafter *LIAMCO Award*].

139. BP Exploration Co. (Libya) Ltd. v. Gov't of the Libyan Arab Republic, 53 I.L.R. 297 (1979) [hereinafter *BP Award*]. For a good discussion of the background of the case, see generally Joel M. Fisher, Albert Golbert, & Bahram Maghame, *British Petroleum v. Libya: A Preliminary Comparative Analysis of the International Oil Companies' Response to Nationalization*, 7 Sw. U. L. Rev. 68 (1975).

140. Texaco Overseas Petroleum Co./California Asiatic Oil Co. v. Gov't of the Libyan Arab Republic, Jan. 19, 1977, 17 I.L.M. 1 (1978) [hereinafter *TOPCO Award*]. The original French award is published at 104 Journal du Droit International 350 (1976) (Fr.). For a helpful commentary, see Jean-Flavien Lalive, *Un grand arbitrage pétrolier entre un gouvernement et deux sociétés privées étrangères [The Great Oil arbitration Between a Government and Two Foreign Private Corporations]*, 104 Journal du Droit International 320 (1976) (Fr.).

141. *LIAMCO Award*, 20 I.L.M. at 22-23.

142. *Id.* at 78.

143. *See BP Award*, 53 I.L.R. at 297; *LIAMCO Award*, 20 I.L.M. at 1-2; *TOPCO Award*, 17 I.L.M. at 25-29.

servanda, and it is worth quoting the most relevant passages at length.

In the *BP* award, Sole Arbitrator Lagergren needed but one paragraph to establish that under the law applicable to the contract—by a choice of law clause common to all of the concessions the relevant law was "the principles of law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals"[144]—the nationalization was clearly a breach of contract requiring compensation. In Lagergren's view,

> No elaborate reasons are required [to justify enforcing the contract. The [nationalization]] constitute[s] a fundamental breach of the BP Concession as they amount to a total repudiation of the agreement and the obligations of the Respondent [Libya] thereunder, and, on the basis of rules of applicable systems of law too elementary and voluminous to require or permit citation, the Tribunal so holds. Further, the taking by [Libya] . . . clearly violates public international law . . . .[145]

Given the breach, BP was entitled to damages, which Lagergren would determine at a later proceeding.[146] Before that proceeding, however, BP and Libya reached a settlement agreement in which BP was paid "an immediate cash payment of approximately [GB]£17.4 million sterling."[147]

The other two Libyan awards—*LIAMCO* and *TOPCO*—take Libya's invocation of sovereignty more seriously, analyzing at relative length whether the UNGA permanent sovereignty resolutions might have some relevance to the disputes. Sole Arbitrator René-Jean Dupuy's discussion in the *TOPCO* award remains the most extensive rejection of CERDS' international legal significance. In Dupuy's view, the ability of states to make binding commitments to investors was an attribute of, rather than an affront to, state's sovereignty: "the State, by entering into an international agreement with any partner whatsoever, exercises its sovereignty whenever the State is not subject to duress and

144. *BP Award*, 53 I.L.R. at 303.

145. *Id.* at 329.

146. *See id.* at 357.

147. *Id.* at 298.

where the State has freely committed itself through an untainted consent."[148] This basic principle was supported both by Libyan and Koranic law and by international law and practice, and was reflected in UNGA Resolution 1803, which, as Dupuy notes, explicitly provides that "foreign investment agreements . . . shall be observed in good faith."[149] The result, Dupuy holds, is that:

> a State cannot invoke 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 rights of the contracting party which has performed its various obligations under the contract.[150]

This is true in spite of CERDS Article 2, which for Dupuy lacks any legally binding force both because of the lack of support for CERDS by developed countries[151] and because CERDS Article 2 is inconsistent with "general practice of relations between States with respect to investments" which recognizes the investors' rights to compensation for breach of contract and the ability of states and investors to submit their investment disputes for final resolution by international tribunals.[152] Furthermore—and this is Dupuy's final nail in the CERDS coffin—CERDS itself supports the enforcement of investment contracts by explicitly recognizing that "international obligations" should be fulfilled in "good faith."[153] Dupuy's sole fillip to the permanent sovereignty movement is his view that permanent sovereignty—which Dupuy accepts as a principle that has been "continuously . . . affirmed by the United Nations"[154]—simply means that a state cannot by contract *permanently* alienate its sovereignty over natu-

148. *TOPCO Award*, 17 I.L.M. at 23-24.

149. *Id.* at 24.

150. *Id.* at 23-24.

151. *Id.* at 29.

152. *Id.* at 30-31.

153. *Id.* at 31.

154. *Id.* at 26. Dupuy's position that permanent sovereignty over natural resources is a widely accepted principle of international law is undoubtedly correct, at least at a superficial level. As Schrijver notes, the principle, "despite its complicated genesis has achieved a firm status in international law and is now a widely accepted and recognized principle of international law," SCHRIJVER, *supra* note 51, at 377. Though what, in practice, it actually means is still uncertain. Dupuy's application was exceptionally (but reasonably and, in retrospect, probably not all that surprisingly) narrow—permanent sovereignty is not, Dupuy says, a *jus cogens* norm that trumps a state's other international obligations, including the obligation to honor contracts in good faith.

ral resources. But where, as with the Libyan concessions, the contracts represented merely a "limitation, partial and limited in time, of the exercise of sovereignty," this should be viewed as a fully enforceable exercise of the state's sovereign prerogative to enter binding commitments.[155]

Dupuy's conclusion is a commonsensical tour de force in support of the continuing vitality of the principle of *pacta sunt servanda,* and one totally at odds with Guzman's description of the post-CERDS legal landscape:

> good faith . . . has an important place even in [CERDS]. One should conclude that a sovereign State which nationalizes cannot disregard the commitments undertaken by the contracting State: to decide otherwise would in fact recognize that all contractual commitments undertaken by a State have been undertaken under a purely permissive condition on its part and are therefore lacking of any legal force and any binding effect. From the point of view of its advisability, such a solution would gravely harm the credibility of States since it would mean that contracts signed by them did not bind them; it would introduce in such contracts a fundamental imbalance because in these contracts only one party—the party contracting with the State—would be bound. In law, such an outcome would go directly against the most elementary principles of good faith and for this reason it cannot be accepted.[156]

Dupuy awarded the investor *restitutio in integrum*[157]—akin to a right to demand specific performance, a decision which simply encouraged Libya to negotiate with the investor a voluntary settlement of US$152 million in Libyan crude oil.[158]

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155. *TOPCO Award,* 17 I.L.M. at 26.

156. *Id.* at 31.

157. *Id.* at 36.

158. *See Libya to Compensate Two U.S. Companies,* N.Y. TIMES, Sept. 26, 1977, at 59. Much of the academic commentary on the Libyan trilogy has focused on the contrasting remedial outcomes, comparing in particular Dupuy's willingness to grant *restitutio in integrum* with the insistence of the *TOPCO* and *LIAMCO* tribunals that damages, and not specific performance, was the appropriate remedy. *Compare* Robin C. A. White, *The Expropriation of the Libyan Oil Concessions: Two Conflicting International Arbitrations,* 30 INT'L & COMP. L.Q. 1 (1981) (arguing in favor of damages rather than restitution), *and* A.A. Fatourous, *International Law and the Internationalized Contract,* 74 AM. J. INT'L L. 134 (1980), *with* Von Mehren & Kourides, *supra* note 67, at 533-45 (arguing in favor of Dupuy's award of specific performance). Von Mehren and Kourides also argue convincingly that the different outcomes were largely due to different litigation strategies by the claimants.

The *LIAMCO* Award makes many of the same points. First, states are free to use choice of law clauses to apply international law to govern their relationships with investors.[159] Second, general principles of law, including Libyan law "form a compendium of legal precepts and maxims, universally accepted in theory and practice," supporting "the principle of sanctity of property and contracts . . . [and] the obligation of compensation in cases of expropriation."[160] Third, it is "widely accepted in international law" that arbitration provisions in contracts are enforceable despite the repudiation of the contract as part of a nationalization.[161] Lastly, the "sanctity of contracts" or the "right to conclude contracts is one of the primordial civil rights acknowledged since olden times" and is a "fundamental right" reflected in Libyan law, Islamic law, and in the UNGA permanent sovereignty resolutions themselves, including CERDS, through the duty to fulfill international obligations in good faith.[162]

The only aspect of the Libyan trilogy that would seem to provide any support whatsoever for Guzman's theory that CERDS destroyed the principle of *pacta sunt servanda* is the *LIAMCO* Award's discussion on the issue of damages. And this would be a very weak reed on which to base the theory. The precise issue was whether the investor's lost future profits should necessarily be factored into the award's quantum. Sole arbitrator Sobhi Mahmassani viewed the Hull Rule's "adequate" standard as rigidly and *always* requiring lost profits. In his view, it was doubtful whether the Hull Rule was ever actually reflected in international custom—not an insupportable view, incidentally.[163] For Mahmassani, it appeared that the question of automatically including future lost profits was "controversial" with "substantial divergences of view,"[164] such that the Hull Rule—if it meant that lost profits were always required—was now a "tech-

159. *LIAMCO Award*, Apr. 12, 1977, 20 I.L.M. 1, 64 (1981).

160. *Id.* at 72.

161. *Id.* at 77.

162. *Id.* at 105-10. On *pacta sunt servanda* as a primordial principle, see Hans Wehberg, *Pacta Sunt Servanda*, 53 AM. J. INT'L L. 775, 775 (1959) ("Few rules for the ordering of society have such a deep moral and religious influence as the principle of the sanctity of contracts: *Pacta sunt servanda*.").

163. For citations to the debate over whether the Hull Rule was part of customary international law, see *supra* note 66.

164. *LIAMCO Award*, 20 I.L.M. at 131-32.

nical rule for the assessment of compensation, a useful guide . . . stand[ing] only as a maximum . . . ."[165] He concluded that where the nationalization that had led to the breach of contract was "lawful" in the sense of being non-discriminatory and for a public purpose, as he found to be the case here, the question of including lost profits should be analyzed using the language of "equity" rather than of "adequacy." The importance of the semantic shift should not be exaggerated; developed countries themselves had referred to the proper standard under international law as one of "equitable" compensation.[166]

More importantly, in application, "equity" meant that LIAMCO was entitled to lost profits where those profits were reasonably certain. Mahmassani accordingly awarded the company approximately US$80 million, an amount reflecting an estimate of lost future profits for one concession area but not for another, where profitability was less certain.[167] The *LIAMCO* tribunal's award is thus readily compatible in outcome with later awards purporting to apply the Hull Rule's "adequate" standard of compensation. However, it also suggests that lost profits should not be awarded where profitability is too speculative.[168] In fact, the sole arbitrator in Shufeldt's Case held that where a state violates its equitable duty to honor its contractual obligations, damages are "always recoverable" but that lost profits "must be the direct fruit of the contract and not be too speculative and remote."[169]

C. *The Aminoil Award*

The central message of the Libyan trilogy is that the princi-

165. *Id.* at 143.

166. *See* SCHRIJVER, *supra* note 51, at 60 (quoting Sweden's observation during the negotiations over UNGA Resolution 1803 that the proposed resolution should not negate the host state's duty under international law to pay "equitable compensation" for nationalized property).

167. *LIAMCO Award*, 20 I.L.M. at 171.

168. *See, e.g.*, Biloune v. Ghana Investments Centre, 95 I.L.R. 183, 228 (1990) (awarding a Syrian investor restitution of his investment in a hotel project, where Ghana had breached the investment contract and expropriated the investment).

169. Shufeldt's Case, *supra* note 90, at 819. It is difficult to understand Judge Higgins' reading of the *LIAMCO* award as holding that the "equitable" standard of compensation meant "claims based on [lost profits] were in effect excluded." ROSALYN HIGGINS, PROBLEMS AND PROCESS: INTERNATIONAL LAW AND HOW WE USE IT 142-43 (1994). Sole arbitrator Mahmassani is careful to state that lost profits might indeed be awarded under an "equitable" standard, and indeed, as I noted above, he awards them for the loss of one of LIAMCO's concessions.

ple of *pacta sunt servanda* was quite alive and well even in the period immediately following the CERDS resolution. That same basic message was reaffirmed in a number of other international arbitrations of the period. The most important of these is undoubtedly the 1982 *Aminoil* award,[170] which has been called the "most significant arbitral contribution . . . to the law of state contracts and state responsibility for those contracts" of the post-CERDS period.[171] It remains a remarkable example of subtle, sophisticated, and pragmatic international jurisprudence, notable in part for its application of a relational theory of contract under which it found that the original written terms of the oil concession had been implicitly, and in some instances explicitly supplemented and modified over the years by the company's repeated capitulations to Kuwait's demands for a different relationship more favorable to Kuwait.[172] The facts underlying the dispute are quite complex,[173] but essentially Aminoil alleged that Kuwait's 1977 nationalization of its oil concession was in breach of a 1948 concession agreement, formally modified and supplemented in 1961 and informally modified again in 1973.[174] The agreement contained a stabilization clause in which Kuwait promised not to change the concession's legal regime absent Aminoil's consent.[175] The basic questions addressed by the tribunal were whether, in light of this clause and the parties' relationship as a whole, Kuwait was legally prevented from nationalizing the concession (the tribunal held that it was not); and whether, in any event, Kuwait owed Aminoil compensation for

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170. Kuwait v. American Independent Oil Co., 21 I.L.M. 976 (1982) [hereinafter *Aminoil*].

171. Pierre-Yves Tschanz, *The Contributions of the Aminoil Award to the Law of State Contracts*, 18 INT'L L. 245, 246 (1984); *see also* Fernando R. Tesón, *State Contracts and Oil Expropriations: The Aminoil-Kuwait Arbitration*, 24 VA. J. INT'L L. 323, 358 (1984) (describing the award as a "major contribution" that "[r]ight or wrong is deserving of respect").

172. In departing from the black letter of the original contractual documents to construe the parties' actual and evolving expectations, the *Aminoil* award shares certain affinities with Macneil's influential relational theory of contracts, though the *Aminoil* tribunal does not cite his scholarship. For a journal-length review of Macneil's theory and its influence, see Jay M. Feinman, *Relational Contract Theory: Unanswered Questions A Symposium in Honor of Ian R. Macneil: Relational Contract Theory in Context*, 94 NW. U.L. REV. 737 (2000).

173. For helpful summaries, see generally Tschanz, *supra* note 167 and Tesón, *supra* note 167.

174. *See Aminoil*, 21 I.L.M. at 979; *see also* Tschanz, *supra* note 167, at 246.

175. *See Aminoil*, 21 I.L.M. at 990-91; *see also* Tschanz, *supra* note 167, at 247; Tesón, *supra* note 167, at 325.

the taking.[176] In what was becoming a familiar practice, the tribunal purported to apply a mixture of Kuwaiti and international law, including general principles of law, to rule largely in Aminoil's favor. Of particular interest is that the tribunal easily and laconically dismissed Kuwait's invocation of the permanent sovereignty resolutions. It found that Kuwait's argument that,

> permanent sovereignty over natural resources has become an imperative rule of *jus cogens* prohibiting states from affording by contract or by treaty, guarantees of any kind against the exercise of the public authority in regard to all matters relating to natural riches [. . .] lacks all substance.[177]

Furthermore, the tribunal recognized the principle of *pacta sunt servanda* as "fundamental,"[178] holding that Kuwait was obligated to compensate Aminoil for the nationalization, and that compensation must be "appropriate" as required by UNGA Resolution 1803.[179] To determine the appropriate amount required taking into account "all the circumstances relevant to . . . the case,"[180] and including in particular Aminoil's "legitimate expectations."[181] The end result was an award in Aminoil's favor of over US$179 million, an amount which the tribunal meant to reflect Aminoil's lost future profits based on the company's expectation of making a "reasonable rate of interest" with inflation.[182] The *Aminoil* award presents numerous subtleties and points of potential criticism,[183] but the basic lesson to be taken is both clear and fully consistent with earlier awards, and particu-

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176. *See Aminoil*, 21 I.L.M. at 1979-80; Tesón, *supra* note 167, at 336, 350-52.

177. *Aminoil*, 21 I.L.M. at 1021.

178. *Aminoil*, 21 I.L.M. at 1023. The tribunal's characterization of *pacta sunt servanda* as "fundamental" is similar to the sentiments of one of Dezalay and Garth's sources, who, discussing the Libyan cases, noted that "the point we [as advocates for the application of general principles of law] were making really was whatever system of law you take, you can pick out a few really basic norms. For instance, murder is wrong, contracts are to be honored rather than breached, you know." DEZALAY & GARTH, *supra* note 132, at 88 n.53. Or, as Goldman puts it, international arbitrators tend to view *pacta sunt servanda* as part of the *lex mercatoria* said to govern international commercial relationships as a sort of natural law, separate and apart from any municipal legal system. Berthold Goldman, *The Applicable Law: General Principles of Law—the Lex Mercatoria, in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 125 (Julian Lew ed., 1986).

179. *Aminoil*, 21 I.L.M. at 1033.

180. *Id.* at 1033.

181. *Id.* at 1041.

182. *Id.* at 1042.

183. For example, in his separate opinion to the award, Sir Fitzmaurice criticized the conclusion that the stabilization clause did not make the nationalization unlawful.

larly with the Libyan trilogy: notions of permanent sovereignty do not allow states to abrogate contracts with investors without paying meaningful compensation that will, under many circumstances, include some allowance for the investor's lost future profits.

D. *Other Post-CERDS Cases*

Two other awards from the period immediately post-dating CERDS are worth discussing in some detail. In the 1979 award in the case of *AGIP Company v. Popular Republic of the Congo,*[184] AGIP initiated arbitration under the arbitration clause in an oil products distribution contract that the state had repudiated as part of nationalization.[185] The tribunal declared the Congolese government in breach of numerous clauses in the agreement.[186] Most importantly, the tribunal easily held that the nationalization breached the contract's "stabilization clause" in which the government had promised not to apply "any subsequent law or decree that aims to alter the Company's status,"[187] both under Congolese law (which reflected the French Civil Code)[188] and under international law,[189] which applied along with Congolese law under the contract's choice of law clause.[190] The tribunal recognized that "there can nowadays be no doubt concerning the right of a state to nationalize" foreign-owned property,[191] but forcefully rejected the notion that this right, or the host state's "sovereignty," meant that a promise not to change the legal regime could thus be breached without consequence.[192] The binding force of the contract flowed "from the common will of the parties expressed at the level of [the] international juridical order," the contract was "freely accepted by the government,"

Id. at 1051. Though in truth it is not clear that a finding of unlawfulness would have meaningfully impacted the quantum awarded to Aminoil.

184. AGIP Co. v. Popular Republic of the Congo (1979), *translated and reprinted in* 21 I.L.M. 726 (1982).

185. *See id.* at 731.

186. *See id.* at 732-33.

187. *See id.* at 734.

188. *Id.* at 734.

189. *Id.* at 735.

190. Article 15 of the contract provided that the applicable law was "Congolese law, supplemented if necessary by any principle of international law." *Id.* at 731.

191. *Id.* at 735.

192. *See generally id.*

and "concluding an international agreement with a private individual" was an exercise of "sovereign power" rather than a limitation of it.[193] With no discussion of the UNGA permanent sovereignty resolutions, the tribunal held that "full compensation" was owed to the Italian company, as the nationalization was "not just an act of nationalization but also a series of repudiations by the Government of its contractual undertakings."[194] And "full" compensation meant "both the loss suffered (*damnum emergens*) and the loss of profits (*lucrum cessans*)."[195]

The tribunal in the 1982 award of *Company Z (Republic of Xanadu) v. State Organization ABC (Republic of Utopia)*, makes the same points, albeit more extensively and even more powerfully.[196] The award was published without revealing the parties' names, though from the text of the award it appears that Utopia was a francophone African state. Utopia had repudiated a natural resources agreement and sought to avoid arbitration (and liability for the repudiation) by claiming that its repudiation was an act of sovereignty over natural resource; Utopia cited CERDS in support of its position.[197]

As to the tribunal's jurisdiction (and the arbitrability of the dispute), the tribunal noted that it was:

> superfluous to add that a general principle, universally recog-

193. *Id.* at 735-36.

194. *Id.* at 737.

195. *Id.* The literature and jurisprudence on the quantum of compensation due for nationalizations or expropriations typically addresses the issue in terms of the concepts of *damnum emergens* and *lucrum cessans*, where the first is generally understood to indicate the value of the taken property absent any consideration of lost profits or consequential damages, and the latter indicates lost profits. *See* C.F. Amerasinghe, *Some Aspects of the Quantum of Compensation Payable upon Expropriation*, 87 AM. SOC'Y INT'L L. PROC. 459, 478 (1993). Or as Nouvel describes the distinction, *damnum emergens* represents "toutes les dépenses qu'elle a faites en pure perte dans l'accomplissement de ses obligations contractuelles (*damnum emergens*) et, d'autre part, tous les bénéfices que l'exécution régulière du contrat lui aurait rapportés (*lucrum cessans*)." Yves Nouvel, *L'indemnisation d'une expropriation indirecte [Damages for Indirect Expropriation]*, 5 FORUM DE DROIT INTERNATIONAL 198, 199 (2003) (Fr.). However articulated, the *damnum emergens/lucrum cessans* distinction fits uneasily into the "reliance versus expectation damages" framework familiar to students of United States contract law, though an award of *damnum emergens* plus *lucrum cessans* would be equivalent, in theory, to an award of full expectation damages. As Nouvel notes, the modern tendency of international tribunals is to award lost profits only where the expropriated property is a "going concern" whose future profitability has been adequately demonstrated. *Id.* at 200.

196. Company Z (Republic of Xanadu) v. State Organization ABC (Republic of Utopia), 8 Y.B. COMM. ARB. 94 (1983).

197. *Id.* at 108, 111-15.

> nized nowadays . . . would in any case prohibit the Utopian State . . . to repudiate the undertakings to arbitrate which it made itself . . . . The position of contemporary positive law of international relations is that a Government bound by an arbitration clause . . . cannot validly free itself of this obligation by an act of its own will, such as for example a change in its internal law or by unilateral termination of the contract.[198]

Indeed, for the tribunal to pronounce on the remedial consequences of the repudiation in no way entailed an improper challenge to the state's sovereign right to change its policies as it saw fit, as the tribunal did not claim the power to order specific performance, just the payment of compensation equivalent to performance.[199]

As to the sovereign state's ability to enter into binding contracts more generally, here too the law was clear:

> It cannot be maintained . . . that the Utopian State, by virtue of its national sovereignty, is unable to validly undertake obligations . . . . To deny . . . the faculty to validly bind itself would clearly entail an unacceptable limitation of its sovereignty.
>
> . . . the right of the Utopian State to change course and to abandon the policy previously adopted . . . although indisputable, clearly does *not* imply that non-performance of the contract must have no consequence, for example, of a financial nature or, which is more or less the same thing, that the consequences would exclusively depend on the unilateral and sovereign appreciation of the Utopian Government, and would thus escape arbitration. Such a theory would be incompatible with the fundamental principle of the binding force of undertakings freely concluded (*pacta sunt servanda*) . . . .[200]

Citing Dupuy's award in *TOPCO*, the tribunal went on to reject Utopia's argument that CERDS had any binding effect to the contrary and, like Dupuy, emphasized that CERDS expressly recognized the duty to perform international obligations in

198. *Id.* at 109.

199. *Id.* at 113. The *Company Z* award concerned jurisdiction, not the merits of the dispute, and it is not known how the dispute was ultimately resolved. However, the jurisdictional award leaves little doubt that the tribunal would have held that the substantive elements of the contract were binding and that damages were owed.

200. *Id.* at 113-14.

good faith.[201]

Numerous other contemporaneous awards affirm (or more simply apply without comment) the basic lessons of the awards discussed above. In the interest of brevity and the reader's patience, I will relegate these additional examples, not cited previously, to the footnotes.[202]

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201. *Id.* at 115.

202. *See, e.g.*, Amco Asia Corp. v. Republic of Indonesia, ICSID Case No. ARB/81/1 (Award), 24 I.L.M. 1022 (1985).

> [T]he principle *pacta sunt servanda* is a principle of international law . . . . Contracts as a principle of ordering rests on the proposition that individuals and legal entities make, for their own accounts and on their own responsibility significant decisions respecting resource utilization and allocation. The form of order which a society seeks to achieve by accepting that institution of contract thus depends upon the recognition that, in principle, *pacta sunt servanda.* It follows that the binding force of contractual duties for parties to a contract or agreement is recognized in every legal order that utilizes the institution of contract.

Id.; Amco Asia Corp. v. Rep. Indonesia, ICSID Case No. ARB/81/1 (Decision on Jurisdiction), 23 I.L.M. 351 (1983) ("[T]he application of the fundamental principle *pacta sunt servanda*, a principle common, indeed, to all systems of internal law and to international law" meant that the contractual agreement to arbitrate was enforceable). For examples of ICSID award, see Liberian E. Timber Corp. (LETCO) v. Republic of Liberia, 26 I.L.M. 647 (1987) [hereinafter *LETCO*] (awarding the foreign investor damages, including lost profits, for Liberia's breach of a concession agreement); Benvenuti et Bonfant v. People's Republic of the Congo, 21 I.L.M. 740 (1982) (awarding an Italian investor in a bottled-water factory lost profits where the state had breached the contract and seized the investor's property); Petrola Hellas v. The Greek State, ICC Award of Apr. 22, 1978, *excerpted in* 11 Y.B. COMM. ARB. 105 (1986) (enforcing a contractual provision that prevented Greece from imposing a "one-time extraordinary tax" on a foreign investor, and noting that when a state "unilaterally cancel[s] its contractual obligations . . . damages would indeed have to be made good . . . on the strength of the principles of good faith"); ICC Case No. 2321 (1974), 1 Y.B. COMM. ARB. 133, 135 (1976). ICC Case No. 2321 rejected the state party's argument that its sovereignty meant that it could not validly bind itself by contract to arbitrate the particular dispute and noting that:

> I have found some difficulties to follow a line of reasoning that a State, just because of its supreme position and qualities, should be unable to give a binding promise. The principle of *pacta sunt servanda* is generally acknowledged in international law and it is difficult to see any reason why it should not apply here. A sovereign State must be sovereign enough to make a binding promise[.]

ICC Case No. 2321 (1974), 1 Y.B. COMM. ARB. at 135; *see also* Revere Copper & Brass Inc. v. OPIC, 56 I.L.R. 258, 284 (1978) (finding that a mining concession contract was binding as a matter of international law even though Jamaica's legislature had constitutional power to pass legislation that abrogated certain provisions). *Revere* is an arbitration between a U.S. foreign investor and the U.S. government-sponsored investment insurance agency, the Overseas Private Investment Corporation ("OPIC"), and concerned whether OPIC was liable under the insurance policy to indemnify Revere for damages resulting from Jamaica's interference with Revere's concession. The award is helpfully

IV. *EXPLAINING* PACTA SUNT SERVANDA*'S RESILIENCY*

Why did the permanent sovereignty movement fail to weaken the principle of *pacta sunt servanda*? Part of the reason undoubtedly relates to the ambiguity of CERDS' language and its inconsistency with and ambiguous relationship to the language of the various other permanent sovereignty resolutions of the era.[203] The uncertain law-making status of UNGA resolutions undoubtedly was also a factor as well. Given the choice between applying CERDS, in all of its extravagance and controversy, as mandatory, non-derogable "law," versus applying some other law—Resolution 1803, for example, or "general principles of law," or principles of "good faith,"—it is no real surprise that sober-minded tribunals would chose to invoke the latter and not the former.[204]

Arbitral tribunals, staffed for the most part by highly accomplished Western (or Western-educated) lawyers inherently sympathetic to their own jurisdiction and to the notion of *pacta sunt servanda* as a foundational principle of all modern legal systems, had little trouble determining that the state promises should readily be upheld.[205] For example, the idea that states were somehow forbidden by custom (or by CERDS) to allow neutrals to decide investment disputes never gained traction in part because its application to developing countries with no real history

analyzed in, David D. Doy, Jr., *Arbitration of Economic Development Agreements: The Impact of* Revere v. OPIC, 20 VA. J. INT'L L. 861 (1980).

203. As Judge Higgins observes:

> [N]o two [UNGA] resolutions which form the stream of source materials that make up the concept [of permanent sovereignty] say the same thing. Some do require compensation, some do not. Some do refer to international legal standards, some do not. Some do make reference to binding obligations, some do not.

HIGGINS, *supra* note 165, at 141-42.

204. *See LETCO*, 26 I.L.M. at 665 (addressing the possibility that Liberia's expropriation of the concession might be justified as a "nationalization," the tribunal cited Resolution 1803, and not CERDS, as the "generally accepted statement of international law" on the question of nationalizations).

205. *Cf.* DELAZAY & GARTH, *supra* note 132, at 18-30 (arguing that the international commercial arbitration system reproduces itself in part by privileging the selection of arbitrators who share a common acculturation and whose training and socialization ensure their support for the system). To make a related but somewhat more cynical point, we can observe that international arbitrators had tangible (e.g., pecuniary) incentives both to find they had jurisdiction to decide investor-state disputes and to resolve those disputes in ways that would encourage investors to continue to insist on including arbitration clauses in their investment contracts.

of an independent judiciary is so at odds with the axiomatic principle of *nemo iudex in sua causa*—the notion that a party to a legal dispute should not be allowed to authoritatively adjudicate that dispute[206]—and in part because it conflicted with longstanding state practice of inserting international arbitration clauses in foreign investment contracts.[207] Indeed, even if we assume that CERDS was "binding" international law, CERDS itself left arbitrators plenty of room to hold in favor of their own jurisdiction, as CERDS implicitly provided that host states could resolve disputes with investors by arbitration where the choice of arbitration had been "freely" made.[208]

The idea that promises could be broken with impunity was one that could easily be dismissed not only on doctrinal grounds as inimical to Resolution 1803, to fundamental principles of law common to most if not all municipal legal and moral systems, and even to CERDS' own declaration that international obliga-

206. *Cf.* FRIEDMANN, *supra* note 7, at 196 (characterizing the principle of *nemo iudex* as a "general principle[ ] of law applicable to international legal relations"); *see also* Société des Grands Travaux de Marseille v. East Pakistan Indus. Dev. Corp., ICC Case No. 1803 (1972), *excerpted in* COLLECTION OF ICC ARBITRAL AWARDS 1974-1985, at 40, 44 (Sigvard Jarvin & Yves Derains eds., 1990). This award rejected an attempt by Pakistan's president to retroactively annul by presidential order an ongoing arbitration between a French company and a Pakistani state-owned company, and to prospectively void any resulting award, as:

> wholly repugnant to . . . natural justice, fair dealing, and the standards of morality binding upon sovereign Governments. The notion that a debt should become void and indeed nonexistent *ab initio* for no better reason than that the debtor has chosen to put it in dispute is an extreme example of what natural justice abhors—the person or the public authority setting itself up as judge of its own cause.

Société des Grands Travaux de Marseille v. East Pakistan Indus. Dev. Corp., ICC Case No. 1803 (1972), *excerpted in* COLLECTION OF ICC ARBITRAL AWARDS 1974-1985, *supra*, at 40, 44.

207. As Ray noted in his comments on the *ARAMCO* arbitration, the claim that sovereignty made investment disputes inherently non-arbitrable was "obvious nonsense. No sacrifice is made. Arbitration of this sort in truth involves only a sound and statesmanlike exercise of sovereignty—not to control the result, not to cast doubt upon its legitimacy but to share with the other party in an impartial, objective judgment." Ray, *supra* note 117, at 947. Indeed, the capacity of states, or of state entities, to irrevocably commit themselves to arbitrate disputes with private parties has long been viewed as "a substantive rule of private international law the observance of which is obligatory." Jan Paulsson, *May a State Invoke its Internal Law to Repudiate Consent to International Commercial Arbitration?*, 2 ARB. INT'L 90, 95 (1986).

208. CERDS, *supra* note 56, art. 2(c) (noting that nationalization disputes could be settled by "other peaceful means . . . in accordance with the principle of free choice of means.").

tions should be upheld in good faith, but also on pragmatic grounds as inimical to the economic development that developing countries so keenly desired and that the permanent sovereignty movement, at heart, aimed to promote.[209]

Even more important, though, was the fact that by the time the permanent sovereignty movement reached its apogee in the 1970s, the era of the classical natural resources concession, imposed upon colonial or quasi-colonial dependencies for excessively long periods of time and on wildly uneven terms, was already dead and gone.[210] The fundamental (and most sympathetic) goal of the movement was always to give newly-independent developing countries the freedom to walk away from what some might reasonably describe as odious or even immoral legacy agreements.[211] In some cases, these legacy

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209. *See* Ray, *supra* note 117, at 945, 957 (noting that the main justification for recognizing investment contacts as legally binding is that they promote "pragmatic collaboration" that allows "economic progress"); Wehberg, *supra* note 158, at 786. Wehberg states:

> the principle of sanctity of contracts is an essential condition of the life of any social community. The life of the international community is based not only on relations between states, but also . . . on the relations between states and foreign corporations . . . . No economic relations betweens states and foreign corporations can exist without the principle of *Pacta sunt servanda.* This has never been disputed in practice.

Wehberg, *supra* note 158, at 786; Bourquin, *supra* note 128, at 104 ("It is not suggested that the State could openly violate its written engagements [as a virtue of its sovereignty]. Such a thesis would be manifestly inadmissible, since it would deprive the contract of all value concerning the obligation of the state.").

210. By the 1970s, investors and host states in the most politically sensitive sectors were entering into new forms of cooperative arrangements that sought to promote stability through contractual flexibility. Thus investment contracts were of significantly shorter duration than concession agreements of old, and often contained formal provisions allowing for contractual adjustment in the event of changed circumstances. *See* Abdullah Al Faruque, *Renegotiation and Adaptation of Petroleum Contracts: The Quest for Equilibrium and Stability*, 9 J. WORLD INVEST. & TRADE 113 (2008) (discussing the use of renegotiation and adaptation clauses); Thomas W. Wälde, *Revision of Transnational Investment Agreements: Contractual Flexibility in Natural Resources Development*, 10 LAW. AM. 265, 279 (1978) ("In response to these developments and developing countries demands in negotiations, agreements with [investors] in natural resources provide for an increasingly shorter period of time."). Other important changes included the increasing use of "service contracts" and other arrangements allowing for greater host government participation and control over the management of the venture. *See generally* Adede, *supra* note 68 (comparing provisions in traditional and modern concession contracts); J. Evans Attwell, *Changing Relationships between Host Countries and International Petroleum Companies*, 17 HOUS. L. REV. 1015 (1980).

211. The essential issue at stake in the permanent sovereignty movement was whether newly independent states should "have a right to start with a clean slate (*tabula*

contracts readily appear to be excessively onerous, and it is difficult to imagine a morally convincing argument that a fragile, newly-independent state should be obliged as a matter of international legal principle to live up to them.[212] The difficult task facing developed and developing countries alike as decolonization unfolded was crafting a principled reason why some promises to investors should not necessarily be rigidly enforced, while others should generally be enforced. That task was made largely unnecessary, as investors and their home governments allowed developing countries to escape facially unjust contractual arrangements out of a sense of political and economic realism, so that by the late 1960s and early 1970s the most troublesome colonial-era arrangements had already been unwound through

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rasa) and to be released from obligations entered into by the former colonial powers." SCHRIJVER, *supra* note 51, at 5. It was, in other words, to modernize contractually-based relations, not to destroy the institution of contract. Modern scholars make similar arguments that developing countries should be relieved of the obligation to repay "odious debts"—that is, debts incurred and squandered or stolen by corrupt regimes. *See generally* Lee C. Buchheit et al., *The Dilemma of Odious Debts*, 56 DUKE L.J. 1201 (2007).

212. Zambia offers a good example of the history and content of the most problematic of these colonial-era obligations. Upon independence, the country was saddled with investment concessions dating to Cecil Rhodes' adventures in the region. According to Peter Slinn, Rhodes:

> [S]en[t] agents north of the Zambezi to make "treaties" with local African rulers and thus to forestall foreign rivals pressing into the area from the north, east, and west. In June 1890, one of these agents, Frank Lochner, obtained the first in a series of concessions from Lewanika, the Lozi ruler who dominated the upper Zambezi area. This agreement was "to be considered in the light of a treaty" between the Lozi (or Barotse) people and the Government of Queen Victoria, although it was on the Chartered Company's [BSAC's] behalf that Lochner agreed to protect Lewanika and pay him a subsidy. In return Lewanika granted to the Chartered Company sweeping commercial concessions including "the sole absolute and exclusive and perpetual right and power . . . over the whole of the territory of the Barotse nation, or any future extension thereof including all subject and dependent territories . . . to search for, dig, win and keep diamonds, gold, coal, oil, and all other precious stones, minerals or substances.

Peter Slinn, *The Legacy of the British South Africa Company: The Historical Background*, *in* ECONOMIC INDEPENDENCE AND ZAMBIAN COPPER: A CASE STUDY OF FOREIGN INVESTMENT 23, 24 (Mark Bostock & Charles Harvey eds., 1972) (internal citations omitted). As Zambia moved toward independence, the United Kingdom initially claimed that the principle of *pacta sunt servanda* meant that the contracts should remain in force. But by the early 1940s, "[o]fficial feeling now tended toward the view that it was wholly inconsistent with modern notions of development that private companies should extract from colonial territories large sums that were not the fruits of industrial enterprise but of ancient concession agreements with unknowing local rulers." *Id.* at 40-41.

renegotiation.[213] By the time of CERDS, existing investment contracts were much more clearly *not* the product of colonial imposition or of radically unfair advantage-taking by overbearing investors.

In short, what the permanent sovereignty movement was capable of achieving was already achieved by the time of the great oil arbitrations, and what it was capable of achieving was in any case very modest—limited at most, as Judge Rosalyn Higgins says, to the idea that:

> [i]f, in their infancy as independent states, [developing countries] assumed obligations out of all line with commercial realities, and if such arrangements were made for very long periods of time, tribunals look sympathetically at ways to liberate the state from the disadvantageous contract.[214]

And even this is probably an overstatement of the movement's achievements, as actual examples of international tribunals "look[ing] sympathetically at ways to liberate the state" from its "disadvantageous contracts" are few and far between. Indeed, Judge Higgins goes on to note that the great oil arbitrations solidified the notion that "nationalizations do require compensation [and] [t]he concept of permanent sovereignty over natural resources does not leave a state free to ignore contracts it has voluntarily entered into."[215]

V. *SUMMARY AND RESPONSES TO POTENTIAL OBJECTIONS*

In his 1961 commentary on the *ARAMCO* award, George Ray, ARAMCO's general counsel, argued that it was:

> apparent that the *ad hoc* law of contract and *pacta sunt servanda* came into being initially and have endured throughout the centuries for sound reasons. During these times when the absolutists are endeavoring to establish state dictation as mankind's only rule of life, development agreements and these enduring principles—principles which have withstood the ravages of attack and time—furnish ample reason for us to believe that good faith performance of contractual obliga-

213. *Cf.* Wälde, *supra* note 206, at 274 ("Few major contracts ever survive unaffected under the initial conditions until their stipulated termination. Major nationalizations appear in times of high political conflict and visibility, but most changes in the 'rules of the game' come about by less visible renegotiations.") (citations omitted).

214. HIGGINS, *supra* note 165, at 141-42.

215. *Id.*

tions will find support, now and hereafter, under a worldwide rule of law.[216]

In the preceding Parts, and in the spirit of the truism that an ounce of fact is worth a pound of theory, I have shown that Ray's prediction was, in fact, correct. A "worldwide rule of law" continued to support the principle of "good faith performance of contractual obligations" despite the "ravages of attack" that CERDS may have represented.[217] Indeed, the strongest and most meaningful and authoritative statements in support of the principle came at the height of the NIEO movement, and well before the explosion in popularity of BITs in the 1990s.

We can extract five main summary points from the discussion: (1) across the entire post-war era, arbitral tribunals have consistently and reliably recognized their jurisdiction to decide disputes over a host state's contractual obligations to foreign investors; (2) those tribunals have consistently and reliably looked outside of the host state's domestic legal system, when necessary, to identify applicable contract-supporting legal rules;[218] (3) whether purporting to apply municipal law, general principles of law, or international law, tribunals routinely state strong support for the principle of *pacta sunt servanda*; (4) in applying that principle, arbitral tribunals will reliably award meaningful compensa-

216. Ray, *supra* note 117, at 958.

217. I say "may" because it seems clear that many developing countries would *not* have supported a version of CERDS that explicitly sought to establish an international legal regime in which state promises to investors were meaningless, as many, if not most, developing countries continued to actively seek foreign investment throughout the 1970s, and they undoubtedly recognized that a world without *pact sunt servanda* would likely cause needed investment flows to collapse. *Cf.* Robert O. Keohane & Van Doorn Ooms, *World Politics and International Economics: The Multinational Firm and International Regulation*, 29 INT'L ORG. 169, 170 (1975) ("Almost every government in the world . . . attempts to entice foreign capital."). It is also instructive to note that in the first investment dispute to be registered with ICSID, the *Holiday Inns* case, Morocco affirmed from the beginning of proceedings in the early 1970s that it was in principle bound by the investment contract at issue, and was in principle bound to arbitrate contract disputes, an indication that at least some developing countries were not so anxious to declare *pacta sunt servanda* to be dead. *See* Pierre Lalive, *The First 'World Bank' Arbitration (*Holiday Inns v. Morocco*)—Some Legal Problems*, 51 BRIT. Y.B. INT'L L. 123, 151 (1980).

218. As Judge Higgins summarizes the line of cases discussed above, "the study of arbitral practice tells us this: whether there is only a domestic-law-proper clause; or whether there is a 'mixed' international-law and domestic-law clause (as in the Libyan arbitrations or in Article 42) [of the ICSID Convention], international arbitrators are very likely to find international law relevant." HIGGINS, *supra* note 165, at 141.

tion, at the maximum roughly equating to the investor's non-speculative expectation loss, and at a minimum roughly equating with the investor's reliance loss; (5) this willingness to support state promises to investors has not depended on the presence of BITs.

The awards that illustrate these points are not hidden away in dusty and inaccessible archives. They are publicly available and should be familiar to doctrinally-oriented scholars and to practitioners of international investment law, even if they are largely ignored by the international legal scholars of a more social scientific bent whose mythic explanation (and justification) for BITs I have challenged here. Nor have I cherry-picked awards that support my argument; the awards discussed are the most important and most cited awards addressing *pacta sunt servanda*'s applicability to investment contracts, and there are, to my knowledge, *no* awards or other decisions by international tribunals supporting Guzman's theory that CERDS allowed developing countries to breach contracts with impunity.[219]

I conclude this Part with four caveats, designed to clarify the limits of my argument and to articulate and respond to potential objections. First, I do not mean to claim that there are no outstanding doctrinal uncertainties whatsoever about important aspects of the enforcement of state promises. Indeed, a number of important issues remain unsettled in theory and in practice. They include the circumstances under which lost profits should be awarded (perhaps not incidentally, this issue is also unsettled as a matter of municipal contract law and of international commercial law more generally),[220] the precise effect of long-term "stabilization clauses," whereby a state promises the investor not

219. This is not to say that investors never lose contract-based international arbitrations; they occasionally do. *See, e.g.*, National Oil Corp. (Libya) v. Libyan Sun Oil Co. (U.S.A.), ICC Case No. 4462/AS (1985), 29 I.L.M. 567, 600 (1990) (rejecting the investor's defense of *force majeure* in a state action against the investor for breach of contract); Wintershall A.G., et al. v. Gov't of Qatar, 28 I.L.M. 798, 803-04 (Ad Hoc Arbitral Tribunal 1989) (holding that, as a matter of pure contract interpretation, Qatar was not in breach of its obligations under a petroleum exploration and production sharing agreement); Imperial Ethiopian Gov't v. Baruch-Foster Corp., 535 F.2d 334 (5th Cir. 1976) (enforcing an arbitral award in favor of Ethiopia, where the arbitrators had held that Ethiopia's repudiation of a natural resources concession was justified by the investor's prior breach). The point is that investors do not lose these cases because of some supposed right of host states to breach their contractual obligations with impunity.

220. *See* John Y. Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEO. J. INT'L L. 61 (2004).

to change its laws or regulations for an extended period of time,[221] and the liability of governments for breaches of contracts by state enterprises that are formally separate from the government.[222] There is also the perennial and perhaps insoluble academic debate over whether at least certain kinds of state contracts should in principle be governed exclusively by host state law.[223] The international law and international practice governing state promises to investors remain creatures in continuous development and refinement, and any litigated case will undoubtedly give rise to a multitude of legal and factual ambiguities and uncertainties. Nonetheless, it is beyond any doubt that state promises to investors are, and have long been, strongly presumptively enforceable, with a duty to meaningfully compensate in the event of breach. For investors to benefit from this well-established presumption, all they need to do is to ensure that any disputes over the state's performance of its promissory obligations are adjudicated by neutral, authoritative decision-mak-

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221. *See, e.g.*, Wälde & Ndi, *supra* note 9, at 247 (describing the uncertainty as one of whether the breach of a stabilization clause will give rise to a "special right of compensation" beyond the amount of compensation due for a breach of a contract that does not contain a stabilization clause). But this uncertainty is a far cry from the notion that international law does not recognize state promises as essentially and meaningfully binding, and analysts should be careful not to confuse the issue of the enforceability of long-term stability clauses in the natural resources sector with the more basic and settled issue of the general enforceability of investment contracts. To do so is a bit like arguing that the hesitancy of municipal courts to strictly enforce certain long-term employment contracts (with their implications of indentured servitude or slavery) means that municipal courts do not meaningfully enforce employment contracts more generally.

222. On the potential problem of enforcing arbitration clauses in contracts with state enterprises against the government (a problem that might be described as "reverse veil-piercing"), see generally KARL-HEINZ BÖCKSTIEGEL, ARBITRATION AND STATE ENTERPRISES (1984).

223. This is the debate over the "internationalization" of investment contracts. For a recent discussion, see A.F.M. Maniruzzaman, *State Contracts in Contemporary International Law: Monist versus Dualist Controversies*, 12 EUR. J. INT'L L. 309 (2001). But it has been clear at least since Mann's early articles on the subject (and the awards discussed above very clearly indicate) that where the contract at issue does in fact contain a choice of law clause indicating that the tribunal should apply general principles of law, or international law, or otherwise contains some indication of party intent to apply such principles, then tribunals will almost certainly, and without much discussion or controversy, proceed to do so. *See generally* F.A. Mann, *The Law Governing State Contracts*, 21 BRIT. Y.B. INT'L L. 11 (1944); F.A. Mann, *The Proper Law of Contracts Concluded by International Persons*, 35 BRIT. Y.B. INT'L L. 34 (1959); F.A. Mann, *State Contracts and State Responsibility*, 54 AM. J. INT'L L. 572 (1960). *See generally* Lalive, *supra* note 129; Landau, *supra* note 53, at 814. This respect for party autonomy as to choice of law is also embedded in the ICSID Convention, *supra* note 15, art. 42.

ers—international arbitrators—whose jurisdiction and awards on the merits are reliably recognized and supported by international law and practice.[224]

Second, I do not mean to say that BITs do not support the principle of *pacta sunt servanda.* Rather, as noted above, they do explicitly reaffirm it through "umbrella" clauses that repeat the mantra that states should honor promises made to investors, though it bears emphasizing that reaffirming is not the same as reestablishing.[225] BITs also indirectly support *pacta sunt servanda* by imposing a duty to pay "adequate" compensation for expropriation, and by otherwise committing host states to treat investors "fairly and equitably." As the analysis above suggests, however, this support is largely (if not entirely) unnecessary, and in some cases BITs can actually complicate *pacta sunt servanda* principles by interfering with or overriding contract-based dispute settlement procedures.[226]

Third, I do not mean to deny that there are occasional statements in the academic literature, especially in the years immediately surrounding the passage of CERDS, suggesting that the Hull Rule's standard of adequate compensation for expropriation had at least partially given way to some new standard that might in limited circumstances provide the investor with some-

224. The New York Convention, *supra* note 128, and ICSID Convention, *supra* note 15, provide the main formal international legal support for the international arbitration of foreign investment disputes. *See generally* Choi, *supra* note 128. It is important to recognize that BITs are in no way necessary to enable investors to arbitrate contract-based disputes with foreign governments, even before ICSID. To access ICSID, all that the investor needs to do is insert an ICSID arbitration clause in his contract with the host state; there is no need for the host state to have first consented to ICSID arbitration through an investment treaty.

225. As Schwarzenberger notes in his commentary on the 1959 Abs-Shawcross Draft Convention on Investments Abroad, which provided a highly influential model for subsequent BITs, the "sanctity of undertakings" provision in the draft—the draft's version of the umbrella clause—was redundant to or "declaratory of customary international law" because the bad faith breach of an investment contract was a already a "contravention of the minimum standard of international law." Schwarzenberger, *supra* note 47, at 160.

226. *See, e.g.*, Yuval Shany, *Contracts Claims vs. Treaty Claims: Mapping Conflicts between ICSID Decisions on Multisourced Investment Claims*, 99 AM. J. INT'L L. 835, 848 (2005); *see also* Walid Ben Hamida, *L'arbitrage Etat-investisseur face à un désordre procédural: la concurrence des procédures et les conflits de juridictions* [*Arbitration Between States and Investors Faces Procedural Confusion: Competing Procedures and Conflicting Jurisdictions*], ANNUAIRE FRANÇAIS DE DROIT INTERNATIONAL 564 (2005) (Fr.) (discussing the "procedural confusion [*désordre*]" caused by the overlap between investment treaties and investment contracts).

thing less than what the Hull Rule arguably would require. But serious academic statements in support of the permanent sovereignty movement are in fact quite modest in their claims, especially as to the central issue of the vitality of *pacta sunt servanda.*

For example, Rainer Geiger presents perhaps the most important and widely cited academic defense of a flexible principle of *pacta sunt servanda* that would allow states to escape from contractual obligations in certain situations.[227] However, Geiger's article does little more than advocate analogizing a loosely defined, but presumably narrow, subset of state contracts that he calls "economic development agreements" to the *contrat administratif* of French civil law. According to Geiger's proposal, states could breach economic development agreements subject to an obligation to pay damages for "actual losses," or *damnum emergens*, but with no obligation to pay damages for lost profits, or *lucrum cessans.*[228]

Geiger's position is not that far off from the international practice, represented by the cases discussed above, which recognizes the abstract right of states to nationalize investor property, including by breaching contracts, subject to a right to pay compensation.[229] The main difference is Geiger's assertion that lost profits should never be awarded. Yet, Geiger's position on that point has never been accepted by international tribunals[230] or by other scholars sympathetic to the *contrat administratif* analogy.[231]

227. Rainer Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT'L & COMP. L.Q. 73 (1974).

228. *Id.* at 103.

229. *Id.* at 102-03.

230. One of the few examples of a tribunal sympathetic to the *contrat administratif* analogy is found in ICC Award No. 1526 of 1968, *excerpted in* COLLECTION OF ICC ARBITRAL AWARDS 1974-1985, at 218 (Sigvard Jarvin & Yves Derains eds., 1990). The arbitrator found that a Belgian investor's concession contract with State X resembled an "an administrative concession," that State X had the right to unilaterally terminate it, but that that right must entail the payment of damages plus interest, including lost profits. *Id.* at 220-21. Of particular interest is that the tribunal found it to be beyond doubt that a concession granted in the form of a bilateral contract [*contrat synallagmatique*] is always subject, even implicitly, to an obligation of damages with interest in the case of early termination [*retrait avant terme*], and that the doctrine and jurisprudence are in this regard without ambiguity. *Id.* at 220; *see also* Yves Derains, Commentary, *Sentence rendue dans l'affaire no. 1526 en 1968* [*Verdict Rendered in Case No. 1526 in 1968*], JOURNAL DU DROIT INTERNATIONAL 915 (1974) (Fr.).

231. For example, Friedmann also argues for a *contrat administratif* conception of investment contracts, under which developing countries might have some inalienable right to unilaterally amend or rescind at least some kinds of contractual arrangements

Nor does Geiger claim that his proposal accurately represents actual international practice, and he explicitly recognizes that "[l]egal guarantees are . . . indispensable for the protection of foreign investment."[232]

Other commentary by prominent academics sympathetic to the permanent sovereignty movement is similarly modest in its claims as to what the movement was realistically capable of achieving or what it actually achieved. Chowdhury views CERDS as, at best, establishing only an "emerging norm" supporting the idea that compensation for nationalization is to be determined on equitable principles based on a balancing of "all the circumstances of each particular situation."[233] Asante suggests that the NIEO movement should be understood simply as calling for a "triumph of common sense" over strict theories of *pacta sunt servanda* where "agreements must be kept at all cost."[234] For him, this means recognizing a modern relational-contract theory of host state-investor relations, in which the relationship changes dynamically over time in response to unforeseen developments. Zakariya argues that the permanent sovereignty movement merely stands for the proposition that the doctrine of *pacta sunt servanda* must be qualified by the principle of *rebus sic stantibus* (changed circumstances).[235] And Riad claims that the effect of the permanent sovereignty resolutions has been to establish that compensation for nationalization (or breach of contract) must be paid, but that the precise amount should be "calculated on an equitable basis in accordance with the circumstances relevant to

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with foreign investors, but he would require the state to provide the investor with a monetary "indemnity for the consequences of the [state's] interference" with the contract. FRIEDMANN, *supra* note 7, at 202. The amount of the indemnity would equal at least the investor's *damnum emergens*, and could also include lost profits, though lost profits might be justifiably denied in cases involving overwhelming necessity. *Id.* at 204-05. Friedmann suggests that in practice many disputes over breaches of international concession agreements settle somewhere between the minimum of *damnum emergens* and the maximum of *damnum emergens* plus *lucrum cesans*. *Id.* at 205.

232. Geiger, *supra* note 223, at 102-03.

233. Subrata Roy Chowdhury, *Permanent Sovereignty over Natural Resources*, *in* PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES IN INTERNATIONAL LAW 1, 6, 15 (Kamal Hossain & Subrata Roy Chowdhury eds., 1984).

234. Samuel K.B. Asante, *Stability of Contractual Relations in the Transnational Investment Process*, 28 INT'L & COMP. L. Q. 401, 405, 408 (1979).

235. Hasan S. Zakariya, *Changed Circumstances and the Continued Validity of Mineral Development Contracts*, *in* LEGAL ASPECTS OF THE NEW INTERNATIONAL ECONOMIC ORDER 263 (Kamal Hossain ed., 1980).

each particular case."[236]

And finally, the fourth caveat is to admit the very rare instances of language in arbitral awards that is arguably hostile to the principle of *pacta sunt servanda* as it has been repeatedly affirmed in the awards already discussed above, particularly—and apparently only—in the jurisprudence of the *sui generis* Iran-U.S. Claims Tribunal.[237] But in these cases the statements at issue are clearly dicta, and they are quite vigorously disputed by other members of the tribunal and are not reflective of actual outcomes of Tribunal awards. In essence, what these occasional statements suggest is that some debate continues to percolate as to whether the proper standard of compensation under international law for a subset of nationalization scenarios is an inflexible one, always requiring "full" compensation—by which is meant compensation including lost profits—or whether tribunals enjoy some limited measure of flexibility in determining how much compensation is "just" or "fair."[238] What is clear is that in all of the available adjudicated cases, including those of the Iran-U.S. Claims Tribunal, investors received substantial and meaningful awards of compensation, often approximating the "full" compensation that investors would receive if, for example, their claims were being litigated before a U.S. court under the Fifth

236. Taric Fouad A. Riad, *Host Countries' Permanent Sovereignty over Natural Resources and Protection of Foreign Investors*, 39 REVUE EGYPTIENNE DE DROIT INTERNATIONAL 35, 79 (1983). Riad's claim is similar to that of Sornarajah, a well-known and respected critic of strong international legal rights for foreign investors. *See generally* M. Sornarajah, *Compensation for Nationalization Expropriation: The Emergence of New Standards*, 13 J. WORLD TRADE L. 108 (1979).

237. See, for example, Judge Lagergren's statement in INA Corp. v. Islamic Republic of Iran, Award No. 184-161-1, 8 IRAN-U.S. CL. TRIB. REP. 373, 386-90 (Aug. 12, 1985), which speculates that in a hypothetical case of "lawful large-scale nationalizations in a state undergoing a process of radical economic restructuring" the standard of adequate (or fair market value) compensation, under which lost profits should be awarded, would "normally" have to be "discounted," or Judge Virally's statement in Amoco Int'l Fin. Corp. v. Iran, Award No. 310-56-3, 15-II IRAN-U.S. CL. TRIB. REP. 189, 242-43 (July 14, 1987) that the duty of states to honor contractual obligations did not mean that "private interests [are] permitted to prevail over duly established public interest, making impossible actions required for the public good" and that "private parties who contract with a public entity are only entitled to fair compensation when measures of public policy are implemented at the expense of their contract rights." Virally's views in the case have attracted strong academic criticism, *see, e.g.*, HIGGINS, *supra* note 165, at 143-44, and neither his nor Judge Lagergren's have ever been applied in actual awards.

238. *Compare* M.H. Mendelson, *What Price Expropriation? Compensation for Expropriation: The Case Law*, 79 AM. J. INT'L L. 414 (1985), *with* Oscar Schacter, *Compensation Case: Leading and Misleading*, 79 AM. J. INT'L L. 420 (1985).

Amendment's "takings" clause.[239]

VI. *SOME SPECULATIVE CONCLUDING THOUGHTS*

This Article opened by quoting from McDougal and Lasswell's famous proposal to identify and appraise "diverse systems of public order,"[240] and it seems fitting, and not just for reasons of symmetry, to close the Article by quoting from the same proposal, as doing so allows us to explore, albeit briefly, my argument's larger but also more speculative implications.

McDougal and Lasswell were primarily concerned with critiquing the "make-believe" description of international law promulgated by "traditional legal scholars" who gave "unquestioning verbal deference to the proposition that if there is any international law at all, it is a universal law, embracing the organized governments of the world community as a whole."[241] The problem with "make-believe universalism" was in part that it ig-

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239. *Cf.* Haliburton Fales, *A Comparison for Nationalization of Alien Property with Standards of Compensation under United States Domestic Law*, 5 NW. J. INT'L L. & BUS. 871, 901 (1983). The article states that:

> The principal conclusion that can be drawn from a study of the law in different system is that . . . the sense of justice which pervades all legal systems tends to lead to very similar results by sometimes quite different paths . . . . [T]his is true as well in the law of compensation . . . both for the nationalization of alien property under international standards and for the law of compensation applied in the United States under analogous conditions.

Id.; Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474, 503 (1991).

Norton points out that:

> Recent international tribunals have consistently affirmed a requirement under international law that full compensation be paid for expropriations of foreign property. A theoretical debate persists over the scope of possible exceptions to that standard, but the recent decisions suggest that only truly extraordinary circumstances would be likely to support such exceptions.

Norton, *supra*, at 503.

I should emphasize that I do not mean to slight the potential legal or practical difficulties that investors might face when seeking execution of awards against sovereign states, such as where the executing state recognizes a strong rule of sovereign immunity against execution, or where the host state does not have easily attachable assets abroad. Where execution is impossible, the practical value of a strong international principle of *pacta sunt servanda* is obviously reduced. However, there is little reason to think that arbitral awards rendered under BITs are any less likely to suffer from problems of execution than arbitral awards rendered under contract, especially given the supporting structure of the New York Convention, *supra* note 128, and other international arbitral conventions.

240. McDougal & Lasswell, *supra* note 1.

241. *Id.* at 2.

nored the diversity of views as to what supposedly universal principles meant, or how they should be applied.[242] It also slighted the fact that supposedly universal rules might reify particular "allocations of power" or particular positions on contested public policy issues;[243] and it tended to privilege a single actor—the state—as the primary generator of universal principles, while ignoring the plurality of sub-state or supra-state sources of internationally relevant laws, norms, and patterns of behavior.[244]

If the modern BIT-based system of international investment law has a fundamental problem, the problem principally lies in the system's universalistic claims and pretensions, rather than in the occasional set of inconsistent arbitral decisions that other scholars have identified as the primary source of a crisis of legitimacy.[245] These universalistic claims and pretensions manifest themselves in at least two ways.

The first manifestation is the increasing tendency of analysts to view BIT promises as not simply *lex specialis*, binding only between treaty partners,[246] but as both indicative of and constituting a universal, one-size-fits-all, customary international law of foreign investment that binds *all* states, whether they wish to be bound or not. Judge Schwebel has described this approach rather grandiosely as an "essentially unified law of foreign investment" that has "reshaped" the customary international law in a way that "vault[s] over the traditional divide between capital-exporting and capital-importing states."[247]

The second and interrelated manifestation is the fact that

242. *Id.*

243. *Id.*

244. *See* Berman, *supra* note 1, at 301-02.

245. For the most important article on inconsistent decisions as causing a crisis of legitimacy, see Franck, *supra* note 22. *See also* Susan D. Franck, *The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties Have a Bright Future?*, 12 U.C. DAVIS J. INT'L L. & POL'Y 47 (2005).

246. *See, e.g.*, Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT'L L. & BUS. 327 (1994) (arguing that BITs do not create customary international law).

247. Stephen M. Schwebel, *Investor-State Disputes and the Development of International Law: The Influence of Bilateral Investment Treaties on Customary International Law*, 98 AM. SOC'Y INT'L L. PROC. 27 (2004) [hereinafter Investor-State Disputes]. *See generally* Matthew C. Porterfield, *An International Common Law of Investor Rights?*, 27 U. PA. J. INT'L ECON. L. 79 (2006) (taking a skeptical view of the wisdom of BITs as creating a universal "common law" for foreign investment); Jeswald W. Salacuse, *The Treatification of International Investment Law*, 13 L. & BUS. REV. AM. 155, 165 (2007) (suggesting that BITs could embody "general principles of law").

the development of this new "common law of investment" has been placed primarily in the hands of an exceedingly small pool of super-elite, like-minded international lawyers who operate largely divorced from any municipal political process, who have shown a tendency to interpret the vague language of BITs expansively in favor of new customary international legal rights for investors,[248] and who tend to view the current system as but an intermediate stage in a process intended to lead, at their direction, to an eventual and complete global harmonization of international economic law.[249]

These manifestations together suggest a system of hubristic ambition that ignores at its peril the basic truths that foreign investment is, at least at some level, inherently controversial, that ideas about the value of foreign investment will ebb and flow over time, and that states do not, or will not always, agree on the proper content of the package of legal rights that foreign investors should enjoy. The creation of foreign investment law and policy is necessarily a political task, entailing in some instances sensitive decisions about the allocation of valuable rights, or about the "allocation of power," to quote McDougal and Lasswell again.[250] The danger is that the current system reifies as universal and justifies as natural and necessary a certain allocation of power that deviates from that which others, with legitimate—if largely unrecognized stakes—in the shape and content of foreign investment law, would choose to implement if they were among the privileged few charged with the constitution of these new and supposedly universal principles.

For the reasons above, I would modestly suggest that a minimalist system of international investment law may provide a more desirable alternative to BITs, and one more resilient to the political challenges that have caused a small but growing num-

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248. This tendency toward expansive, pro-investor interpretations is evident, for example, in the well-known *Tecmed* award, which asserted that customary international law now recognizes that investors have a broad right to operate in a "transparent" policy environment. *See* Tecnicas Medioambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2 (Award), para. 154 (May 29, 2003); *cf.* Robbins, *supra* note 27 (discussing the danger that customary international "minimum treatment" provisions in BITs may lead tribunals to increasingly impose "positive obligations" upon host states, risking a political backlash).

249. *See* Francisco Orrego Vicuna, *Foreign Investment Law: How Customary is Custom?*, 99 AM. SOC'Y INT'L L. PROC. 97, 98 (2005).

250. McDougal & Lasswell, *supra* note 1.

ber of states to avoid, abandon, or otherwise attempt to undermine the BIT regime as no longer compatible with their national interests.[251]

What would a minimalist system entail? A fuller discussion must await a future article, but it would consist of a very small core of truly universal, foundational principles, roughly akin to McDougal and Lasswell's basic principle of human dignity. Those foundational principles would primarily include the principle of *pacta sunt servanda* and the supporting principle that states are free to commit themselves to resolving their investment disputes by resort to neutral adjudicators. These foundational "international" principles could be supplemented by whatever terms of bargain the particular host state and the particular investor would wish to govern their relationship, with this bargained-for law, complemented by the host state's municipal law where necessary, operating as a true *lex specialis*. In other words, a minimalist system would rely to a largely exclusive extent on the parties to a particular investment relationship to provide the substantive governing legal content, with the relationship supported "internationally" by the relatively simple notion that promises should, normally, be kept.

This is the regime of contract law, described above, that has long existed independently of the more complicated and controversial trapping of BITs. A system that relies on internationally-enforceable investment contracts as *the* main law governing foreign investment would allow the expression of diverse approaches to foreign investment policy. It would also allow host states to moderate their investment-related legal commitments on a case-by-case basis. If changing circumstances suggest that particular guarantees such as guaranteed access to international

251. *See, e.g.*, Ann Capling & Kim Richard Nossal, *Blowback: Investor-State Dispute Settlement Mechanisms in International Trade Agreements*, 19 GOVERNANCE 151 (2006) (describing Australia's successful resistance to including an investor-state arbitration provision in its recent FTA with the United States); *In Dispute: Bolivia's ICSID withdrawal raises fear of mass exodus*, FDI MAGAZINE, Dec. 3, 2007, http://www.fdimagazine.com/news/fullstory.php/aid/2206/In_Dispute:_Bolivia_92s_ICSID_withdrawal_raises_fear_of_mass_exodus.html (discussing Bolivia's withdrawal from ICSID and discontent with the ICSID system among other developing countries); Chung, *supra* note 24, at 969-75 (describing examples of states "escaping the unfair BIT regime by defying arbitration"); Schwebel, Investor-State Disputes, *supra* note 243, at 30 (chastising the United States for its "deplorable" decision to weaken investor rights contained in the 2004 model United States BIT, a decision made in light of fears that tribunals were interpreting the provisions of earlier BITs too expansively).

arbitration or promises of "fair and equitable treatment" are growing too costly, governments could easily amend their bargaining positions and their contractual practices on a rolling basis as existing agreements expire. As new deals are being negotiated or renegotiated on a regular basis, particular bargains in force at a particular time—particular allocations of power—are more likely to reflect current perceived needs, current political and economic sensibilities, and current constellations of bargaining power.

In short, a minimalist international investment law may prove to be more resilient than the current BIT system to changes in ideas about the costs and benefits of foreign investment; moreover, precisely because it would avoid the universalistic pretensions of BITs, it would be more resilient to changes in ideas about the costs and benefits of particular international legal guarantees to foreign investors. A minimalistic international investment law would place primary responsibility for generating relationship-specific foreign investment law squarely on the shoulders of host states and investors, with this law manifesting itself in part, and primarily, in the form of investment contracts supported, as they have long been supported, by a robust international legal principle of *pacta sunt servanda.*