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## ADDRESS

# CLAIMS BETWEEN STATES AND PRIVATE ENTITIES: THE TWILIGHT ZONE OF INTERNATIONAL LAW\*

*Derek W. Bowett\*\**

Contractual relationships between developed states and foreign private entities are common enough: one has only to think of the licensing of oil exploration in the North Sea by Norway and the United Kingdom, or on the Atlantic seaboard by the United States. In such relationships it is axiomatic that the law of the contracting state governs such contracts, for states like the United Kingdom and the United States would contract on no other basis. Yet, when English or American firms contract with developing states, they seek to invoke either general principles of law or international law as part of the governing law, or "proper law," of their contracts. The reason for this is clear. It is that they distrust a choice of the law of the contracting state because they fear the ability of the contracting state to change that law, or otherwise use its powers under its own law, to the detriment of the contractual rights of the foreign corporation. The questions which this lecture addresses are whether resort to general principles or to international law is practically sensible or even legally tenable.

### I. THE GOVERNING OR "PROPER LAW" OF THE CONTRACT

There are only two possibilities: either there is no express choice of law, or there is such a choice.

#### *A. No Express Choice of Law*

In this situation there are two different theories commonly used to exclude the application of the law of the contracting state.

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### 1. The "Vacuum" Theory

This is the theory<sup>1</sup> that a contract is, in effect, its own proper law, in that it can provide the totality of law needed to regulate the relationships between the parties, without the need to have recourse to any legal system. It is, in short, the theory that a contract can be applied in a legal vacuum.

The theory encounters difficulties which are both theoretical and practical, and it can be criticized on both grounds. At the theoretical level it can be said that, for a contract to be binding, there must be some rule of law extraneous to the contract itself to dictate this result. At the practical level it can be said that no contract could possibly contain, as express clauses, all the complex body of law necessary to deal with eventualities such as mistake, misrepresentation, breach, frustration and the like. The need for a proper law is precisely the need to have recourse to the detailed body of rules which an established legal system provides to cover such eventualities. And there is the further consideration that, if one excludes all legal systems as governing law, one also excludes all concepts of public policy. One is left with a contract attached to no legal system and thus totally free of all restraints of public policy.<sup>2</sup>

Not surprisingly, therefore, courts have tended to reject the vacuum theory. This rejection was expressed by Professor Sauser-Hall in the award in *Saudi Arabia v. Arabian American (Aramco)*<sup>3</sup> in the following terms:

It is obvious that no contract can exist *in vacuo*, i.e. without being based on a legal system. The conclusion of a contract is not left to the unfettered discretion of the Parties. It is necessarily related to some positive law which gives legal effects to the reciprocal and concordant manifestations of intent made by the parties. The contract cannot even be conceived without a system of law under which it is created. Human will can only create a contractual relationship if the applicable system of law has first recognized its power to do so.<sup>4</sup>

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1. See McNair, *The General Principles of Law Recognized by Civilized Nations*, 33 BRIT. Y.B. INT'L L. 1, 9 (1957); Verdross, *Die Sicherung von Ausländischen Privatrecht aus Abkommen zur Wirtschaftlichen Entwicklung Schiedsklaussen*, 18 Z.A.O.R.V. 635 (1957).

2. It cannot be said that this void would be filled by a Court applying the public policy of the *lex fori*. For where litigation ensues before a "delocalized" arbitral tribunal there is no *lex fori* in the accepted sense. And even before a national tribunal the application of the public policy rules of the forum is the application of a governing law and therefore a rejection of the "vacuum" theory.

3. 27 I.L.R. 117 (Arb. Trib. 1958).

4. *Id.* at 165.

## 2. The "Internationalization" Theory

A different theory is that some contracts are by their very nature "internationalized" and therefore subject to international law either instead of, or in addition to, the law of the contracting state. This was the view adopted by Dupuy, as sole arbitrator in *Texaco v. Libyan Arab Republic (Topco)*,<sup>5</sup> and it has many adherents.

The theory also has many critics.<sup>6</sup> Not the least of its difficulties is that no convincing definition of the category of contracts so "internationalized" has ever been given. Moreover, the fact that western, developed states concluding the same type of so-called "development" contracts involving investment by foreign investors do not accept the theory of "internationalization" inevitably raises the question why such contracts are only "internationalized" if concluded by developing states.<sup>7</sup>

Thus, there are arbitral decisions in which the theory has been either rejected<sup>8</sup> or ignored,<sup>9</sup> and it has to be said that the theory seems an essentially self-serving theory designed to support a very partisan, capitalist approach to contractual disputes. For it is essential to grasp the essential aim of this theory. Its aim is twofold: first, to remove the contract from the control of the law of the contracting state (i.e., by substituting international law as the proper law) and, second, to deprive the state of the right to change its law and thereby affect the contract (i.e., by invoking the international law maxim, *pacta sunt servanda*).

## 3. The Preferable Solution

The preferable solution is achieved by applying normal principles of the conflict of laws, that is to say by determining, objectively, the law with which the contract has the closest connection. Presumptively, this is the law

5. 53 I.L.R. 389 (1977), 17 I.L.M. 1 (Int'l Arb. Trib. 1978).

6. For criticism of the theory see F. RIGAUD, *DROIT PUBLIC ET DROIT PRIVÉ DANS LES RELATIONS INTERNATIONALES* 435 (1977); Wengler, *Les Accords entre Etats et entreprises étrangères, sont-ils des traités de droit international?*, 76 REV. GÉN. DR. INT. PUB. 313 (1972); Verhoeven, *Contrats entre Etats et ressortissants d'autres Etats*, LE CONTRACT ÉCONOMIQUE INTERNATIONAL: STABILITÉ ET ÉVOLUTION 115, 141 (1975).

7. Fatouros, *International Law and the Internationalized Contract*, 74 AM. J. INT'L L. 136 (1980).

8. See Paulsson, *The ICSID Klöckner v. Cameroon Award: The Duties of Partners in North-South Economic Development Agreements*, 1 J. INT'L ARB. 145, 157 (1984): "We do not intend to apply new or exceptional legal principles to turn-key operations only because they concern projects affecting the economic and social development of a given country." This is a salutary rejection of the idea that such contracts form a special category.

9. Significantly, in *Kuwait v. American Indep. Oil Co. (Aminoil)*, 21 I.L.M. 976 (Arb. Trib. 1982), the tribunal placed no reliance on the controversial theory of "internationalization," but relied on the choice-of-law clauses in the agreement and the evidence of Kuwait law.

of the contracting state party,<sup>10</sup> and, although this is rebuttable, it will normally be a difficult presumption to rebut if the contract is to be performed in that state and if, by the law of the state itself, the state is mandatorily required to contract by reference to that law.

Certainly there have been some few cases in which the state's law has been inadequate to deal with the specific problem posed, and so arbitral tribunals have understandably had to supplement the state's law by reference to "general principles of law."<sup>11</sup> But the use of general principles as a supplementary source of law, to avoid a *non-liquet*, is very different from the disregard of the contracting state's law as the basic, proper law. Moreover, as the legal systems of developing states become more sophisticated, the need for supplementation by "general principles" will decrease.

### B. Situations of an Express Choice of Law

All systems of law allow freedom of choice (autonomy of will) subject to any restraints of public policy, and such choice should in principle be respected.<sup>12</sup> If, therefore, the parties have expressly chosen to submit their contract in some degree to either "general principles of law" or international

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10. *Serbian & Brazilian Loans Cases*, Judgment No. 14 & Judgment No. 15 (1929), P.C.I.J., ser. A, No. 20, at 42, No. 21, at 121; *Aramco*, 27 I.L.R. at 167 (Sausser-Hall as arbitrator).

11. See, e.g., *Société Riale v. Ethiopia*, 8 R.A.T.A.M. 742 (1929); *Petroleum Dev. Ltd. v. Sheikh of Abu Dhabi*, 18 I.L.R. 144 (Arb. Trib. 1951); *Aramco*, 27 I.L.R. at 168-70, 171.

12. But see the extraordinary decision by an International Chamber of Commerce Court of Arbitration in *S.P.P. (Middle East) Ltd. v. Egypt*, 22 I.L.M. 752 (I.C.C. Ct. Arb. 1983), which, in the writer's view, is wholly fallacious. In that case the court accepted that Egyptian law was the proper law of the agreement, that is to say the "relevant domestic law." But the court went on to find that international law could be deemed as part of Egyptian law and therefore concluded: "[W]e find that reference to Egyptian law must be construed so as to include such principles of international law as may be applicable and that national laws of Egypt can be relied upon only in as much as they do not contravene said principles." *Id.* at 771.

This conclusion must be wrong, because virtually all municipal law systems allow for the incorporation or application of relevant rules of international law. The court's conclusion that principles of international law override internal legislation in the event of inconsistency is contrary to the practice in most states. Moreover, it means, in effect, that an express choice of a given system of municipal law to govern a contract can never, as such, be an exclusive choice. For whether that chosen law be English, French, Egyptian, or Iranian, to the extent that international law forms part of those legal systems, it would be open to any court to by-pass the chosen proper law and apply the principles of other municipal systems as "general principles of law" forming part of international law. This would be entirely contrary to the expectations of the parties, a point which has been so manifestly overlooked by this very unfortunate decision. In short, whenever there is a contractual choice of a specific, municipal legal system as the proper law, the choice is to that legal system per se. There is no *renvoi* to international law, and thereby to other municipal systems generally, via the concept of "general principles of law" as a part of international law.

law, the question is not so much whether the choice is permissible but rather what its implications will be.

Usually the choice is not in substitution of the law of the contracting state party, but by way of supplement to that law. A typical example is Clause 28 of the Libyan concession which was at issue in the *Topco* case.<sup>13</sup> The clause provided as follows:

This concession shall be governed by and interpreted in accordance with the principles of the 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.<sup>14</sup>

The intention seems tolerably clear. It is to control the application of Libyan law to the contract by allowing the application of Libyan law only where its principles coincide with international law, and, if there is no coincidence, to refer instead to "general principles."

But how can one expect coincidence between the Libyan law of contract and international law when, in fact, international law contains no rules about contracts? The answer given to this question by the western investor is, in effect, that international law, while containing no rules about private law contracts, does contain rules about treaties which can be used by analogy. And the fundamental rule of treaty law is *pacta sunt servanda* (treaties are binding) so that, applying that rule, the state party cannot rely on Libyan law so as to assert a right to vary or terminate the contract.

In fact, however, the claimed analogy is no analogy at all. The investment contract between a state and a private entity not only is not a treaty but cannot even be regarded as analogous to a treaty. For there is a world of difference between an agreement under international law between two equal, sovereign states and a contract between a state and a private party governed *prima facie* by the state's own law. Obviously, with a treaty one state cannot use its own municipal law to vary its treaty obligations towards another state. But it is by no means obvious why, with a private law contract, the state party should not assert that right. Indeed, as we shall see, states commonly do assert such a right.

If recourse is had to "general principles" then, in actual practice, the so-called "general principle" usually invoked by the western investor is the same principle, *pacta sunt servanda*, or contracts are binding. In fact, however, no legal system applies that principle without qualification. And in the

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13. 53 I.L.R. at 389, 17 I.L.M. at 1.

14. *Id.* at 404, 17 I.L.M. at 11.

domain of state contracts, the qualification recognized by almost all legal systems is that the state party to a public or state contract has exceptional, prerogative powers to vary or even terminate the contract for the public good and in the public interest, subject only to the duty to pay compensation.

The principle prerogatives vested in the administration as a contracting party may be classified as relating to (1) control or direction of the contract (including the variation of contractual conditions); (2) unilateral termination of the contract; and (3) sanctions against the contractor (including readjustment of the contract price or recovery of excess profits).<sup>15</sup>

As regards termination, it has been said that:

The most radical of special prerogatives enjoyed by the administration is the right to terminate the contract unilaterally, when the public interest so requires.

This drastic power is a widespread feature of national systems of procurement, and is evidently considered necessary in order to maintain the freedom of action of public authorities.<sup>16</sup>

In 1961, the American Bar Association prepared a report entitled "The Protection of Private Property Invested Abroad,"<sup>17</sup> after examining the municipal law of the United States, England and France. It concluded that state contracts in these countries are subject to the "overriding power of the state to terminate or alter them in the public interest, provided proper indemnification is 'given.'" As the United States Supreme Court has said:

The taking of private property for public use upon just compensation is so often necessary for the proper performance of governmental functions that the power is deemed to be essential to the life of the State. It cannot be surrendered, and if attempted to be contracted away, it may be resumed at will.<sup>18</sup>

Indeed the law of the United States extends the state's sovereign powers to the performance of contracts generally. As was said in *Wunderlich Contracting Co. v. United States*:<sup>19</sup> "Actions of a general and public character, implementing programs in the national interest, are considered to be acts of

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15. 7 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW, *Contracts in General*, ch. 4, *Public Contracts* 37 (1982).

16. *Id.* at 40. The legal systems reviewed, and supporting the proposition are those of France, West Germany, Italy, the United Kingdom, and the United States.

17. See Z. KRONFOL, PROTECTION OF FOREIGN INVESTMENT 82 (1972).

18. *Georgia v. City of Chattanooga*, 264 U.S. 472, 480 (1924); see *Atlantic Coast Line Ry. v. Goldsboro*, 232 U.S. 548 (1914); *McAllister, United States Constitutional Law and its Relation to a Contract Between a State and a Foreign National*, RIGHTS AND DUTIES OF PRIVATE INVESTORS ABROAD 213, 249-51 (1965).

19. 351 F.2d 956 (Ct. Cl. 1965).

the sovereign for which [the United States] cannot be held liable in damages."<sup>20</sup> The same principle has recently been affirmed in the English Court of Appeal by Lord Denning in *Czarnikow Ltd. v. Rolimpex (C.A.)*,<sup>21</sup> when he said: "a government cannot fetter its duty to act for the public good. . . . [It] can bind itself to perform a contract with an implication that it will not do anything to hinder or prevent the performance of its obligation thereunder."<sup>22</sup> Thus, if there is a general principle to be applied, it is not the absolute sanctity of all contracts, for no such principle exists, but rather the principle of the state party's exceptional prerogative powers in relation to the contract.<sup>23</sup> It should be emphasized, however, that such principle would not permit arbitrary, executive modifications of a contract. It would permit contractual modifications only when made in a lawful regular manner, by decree or legislative act normally, and for the public good.

The conclusion to which this argument leads is clear: even a reference to "international law" or "general principles of law" does not produce any rule

20. *Id.* at 967.

21. [1978] 1 Q.B. 176, *aff'd*, 1979 A.C. 351. This proposition goes back to the earlier decision in *Rederiaktiebolaget Amphitrite v. The King*, [1921] 3 K.B. 500.

22. [1978] 1 All. E.R. 81, 83.

23. The idea that the assertion of a governmental power to vary contracts with foreigners is essentially a policy favored by developing states is quite untenable, for western european states now do so, particularly in the domain of petroleum concessions. As recently stated by two English authors: "It will have become clear to oil companies that the UK and Norwegian Governments are no more willing than their OPEC counterparts to stick rigidly to contracts that they deem unreasonably disadvantageous and that there is no absolute constitutional protection in either country for the principle *acta sunt servanda*." Daintith & Gault, *Acta Sunt Servanda and The Licensing and Taxation of North Sea Oil Production*, 8 *CAMBRIAN L. REV.* 28, 42 (1977). The point can be illustrated by the United Kingdom legislation of 1975. The effect of that legislation has been described in the following terms:

The Petroleum and Submarine Pipe Lines Act of 1975 made substantial changes in the terms of all existing production licenses, introducing, *without compensation*, new obligations, particularly in regard to development programmes and depletion, and much stricter limitations on assignments. In facing predictable Parliamentary criticism that the Act displayed a disrespect for the United Kingdom's contractual obligations and for the rule of law, and even constituted an illegal expropriation of license rights in international law, Ministers consistently professed to see no difference between what the Act was doing and the alteration of regulatory or fiscal measures with the effect of making contracts more onerous . . . .

T. DAINTITH & G. WILLOUGHBY, A MANUAL OF UNITED KINGDOM OIL AND GAS LAW 30 (1977) (emphasis added).

The United Kingdom Government formally rejected any suggestion of impropriety or even a duty to compensate. In addressing Parliament, Anthony Wedgwood Benn, the United Kingdom's Secretary of State for Energy, said: "the change in the legal framework that is available to Governments and is regularly used by a whole host of environmental, health, tax and other measures which are taken by any responsible government, does not include the provision to compensate as a result." 5 *PARL. DEB.*, H.C. (5th ser.) 1167 (1975) (Report of Standing Comm. D on Petroleum and Submarine Pipelines Bill).



of the absolute sanctity of contracts. On the contrary, it should produce a rule which recognizes the state party's rights to vary such contracts, subject to compensation, for such a rule obtains in virtually all legal systems, including international law itself, by virtue of the recognition of the state's sovereignty over its natural resources.<sup>24</sup> It equally follows that if the state party exercises prerogative powers to which it is entitled by law, it is impossible to characterize its action as unlawful, and this has important consequences on the level of compensation required, as we shall shortly see. But, first, there is a preliminary question on whether that conduct, lawful or unlawful, is to be so characterized by municipal law or by international law.

## II. THE LEGALITY OR ILLEGALITY OF THE STATE'S CONDUCT

The initial premise must be that any issue of breach of contract must *prima facie* be governed by the proper law of the contract. It follows that, *prima facie*, international law is almost wholly irrelevant to this issue. Nevertheless, one would have to recognize three exceptional situations in which international law might be relevant.

### *A. Where International Law is Expressly Chosen as Part of the Proper Law*

As indicated above, the relevance of international law is theoretically undeniable in such a case, but its practical relevance is limited by the fact that international law contains no rules relevant to a breach of contract as such. It is really to overcome this deficiency that some authors, including the United States Restatement on Foreign Relations Law,<sup>25</sup> make the argument that the rules on expropriation of property apply. The argument is that contractual rights are a form of property. Therefore, interference with contractual rights is a form of deprivation of property rights, and international law prohibits such interference unless done for a public purpose, on a nondiscriminatory basis, and subject to appropriate or fair compensation.

It will be seen that, in substance, this approach makes very little difference to the requirements of a lawful exercise of a state's prerogative rights. For most legal systems would require that such exercise be for the public good (or for a public purpose), on a nondiscriminatory basis and subject to com-

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24. See PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES IN INTERNATIONAL LAW chs. 2, 3 (Hossain & Chowdhury eds. 1984). Of course, this rationale would tend to confine the state's prerogative powers to vary contracts to those dealing with the exploitation of natural resources, whereas by the application of general principles of law, these prerogatives would apply to state contracts generally.

25. See RESTATEMENT OF FOREIGN RELATIONS LAW § 712, at 529-34 (Tentative Draft 1985).

pensation. So the argument that the state's conduct is governed by international law adds very little to the substantive requirements *except* in the extreme situation of a state claiming, by virtue of its own municipal law, prerogatives not generally recognized to the state under most systems of law, such as the right to discriminate against aliens or the right to refuse all compensation.

In any event, in so far as international law does form part of the chosen proper law, any breach of its relevant rules will remain a breach of contract vis-a-vis the private party. It would not per se become a basis of any international responsibility vis-a-vis the state of the nationality of that private party.

*B. Where the State Party is Responsible For a "Denial of Justice"*

Circumstances may be envisaged in which the state acts so as to deny to the private party the contractual remedies to which it is prima facie entitled under the state's own law; for example, where the state denies to the private party access to its courts for the purpose of litigating its claim against the state, or refuses to arbitrate despite a clear contractual commitment to do so, or refuses to comply with a judicial or arbitral award against it. In such cases, the complaint against the state party is no longer simply that of a breach of contract, but becomes one of "denial of justice" involving the responsibility of the state on the international level. And precisely because the issue is no longer a contractual issue, the complaint of denial of justice, of breach of international law, is more properly pursued internationally by the state of the nationality of the private party, and not by the private party itself.

*C. Where the State Party is Responsible For a Breach of Treaty*

It may happen that, because of the express undertakings entered into by the state party under the terms of some treaty, such as a treaty on friendship, navigation and commerce, there is a violation of the treaty. Here again, the remedy should be pursued on the international level by the other state party and not by the private entity.<sup>26</sup>

### III. REMEDIES

The private claimant will normally seek one of three possible remedies: a declaration of rights, a claim for restitution (or specific performance), or a claim for compensation or damages. Although favored by Dupuy in the

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26. It may be noted that, contrary to this view, a number of United States claimants before the United States/Iran Claims Tribunal assert a right directly to invoke the 1955 Treaty of Amity between the United States and Iran.

*Topco* case,<sup>27</sup> as the primary remedy, restitution is largely impractical in contracts requiring continuing performance in the territory of the state party<sup>28</sup> when the state has decided that the public good requires the variation or termination of the contract. A claim for a declaration of rights will often be a disguised form of demand for restitution.<sup>29</sup> Thus, in the majority of cases, the real remedy will lie in a monetary award, and it may be best to refer to compensation as the remedy for a *lawful* taking or termination of contract and damages as the remedy for an *unlawful* taking or termination.

#### A. *Compensation or Damages: The Difference Between Lawful and Unlawful Conduct*

As seen above, all legal systems recognize that the state party has the right to exercise certain prerogatives, so that perfectly lawful conduct in relation to a contract may give rise to compensation. Conversely, a state party may act unlawfully, and give rise to a legal liability to pay damages. The measure of the amount due can scarcely be the same, for it would be absurd if the law were to visit a lawful and an unlawful act with identical consequences. The question, therefore, is where is the difference?

It is suggested that this question is not identical to the much-debated question on the standard of compensation due for unlawful expropriation,<sup>30</sup> because that particular debate has scarcely addressed the distinction which we are now making. Indeed, the question may best be approached by asking not "How much?" but rather "Compensation for what?" In short, one needs to separate out the various heads of claim.

#### B. *The Heads of Claim*

In general, there will be three main heads of claim: the value of physical assets, loss of profits, and interest.

##### 1. *The Value of Physical Assets*

Here the controversy is usually not over the existence of the obligation to compensate, for that is, in principle, usually admitted, but over how one

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27. 53 I.L.R. at 389, 17 I.L.M. at 1.

28. It may, however, be a practical remedy in cases where the return is sought for a specific chattel, such as a ship, or aircraft.

29. See Lagergren's treatment of the claim by British Petroleum in *BP v. Libyan Arab Republic*, 53 I.L.R. 297 (Arb. Trib. 1974).

30. This is essentially the controversy over whether the standard required is the "Hull formula," i.e., prompt, adequate and full compensation, or a more flexible standard of "reasonable," "fair," or "equitable" compensation. See RESTATEMENT, *supra* note 25, at 518-32. Mendelson & Schachter, *What Price Expropriation?*, 79 AM. J. INT'L L., 414, 420 (1985).

values the assets. The choice tends to lie between net book value of the assets, depreciated value, market value and so forth. It is usually assumed that the value must be realistic and not an artificially low value resulting directly from the threat of a governmental takeover.

## 2. *Loss of Profits (or "Going Concern Value")*

There is good reason to assert that, whether or not recoverable for an *unlawful* act, there is no basis for awarding loss of profits for any period *after* the date of the award of compensation when the state party's conduct has been lawful. This is firstly because of the need to differentiate between an unlawful and a lawful act, and secondly because the authorities usually cited to support a claim for loss of profits are highly suspect.

Recent commentaries by American authors<sup>31</sup> seek to support the standard of "going-concern value" by reference to decided cases. But the presentation of the case authorities is self-serving and suspect. For example, the *Sapphire* case<sup>32</sup> was undefended, eventually nullified by an Iranian court, and the award never implemented. Moreover, as the decision in the *LIAMCO* arbitration<sup>33</sup> brought out, it is a relatively old case of very limited precedential value. Of the so-called "Libyan" cases, all were undefended: in the *BP* case,<sup>34</sup> Judge Lagergren found that the expropriation was not a valid nationalization because it was discriminatory and undertaken for political motives (and therefore not a precedent for a *lawful* nationalization); and the *LIAMCO* decision actually rejected the standard of full compensation. The Mahmassani award in the *LIAMCO* case cannot truly be regarded as an award of lost profits. It was in relation to the Raguba Field (Concession 20) that LIAMCO claimed, by virtue of its 25% interest in the Concession, for *two* sums to cover its loss of production (or profits). These sums were \$90,420,000 (for 1974-1976) and \$216,680,000 (for 1977-1988), and only the latter sum represented *future* profits. The arbitrator awarded only \$66,000,000—i.e., *less* than the claimant's estimate of *past* profits—and this on the basis of a calculation based on the unjust enrichment to Libya, plus some allowance for LIAMCO's investment expenses in the field. As the arbitrator made clear, the formula for "equitable compensation," not "prior, adequate, and effective" compensation, was adopted in determining compen-

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31. See, e.g., Clagett, *Protection of Foreign Investment Under the Revised Restatement*, 25 VA. J. INT'L L. 73 (1984).

32. *Sapphire Int'l Petroleum Ltd. v. National Iranian Oil Co.*, 35 I.L.R. 136 (Arb. Trib. 1963).

33. *Libyan Amer. Oil Co. (LIAMCO) v. Libyan Arab Republic*, 62 I.L.R. 141 (1977).

34. 53 I.L.R. at 297.

sation in that case.<sup>35</sup>

There are two decisions by the International Centre for Settlement of Investment Disputes which are sometimes cited as support for the proposition that future profits are recoverable, but in fact they are of doubtful value. Both involved unlawful expropriation, so they are not cases of lawful nationalization. In one case, *AGIP S.p.A. v. The Congo*,<sup>36</sup> the sum awarded was the purely nominal one of one franc. In the other case, *Benvenuti et Bonfant v. The Congo*,<sup>37</sup> the profits recovered were actually *past* profits, payable as dividends on a shareholding by virtue of the by-laws of the company. A right to a dividend is not truly a right to future profits.

The *Aminoil* decision<sup>38</sup> is also a very problematical authority, for although Aminoil certainly claimed for loss of future profits, the tribunal's total award of \$176 million was *less* than Aminoil's assessment of the depreciated replacement costs of its assets.<sup>39</sup> Moreover, although the tribunal indicated that it was making an allowance for the value of the company as a going concern, it preferred to use the concept of a "reasonable rate of return" on the investment, rather than "loss of profits" as such. Indeed, one writer had concluded that the Tribunal allowed nothing for loss of profits over the remaining thirty years of the concession.<sup>40</sup>

It is true that the United States/Iran Claims Tribunal has made certain awards recognizing "going concern value" as a basis for compensation,<sup>41</sup> but the reasoning for these awards is, with respect, by no means clear, and these few decisions—involving as they do rather particular circumstances peculiar to those cases—cannot yet be said to provide a sound, decisional basis for the recovery of future profits. Indeed, the sounder approach appears to have been articulated by the tribunal in the *INA* case where it recognized that international law with respect to compensation had undergone a "reappraisal."<sup>42</sup> As the tribunal's decision pointed out, what was at stake was only "a rather small amount shortly before nationalization."<sup>43</sup>

There is yet a third, and quite different, reason of principle to reject loss of

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35. *LIAMCO*, 62 I.L.R. at 218.

36. *AGIP S.p.A. v. The Congo*, 21 I.L.M. 726 (I.C.S.I.D. 1979).

37. *Benvenuti et Bonfant v. The Congo*, 21 I.L.M. 740 (I.C.S.I.D. 1980).

38. *Aminoil*, 21 I.L.M. at 976.

39. See Refern, *The Arbitration Between the Government of Kuwait and Aminoil*, 55 BRIT. Y.B. INT'L L. 211, 221 (1983).

40. Mann, *The Aminoil Arbitration*, 54 BRIT. Y.B. INT'L L. 65, 108 (1984).

41. See, e.g., *American Int'l Group, Inc. (AIG) v. Islamic Republic of Iran*, 4 Iran-U.S.C.T.R. 96 (1983); *Starrett Housing Corp. v. Islamic Republic of Iran*, 4 Iran-U.S.C.T.R. 122 (1983).

42. *INA v. Iran*, Case No. 161, Award No. 184-161-1, at 8.

43. *Id.*

profits. In the *Aminoil* case the tribunal emphasized the obligation of a dispossessed or expropriated corporation to reinvest the proceeds of any arbitral award.<sup>44</sup> This would accord entirely with the common law duty of a plaintiff to mitigate his damages. Conceptually, therefore, when the private claimant receives, by way of an award, compensation representing the value of his assets, plus any loss of profits in the interim period between the act of nationalization, breach of contract or expropriation and the date of the award, at that date he receives back the value of his business. His "capital" is returned to him.<sup>45</sup> He is presumed to invest that capital elsewhere so that it will earn him profits in some other business, in some other country. Why, therefore, should the private claimant expect the tribunal to award him loss of profits under the terminated contract for the same period during which the same capital is earning a second set of profits elsewhere? On the assumption that he has put his returned capital to good use, the claimant, in effect, is claiming a double recovery for loss of profits. Such a claim seems both illogical and unethical.

### 3. Interest

Interest payments are normally made to cover the period between termination of the contract and payment of the award, on the basis that the claimant's capital has been taken and is no longer available to him for use, so that it ought to be regarded as conceptually earning interest. Yet, clearly, this capital cannot be earning *both* interest *and* profits, so the claimant ought properly to be put to his election as to which of the two he wishes to claim. Equally, if the value of the claimant's assets is determined at the date of the taking, or termination of the contract, and then brought into line with the rate of inflation from that date until the date of the award, then there is no basis for awarding either interest or loss of profits in addition to this "inflation factor." For, if the capital sum was invested and earning either profits or interest, the capital sum would remain constant, and it would be the profits or interest which would add to that sum so as to increase it in line with (or in advance of) inflation. Thus to build in an "inflation factor" is to substitute for either profits or interest: it is illogical to award such a factor in addition to either.<sup>46</sup>

In conclusion it may be said that claims on the international level, brought

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44. *Aminoil*, 21 I.L.M. at 1039.

45. Of course this sum may be reduced by any counterclaims of the respondent state party. These may be for debts, unpaid taxes, faulty work performance, or even "unjust enrichment." Many legal systems allow the state to recover excessive profits made by a private contractor.

46. This seems to be what the tribunal did in *Aminoil*, 21 I.L.M. at 976.

by private entities against states as contractual claims seem to exhibit a number of extravagant and illogical features which no municipal court would entertain. If investor corporations asserted claims against foreign states on more or less the same basis as they would claim against their own state under a similar contract, it seems that a good deal of the controversy surrounding this area of “transnational” law could be eliminated.