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Ph.D.

2 May 1992

**THE LAW GOVERNING OIL CONCESSION AGREEMENTS AND THE PERMANENT
SOVEREIGNTY OF STATES OVER THEIR NATURAL RESOURCES,
WITH SPECIAL REFERENCE TO ISLAMIC SHARI'AH LAW**

By

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**A thesis re-submitted for the degree of
Doctor of Philosophy**

**Faculty of Law
University of Sydney**

February 1992

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ
١ يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ

In the name of Allah Most Gracious, Most Merciful.

"The Holy Qur'an says:

O ye who Believe, Fulfil (All) obligations."

Sura V, Verse I

*To the memory of my parents,
and to my wife and children.*

ACKNOWLEDGMENTS

The original version of this thesis was submitted in 1990 for the degree of Doctor of Philosophy in Law in the University of Sydney, Australia. This version, resubmitted in February 1992, includes amendments suggested by the three examiners, to which I am most grateful.

In addition, the author wishes to express his deepest appreciation to Professor James Crawford, the Dean of Faculty of Law, for his advice, guidance and continuing support during the writing of this thesis.

The author is indebted to the Minister of Petroleum and Mineral Resources, Kingdom of Saudi Arabia, for financing his study in the United States of America and Australia. This support made it possible to complete the Masters and Ph.D. thesis.

He would particularly like to thank the Ministry of Petroleum and Mineral Resources, His Excellency Hisham Nazer, and Mr Abdul Aziz Al Sheneber, the Deputy Minister. The author is indebted to the support and responsiveness of the staff at the Ministry for promptly answering his many queries.

He also wishes to thank: His Excellency, Dr Mutleb Alnafeesah, President of Experts Department in the Cabinet of Kingdom of Saudi Arabia; Dr Mohammed T. El Ghounemi, Professor of International Law and Head of Department of International Law at the University of Alexandria, and the legal adviser to the Saudi Arabia Ministry of Petroleum and Mineral Resources; Sheikh Abdullah Ibn Ghedayan, member of the permanent committee for scientific researches and Ifta in the Kingdom of Saudi Arabia for their encouragement and assistance.

Finally, special thanks and deepest appreciation is due to his wife for her patience and encouragement during the period of studies which contributed to the completion of this thesis, and to his children who reminded him of the most important duties in his life.

SYNOPSIS

An important problem in modern international law is the creation of a secure environment for the flow of private foreign investment. This is because the economic development of Third World countries requires foreign capital and skills, to enable them to develop their natural resources. This is especially true of the development of the economies of oil exporting countries, because such capital and skills can only be attracted if a secure investment climate is provided.

Recently, a number of legal measures have been taken to ensure the legal security of foreign investment, by bilateral and multilateral agreements, by international conventions and organizations, and by legal guarantees provided by States requiring foreign capital and skills.

The primary focus of this thesis is on the legal problems that arise in the case of disputes between capital-importing States and the providers of that capital. Specifically, the study is an enquiry into the law governing oil concession agreements and the permanent sovereignty of oil exporting States over their natural resources.

One view has been that investment protection disputes should be made subject to the rules of international law, e.g. by choice of law clauses invoking international law or the general principles of law. However, most Third World countries believe that such disputes should be subject to local jurisdiction, at least as between capital importing States and foreign investors. This opinion has been supported by United Nations resolutions since 1952.

This thesis concludes that the most applicable law to govern oil concession agreements is the law having the closest connection with the agreement, as no one law can be made compulsory in every case. Further, international law has recognized the sovereignty of a State and its right to nationalize natural resources in its territory, on condition that, for a public purpose, non-discrimination and compensation is paid according to whatever the international standard of compensation may be.

Traditionally it has been considered unlawful for a State to nationalize foreign property; if this is done it must be accompanied by restitution in kind or if this is impossible, full payment of the value plus any losses sustained. This principle is known as the Hull rule; it is summarized by the formula that compensation must be "adequate, prompt and effective". On the other hand, Third World countries generally argue that nationalization is legal, providing "adequate" or "appropriate" compensation is paid.

This thesis also examines these issues as they arise under Islamic Shari'ah. The thesis concludes that under the principle of *Durura* in Islamic Shari'ah, a State may nationalize its resources, when prompted by the necessity of ensuring the continued development of the State, and in the interests of its community. Thus the position under Islamic Shari'ah is thus not very different from the position under international law.

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ABBREVIATIONS

<i>A2d</i>	Atlantic Reporter, Second Series
<i>AALS</i>	Association of American Law Schools
<i>ABAJ</i>	American Bar Association Journal
<i>AC</i>	Law Reports, Appeal Cases
<i>AD</i>	Annual Digest of Public International Law Cases
<i>ADIL</i>	Annual Digest of International Law
<i>AIOC</i>	Anglo-Iranian Oil Company
<i>AJCL</i>	The American Journal of Comparative Law
<i>AJIL</i>	The American Journal of International Law
<i>ALJ</i>	Australian Law Journal
<i>All ER</i>	All England Law Reports
<i>Aminoil</i>	American Independent Oil Company
<i>AOC</i>	Arabian Oil Company
<i>APPA</i>	The African Petroleum Producer's Association
<i>Aramco</i>	Arabian American Oil Company
<i>ASIL</i>	The American Society of International Law
<i>BFSP</i>	British and Foreign State Papers
<i>BP</i>	British Petroleum Company
<i>BYIL</i>	The British Year Book of International Law
<i>Calif LR</i>	California Law Review
<i>Ch/ChD</i>	Law Reports: Chancery Division
<i>CILSA</i>	Comparative and International Law Journal of Southern Africa
<i>CJS</i>	Corpus Juris secundum
<i>CLR</i>	Commonwealth Law Reports

<i>Col LR</i>	Columbia Law Review
<i>EC/EEC</i>	European Community/European Economic Community
<i>ECOSOC</i>	Economic and Social Council
<i>EDA</i>	Economic Development Agreement
<i>EGPC</i>	Egyptian General Petroleum Corporation
<i>F2d</i>	Federal Reporter, Second Series
<i>F Supp</i>	Federal Supplement
<i>Fischer</i>	A collection of International Concessions and Related Instruments Contemporary Series (ed. by P. Fischer)
<i>Ga J Intl & Comp L</i>	Georgia Journal International and Comparative Law
<i>GCC</i>	The Arabian Gulf Co-operation Council
Hackworth, <i>Digest</i>	GH Hackworth, Digest of International Law, Washington, 3, 1942, 5, 1948.
<i>Hague Recueil</i>	Academie de Droit International, Recueil des Cours
<i>IBRD</i>	International Bank for Reconstruction and Development
<i>ICJ</i>	International Court of Justice
<i>ICLQ</i>	International and Comparative Law Quarterly
<i>ICSID</i>	International Center for Settlement of Investment Dispute
<i>IEA</i>	International Energy Agency
<i>IJIL</i>	Indian Journal of International Law
<i>ILC Yearbook</i>	International Law Commission Yearbook
<i>ILJ</i>	International Law Journal
<i>ILM</i>	International Legal Materials
<i>ILR</i>	International Law Reports
<i>IPG</i>	Iraq Petroleum Company
<i>Isl Lit</i>	Islamic Literature (Lahore)
<i>Isl Rev</i>	Islamic Review
<i>Isl Stud</i>	Islamic Studies (Islamabad)

<i>JPL</i>	Journal of Public Law
<i>Liamco</i>	Libyan American Oil Company
<i>Lloyd's Rep</i>	Lloyd's List Law Reports
<i>JMLC</i>	Journal of Maritime Law and Commerce
<i>JPHS</i>	Journal of the Pakistan Historical Society
<i>Jur Rev</i>	Judicial Review
<i>JWTL</i>	Journal of World Trade Law
<i>KB</i>	Law Reports, King's Bench
<i>KOC</i>	Kuwait Oil Company
<i>LNTS</i>	League of Nations Treaty Series
<i>LQR</i>	Law Quarterly Review
<i>Mass</i>	Massachusetts Supreme Court Reports
<i>MEES</i>	The Middle East Economic Survey
<i>MLR</i>	Modern Law Review
<i>MW</i>	Muslim World
<i>NE</i>	North Eastern Reporter
<i>NIEO</i>	New International Economic Order
<i>NILR</i>	Netherlands International Law Review
<i>NOC</i>	National Oil Company
<i>NIOC</i>	National Iranian Oil company
<i>NYIL</i>	Netherlands Year Book of International Law
<i>NYS</i>	New York Supplement
<i>NYUJILP</i>	New York University, Journal of International Law and Politics
<i>NYULR</i>	New York University Law Review
<i>OAPEC</i>	Organization of Arab Petroleum Exporting Countries
<i>OECD</i>	Organization of Economic Cooperation and Development

<i>OPEC</i>	Organization of Petroleum Exporting Countries
<i>OPIC</i>	Overseas Private Investment Corporation
<i>PCIJ</i>	Permanent Court of International Justice
<i>Petromin</i>	General Petroleum and Mineral Organization of Saudi-Arabia
<i>PP</i>	Parliament Papers. British Sessional Papers, House of Commons.
<i>Proc ASIL</i>	Proceedings of the American Society of International Justice Reports
<i>QB</i>	Queen's Bench Reports
<i>QBD</i>	Law Reports, Queen's Bench Division
<i>QdR</i>	Queensland Reports
<i>RIAA</i>	United Nations, Reports of International Arbitral Awards
<i>Texaco</i>	Texaco Overseas Petroleum Company
<i>UN</i>	United Nations
<i>UNCITRAL</i>	United Nations Commission on International Trade Law
<i>UNCTAD</i>	United Nations Conference on Trade and Development
<i>UNGA</i>	United Nations General Assembly
<i>UNTS</i>	United Nations Treaty Series
<i>US</i>	United States Reports
<i>USC</i>	United States Code
<i>USTC</i>	United States Tax Cases
<i>USTS</i>	United States Treaties Series
<i>VJIL</i>	Virginia Journal of International Law
<i>VR</i>	Victorian Reports
Whiteman, <i>Digest</i>	MM Whiteman, Digest of International Washington, 8, 1967
<i>WLR</i>	Weekly Law Reports

PART I - INTRODUCTION

CHAPTER 1

INTRODUCTION

1. Aim of The Thesis

In past centuries there existed a relative self-sufficiency in the states of the world, with little need for economic transactions between them. Thus there were relatively few disputes and no impetus to establish a system of conflict of laws. However, as contact between states increased and expanded, trade created economic interdependency. The need arose to establish means of settling international disputes, including international commercial disputes. This need was particularly acute in relation to agreements to exploit the natural resources of another country - that is, concession agreements. The status and effect of these agreements is the focus of this thesis.

Part I will outline the aim of this thesis, offer a definition of the various kinds of concession agreements, and outline the development of concession agreements, particularly where they are concerned with the relationship between oil exporting and oil importing countries. This will be followed by looking at the legal nature of oil concession agreements in various legal systems.

In the second Part of this thesis I will look at issues involved in the choice of law and forum in governing contracts, and at what these issues imply for oil concession agreements in particular. I will then look at the issues involved in the choice of State law as the substantive law of a contract between a State and a national of another State. This discussion will include those cases where the choice of law is not specified, and will deal with the question whether principles of international law or general principles of law can be applied either as the proper law or to augment the proper law. These issues particularly arise between developing countries and capital exporting States.

Traditionally, capital exporting countries have argued for the need for the application of general principles of law or of international law, on the grounds that host States do not possess a legal system sufficiently sophisticated to deal with the complex legal questions that arise out of international transactions, and also that as it is possible for a State to alter its own laws during a contract, using only that State's law poses unacceptable risks to the foreign party. These risks, it is argued, can only be averted through the use of international law or general principles of law.

By contrast, in resolving the problem of the applicable law the opinion of developing countries is likely to differ from those of the First World. To developing countries the most applicable law must be the national law of the state party. This conflict is seen repeatedly in disputes over oil concession agreements, where the failure of some international jurists to take into account the rights of developing countries has led since the 1950's to much discussion in the United Nations and other international forums. These rights were seen to evolve at the same time as the rise of OPEC, OAPEC and national oil companies, with the concomitant economic pressure they proved to be able to exert, and because of the solidarity of the Third World countries committed to re-formulating the rules of the international legal order.

Part III of this thesis looks at the stabilization of oil concession agreements. This involves a discussion of the emerging recognition of the concept of permanent sovereignty over natural resources, as Third World countries struggle to regain control over their natural resources. This trend for national economic control is a characteristic of the world in the 20th century. But so is greater economic interdependence among nations, and the question is, how are the two to be reconciled?

The question of oil concession agreements has had a high profile in the last twenty years, due to the numbers of unresolved conflicts which have had both national and international relevance. To oil producing countries, their extreme economic dependence on this resource has meant that oil has played a great role in domestic policy formulations. The oil producing countries demanded an increasing degree of control over their resources. By the end of 1951 they were

demanding 50% share of profits with the companies operating the concessions. Therefore, there was a trend to establish full ownership of petroleum enterprises, a trend made explicit by OPEC in 1968 when it emphasised the inalienable right of all States to exercise permanent sovereignty over their natural resources.¹ And, as we will see, their right to control their resources has been recognized both in treaties and in numerous United Nations resolutions.

This thesis also makes special reference to the Islamic Shari'ah, the legal system of the Arabic nation, which is also the national law of a number of the most important oil producing States. Islamic Shari'ah is described as a comprehensive legal system which for more than one thousand years has been capable of dealing with foreign people and with conflicts that have arisen in dealings with them. An analysis of Islamic Shari'ah shows that it is substantially consistent with modern developments in international law. Accordingly, this thesis attempts to justify the position of oil exporting countries of the Third World, with particular reference to those which rely on the Islamic Shari'ah, in exerting increasing control over their natural resources.

2. Structure of this Thesis

To give effect to this general aim, the thesis has the following particular structure.

In Chapter One I define oil concession agreements, referring to the nature of the agreement under different legal systems and the development of relationships between oil importing and oil exporting countries.

In Chapter Two the implications of choice of law and forum on oil concession agreements will be analysed.

In Chapter Three I will discuss the dispute settlement mechanisms in some oil exporting countries.

1 OPEC General Information & Chronology (1986) 36.

In Chapter Four I will analyse the various limitations that may exist on choice of law and forum. The freedom of the parties to choose the proper law or forum is not absolute, since certain limitations on the parties' choice have been recognised by judicial decisions and international treaties.

In Chapter Five I will look at the many laws applicable to oil concession agreements and the use of the notion of "the most real connection" as the basis of resolving the problem of choice of law.

In Chapter Six I will discuss the development of the concept of permanent sovereignty over natural resources and the implications of its acceptance. Then I will compare the international concept with the concept as it is understood in Islamic Shari'ah.

In Chapter Seven I will discuss the issues related to fundamental change of circumstances as they pertain to the renegotiation of oil concession agreements and the effect of stabilization clauses, while in Chapter Eight I will discuss the issues related to fundamental change of circumstances and contract termination in Islamic Shari'ah.

In Chapter Nine I will discuss the issue of expropriation of foreign-owned property, with special regard to oil concession agreements and the right of States to control their natural resources.

In Chapter Ten I will discuss the problem of the payment of compensation and the varying standards that have been used in such cases. The conflict between the demands of prompt, adequate and effective compensation, which may pose intolerable demands on developing countries, and the Third World position of appropriate compensation will be discussed.

Of course it is recognized that the various differences in the positions of capital-importing and capital-exporting countries, of industrialized and Third World countries, which are discussed here, are not simply legal or doctrinal differences. They relate to the cultural values, economic position and political history of the countries concerned. But those differences are often expressed,

and fought out, in legal terms, and the legal doctrines have thus been a vehicle for communication and accommodation, as well as change. For these reasons it is useful to study the various legal doctrines themselves, and this will be done here.

3. The Nature of Concession Agreements

The legal nature of concession agreements between the government of a state and an individual or a business association has been much discussed. The importance to the world economy of the concession system, especially where it involves the exploitation of oil and basic minerals, largely accounts for this interest. Concessions typically owned or at least partly owned by foreign nationals can be found in Africa, the Middle East, Latin America and in other countries. Here I briefly discuss the definition and kinds of concession agreements.

(a) Definition of "Concession" in General

The term concession implies the granting of a franchise, license, patent, charter, monopoly or privilege to a national or foreign company by a state within an exclusive area of its land for a period of time. Thus the term is a broad one, as was indicated in *German Government v. Reparations Commission* (1924) where the Arbitral Tribunal, in attempting to interpret article 260 of the Treaty of Versailles, stated "the concept of the concession is very wide and varied; it may extend, according to the legislations and the doctrines concerned, from the grant of titles of nobility or of a burial ground, to that of certain public functions involving, for instance, the right to expropriate or the right to regulate".² By contrast Gidel adopted this definition:

A contract by which one or several persons are engaged to execute a work on the consideration of being remunerated for their effort and expenses, not by a sum of money paid directly to them by the administration after the completion of the work,

2 *Annual Digest of International Law Cases (1923-1924)* 341.

but by a receipt of a return levied for a more or less lengthy period of time on the individuals who profit from the work....³

These definitions are rather variable, and it may not be possible to go further than Mosler, who defined a concession as "the grant to an individual of rights under municipal law which touch the public interest" and stated that beyond this term "concession" has no fixed legal meaning.⁴ Thus in the *Arbitration between the Kingdom of Saudi Arabia and Aramco* of 1958, the Arbitrator stated:

the legal nature of economic concessions is not the same in the case of public service concessions, or of pure public works concessions, or of concessions for the occupation of the public domain or the exploitation of State resources, or of port concessions, or of concessions of water works or of land, for instance in the colonies, or, lastly, of mining concessions. It does not seem possible to subsume all these various concessions under a common concept; This was recognised by the French Conseil d'Etat in its opinion of 19 and 26 December 1907 about various questions relating to mining concession.... Finally, the legal nature of the concession is not the same in the different systems of law.⁵

(b) Different Kinds of Concession Agreements

Concession agreements may take several forms, including economic concessions and political concessions. Economic concessions cover a variety of business enterprises, among the most important of which are oil concession agreements, especially in the Middle East, which contains the world's largest oil reserves.

There are two main areas that typically become the subject of concession agreements. These are (i) public utilities and (ii) the exploitation of natural resources, although it is possible for most kinds of economic activity to be the

3 Gidel, *Des Effets de l'Annexion sur les Concessions* (1904) 123, quoted by DP O'Connell, *The Law of State Succession* (1956) 106.

4 H Mosler, *WirtschaftskonzeSSIONen bei Änderung der Staatshoheit* 79 (1948), quoted by T Huang, *Some International & Legal Aspects of the Suez Canal Question*. *AJIL* 51 (1957) 291.

5 *ILR* 27 (1963) 157. See also DP O'Connell, 106-7 & KS Carlston, *Concession Agreements and Nationalization* *AJIL* 52 (1958), 260 for other definitions.

subject of a concession agreement. Public utilities include cables, telegraphs, shipping, roads and air travel. Natural resources cover not only petroleum but also minerals, coal, timber, rubber and agricultural products.⁶ But as Huang points out

In the more important concessions the principal grant may be supplemented by auxiliary rights, such as rights over land, right of eminent domain, exception from taxation and customs dues for a stipulated period, or for the duration of the concession, right to exploit mines together with the operation of railways, stations and other appurtenances.⁷

But in addition to economic concessions, there can be political concessions agreements typically contained in a treaty, as was the case when China conceded the Chinese Eastern Railway to Russia, the Shantung Railway and the Port of Kiauchau to Germany, part of the Port of Tientsin to Belgium, and Weihaiwei to Britain.⁸ However such political concessions are now more or less obsolete, and will not be further discussed in this thesis.

For present purposes a concession agreement can thus be defined as an economic development agreement which is bilateral in nature, i.e. it implies mutuality of obligation.⁹ This point was emphasized by Lord McNair as follows:

These contracts are entered into for many purposes and bear many names. Amongst the purposes may be mentioned the development of oil or other mineral resources; the laying of pipe-lines for oil; the development of an uncultivated area for the purposes of agriculture or forestry and perhaps they are best described as "economic development agreements". They are often called "concessions", but the objection to this term is that it is apt to conceal the bilateral character of the transaction, and moreover it is often used, popularly, to denote the area in respect of which the agreement is made.¹⁰

6 Huang, 292-3.

7 Id, 293.

8 *Encyclopaedia Britannica*, V1 (1958) 201.

9 JN Hyde, *Economic Development Agreement*, *Hague Recueil* 15 (1962 1) 105,267.

10 Lord McNair, *The General Principles of Law Recognized by Civilized Nations*, *BYIL* 33 (1957) 1.

Economic concession agreements are a unique type of contract between a State and a company. They are used to facilitate the use of private enterprise in the development of a State's resources where the State does not have sufficient resources to do it alone.

However, they are not necessarily ordinary agreements, ruled by the law of a State. Difficulties can therefore arise from their mixed nature, though Olmstead notes that "such agreements are limited in subject matter to the extent that the terms must not provide for performance inconsistent with international standards".¹¹ The relationship of the parties is seen as more an association "in which the equality of the parties is the rule".¹² It is common that recourse to arbitration in the event of conflict is included in such concession agreements. Relying on these kinds of arguments, foreign oil companies have often reiterated the view that oil concession agreements are not government contracts, but international agreements. According to this view the concession is therefore outside the jurisdiction of a State's regulatory powers. However, these assertions have not been supported: by looking at French and other authorities, it can be shown that such concessions were considered a public service concession subject to the jurisdiction of the State.¹³ Moreover, the view that economic concession agreements are autonomous instruments of an international character has little apparent legal authority and very few cases have relied on that view, *Texaco* being the disputed exception. "The most fundamental problem is to locate sufficient authority in support of the view that the agreements are directly governed by international law",¹⁴ where one party is an individual or company. This view was expressed in the *Anglo Iranian Oil Company Case*, where the International Court referred to an oil concession agreement as "nothing more than a concessionary contract" between a State and a foreign company.¹⁵

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- 11 CJ Olmstead, Economic Development Agreements Part II, 49, *California Law Review*, (1961) 507.
- 12 M Bourquin, Arbitration & Economic Development Agreements, *The Business Lawyer* 15 (1960) 860.
- 13 H Sultan, Legal Nature of Oil Concessions, *Revue Egyptienne De Droit International* 21 (1965) 73.
- 14 EJ Paassivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes* (Cambridge, PhD thesis, 1988) 80.
- 15 *ICJ Reports* (1952) 112.

Similarly, in the *Letco Case* where the tribunal decided that most appropriate law was the law of Liberia, the place of performance of the contract.¹⁶

(c) **The Development of Relations Between Oil Producing and Importing Countries**

In the immediate post-war period, developed countries sought to be assured that their interests in the exploitation of foreign natural resources were protected. A mutual dependence of interests existed between oil companies and their home governments, at a time when developing countries were coming to rely increasingly on oil as an energy source. The role of the exporting countries was that of tax collector. "They were not in a position to participate in any decision regarding the operations of the oil industry within their national borders".¹⁷

By the early 1970s the position of oil producing countries changed to that of real oil exporters. Co-ordinated by the newly established Organization of Petroleum Exporting Countries (OPEC), they began to take increasing control over both the production and distribution of oil. This change of status was emphasised by the Arab oil embargo from October 1973 to March 1974. This change of status met with considerable hostility from western governments and the western press. This hostility led to the creation of the International Energy Agency after the Washington Energy Conference of 1974. The IEA was a powerful group of oil importing countries, with an advisory committee of national and international companies belonging to IEA countries.

OPEC was, however, successful in raising the price of oil in October 1973, one day before the Organization of Arab Petroleum Exporting Countries (OAPEC) imposed an embargo on oil exports to the United States because of its support for Israel in its war with the Arabic nation. That embargo can be seen as an important stage in the continuing differences between oil exporting and importing countries. Importing countries need to obtain cheaper oil to sustain and expand their own development, and foreign oil companies wish to continue

16 *ILM* 26 (1987) 661.

17 AA Attiga, *Interdependence on the Oil Bridge, Risks and Opportunities*, 1988, 56-8.

their domination of oil resources in producing countries. Exporting countries need a price for oil which will sustain their desire for internal development and international sovereignty. This goal is supported, as we will discuss in Part III, Chapters 6 and 9 of this thesis, by international law and United Nations resolutions.

4. The Legal Nature of Oil Concession Agreements

In this section I will outline the legal nature of oil concessions in the different legal systems as follows:

- (a) Under civil law
- (b) Under common law
- (c) Under former Soviet law
- (d) Under Islamic Shari'ah (law)

(a) Under Civil Law

Under French law and in countries which adhere to the civil law a concession might be classified in two different ways:

- (1) as a contract under private law dealing with commercial or industrial matters.
- (2) as a unilateral administrative act.

Jèze stated that:

... the fact of its having been solicited by the grantee does not suffice to turn it into a contract...the concession is an act-condition which subjects the concessionaire to an objective and impersonal legal regime, a fact which implies the existence of laws and regulations pursuant to which the concession is granted.¹⁸

Despite this it is customary in French law to consider that any concession is contractual in nature. There are three major types of concession:

- (1) A public service concession, which is sometimes considered to have a dual legal nature. As between the parties is a contract between the grantor and the concessionary; as against users, it is considered a public law regulation.
- (2) A pure public works concession, by which a concessionaire undertakes to build, maintain and manage public works and receive remuneration resulting from this exploitation.
- (3) A mining concession, including oil concessions. These are considered to be completely different from a public service concession and are defined as that "by which the public authority creates a perpetual ownership... since the complete ownership of the mine reverts to the State at the end of the concession".¹⁹

The difference between a public service concession and an oil concession under civil law was indicated in the *Arbitration between the Kingdom of Saudi Arabia and Aramco of 1958*:

Mining and oil concessions are not public service concessions because they do not include any provision in favour of users. To use the words of Planiol, the mine is not destined to public use and is exploited by the concessionaire in his own private interest. ... The concessionaire enjoys a nearly total freedom, and is neither bound by clauses concerning maximum tariffs for sales nor by prohibitions of preferential tariffs, which are the usual features of the *cahiers des charges* in public service concessions.²⁰

As Duez and Debeyre state:

The concession of a mine should not be confused with the concession of a public service.... The exploiter of a mine does not administer a public service. His exploitation remains a private enterprise subject to the rules of private law to the extent that no express derogation is made thereto by the law...with regard to new concessions granted under the law of 1919, the State's control over the mining exploitation is accentuated while preserving its character of a private enterprise. The regime of

19 Id, 160-1.

20 Ibid.

mines brings these private enterprises closer to public service, although the activity involved is not susceptible to be treated as a public service since no prestations are furnished to the public.²¹

In conclusion, it may be said that a mining concession in French law is an act *sui generis*, which cannot be completely assigned to any other category. It is an act which partakes of the nature of a unilateral act in that it depends on the authorization of the State and of that of a contract in that it requires an agreement of the respective wills of the State and of the concessionaire.

(b) **Under Common Law**

Common law consists of the body of non-statutory law applicable in England and in other countries where English law was received or adopted, comprising rules which have been recognized by the courts as always having existed from the earliest times or which have been developed through the course of judicial decision.²² In English law, the general rules of the law of contract apply to concessionary agreements except where one party to the agreements is the Crown. A mining concession may be seen as a lease or as the creation of a *profit à prendre*.²³ Whyatt C.J. discussed the distinction between a lease and a *profit à prendre* as follows:

As is well known, it is frequently a matter of difficulty for a court to decide whether a particular instrument operates to create a lease or a *profit à prendre*. Each case must depend upon its own particular circumstances and the intention of the parties must be gathered from the instruments as a whole. If the court is of the opinion that the intention of the parties is to confer a right of exclusive possession, unattended by a simultaneous right in any other person, the court construes the instrument as a lease, but if, on the other hand, the instrument merely confers a right to use another's land for the purpose of taking a "profit" from it, the land itself remaining in the possession and control of the owner, then it will be regarded as a *profit à prendre*. Applying these principles, as nearly as may be, to the appellants' concessions, it appears to me that the grant by the government

21 Duez and Debeyre, *Droit Administratif* (1952) 606-611. Quoted by Henry Cattán, *The Law of Oil Concessions in the Middle East & North Africa* (1967) 81.

22 E Sykes, *The Employer, The Employee & The Law* (1964) 7; A Harding, *Social History of English Law* (1966) 30; W Friedmann, *Changing Functions of Contract in the Common Law*, *University of Toronto Law Journal* IX (1951) 15, 41.

23 *The Arbitration between Saudi Arabian Government & Aramco* (1958) *ILR* 27 (1963) 161.

to the appellant was more analogous to a lease than to a *profit a prendre* since it gave the concessionaire an exclusive power to explore and exploit the petroleum existing in the strata in the concession area for a term of years and contained nothing whatever to suggest that any other person could lawfully exercise any similar power in relation to the strata.²⁴

However, as a general rule of public policy a public authority cannot be prevented by an existing contract from acting in a way essential to its existence and for which was created. As the Transvaal Commission Report stated:

No reasonable man can anticipate that a government can indefinitely fetter the legislation of the future, and indeed, in countries such as Great Britain, where opinion is tender to vested interests, modification without compensation has been made in the statutory powers and privileges of undertakings incorporated under parliamentary powers and relating to gas, water, electric light, public transport and other subjects with which the well-being of the community at large is closely bound up.²⁵

In United States law, the problem that arises out of the conflict between the needs of the State and the need to protect private contractual rights can be seen by comparing *Lynch v United States* (1934), where it was stated that... "its rights and duties therein are governed generally by the law applicable to contracts between private individuals...",²⁶ and *Norman v Baltimore & Ohio hC* (1935) which stated:

Contracts however expressed, cannot fetter the constitutional authority of the Congress. Contracts may create right or property, but when contracts deal with a subject matter which lies within the control of congress they have a congenital infirmity. Parties cannot remove that transaction from the reach of dominant constitutional power by making contracts about them.²⁷

24 NV De Bataafsche, *Petroleum Maatschappij & others v. The War Damage Commission.* (1956) *ILR* 23 (1956) 810.

25 Transvaal Commission Report, Cmd. 623 (1901)8.

26 [1934] 292 *US* 571.

27 [1935]9 294 *US* 240.

In general the discussion in the United States is dominated by constitutional provisions which protect an individual's liberty and property.²⁸

(c) Under Former Soviet Law

During the period 1922-1927 the Soviet Union granted concessions to foreigners who were treated as exempt from the prevailing legal order.²⁹ The view taken at the time was that:

A concession implies an element of exemption from the general regime established by law. A concessionaire is granted rights with regard to the exploitation of the object of concession (in industries, concessions with regard to the industrial enterprise) which under general laws are not granted to a private business.³⁰

The former Soviet Union had two kinds of "concession agreements", those with Comecon countries and those with members of non-Comecon countries.

From 1971 joint equity ventures with members of Comecon were developed. These were restructured in 1986, when the emphasis changed from trade to forming joint enterprises, joint organisations and international associations. The creation of these entities were regulated by a decree of the USSR Council of Ministers, adopted on 13 January 1987.

As far as countries outside Comecon were concerned, the Soviet Union passed legislation in September 1987 which made joint enterprises between capitalist countries and Soviet organisations into juridical persons, formed on the basis of a contract between the parties. Under former Soviet law a juridical person could possess, use and dispose of property in accordance with the purpose of its activities and of the property itself. It was protected in the same manner as the property of Soviet State organisations.³¹

28 See further, S Toriguian, *Legal Aspect of Oil Concessions in the Middle East* (1972) 23.
 29 Huang, 291.
 30 Vladimir Gsovski, *Soviet Civil Law*, II, 68 Citing Karass, *Concession*, Magerovsky, *Fundamentals of Soviet Law*, 356, 358 (In Russian 2nd edn 1929), quoted by Huang, 291.
 31 WE Butler, *Soviet Law* (1988) 388-9.

(d) Under Islamic Shari'ah Law

Islamic Shari'ah is of major importance because it is the basis of the law for all Muslim people in the world. Numerous Muslim States are oil producing countries so it is necessary to study the concept of concession in Islamic Shari'ah.

Concessions were known in early Islamic nations. They were concessions to reclaim vacant land without an owner, or for the exploration and exploitation of minerals such as silver, gold, iron, lead and copper (classified as hidden mines); surface mines such as naphtha (oil), sulphur and water were also included.³² These are two terms for such concession agreements in Islamic Shari'ah, *Iqta* and *Ijarat*.

As to the first, *Iqta*, Ibn Kudamah, the Hanbali school jurist (d 1223 A.D.), defined a concession agreement as follows:

Minerals are free, he who finds a mineral is entitled to take his need thereof by priority to others, after which he must go away to let others satisfy also their needs: he cannot appropriate the vein or mine or deposit except with and as a result of his appropriation of the grounds where such vein or mine or deposit is found: this appropriation may be through an *Iqta'* or a grant from the Imam or through occupancy and reclaiming it if it is a *mawat* (dead land), which has no owner... No one is permitted to collect or dig out a mineral contained in the property of someone else because the ownership of the land comprises the owner of its apparent and hidden parts and layers. Liquid minerals in particular are, according to the prevalent opinion, always free and not liable to be appropriated by '*Iqta'* or occupancy or by whoever owns the ground where they are found if they happen to be found in an owned property.³³

Thus, according to the prevailing opinion in the Hanbali School, liquid minerals whether apparent or hidden are not liable to private appropriation either through discovery and occupancy or through an '*Iqta'* or grant by the Ruler.

32 Land in Islamic Shari'ah is divided into two types: (1) A Mowat (dead land) which has no owner; (2) Living Land.

33 *Arbitration between Saudi Arabian Government & Aramco*. Transcript of Arbitration proceedings II, 761. This transcript was not published, quoted by Cattam, 57.

Sheikh Mohammad Abuzahra stated in the *Aramco* arbitration of 1958 that:

As to its legality [the concession] is to be considered as coming within an Islamic legal institution known as *'Iqta'al mawat* (literally, allotting of undeveloped land) or as a grant of the right to take possession of minerals. It is well established that an *'Iqta'* for minerals which are under the ground is recognized by the Shari'ah. In such an *'Iqta'*; the leader of the Moslem Community (Imam) grants permission to one or more persons to explore a specified area and to take out whatever minerals he may discover.... It is established and accepted that whoever first takes possession of a buried mineral has the best claim to it. It is his property. He has the right to continue to take the mineral and no other person has a right to compete with him for it.³⁴

Another form of hire agreement similar to concession agreements was known as "*Ijarat*" or hire and lease agreements. "*Ijarat*" in Islamic Shari'ah is the sale of the use or benefit of a thing, and as such forms part of the law of sale.³⁵ In a contract for an *Ijarat* a rent or payment is specified to be paid in exchange for the use of the thing. There are two kinds of *Ijarat* contract, the first for a specified period, the second for a specified piece of work.³⁶

The law requires that both the rent for the thing hired, or the wages for the work performed, as well as the use and the object hired, must be well defined.³⁷ Ennawawi from the Shafi'i school writes; "You cannot have a valid hire contract to remove the skin of an animal against its skin as payment for the services rendered, or promise a part of the flour as payment for services in a contract to grind wheat".³⁸

The "*Majallah*" - the Ottoman Civil Code - based on the Hanafi school of Islamic Shari'ah, dealt with "*Ijarat*" in the following provisions.

Art: 449: The subject matter of the contract of hire must be specified. Consequently, if one of two shops is let on hire, without the particular shop in question being specified, and the

34 Id, 57 - 8.

35 Ibn Kudamah, *Al Mughni*, 5, 389-99 (Arabic Text).

36 Id, 402.

37 *Le précis de droit d'Ibn Kudamah, Henri Laoust - 1950*, quoted by Toriguian, 100.

38 *Minhaj el Talibin - van Der Berg, II, 151-2*, quoted by Toriguian, 100.

lessee being given an option as to which one he will take, such contract is invalid.

Art: 450: The rent must be clearly ascertained.

Art: 451: In a contract of hire, the advantage to be derived from the subject matter of the contract must be specified in such a manner as to avoid any possibility of dispute.

Art: 454: In the case of hire of land, the period of hire must be stated; the purpose for which such land is to be used...

Art: 457: The advantage to be derived from the thing hired must be capable of enjoyment. Consequently, a contract of hire in respect to a runaway animal is invalid.

Art: 465: If the rent consists of merchandise, or things estimated by measure of capacity, or by measure of weight, or things estimated by enumeration and which closely resemble each other, such rent must be made known by stating both the amount and description thereof.³⁹

In accordance with the Hanbali School,⁴⁰ oil concession agreements are classified as a form of mining concession. Oil concession contracts can be made provided that they do not contradict the laws of the Shari'ah. Generally they would not contradict them, as such concession agreements conform to two fundamental principles of the Muslim legal system. The first is the principle of the liberty of contract within the limits of divine law and the second is the principle of respect for contracts. Regarding the first principle, Ibn Taimiya stated:

... men shall be permitted to make all the transactions they need, unless these transactions are forbidden by the Book or by the Sunnah...⁴¹

The second basis for the rule, in Ibn Taimiya's opinion, results from the fact that Islamic Shari'ah does not distinguish between a treaty, a contract of public or administrative law and a contract of civil or commercial law. All these

39 CA Hooper. *The Civil Law of Palestine & Transjordan*, 1938, quoted by Toriguian, 101.
40 The Hanbali School (780-855 AD) is one of four schools in Islamic Shari'ah. The Hanbali School like the other schools is dominated by the principles of the Holy Qur'an and the Sunnah, the tradition of the prophet Mohammad. It is the predominant school in Saudi Arabia and other countries.

41 *Arbitration between Saudi Arabia Government & Aramco* (1958) ILR 27 (1963) 163.

types are viewed by Muslim Jurists as agreements or pacts which must be observed, since God is a witness to any contract entered into by individuals or by collectivities. Under Islamic Shari'ah, a valid contract is obligatory, in accordance with the principles of Islam and the law of God, as expressed in the Qur'an: "Be faithful to your pledge to God, when you enter into a pact."⁴²

PART II - CHOICE OF LAW AND CHOICE OF FORUM AND THEIR IMPLICATIONS FOR OIL CONCESSION AGREEMENTS

CHAPTER 2. CHOICE OF FOREIGN LAW AND FORUM

1. Introduction

Private international law or the conflict of laws deals with the rules relating to the effect of foreign law on the decision of a civil case. These rules are national in character and are adopted by the legislatures and courts of different states.¹ In cases which have a geographical connection with more than one country, it becomes necessary to decide which law is to apply in determining the case, and whether the forum or a foreign court should exercise jurisdiction.² Thus, in the words of Castel:

Conflict of laws is that branch of the law of each province or territory... which, in a case involving one or more legally relevant foreign elements connecting it with more than one legal unit, determines before the courts of what unit this case should be heard and by the law of what unit each relevant issue should be decided.³

In Anglo-American systems, this branch of the laws is called "conflict of laws". In civil law countries such as France and other countries which follow the French system, it is called "private international law".

The rules which make up the conflict of laws have developed from several sources, national and international. Some principles have been taken from public international law, and have in a few instances led to an overlap of public and private international law: these include sovereign and diplomatic immunity from suit. Where treaties have been entered into, uniform conflict of

1 JG Castel, *Conflict of Laws* (5th edn, 1984) 1-3.

2 RH Graveson, *The Conflict of Laws* (7th edn, 1974) 3.

3 Castel, 1-3.

law rules are often incorporated. In addition, principles drawn from international and comparative jurisprudence and foreign judicial decisions are considered as sources in the conflicts of law, which in that sense has an international aspect or tradition that distinguishes it from other areas of domestic law.

Within any system it is likely that legislation will have formal priority as a source of conflicts of law rules: where such legislation exists it must be applied by the courts of that jurisdiction.⁴ In common law countries, legislation has been a very minor source of conflicts rules hitherto: this situation is however changing, especially since legislation may be necessary to give effect to international conventions, which are an increasingly important source of conflicts rules.⁵ Despite this, judicial decisions have been far more important than legislation in the development of conflict of law or private international law in different legal systems.⁶ And, unlike other areas of municipal law, writers have also been important in the development of conflicts of law principles. While judges tend to deal with immediate situations, writers have provided a major source for the development of the theoretical basis and structure of the conflict of laws.

It is the purpose of this chapter to examine the choice of the proper law by which the parties are to govern their contracts. This is important because oil concessions, whatever else they may be, are initially contracts, entered into under some national legal system. The principles by which it is decided what the governing law of an oil concession is may be of great significance, especially when questions of variation, renegotiation or cancellation arise.⁷ I will look at problems of choice of governing law in accordance with the different theories applied in different legal systems, and at the implications of these theories for the way in which the parties should choose the proper law in a particular case. In particular, I will discuss whether the parties are free to choose any law whatever to govern their contracts, or whether limitations on this choice may be imposed. Further, as there is a tendency to choose foreign law I will look at the reasons for this. Then I will examine cases where a choice of proper law has not

4 AE Anton, *Private International Law* (2nd edn, 1990) 14.

5 See EI Sykes & MC Pryles, *Conflicts of Laws. Commentary and Materials* (1988) 6.

6 Ibid.

7 See Chapter 5.

been expressly stated: the question is how the court should determine the applicable law, and in particular in what circumstances it should determine, in the case of oil concession agreements, that the proper law is a foreign law. Finally, I will discuss the importance of arbitration in the settling of disputes, and the significance of the arbitration agreements in the choice of law. In particular, examples of the choice of proper law for the arbitration of disputes in some concession agreements and petroleum laws will be given.

2. The Notion of a Proper Law of Contract in Different Legal Systems

In general the proper law is the system of law chosen by the parties to govern their contractual relationship. The proper law governs most but not necessarily all matters affecting a contract.⁸ It has been stated that:

the fact that one aspect of a contract is to be governed by the law of one country does not necessarily mean that that law is to be the proper law of the contract as a whole.⁹

The questions whether the parties possess capacity, whether an agreement has been reached or whether the contract is formally valid are not necessarily governed by the same system of law. But the court will not split the contract in this sense readily or without good reason.¹⁰ Instead, "there is a primary system of law... the proper law of the contract, which usually governs most matters affecting the formation and substance of the obligation".¹¹

As to the determination of the proper law, there are two major theories, based on "the intention of the parties", and on "the most real connection" of the transaction with the legal system in question.

8 *Dicey & Morris on the Conflict of Laws* (11th edn) 2 (1987) Ch 32, 1161; Cheshire, North & Fawcett, *Private International Law* (1987) 447.

9 *Re United Railways of the Havana and Regla Warehouses* (1960) Ch 52, 92.

10 *Kahler v. Midland Bank Ltd* [1950] AC 24, 42 (Lord MacDermott).

11 Cheshire, North & Fawcett, 448.

(1) The Theory of the "Intention of the Parties"

Dicey's "subjective" theory states that the proper law is based on the intention of the parties. According to Dicey:

The term proper law of a contract means the law, or the laws, by which the parties intended, or may fairly be presumed to have intended, the contract to be governed; or (in other words) the law or laws to which the parties intended or may fairly be presumed to have intended, to submit themselves.¹²

Similarly Lord Atkin in *R v. International Trustee for the Protection of Bondholders A.G.*¹³ stated that:

Their intention will be ascertained by the intention expressed in the contract, if any, which will be conclusive.

According to this theory, where there is an express choice of law by the parties, that law which has been chosen has necessarily to be the proper law. And in fact most countries agree upon the adoption of the intention of the parties as a fundamental rule.

In English law there are two theories (1) the intention of the parties and (2) the localisation of the contract. According to the former theory, the parties' intention is decisive. Judge Willes stated that:

In such cases it is necessary to consider by what general law the parties intended that the transaction should be governed, or rather to what general law it is just to presume that they have submitted themselves in the matter.¹⁴

12 Dicey, 7th edn, Rule 148, 717. However in the 11th edn and under Rule 180 Dicey & Morris stated: "The term 'proper law of a contract' means the system of law by which the parties intended the contract to be governed, or, where their intention is neither expressed nor to be inferred from the circumstances, the system of law with which the transaction has its closest and most real connection." Dicey & Morris (1987) ch 32, 1161.

13 [1937] AC 500,529.

14 *Lloyd v. Guibert* [1865] LR 1 QB 115, 120.

Similarly, Lord Atkin stated:

The legal principles which are to guide an English Court on the question of the proper law of a contract are now well settled. It is the law which the parties intended to apply...¹⁵

However, there may be problems deciding what the intention of the parties was at the time of making the contract. It is simplistic to define by the *laissez-faire* notion,¹⁶ the proper law as that system of law with reference to which the contract has in fact been made.¹⁷

An alternative view relies on the localisation of the contract. According to this theory, the proper law of a contract is the law of the country in which most elements of the contract are most densely grouped. Rather than a subjective interpretation of intention, it implies an objective interpretation, that while free to choose the connecting factors, "their intention is taken to be that the governing law shall be the law of the country in which the chosen factors show the contract to be localized".¹⁸ The implication is that they would not be allowed to select a governing law if it was in conflict with the natural locale of the contract.

United States law in this area is confused. Some States have adopted the law of the place of constructing, some the law of the place of performance, and some the law intended by the parties. Federal courts have usually applied the law of the State or country intended by the parties.¹⁹

In French law the effects of a contract and its validity are governed by the intention of the parties. Unless expressly stated the parties are seen to have contracted according to the laws of the place where the contract was made and, where they are the same nationality, they are seen to have contracted according

15 *R v. International Trustee* [1937]AC 500,529. See further Cheshire, North & Fawcett, 449.

16 *Ibid.*

17 *Id.*, 455.

18 *Id.*, 450.

19 EG Lorenzen, "Validity and Effects of Contracts in the Conflict of Laws" *Yale Law Journal* 30 (1920-1) 565.

to their national law.²⁰

In German law, the intention of the parties is the controlling rule, and where that intention is not expressed or unclear, courts use the place of performance to determine the law, unless they can be convinced some other law should be applied.²¹

Italian law, strongly influenced by Mancini, states that "The substance and effect of obligations are deemed to be regulated by the law of the place in which the acts were done".²² Other European countries adopt the intention of the parties as the deciding factor, and most of them refer to the law of the place of contracting as the presumed intention.²³

The Bustamante Code is an attempt by Latin American countries to develop a conflict of laws code. It was ratified in 1928 by fifteen Latin American states, but with six countries expressing general reservations. It states that if there is no express law governing the contract, then, "the personal law common to the contracting parties shall be first applied, and in the absence of such law there shall be applied that of the place where the contract was concluded."²⁴

In Australia the choice of proper law will be in accordance with the forum's choice of law rule, which governs most substantive aspects of a contract. It does not, however, govern questions of form and illegality. It is generally held that the formalities of a contract are valid if they comply with the *lex loci contractus*, even though the contract is formally invalid under proper law. Also, contracts which involve acts considered illegal in a foreign State will not be enforced.²⁵

By a provision of the 1889 Convention of Montevideo, South American States parties are bound by Article 33 which states that "the law of the place of

20 Id, 567.

21 Ibid.

22 Id, 568.

23 Ibid.

24 AM Vickers, The Choice of Law Clause in Contracts Between Parties of Developing and Developed Nations, *GA J Intl & Comp L*, 11 (1981) 627.

25 EI Sykes & MC Pyles, *Australian Private International Law* (3rd edn, 1991) 748.

performance governs... all matters concerning contracts whatever their nature".²⁶

Under Japanese law, Article 7 of the Civil Code 1919 provides that the "will of the parties" is a determining factor effecting legal transactions and that if this is not clear "the law of the place where the transaction is entered into shall control".²⁷ However, there are different interpretations of this rule, and differing rules apply where the intention of parties are not clearly determined, as we will see later.

(2) The Theory of the "Most Real Connection"

The objective theory of Westlake contends that the proper law of a contract is that which has "the most real connection" with the contract. He stated:

In these circumstances it may be said that the law by which to determine the intrinsic validity and effects of a contract will be selected in England on substantial considerations, the preference being given to the country with which the transaction has the most real connection, and not to the law of the place of contract as such.²⁸

There is considerable support for this theory in English law. Lord Simonds stated that the proper law is "the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connexion".²⁹ Similarly Denning LJ in *Boissevain v. Weil*³⁰ noted that the proper law of the contract...

depends not so much on the place where it is made, nor even on the intention of the parties or on the place where it is to be performed, but on the place with which it has the most substantial connection.

26 Lorenzen, 570.

27 Id, 572.

28 J Westlake, *Private International Law* (7th edn, 1925) 302.

29 *Bonython v. Commonwealth of Australia* [1951] AC 201, 219.

30 [1949] 1 KB 482, 490.

(3) Evaluation of the Competing Theories

Neither the "objective" nor the "subjective" theory are seen to be a complete explanation. As Graveson stated:

...the answer is not that one is right and the other wrong, but that neither is a complete exposition of the matter.³¹

On the other hand, many jurists now maintain that regardless of which theory was followed the applicable law would still be the same.³² According to Cheshire:

It must be confessed that in actual practice it will not make an iota of difference to the actual decision of a contested case which of them... the objectivist or subjectivist.³³

Similarly, Morris stated that:

...the court is likely to reach the same result whether it inquires what was the presumed intention of the parties or whether it inquires with what law the contract had the most substantial connection.³⁴

3. Express Choice of Law and the Limitations upon It

There are three possible situations where it is necessary to determine the proper law:

- (1) Where the parties have made an express choice of proper law to govern their contract, that law will be the proper law of the contract.
- (2) Where an express choice of the proper law is not made by the parties, the court will examine the terms of the contract and

³¹ Graveson, 406.

³² RK Ramzani, "Choice of Law Problems and International Oil Contracts: A Case Study" *ICLQ* 11 (1962) 505, 506.

³³ Cheshire, "The Significance of the Assunzione" *BYIL* 32 (1955) 126 and see Ramzani 16.

³⁴ JHC Morris, "The Proper Law of the Contract: A Reply" *ICLQ* 3 (1950) 197. See also EJ Cohn, "The objectivist practice on the proper law of contract" *ICLQ* 6 (1957) 373; FA Mann, "The Proper Law of the Contract" *ICLQ* 3 (1950) 68.

all facts surrounding it to determine whether there is an inferred choice of proper law by the parties.

(3) In the absence of a choice of proper law, express or inferred, courts have tended to declare the proper law as that law "with which the transaction has the closest and most real connection",³⁵ in an attempt to find an objective approach to the determination of proper law.

It is proposed to deal with each of these in turn.

(1) Express Choice of Proper Law

(a) The Basis of Choice of Law

The determination of the proper law of the contract will not create any difficulty as long as the parties have expressed which legal system is to govern their contract.³⁶ Dicey and Morris state that:

when the intention of the parties to a contract, as to the law governing the contract, is expressed in words, this expressed intention, in general, determines the proper law of the contract.³⁷

To the same effect the American Law Institute's *Restatement Second, Conflict of Laws* (1971) provides in ss187-8:

187. (1) The law of the State chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the State chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either:

35 *Bonython v. Commonwealth of Australia* [1951] AC 201; *Tomkinson v. First Pennsylvania Banking & Trust Co.* [1961] AC 1007, 1068, 1081; *Miller v. Whitworth Street Estates Ltd* [1970] AC 583; *Rossano v. Manufacturers Life Insurance Co. Ltd* [1963] 2 QB 352; *Amin Rasheed Shipping Corp v. Kuwait Insurance Co.* [1983] 3 WLR 241, 255; *Compagnie D'Armement Maritime SA v. Compagnie Tunisienne de Navigation SA* [1971] AC 572.

36 The first case to establish the rule expressly was *Gienar v. Meyer* [1796] 2 HyBl 603.

37 Dicey & Morris (1987) 1168-9.

(a) the chosen State has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen State would be contrary to a fundamental policy of a State which has a materially greater interest than the chosen State in the determination of the particular issue and which, under the rule of s188, would be the State of the applicable law in the absence of an effective choice of law by the parties.

(3) In the absence of a contrary indication of intention, the reference is to the local law of the State of the chosen law.

The generally accepted view is thus that when the parties have expressed what law they intend to govern their contract "*prima facie* their intention will be effectuated by the court".³⁸ The basis of this principle is that parties are free to choose the governing law of their contract with respect to matters that lie within their contractual power.³⁹ In other words, the freedom of the parties to choose the proper law derives from the principle of freedom of contract.⁴⁰

*Vita Food Products Inc v. Unus Shipping Co. Ltd*⁴¹ is the leading authority on the freedom of parties to choose the proper law to govern their contract. This case determined that parties are free to submit their contract to any foreign law. Goods were shipped in Newfoundland under bills of lading which contained a clause that the contract was to be governed by English law. These bills were provided for exemption from liability of damage due to the negligence of the shipowners servants. An action was brought against the shipowner in respect of damage to the goods, but the court held that by applying the intended English law, the shipowner was within the exceptions which exempted him from liability. This acceptance of the choice of English law as the proper law was maintained

38 *Mount Albert Borough Council v. Australasian, etc Assurance Society Ltd* [1938] AC 224, 240 (Lord Wright).

39 WM Reese, "Power of Parties to Choose the Law governing their Contract" ASIL 54 (1960) 49; Dicey & Morris (1987) 1170; Cheshire, North & Fawcett, 451-2. Kahn-Freund stated that: "The rule of "autonomy" in the conflict of laws is like nature; you cannot drive it out even with a pitchfork", quoted by TMC Asser, "Choice of Law in Bills of Lading" *JMLC* 5 (1974) 355.

40 F Savigny, *Treatise on the Conflict of Laws* (2nd edn, 1880) (trans Guthrie) ss369-70, quoted by A Thomson, "A Different Approach to Choice of Law in Contract" *MLR* 43 (1980) 650.

41 *Vita Food Products v. Unus Shipping Co.* [1939] AC 277.

even though the contract has no apparent connection with England. Speaking for the House, Lord Wright accepted this "older, subjective view of the proper law", and said that "connection with English law is not as a matter of principle essential".⁴²

The principle of the parties' freedom to choose the proper law has been recognized in many countries, although in some cases with modifications. In England this principle has been recognized for about two centuries.⁴³ In civil law countries the principle is given a less liberal application: the parties' choice of law will be respected if the law chosen has some internal connection with the parties or the transaction.⁴⁴ In the United States the principle of party autonomy has been recognized. As Jackson stated:

the tendency of the law is to apply in contract matters the law which the parties intended to apply.⁴⁵

As we have seen, the *Restatement Second of Conflict of Laws* (1971) with some qualification provided for this principle.⁴⁶ In the Soviet Union article 126 of the Soviet Merchant Shipping Code 1968 *inter alia* provides that "the parties may choose a law to regulate their contract rights and duties as long as the law chosen does not violate Soviet public order and does not lead to any change in the fundamental norms of the Merchant Shipping Code".⁴⁷

Thus both under civil law and common law countries the principle of the parties' freedom to choose the proper law governing their contract has been recognized. This principle is also generally reflected in international treaties, including the United Nations Convention on Contract for the International Sale

42 [1939] AC 277,290.

43 Cheshire, North & Fawcett, 451; Graveson, 6-8.

44 E Rabel, 2 *The Conflict of Laws, A Comparative Study* (2nd edn, 1960) 359-431; M Wolff, *Private International Law* 2nd edn (1962) 413-28.

45 *Lauritzen v. Larsen* 345 US 571, 589 [1953] quoted by Albert A Ehrenzweig, "Contract in the Conflict of laws" *Col LR* 59 (1959) 984.

46 For a criticism of this, see RA Sedler, "The Contracts Provisions of the Restatement (Second). An Analysis and a Critique" *Col LR* 72 (1972) 279.

47 WE Butler & JB Quigley, trans, *The Merchant Shipping Code of the USSR* (2nd edn, 1968).

of Goods, Vienna, 1980,⁴⁸ the Law of the Sea Treaty 1982,⁴⁹ the Hague Convention on the Law applicable to International Sales of Goods, 1955, the Hague Convention on the Law applicable to Contracts for the International Sale of Goods, 1985⁵⁰ and the draft Convention on the Law applicable to Agency 1976, as well as the EEC draft Convention of 1972.⁵¹ Thus, Article 3(1) of the EEC Convention provides that:

the choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case.

Article 7(1) of the Hague Convention on the Law applicable to Contracts for the International Sale of Goods (1985) provides:

A contract of sale is governed by the law chosen by the parties. The parties' agreement on this choice must be express or be clearly demonstrated by the terms of the contract and the conduct of the parties, viewed in their entirety. Such a choice may be limited to a part of the contract.

Thus the freedom to choose the proper law has been recognized, with limitations in certain cases, in both national law and treaties. But the crucial question for the purposes of this thesis is what limitations can properly be imposed on this freedom, as a matter of national and international law.

Developing countries may not have sufficient bargaining power in their relationship with developed countries to feel that unlimited freedom in the choice of law would be equitable. Further Vickers notes that:

Allowing firms from developed nations to select from any available rule of law often results in choices that are the most economically feasible, but nevertheless are unacceptable to the developing world's socio-economic interests."⁵²

48 United Nations Document A/CONF 97/18 (1980).

49 See United Nations Law of the Sea Treaty, article 293 (United Nations Document A/CONF 62/122, 7 October 1982).

50 C McLachlan, "The New Hague Sales Convention and the Limits of the Choice of Law Process" *LQR* 102 (1986) 591.

51 AL Diamond, "Conflict of Laws in the EEC" *Current Legal Problems* 32 (1979) 158.

52 Vickers, 620.

Without limitations preventing a choice of law to circumvent public policy, there would be little incentive for developing nations to have confidence that the contract would cater for their interests. Similarly, without the limitation that a law be *bona fide* and legal, the same inequalities in the bargaining position of States could lead to developing nations being forced into using a system of law without protection.

In this chapter, I will discuss the limitations that may be imposed by national law on freedom of contract. In the next chapter, I will discuss the limitations which are permissible under the various treaties.

(b) Tendency to Choose Foreign Law

As we have seen the general principle, the starting point in this area, is that the parties have complete freedom to choose the proper law to govern their contract. Therefore, there is a tendency of parties to a contract to choose a foreign law to be applied in the case of a dispute between them. The parties may resort to a foreign law when they feel that the legal system of one or both of the contracting states is not detailed enough to deal with intricate technical problems which may arise, or they may choose a neutral law especially in cases where there is a "desire to ensure the elimination of the possibility of the State subsequently altering the terms of the contract through unilateral legislation or administrative act",⁵³ or they may choose a law which they feel is more adequate for their case, for example where the municipal law of one or other of the States is considered to be insufficiently developed.⁵⁴

In this case there is a tendency to choose a well-known or highly elaborate legal system of another state to govern the contract, even if there is no immediate connection with this contract. An important reason why a party to a contract has a tendency to choose a foreign law, is that in international trade disputes, the legal system particularly of an involved party may not be perceived

53 D Suratgar, "Considerations Affecting Choice of Law Clauses in Contracts between Governments and Foreign Nationals", *Indian Journal of International Law* 2 (1962) 293, 299.

54 Ibid.

as treating both parties fairly.⁵⁵ Therefore a legal system must be chosen which best suits each contract. This, it is hoped, will prevent a national court showing a preference for domestic law and leading to a bias in favour of its nationals, and thus avoid international diplomatic intervention.⁵⁶

(2) Limitations on Choice of Law

There are limitations on the freedom of parties to choose their governing law in certain cases. Lord Wright stated in the *Vita Food* case that the choice must be "*bona fide* and legal" and that there should be "no reason for avoiding the choice on the grounds of public policy".⁵⁷ The first part of this provision is interpreted to mean "that the parties cannot pretend to contract under one law in order to validate an agreement that clearly has its closest connection with another law"⁵⁸ and which would be invalid under that law. Thus, where the express choice of the proper law by the parties is not *bona fide* and legal, or where it is contrary to public policy this choice will be ineffective, and the court will apply the proper law ascertained objectively, or, in certain cases, the law of the forum.

This principle was applied in *Golden Acres Ltd v. Queensland Estates Pty Ltd*,⁵⁹ where a Queensland estate agent company attempted to recover commission owing to it under a contract expressly providing that the contract was governed by the law of Hong Kong. The contract provided that "for all purposes arising under this agreement, the same shall be deemed to be entered into in the colony of Hong Kong". Judge Hoare refused to give effect to the choice of law because "the attempted selection of this law was for no other purpose than to avoid the operation of the Queensland law", and that the choice of the Hong Kong law "was in the circumstances against public policy".⁶⁰ Thus he applied Queensland law.

55 Id, 300.

56 Id, 290.

57 [1939] AC 277,290.

58 Cheshire, North & Fawcett, 454.

59 [1969] QdR 378, 385. This decision affirmed on different grounds sub nom *Freehold Land Investments Ltd v. Queensland Estates Pty Ltd* [1970] 123 CLR 418. See D St L. Kelly, "Reference, Choice, Restriction and Prohibition" *ICLQ* 26 (1977) 868.

60 [1969] QdR 378, 385.

In *Compagnie D'Armement Maritime SA v. Compagnie Tunisienne de Navigation SA*,⁶¹ Lord Diplock stated:

The English Courts will give effect to their choice unless it would be contrary to public policy to do so.

The question is when it will be held to be contrary to public policy to choose another system of law. In *Boissevain v. Weil* Denning L.J. stated:

I do not believe that parties are free to stipulate by what law the validity of their contract is to be determined. Their intention is only one of the factors to be taken into account.⁶²

As a general proposition one can state that, in selecting the proper law for a contract, the parties must prove that the purpose of the choice is for commercial or other valid reasons. It would be invalid if it were selected to evade the mandatory laws of the most closely connected legal system.⁶³

However, "there have been hardly any cases where an express choice of law has been denied effect."⁶⁴ In the *BHP Petroleum Pty. Ltd v. Oil Basins Ltd*⁶⁵ the judge upheld the choice of law even though he recognised there was little connection between the contract and the State of New York, which was the chosen proper law of the contract, as he felt there was no attempt to avoid the fiscal and policy provisions of the legal systems more closely connected to the contract.

There is much ambiguity in this area, and it is perhaps generally held that it is an indication of good faith that there is a connection between the agreement and law chosen though providing there is no attempt to avoid a more connected law an express choice can still be *bona fide* and legal.⁶⁶

61 [1970] 3 *All ER* 71-91.

62 [1949] 1 *KB* 482, 491.

63 *Boissevain v. Weil* [1949] 1 *KB* 482, 490. See also JG McLeod, *The Conflict of Laws* (1983) 478.

64 Sykes & Pryles (1991) 598.

65 [1985] *VR* 725.

66 Cheshire, North & Fawcett, 454.

Another ground for limiting party autonomy in the choice of law relates to an indefinite or uncertain choice. It has been said that the parties cannot choose a "floating" proper law to govern their contract. "The proper law must exist and be identifiable at the time when the contract is made".⁶⁷ Therefore, it has been stated that a clause in a contract must not allow for the possibility of choosing between a range of alternative legal systems at some future time.

In *Dubai Electricity Co. v. Islamic Republic of Iran Shipping Lines*,⁶⁸ goods were shipped from Hamburg to Dubai by an Iranian state-owned ship. The bill of lading and all disputes arising shall "in the option of the carrier to be declared by him on the merchant's request be governed either by (1) Iranian law or (2) German law or (3) English law".⁶⁹ The judge decided that this amounted to a floating law and that the proper law had to be built into the contract. He noted "It is I think clear and not disputed that this clause in the bill of lading is bad" and that a proper law should "be built into the fabric of the contract from the start and cannot float in an indeterminate way until finally determined at the option of the party."⁷⁰

However, it is possible that a certain proper law may be used in one event and another in another event. In *Astro Venturoso Compania Naviera v. Hellenic Shipyards SA. The Mariannina*,⁷¹ the bills of lading provided that "Any claim and or dispute arising under this bill of lading shall be referred to arbitration in London pursuant to English arbitration law... but if for any reason it is ruled by a competent authority that the... arbitration provision is unenforceable then any claim and/or dispute... shall be governed by Greek law..."⁷²

The judge noted that though the clause was unusual "There was no reason why there could not be good commercial sense in a fall-back provision of this kind".⁷³ He concluded that the proper law was English law.⁷⁴

67 Cheshire, North & Fawcett, 455.
 68 [1984] 2 Lloyd's Reports 380.
 69 Ibid.
 70 Id, 385.
 71 [1983] 1 Lloyd's Report, 12 (C.A.).
 72 Ibid.
 73 Id, 13.
 74 Ibid.

As a general principle, and although there are differences of opinion, it would appear that authority establishes that the proper law must be decided, or be capable of being decided, on the same day as the contract is signed,⁷⁵ and that subsequent behaviour of the parties is not to be considered in determining the proper law, except to the extent that the contract specifically so allows.⁷⁶

Again the choice of law will be disregarded if it is seen as meaningless. This would occur for example if the legal system in question ceased to exist or if, as in the *Compagnie D'Armement Maritime SA v. Compagnie Tunisienne de Navigation SA*,⁷⁷ the contract states something meaningless in practice. In this case, Clause 13 of the contract stated that:

This contract shall be governed by the laws of the flag of the vessel carrying the goods.

The House of Lords held that the choice of law clause was meaningless as the contract contemplated its completion by means of a number of ships under different flags. As it was impossible to decide from among the flags the proper law of the contract, that question had to be determined independently.

Against this background, Reese outlines four limitations which are concerned with the matters that lie within the contractual power of the parties.⁷⁸

(1) The parties' power of choice is limited in the first place to multi-state contracts i.e. the "contracts which have significant contacts in two or more States".

(2) "The choice of law will be denied effect if it is procured by misrepresentation, duress, undue influence or mistake".⁷⁹

75 *Rossano v. Manufacturer's Life Insurance Co.* [1963] 2 QB 352, 362.

76 *James Miller and Partners Ltd. v. Whitworth Street Estates (Manchester) Ltd.* [1970] AC 583, 603-611.

77 [1971] AC 572.

78 WM Reese, "Contracts & the Restatement of Conflict of Laws Second" *ICLQ* 9 (1960) 535 states: "A limitation upon the parties' power to choose the governing law will be imposed only with respect to questions that lie beyond their contractual power. Such questions include issues of capacity, of formalities, as the Statute of Frauds, and of substantial validity (eg illegality and the need for consideration)."

79 WM Reese, "Power of Parties to choose law Governing Their Contract" *ASIL* 54 (1960) 52.

(3) It will be denied effect if "there is no reasonable basis for the parties' choice".⁸⁰ However, there is some discussion as to the kind of connection a contract should have with the chosen law. There is a tendency to support the opinion that the parties can only select a system "which has a substantial though not necessarily preponderant connection with the contract".⁸¹ In particular a system of law cannot be chosen to evade the application of an otherwise applicable law.

(4) "Fulfilment of the parties' intentions is not the only value in contract law. Regard must also be had for States interests".⁸²

An implication of the fourth limitation is that the forum will only deny effect to a choice of law provision in order to protect a fundamental policy of the State of the otherwise governing law.⁸³ The nationalization of a State's assets is a fundamental and substantial policy which would if these limitations were applied allow the State law to supersede the choice of the proper law of a contract.

(3) Incorporation of Foreign Law

Parties may choose by express selection to have their whole contract governed by the proper law of a State, or may choose to incorporate only part of that law into the contract. In the former case, the chosen law is seen as "a living and changing body of law",⁸⁴ and any change in that law may affect the performance of the contract. In the later case, the incorporated part must become part of the terms of the contract, providing it can be determined to be valid and effective. This remains constant and cannot be effected by any change in the law from which it was incorporated.

One must thus distinguish between the express selection of a proper law to govern the whole contract and the incorporation of a foreign law to govern a particular matter. As Cheshire and North state:

80 Id, 53.
 81 PE Nygh, *Conflict of laws in Australia* (1971) 341.
 82 Reese (1960) 53.
 83 Id, 54.
 84 Wolff, 424.

It is important to distinguish carefully the express selection of the proper law from the quite different process of the incorporation in the contract of certain domestic provisions of a foreign law. There are two different courses open to the parties. They may, within the limits already discussed, select a given law as a whole to govern the contract or, having already created a contract that is valid according to the law to which it naturally belongs, they may incorporate therein the domestic and relevant rules of some other legal system, which thereupon become terms of the contract. This incorporation may be effected either by a verbatim transcription of the relevant provisions or by a general statement that the rights and liabilities shall in certain respects be subject to the chosen law. The latter is only a short-hand method of expressing the agreed terms. Thus the parties to an English contract for the sale of goods may expressly provide that their duties with regard to performance shall be regulated by the rules contained in the Swiss Code, whether a particular term incorporated in this manner is valid and effective is, of course, a matter for the proper law to determine.⁸⁵

Regarding the effect of incorporation they assert...

It is well established that this right of incorporation may be freely exercised.⁸⁶

Since the 1930's, oil concession agreements, incorporated international law and general principles of law, have been called on, in case where a failing of the primary law of the agreement may have occurred. An example, is the International Oil Consortium's Agreement with Iran (1954), Article 46, where the principles of law recognized by civilized nations in general were to be used should the "principles of law common to the nations" involved in the contract prove not to be in agreement.

In the 1960s the following policy became part of the 1955 Libyan petroleum law and was incorporated into existing concessions on 20 January 1966. It stated that in the absence of principles of law consistent with the law of Libya, general principles of law were to be used, including those applied by international tribunals.

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Cheshire's Private International Law (8th edn, 1970) 210.

Ibid.

(4) Inferred Choice of Proper Law

Where the proper law is not expressed by the parties, it is the duty of the court to see if a proper law can be inferred by looking at all the factors surrounding the contract.⁸⁷ The court will consider a variety of factors surrounding the contract. Perhaps the most significant factor is the presence of a choice of jurisdiction or arbitration clause referring to a particular country. Other factors have included the form of the documents made with respect to the transaction,⁸⁸ the style and terminology in which the contract is drafted,⁸⁹ the use of a particular language⁹⁰ (through this is not generally an important factor),⁹¹ the use of a "follow London" clause,⁹² the nature and location of the subject matter of the contract,⁹³ the currency in which payment is to be made,⁹⁴ the residence⁹⁵ and occasionally the nationality, of the parties,⁹⁶ a connection with a preceding transaction,⁹⁷ or the fact that one of the parties is a government.⁹⁸ In concession agreements, where one party is a government the system of law with which the transaction has its most substantial and real connection would almost inevitably be that of the state party.

In early agreements between States and oil companies connected to the developing of the potential oil resources of a State, the applicable law was only stipulated in very general terms, such as a provision to interpret the clauses of the agreement "in good faith and in a spirit of goodwill" or "in accordance with the principles of mutual goodwill and good faith."⁹⁹ This could be interpreted as rejecting the application of the national law of the State party. A similar legal

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- 87 Dicey & Morris (1987) 1182; Cheshire (1970) 200.
 88 *Chamberlain v. Napier* [1880] 15 Ch D 614; *James Miller and Partners Ltd v. Whitworth Street Estates (Manchester) Ltd* [1970] AC 583.
 89 *Chatenay v. Brazilian Submarine Telegraph Co. Ltd* [1891] 1 QB 79, 82; *Amin Rasheed Shipping Corp v. Kuwait Insurance Co* [1984] AC 50, 460-1.
 90 *The Leon XIII* [1883] 8 PD 121; *Chatenay v. Brazilian Submarine Telegraph Co. Ltd* (1891) 1 QB 79.
 91 *The Industrie* [1894] 58, 71; *Coast Lines Ltd v. Huding and Veder Chartering NV* [1972] 2 QB 34, 47-50.
 92 *Armadora Occidental SA v. Horace Mann Insurance Co.* [1977] 1 WLR 1098.
 93 *Lloyd v. Guibert* [1865] LR 1 QB 115, 122-3.
 94 *R v. International Trustee for the protection of Bondholders AG* [1937] AC 500, 553; *Sayers v. International Drilling Co. NV* [1971] 1 WLR 1176, 1183-6.
 95 *Jacobs v. Credit Lyonnais* [1884] 12 QBD 589.
 96 *Re Missouri Steamship Co.* [1889] 42 Ch D 321, 328-9.
 97 *The Freights Queen* [1977] 2 Lloyds Rep 140; *The Adriatic* [1931] 241, 247.
 98 *R v. International Trustee for the Protection of Bondholders AG* [1937] AC 500, 531-57.
 99 See Chapter 5.

inference may arise from an arbitration clause embodied in an oil concession or other State contract.¹⁰⁰

In *Abu Dhabi v. Petroleum Development Ltd* in 1951, the arbitrator considered that given that the contract had been made in Abu Dhabi and was to be wholly performed in that country "...If any municipal system of law were applicable it would *prima facie* be that of Abu Dhabi..." However, there was not, in his opinion, "...any settled body of legal principles applicable to the construction of modern commercial instruments".¹⁰¹ In *Qatar v. International Marine Oil Company* in 1953,¹⁰² the arbitrators noted that no law had been stipulated to govern the contract, and as in the previous case Islamic law was not seen to be sufficient to interpret the contract. There was a similar arbitration decision in the *Saudi Arabia and Aramco Case* in 1958.¹⁰³ In all these cases the arbitration tribunal decided that general principles of law would be the law governing the concession agreements.

That, contrary to the opinion of the arbitrators, Islamic Shari'ah was a developed and sophisticated legal system, will be further discussed in Chapter 5.

4. Implied Choice of Law and Foreign Law as the Proper Law

(1) Ascertaining the Proper Law in the Absence of Express or Inferred Choice

Ascertaining the proper law in the case of contract may be a complex matter, because of the many factors which may be connected to the case. These factors include where a contract is made, where it is to be performed, the place of domicile, nationality or business of the parties, the form in which the contract is drafted. But as Lord Atkin stated:

100 H Cattam, *The Law of Oil Concessions in the Middle East and North Africa* (1967) 91.
 101 *ICLQ* 1 (1952) 247, 261.
 102 *ILR* 20 (1953) 545.
 103 *ILR* 27 (1963) 163.

...all these rules serve only to give *prima facie* indications of intention. They are all capable of being overcome by counter-indications, however difficult it may be in some cases to find such.¹⁰⁴

In the absence of express or inferred choice of proper law of the contract by the parties, Lord Atkin stated:

...If no intention be expressed the intention will be presumed by the court from the terms of the contract and the relevant surrounding circumstances...¹⁰⁵

The editors of Dicey and Morris set out three sub-rules of their present rule 180.¹⁰⁶ Sub-rule 3 provides:

When the intention of the parties to a contract with regard to the law governing it is not expressed and cannot be inferred from the circumstances, the contract is governed by the system of law with which the transaction has its closest and most real connection.

But, as the leading Australian text, Sykes and Pryles, notes, the editors to Dicey and Morris preface these rules...

with the remark that the English Courts have adopted a flexible system for determining the proper law and they offer the sub-rules only as maxims by which the English Courts are in the main guided.¹⁰⁷

They go on to comment that:

...reference to the parties' intention, except in the case of an express contractual stipulation of the proper law, is fast disappearing...¹⁰⁸

104 *R v. International Trustee for the Protection of Bondholders* [1937] AC 500, 529.
 105 *Ibid.*
 106 Dicey & Morris (1987) 1190-1.
 107 EI Sykes & MC Pryles (1991) 660.
 108 EI Sykes & MC Pryles (1988) 694.

The *Restatement Second, Conflict of Laws* provides that:

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include:

- (a) the needs of the interstate and international systems,
- (b) the relevant policies of the forum,
- (c) the relevant policies of other interested States and the relative interests of those States in the determination of the particular issue,
- (d) the protection of justified expectations,
- (e) the basic policies underlying the particular field of law,
- (f) certainty, predictability and uniformity of result, and
- (g) ease in the determination and application of the law to be applied.

188. Law governing in Absence of Effective Choice by the Parties

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the State which, with respect to that issue, has the most significant relationship to the transaction and the parties under [these] principles...

(2) In the absence of an effective choice of law by the parties the contacts to be taken into account in applying the principles to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same State, the local law of this State will usually be applied, except as otherwise provided...

In ascertaining the proper law the court must take into consideration all the variables that may pertain to the case. These variables may include where

the contract was made,¹⁰⁹ where it is to be performed,¹¹⁰ the nature of the legal personalities of the parties,¹¹¹ the nationality of the parties, the domicile of the parties, their place of business, etc. No single factor is decisive but in each case the priorities of the connecting factors must be used to decide the proper law.¹¹²

In oil concession agreements the factors that have to do with place of contracting, performance, location of the subject matter and place of domicile of the parties indicate clearly that the State's law would prevail. Thus in *Qatar and the International Marine Oil Company* (1953), the arbitrator concluded that the law of Qatar was the appropriate law.¹¹³ A similar decision was reached in 1958 in *Aramco v. Saudi Arabia*. The award stated:

The law in force in Saudi Arabia should also be applied to the content of the concession because this State is a party to the agreement, as grantor, and because it is generally admitted, in private international law, that a sovereign State is presumed, unless the contrary is proved, to have subjected its undertakings to its own legal system. This principle was mentioned by the Permanent Court of International Justice in its Judgements of July 12, 1929 concerning the *Serbian and Brazilian Loans*..."¹¹⁴

(2) Presumption as to Proper Law

In the past, certain presumptions, notably those favouring the place where the contract was made, the place where the contract was executed, or the law of flag relating to maritime transport, were used to determine the proper law to be applied to a case.¹¹⁵ Now such presumptions are considered to be "out of fashion and rejected".¹¹⁶ No longer can precedence be given to any single factor as decisive. Rather, it is now considered that when there are a variety of circumstances to be considered in deciding on the proper law, the "former

109 *P & O Steam Navigation Co. v. Shand* [1865] 3 Moo PC NS 272.

110 *Re Missouri Steamship Co.* [1889] 42 Ch D 321, 341; *James Miller & Partners Ltd v. Whitworth Street Estates (Manchester) Ltd* [1970] AC 583.

111 *R v. International Trustee for the Protection of Bondholders* [1937] AC 500, 531; *National Bank of Australasia Ltd v. Scottish Union & National Insurance Co.* [1952] AC 493.

112 Chesire, North & Fawcett, 448.

113 *ILR* 20 (1953) 545.

114 *ILR* 27 (1963) 167.

115 *R v. International Trustee for the Protection of Bondholders* [1937] AC 500, 529; *Merwin Pastoral Co. Pty Ltd v. Moolpa Pastoral Co. Pty Ltd* [1933] 48 CLR 565, 576.

116 *Chitty on Contracts* (1989) 2169.

presumptions are now no more than factors which the Courts will take into account simultaneously with all the other circumstances of the case".¹¹⁷

When there are many factors involved in deciding the proper law no one factor or presumption can override any other. This is illustrated by *The Assunzione*:¹¹⁸

When such a position arises all the relevant circumstances must be borne in mind, and the tribunal must find, if it can, how a just and reasonable person would have regarded the problem ... in the most convenient way and in accordance with business efficiency.

Two important grounds here are, first, that the contract is to be carried out in the State in question (*lex loci solutionis*),¹¹⁹ and secondly, that that State is the grantor of the concession.

However, whatever the general situation with respect of presumptions as to the proper law, traditional oil producing countries presume that oil concession agreements are governed by the "*lex loci solutionis*", the place of performance being within the territory of the State. In these cases it should be presumed that the national law will be the proper law for the parties' contract and should be the applicable law.

(3) The Connection of the Transaction with a System of Law

There is much controversy over whether the connection is to be with a system of law, or with a particular country, i.e. the country with which the transaction has the closest and most real connection. Earlier cases tended to require a connection with a country,¹²⁰ but the modern tendency is to adopt the connection with a system of law.¹²¹ The connection with either a country or a system of law should be based on the "transaction" contemplated by the contract:

117 Nygh, 344.

118 *The Assunzione* (1954) 176, 179 (Singleton LJ), quoted by Graveson, 431.

119 Lord McNair, *The General Principles of Law Recognized by Civilized Nations*, *BYIL* 33 (1957) 5.

120 *Boissevain v. Weil* [1949] 1 KB 482, 490.

121 *Bonython v. Commonwealth of Australia* [1951] AC 201-19; Chitty, 2081.

this means that the connection should be with what is to be done under the contract, rather than just with the technical form of the contract. This is used as a guide to determining whether the major connection is with a system of law or the law of the country.¹²² In *James Miller and Partners Ltd v. Whitworth Street Estates*¹²³ the judges could not agree on the proper law of the contract and by a majority chose British law, although differing in their definition of the relevant connecting factors. Lord Reid and Wilberforce held that the tests of "system of law" and "country" should be combined.¹²⁴ But in *Rossano v. Manufacturers Life Insurance Co.*,¹²⁵ Judge McNair stated that "the correct formulation is the system of law and not the country with which the transaction has its closest and most real connexion". Here, although the case was most closely connected with Egypt, it was held that as it was most closely connected with Ontario law, this should be the proper law of the contract.

A more recent case where a court determined by looking at the facts and circumstances a connection with a system of law was *Amin Rasheed Shipping Corporation v. Kuwait Insurance Co.*¹²⁶ Among the factors leading to the conclusion were that the contract was written in the English language and that the wording followed Lloyd's policy schedule. Further at the time the contract was written there was no Kuwaiti law of marine insurance. British law was seen to be the closest relevant system of law.

This is an important issue for the purpose of concessions where the State concerned will invariably be the country most concerned, but where the legal system most concerned may be able to be manipulated. Common law states, for example, if the United States and United Kingdom have a contract between them and the contract is for the supply of oil to the United Kingdom from the United States, the United States' port in that case is the place where the transaction is to be carried out and the *lex loci solutionis* is United States law. Until recently the presumption was that United States law would apply.

122 *Coast Lines Ltd v. Hudig & Veder Chartering NV* [1972] 2 QB 34, 46-50.

123 [1970] AC 500, 531.

124 *Ibid.*

125 [1963] 2 QB 352.

126 [1984] AC 50. Article 4(1) of EEC Convention of 1972, provides that in the absence of a choice of the proper law by the parties, a contract is governed by the law of the country with which it is most closely connected.

However, this presumption has been rejected by recent cases which adopt the most real connection test, with the *lex loci solutionis* being just one factor to be weighed in the general circumstances of the case.

The implications are on both sides. From the concession State's point of view, it controls the legal system of the country where the transaction is mostly to be carried out and is therefore better able to manipulate this legal system than the foreign contracting parties. The arbitrator may also be at a disadvantage because he may not be familiar with local law, and may wish to utilize a system of law which is seen to be "neutral" and with which he is familiar. Needless to say foreign parties will seek the application of a system of law other than that of the State party, and ideally a system with which they are familiar. Hence the varied pattern of the results in the arbitrations.

5. The Choice of the Proper Law of Arbitration

Arbitration has become an important neutral forum for the settling of disputes between States and foreign enterprises. The efficacy, confidentiality and expertise of arbitration have been used increasingly for world trade disputes and for oil disputes in particular, as we will see later. It is self-evident that the confidence of capital exporting nations increases with the assurance of a neutral forum for the arbitration of disputes, and there are indications that States are increasingly willing to submit to international arbitration. For the same reasons parties must have confidence in the law governing their arbitration.

Third World countries now show greater acceptance of United Nations resolutions which provide for the mechanism of arbitration as an instrument in the settlement of disputes. In particular an increasing number of States adhere to the ICSID Convention. By 1987, 97 States had signed it and recent bilateral protection treaties suggest there is an increasing acceptance of international arbitration within the ICSID system.¹²⁷

In this regard, the Secretary General of the United Nations in his report

127 EJ Paasivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes* (Cambridge Ph.D. thesis, 1988) 23-4.

of 7 April 1983 on Permanent Sovereignty over Natural Resources, stated:

Arbitration is the prevalent mode for the settlement of the disputes that inevitably arise. Its function is to motivate the parties to reach an agreement among themselves in order to avoid the intervention of third parties and, eventually, to provide a neutral forum for settling and deciding disputes. Major petroleum producers have successfully insisted on the jurisdiction of their national courts. Similar policies are adhered to in most Latin American countries. In other countries, arbitration, either under the auspices of the international chamber of commerce (ICC) or the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) is the rule.¹²⁸

(1) Methods of Expressing Choice

Usually an arbitration agreement is a clause included in a contract, and the proper law of the contract will often be the proper law of the arbitration included within it. Dicey and Morris state that:

...the choice of the proper law of the contract, which includes the agreement to arbitrate, coincides with the choice of the law governing the arbitration proceedings. It cannot however be doubted that the courts would give effect to the choice of a law other than the proper law of the contract.¹²⁹

An arbitration agreement is a separate agreement to submit a particular dispute to arbitration, and it is at least theoretically possible for such an arbitration to have a different law from the proper law of the contract. On the other hand, if there is an express choice of arbitration law and it specifies the country of arbitration, this becomes an important factor which indicates that the place of arbitration is the proper law. If there is no express choice of law, it is to be inferred from terms and nature of the contract and the circumstances of the case.¹³⁰

128 E/C. 7/1983/5. 16 Para 47, quoted by Paasivirta, 23.

129 Dicey & Morris (1980) 1128.

130 MC Pryles, *Comparative Aspects of Prorogation and Arbitration Agreements* *ICLQ* 25 (1976) 543. DR Thomas, *Arbitration Agreements as a Signpost of the Proper Law*. *Lloyd's Maritime and Commercial Law Quarterly* (1984) 141. Mustill & Boyd, *Commercial Arbitration Clauses* (1982) 317; Sykes & Pryles (1991) 141.

The major issue is the strength to be given to the designation of a place of arbitration but not an express law. On this issue, Dicey and Morris state that:

Where the parties fail to choose the law governing the arbitration proceedings, those proceedings will almost certainly be governed by the law of the country in which the arbitration is held, on the ground that it is the country most closely connected with the proceedings.¹³¹

Two pertinent cases are *Tzortzis v. Monark Line A/B* when the forum clause provided "an irresistible inference which overrides all other factors",¹³² and *Compagnie d'Armement Maritime SA v. Compagnie Tunisienne de Navigation SA*, when the House of Lords decided that though significant the designation of a place of arbitration was neither decisive nor irresistible.¹³³ In this case the contract contained a clause providing for arbitration in London but all the other contracts were connected to France and Tunisia, which shared the same law. The House of Lords held that the proper law was French. Modern rulings indicate, however, that there is a strong tendency to infer that the proper law of arbitration is that of the country where the arbitration was designated. This can only be overridden by an express choice of law clause or by the amassing of other significant factors pointing to another legal system.¹³⁴

(2) Absence of express choice of law in arbitration clause

When parties to a contract do not expressly state where and by what law their arbitration is to occur, the intention of the parties must be inferred from the agreement. In the *Alsing Case*, the Swiss arbitrator inferred that the law of the arbitration was Greek law. In 1920 the government of Greece and the Swedish Match Company and its associates concluded a concession agreement under Greek law containing two contracts, a loan contract with the Swedish Match Company, and a contract with Alsing for the exclusive supply of matches to the Greek government for a period of twenty years. The government by law had a monopoly in the manufacture, import and sales of matches in Greece.

131 Dicey & Morris (1980) 1128.

132 [1968] 1 *WLR* 406, 413 (CA).

133 [1971] *AC* 572. See Sykes & Pryles (1991) 142-7. Thomas 144.

134 Sykes & Pryles (1991) 142-7.

Both contracts were signed for the companies by the same agent, ratified for the government by the same decree law and published together in the government's Official Journal. Article 10 provided:

Any dispute or difference between the government and the company regarding the application, execution and interpretation of the present contract will be adjudged by two arbitrators, one of whom shall be appointed by the government and the other by the company.

The arbitrators shall be appointed within fifteen days after the date on which one of the contracting parties shall have duly notified the other in writing of its desire to settle the dispute by arbitration.

The arbitrators appointed, who may also be of foreign nationality, shall adjudge the dispute submitted to them irrevocably and without appeal; recourse to any other Jurisdiction and any other procedure is precluded.

Should the arbitrators not reach agreement. They may, at the request of one of them, unanimously appoint, within twenty (20) days following such a request, a third party as umpire. In case of disagreement as to who the umpire is to be, he shall be the president of the Swiss Federal Tribunal, or, in default of the latter, the President of the supreme court of appeal of the Netherlands. The umpire's decision shall be irrevocable and final and the contracting parties shall submit to it without dispute. The umpire's decision shall be given within two months at the latest.¹³⁵

There was no express choice of law clause. In 1954 the parties had a dispute which led to arbitration.

The umpire held that Greek law was the proper law of the arbitration, on the basis that:

In [choosing a Swiss umpire] they did not agree that, at this stage of the arbitration proceedings, the law to be applied should be redetermined according to the rules followed by the Judge newly called upon to settle the dispute without appeal, and whose nationality was not yet certain.¹³⁶

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SM Schwebel "*The Alsing Case 1920*" *ICLQ* 8 (1959) 320, 326.
Id., 326.

It may be worth noting that the arbitrator recorded the parties agreement that:

given the interdependence and the common source of the systems of law in force in continental Europe, the question of the law to be applied is rather a question of principle without much practical significance.¹³⁷

In the course of his reasoning, the arbitrator referred to Swiss, French and German law, but this was stated to be merely in order to fill gaps in Greek law or to test and illustrate his results by comparison.

An important issue is to do with the strength of inference implied when the nationality of the arbitrator is decided. It is generally seen to infer that the law of the arbitration will be that of the law of the country of the arbitrators, though as already seen, not always. The presumption is seen to be at its strongest, when it refers to a local system of law which has developed an established scheme of administration and at its weakest in a one-off contract where the country is chosen for its neutrality.¹³⁸

(3) Choice of Arbitration Clauses in Oil Concession Agreements

Oil concession agreements have frequently provided for arbitration as the mechanism of dispute settlement. The reason may be that the parties believed that arbitration procedures are more flexible and faster than normal judicial procedure. Arbitration may also give the parties more flexibility through their negotiations in accordance with the provisions of the agreements themselves as a basis for the solution of their differences. Consequently, arbitration tends to be adopted in preference to domestic courts.

Arbitral clauses in oil concession agreements usually follow the same pattern. The parties to a dispute appoint the arbitrators, who in turn select an umpire. The arbitrators and the umpire must be impartial and experienced in legal matters. Where the parties or their arbitrators fail to select an umpire they

137 Id. 327.

138 DR Thomas, 148-9.

request a neutral international authority, such as the President of the International Court of Justice, or the President of the Supreme Court of a State, such as Switzerland or Sweden, or the Court of Arbitration of the International Chamber of Commerce, to do so.¹³⁹ We will see examples from the oil concession agreements where the parties have expressed a choice of law and other examples where the parties have not expressed such a choice.

(a) Oil Concession Agreements containing an Express Choice of Law

Iran and the Pan American Oil Company in their concession agreement of 1958 provided in Article 38 that any dispute arising under their agreement was to be decided according to:

The general principles of law recognized by civilized nations, or alternatively, Swiss, Danish, Swedish or Brazilian law.

The concession agreement of 17 May 1935 between *Petroleum Development (Qatar) Ltd and the Ruler of Qatar* provided:

The Sheikh and the company declare that they base action upon this agreement on the basis of good faith and pure belief and upon the interpretation of this agreement in a manner consistent with reason.

The offshore concession agreement of 5 July 1958 between the *Kuwait Government and the Japanese-Arabian Oil Company* provided:

The parties base their relations with regard to this agreement on the principle of good will and good faith. Taking account of their different nationalities, this agreement shall be given effect and must be interpreted and applied in conformity with the principles of law common to Kuwait and Japan, and in the absence of such common principles, then in conformity with the principles of law normally recognized by civilized nations in

139 See further, JF Lalive, *Contracts between a State or a State Agency and a Foreign Company* *ICLQ* 13 (1964) 991. Note that the terms "arbitrator", "umpire", "referee" etc are used without any very clear difference between them. The basic principles of impartiality etc would apply whatever the title.

general, including those which have been applied by international tribunals.

(b) Oil Concession Agreements lacking an Express Choice of Law

Article 31 of the oil concession agreement of 1933 between the *Saudi Arabian Government and the Arabian American Oil Co. (Aramco)* provided:

Any doubt, difference, or dispute shall arise between the government and the company concerning the interpretation or execution of this contract, or anything herein contained or in connection herewith or the rights and liabilities of the parties hereunder, it shall, failing any agreement to settle it in another way, be referred to two arbitrators...

This Article did not contain a choice of law clause. Instead it allowed the arbitrators to choose the applicable law. It provided:

The decision of the arbitrators, or in the case of a difference of opinion between them, the decision of the referee, shall be final. The place of arbitration shall be such as may be agreed upon by the parties, and in default of agreement shall be the Hague, Holland.

The arbitration agreement between the *Saudi Arabian Government and Aramco* of 23 February 1955 provided:

The dispute being of a purely legal character, the first question to be decided by the arbitration tribunal is what law is to be applied to the relationship existing between the parties.

The arbitration tribunal shall decide this dispute:

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

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

Saudi Arabia law, as used herein, is the Muslim law:

- (a) as taught by the School of Imam Ahmad Ibn Hambal;
- (b) as applied in Saudi Arabia.¹⁴⁰

The agreement between the *Saudi Arabian government and the Trans Arabian Pipeline Company* of 1366 AH (1947) for arbitration of disputes provided in Article 23:

The decision of the arbitrators, or, in the case of a difference of opinion between them, the decision of the umpire, shall be final. The place of arbitration shall be such as may be agreed by the parties, and in default of agreement, shall be Jeddah, Saudi Arabia.

Again there was no express choice of law clause, and it was the responsibility of the arbitrators to determine the applicable law.

The agreement between the *Saudi Arabian government and the Japan Petroleum Trading Company Ltd*, of 18 Jumada I, 1377 AH (10 December 1957) provided in Article 55 for arbitration of disputes. It did not express any choice of law, but allowed the arbitrators to apply the applicable law:

...The decision of the arbitrators, or in the case of a difference of opinion between them, the decision of the majority shall be final, conclusive and binding upon both parties. The place of arbitration shall be Saudi Arabia or such other place as may be agreed upon by the parties...

However, article 47 provides that the rights of the company shall be exercised in a lawful manner subject to the law of the country and existing agreements.

The agreement between the government of *Saudi Arabia and Getty Oil Company* of 22 Rabi'a 11, 1368 AH (20 February 1949) provided in article 45 for the arbitration of disputes in terms similar to article 55 of the Japan Petroleum Trading Company agreement.

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Saudi Arabian Government v. Ex-Arabian American Oil Company (Aramco Arbitration) ILR 27 (1963) 153-4.

Article 40 of the *Iraq Petroleum Company (IPC)* agreement of 14 March 1925 as revised by further agreements of 29 March 1931 and 3 February 1952 provided:

...The decision of the arbitrators, or in the case of a difference of opinion between them the decision of the referee, shall be final. The place of arbitration shall be such as may be agreed by the parties, and in default of agreement shall be Baghdad.

There was no express choice of law clause, with the arbitrators being required to determine the applicable law.

(4) Choice of Arbitration Clauses in Petroleum Laws

The petroleum laws of some countries in Africa and the Middle East provide for the settlement of dispute by party-selected arbitrators and a neutral referee. This practice may have been influenced by the French decree of 13 November 1956 which gave authority to the French overseas territories to insert arbitration clauses in certain commercial arrangements, for example, with mining companies.

In the case of Italy and in accordance with the Italian Code of Civil Procedure the 1951 Italian Petroleum Law calls for arbitration at a domestic level.

Concerning Pakistan's petroleum production and mining concession rules a Judge of the Federal Court decides the controversy if two party-chosen arbitrators disagree.

A similar provision for settling differences between the petroleum administration of the council of ministers and oil companies was made pursuant to the Turkish petroleum law of 7th March 1954.¹⁴¹

141 See further, Suratgar, 290-1.

Article 45 of the Egyptian Law No 66 of 1953 on mines and quarries provides:

For the purposes of arbitration in the cases specified in this law, a board shall be formed consisting of three members, one to be nominated by the Ministry of Commerce and Industry, the second to be chosen by the lessee, and the third to be elected by the general assembly of the administrative court from amongst its members; this latter member shall preside over the board. The decisions of the arbitration board shall not be subject to any appeal.

On 10 June 1955 the Libyan government issued the Libyan Petroleum Law. This was amended many times. This amendment, together with the other amendments introduced by the Libyan law of 1965, was incorporated in the existing Libyan concessions on 20 January 1966. Article 28(7) was the final form of the article which allowed for arbitration of disputes. It provides:

This concession shall be governed by and interpreted in accordance with, the principles of law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.¹⁴²

Article 4 of the Venezuelan Law of Hydrocarbons of 13 October 1955 provides:

Any doubts and controversies of whatever nature that many ensue because of this concession and which cannot be amicably settled, shall be decided upon by the competent courts of Venezuela, and in accordance with its laws, and for no reason nor for any cause shall they give rise to foreign claims.¹⁴³

Article 14 of the Petroleum Law of Iran of July 1957 provided:

Any differences arising between the national Iranian Oil Company and other parties, if not resolved through a machinery

142 Article 28(7) of the Second Schedule to the Libyan Petroleum Law No. 25 of 1955. *Middle East Law Review*, 1 No.6 September 1958, 286. See *ILR* 53 297, 302-3, 389, 393-8.

143 See further, S Toriguian, *Legal Aspect of Oil Concessions in the Middle East* (1972) 77,78.

for amicable settlement which shall be laid down in the agreement, shall be referred to conciliation and arbitration, the rules relating to which shall also be determined as considered appropriate in each agreement.¹⁴⁴

Article 50 of the Saudi Arabian Mining Code of 1382 AH (1963) which was amended in form but not substance in article 55 1392 AH (1972) provided for the establishment of an independent board for the appeal of disputes arising from its application as follows:

There shall be established pursuant to this code an independent board for the appeal of disputes arising from the application of this code, consisting of not less than three and not more than five members to be chosen, regardless of nationality, from eminent and highly reputable jurists and judges experienced in international law and in problems relating to leases.

The members of the board shall not be called to account civilly or criminally except in accordance with rules to be prescribed by a special law. A decision shall be issued by the Council of Ministers for the formation of the board, setting forth the rules of pleading before it. The board shall be provided with an adequate number of technical and administrative personnel.

(6) Choice of Law: Conclusion

The principle of permanent sovereignty dictates that a State should maintain control over its resources. This puts resource-rich states in direct conflict with capital exporting states, who are interested to gain and remain in control of those resources. This conflict of interest can be seen in the differing views on the choice of law rules.

It is clearly in the interest of oil producing countries to have their contract governed by municipal law. By contrast capital exporting countries choose international law or general principles of law as the governing law, to avoid the application of municipal law.

This conflict is seen to be resolved in juristic opinion, by allowing parties the freedom to choose the law of the contract. This principle has been applied to most oil concession agreements from the middle of this century.

However, because of the urgent need of Third World countries for revenue, they are often compelled to accept the choice of law of capital exporting States. This may be disguised, when the municipal legal system is described as not specialized or adequate enough to cover the contract, but in fact the choice of another legal system is motivated by a decision to avoid the municipal system of the other party.

There is a strong tendency to choose arbitration as the method of dispute resolution, as the inherent conflict of the choice of law can be seen to be arbitrated by a neutral arbitrator. Though not always satisfactory the use of an "umpire" in arbitration is the only way at present to resolve this conflict.

7. Choice of Forum and its Relation to Choice of Law

Judicial jurisdiction is the legal power and authority of a court to make a valid decision binding on the party or parties concerned in any matter properly brought before it.¹⁴⁵

When the parties' contract stipulates that the courts of a specified foreign country have exclusive jurisdiction over their contract in case there arises any disputes between them, they intend to exclude the jurisdiction of other foreign courts. Thus a choice of forum intends...

to grant jurisdiction to the courts of a certain country or place to the exclusion of other courts that might be equally or more competent to take jurisdiction. It contemplates that the latter courts will defer to the parties choice in the event that one party later reneges by bringing suit in such a non-chosen tribunal.¹⁴⁶

145 Graveson, 94. See also DA Johnston, "Admiralty. International Commercial Transactions - Choice of Forum Clauses presumed valid" *NYUJILP* 6 (1973) 367.

146 M Friedman, "The Validity and Efficacy of Choice Of Law Clauses in International Contracts" 5 *Liberian LJ* 71 (1969) 71-72, quoted by IM Farquharson, "Choice of Forum Clauses. A Brief Survey of Anglo-American Law" *International Lawyer* 8 (1974) 85-6.

The choice of forum implies two concepts, that, of prorogation, which denotes the acceptance by the parties of the particular jurisdiction, and derogation, which infers that the parties do not want action to be pursued within other jurisdictions.¹⁴⁷ It is the later notion which has caused the most concern as it could encroach on the rights of a State with an interest in the case.

There are differences between States in the freedom given to parties to chose their own forums, but it cannot be denied that there is a trend towards accepting the rights of parties to such a choice, provided at least that such a choice is considered reasonable. An important justification for this trend is that it provides a secure and predictable environment in which international trade can occur. Much the same considerations apply within a federal system in terms of interstate transactions.¹⁴⁸

The validity of a choice of forum clause as a *grant* of jurisdiction has been recognized in international law. The courts of most countries recognize the validity and effect of a party's choice of forum as conferring jurisdiction without the need for any other link with the forum:¹⁴⁹ the same is true of the various international conventions on jurisdiction and recognition of judgments, with exceptions relating to certain matters only.¹⁵⁰

A non-selected forum may be denied jurisdiction unless "the other State would be a substantially less convenient place for the trial of the action than this State".¹⁵¹ Secondly, a forum selection clause may be denied "if the plaintiff cannot secure effective relief in the other state..."¹⁵² This could happen if the court is not empowered to hear this type of action, or if it lacks subject matter jurisdiction over the claim.¹⁵³ The third reason is when it can be shown it "was obtained by mis-representation, duress, the abuse of economic power, or other

147 Farquharson, 86.

148 M Gruson, Forum-Selection Clauses in International and Interstate Commercial Agreements, *University of Illinois Law Review* 1 (1982) 156.

149 A Lenhoff, "The Parties' Choice of a Forum Prorogation Agreement" *Rutgers Law Review* 15 (1961) 414, 419, Farquharson, 86.

150 LO Lagerman, "Choice of Forum Clauses in International Contracts. What is Unjust and Unreasonable?" *International Lawyer* 12 (1978) 794.

151 Lagerman, 781.

152 Model Choice of Forum Act ss3(2).

153 Lagerman, 783.

unconscionable means".¹⁵⁴ Finally, it would be denied if it were found to be unreasonable, if "it would for some other reason be unfair or unreasonable to enforce the agreement",¹⁵⁵ such as when a State by applying its laws would violate the public policy of the foreign State's law.¹⁵⁶

8. Choice of Forum in Different Legal Systems

(1) The United States

The current American position can be said to have evolved from the gradual erosion of the common law approach where most courts would refuse to accept an agreement that was in derogation of the exercise of its jurisdiction. In other words, while accepting jurisdiction based solely on a choice of forum clause, the courts "did not let the fact that they were not the chosen forum deter them from hearing the case",¹⁵⁷ unless a case was considered to be exceptional. In *Mittenthal v. Mascagni*¹⁵⁸ a Massachusetts court ruled that the parties' choice of forum would be upheld although both parties to the contract were foreigners. In *Gitler v. Russian Co.*¹⁵⁹ the choice of forum clause was agreed on after the cause of action arose.¹⁶⁰ This contract which could be seen as a partial settlement agreement, included a provision that the plaintiff promise not to pursue a remedy in enforcement of a judgement except in the courts of Russia.¹⁶¹ The court maintained that the parties could agree "not to submit to the courts a particular pending controversy".¹⁶²

On the other hand, objections to a choice of forum clause were proposed by Chief Justice Shaw in *Nute v. Hamilton Mutual Insurance Co.*¹⁶³ These were

154 Model Choice of Forum Act ss3(4).

155 Id, Act ss 3(5).

156 Lagerman, 787.

157 WM Reese, "The Supreme Court Supports Enforcement of Choice of Forum Clauses" *International Lawyer* 7 (1973) 534; WM Reese, "The Contractual Forum Situation in the United States" *AJCL* 13 (1974) 187.

158 66 NE 425 (Mass 1903).

159 108 NYS 793 (1903).

160 See JT Gilbert, "Choice of Forum Clauses in International and Interstate Contracts" *Kentucky Law Journal* 65 (1976) 13.

161 Ibid.

162 108 NYS 794.

163 72 Mass 174 (1856).

based on the idea that choice would be inconvenient to the parties, could threaten the perception of a court's relative competence and partiality, and was an attempt to oust courts of their statutory jurisdiction.¹⁶⁴ On these grounds, the forum selection agreement was held unenforceable. This view became entrenched in American courts and although challenged by commentators was not seriously questioned until 1949.

In that year Judge Learned Hand made the first important statement undermining this approach, noting that: "in truth, I do not believe that, today at least, there is an absolute taboo against such contracts at all. In the words of the Restatement of Contracts ss558 (1932), they are invalid only when unreasonable..."¹⁶⁵ This "reasonableness" test was applied in 1955 in the case of *Wm. H. Muller and Co. v. Swedish American Line Ltd.*¹⁶⁶ In this case Muller shipped goods on a Swedish American ship. The Agreement stipulated that the Swedish Court was to have exclusive jurisdiction over any disputes. Muller claimed that the Carriage Of Goods by Sea Act made the choice of forum invalid.¹⁶⁷ The court ruled that the choice of a Swedish Court did not lessen a carrier's liability.¹⁶⁸

The parties by agreement cannot oust a court of jurisdiction otherwise obtaining; notwithstanding the agreement the court has jurisdiction. But if in the proper exercise of its jurisdiction, by a preliminary ruling the court finds that the agreement is not unreasonable in the setting of the particular case, it may properly decline jurisdiction and relegate a litigant to the forum to which he assented.¹⁶⁹

Five factors were listed as needing to be considered in determining the reasonableness of the forum limitation provision. Those limitations were:

1. Ownership of the ship and place of construction (when the ship was lost at sea).
2. The nationality and residence of the crew members.

164 JM Reilly, "Enforceability of 'Choice of Forum' Clauses" *California Western Law Review* 8 (1972) 326.

165 *Krengerv. Pennsylvania RR.* 174 F.2d 556, 561 (2d cir. 1949), quoted by Gilbert, 13-14.

166 224 F 2d 806 (2d Cir, 1955).

167 46 USC ss1300-15, ss1303(8) (1970).

168 224 F 2d 806, 807.

169 Id, 808.

3. Whether the chosen court will apply the same measure of damages as the instant forum.
4. Whether the chosen forum's limitation proceedings are more restrictive and
5. The potential for fair and just adjudication of the case in the chosen forum.¹⁷⁰

In 1965, in *Central Contracting Co. v. CE Youngdahl and Co.*¹⁷¹ the reasonableness test was applied with the result that the choice of forum clause was upheld. The Pennsylvania Supreme Court stated that "such an agreement is unreasonable only where its enforcement would under all the circumstances existing at the time of litigation, seriously impair the plaintiff's ability to pursue his cause of action..."¹⁷²

Again in 1966 *Central Contracting Co v. Maryland Casualty Co.*¹⁷³ the *Youngdahl* case was relied on and the choice of forum clause was upheld on the grounds that no unreasonableness could be found.¹⁷⁴ The court considered that the most pertinent elements were the "distance from the plaintiff's home office" and "the complementary choice of law provision".¹⁷⁵ Hawaii,¹⁷⁶ Minnesota,¹⁷⁷ New York¹⁷⁸ and Washington¹⁷⁹ have adopted the reasoning of *Muller* and *Youngdahl*.

As I will discuss in the next chapter on limitations on choice of law and forum, the Model Choice of Forum Act was approved in 1968 by the National Conference of Commissioners on Uniform States Law in the United States. Courts were allowed greater discretion as to whether to uphold the choice of forum clause.

170 Ibid. See Gilbert, 15; Reilly, 327. Muller was not the first case to enforce a forum-selection clause, but it aroused interest in re-evaluating the traditional view about such clauses: see Gruson, 144-5.

171 209 A 2d 810 (1965).

172 Id, 816.

173 367 F 2d 341 (3d Cir, 1966).

174 Id, 344-5.

175 Ibid. See Gilbert, 17-19; JR Keys, "New Freedom in the Negotiation of International Contracts. The Supreme Court upholds Forum Selection Clauses" *Law and Policy in International Business* 5 (1973) 705.

176 *Hawaii Credit Card Corp v. Continental Credit Card Corp* 290 F Supp 848 (D Hawaii) (1968).

177 *Matthiessen v. National Trailer Convey Inc* 294 F Supp 1132 (D Minn, 1968).

178 *National Equip Rental, Ltd v. Sanders* 271 F Supp 756 (EDNY, 1967).

179 *General Elec Co. v. City, of Tacoma* 250 F Supp 125 (W D Wash, 1966). See Reilly, 329.

(2) England

English law has been based upon the concept of "party autonomy". Its civil law jurisdiction started with the principle that the parties choice of forum should, subject to a few exceptions, always be given effect.¹⁸⁰ However, in a desire to guard the rights of the judiciary, the ouster rule was developed. This rule asserted that "the jurisdiction of an English Court could not be ousted by agreement between the parties".¹⁸¹ But a court could decide not to exercise its jurisdiction.¹⁸² This gave the greatest possible effect to the intention of the contracting parties, while protecting the rights of the State. But there were limitations to this right where the intention were not "*bona fide* and legal", or where there was some "reason for avoiding the choice on the grounds of public policy."¹⁸³

Modern English law has continued this tradition. It distinguishes between the clauses that commit parties to the exclusive jurisdiction of foreign courts and those providing for non-exclusive jurisdiction.¹⁸⁴ The courts recognize choice of forum clauses in both domestic and international jurisdiction "subject only to certain public policy considerations usually under the idea of administration of justice."...¹⁸⁵ The position in English law is that if the parties accept the jurisdiction of the English courts by contract (notwithstanding the complete absence of any connections between the forum and the case) the courts will give effect to that choice. But if by the same kind of clause a forum outside England is selected the foreign proceedings may be, in certain circumstances, set aside or stayed.

180 Farquharson, 88.

181 A Aballi, Comparative Developments in the Law of Choice of Forum, *NYUJILP* 1 (1968) 192-93, quoted by Farquharson, 89.

182 Ibid.

183 Lord Wright, *Vita Food Products Inc. v. Unus Shipping Co.* [1939] AC 277. In spite of the fact that this expression involves only the proper law, it states the principle of party autonomy, which encompasses forum-selection clauses. See Farquharson, 90.

184 L Collins, "Choice of Forum and the Exercise of Judicial Discretion - the Resolution of an Anglo-American Conflict" *ICLQ* 22 (1973) 332, 333. See also C Noles, "Enforcement of Forum Selection Agreements in Contracts Between Unequal Parties" *GA Intl & Comp L* 11 (1981) 703.

185 Farquharson, 93.

In all cases the English courts have the discretion to decide the case, but they will usually uphold the choice of forum clause, in the case at least of a defendant on whom service of process outside English jurisdiction is required, by refusing jurisdiction. Thus if there is a submission to a foreign court, a plaintiff, to be allowed to continue a case in England, must make "a strong case" why this should be done. One of the most vital issues here is whether all the evidence is in England.

If the court selected is a foreign court but the plaintiff applies to the English court, the defendant may apply to have the case stayed.¹⁸⁶ In recent years, there has been some controversy over *forum non conveniens*, which have shifted the onus to the defendant to prove that the action should be stayed.¹⁸⁷ In *MacShannon v. Rockware Glass Ltd* 1977¹⁸⁸ four Scotsmen injured in industrial accidents were advised to sue in England rather than Scotland, as it was felt they would obtain a more favourable ruling in England. The defendants applied for a stay, which was refused. Lord Diplock stated:

In order to justify a stay the defendant must show more than that it is warranted by the scales of convenience being weighted in his favour.

In *The Abidin Daver* in 1984,¹⁸⁹ a Cuban vessel collided with a Turkish vessel in Turkish waters. The owners began action in Istanbul, the Cuban owners in the English Admiralty Court. The Turkish owners were granted a stay of the English action. Basing their decision on the doctrine of *forum non conveniens* the House of Lords ruled that the Turkish court was the natural and more appropriate forum, unless the plaintiff could prove he would be deprived of personal or judicial advantage legitimately.

The problem that has arisen out of this is how a court is to interpret "legitimate personal or judicial advantage". In 1986 Lord Goff, listed this as one of several factors to be considered in deciding on a stay of proceedings; other

186 Collins, 332. See also Graveson, 117.

187 For further detail see JG Collier, *Conflict of Laws* (1987) 78.

188 [1978] AC 795.

189 [1984] AC 398.

factors were that a stay would be granted only if the other court was appropriate to the trial, that the onus was on the defendant to show that the other forum is clearly appropriate, and that the court must look at with what action there was the closest and most real connection.¹⁹⁰

(3) Latin America

The position in the countries of Latin America varies. In Guatemala, for example, Article 14 of the Civil and Commercial Procedure Law provides that irrespective of any agreement to the contrary, the plaintiff may always bring action at the domicile of the defendant. By contrast Article 237 of the Panamanian Judiciary Code states that "express prorogation by contract determines the exclusive competence of the court chosen by the parties".¹⁹¹

Mexico and Cuba accept that the court chosen by the parties in a contract is primarily competent and that alternative rules of competency should be applied only when the court has not been chosen, while in Argentina preference is given to the place of performance designated by the parties. But there appears to be a trend away from upholding choice of national forum clauses.

In Brazil, where the courts usually uphold exclusive jurisdiction clauses, statutory restrictions are applied to cases involving Brazilian real estate, which must be brought before Brazilian courts, and labour matters, which have courts designated by statute. But In a 1962 decision of the courts of Guanabara, Rio de Janeiro it was ruled that the jurisdiction of Brazilian courts was a matter of public policy and could not be waived.¹⁹²

In Argentina, the trend away from upholding choice of forum clauses can be seen in the changed opinion in *Compte Y Cia v. Ybarra Y Cia* (1936) where "the opinion concluded that Argentinian sovereignty and the protection of its jurisdiction required that exclusive jurisdiction clauses be disregarded in the international sphere."¹⁹³ In that case the contract had stipulated the Courts of

190 [1986] 3 *WLR*, 971.

191 MA Schwind, "Derogation Clauses in Latin-American Law" *AJCL* 13 (1964) 168.

192 *Id.*, 168-70.

193 Decision of 16 November 1936, quoted by Schwind, 171.

Seville in Spain as the exclusive forum, but the Procurator General argued that the prior case law could be changed.

On the other hand the Latin American Convention on Private International Law of 1928 (the Bustamante Code) recognized the principle of choice of forum.¹⁹⁴ Article 318 of the Bustamante Code provides that lawsuits should be brought to the judge to whom the parties have submitted, provided that at least one of the parties is a citizen or domiciliary of the State of the forum and that local law does not forbid the submission. This code was relied on in *Holzmann v. Gainsborg* in 1950 between Chile and Bolivia.¹⁹⁵

(4) Europe

(a) French Law

The principle of choice of Forum is fundamental in French law¹⁹⁶ and there is no limitation to it, whether a dispute is contractual, *in personam* or *in rem*, or whether covering real or personal property.¹⁹⁷ Under Article 14 and 15 of the Civil Code, the privileges extended to French nationals are not upheld if there is an explicit agreement that jurisdiction be in a foreign court: however if this agreement is not expressly stated there is no presumption of waiver.¹⁹⁸

(b) German Law

German law allows a choice of forum to parties in dispute by express or applied agreement.¹⁹⁹ Only in certain situations covered by the Code of Civil Procedure limiting party autonomy is this choice not valid. The most important of these limitations is under §40 of the Code which provides that "no contractual change of competence is allowed as to non-pecuniary claims and those pecuniary

194 Lagerman, 794.

195 *Holzmann v. Gainsborg* [1950] 47 *Revista de Derecho, Jurisprudencia y Ciencias Sociales* 11.1 509 quoted by Schwind, 172.

196 Lenhoff, 414-40.

197 *Id.*, 442.

198 *Ibid.*

199 A Drobniq, *American German Private International Law* (1972) 323 quoted by Noles, 703.

claims which fall under an exclusive competence".²⁰⁰ Because of this, the principle of choice of forum does not operate in relation to non-pecuniary family law claims, or in matters which are exclusive to the jurisdiction of German courts.²⁰¹

(c) Other European Countries

The principle of choice of forum is accepted in most European countries, although subject to a range of qualifications. However in Spain, Portugal and Hungary no effect is given to choice of forum clauses, showing a strong tendency to protect local citizens by guaranteeing a local forum. In Italy, forum selection clauses stipulating a court other than the Italian courts will generally not be enforced unless the agreement is in writing and involves alien or an alien and a non-resident non-domiciled citizen, and has to do with pecuniary matters.²⁰² On the other hand, Italy shows a bias towards prorogation clauses: unless the action relates to immovable property outside Italy, a prorogation clause is a sufficient basis for the exercise of jurisdiction.²⁰³ As well, parties may choose to designate that their place of domicile is Italy. Such a designation in the contract will be accepted.

Austria, Belgium, Greece and Switzerland tend to uphold the choice of forum unless it involves a matter of public policy or involves immovables within the state, while the Scandinavian countries take the choice of forum provision for granted.²⁰⁴

9. The Principle of Choice of Forum in International Agreements

This principle is reflected in the Draft Convention on the Jurisdiction of the Selected Forum in the Case of International Sales of Goods prepared by the Hague Conference in 1956, which expressly recognizes the validity of forum

200 Pyles, 569.

201 Ibid.

202 JM Perillo, "Selected Forum Agreements in Western Europe" *AJCL* 13 (1964) 163, 165.

203 Ibid.

204 Ibid.

selection clauses.²⁰⁵ The Hague Conference on Private International Law approved the 1964 Hague Convention, based on this Draft. This Convention treats forum provisions as presumptively valid both in prerogative and derogative senses, so that no court other than the selected one would have the right to hear action covered by the agreement except in specifically defined situations.²⁰⁶

Article 2 provides that:

This Convention shall apply to agreements on the choice of court concluded in civil or commercial matters in situations having an international character...

Article 3 provides that:

This Convention shall apply whatever the nationality of the parties.²⁰⁷

The EEC Convention of 27 September 1968, on Jurisdiction and the Enforcement of Civil and Commercial Judgements is also relevant. Article 17 provides:

If by an agreement in writing or a verbal agreement confirmed in writing when at least one of the parties is domiciled in the territory of a contracting State, the parties have designated a court or the courts of a contracting State as competent to settle disputes...only the designated court or the courts of that State shall have jurisdiction.²⁰⁸

The Bustamante Code in 1928 provides in Article 318 that law-suits in civil and commercial matters shall be brought in the first instance before the judge "to whom the litigants expressly or impliedly submit themselves..."²⁰⁹ But Pyles states that "the Bustamante Code does not seem to have had a great effect. There is some doubt about the extent of its operation and Article 318

205 Lagerman, 794.

206 Gilbert, 29.

207 The text of the Hague Convention is found in *AJCL* 13 (1964) 629.

208 See generally Pyles, 573.

209 *Ibid.*

expressly permits the invocation of local law to deny effect to prorogation agreements."²¹⁰

10. Conclusion

There is, despite certain exceptions, a trend towards upholding choice of forum clauses in the trading nations of the developed countries. By contrast, the developing countries are more likely to seek to protect national interests by imposing limits on such clauses, or refusing to recognize their effect. Thus there are likely to be areas of conflict between developing and developed countries.

Thus Third World countries may attempt to protect themselves by stipulating national forums for the settlement of certain classes of disputes. For example, the tendency in the countries of Latin America is not particularly favourable to supporting choice of forum clauses in international contracts.²¹¹ The reason for this may be the perceived weaker bargaining position in contract formation of parties from Third World countries, particularly when faced with multi-national corporations.²¹²

11. Conflict of Laws in Islamic Shari'ah Law

Conflicts of law in Islamic Shari'ah usually concern questions relating to domicile, marriage, divorce, succession, wills, contracts etc, of non-Muslims and foreigners resident in Muslim territory.²¹³ The private international law of Islam is a part of "*Figh*" jurisprudence. Foreign relations in Islamic Shari'ah are regulated by special laws, which derive their "authority not from any foreign source, but from the sovereign will of the Muslim State itself".²¹⁴ However in practice the rules reflect great tolerance of choice of other laws.²¹⁵

210

Ibid.

211

Schwind, 173. Gilbert, 24.

212

Noles, 705.

213

AK Pavithran, *Public International Law, Western and Eastern* (1965) 669.

214

Ibid.

215

A Msallam, *Private International Law* (1966) 157 (Arabic text).

It is not possible within the scope of this thesis to discuss comprehensively conflicts of laws as recognized in Islamic Shari'ah. I will however outline some of the basic conflicts principles.

(1) The Position of Foreigners in Islamic Jurisprudence

Islamic jurisprudence distinguishes between a native of an Islamic State and a foreigner by dividing the world into two separate parts: *Dar al Islam*, the Islamic world, ruled by Muslims, and *Dar al Harb*, the rest of the world, ruled by non-Muslims. It allows that providing they are not at war there is no restriction on commercial and political relations between them. Following a war and after peace agreements are signed, it is possible to resume relations. The term used to describe the people of *Dar al Harb* would change from "the warriors" to "the peaceful ones."²¹⁶

The citizens of countries known as *Dar al Islam* are of two categories: the first are Muslims, the second non-Muslims who are permanent residents of a Muslim country. The second group are referred to as "*Dhimmis*": they are granted the benefit of Islamic nationality and are not considered to be foreigners. It is not possible for a Muslim of any nationality to be considered a foreigner in *Dar al Islam*, even if he comes from a country ruled by non-Muslims. So the term foreigner is restricted to refer to those non-Muslims living in *Dar al Harb*.

Should a foreigner enter *Dar al Islam* he will be granted safety, providing he initiates communication with the Muslims or "*Dhimmis*". He is referred to as "*Musta'min*" or a seeker of safety. Should a *Musta'min* marry a "*Dhimmis*", the marriage confers "*Dhimmis*" status on the "*Musta'min*" either male or female. Thus marriage confers nationality on a "*Musta'min*". Further a "*Musta'min*" will acquire "*Dhimmis*" status if he lives in *Dar al Islam* for a long time. The length of time is unspecified but tends to be less than that required by more recent nationalization laws. In any event a *Musta'min* will enjoy the same care and treatment in government and law as Muslim citizens.²¹⁷

216 Id, 110.

217 Id, 111.

(2) The Meaning and Consequences of "Dhimmis" Status

The term *Dhimmis* was given by Muslims to the followers of the religions it considered to be the revealed religions, i.e. persons of Christian or Jewish faith, the so called "*ahl al-kitab*" (people of the book).

According to the jurists a contract between a Muslim and a *Dhimmis* was called a *Dhimma*. This contract conferred a protected person status on the *Dhimmis*. It gave him the right to stay in Islamic territory, security for his person and his belongings, freedom of religious practice and defence against an enemy. In the Hanbali school it was also stipulated that a *Dhimmis* must not speak ill of the Islamic religion and should not be involved in any action detrimental to believers.²¹⁸ There is also an obligation to obey all rules of Islamic Shari'ah which do not contradict their faith.²¹⁹

(3) Islamic Jurisprudence and Positive Laws

Prior to the development of a comparable jurisprudence in feudal Europe, the Arabian nation had a legal system which depended on Islamic jurisprudence. Islamic jurisprudence is not only a religious jurisprudence but also the jurisprudence of a State. It covers the relationship between Muslims and non-Muslims having the same nationality or citizenship, and is therefore a legislative jurisprudence for everyone. It is not possible for the positive laws and the religion it depends on to be considered in the same category. As these are not equivalent it is impossible to have laws conflicting on the base of "*la notion rattachee*".²²⁰ Since Islamic jurisprudence does not rule on "*la notion rattachee*", this will have an effect in conflicts between other positive laws and legislation.

However, the Islamic State has long had relations with foreigners. Islamic jurisprudence organized these relations not after "*la notion rattachee*", which means that relations with foreigners be governed by a certain law, but directly after the positive rules mentioned in Islamic jurisprudence under

218 M Khadduri, *War and Peace in the Law of Islam* (1960) (1955) 176.

219 Msallam, 156.

220 Ibid.

headings such as the non-Muslims' special rules, the difference between *Dar al Islam* and *Dar al Harb*, marriage with non-Muslims, and rules regulating relations between *Dhimmi*s and *Musta'min*s.²²¹ In those rules there is a recognition of the rules of "*Dhimmi*s", as long as those rules do not contradict Islamic Shari'ah.

(4) Jurisdiction over non-Muslims

The Islamic Shari'ah was originally a code concerned with territorial matters, and not -- as has been mistakenly inferred in Europe -- a personal code ruled by the principles of subjective law. In principle *Dhimmi*s were considered to be under the jurisdiction of their own religious leaders. The Muslim Judge (*qadi*) has jurisdiction over a dispute between two *Dhimmi*s. However, opinion was divided over cases where the two *Dhimmi*s were brought before a Muslim Judge. The Hanbali School held the view that the judge was to try the case, whereas the Maliki school and the Shafi'i school saw the judge as having a choice.²²² On this issue the Holy Qur'an says:

...If they do come to thee, either judge between them [the *Dhimmi*s] or decline to interfere...²²³

and further:

...Judge between them [the *Dhimmi*s] by what God hath revealed, and follow not their vain desires...²²⁴

In either civil or criminal case the Muslim judge had to apply Islamic Shari'ah for "Islam must dominate and not be dominated".²²⁵ The Holy Qur'an says "But who, for a people whose faith is assured, can give better judgment than God",²²⁶ and also: "...And never will God grant to the unbelievers a way [to triumph] over the Believers."²²⁷

221 Ibid.

222 M Khadduri & HJ Liebesny, *Law in the Middle East* 1 (1955) 337.

223 The Holy Qur'an Sura V. verse 45.

224 The Holy Qur'an Sura V verse 51.

225 Khadduri & Liebesny, 337.

226 The Holy Qur'an Sura V verse 53.

227 The Holy Qur'an Sura IV verse 141.

According to the Malikis school, the choice of law in a case involving two *Dhimmis*, should be the national law of the parties to the dispute, even if the judge be Muslim. However, should this national law contradict Islamic Shari'ah it would have to be rejected for reasons of public order. The concept of public order in Islamic Shari'ah is essentially a religious one, for it involves a people who relate everything to God and who have established their law on the basis of their faith.

One may take as an example a situation where a judge had to decide between two *Dhimmis* on the sale of wine or pork, (both of which are prohibited in Islamic Shari'ah). They, according to the Malikis school, an Islamic Judge would either have to decline judging the case or apply the appropriate rules of the Islamic Shari'ah. On the other hand the judge would be obliged to enforce the contract concluded among *Dhimmis* unless its provision infringed upon the precepts of Islamic Shari'ah. This principle applies to all contracts between *Dhimmis*.²²⁸

CHAPTER 3

DISPUTE SETTLEMENT MECHANISMS IN THE ORGANIZATION OF PETROLEUM EXPORTING COUNTRIES AND SOME MEMBER STATES

1. Background

In a move to ensure control over the supply of oil, the League of Arab states formed an Oil Exports Committee in 1951. A growing sense of national identity moved Arabic countries to emphasise their aspirations for a single Arab nation, and encouraged them to devise a united policy to protect and control their oil. In 1954, a Petroleum Department was set up within the League of Arab States as a permanent regulatory body. In 1957 the Economic Council of the Arab League established a Petroleum Congress in Cairo. However, they "were aware that such an association could only be effective if it included Arab as well as non-Arab large exporters of petroleum". In 1959 they invited Venezuela and Iran as observers to the Petroleum Congress. From this time there has been an increased co-operation among the oil producing countries, which have extended their contact with each other, based on principles of co-operation and the co-ordination of policies.¹ The result of this co-operation has been the establishment of several petroleum organizations: OPEC in 1960, OAPEC in 1968, and the African Petroleum Producer's Association (APPA) in 1987. OPEC and OAPEC have provision in their constitutions for settling the disputes of members, as we will see later, but APPA has no similar provision in its Constitution.²

(a) The Organization of Petroleum Exporting Countries (OPEC)

Between 10 and 14 September 1960 the representatives of the Governments of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela met in Baghdad.

1 MA Ajomo, "An Appraisal of the Organization of the Petroleum Exporting Countries (OPEC)" *Texas International Law Journal* 13 (1977) 12, 14.

2 APPA Constitution of 1987. APPA members are Algeria, Gabon, Libya, & Nigeria. This information was provided by Nigerian National Petroleum Corporation.

Here OPEC was established as a permanent inter-governmental organization based in Vienna. Later other petroleum exporting countries joined as full members: Qatar (1961), Indonesia (1962), Libya (1962), United Arab Emirates (1974), Algeria (1969), Nigeria (1971), Ecuador (1973), Gabon (1975). OPEC now has thirteen members.³

Article (2) of the OPEC Statute states its aim as follows:

A. The principal aim of the organization shall be the co-ordination and unification of the petroleum policies of member countries and the determination of the best means for safeguarding their interests, individually and collectively.

B. The organization shall devise ways and means of ensuring the stabilization of prices in international oil markets with a view to eliminating harmful and unnecessary fluctuations.

C. Due regard shall be given at all times to the interests of the producing nations and to the necessity of securing a steady income to the producing countries: an efficient, economic and regular supply of petroleum to consuming nations; and a fair return on their capital to those investing in the petroleum industry.

OPEC has made many recommendations and resolutions, particularly dealing with the major problems facing the member countries, the world economy, and the confrontations between nations concerned with oil. The guiding principle of OPEC has been to encourage the national development of member nations and to allow them to exercise control over their own resources and economies.⁴ Highlights of its activity have been as follows:

(1) On 15-21 January 1961 the Caracas Conference adopted a resolution for a comprehensive study on the economics of investment in the oil industry by concession-holding companies. It also emphasized the restoration of prices to levels which members considered justified and appropriate.

3 Abu Dhabi's membership (1967) was transferred to the United Arab Emirates after the formation of the United Arab Emirates which included Abu Dhabi in 1974. See MA Ajomo 14-15.

4 Id., 26. See GG Kaplan, "International Economic Organization, Oil and Money" *Harvard International Law Journal* 17 (1976) 203.

(2) On 24-31 December 1963 in Riyadh, the 5th Conference resolved to establish a three-member OPEC Negotiation Committee (Iran, Iraq, and Saudi Arabia) with the oil companies on royalty payments and marketing expenses; to compile a code of uniform petroleum laws and to initiate studies on the establishment of an Inter-OPEC High Court for the settlement of disputes relating to petroleum matters, and to prepare a project to set up an Inter-OPEC Commission to examine crude oil prices on a regular basis.

(3) On 5-6 October 1967 in Taif (Saudi Arabia) A consultative meeting of Five member countries decided to enter into negotiations with the oil companies to eliminate the allowances stipulated in the royalty agreements.

(4) On 6-10 November 1967 in Djakarta, A meeting of representatives of the National Oil Companies of OPEC member countries authorized the OPEC Secretariat to commission a study on the co-ordination of policies of national oil companies (NOCs) in the international market.

(5) On 24-25 June 1968 in Vienna, the 16th OPEC conference adopted a "Declaratory Statement of Petroleum Policy in Member Countries". The Statement emphasized, *inter alia*, that member governments should endeavour to explore for and develop their hydrocarbon resources directly; acquire reasonable participation in the ownership of the concession-holding companies, participate in choosing the acreage to be relinquished, and base the assessment of the companies' income, taxes and any payments to the State on a posted or tax reference price for those hydrocarbons produced under contract. It also emphasized the inalienable right of all countries to exercise permanent sovereignty over their natural resources.

(6) On 9-12 December 1970 in Caracas, the 21st OPEC Conference resolved that all member countries were to adopt a set of objectives namely, to establish 55 per cent as the minimum rate of taxation on the net income of oil companies; to eliminate disparities in posted or tax reference prices of crude oils on the basis of the highest posted price applicable in member countries, taking into consideration differences in gravity and geographic location; to establish a uniform general increase in the posted or tax reference prices in all member

countries to reflect general improvement in the conditions of International petroleum markets, to adopt a new system for the adjustment of gravity differential of posted or tax reference prices; and to eliminate completely the allowances granted to oil companies as from the beginning of 1971. This resolution achieved something of a revolution in the global oil situation, giving the oil producing countries considerably more power in creating a stable high price for crude oil. This was gained at the expense of foreign oil companies.⁵

(7) On 4-6 March 1975 in Algeria, the Conference of Sovereigns and Heads of State of OPEC member countries adopted a "Solemn Declaration" which emphasized inter alia, mutual respect for the sovereignty and equality of all member nations of the international community in accordance with the UN Charter, and reaffirmed the sovereignty and the inalienable right of all countries to the ownership, exploitation and pricing of their natural resources.⁶

(b) The Organization of Arab Petroleum Exporting Countries (OAPEC)

On 9 January 1968 the Organization of Arab Petroleum Exporting Countries (OAPEC) was established by Saudi Arabia, Kuwait, and Libya, and was based in Kuwait. Eventually all the Arab producing countries (United Arab Emirates, Bahrain, Algeria, Syria, Iraq, Qatar, Egypt and Tunisia) joined the organization.⁷ Article 2 of the agreement emphasized the organization's major goals as follows:

to promote co-operation and close ties between the member countries in economic activities related to the oil industry, to determine ways of safeguarding their legitimate interests - both individual and collective in the oil industry, to unite their efforts, so as to ensure the flow of oil to consumer markets on equitable and reasonable terms, and to create a favourable climate for the investment of capital and expertise in their petroleum industries.

5 Ajomo, 27-8.

6 *OPEC Official Resolutions and Press Releases, 1960-1983*. See also *OPEC General Information and Chronology* (1986) 25.

7 For further information, M Tetreault, *The Organization of Arab Petroleum Exporting Countries: History, Policies, and Prospects* (1981).

The central objective of this article is:

- (a) To take adequate measures to ensure the co-ordination of the petroleum economic policies of members.
- (b) To take measures to ensure the harmonization of the legal systems in the member countries to the extent required for the organization to carry out its activity.
- (c) To help members to exchange information and expertise, and to provide opportunities for the citizens of member nations to be trained and employed by member nations where the opportunities exist.
- (d) To actively encourage, co-operation among members to work towards solutions to problems facing them in the petroleum industry.
- (e) To utilize members' resources and to combine their potential abilities to create joint ventures in the various phases of the petroleum industry. Such ventures may be undertaken, by all members or those interested in such projects.

OAPEC was established as a result of the growing Arab nationalist movement and the desire of member nations to exercise their right to control their natural resources for the interests of their nations and their national income. Many projects have been initiated by OAPEC. These have included:

- (1) Arab Maritime Petroleum Transport Company (AMPTC) 6 May 1972
- (2) Arab Shipbuilding and Repair Yard Company (ASRY) 8 December 1973
- (3) Arab Petroleum Investments Corporation (APICORP) 14 September 1974
- (4) Arab Petroleum Services Company (APSC) 23 November 1975
- (5) Arab Petroleum Training Institute (APTI) 1979
- (6) Arab Engineering Company (AREC) 22 March 1981.⁸

OAPEC's member nations have subsequently considered many related issues, such as pricing production levels and production methods. It is also concerned with the relations between States within the Arab nation. On a practical level it provides for technical conferences and seminars where non-OAPEC States are invited to attend. Further, it liaises with other countries in the world on behalf of members, especially in connection with energy and development problems.⁹

2. Judicial Tribunals in OPEC/OAPEC Countries

(a) The OPEC High Court

At OPEC's Fifth Conference held in Riyadh, Saudi Arabia, between 24 and 31 December 1963, a resolution was passed to establish an Inter-OPEC High Court. Resolution v. 41(2) states:

(1) that the Secretary General shall invite a number of experts from member countries and, if necessary, from other countries, to work on the compilation of a code of uniform petroleum laws, and that a comprehensive report in this connection shall be submitted for consideration to member countries; and

(2) that the Secretary General shall forthwith initiate studies for the establishment of an inter-OPEC High Court for the settlement of all disputes and differences relating to petroleum matters, except for member countries whose legal system does not allow them to participate in the establishment of such a court, and prepare a project thereon for submission to member countries; and that, further, the statutes of the said High Court shall be so conceived as to allow the court to act both in an advisory and in a judicial capacity.¹⁰

The jurisdiction of this court was to extend over "all disputes and differences relating to oil matters". It was to be the administrative court of the Organization and to provide jurisdiction on international controversies that were

9 Article (3) of the OAPEC Agreement provided that:

The provisions of this agreement are not deemed to affect the rights and obligations of members in respect of their agreement with the Organization of Petroleum and Exporting Countries. The parties to this agreement are to be bound by the ratified resolutions of OPEC and shall be bound by them even though they are not members of OPEC.

10 OPEC Resolution v 41.

related to oil. Further it was to cover controversies over the interpretation, application and termination of oil concession agreements between OPEC member governments and oil companies or enterprises.¹¹ Despite this resolution the Inter-OPEC High Court did not come into existence. This left OPEC without a formal method of settling disputes by arbitration or judicial settlement.¹² This deficiency encouraged members of OPEC to convene the OPEC Conference. The Conference was to be the supreme authority of the organization. It would consist of delegated representatives of all members of OPEC. It would discuss problems and attempt to find solutions.¹³ The writer contacted the legal department of OPEC in Vienna in connection with this thesis and was informed that the conferences have dealt with a number of disputes between members of OPEC, notably between Iran and Iraq over oil production quota. With the outbreak of the Iran-Iraq war however this ceased to be an issue.¹⁴

(b) The OAPEC Judicial Tribunal

Article 21 of the OAPEC Constitution provided for the establishment of a Judicial Tribunal, by way of a Protocol to be agreed upon by member countries. The Judicial Tribunal's Protocol was signed in Kuwait on 9 May 1978, and came into effect in April 1980. Because of the tight connection between the Tribunal's jurisdiction, and the organisation's activities (with its emergent companies), the Tribunal is considered as OAPEC's judicial arm, as indicated by the Organization's Agreement and the Judicial Tribunal Protocol. The OAPEC Judicial Tribunal is the first inter-Arab judicial system.

The foundation of the Tribunal was the beginning of a new trend confirmed when the Arabian Gulf Co-operation Council (GCC) established a special Tribunal for treating the disputes between the members. Its Statute was promulgated in Abu Dhabi (United Arab Emirates) on 21 Rajab 1401 AH corresponding to 25 May 1981. These developments may sustain the idea of

11 M. Mughraby, *Permanent Sovereignty over Oil Resources* (1966) 129.

12 Ajomo, 17.

13 Articles 10, 11 of the OPEC Statute.

14 This information was provided by Mr Muhammad Baghdadi from the Legal Department of OPEC in Vienna (May 1989).

establishing an Arab Court of Justice with general jurisdiction. The Arab League's Committees are now studying a draft Statute for such a Court.¹⁵

Article 22 of the OAPEC Agreement provides that "the judges of the Tribunal shall be chosen from persons whose impartiality is not in doubt and who fulfil the necessary conditions for holding the highest legal positions in their countries, or are jurists of international repute ..."

OAPEC and its members with their emergent companies have standing before the Judicial Tribunal. Oil companies operating in an OAPEC member territory may also enjoy the same right, whether they belong to the OAPEC members or are foreign companies, if the member and the company have agreed to refer their future or current disputes to the Judicial Tribunal. Article 24(C) of the Protocol permits other parties to bring cases before the Tribunal, and also provides that the Judicial Tribunal may review any cases classified by the OAPEC Council as within the Tribunal's jurisdiction.

The Judicial Tribunal differs from most other international courts in that the right to initiate proceedings can be exercised by states, international organizations, international public companies having a commercial aspect, and national or international private companies. The Judicial Tribunal's jurisdiction arises under Article 23 of the OAPEC Agreement, and Articles 24, 25, 26, 27 of the Judicial Tribunal Protocol.¹⁶ The Tribunal's jurisdiction consists of:

- (1) obligatory jurisdiction
- (2) optional jurisdiction
- (3) consultative jurisdiction.

(1) The Tribunal's Obligatory Jurisdiction

According to Article 23(1) of the OAPEC Agreement, and Article 24(1) of the Judicial Tribunal's Protocol, the Tribunal is entitled to deal with the following disputes:

15 *OAPEC Judicial Tribunal Report* (1985) 8.

16 See further Appendix 1.

(a) disputes concerning the interpretation and application of the Agreement, and the execution of its obligations. The countries members, the organization and its companies are all admitted as parties in these disputes.

(b) disputes between two members or more in the oil industry, on condition that the dispute must not involve the sovereignty of any country member involved in the disputes.

(c) disputes determined by the Council to be within the Tribunal's Jurisdiction, subject to the same provision as in clause (b) above.

Subject to these restrictions the Tribunal may deal with any one of these disputes provided that one party wishes to proceed: it does not need the approbation of the other party. Article 74(2) of the Tribunal's procedural rules states that if the accused - after being duly warned that an action is taken against it - does not appear before the Tribunal or fails to carry out any later step in the proceedings, the accuser may proceed to claim judgment *in absentia*, and the Tribunal must continue with the proceeding.

(2) The Tribunal's Optional Jurisdiction

Article 23(2) of the OAPEC Agreement and Article 24(2) of the Judicial Tribunal's Protocol define the disputes which can be treated by the Tribunal after an agreement between the parties. These are:

- (a) Disputes between any country member and the oil companies working in its territory.
- (b) Disputes between a country member and an oil company belonging to another member.
- (c) Disputes between two members or more, except for that mentioned in article 23(1).

The Tribunal cannot treat those cases unless the disputing parties agree previously to be judged by the Tribunal. This text is considered as a basis for the countries members and their companies and foreign companies working in

their territories to agree to insert provisions in their future agreements, selecting the Tribunal to arbitrate disputes under those agreements, when the parties do not agree to refer such disputes to the national law of the country member.

(3) The Tribunal's Consultative Jurisdiction

The Tribunal may give a consultation in respect of cases duly referred to it by the Organization's Council of Ministers. According to Article 77 of the Tribunal's Rules of Procedure, the Council has a wide power to refer to the Tribunal a particular case or class of cases, or to allow a member or an emergent company or institution to claim for a consultation from the Tribunal in a certain case.

3. The Rules of Law applied by the Judicial Tribunal Since Its Foundation

According to Article 26 of the Judicial Tribunal's Protocol, the Tribunal gives judgment by reference to the Protocol, the Islamic Shari'ah, and international law. In these matters it applies:

- (a) the Organization's Agreement and any international conventions which bind the parties to the dispute;
- (b) international custom accepted as binding;
- (c) the general principles of law applied in international society;
- (d) the general principles in the member countries' laws.

In addition...

- (e) The Court's judgments and the trends of the great jurists in the public law in the member countries may be drawn on as required.

Disputes dealt with by the Tribunal according to its optional jurisdiction may be judged according to the law which the Tribunal believes should be applied to settle the case.¹⁷

4. Cases before the Tribunal since its Foundation

Two cases have been brought before the Tribunal.

(a) *Iraqi Republic v. Syrian Arab Republic (1982)*

The Iraqi Republic requested to proceed against the Syrian Arab Republic about "the cessation of crude oil transportation across Syrian territory", relying on the Tribunal's jurisdiction under Article 24(2)(C) of the Judicial Tribunal's Protocol, and to Article 15 of the Complementary Agreement between the Governments of Iraq and Syria. This Complementary Agreement of 26 November 1981 provided for the transportation of Iraqi crude oil across Syrian territory and for oil to be supplied to Syria for its local consumption.¹⁸

The writer contacted the Secretary of the Judicial Tribunal of OAPEC in connection with this thesis and was advised that the case is still pending.¹⁹

(b) *Sea Arab Company for Oil Transportation v. Government of the People's Democratic Algerian Republic (1983)*

On 27 August 1983, the Sea Arab Company for Oil Transportation requested to proceed against the Government of the People's Democratic Algerian Republic, because "the accused party did not keep to its financial obligations towards the accuser company, due by the agreement of the company establishing and its statute, and by the decisions of its General Assembly".²⁰

17 The OAPEC Statute of 1968. See also the Judicial Tribunal of OAPEC Protocol of 1978.
 18 OAPEC Judicial Tribunal Reports 1985, 1986, 1987.
 19 This information was provided by Dr Reaz Addaody, Registrar of the Judicial Tribunal of OAPEC (February 1992).
 20 OAPEC Judicial Tribunal Reports 1985, 1986, 1987.

On 28 October 1989, the lawyers representing both parties informed the President of the Judicial Tribunal of OAPEC that both parties had agreed to settle their dispute and applied to expunge their claim from the Tribunal's list. Accordingly the Judicial Tribunal decided on 5 R Thani 1410 AH (corresponding to 4 November 1989) to delete the case from its schedule and register the case as settled, according to Article 70 of the Rules of Procedure of the Tribunal.

5. The Board of Lease Appeals of the Kingdom of Saudi Arabia

The Kingdom of Saudi Arabia enacted the first Mining Code under Royal Decree No. 40 dated 11 Ramadan 1382 AH, corresponding to 5 February 1963, as amended under the Royal Decree No. 21 dated 20 Jumad Al Awal, 1392 AH, corresponding to 1972. This provided, in Article 55 for the establishment of a Board of Lease Appeals, an independent board to hear appeals in disputes arising from the application of the Mining Code. This Article read as follows:

There shall be established pursuant to this Code an independent board for the appeal of disputes arising from the application of this Code, consisting of not less than three and not more than five members to be chosen, regardless of nationality, from eminent and highly reputable jurists and judges experienced in international law and in problems relating to leases. The members of the board shall not be called to account civilly or criminally except in accordance with rules to be prescribed by a special law...

This Article applies exclusively to mining; moreover Article 2(a) excludes petroleum, natural gas, and derivatives thereof, and Article 2(b) excludes pearls, corals, and similar substances from the scope of its jurisdiction.

Despite these exclusions, several oil concession agreements concluded by the Government of Saudi Arabia provide for the jurisdiction of the Board of Lease Appeals. For example, two concession agreements were concluded between the Government of Saudi Arabia, and General Petroleum and Mineral Organization "Petromin", a public organization under the laws of Saudi Arabia in 1387 A.H. corresponding to 1967. These were concluded for the purpose of discovering and producing hydrocarbons, including petroleum, natural gas, asphalt and any other petroleum products, by-products, and derivatives in the Red Sea

and Empty Quarter areas. Article 54 of both agreements prohibits that the Board of Lease Appeals is to constitute a forum for any dispute which might arise. It states:

Article 54

If any doubt, difference or dispute shall arise between the Government and PETROMIN concerning the interpretation or the performance of this Agreement or anything herein contained or in connection herewith, or the rights and liabilities of PETROMIN, and failing any agreement to settle it by any other method, the doubt, difference or dispute shall be submitted to the Board of Concession Appeals provided for in Article 50²¹ of the Saudi Arabian Mining Code.

If and when an international court is created for the settlement of controversies arising from Middle Eastern Oil Concessions, PETROMIN and the Government shall examine together the possibilities of substituting that court for the above mentioned Board of Concession Appeals.

Further the Concession Agreement between Saudi Arabia and the French Company Auxrab in 1384 AH corresponding to 1965, provided in Article 63 that the Board of Lease Appeals would provide a forum for any dispute which might arise:

...If no agreement is reached by the Committee of Experts, the parties shall submit the doubt, difference or dispute to the Board of Concession Appeals provided for in Article (55) of the Saudi Arabian Mining Code...

This suggests that the jurisdiction of the Board extends to petroleum concession agreements with foreign companies, because there is no provision that prevents the parties to a concession agreement from agreeing to submit their disputes to the Board.

6. Conclusion

Oil exporting countries as a consequence of their membership of OPEC and OAPEC have proposed or established forums to submit disputes which may arise between member governments and foreign petroleum companies, and between member countries themselves. The OPEC High Court has not yet been established, but OAPEC has established its Judicial Board and a number of cases have been brought before it. Saudi Arabia also has a Board of Lease Appeals. Although this Board was established to provide jurisdiction for mining disputes, there is no provision to prevent it exercising similar jurisdiction on disputes between the government and foreign oil companies which may be submitted to it.

A consequence of the development of OPEC and OAPEC is that the interests of oil producing States can be protected from the threat of interference from more powerful states with interests in oil companies operating in their territory. This protection ensures that another country's law will not be used in disputes between the company and the member State.

CHAPTER 4

LIMITATIONS ON CHOICE OF LAW AND CHOICE OF FORUM

1. Introduction

As we have seen, a basic principle of conflict of laws is the freedom of the parties to choose the law to govern their contract. Under both civil law and common law, the principle of party autonomy, with limitations in certain cases, is recognized. This principle is also generally reflected in international conventions dealing with this area. But there are several provisions in these conventions which allow exceptions to the rule of freedom of choice by allowing the application of mandatory rules.

Further, in commercial contracts the parties may designate a forum as the exclusive forum to deal with any dispute which may arise between them. These clauses are very common in international contracts and may or may not be combined with a choice of law clause.¹ There are also, however, certain limitations on the ability of parties to choose their forum, recognized by international conventions.

In this chapter I will discuss the possible limitations on choice of law and forum, with special reference to the choice of law governing oil concessions, and various limitations on choice of forum as they apply to oil exporting countries.

1 C Noles, "Enforcement of forum selection agreements in contracts between unequal parties" *Ga J Intl & Comp L* 11 (1981) 693.

2. Limitations on Freedom of Choice of Law

(1) Treaties Guaranteeing Choice of Law

(a) Mandatory rules

(i) Definition

Mandatory rules have developed from the perceived need for State intervention for three reasons, first, to protect the weaker party to a contract in domestic law, second, to protect the social and economic interests of the State, and third, to impose internationally agreed standards in respect of particular contracts. In particular, the second of these processes has led to the need to define mandatory rules in international contracts and the role they should play.²

Article 3(3) of the EEC Convention on the Law applicable to Contractual Obligations of 19 June 1980³ defines mandatory rules as "rules of law of a country which cannot be derogated from by contract". Article 3(3) provides that...

The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign tribunal, shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called "mandatory rules".

North states that:

Article 3(3) allows the parties to choose the law of any country but, if all the elements of the contract are connected with one country, the choice of the law of a second country is not to prejudice the application of the mandatory rules of the first country. The objective is clear: the parties cannot evade the application of any of the mandatory rules of their domestic law by a choice of law clause. "Mandatory rules" has, and rightly

2 C McLachlan, "The New Hague Sales Convention and the Limits of the Choice of Law Process" *LQR* 102 (1986) 620. See also AL Diamond, "Conflict of Laws in the EEC", *Current Legal Problems* 32 (1979) 155.

3 Opened for signature, 19 June 1980: 23 *OJ Eur Comm* (No L 266) 1 (1980).

has, a broad meaning extending to all domestic law which cannot be derogated from by contract.⁴

Common examples of mandatory rules are laws concerned with contracts of employment and some consumer contracts.⁵ The notion of mandatory rules is clearly designed to curtail the right of the parties to avoid state regulation by choosing some other law. However problems of implementation remain.⁶ MacLachlan has suggested that mandatory rules problems could be solved by the adoption of international standards (such as for example the use of international human rights standards) to define "public policy", in contexts such as cultural property, in discussions of legislative jurisdiction in economic law and in exchange control under the Bretton Woods agreement.⁷ As the EEC Convention provides, the forum's ability to apply mandatory rules of its own would not be impeded by its power to apply the mandatory rules of another state, although other exclusionary rules of the conflicts of law place limits on this power. Also, if a contract has a close connection with a third country and if there are mandatory rules in that contract, they may be applied by the judge, regardless of the law of the contract. *A fortiori* a consumer or employee should be protected by the laws of the country of sole connection.⁸

(ii) The Scope of Mandatory Rules.

Article 3(3) of EEC Convention applies to the rules of the law of a country with which all relevant elements of the situation at the time of the choice of law are connected. Article 7 (1) & (2) further provide:

(1) When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules,

4 PM North, "The EEC Convention on the Law Applicable to Contractual Obligations, 1980. Its History and Main Features" in PM North (ed), *Contract Conflicts* (1982) 18.

5 D Jackson, "Mandatory rules and Rules of Ordre Public" id, 65.

6 McLachlan, 626.

7 Ibid.

8 See M Wolff, "Some Observations on the Autonomy of Contracting Parties in the Conflict of Laws" *Trans Grotius Society* 35 (1949) 143, 147.

regard shall be had to their nature and purpose and to the consequences of their application or non application.

(2) Nothing in this Convention shall restrict the application of the rules of the law of the forum in a situation where they are mandatory irrespective of the law otherwise applicable to the contract.

In this regard, Article 7 creates various ways to avoid the application of some rules of the Convention under certain circumstances: it has been said that "in so doing [Article 7] adds to the flexibility of the Convention".⁹ But these provisions are not acceptable to some writers, as will be seen. Article 7 also concerns the application of the mandatory rules of a law other than *lex causae* under certain circumstances, where the courts have a discretion.

(iii) The Application of the Law of Closest Connection

The laws of another country may under the EEC Convention supersede those chosen by the contracting parties, where that legal system has a close connection with the contract.¹⁰ The precise nature of this connection has been debated, yet under Article 7(1) of the EEC Convention "there must be something more than a relatively minimal connection between the country of the rule and the situation when compared with that of the governing law".¹¹ Further the forum must consider this rule within the context of the case to determine if it is more applicable than the most closely connected law. The object of Article 7 is to take into account the community interest,¹² which the parties have already indicated their connection with through the elements of the transaction. Philip states that:

The principal condition for applying a rule of another law under paragraph (1) is that there is a close connection between the situation and the country to the law of which that rule belongs. Where the contracting parties themselves have chosen the applicable law and where that law is different from that which would have been applicable, failing any choice by the parties, the

9 A Philip, "Mandatory rules, public law (political rules) and choice of law in the EEC Convention" in North (1982) 81.

10 For further details, see chapter 2.

11 Jackson, 73.

12 Ibid.

latter law presents a close connection with the situation since the situation is most closely connected with that law. But even other laws may be given effect under paragraph (1), since a close connection may exist without the connection being the closest. Thus, where the applicable law is that with which the situation is most closely connected there may still be situations where another law may be applied under paragraph (1)...¹³

However, there have been many criticisms of Article 7, particularly on the basis that it creates uncertainty in a contract and that it requires four hypothetical conditions to be met (viz, that it must be connected with another country, that this country must have mandatory rules, these rules must purport to exclude the application of every other law and that this is justified by the special nature and purpose of these laws). More importantly, it creates even more complexity for judges in deciding which legal system is the most valid.¹⁴

(iv) Application of Mandatory Rules of Another Country

As we have seen Article 7(1) provides for the application of the mandatory rules of the law of another country with which the situation has a close connection. The rules which may be applied under this provision of this Convention are rules pertaining to any legal system, with which there is a close connection irrespective of the law otherwise applicable to the contract under Article 7(2).¹⁵ But the application of mandatory rules of another country is not new to English law. For example, in *Ralli Brothers v. Compania Naviera Sota y Aznar*, a Spanish ship was to carry jute from Calcutta to Barcelona at a freight of 50 pounds per ton. The contract was in English and contained a clause specifying that disputes were to be settled by arbitration in England under English law. However after the contract was signed, the Spanish government prohibited payment of freight of more than 10 pounds per ton. When the charterers tried to claim the balance of payment when they delivered the jute in Spain, they were refused. The Court of Appeal in England recognized the Spanish law and dismissed the claim for the balance.¹⁶

13 Philip, 103.

14 L Collins, "Contractual Obligations. The EEC Preliminary Draft Convention on Private International Law" *ICLQ* 25 (1976) 50-1.

15 Philip, 103.

16 [1920] 2 KB 287.

Similarly in *Regazzoni v. K.C. Sethia (1944) Ltd*, a contract for the sale of jute bags between an Indian seller and a European buyer was governed by English law, both parties contemplating that the jute should be shipped from India to Genoa for resale in South Africa. The seller repudiated the contract because the buyer intended to resell the jute bags in South Africa, although the export of jute bags from India to South Africa was prohibited under India law. The buyer claimed damages under English law which was the proper law of the contract, but the House of Lords gave effect to the Indian prohibition and refused to allow the claim.¹⁷

(v) Evaluation of Article 7 of the EEC Convention

It is evident that Article 7 is intended to prevent "forum shopping" as Courts are inclined to apply the directly applicable laws of their own country to cases within their jurisdiction. However as Lando notes, "Such rules have seldom been applied as 'immediately applicable' by the courts of foreign countries, and their application depends on where the action was brought".¹⁸ Thus by attempting to state the immediately applicable foreign laws the Convention attempts to create a more equal and uniform situation. Drobniġ similarly notes that:

First, States should mutually pay regard for each others interests, and second, citizens should not be exposed to contradictory rules... and the third principle... comes into play with regard to mandatory rules which aim at the protection of the weaker, or the less experienced, contracting party.¹⁹

On the other hand there have been some serious criticisms of the article - most notably by Mann,²⁰ who finds that its vague and imprecise nature contributes to uncertainty in the law and problems in practice. He states:

17 [1958] AC 301.

18 Ole Lando, "The Substantive Rules in the Conflict of Laws: Comparative Comments from the Law of Contracts" *Texas International Law Journal* 11 (1976) 521-2.

19 FA Mann, "Contracts Effect of Mandatory Rules" in K. Lipstein (ed) *Harmonization of Private International Law By the E.E.C.* (1978) 35.

20 *Id.*, 35-6.

It gives to the third country's law a far greater effect than to the proper law or the *lex fori*. For the third country's law to be operative "a significant link" is sufficient. For the proper law to apply there must be a real choice by the parties or a close and substantial connection. For the public policy of the forum to apply some elementary principle of justice or morality must be at stake.

In his view such a situation would "constitute the most serious obstacle to international trade. I doubt whether the Convention as a whole does anything to enhance the certainty of the law". He also points out that "there is no justice in the proposition that either party to a contract can demand the application of a law to which it has not submitted", and that defaulters would easily abuse the provision. The primary duty of the international legislature to prevent such consequences.

All that should be pointed out in connection with Article 7 is that, first, it treats this enormously complex and practical problem with less than the attention it deserves, and, second it enlarges the problem in the following way; the normal conflict is between the ordinary rules of private international law of State X, the State of the forum, which leads to the application of the law of State Y, on the one hand, and the public law of State X, which insists on the application of the internal law of State X. Article 7 enlarges this problem (perhaps in order to avoid charges of encouragement of forum shopping) by allowing the possible application not only of the public law of the forum but also of any of the public law of any State with which the contract is "connected".²¹

Fletcher argues that the lack of precision of the terms "close connection" and "situation", and the extent to which they prove to be uncertain, will encourage greater judicial subjectivity in the choice of law. Parties can no longer feel confident about which law will be applied to their case, nor will they be able properly to evaluate all the consequences of a legal agreement. There is also the problem of how to identify and classify mandatory rules.²²

It seems therefore that Article 7(1) has (probably unintentionally) created a sense of insecurity as to which law is to be used in deciding on a case,

21 Collins 51, and see FA Mann, "Statutes and the Conflict of Laws" *BYIL* 46 (1972-73) 117.
22 Ian F Fletcher, *Conflict of Laws and European Community Law* (1982) 170.

and would if applied give rise to that which it intended to prevent, a less equal and uniform environment in which contracts could be made.

(b) Limitations on Freedom of Choice of Law

The various international instruments dealing with this issue provide for a number of limitations on the freedom of the parties to choose the proper law of their agreement.

(i) The EEC Convention on the Law Applicable to Contractual Obligations of 1980

Article 1(1) of the EEC Convention of 1980 provides that:

This Convention shall apply to contractual obligations in any situation involving a choice between the laws of different countries.

That means that it applies whether the situation is international or of an internal nature. Article 3(1) of the Convention recognizes the freedom of choice of law by the parties to govern their contract:

A contract shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract.

There is no general limitation on the parties' choice in the Convention. Whatever limitations there are must be taken from expressed provisions of the Convention.²³ However, the freedom of the parties to choose the proper law to govern their contract is subject to several limitations under the Convention. These are as follows:

- (1) According to Article 1(3) the Convention does not apply to contracts of insurance which cover risks situated in the territories of the member states of EEC Convention. In order to determine whether a risk is situated in these territories the court must apply its internal law.
- (2) Article 3(3) provides that the choice of a law by the parties as the proper law of their contract is not to prejudice the application of mandatory rules of the law of the country to which the situation is closely connected, unless the situation has an international element.

The fact that the parties have chosen a foreign law, whether or not accompanied by the choice of a foreign Tribunal shall not where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of rules of the law of that country which cannot be derogated from by contract, hereinafter called "mandatory rules."

- (3) Article 5(2) makes a further exception for consumer contracts:

...a choice of law made by the parties shall not have the result of depriving the consumer of the protection afforded to him by the mandatory rules of the law of the country in which he has his habitual residence.

- (4) Article 6(1) provides that "in a contract of employment a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law which would be applicable to the contract in the absence of choice of law".
- (5) Article 7(1) provides that "when applying under this Convention, the law of a country effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract ...".

- (6) Article 9(6) makes further limited reference to mandatory rules:

A contract, the subject matter of which is a right in immovable property or a right to use immovable property shall be subject to the mandatory requirements of form of the law of the country where the property is situated if by that law those requirements are imposed irrespective of the country where the contract is concluded and irrespective of the law governing the contract.

- (7) Article 16 provides that "the application of a rule of the law of any country specified by this Convention may be refused only if such application is manifestly incompatible with the public policy (*ordre public*) of the forum". That means that public policy (*ordre public*) is outside the scope of the Convention.

From the foregoing survey, it seems that the general recognition of party autonomy and the other provisions in various countries regarding choice of law seems to have influenced States not to make any stipulations on choice of law or to prohibit particular choices of law in international treaties. As a practical matter, any such treaty stipulations restraining choice of law would destroy the flexibility and ease of carrying on trade and commercial co-operation between developed and developing countries with divergent legal systems, because commercial men should, otherwise than in exceptional cases, need to take advice only on one system of law before making their decision to enter into the transaction. Prior limitations on choice of law are not the place to solve difficult problems which may arise relative to a dispute.²⁴ Thus limitations on the choice of law decided on by the parties to a contract of international trade are probably unwarranted. Such stipulations could dilute the generally accepted principles of choice of law recognized under most legal systems, and would be prejudicial to the smooth conduct of international commercial transactions. On this ground Article 7(1) is unnecessary and detrimental to international contracts. As Vickers has stated, the principle of party autonomy can be supported for a number of reasons.

First, trade between nations is unlike a domestic transaction: in keeping with its international character, the regulation of trade and trade-related disputes should not be tied to one specific legal system. The legal system chosen should be the one best suited for each particular contract. Second, national courts often show a preference for their domestic law and could be biased in favour of nationals, discriminating against foreign parties... Third, a lack of trust by developed countries in the legal systems of developing countries, particularly where the systems are new leads to selection of the law of a developed nation.²⁵

(ii) The Hague Convention on the Law Applicable to Contracts for the International Sale of Goods 1985

It has been noted that in some respects the new Hague Sales Convention allows greater party autonomy than previously.²⁶ However, there remain limitations on this autonomy, as follows:

- (1) Article 1(b) covers those instances where the only reason for applying a foreign law is the stipulation by the parties in a contract. It states that the Convention shall not determine the law applicable to contracts of sale of goods where the need for a choice of law "arises solely from a stipulation by the parties as to the applicable law, even if accompanied by a choice of court or arbitration". Further the Convention limits the choice of law to the legal system of nations and does not accept the choice of non-national systems.
- (2) Article 17 provides that the laws of the forum must be applied regardless of the laws that would otherwise govern the contract. It provides that...

The Convention does not prevent the application of those provisions of the law of the forum that must be applied irrespective of the law that otherwise governs the contract.

25 AM Vickers, "The choice of law clause in contracts between Parties of Developing and Developed Nations" *Ga J Intl & Comp L* 11 (1981) 620-1.
 26 McLachlan, 603-604.

- (3) Article 18 provides that application of the Convention can be refused when it would be against public policy:²⁷

The application of a law determined by the Convention may be refused only where such application would be manifestly incompatible with public policy (*ordre public*).

- (4) Article 9 deals with specific areas, such as sales by auction or on a commodity, and accepts that the parties' choice of law is valid only in so far as the law of the place where it is located does not prohibit such a choice.
- (5) Article 8(1) states that sales contracts are to be governed by the law of the person who delivers the goods, that is the seller rather than the buyer,²⁸ unless "negotiations were conducted and the contract concluded by and in the presence of the parties in that buyer' State", "the contract provides expressly that the seller must perform his obligation to deliver the goods in that [the buyer's] State", or "the contract was concluded on terms determined mainly by the buyer, and in response to an invitation directed by the buyer to persons invited to bid".²⁹

(2) Prohibitions in Legislation and their Recognition by Courts and Arbitrations

The trend towards allowing parties unlimited choice of the governing law of their contract is, as I have noted, subject to certain limitations. A related problem involves national rules which prohibit two parties from entering into a contract at all, and thus raise the question of the legality of such a contract, if made. I will discuss such prohibitions and their recognition under the following headings:

- (1) Where the contract is contrary to public policy;
- (2) Where the contract is illegal by the law of the place of performance;
- (3) Where the contract is illegal by foreign legislation.

²⁷ Id, 604.

²⁸ Id, 605.

²⁹ Article 8 (2)(a), (b) & (c). See id, 606-7. See also EI Sykes & MC Pryles, *Australian Private International Law* (1991) 610-1.

It will be assumed that a contract cannot be made under a law that would declare it invalid (as distinct from merely unenforceable).

(a) Contracts Contrary to Public Policy

The legislation of most states embodies the notion of public policy.³⁰ This has been stated by Lord Diplock in the following terms:

English law accords to the parties to a contract a wide liberty to choose both the proper law and the curial law which is to be applicable to it ... The English Courts will give effect to their choice unless it would be contrary to public policy to do so.³¹

Similarly, according to Dicey and Morris:

It is a general principle of the conflict of laws that the courts of a country will not apply any foreign law if and in so far as its application would lead to results contrary to the fundamental principles of public policy of the *lex fori*... The English courts have given effect to this principle in the law of contract, e.g. by refusing to enforce contracts which are opposed to the general policy of English law.³²

Thus "No action lies in England upon a contract that infringes the distinctive public policy of English law, as the law of the forum".³³ It has been noted that conflict with English public policy is the essential criterion.³⁴ Thus English courts have refused to enforce contracts in restraint of trade,³⁵ contracts entered into under duress or coercion,³⁶ and contracts involving trading with an enemy, whatever their proper law.³⁷ They "will also regard as void any contract

30 J Prebble, "Choice of Law to Determine the Validity and Effect of Contracts. A Comparison of English and American Approaches to the Conflict of Laws" *Cornell LR* 58 (1973) 509. See also MG Paulsen & MI Sovern, "Public Policy in the Conflict of Laws" *Col.Law Review* 56 (1956) 969, 1003-4; E Rabel, *The Conflict of Laws. A Comparative Study* (1960) 551; JG Collier, *Conflict of Laws* (1987) 331.

31 *Compagnie Tunisienne de Navigation SA v. Compagnie d'Armement Maritime SA* [1971] AC 572, 603.

32 Dicey & Morris, *Conflict of Laws* (11th edn, 1987) 1226. See PS Smedresman, "Conflict of laws in International Commercial Arbitration: A Survey of Recent Developments", *California Western International Law Journal* 7 (1977) 341.

33 Cheshire, North & Fawcett, *Private International Law* (1987) 483.

34 *Ibid.*

35 *Rousillon v. Rousillon* [1880] 14 Ch D 351.

36 *Kaufman v Gerson* [1904] 1 KB 591.

37 *Robson v. Premier Oil & Pipeline Co.* [1915] 2 Ch 124, 136.

the recognition of which might constitute a hostile act against a foreign friendly government,³⁸ or those which conflict with currency regulations.³⁹ In the United States, the *Restatement, Second, Conflict of Laws* (1971) section 187(2)(b) states that the law chosen by the parties will not apply if it is against the public policy of the state with the greater material interest in the case. It goes on to state that "an express choice of law may be struck down by the forum as contrary to the public policy not merely of the forum, but possibly of some other State".⁴⁰

It does however appear unlikely that the public policy of other states would be given the same weight as the forum state. In England it has been stated that "no court applies the public policy of any country but its own".⁴¹ Yet, English courts do recognize other country's jurisdiction if to not do so would hamper good relations with foreign powers, or prejudice the interests of the United Kingdom. This can be seen in *Regazzoni v. K.C. Sethia (1944) Ltd.*⁴² Though English law was chosen to govern the transaction, it was noted that in referring to a friendly foreign country a basic principle of comity should be applied, and the contract declared illegal, as to enforce it would have violated a foreign law on foreign soil.⁴³ Public policy was also applied in *Golden Acres Ltd v. Queensland Estates Pty Ltd.*⁴⁴ Here the contractual choice of Hong Kong law was overruled by Hoare J, who saw it as contravening the terms of a Queensland Act (the Auctioneers, Real Estate Agents, Debt Collectors and Motor Dealers Act 1922 (Qld)). He held that the choice of law was an attempt to override the local law and was not "a *bona fide* selection".⁴⁵

(b) Contracts Illegal by the Proper Law.

For most purposes in English law, legality is governed by the proper law, so that for a contract to be enforced in England it must be legal according to the

38 *De Wutz v. Hendricks* [1824] 2 Bing 314. See *Regazzoni v. K.C. Sethia 1944 Ltd* [1958], AC 301 a case about Indian legislation which prevented the shipping of goods from India to South Africa, a case of the application of the mandatory rules of another country.

39 *Kahler v. Midland Bank Ltd* [1950] AC 24, 36.

40 Prebble, 512.

41 Dicey & Morris, 955. See also Prebble, 514.

42 [1958] AC 301.

43 Prebble, 514.

44 [1969] Qd R 378.

45 [1969] Qd R 378, 385.

proper law, whether or not it is legal by (domestic) English law. A contract illegal under the proper law will not be enforced even though it is legal in the place where it is made.⁴⁶ In *Kahler v. Midland Bank Ltd*, Lord Simonds remarked:

...the courts of this country will not compel the performance of a contract if by its proper law performance is illegal.⁴⁷

In *Re Helbert Wagg and Co. Ltd*,⁴⁸ the proper law of the contract was German, and a German law (made after the contract was entered into) stipulated that payments under a contract be made to a German public fund. This was upheld in England even though the contract stipulated the payment was to be in London. The argument that the German law in effect expropriated the debt was rejected.

In a Federal Court decision in Hamburg on the 22 June 1972 the German Court decided to uphold a Nigerian law prohibiting the sale of cultural objects. The court held the contract unenforceable "in the interest of maintaining proper standards for the international trade in cultural objects".⁴⁹ The case, between the German company seeking damages for the loss of six bronze statues and a Nigerian company, was seen by the court to contravene the UNESCO Convention on the Means of Prohibiting the Illicit Import, Export and Transfer of Ownership of Cultural Property.⁵⁰ This was not strictly speaking a case of the direct application of the Nigerian law as such. Instead the Nigerian law became relevant because the German Civil Code referred to public policy, and the UNESCO Convention was taken as a reflection of public policy.

46 RH Graveson, *The Conflict of Laws* (1974) 433-4.

47 [1950] AC 24, 27.

48 [1956] Ch 323.

49 *Federal Court Decision, Hamburg*, 22 June 1972: BGHZ, 59, 83; cited by McLachlan, 623-4.

50 *Ibid.*

(c) **Contracts Illegal Under Interstate or Foreign Legislation**

The Door to Door Sales Act 1971 (SA) attempts to protect the purchasers from door to door salesmen by limiting the kind of contracts such vendors can use. Specifically, it restricts the law of such contracts to South Australian law, and that the forum for the court must be in South Australia. Professor Kelly notes that:

... the South Australian provision is ineffective, at least in isolation, in ensuring the non-enforceability of an affected contract in an interstate forum.⁵¹

A contract concluded between Benteler, and the Belgian Steel Company *ABC* and the Belgian State concerning the industrial and financial restructuring by Benteler of the Company *ABC*, led to dispute between them. When Benteler took the Belgian State to arbitration as provided in the contract, the Belgian State used Article 1676 para (2) of the Belgium Judicial Code, which prohibits the state from concluding any agreement which authorised it to have recourse to arbitration. This article provides:

Except for legal persons of a public law character, anyone who has the capacity or competence to compromise may conclude an arbitration agreement. The State may conclude such agreement if a treaty authorises it to have recourse to arbitration.

In response Benteler quoted the European Convention on International Commercial Arbitration of 1961 to which Belgium had adhered. It stated:

1. In the cases referred to in art. 1 para 1 of this Convention, legal persons considered by the law which is applicable to them as 'legal persons of public law' have the right to conclude valid arbitration agreements.

2. On signing, ratifying or acceding to this Convention any State shall be entitled to declare that it limits the above faculty to such conditions as may be stated in its declaration.

In this case, the tribunal declared that Belgium was bound by the arbitration agreement. It did not agree that the issue was a commercial matter under Belgium domestic law nor was it international. Though Belgium had the capacity to enter into private law contracts containing arbitration clauses, it was under Belgian State jurisdiction able to conclude such an agreement. The validity of such national judicial codes in international forums is thus controversial.⁵²

The Unfair Contract Terms Act 1977 (UK) seeks to control the use of exemption clauses in many kinds of contract and to prevent the use of a proper law when the primary reason for the choice appears to be to avoid the provisions of the act. Section 27 (2) states that:

This Act has effect notwithstanding any contract term which applies or purports to apply the law of some country outside the United Kingdom, where (either or both):

- (a) the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this act; or
- (b) in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf.

The intention is to prevent the parties to a contract, which is most closely connected with the United Kingdom, from contracting out of the controls of the 1977 Act by a choice of the law of a country other than the United Kingdom.⁵³ The controls of the 1977 Act do not apply where the proper law which has been chosen by the parties is the law of the United Kingdom⁵⁴ or to an "international supply contract".⁵⁵ The 1977 Act does not seek to prevent the choice of a foreign law, but it could be used to invalidate its choice.⁵⁶

52 (1985) *10 Year Book of Commercial Arbitration* 37.
 53 Cheshire, North & Fawcett, 469.
 54 *Unfair Contract Terms Act 1977 (UK)* ss27(1).
 55 s26.
 56 Cheshire, North & Fawcett, 469.

3. Limitations on Choice of Forum

(1) Various International Aspects

The parties to a commercial contract may stipulate that the forum of a specified foreign country shall be the exclusive forum for litigation arising under their contract, i.e. that they will litigate such dispute only in that forum.⁵⁷ However, there are various international limitations on such a choice of forum.

(a) International Conventions

(i) The Hague Convention on the Choice of Court of 1964

The Hague Convention on the Choice of Court was approved by the Tenth Session of the Hague Conference on Private International Law in 1964.⁵⁸ It has had a strong influence in achieving the acceptance of the idea that the choice of forum is valid unless there are reasonable grounds to deny its validity. The Hague Convention accepts that choice of forum provisions are valid both in prorogative and derogative senses.⁵⁹ It stipulates that it applies only in civil and commercial matters and not to areas traditionally subject to local jurisdiction, such as family law maintenance obligations, succession, bankruptcy and disputes over immovable property. Article (2) provides:

This Convention shall apply to agreements on the choice of court concluded in civil or commercial matters in situations having an international character.

It shall not apply to agreements on the choice of court concluded in the following matters:

- (1) The status or capacity of persons or questions of family law including the personal or financial rights or obligations between parents and children or between spouses.

57 M Gruson, "Forum-selection Clauses in International and Interstate Commercial Agreements" *University of Illinois Law Review* 1 (1982) 134. Forum selection clauses are sometimes called choice of forum or prorogation agreements. See J McKnight, "Freedom of contract-forum selection clause" *Arkansas Law Review* 27 (1973) 539; A Lenhoff, "The Parties' Choice of a Forum: Prorogation Agreements" *Rutgers L Review* 15 (1961) 414.

58 *ILM* 4 [1965] 348-9.

59 JT Gilbert, "Choice of Forum Clauses in International and Interstate Contracts" *Kentucky Law Journal* 65 (1976) 29.

- (2) Maintenance obligations not included in the first sub-paragraph.
- (3) Questions of succession.
- (4) Questions of bankruptcy, compositions or analogous proceedings, including decisions which may result therefrom and which relate to the validity of the acts of the debtor.
- (5) Rights in immovable property.

Article 4 provides that the forum agreement is void or voidable in case the choice of court is in the circumstances not fair and reasonable:

... the agreement on the choice of court shall be void or voidable if it has been obtained by an abuse of economic power or other unfair means.

As Professor Reese states, this provision would act as an "essential safety valve", as it would be impossible to predict the different kinds of situations which could arise.⁶⁰ Article 6 also provides:

Every court other than the chosen court or courts shall decline jurisdiction except:

- (1) Where the choice of court made by the parties is not exclusive,
- (2) Where under the internal law of the State of the excluded court, the parties were unable, because of the subject-matter, to agree to exclude the jurisdiction of the courts of that State,
- (3) Where the agreement on the choice of court is void or voidable in the sense of Article 4,
- (4) For the purpose of provisional or protective measures.

This is significant as it indicates a growing acceptance that choice of forum clauses are valid and will be enforced, in the absence of overriding arguments to the contrary.⁶¹

Articles 12-15 outline the reservations a State may impose on freedom of the choice of forum. Article 12 provides:

60 WM Reese, "A Proposed Uniform Choice of Forum Act" *Columbia Journal of International Law* 5 (1966) 193, 204.

61 Gilbert, 30.

Any contracting State may reserve the right not to recognise agreements on the choice of court concluded between persons who, at the time of the conclusion of such agreements, were its nationals and had their habitual residence in its territory.

Article 13 provides:

Any contracting State may make a reservation according to the terms of which it will treat as an internal matter the juridical relations established in its territory between, on the one hand, physical or juridical persons who are there and, on the other hand, establishments registered on local registers, even if such establishments are branches, agencies or other representative of foreign firms in the territory in question.

Article 14 provides:

Any contracting State may make a reservation according to the terms of which it may extend its exclusive jurisdiction to the juridical relations established in its territory between, on the one hand, physical or juridical persons who are there and on the other hand establishments registered on local registers, even if such establishments are branches, agencies or other representatives of foreign firms in the territory in question.

And Article 15 provides:

Any contracting State may reserve the right not to recognise agreements on the choice of court if the dispute has no connection with the chosen court, or if, in the circumstances, it would be seriously inconvenient for the matter to be dealt with by the chosen court.⁶²

This Convention is intended to give effect to three principles. First, it validates the agreement of the parties on the choice of a court within the scope of the Convention. The second main principle concerns the effects of the agreement of the parties and is embodied in Articles 5, 6, and 15. The third is to ensure the recognition and enforcement abroad of judgments of the chosen court.

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See further RH Graveson, "The Tenth Session of the Hague Conference of Private International Law" *ICLQ* 14 (1965) 541.

(ii) The EEC Convention on Jurisdiction and the Enforcement of Civil and Commercial Judgments, 1968

On 27 September 1968 the EEC signed a Convention on Jurisdiction and the Enforcement of Civil and Commercial Judgments. It does not entirely exclude the various national laws of the member countries. Under Article 16, if a state's laws claim sole jurisdiction then this right cannot be removed by contract. Further, an agreement is null and void if it contravenes Article 12 and 15.⁶³

(iii) The American Convention on Private International Law (Bustamante Code) 1928

In 1928 the American Convention on Private International Law was ratified by some Latin American countries. This is known as the Bustamante Code and provides for choice of forum providing "...that one of them at least is a national of the contracting state to which the judge belongs ... unless local law is to the contrary".⁶⁴ Pryles comments that "This could be taken to require suit in the chosen forum to the exclusion of other courts". He adds "Some support for this view is found in Article 321 which defines an express submission as 'the submission made by the interested parties by clearly and conclusively renouncing their own court'..."⁶⁵

(b) The Model Choice of Forum Act 1968 (USA)

The Model Choice of Forum Act was approved in 1968 by the National Conference of Commissioners on Uniform State Laws in the United States.⁶⁶ This Act, though influenced by the Hague Convention, allows judges more discretion in deciding whether to uphold the choice of forum clause.

63 Ibid. See further M Pryles & FA Trindade, "The Common Market Convention on Jurisdiction and the Enforcement of Judgments" *ALJ* 48 (1974) 185.

64 M Pryles, "Comparative Aspects of Prorogation and Arbitration Agreements" *ICLQ* 25 (1976) 573.

65 Ibid. See also MA Schwind, "Derogation clauses in Latin-American Law" *AJCL* 13 (1964) 172.

66 WM Reese, "The model choice of forum Act" *AJCL* 17 (1969) 292. Also WM Reese, "The Contractual Forum situation in the United States" *AJCL* 13 (1964) 187, 192.

Section 2 (Action in this state by agreement) provides:

- (a) If the parties have agreed in writing that an action on a controversy may be brought in this State and the agreement provides the only basis for the exercise of jurisdiction, a court of this State will entertain the action if:
- (1) The court has power under the law of this State to entertain the action;
 - (2) This State is a reasonably convenient place for the trial of the action;
 - (3) The agreement as to the place of the action was not obtained by misrepresentation, duress, the abuse of economic power, or other unconscionable means; and
 - (4) The defendant, if within the State, was served as required by law of this State in the case of persons within the State or, if without the State, was served either personally or by registered (or certified) mail directed to his last known address.

Sub-section (b) exempts certain clauses, including especially arbitration clauses, as well as the appointment of an agent for the service of process pursuant to statute or court order.

Although effect should be given to a choice of forum subject to the various exceptions set out, the model Act leaves a non-selected court in which proceedings have been commenced free, within broad limits, to determine whether to dismiss or stay the action. Section 3 provides:

If the parties have agreed in writing that an action shall on a controversy be brought only in another State and it is brought in a court of this State, the court will dismiss or stay the action, as appropriate, unless

- (1) The court is required by statute to entertain the action;
- (2) The plaintiff cannot secure effective relief in the other State, for reasons other than delay in bringing the action;
- (3) The other State would be a substantially less convenient place for the trial of the action than this State;
- (4) The agreement as to the place of the action was obtained by misrepresentation, duress, the abuse of economic power, or other unconscionable means; or
- (5) It would for some other reason be unfair or unreasonable to enforce the agreement.

The decision of the Supreme Court in *Bremen v. Zapata Off-shore Co.*⁶⁷ should be seen against the background of the Model Choice of Forum Act, whose standards it substantially applied. A contract between an American corporation and a German ocean-tug company, to tow an oil rig from the United States to Ravenna, Italy, stated that "any disputes arising must be treated before the London Court of Justice". Neither party to the towage contract had any connection to England. The United States Supreme Court declared that the forum selection clause was binding and Zapata's attempt to have the case heard in the United States failed. The Court held that the forum selection clause must be applied "unless Zapata could meet the heavy burden of showing that a trial in the United States district court in Tampa, Florida, would be much more convenient and that a trial in London would deprive Zapata of a meaningful day in court".⁶⁸ It stressed that the chosen forum was neutral, that the choice of forum clause had been freely negotiated between experienced businessman and was not an instance of using overweening bargaining power, and that there was no evidence of undue influence or fraud.⁶⁹ The Supreme Court was clearly motivated by a desire to create contract security for businesses engaged in international trade.⁷⁰

67 407 US 1 [1972]. See further L Collins, "Forum Selection and an Anglo-American Conflict" *ICLQ* 20 (1971) 550; Reese in his comment on this case, *International Lawyer* 7 (1973) 530; GR Delaume, "Choice of Forum Clauses and the American Forum" *JMLC* 4 (1973) 295; K Nadelmann, "Choice of Court Clauses in the United States" *AJCL* 21 (1973) 124.

68 Gruson, 148. See also IM Farquharson, "Choice of Forum Clauses. A Brief Survey of Anglo-American Law" *International Lawyer* 8 (1974) 97. This case was brought in admiralty but the Supreme Court implied that the decision should not be limited to admiralty. The Court strongly affirmed that choice of forum clauses should be given effect in all situations by positively stating that the case should be read in conjunction with *National Equipment Rental Ltd v. Szukhent* 375 US 311 [1964].

69 Gilbert, 27.

70 A case in which a choice of forum agreement was not given effect because it was "clearly and probably unreasonable" is *Calzavara v. Biehl & Co.* 181 SO 2d 809 (La App 1966). In that case, "the Court ignored a contract provision purporting to give an Italian Court exclusive jurisdiction over an action by Louisiana resident against a Louisiana Corporation": WM Reese & M Rosenberg, *Conflict of Laws* (1971) 213.

(c) *The Restatement (Second), Conflict of Laws, section 80 (1971)*⁷¹

The Restatement directs the court to give effect to a choice of forum clause if the choice is fair and reasonable.⁷² However it provides:

The parties agreement as to the place of the action cannot oust a State of judicial jurisdiction, but such an agreement will be given effect unless it is unfair or unreasonable.

This rule demands that a party breaching the choice of forum clause show why it should not be enforced. This proof would be either that the choice of forum clause was not part of the contract or that it was "unfair or unreasonable".⁷³

4. Conclusion

It appears that the freedom of the parties to choose the proper law to govern their contract has been widely recognized, but with certain limitations on their choice under international conventions. Further, the parties have the freedom to choose a forum to be the exclusive forum for any litigation subsequently arising between them, so that they will litigate such disputes only in that forum. Again certain limitations on the parties' autonomy are recognized by international conventions, such as the EEC Convention applicable to Contractual Obligations, 1980. This, as we have seen, allowed for effect to be given to the mandatory rules of countries which have a close connection with the case. But the view has been expressed that these provisions may create a less secure environment for international trade.

71 Restatement of Conflict of Laws (1934) 617. Comment (a) states: "the parties to a contract may provide that all actions for breach of the contract shall be brought only in a certain court, and the courts of other States will usually give effect to such a provision; but the requirement can be imposed only by consent of the parties and as a term of a contract. If the parties agree, it is not like the case of one State prescribing by its statute what the courts of another State may do." But the *Restatement of Contracts* (1932) 558 is much more restrictive: "A bargain to forego a privilege, that otherwise would exist, to litigate in a federal court rather than in a State court, or in a State court rather than in a federal court, or otherwise to limit unreasonably the tribunal to which resort may be had for the enforcement of a possible future right of action ... is illegal." See Gruson, 145.

72 *Restatement (Second) of Conflict of Laws* (1971) ss80.

73 JM Reilly, "Enforceability of "Choice of Forum" Clauses" *California Western Law Review* 8 (1972) 333.

The new Hague Sales Convention of 1985 is said to give greater autonomy in choice of law than previous conventions, though important limitations remain, in particular a reiteration of the public policy limitation (Article 18). Further, Article 1(6) states that the stipulation of the parties cannot be the sole reason for the choice of law, and it recognizes certain overriding powers to the law of the forum (Article 17). It also makes provision for consumer contracts designed to protect the buyer: Article 9 limits such contracts to those which do not conflict with the law of the place where the article is located.

There are also legislative restrictions on the parties to certain kinds of contracts to apply any law they choose. These include: (1) where the contract is contrary to public policy; (2) where the contract is illegal by the law of the place of performance; (3) in certain cases, where the contract is illegal by foreign or interstate legislation. Both courts and arbitral tribunals have recognized such prohibitions in legislation.

So far as limitations on choice of forum are concerned, again the general position is one of freedom of contract, but subject to various overriding limitations. This position is reflected in the Hague Convention on the Choice of Court in 1964, in the United States Model Choice of Forum Act, approved in 1968 by the National Conference of Commissioners,⁷⁴ and in the *Restatement Second, Conflict of Laws* (1971).

CHAPTER 5

THE LAW GOVERNING OIL CONCESSION AGREEMENTS

1. Introduction

In Chapter 2 we have seen that the parties of the contract are free as a rule to choose the law or legal principles to govern their contract. In Chapter 4 we saw that this freedom is not absolute but there are limitations on their choice. Apart from the case of an express choice of law by the parties, various laws and legal principles have been suggested as being applicable to govern the relation of the parties but there is no consensus on this matter.

In a contract between a State and a private party private companies believe that a contract might be against its interests if it were to be subject to State law. However, indicating this too explicitly could force the state to demand its own law. Conversely, governments particularly of Third World nations have been anxious that these contracts (affecting the development of their State) proceed smoothly, and for this reason have been reluctant to demand the State's law as the law of the contract. For this reason, there is a tendency to use an "oblique and indirect" approach to the choice of law in such contracts in most cases, except in cases where the lender is in a notably more powerful position.¹

However, a great body of opinion respects the right of parties to a contract to select for themselves the law appropriate to their contract as both parties have a motive of self-interest, and it is unlikely they would exercise this choice in a capricious way. Further, even where the chosen system is quite unconnected to the contracting parties it is reasonable to see this as the combined desire to use a neutral and experienced forum "such as the system referred to in the standard form contracts of the particular trade".²

1 JF Lalive, "Contracts Between a State or a State Agency and a Foreign Company" *ICLQ* 13 (1964) 992.

2 A.E. Anton, *Private International Law* (2nd edn 1990) 264.

Furthermore, the choice of non-national law may be adopted where there is no express choice of law by the parties, and when the court or arbitral tribunal rule that the proper law can be inferred from the circumstances surrounding the contract, or may be adopted by the contracting state or when the national law is subject to exclusion.

In this chapter I will analyse what has been suggested with respect to the applicable law, in its application to state contracts or concession agreements. Then I will discuss other laws applicable to govern oil concession agreements, and in particular the choice of non-national law as the proper law to govern oil concession agreements. I will discuss these issues with respect to oil concession agreements under four aspects -- juristic opinions, the provisions of concession agreements, state laws and the decisions of arbitration tribunals.

2. The Law Applicable to Oil Concession Agreements

As a result of increasing contact among states and because of expanded trade, economic transactions and exploration of natural resources, agreements concluded between a state and foreign oil companies have aroused a great deal of interest and controversy. Much debate has emerged about the applicable law which should govern the agreement, and the ways to resolve any dispute which may arise.

Various laws and legal principles have been suggested as applicable to oil concession agreements in the absence of a choice of proper law by the parties. These include the *lex contractus*, national law, the general principles of law, and international law itself. I will discuss each of these, before suggesting a solution.

(1) The *Lex Contractus*

It has been suggested that the terms and conditions of international contracts such as oil concession agreements, create the law of their relationship between the parties, and that the binding effect of these terms and conditions should accordingly be recognized by every legal system. In certain legislation it has even been declared that a contract is to be the law between the parties. The

"*Majallah*", the Ottoman Civil Code, recognized this principle, and was embodied in all the civil codes of Arab countries.³

Islamic Shari'ah provides that "the contract is the law of the contracting parties" on condition it does not contravene the rules of the Islam. Similarly, the principle enunciated by Article 1134 of the French Civil Code is that "*les conventions légalement formées tiennent lieu de loi à ceux qui les ont faites.*"⁴

In Carlston's view, a typical oil concession agreement in the Middle East "becomes the fundamental or constitutive law of the joint enterprise of the government and the concessionaire."⁵ Similarly, in the arbitration between the *Government of Saudi Arabia and Aramco*, the arbitration tribunal held that "The concession agreement is thus the fundamental law of the parties..."⁶

In the view of Verdross and Bourquin, the economic development agreement creates as the *lex contractus* "an independent legal order regulating the relationship between the parties." They refer to the economic development agreement as a "quasi-international agreement."⁷ Verdross stated:

...the *lex contractus*, created by a *quasi-international* agreement is an independent legal order, regulating the relation between the parties exhaustively. Naturally, the *lex contractus* may refer, for its interpretation or the filling up of eventual gaps, to the legal order of the contracting State, or of the other party, or to international law. But these legal orders can only be applied inasmuch as they are delegated by the *lex contractus*, because it is the latter which, in a sovereign way, stipulates the mutual rights and duties of the parties.⁸

Whether a contract can be governed simply by its own *lex contractus* is, however, a matter of controversy. The primary difficulty appears to exist in the operation of the agreement rather than its creation,⁹ which has led a number of

3 H Cattan, *The Law of Oil Concessions in the Middle East and North Africa* (1967), 33.

4 Ibid.

5 KS Carlston, "International Role of Concession Agreements" *Northwestern University Law Review* 52 (1957) 636.

6 *ILR* 27 (1963) 168.

7 Lalive, 997.

8 A. Verdross, *Quasi-International Agreement*, *Year Book of World Affairs* 22 (1964), 230.

9 Cattan, 37.

writers to conclude that it is impossible for a contract to exist independently of a legal system. As Lord McNair said:

It is often said that the parties to a contract make their own law, and it is, of course, true that, subject to the rules of public policy and *ordre public*, the parties are free to agree upon such terms as they may choose. Nevertheless, agreements that are intended to have a legal operation (as opposed to a merely social operation) create legal rights and duties, and legal rights and duties cannot exist in a vacuum but must have a place within a legal system which is available for dealing with such questions as the validity, application and interpretation of contracts and, generally, for supplementing their express provisions. Often such contracts may give some indication of the legal system within which they, or some part of their provisions, are intended to operate...¹⁰

Mann has argued trenchantly that it is untenable to have any legal relationship outside a legal system, and that it is impossible for a contract to exhaustively regulate the relationship of the parties in a contract. He said "contracts are written against the background of a system of law, its *jus cogens*, its rules of construction and so forth."¹¹ The same view is taken by Lalive:

This theory, however, is not satisfactory, it appears artificial and begs the question. A contract must be inserted in a pre-existing legal order and cannot remain in a vacuum. This order should be clearly defined or, at least, ascertainable by way of legal or judicial interpretation.¹²

The *Aramco Arbitration Tribunal* in 1958 stated:

It is obvious that no contract exists *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

10 Lord McNair, *The General Principles of Law Recognized by Civilized Nations*, *BYIL* 33 (1957) 7.

11 FA Mann, *The Proper Law of Contracts Concluded by International Persons*, *BYIL*, 35 (1959), 49, 50 and see, his "The Proper Law in the Conflict of Laws" *ICLQ* 36 (1987), 437.

12 Lalive, 998.

parties. The contract cannot even be conceived without a system of law under which it is created.¹³

(2) National Law

Some have argued that the national law or municipal law of the contracting state is necessarily or at least presumptively applicable to an oil concession agreement concluded between the State and foreign oil company. Host-states prefer to apply their own law to resolve any dispute which arises between one of them and a private foreign company. They believe this for the following reasons.

- (1) Since the State is a party to the agreement as grantor of the concession it should apply its law under principles of *lex loci contractus*, "the law of the place of the contract".
- (2) Since oil resources are within the territory of the State and under its proprietary rights, the national law under the principle of "*lex loci rei sitae*", the law of the place where the thing is situated, should apply.
- (3) Since the "*lex loci solutionis*", the place of performance, is within the territory of the State, the national law should apply.¹⁴

This principle was confirmed by the General Assembly of United Nations Resolution 2158 (XXI) of 25 November 1966 which provides:

That the exploitation of natural resources in each country shall always be conducted in accordance with its national laws and regulations.¹⁵

But the same view has been expressed for much longer than that: it goes back at least to the judgment of the Permanent Court of International Justice in the

13 *Arbitration between Saudi Arabia Government and Aramco* (1958) (special publication), 5 quoted by Lalive, 998.

14 McNair, 5.

15 United Nations General Assembly Resolution 2158 (XXI).

Serbian and Brazilian Loans Cases.¹⁶ This point was conceded in the *Aramco Arbitration* (1958), where it was stated that:

The law in force in Saudi Arabia should also be applied to the content of the concession because this State is a party to the agreement, as grantor, and because it is generally admitted, in private international law, that a sovereign State is presumed, unless the contrary is proved, to have subjected its undertakings to its own legal system. This principle was mentioned by the Permanent Court of International Justice in its judgments of July 12, 1929 concerning the *Serbian* and *Brazilian* loans...¹⁷

In spite of these views, which would appear axiomatic, there are several writers and jurists who hold contrary opinions. The British House of Lords and the French Court of Cassation have rejected the idea that there is a particular presumption which may apply to contracts concluded between a State and a foreign party.

In *R v. International Trustee for the Protection of Bond Holders AG*, a case which arose upon a gold loan issued by the British government in New York in 1917, the House of Lords rejected English law as the proper law of the contract and stated:

It appears therefore that in every case whether a government be a party or not the general principle which determines the proper law of the contract is the same: it depends upon the intention of the parties either expressed in the contract or to be inferred from the terms of the contract and the surrounding circumstances ... that a government as a party is entitled to great weight in drawing the appropriate inference, but it is not conclusive and is only one factor in the problem.¹⁸

The French Court of Cassation has also reached the same conclusion:

The law applicable to contracts, whether with regard to their formation or whether with regard to their effects and conditions, is that which is adopted by the parties. This principle applies to

16 *P.C.I.J.* Series A No 20 (1929), 42.

17 *ILR* 27 (1963) 167.

18 [1937] *AC* 500-531. See also FA Mann, *Studies in International Law* (1973), 221; Lalive, 993, 994.

contracts concluded between a State and a foreign national when such contracts, both by their nature and the form in which they were made, fall within the category of agreements of private law which can be assimilated to those concluded between individuals.¹⁹

From the foregoing discussion it would appear that a contract concluded between a State and foreign element is not always submitted to a State's own national law.

(3) The General Principles of Law Recognized by Civilized Nations

According to Article 38(1)(c) of the Statute of the International Court of Justice, the general principles of law recognized by civilized nations constitute one of the sources of international law as applied by it.²⁰ In part by derivation from this sub-clause, reference is often made to "transnational law",²¹ a "common law of nations",²² "a modern law of nature",²³ "general principles of law" or principles of natural law and equity²⁴ or of "mutual good will and good faith".²⁵ Cattan prefers "to retain the designation made of these principles in international conventions and State contract as 'the general principles of law recognised by civilized nations' or, more simply 'the general principles of law'."²⁶

19 Translation from Cassation, *Ch. Civile*, 31 May 1932, D 1933, I 169-S-1933. 1.17, quoted by Cattan, 41. See also Lalive, 993.

20 RB Schlesinger, *Research on the General Principles of Law Recognized by Civilized Nations*, *AJIL*, 51 (1957), 734; Bin Cheng, *General Principles of Law as Applied by International Courts & Tribunals* (1987); JN Hazard, *The General Principles of Law*, *AJIL*, 52 (1958), 91; G Herczegh, *General Principles of Law and the International Legal Order* (1969), 39; D Suratgar, *Considerations Affecting Choice of Law Clauses in Contracts Between Governments and Foreign Nations*, *Indian Journal of International Law* 2 (1962), 273.

21 PC Jessup, *Transnational Law* (1956).

22 Described as the "droit commun des nations" by P Fouchard, *L'Arbitrage Commercial International*, vol. II, 445, quoted by Cattan, 62.

23 *ICLQ* 1 (1952), 247.

24 Schlesinger, 742.

25 These principles as used in international oil concession agreements mean "general principles of law recognised by civilized nations". This would appear from such international arbitral precedents as the *Lena Goldfields Arbitration*, *Abu Dhabi case*, and the *Qatar case*. See further RK Ramazani, *Choice of Law, Problems and International Oil Contracts*, A Case Study, *ICLQ*, 11 (1962), 511.

26 Cattan, 62.

There are many opinions to the effect that this designation is antiquated.²⁷ Since 1945 the Permanent Court has been replaced by the International Court of Justice, and many new States have gained their independence. Now more than 163 States are members of the United Nations. The question is: do not all of these States have legal systems applicable or which qualify them for application under Article 38(1)(c)?

Harris criticizes the expression "civilized nations" and prefers the expression "the general principles recognized in the legal system of independent States".²⁸ I share this opinion. The phrase "civilized nations" evolved in the colonial era of the 19th century to refer to those nations, especially European, which were colonizing powers. It is in this century antiquated and contrary to the notion of sovereign equality. Further, it has connotations that link it primarily or even exclusively to expanding capitalistic societies, and which do not embrace the socialist and developing nations of the 20th century. The expression "the general principles recognized by the legal systems of independent States" more adequately describes the reality of nations forming sovereign States irrespective of their political systems and the stage of their economic development.²⁹

Differences of opinion arise over whether general principles of law exist independently of any other legal system or whether they are merely a source of international law as is indicated by Article 38(1)(c) of the Statute. Traditionally, they have been perceived as deriving from the municipal law of States and filling in the gaps of international law.³⁰ In practice there is often an assumption in international agreements and arbitration cases that the general principles of law are a source of international law, but not more. Some have taken it for granted that "general principles of law belong to international law and are to be equiparated to general principles of international law".³¹

Referring to the Oil Concession Agreement between *Iran and Pan American International Oil Company* of 1958, Ramazani stated:

27 DJ Harris, *Cases and Material on International Law* (4th edn 1991) 48-50.

28 Ibid.

29 Herczegh, 39.

30 I Brownlie, *Principles of Public International Law* (4th edn, 1990) 15, 17; G. Schwarzenberger, ED Brown, *A Manual of International Law* (6th edn, 1976) 27.

31 Lalive, 1000.

Thus, it may be submitted, Iran and Pan American International Oil Company by making express reference to the "principles of good will and good faith" have intended to apply "the general principles of law recognized in civilized nations" to their contract. Article 38 paragraph 1(c) of the Statute of the International Court of Justice (Article 38, paragraph 3 of the old Statute) has made these principles a source of public international law. Hence, Iran and Pan-American International Oil Company would seem to have intended to apply public international law in that sense as well.³²

However, there is now a question as to whether the general principles of law are to be seen as the sources of international law exclusively or whether they are common to all legal systems including municipal law.

The current consensus of opinion is that general principles of law are common to all systems of law including international law and municipal law.³³ These principles may be applied in the case of the absence of the choice of the parties even without intention of the contract parties. They will be gathered from provisions of the contract or the circumstances surrounding the contract by the court or arbitration tribunal in case of dispute. Many of the recent oil concession agreements and petroleum laws provided expressly or implied the application of these principles, as we will see.

(a) The Definition of These Principles in Accordance with Jurists' Opinions

There is no accepted definition of the general principles of law, but only a variety of opinions. Lord McNair asked the following question: what are the general principles of law recognized by civilized nations? He replied to his question: "I do not propose to prepare a list of the rules of law likely to be recognized as general principles".³⁴ He referred to two examples, the principle of "unjust enrichment" which was referred to in the *Lena Goldfields Arbitration*, and the principle of "respect for acquired rights", which "has frequently been applied by international tribunals to the rights acquired under concessions." Lord McNair's view of this issue with reference to the economic question is that the

32 Ramazani, 512.

33 Cheng, 390.

34 McNair, 15.

general principles of law are applicable to govern those contracts between "corporations belonging to countries which have capital and skill to spare, and the governments of certain countries which have natural resources awaiting development but not enough capital or skill available for that purpose."³⁵

Schlesinger in his research on the general principles of law recognized by civilized nations stated that:

In countless cases, international courts have referred to this source of international law, and have invoked the general principles as a basis for their decisions. But if we read the opinions, we look in vain for an answer to the question: How did the court know that the particular rule or principle it relied on was in fact a general principle of law recognized by civilized nations? In case after case, the judge writing the opinion simply expressed a hunch, a hunch probably based upon the legal system or systems with which he happened to be familiar. As Dr Schwarzenberger emphasizes in his foreword to Dr Cheng's useful monograph on Article 38, it is *not* the fault of the judges that they have to resort to such an unscientific method. Nor is it the fault of those teaching and practicing international law. It is the comparatists, Dr. Schwarzenberger points out, who thus so far have failed to give any concrete answers, based on comparative research, to the question. What *are* the general principles of law which are recognized by civilized nations? As long as concrete answers to this question are lacking, there is necessarily a gap in the structure of public international law, a gap which can be filled only by those who have learning and experience in what is commonly called comparative law.³⁶

Similarly, Mann wrote:

It is impossible, or would at any rate be inexact, to speak of the application of the general principles of law recognized by civilized nations. The general principles are not a law or a legal system that can be applied or referred to ... Lord McNair, who has recently given attention to the problem of internationalization, somewhat surprisingly considers the general principles as affording, in certain cases, 'the choice of a legal system', and indeed, describes them as a 'system of law'. Yet it is hardly open to doubt that, unless they are equated to public international law the general principles are not a legal system at all, and Lord McNair clearly refuses so to equate

35 McNair, 1.
36 Schlesinger, 734,735.

them. For he submits that the contracts he has in mind are not 'governed by public international law *stricto sensu*', but 'should be governed by the general principles of law recognized by civilized nations.'³⁷

From the foregoing illustration, the general principles of law recognized by civilized nations according to Jenks's opinion "are not a legal system in the traditional sense or of the accepted type, but whether they can serve as a proper law depends, it is submitted not on any preconceived notion of what constitutes a legal system but on whether they can fulfil satisfactorily in practice the function of a proper law and are in fact used for that purpose".³⁸

But according to Cheng the functions served by general principles of law are as follows: (1) they constitute the source of various rules of law, which are merely the expression of these principles; (2) they form the guiding principles of the judicial order according to which the interpretation and application of the rules of law are orientated; (3) they apply directly to the facts of the case wherever there is no formulated rule governing the matter. Whether these principles are general principles of international law or of municipal law, in his view:

"These principles belong to no particular system of law, but are common to them all."³⁹

(b) Early Arbitral Decisions

In a number of awards in the immediate post-war period, some version of "general principles of law" was applied. For example in the arbitration between *Lena Goldfields Company Ltd* and the former Soviet Government (1930), Article 89 of the Concession Agreement provided:

The parties base their relations with regard to this agreement on the principle of goodwill and good faith as well as on reasonable interpretation and the terms of the agreement.

37 Mann, (1959) 44, 45.

38 W Jenks, *The Proper Law of International Organizations* (1962), 152.

39 Cheng, 390.

The tribunal decided that on all domestic matters in the U.S.S.R. Soviet law should apply except in so far as they were excluded by the contract, and accordingly that in regard to performance of the concession contract by both parties inside the U.S.S.R. Russian law was the proper law of the contract, but held that "for other purposes the general principles of law such as those recognized by Article 38 of the Statute of the Permanent Court of International Justice at the Hague should be regarded as the proper law of the contract."⁴⁰

The arbitrator, Lord Asquith of Bishopstone, in the arbitration between *Petroleum Development (Trucial Coast) Ltd. and Abu Dhabi* (1951) stated:

What is the "proper law" applicable in construing this contract? This is a contract made in Abu Dhabi, and wholly to be performed in that country. If any municipal system of law were applicable, it would *prima facie* be that of Abu Dhabi, but no such law can reasonably be said to exist... The Sheikh administers a purely discretionary justice with the assistance of the Kor'an; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments. Nor can I see any basis on which the municipal law of English could apply. On the contrary, Clause 17 of the Agreement... repels the notion that the municipal law of any country, as such, could be appropriate. The terms of that clause invite, indeed prescribe the application of principles rooted in the good sense and common practice of the generality of civilized nations, a sort of "modern law of nature."⁴¹

In fact Article 17 of the Concession Agreement did not mention or stipulate any law which should govern this agreement.⁴²

In the arbitration between *The Ruler of Qatar and International Marine Oil Company Ltd* in 1953, the arbitrator Sir Alfred Bucknill came to the same conclusion. He stated:

40 *ADIL* (1929-30) Cases 1 and 258. See also A Nussbaum, *The Arbitration Between the Lena Goldfields and the Soviet Government*, *Cornell Law Quarterly* 36 (1950), 31.

41 *ICLQ*, 1 (1952), 247, 261.

42 *Id.*, 240.

...There is no settled body of legal principles in Qatar applicable to the construction of modern commercial instruments ... I need not set out the evidence before me about the origin, history and development of Islamic law as applied in Qatar or as to the legal procedure in that country. I have no reason to suppose that Islamic law is not administered there strictly, but I am satisfied that the law does not contain any principles which would be sufficient to interpret this particular contract ... both experts agreed that certain parts of the contract, if Islamic law was applicable, would be open to the grave criticism of being invalid. According to Professor Milliot, the principal agreement was full of irregularities from end to end according to Islamic law, as applied in Qatar. This is a cogent reason for saying that such law does not contain a body of legal principles applicable to a modern commercial contract of this kind.⁴³

Again in the arbitration between the *Government of Saudi Arabia and the Arabian American Oil Company (Aramco)* in 1958, the *Arbitration Tribunal* held that:

In so far as doubts may remain on the content on the meaning of the agreements of the parties, it is necessary to resort to the general principles of law and to apply them in order to interpret, and even to supplement, the respective rights and obligations of the parties.⁴⁴

The Tribunal added:

Matters pertaining to private law are, in principle, governed by the law of Saudi Arabia but with one important reservation. That law must, in case of need, be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notions of pure Jurisprudence, in particular whenever certain private rights - which must inevitably be recognized to the concessionaire if the concession is not to be deprived of its substance - would not be secured in an unquestionable manner by the law in force in Saudi Arabia.⁴⁵

In the arbitration between *Sapphire International Petroleum and the National Iran Oil Company (NIOC)* in 1963 the arbitrator applied to the dispute the general principles of law recognized by civilized nations. He observed:

43 *ILR*, 20 (1953), 544, 545.

44 *ILR*, 27 (1963), 168.

45 *Id.*, 169.

All the connecting factors cited above point to the fact that the parties therefore intended to submit the interpretation and performance of their contract to principles of law generally recognized by civilized nations.⁴⁶

The arbitrators in the Abu Dhabi, Qatar, and Saudi Arabian cases did not fully understand the rules of Islamic Shari'ah. This lack of understanding led them to reject Shari'ah as inadequate for the purposes of an international arbitration. However, the applicability of Islamic Shari'ah to modern commercial contracts of this kind has been recognized in the opinion of some western jurists. For example, Coulson has shown that Islamic Shari'ah is a legal system capable of supporting in a flexible way, modern legal structures. He states:

The Qur'anic precepts are in the nature of ethical norms, broad enough to support modern legal structures and capable of varying interpretations to meet the particular needs of time and place...⁴⁷

Similarly Schacht saw it as a comprehensive system dealing with the relationship between the individual and the State, and with the sanctity of contracts. He states:

Islamic law, in all its schools, gives clear-cut decisions on a number of problems concerned with the relationship of individual and State, problems which, if I am not mistaken, have become a subject of much interest to western legal thought. The solutions provided by Islamic law go decisively and consistently in favor of the rights of the individual, of the sanctity of contracts, and of private property, and they put severe limits to the action of the State in these matters.⁴⁸

Although it was noted above that there are four Islamic schools of thought, there are in fact no grounds for assuming that the rules of these schools in any significant way conflict.⁴⁹ The differences between them are really differences of emphasis.

46 *ICLQ* 13 (1964) 1015.

47 NJ Coulson, *A History of Islamic Law* (1971) (1964) 225. See also Coulson, "The State and the Individual in Islamic Law", *ICLQ* 6 (1957) 49; JND Anderson & NJ Coulson, *The Moslem Ruler and Contractual Obligations*, *NYULR* 33 (1958) 917.

48 J Schacht, *Islamic Law in Contemporary States*, *AJCL* 8 (1959) 138.

49 M Khadduri and HJ Liebesny, *Law in the Middle East* 1 (1955) 341-342.

(c) More Recent Arbitral Decisions.

By contrast more recent tribunals have reached diverse and contradictory conclusions on this point. A good example is the *Arbitration between Kuwait and the American Independent Oil Company (Aminoil)* in 1982.⁵⁰ In 1977 the Kuwait government nationalized the *American Independent Oil Company (Aminoil)* which had been operating under a concession agreement from the government since 1948. The final revisions to the original Concession Agreement had been made in 1973. Aminoil protested against the government action, and invoked the arbitration provisions of the 1948 Agreement. On 23 July 1979, the parties signed an Arbitration Agreement providing for ad hoc arbitration in Paris. Article 111(2) of the Arbitration Agreement provided as follows:

The law governing the substantive issues between the parties shall be determined by the tribunal, having regard to the quality of the parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world.⁵¹

The parties did not agree what system of law was applicable. This problem was accordingly left to the tribunal to determine. The Award considered the applicable law to be a blend of Kuwaiti law and international law. It stressed that conflict between the two was not likely, as the Government itself in argument had stressed that:

Public international law is necessarily a part of the law of Kuwait.⁵²

So instead of relying on a third legal system, the award relies on combining the traditional "different sources of the law thus to be applied" and on "taking advantage of their resources". The general principles of law being part of international law, they are one of "the different legal elements involved".⁵³ The award made most reference to general principles of international law,

50 Aminoil Arbitration, *ILM*, 21 (1982), 976.

51 *Id.*, 1000.

52 *Ibid.*

53 *Id.*, 1001. See also PY Tschanz, *The Contributions of the Aminoil Award to the Law of State Contracts*, *International Lawyer* 18 (1984), 261.

including the Vienna Convention on the Law of Treaties.⁵⁴ Thus the tribunal looked for a solution in the laws of the state, of which international law formed part. In doing so, it looked towards the general principles of law as helping to bring out "the wealth and fertility of the set of legal rules that the tribunal is called upon to apply."⁵⁵

The Iran-United States Claims Tribunal has also offered the opportunity to analyze the choice of applicable law in international commercial arbitration, and to observe to what extent general principles of law or principles of international law are applicable in this context. While in most cases the judges respected the decision of the choice of law in the original contract, where this did not exist they needed to identify and apply general principles of law and in claims such as those to do with matters of expropriation and expulsion to apply international law. The only guideline provided was in Article V of the Claims Settlement Declaration "The Tribunal shall decide all cases on the basis of respect for law... taking into account relevant usages of the trade, contract provisions and changed circumstances".⁵⁶ This allowed the tribunal a fairly free hand in selecting what it considered to be the most appropriate law.

Naturally given the number of claims and the change of personnel in the arbitration tribunal there were inconsistencies in the decisions made. However there were certain themes, such as the consistent failure of the tribunal to refer to national legal systems, a tendency to apply general principles of law or public international law, but a lack of rules or guidelines as to why either was chosen.

There was a tendency to use general principles of law in cases where it was perceived that (a) the principle of unjust enrichment (b) the principle of *force majeure* (c) principle related to contracts (d) the conflict of laws and (e) certain other principles (such as "changed circumstances") were involved. Some examples of each of these can be given:

54 *Aminoil Arbitration*, 1005.

55 *Id.*, 1001.

56 *Department of States Bulletin* 2047, 4, quoted by JR Crook, *Applicable Law in International Arbitration. The Iran U.S. Claims Tribunal Experience*, *AJIL*, 83 (1989), 281.

(I) Unjust Enrichment

In *Isaiah v. Bank Mellat Award* (30 March 1983) Isaiah claimed that the bank had been unjustly enriched by receiving his funds in exchange for a dishonoured cheque. The tribunal relied on "general principles of law" and held that "it would be inequitable for such a bank to escape liability to the beneficial owner of the funds represented by such a dishonoured cheque and retain the funds to which it had no claim".⁵⁷ The claimant was awarded the amount due on the dishonoured cheque.

In *T.C.S.B. v. Iran* the tribunal concluded that the authority claiming that a valid and enforceable contract must be respected was too great to be superseded by a claim of unjust enrichment.⁵⁸

(II) Force Majeure

The tribunal has recognized force majeure to authorize full, partial and even total suspension of a contract. In *Gould Marketing Inc. v. Ministry of Defense* (27 July 1983)⁵⁹ the Tribunal looking at the upheaval caused by the revolution declared that force majeure had caused the frustration and impossibility of performance of the contract from 1979. This was despite claims of both parties to the contrary. It noted that this general principle could be found in the laws of the United States, the United Kingdom and France.⁶⁰

In *International Schools Services Inc. v. National Iranian Copper Industries Co.*, the Tribunal found that the *force majeure* conditions operating resulted in the termination of the contract and that each party was responsible for its own losses after termination.⁶¹

57 Award No. 35-219-2 (Mar.30, 1983) reprinted in *Iranian Asset Litigation Report* 6, 428 (April 15, 1983), quoted by DP Stewart & LB Sherman, *Developments at the Iran-United States Claims Tribunal, 1981-1983*, *Virginia Journal of International Law* 24-1 (1983), 30-31.

58 *5 Iran - U.S.C.T.R.* 160, 171-2 (1984 I). See also *Lockheed Corp. v. Iran*, A.W.D. 367-829-2 I.A.L.R. June 24, 1988 at 15,887, quoted by Crook, 293.

59 *3 Iran - U.S.C.T.R.* 147 (1983 II); *6 Iran-U.S.C.T.R.* 272 (1984 11), quoted by Crook, 294.

60 *6 Iran - U.S.C.T.R.* 274, quoted by Crook, 294.

61 *9 Iran - U.S.C.T.R.* 187 (1985 II), quoted by Crook, 294.

(III) Principles relating to Contracts

General principles of law were applied by the Tribunal to contracts. These principles require that parties perform their contracts satisfactorily and with due diligence, as was expressed in *General Dynamics Corp. v. Iran* (1984).⁶²

It also maintained that a contract exists when one party performs at the instigation or with the acquiescence of the other party,⁶³ as was evident in *Kimberly-Clark Corp. v. Bank Markazi Iran*. There the Tribunal stated that "a party may not deny the validity of a contract entered into on its behalf by another if by its conduct, it later consents to the contract."⁶⁴ When denying effect to a contract provision in *Harnischfeger Corp. v. Ministry of Roads and Transportation*, the Chamber applied general principles to hold that where a party had either known or should have known about an error, it was generally accepted that a party may not be relieved from liability.⁶⁵

(IV) Principles of Conflict of Laws

Principles of conflict of laws were applied in *Economy Forms Corp. v. Iran*, on the basis that there were general choice of law principles that stated that the jurisdiction with the most significant connection with the transaction must be taken into account.⁶⁶ This principle was restated in *Harnischfeger Corp. v. Ministry of Roads and Transportation*:

The agreement ... makes no reference to governing law, however, under general choice of law principles, the law of the United States, the jurisdiction with the most significant connection with the transaction and the parties, must be taken to govern in this specific case... The United States law applicable to this commercial transaction is the Uniform Commercial Code.⁶⁷

62 5 *Iran - U.S.C.T.R.* 386, 398 (1984 I), quoted by Crook, 295.

63 2 *Iran - U.S.C.T.R.* 334, 339 (1983 I), quoted by Crook, 295.

64 *R.N. Pomeroy v. Iran*, 2 *Iran - U.S.C.T.R.* 372-380 (1983 I), quoted by Crook, 295-6.

65 8 *Iran - U.S.C.T.R.* 119, 133 (1985 I), quoted by Crook, 296.

66 3 *Iran - U.S.C.T.R.* 42-48 (1983 II), quoted by Crook, 297.

67 7 *Iran - U.S.C.T.R.* 90-99 (1984 III), quoted by Crook, 297.

In some cases other general principles of law were identified and applied and in one case "*clausula rebus sic stantibus*" was invoked to justify contract termination, where the situation involved sensitive governmental contracts: *Questech Inc. v. Ministry of National Defense Iran* (1985).⁶⁸

(4) The Application of International Law to Concessions

(a) The Classical View

International law has traditionally been seen to govern the relationships between States or other international entities: it does not recognize private individuals as part of this system, because they do not act independently in international relations. As a result private individuals are not the direct addressees of international law. In other words they are not subjects of international law. Most oil concession agreements in the world especially in the Middle East are concluded between States and private individuals or corporations rather than between States. They are therefore not governed by international law.⁶⁹

This view was axiomatic under traditional notions of international law. For example Lord McNair rejected the idea that international law is applicable to govern a contract or agreement between a State and a private individual or corporation. He said:

It is important that the parties to such contracts should be in agreement as to the system of law which should govern them and within which they should operate ... that system cannot be public international law *stricto sensu*; as at present understood, because the contracts are not interstate contracts and do not deal with interstate relations.⁷⁰

Similarly, Friedman stated that:

68 *9 Iran - U.S.C.T.R.* 107 (1985 II), quoted by Crook, 298.

69 *Serbian and Brazilian Loans Case P.C.I.J.*, Series A. No.20 (1929), 42.

70 McNair, 18-9.

However, it appears to be more correct and to conform more closely with the opinions of the majority of writers that contracts cannot be the subject of international disputes since international law contains no rules respecting their form and legal effect.⁷¹

It is consistent with this position, as Article 34(1) of the Statute of the International Court of Justice provides, that only States may be parties in cases before the Court.

Most arbitral awards support this view, even in the absence of express agreement to choice of proper law. For example the arbitration between the *Government of Saudi Arabia and Aramco* (1958) held that:

As the agreement of 1933 has not been concluded between two States, but between a State and a private American corporation, it is not governed by public international law...⁷²

In the *Anglo-Iranian Oil Company Case*, the International Court did not agree that a contract between the Iranian government and a foreign oil company had the status of an international treaty: it stated that the contract "could not possibly be considered to lay down the law between the two States."⁷³ Subsequently the Security Council failed to take any action on a British complaint in respect of Iran. Ford stated in his comment on this matter:

The Security Council failed to act because the ambiguous and elusive concepts of sovereignty and domestic jurisdiction had created doubts in the minds of some of the delegates.⁷⁴

(b) Contrary Opinions

But some modern writers argue that there is no reason why international law cannot apply to a contract between a State and an individual or a corporation. For example Mann said:

71 S Friedman, *Expropriation in International Law* (1953), 156. Other jurists support this view. See e.g. M. Wolff, *Private International Law* (2nd edn 1962) 416-7.

72 *ILR* 27 (1963) 165.

73 *I.C.J. Reports* (1952), 112, 113.

74 AW Ford, *The Anglo-Iranian Oil Dispute of 1951-1952* (1954) 152.

A contract could be "internationalized" in the sense that it would be subject to public international law "*stricto sensu*", that, therefore, its existence and fate would be immune from any encroachment by a system of municipal law in exactly the same manner as in the case of a treaty between two international persons; but that, on the other hand, it would be caught by such rules of "*jus cogens*" as are embodied in public international law... States are frequently not prepared to submit to foreign law, while private persons either refuse to submit to the law of the contracting State or would be willing to do so, but are confronted with the absence of any such law.⁷⁵

Even those writers who reject international law as the legal system for the agreements between a state and a private company emphasise that while international law does not govern the contract the standards of international law may govern the situation. For example Jiménez de Aréchaga stated that:

We do not believe that there is an international law of contract, but even if it were so, international law contains the fundamental and overriding principle of the permanent sovereignty of the State over all its wealth and natural resources ... It is not the contract as such, but the situation as a whole which is governed by international law, whether or not the parties have so stipulated.⁷⁶

(c) International Conventions

It appears however that in recent international conventions there has been a trend towards the application of international law to State contracts with private parties. The International Convention on the Settlement of Investment Dispute 1965 (*ICSID*) provides in Article 42(1):

The tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the tribunal shall apply the law of the contracting State party of the dispute (including its rules on the conflict of

75 Mann, (1959) 43-6. See also FA Mann, *The Law Governing State Contracts*, *BYIL* 21 (1944) 20; PC Jessup, *A Modern Law of Nations* (1949).

76 International Law in the Past Third of a Century, 159 *Hague Recueil* (1978/I) 1, 308, quoted by EJ Paasivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes*, (Cambridge Ph.D Thesis 1988) 127.

the laws) and such rules of international law as may be applicable.⁷⁷

If this provision is regarded as being in accordance with Article 38 of the Statute of the International Court of Justice, it indicates an extension of the use of international law to govern relations between a state and private parties.

(d) Arbitration Agreements

In *Deutsche Schachtbau-Und Tiefbohrgesellschaft MbH v. Ras AL Khaimah National Oil Co.* (1987) the agreement to arbitrate in Article XXI(1) of the contract was in the following terms:

All disputes arising in connection with the interpretation or application of this agreement shall be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with the Rules.⁷⁸

The problem of ascertaining the applicable law governing a state contract in general and a concession agreement in particular, led to the theory of the freedom of parties to a contract to choose the proper law of the contract. On this view there is nothing to prevent two parties choosing international law as the law applicable to govern their contract.⁷⁹

Thus, in recent years contracts between states and private individuals have been either expressly or implicitly internationalized, especially in the case of oil concession agreements.⁸⁰

77 See for further discussion, G Schwarzenberger, *Foreign Investments and International Law* (1969), 143.

78 [1987] 2 *All ER* 774.

79 *Lalive*, 999.

80 *Ibid.*

**PART III - STABILIZATION OF OIL CONCESSION
AGREEMENTS: THE SUBSTANTIVE LAW**

CHAPTER 6

PERMANENT SOVEREIGNTY OVER NATURAL RESOURCES

1. Introduction

Sovereignty over natural resources, apart from being a legal concept, has widespread economic and political implications. This is particularly so in the context of the availability of foreign capital to the less developed nations. Economic development requires capital, whether domestic or foreign. Since most underdeveloped countries cannot supply their capital needs from domestic sources they seek to obtain sufficient foreign capital from abroad. Foreign capital is used for many purposes, including the development of the oil industry and other mineral resources, agriculture and forestry, or the acquisition of skills and technology.

However, when underdeveloped countries resort to foreign capital, their economic and political evolution can be profoundly affected. Conditions imposed by nations giving aid can cause important changes in the freedom and social conditions of the underdeveloped country. The conflict between underdeveloped countries and foreign investment, as it relates both to permanent sovereignty and freedom of contractual relations, was described by Judge Levi Carneiro in the *Anglo-Iranian Oil Company Case* in the following terms:

When there are so many countries in need of foreign capital for the development of their economy, it would not only be *unjust*, it would be a great mistake to expose such capital, without restriction or guarantee, to the hazards of the legislation of countries in which such capital has been invested.¹

1 *ICJ Rep* 1952, 93,162 quoted by M Domke, "Foreign Nationalizations. Some Aspects of Contemporary International Law", *AJIL* 55 (1961) 585.

This is one basic argument used against the concept of permanent sovereignty over natural resources.

The concept of permanent sovereignty over natural resources was first specifically referred to during the debates on human rights in the United Nations in the early 1950s. In the course of formulating principles of self-determination as a basis for the draft Covenant on Human Rights, the concept of permanent sovereignty over natural resources emerged as an expression of the principle of economic self-determination. The principal reason was the link which many perceived between the concept of permanent sovereignty and their own colonial history and years of dependence. Thus permanent sovereignty became a major demand of the newly independent states, articulated in the form of a claim for economic self-determination. The former Soviet Union and a number of other countries supported these demands, in the United Nations and elsewhere.

Having obtained their political independence, in many cases the former colonies remained frustrated because their natural resources were still exploited by foreign investors in ways which they perceived as not in their interests but in the interests of the developed world. In almost all cases the newly independent countries insisted on control over and active participation in the development of their natural resources, on the grounds that political independence was bound to remain meaningless as long as foreign investors controlled their natural resources.

It was in this setting that demands for economic self-determination, in the form of permanent sovereignty over natural resources, arose. Having learnt that "trade follows the flag" during their colonial past, these countries felt it was important that their control over their natural resources be permanently assured. Otherwise a country could remain in effect bound by the economic constraints previously imposed under colonialism.²

The emergence of the new Asian and African states as members of the international community, and the increased influence that international political

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SK Banerjee, "The Concept of Permanent Sovereignty over Natural Resources - An Analysis", *Indian Journal of International Law* 8 (1968) 516.

institutions, especially the United Nations, played after 1945, brought about a great change in views about permanent sovereignty over natural resources. The legal validity and effect of the numerous resolutions adopted by these institutions, particularly the General Assembly of the United Nations, soon became a hotly debated issue. General Assembly Resolution 1803(XVII) of 14 December 1962 on Permanent Sovereignty over Natural Resources became the cornerstone of this debate, reflecting very fundamental doctrinal divergences among the different countries.

The concept of permanent sovereignty over natural resources markedly affected the direction in which the oil producing countries gained influence and then control of their oil resources. For example it became clear that the oil producing States of the Middle East and other parts of the world should review the concession agreements then in effect. At the end of 1951 a 50/50 formula for the division of profit between producing States and concessionaire companies (whether involving equity joint ventures or contractual joint ventures) became established. An OPEC Declaration of June 1968 included a statement of petroleum policy in member countries, emphasising the equity and feasibility of participation. The Declaration also emphasised "the inalienable right of all countries to exercise permanent sovereignty over their natural resources in the interest of their national development..."³ In this regard OPEC was conspicuously successful. Full ownership of petroleum enterprises became an established trend in developing countries, helping to create a new economic order.

The principle of permanent sovereignty first developed in the early fifties, in accordance with a number of resolutions of the United Nations General Assembly, beginning with Resolution 523(VI) of 12 January 1952.⁴ These

3 OPEC, General Information and Chronology (1986) 36-7.

4 Later resolutions included: Resolution 626(VII) of 21 December 1952; Resolution 837(IX) of 14 December 1954; Resolution 1314(XIII) of 12 December 1958; Resolution 1515(XV) of 15 December 1960; Resolution 1803(XVII) of 14 December 1962, the Declaration on Permanent Sovereignty over Natural Resources; Resolution 2158(XXI) of 25 November 1966; Resolution 2386(XXIII) of 19 November 1968; Resolution 2692(XXV) of 11 December 1970; (UNCTAD) Resolution 88(XII) of 19 October 1972; Resolution 3016(XXVII) of 18 December 1972; Resolution 3037(XXVII) of 19 December 1972; Resolution 3082(XXVIII) of 6 December 1973; Resolution 3171(XXVIII) of 17 December 1973; Resolution 3201(S-VI) of 1 May 1974, the Declaration on the Establishment of a New International Economic Order; Resolution 3202(S-VI) of 1 May 1974, the Programme of Action on the Establishment of a New International Economic Order; and (continued...)

resolutions have been the subject of great controversy between developing and developed countries. In this chapter I discuss the development of the right of permanent sovereignty over natural resources. First, I discuss the development of the concept in the United Nations from 1952 through Resolution 1803 in 1962 to the present. I then discuss the aims and purposes of Resolution 1803 and the criticisms of it, and compare it with Resolution 3281, the Charter of Economic Rights and Duties of States (CERDS). This leads to the question how these key resolutions relate to existing legal norms, thence to the meaning and effect of the concept of permanent sovereignty, and its consequences and status in international law having regard to the practice supporting the concept of permanent sovereignty in international law.

Finally, I discuss permanent sovereignty under Islamic Shari'ah. This includes the notion of pledge, the principle *pacta sunt servanda*, and the legal status of natural resources under Islamic Shari'ah.

2. The Development of the Concept of Permanent Sovereignty in the United Nations

The history of the concept of permanent sovereignty is concurrent with the history of the struggle between the capital exporting countries and the capital importing countries, and the economic development of the latter. As Zakariya said:

The battle for economic self-determination and permanent sovereignty over natural resources was fought simultaneously in the post-World War II era on two fronts, viz the concrete political and economic action by some of the developing nations, individually or collectively, and the theoretical refinement of the underlying legal concepts and principles within the United Nations System. Any progress and success achieved on one front was bound to influence, if not determine the outcome of the other.⁵

4(...continued)

Resolution 3281(XXIX) of 12 December 1974, the Charter of Economic Rights and Duties of States (CERDS).

5 HS Zakariya, "Sovereignty over Natural Resources and the Search for a New International Order", in K Hossain (ed), *Legal Aspects of the New International Economic Order*, (1980) 208.

The concept of sovereignty conceived by the capital importing States was in the nature of Austin's definition of sovereignty, "absolute and unqualified by any limitations of international responsibility".⁶ But capital exporting states held that "while territorial sovereignty was a legal attribute of every State, it was limited by the duties and obligations imposed on States by international law and by the economic and political necessities of the growing interdependence of the world community."⁷ Further they believed that the concept of permanent sovereignty over resources claimed by the less developed nations "was derived from the unwarranted and mistaken extension of the sovereign rights of State to mean the rights of ownership".⁸

Wortley, who supported the cause of the Western capital exporting states, argued that:

Much confusion has arisen from the nineteenth century exaggerations of the powers of the territorial sovereign over persons and things in its territory... It has been rightly said that everything actually in the territory of the State, considered in itself and independently of the persons to whom it belongs, must be deemed subject to the right of the *imperium* of the territorial sovereign. Yet *imperium*, sovereignty and eminent domain are *not* ownership; territorial sovereignty exists in the framework of international law; it is not superior to it... Because a sovereign State may control and expropriate property in its territory, this does not mean that it can, at will, disregard the claims made, by virtue of public international law, to restitution or to just compensation or that it may always insist on its own conception of private property.⁹

Against the background of these basic arguments, it is necessary to trace the development of the principle of permanent sovereignty through legal and diplomatic forums and through a series of United Nations resolutions.

6 Banerjee, 516.

7 Ibid.

8 Ibid.

9 BA Wortley, *Expropriation in Public International Law* (1959) 12.

(1) The Human Rights Commission and Resolution 626(VII) of 21 December 1952

The concept of permanent sovereignty over natural resources was first addressed in 1952 in the Human Rights Commission of the United Nations, initiated through a Chilean proposal to the following effect:

The right of the peoples to self-determination should also include permanent sovereignty over their natural wealth and resources and that in no case might a people be deprived of its own means of subsistence on the grounds of any rights that might come from any other States.¹⁰

The General Assembly at its 6th session in 1952 stressed the right of the Third World to determine freely the use of their natural resources so as to further the realisation of their plans of economic development.¹¹ In particular United Nations General Assembly Resolution 626(VII) of 21 December 1952 was adopted. It recognised that:

All member states, in the exercise of their right freely to use and exploit their natural wealth and resources wherever deemed desirable by them for their own progress and economic development, to have due regard, consistently with their sovereignty, to the need for maintaining the flow of capital in condition of security, mutual confidence and economic co-operation among nations.

Further it recommended that:

All member states to refrain from any act, direct, or indirect, designed to impede the exercise of the sovereignty of any state over its natural resources.¹²

The industrialised countries voted against this resolution on the grounds that it did not contain any provision restricting the power of states to expropriate private property or for the recognition of the rights of foreign investors under

10 See Banerjee, 518.

11 Ibid.

12 General Assembly Resolution 626 (VII) of 21 December 1952.

international law, including treaties and other international agreements. The United States representative explained that the resolution would be interpreted by investors as a danger signal that they had better think twice before they placed their capital in the less developed countries.¹³

Six months after the adoption of this resolution, these predictions proved to be correct. The Government of Guatemala used this resolution as a supporting argument when it exercised its sovereignty by taking over the property of the United Fruit Company in Guatemala.¹⁴ In 1954 the Civil Tribunal of Rome in supporting the Iranian Oil Nationalisation law, regarded the adoption of the Resolution within a month after the passage of the Iranian law, as recognition of the international legitimacy of that law.¹⁵

The Human Rights Commission in 1955 stressed the "need" for a practical survey of the concept of permanent sovereignty over natural wealth and resources, and the principles of economic self-determination. Article I paragraph 2 of the draft Covenant on Human Rights read as follows:

The peoples may for their own ends freely dispose of their natural wealth and resources, without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence.¹⁶

During the debate before the United Nations General Assembly, Saudi Arabian representative Ambassador Jamil Al Baroody said:

It is indeed to prevent what had been a frequent occurrence in the nineteenth century, namely, that a weak and penniless government should seriously compromise a country's future by granting concessions in the economic sphere.¹⁷

13 United Nations General Assembly, Official Records, 7th session (A/411, 1952) 497.
 14 JN Hyde, Permanent Sovereignty over Natural Wealth and Resources, *AJIL* 50(1956) 854.
 15 Ibid.
 16 United Nations Doc A/C/3/L, 489.
 17 United Nations General Assembly 10th session, 3rd Committee, 672nd meeting, 240.

(2) Resolution 1314 (XIII) of 12 December 1958

Three years later the debate over the concept of permanent sovereignty over natural resources and economic self-determination was resumed, in the context of a debate as to "whether a country's permanent sovereignty over its natural resources was to be qualified by the rights and obligation of States arising out of international law". The capital investing States still held that "it was illogical to use the term 'sovereignty' in conjunction with 'peoples' which did not yet represent sovereign States".¹⁸

However, the General Assembly adopted Resolution 1314 (XIII) of 12 December 1958, entitled "Recommendation Concerning International Respect for the Right of People and Nations to Self-determination". The resolution drew upon the affirmation of the right as expressed in the draft Human Rights Covenants. It set up a Commission on Permanent Sovereignty over Natural Resources and "instructed it to conduct a full survey of the status of permanent sovereignty over natural wealth and resources as a basic constituent of the right of self determination, with recommendations, where necessary, for its strengthening". It also stated that in the "conduct of the full survey of the status of the permanent sovereignty of peoples and nations over their natural wealth and resources, due regard should be paid to the rights and duties of States under international law and to the importance of encouraging international co-operation in the economic development of under-developed countries".¹⁹

The aim of the Commission "consisted essentially in determining the nature of the right of permanent sovereignty over natural resources; the manner in which that right should be exercised and what measure should be taken into account according to international law".²⁰ At the request of the Commission the Secretariat prepared a study on the status of permanent sovereignty of peoples and nations over natural wealth and resources, national measures affecting ownership or use of natural resources by aliens, State control over natural

18 Banerjee, 525.

19 United Nations General Assembly Resolution 1314 (XIII) of 12 December 1958.

20 United Nations General Assembly Resolution 1803 (XVII) of 14 December 1962.

resources and their exploitation of resources, acquired rights, concession agreements and other issues.²¹

(3) Resolution 1515(XV) of 15 December 1960

While the Commission on Permanent Sovereignty continued its work, the General Assembly adopted Resolution 1515(XV) of 15 December 1960, calling for concerted action for the economic development of economically less developed countries. Paragraph 5 recommended that "the sovereign right of every State to dispose of its wealth and its natural resources should be respected in conformity with the rights and duties of States under international law".²²

(4) Resolution 1803(XVII) of 14 December 1962.

On 14 December 1962 the General Assembly adopted Resolution 1803(XVII) on Permanent Sovereignty over Natural Resources. This resolution emphasised the inalienable right of all States to freely dispose of their natural wealth and resources. It was adopted by a majority of 87 votes in favour, 2 against, and 12 abstentions. The resolution declared that:

1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interests of their national development and of the well-being of the people of the State concerned;
2. The exploration, development and disposition of such resources, as well as the import of the foreign capital required for these purposes, should be in conformity with the rules and conditions which the peoples and nations freely consider to be necessary or desirable with regard to the authorization, restriction or prohibition of such activities;
3. 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

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A Akinsanya, *The Expropriation of Multinational Property in the Third World* (1980) 51.
United Nations General Assembly Resolution 1515(XV) of 15 December 1960.

impairment, for any reason, of that State's sovereignty over its natural wealth and resources;

4. Nationalisation, expropriation or requisitioning shall be based on grounds or reasons of *public utility*, security or the national interest which are recognised as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid *appropriate compensation*, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law. In any case, where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication;

5. The free and beneficial exercise of the sovereignty of peoples and nations over their natural resources must be furthered by the mutual respect of States based on their sovereign equality;

6. International co-operation for the economic development of developing countries, whether in the form of public or private capital investments, exchange of goods and services, technical assistance, or exchange of scientific information, shall be such as to further their independent national development and shall be based upon respect for their sovereignty over their natural wealth and resources;

7. Violation of the rights of peoples and nations to sovereignty over their natural wealth and resources is contrary to the spirit and principles of the Charter of the United Nations and hinders the development of international co-operation and the maintenance of peace;

8. Foreign investment agreements freely entered into by, or between, sovereign States shall be observed in good faith; States and international organisations shall strictly and conscientiously respect the sovereignty of peoples and nations over their natural wealth and resources in accordance with the Charter and the principles set forth in the present resolution.²³

Resolution 1803 had been drafted by the Permanent Sovereignty Commission pursuant to General Assembly Resolution 1314 (XIII) of 12 December 1958, which provided that "the right of peoples and nations to self-determination as affirmed in the two draft covenants... includes permanent

sovereignty over natural wealth and resources". These are the basic operative provisions reproduced in the paragraph 1 of Resolution 1803. The Chilean delegation noted²⁴ at the Assembly's 17th session that the Commission's task...

had consisted essentially in determining the nature of the right of permanent sovereignty over natural resources, the manner in which that right should be exercised and what measures should be taken into account according to international law. The draft resolution referred, on the latter point, to General Assembly Resolution 1515(XV).

Although the main legal premise of the resolution was not challenged directly by members of the former Soviet bloc, the former Soviet Union did stress protection against violations of sovereignty which meant the inalienable right of States to take property and to set their own terms and standards of compensation, and rejecting the concepts of the protection of foreign capital and acquired rights and of the arbitration or international adjudications of related disputes.²⁵

On the other hand some delegations from the developing world held that the Permanent Sovereignty Commission's terms of reference had been "to protect the interest of the developing countries". They felt that the draft resolution should be considered from that point of view and that its principal aim was simply the economic development of underdeveloped countries or the encouragement of the flow of capital to such countries.²⁶

A major criticism of Resolution 1803 is that it affords more protection to multi-nationals than to the host country. Paragraph 4 of Resolution 1803 provides that:

Nationalization, expropriation or requisitioning shall be based on grounds or reasons of *public utility* security or the national interest... in such cases the owner shall be paid *appropriate compensation*... in any case where the question of compensation gives rise to a controversy... settlement of the dispute should be made through arbitration or international adjudication.

24 GA (XVII) A/C.2/SR.834.19.

25 KN Gess, Permanent Sovereignty over Natural Resources, *ICLQ* 13 (1964) 407.

26 Id, 407-408.

Thus the right of a host state to expropriate foreign property is limited by the requirement that the expropriation be not arbitrary or discriminatory but should occur for reasons of public utility, and that in the case of the expropriation, appropriate compensation be paid. "This is a concession to the recipient States but is certainly a victory to the investor States."²⁷ So also was the reference to the need for settlement of disputes through arbitration or international adjudication in cases where all local remedies had been exhausted. Critics feel that these arbitration provisions favour multi-nationals and that international arbitrators are most likely inclined to support the western multi-national investors abroad.²⁸

The fact remains that despite criticisms, Resolution 1803 is based on the principle of the "inalienable right of States to natural wealth and resources which must be exercised in the interest of national development and the well-being of the people of the State concerned". Resolution 1803 paved the way for a number of later resolutions of the General Assembly, from Resolution 2158(XXI) of 25 November 1966 to Resolution 3201 S-VI and 3202 S-VI of 1 May 1974 by which was established the "New International Economic Order", and Resolution 3281 (XXIX) of 12 December 1974, the Charter of Economic Rights and Duties of States. These resolutions reiterated the fundamental principles of Resolution 1803 thereby re-emphasising its importance.

Paragraph 8 of Resolution 1803 provides that:

Foreign investment agreements freely entered into by, or between, sovereign States shall be observed in good faith.

Thus the right of a State to expropriate foreign property is restricted by this provision, implying that a breach of the agreement by the nationalisation is deemed a violation of international law.

27 Akinsanya, 54.

28 Ibid.

(5) Resolution 2158(XXI) of 25 November 1966

General Assembly Resolution 2158(XXI) of 25 November 1966 affirmed "that foreign capital, whether public or private, forthcoming at the request of the developing countries, can play an important role inasmuch as it supplements the efforts undertaken by them in the exploitation and development of their natural resources" and asserted that foreign investment must take place under the control of the States and in accordance with their national development, their interests and their laws. Again this resolution affirmed "the inalienable right of all countries to exercise permanent sovereignty over their natural resources". Developing countries "must increase their share in the administration of enterprises which are fully or partly operated by foreign capital".²⁹

(6) Resolutions 3201 and 3202: The New International Economic Order (NIEO), 1 May 1974

On 1 May 1974 the General Assembly adopted Resolution 3201, the Declaration on the Establishment of a New International Economic Order. The Declaration was stated to be "based on equity, sovereign equality, interdependence, common interest and cooperation among all states, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations..."³⁰ In particular paragraph 4(e) provides for:

Full permanent sovereignty of every State over its natural resources and all economic activities. In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation, including the right to nationalisation or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State. No State may be

29 United Nations General Assembly Resolution 2158 (XXI) of 25 November 1966. This resolution was adopted by 104 votes in favour to none against with 6 abstentions. See also Akinsanya, 55.

30 General Assembly Resolution 3201 (S-VI) of 1 May (1974). This resolution was adopted without a vote.

subjected to economic, political or any other type of coercion to prevent the free and full exercise of this inalienable right.³¹

Paragraph 4(f) asserts:

The right of all States, territories and peoples under foreign occupation, alien and colonial domination or apartheid to restitution and full compensation for the exploitation and depletion of, and damages to, the natural resources and all other resources of those States, territories or peoples.³²

Paragraph 7 provides that the Declaration "shall be one of the most important bases of economic relations between all peoples and all nations".³³

Simultaneously, Resolution 3202, the Programme of Action on the Establishment of a New International Economic Order, provided: "the Charter of Economic Rights and Duties of States (CERDS) shall constitute an effective instrument towards the establishment of a new system of international economic relations based on equity, sovereign equality and interdependence of the interests of developed and developing countries".³⁴

(7) Resolution 3281 (XXIX) of 12 December 1974: the Charter of Economic Rights and Duties of States (CERDS)

On 19 April 1972 the United Nations Conference on Trade and Development met in Santiago. On the initiative of the President of Mexico, the Conference adopted the Charter of Economic Rights and Duties of States, in an attempt to protect the economic rights particularly of developing countries. The final draft of the Charter was submitted to the Second Committee of the General Assembly.³⁵

31 Ibid, paragraph 4 (e).

32 Ibid, paragraph 4 (f).

33 Ibid, paragraph 7.

34 General Assembly Resolution 3202 (S-VI) of 1 May (1974).

35 Akinsanya, 63.

On 12 December 1974 the General Assembly approved the Charter as Resolution 3281.³⁶ The Charter of Economic Rights and Duties of States contains 15 principles concerning the economic, political and other relations among States, including the following:

1. Sovereignty, territorial integrity and political independence of States.
2. Sovereign equality of all States.
3. Non-intervention.
4. Mutual and equitable benefit.
5. Equal rights and self-determination of peoples.
6. Peaceful settlement of disputes.
7. Fulfilment in good faith of international obligations.
8. Respect for human rights and fundamental freedoms.
9. No attempt to seek hegemony and spheres of influence.
10. International cooperation for development.

Of the Charter's 34 articles, the most important for present purposes are:

Article 2

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

(2) Each state has the right:

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

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

(c) To nationalize, expropriate or transfer ownership of foreign property in which case appropriate compensation should be paid by the State adopting such

measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalising 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.

Article 5

(1) All States have the right to associate in organisations of primary commodity producers in order to develop their national economies, to achieve stable financing for their development and, in pursuance of their aims, to assist in the promotion of sustained growth of the world economy, in particular accelerating the development of developing countries. Correspondingly all States have the duty to respect that right by refraining from applying economic and political measures that would limit it.

Article 12

(1) States have the right in agreement with the parties concerned, to participate in subregional, regional and interregional co-operation in the pursuit of their economic and social development. All States engaged in such co-operation have the duty to ensure that the policies of those groupings to which they belong correspond to the provisions of the present charter and are outward-looking...

The vote on the Charter was 120-6 with 10 abstentions. Opposed were certain industrialised countries (United States, Belgium, Denmark, Federal Republic of Germany, United Kingdom, and Luxemburg). The countries which abstained were Austria, Canada, France, Ireland, Israel, Italy, Japan, Norway, Spain and the Netherlands.³⁷ Senator Charles Percy explained why the United States did not support the proposed Charter of Economic Right and Duties of States:

[T]o command general support - and to be implemented - the proposed rights and duties must be defined equitably and take into account the concerns of industrialised as well as developing countries. In extensive negotiations in Mexico City, Geneva and here in New York, the United States worked hard and sincerely with other countries in trying to formulate a Charter that would achieve such a balance... Indeed, agreement was reached on many important articles, and our support for those was shown in the vote we have just taken. On others, agreement has not yet

been reached. Our views on these provisions are apparent in the amendments proposed by the United States and certain other countries, but these regrettably have been rejected by the majority here. Many of the unagreed provisions, in the view of my government, are fundamental and are unacceptable in their present form. To cite a few; the treatment of foreign investment in terms which do not fully take into account respect for agreements and international obligations, and the endorsement of concepts of producer cartels and indexation of prices... Moreover, the provisions of the Charter would discourage rather than encourage the capital flow which is vital for development

³⁸
...

(8) Comparison Between Resolutions 1803 and 3281

Article 2 of Resolution 3281 of 1974, the Charter of Economic Rights and Duties of States, made fundamental changes in Resolution 1803 of 1962.³⁹ I will analyse the changes as follows:

(a) Permanent Sovereignty

Article 2(1) of the Charter provides that a State shall exercise full permanent sovereignty over and possession of "all its wealth, natural resources, and economic activities ...", while Resolution 1803 of 1962 provides that permanent sovereignty extends to all the natural wealth and resources of the State in question. It seems that the Charter is an expansion of the concept of permanent sovereignty over natural resources, compared with Resolution 1803 of 1962. Moreover, it provides for sovereignty over economic activities, which may be independent of the natural wealth and resources of the State.

(b) Protection of Foreign Investment

Under Resolution 1803 of 1962, it is contemplated that imported capital and the earnings on that capital are to be governed by national legislation in force and by international law. By contrast under Article 2(2)(a) of the Resolution 3281 of 1974, imported capital is to be regulated within State national

38 Akinsanya, 61-62.

39 Id, 62-66.

jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities, without any preferential treatment for foreign investment.

(c) Transnational Corporations

Resolution 1803 of 1962 is silent on this point while Article 2(2)(b) of the Charter provides that a State has full authority "to regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies". Transnational corporations, on the other hand, are excluded from intervening in the internal affairs of a host State.

(d) Limits on Nationalisation or Expropriation

Paragraph 4 of Resolution 1803 of 1962 provides that "nationalisation, expropriation or requisitioning shall be based on grounds or reasons of public utility security or the national interest". In marked contrast Article 2(2)(c) does not provide any restriction on rights of the State to expropriate foreign investment.

Capital exporting countries argue that the standards outlined in traditional international law must be maintained otherwise nationalization could not be justified in international law and would become instead an exercise of arbitrary power. However developing countries maintain that the standards are meaningless as it is the role of the State to define and interpret them and thereby provide justification for its acts of nationalization.⁴⁰ Further discussion on this point is in Chapter 9.

40 SR Chowdhury. Permanent Sovereignty over Natural Resources, in K Hossain and SR Chowdhury (eds) *Permanent Sovereignty over Natural Resources in International Law* (1984) 10.

(e) The Principle of Compensation

Paragraph 4 of Resolution 1803 of 1962 further provides that "the owner shall be paid appropriate compensation in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law..." Article 2(2)(c) on the other hand provides merely for "appropriate compensation [to] be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent". That means the compensation will be paid according to the expropriating State's own law, taking into account all circumstances which are considered relevant in accordance with that law. The Charter avoids all reference to international law, such as contained in Resolution 1803 of 1962. However the doctrine of compensation in accordance with the Charter is not a matter of dispute because "the mere use of the expression "should" in lieu of "shall" does not necessarily exclude the obligation to pay compensation". What is significant is that it is the expropriating State that is to determine what "circumstances" are "pertinent".⁴¹ I discuss the compensation issue further in Chapter 10.

(f) Dispute Settlement Mechanisms

Paragraph 4 of Resolution 1803 of 1962 provides:

In any case where the question of compensation gives rise to a controversy, the national jurisdiction of the State taking such measures shall be exhausted. However, upon agreement by sovereign States and other parties concerned, settlement of the dispute should be made through arbitration or international adjudication.

Thus it would appear that any dispute about compensation which may arise should be referred to arbitration or international adjudication. On the other hand Article 2(2)(c) of the Charter rejects any reference to international means such as arbitration and international adjudication, providing as follows:

41 FV Garcia-Amador, "The Proposed New International Economic Order: the new approach to the law covering Nationalization and Compensation", *Lawyer of the Americas* 12 (1980) 28, 40.

In any case where the question of compensation gives rise to a controversy, it is to be settled under the domestic law of the nationalising 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.

Thus the settlement of compensation disputes is a matter for the domestic tribunals of the expropriating State acting in accordance with its national laws, unless by mutual agreement some other peaceful means is sought. In this regard, there is a fundamental difference between this article and the Latin American Calvo doctrine concerning dispute settlement. Article 2 of the Charter does not deny the possibility of the settlement of disputes by mutual agreement, whereas the Calvo Doctrine denies the validity of any contractual clause which provides for international arbitration or any other extranational procedures "instead of or in addition" to the national legal system.⁴²

However, most industrialised countries rejected Article 2 of the Charter, and endeavoured to amend it by a proposal which would have "(a) allowed appeals on investment disputes to international tribunals after the exhaustion of domestic remedies in the host country; (b) stipulated that the standard of compensation should be just compensation in the light of all relevant circumstances."⁴³ That proposal was defeated by a large majority of the developing countries, on the ground that international controversies arising from investment disputes should not be regarded as different from other international disputes and should be governed by the same rules of international law. Thus the question is, what are the rules of international law which must govern the relations between the State and private foreign investment? I discuss this issue in the next section.

42 Chowdhury, 22.

43 Id, 18.

3. The Meaning and Effect of the Concept of "Permanent Sovereignty"

(1) The Distinction between "Sovereignty" and "Permanent Sovereignty"

The term sovereignty in international law has been defined by jurists and political scientists from different perspectives, but always with a common core of "supreme authority". According to Morgenthau:

Sovereignty is the supreme legal authority of the nation to give and enforce the law within a certain territory and in consequence, independent from the authority of any other nation and equality with it under international law.⁴⁴

This may be compared with Schwarzenberger's view:

The principle of legal sovereignty is an abstraction from a number of relevant rules:

(1) Without its consent, a subject of international law is bound by applicable rules of universal or general international customary law and general principles of law recognised by civilised nations.

(2) Additional international obligations may be imposed on any subject of international law only with its consent.

(3) Unless the territorial jurisdiction of a State is excluded or limited by rules of international law, its exercise is exclusively the concern of the State in question.

(4) Subjects of international law may *claim* potential jurisdiction over persons or things outside the territorial jurisdiction. In the absence of permissive rules to the contrary, however, they may actually *exercise* such jurisdiction in concrete instances only within their territories.

(5) Unless authorised by permissive rules to the contrary, intervention by subjects of international law in one another's sphere of exclusive domestic jurisdiction constitutes a breach of international law.⁴⁵

44 HJ Morgenthau, *Politics among Nations* (1964) 318.

45 G Schwarzenberger, *Manual of International Law* (1967) 65.

However, "sovereignty" does not give full freedom to do whatsoever the wishes or actual equality of rights or competences not in accordance with the principles of international law accepted among the nations. As James Crawford states:

Sovereignty does not mean actual equality of rights or competences: the actual competence of a State may be restricted by its constitution, or by treaty or custom. The term "sovereignty" accurately refers not to the totality of powers which all States have, but to the totality of powers which States may, under international law, have. The danger of drawing implications from the term is thus evident.⁴⁶

Whatever the difficulties, it is undisputed that State sovereignty over natural wealth and resources has become a most important subject for both developing and developed countries in international law. Investment by foreign companies has political, social, and economic implications for developing countries. These implications can involve a loss of control by the State over its own political, social and economic development. This loss of control is not acceptable to them and may be contrary to the concept of permanent sovereignty in international law. Even traditional international law recognized the right of States to control their natural wealth and resources. The Governments of France, the United Kingdom and the United States, for example, recognized the general right of a State to nationalize or take over its natural resources in a tripartite statement on 12 August 1956 concerning the nationalization of the Suez Canal Company, where they declared:

They do not question the right of Egypt to enjoy and exercise all powers of a fully sovereign and independent nation, including the generally recognised right, under appropriate conditions, to nationalise assets, not impressed with an international interest, which are subject to its political authority.⁴⁷

But certain issues, such as standards of compensation and stabilization clauses, have been the subject of controversy.

46 J Crawford, *The Creation of States in International Law* (1979) 27.
47 8 Whiteman, *Digest of International Law* (1967) 1106.

According to western industrialized countries the right of states to control their natural wealth and resources in accordance with the minimum international standard entails two rules of customary law:⁴⁸

1. Expropriation must be for a public purpose.
2. Even when expropriation is for a public purpose, it must be accompanied by payment of compensation for the full value of the property, by which is meant "prompt, adequate and effective compensation.

On the other hand Resolutions 1803 and 3281 require at most that the owner of expropriated property be paid "appropriate compensation": this clearly implies that full compensation need not be paid in every case. It depends on the circumstances of each case what amounts to "appropriate compensation".

Thus it can be argued that permanent sovereignty is a concept over and above that of sovereignty in the normal sense, and that it emanates from the right to self-determination rather than from older territorial conceptions of sovereignty. Self-determination itself is deemed a fundamental principle of international law, and as we have seen the concept of permanent sovereignty means that the State has the right to control its natural wealth and resources for the benefit of its people and construction of its economy. The concept of permanent sovereignty is thus an expression of the value of economic self-determination, which helps to resolve such basic questions as whether the State loses any right of sovereignty when it engages itself by a treaty or a contract, or whether the right of permanent sovereignty over natural wealth and resources is inalienable.⁴⁹

Undoubtedly the State loses its sovereignty when it is under the protection of another State, which controls its internal or external affairs, whether by choice or by treaty, and which is placed under the legal authority of another State. But when the State enters into an obligation arising out of a contract for some economic purpose, such as the exploitation or production of its

48 M Akehurst, *A Modern Introduction to International Law* (6th edn 1987) 92-3.
49 Hossain, in Hossain & Chowdhury (eds), viii.

natural resources (eg oil concession agreements) these do not formally affect the sovereignty of the State: there is no question in such a case of the State divesting itself permanently or alienating its sovereignty to the private party. On the other hand, although formal sovereignty may be retained, such arrangements may prove inimical to the interests of the people of the State, especially if they are stated to last for many years. It is this problem of real disadvantage and subordination that the doctrine of permanent sovereignty is intended to address.

According to MT Elghunaimi, there is a distinction...

between the State's right to grant a concession and a concessionaire's entitlement to exercise his concessionary rights. The State's right to grant or withhold a concession is inviolable, as is its right to annul such a concession. But once the concession is granted it is absurd to claim that the operation of such a concession is inimicable to State sovereignty. Once granted a concession becomes a contractual relation, governed by the principles of contractual relations, without reference to the fact that one party may enjoy sovereign rights and another not.⁵⁰

In a sense the notion of permanent sovereignty is an exploration of this distinction. Indeed according to some it is much more. Thus Jiménez de Aréchaga argued that:

The territorial State can never lose its legal capacity to change the destination or the method of exploitation of those resources, whatever arrangements have been made for their exploitation and administration. Moreover, the State can exercise this right, even if a predecessor State or a previous government engaged itself, by treaty or by a contract, not to so do.⁵¹

Brownlie considers that this "particular innovation" of Aréchaga can be justified in accordance with Article 64 of the Vienna Convention of 1969 on the Law of Treaties "if and when the principle of permanent sovereignty emerges as

50 *MEES*, 27 October (1961) 7, quoted by Mohammed Madani, *The Relationship Between Saudi Arabia Domestic Law and International Law. A Study of the Oil Agreements with Foreign Companies*, S.J.D Thesis, George Washington University (1970) 56.

51 Jiménez de Aréchaga, *Recueil des Cours* (1978/I) 297, quoted by Chowdhury, 7-8. See also, Jiménez de Aréchaga, *State Responsibility for the Nationalization of Foreign Owned Property*, *NYUJSLP*, 11 (1978) 179.

a new peremptory norm of general international law (*jus cogens*)". Brownlie had earlier treated the principle of permanent sovereignty as one of the "candidate rules" which may have the special status of *jus cogens*.... However he concedes, albeit "loosely speaking", that "permanent sovereignty is the assertion of the acquired rights of the host State which are not defeasible by a contract or perhaps even by an international agreement."⁵²

On the other hand the main question is whether the right which is inherent in sovereignty is inalienable or not. According to one view...

Sovereignty is inalienable and indivisible. It only belongs to the State and cannot be ceded. As regards sovereignty over natural resources, this is no different from of sovereignty, but is comprised within the latter's general elements, within supremacy and independence.⁵³

The 1982 Montreal Conference of the International Law Association resolved that the first principle in this area was that the right of permanent sovereignty "emanating as it does from the *jus cogens* principle of self-determination, is a fundamental principle of contemporary international law, and an important instrument for the establishment of a new international economic order."⁵⁴

The contrary view is that "when a state makes commitments as reflected in stabilization clauses, it does so, not in derogation of, but in the exercise of the same sovereignty which inheres in it." Thus the Arbitral Award between the *Saudi Arabian Government and Aramco* of 23 August 1958 provided:

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 irrevocable rights. Such rights have the character of acquired rights.⁵⁵

52 Ibid. Article 64 of the Vienna Convention provides: "If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates."

53 G Elian, *The Principle of Permanent Sovereignty over Natural Resources* (1979) 10-11, quoted by Chowdhury, 8.

54 International Law Association, *Report of the Sixtieth Conference, Montreal* (1982) 197.

55 *Arbitration between Saudi Arabia & Aramco ILR* 27 (1963) 168.

Similarly in the *Libya-Texaco Arbitration* the Arbitrator held...

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.⁵⁶

The conflict between the two views appears complete, but in seeking to resolve it, it is necessary to get beyond definitions and to look at the special consequences of the principle of permanent sovereignty. These are what serves to distinguish it from the more general principle of State sovereignty itself.

(2) The Consequences of Permanent Sovereignty

A series of United Nations Resolutions between 1952 and 1974 provide the key elements and basic discussion of the principle of permanent sovereignty. The consequence of this conception means that as a new international economic order emerges the high degree of dominance and control of foreign enterprises in developing States should be changed. Host countries should exercise control over their natural wealth and resources for the benefit of their people. This right of control is in accordance with the concept of permanent sovereignty.

In fact for the last 37 years the concept of permanent sovereignty over natural wealth and resources has been expanding by virtue of United Nations resolutions regarding the right of permanent sovereignty, by the creation of organizations such as OPEC and OAPEC as instruments of international and national cooperation, and by increasing the host countries control over their natural wealth and resources.

In the discussion of the resolutions concerning permanent sovereignty, the participation issue was one of the most important questions and the main distinguishing feature. It has changed the nature of traditional oil concession agreements, producing consequences in the area of the revision and amendment

of old concession agreements; the duration of concession agreements; relinquishment; State participation; the law and practice of nationalization; the widespread establishment of national oil companies; the settlement of disputes; compensation for expropriation; the emergence of new petroleum laws and of new types of agreements. I will deal with each of these in turn.

(1) Revision and Amendment of Old Concession Agreements

Older concession agreements were characterized by a high degree of economic control by the foreign oil companies over the natural wealth and resources of the host States. However, the producing countries called for renegotiation to revise and amend these types of concession agreements according to the concept of permanent sovereignty over natural wealth and resources. The demands of producing countries reflect their right of control over their resources.

(2) Duration of Concession Agreements

The old concession agreements were of excessively long duration, for example over 75 years,⁵⁷ which seemed completely unreasonable. Rival concessionaires received protection over a long period especially if there was no provision in the agreements to change or amend those agreements. But since the concept of permanent sovereignty has emerged, most concession agreements granted after 1952 provide for a shorter term, typically between 25 and 40 years.⁵⁸

(3) Relinquishment

The old concession agreements signed before 1950 sometimes covered the whole territory of the country. This was the case with all concession agreements in the Middle East. Moreover (except for the Saudi Arabia

57 All Middle East concession agreements were granted for this average duration before 1950.

58 This period has typically been provided for in concession agreements in different countries since 1950.

concession agreement with *Aramco* of 1933) these concession agreements contained no relinquishment provision. The size of the exclusive area covered by the original concession agreements of 1933 and 1939 in the eastern province was about 440,000 square miles, or about the size of Texas and California combined.⁵⁹ The D'Arcy agreement (*Anglo-Persian Oil Company* 1901) covered the whole of Iran except the northern provinces of Asterabad, Khorasan, Azerbaijan, Gilan and Mazanderan. This concession agreement did not contain any provision for relinquishment.⁶⁰ These grants, it seems, were the largest individual grants in the world.

Again, all this has changed. A consequence of permanent sovereignty is that the producing countries have requested foreign oil companies to define their area of operation and to agree to the relinquishment of land which needed more time to be developed or would never be developed. Some of the States producers entered into negotiations with foreign oil companies for relinquishment, and other States resorted to unilateral action.

The Saudi Arabian government entered into negotiations with *Aramco* for this purpose. According to their Concession Agreement of 1933, Article 9:

...the company shall relinquish to the government such portions of the exclusive area as the company at that time may decide not to explore further...

Thereafter, as a result of long negotiations *Aramco* relinquished by agreement in 1948 and 1963 a large part of its concession to the Saudi Arabian government.⁶¹

The new type of concession agreement after 1952 provides for the definition of the area of operation to be much more limited and more precise than in the old concession agreements, and includes both relinquishment and joint-venture clauses.

59 *Aramco Handbook* (1960) 136.

60 AW Ford, *The Anglo-Iranian Oil Dispute of 1951-1952* (1954) 15.

61 *Aramco Handbook*, 137.

(4) State Participation

The traditional oil concession agreement stipulated for no changes to be made in its provision. This enabled foreign oil companies to resist any modification or amendment of their concession agreements according to the doctrine of the sanctity of contract. As a result of this attitude, the producing States were not able to share with the foreign oil companies decisions about the volume of production, the administration of enterprises, oil prices, or international oil policy, so as to protect the interests of their people and to ensure the development of their countries and their resources. For these reasons the old concession agreements were a detrimental imposition on the host countries.

However, the foreign oil companies accepted and recognized in principle the rights of people to participation when most of the producing countries demanded renegotiation of existing oil agreements, relying on principle of "*rebus sic stantibus*" as an established principle of international law. This principle is discussed at length in the following chapter.

The period between 1950 and 1960 saw the beginning of State participation in the oil enterprise with the foreign oil companies, including participation in profits, management international oil policy, oil prices and joint-ventures entered into between foreign oil companies and national oil companies. Participation in the negotiations, then, meant assuring effective participation in control and management. Thus major modifications in the structure of the contractual relations between producing States and foreign oil companies were made. The stage was eventually succeeded when the producing countries assumed full control.⁶²

62 F Rauhani, Concession Agreements Survey and Future Trends, *Seminar on International Oil and the Energy Policies of the Producing and Consuming Countries* (OPEC 1969).

(5) Nationalization

The second and most important issue that arose as a result of permanent sovereignty and changed circumstances was the issue of nationalization of foreign oil companies. The producer States encouraged the foreign oil companies to agree to the renegotiation of concession agreements so as to provide for control and complete ownership over their natural resources. The producer States argued that the concept of permanent sovereignty involved the inherent and overriding right of States to control their natural resources.

The *Anglo-Iranian oil company* was the first foreign oil company nationalized by the Mossadegh government in 1951. The collapse of the Mossadegh government on 13 August 1953 did not stop the producers from continuing their endeavour to control their natural resources. Later the foreign oil companies did agree to renegotiate, and through a series of negotiations were forced to accept and recognize the right of people to control their natural resources, provided that adequate compensation was paid.⁶³

Coinciding with this development was the widespread growth of national oil companies, established to represent the State in all joint ventures. Such a public enterprise could exercise greater control over the natural resources and involvement as well as being an operator in the petroleum processing and marketing field, the building of national petrochemical industries and the production and refining of oil itself, although ultimate control over operations usually remains with foreign oil companies.⁶⁴

(6) Compensation

The compensation issue is a complex one, and there is as yet no consensus among the international community concerning the terms and the standard of compensation. The right to compensation depends upon the circumstances surrounding the nationalization. The principle of permanent

63 J Blair, *The Control of Oil* (1976) 78; S Toriguian, *Legal Aspect of Oil Concessions in the Middle East* (1972) 168.

64 J Stevens, *Joint Ventures in Middle East Oil* (1975) 26.

sovereignty over natural resources is however consistent with the recognition by the nationalizing States of the right of foreign oil companies to some measure of compensation for property which has been taken. This issue will be discussed in detail in Chapter 10.

(7) Settlement of Disputes

Some of the newer petroleum laws and concession agreements provide that any disputes which may arise between the State and a foreign oil company shall be governed by and dealt with in accordance with the law of the State and within its jurisdiction. But by mutual agreement between the parties some other peaceful means may be sought when state jurisdiction has been exhausted, for example through recourse to arbitration or international adjudication. This principle was confirmed by the United Nations resolutions referred to above.

Thus the Libyan Petroleum Law of 1955 was amended as mentioned previously, on 20 November 1965, to provide for settlement of disputes as follows:

The 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.⁶⁵

Article 39 of the *Kuwait-Arabian Oil Company Agreement* 1958 provides:

...this agreement shall be given effect and must be interpreted and applied in conformity with the principles of law common to Kuwait and Japan, and in the absence of such common principles, then in conformity with the principles of law normally recognized by civilized nations in general, including those which have been applied by international tribunals.

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Clause 28(7) Second Schedule, the Libyan Petroleum Law No 25 of 1955, *Middle East Law Review*, vol 1 No 6, September 1958, 286. See *ILR* 53 (1979) 297.

The oil concession agreement between the government of *Sierra Leone and American Company Tennessee Sierra Leone Incorporated* (1962) provides:

This agreement shall be governed by and interpreted in accordance with the laws of Sierra Leone and such principles and rules of international law as may be relevant and the arbitrators and umpire shall base the award upon these laws, principles and rules.

It appears that these provisions contrast with the Calvo doctrine which provides that: "the sovereign equality of States requires that a State be free from foreign State interference of any sort."⁶⁶ Thus there is a difference between United Nations Resolution 1803 (1962) and the Calvo doctrine regarding the jurisdiction in case of dispute settlement mechanisms. The resolution reversed the situation and provides for international mechanisms.

By contrast Article 4 of the *Venezuelan Law of Hydrocarbons* of 13 October 1955 provides:

Any doubts and controversies of whatever nature that may *ensue* because of this concession and which cannot be amicably settled, shall be decided upon by the competent courts of Venezuela, and in accordance with its laws, and for no reason nor for any cause shall they give rise to foreign claims.

Article 49 (c) of the *Saudi Arabia Japan Petroleum Trading Company Agreement* (1377) AH 1957 provides:

It is understood that no right under this agreement is or shall be in any manner acquired, either directly or indirectly, by a foreign government or State or foreign governments or States, or by a corporation or any other entity dependent on them, nor may said governments entities or corporations be admitted or accepted as partners or shareholders.

(3) Who has the Right of Permanent Sovereignty: Peoples or States?

As we have seen, successive United Nations resolutions have given some definition to the right of permanent sovereignty over natural resources. But it has often been asked who has that right, the "people" or the "State"? On this question the resolutions are divided.

There is no doubt that the principle of permanent sovereignty has its origins in the principle of self-determination, which is clearly a right of peoples, not of states. This was evident from the earliest formulations of self-determination, for example in the Chilean proposal before the Human Rights Commission in 1952 for "the right of peoples to self-determination". This right was approved in Resolution 626 (VII) of 21 December 1952, and Resolution 1314 (XIII) of 12 December 1958, which provided for the right of peoples and nations to self-determination. Moreover Resolution 1803(XVII) of 14 December 1962 reaffirms the right of peoples and nations to permanent sovereignty over their natural wealth and resources.

Furthermore, in the same terms, both the United Nations Covenant on Economic, Social and Cultural Rights, 16 December 1966,⁶⁷ and the Civil and Political Rights Covenant, 16 December 1966, Article 1(2) provided as follows.⁶⁸

All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit and international law. In no case may a people be deprived of its own means of subsistence.

Article 21 of the African Charter on Human and Peoples' Rights (1981) provides:

(1) All peoples shall freely dispose of their wealth and natural resources. This right shall be exercised in the exclusive interest of the people. In no case shall a people be deprived of it.

67 993 UNTS 3.
68 999 UNTS 171.

(2) In case of spoliation the dispossessed people shall have the right to lawful recovery of its property as well as to an adequate compensation.

(3) The free disposal of wealth and natural resources shall be exercised without prejudice to the obligation of promoting international economic co-operation based on mutual respect, equitable exchange and the principles of International law.⁶⁹

From the foregoing it would appear that the peoples and nations are the direct holders of the right of permanent sovereignty over their natural wealth and resources.

On the other hand other resolutions refer to the right of States to exercise full permanent sovereignty over their natural resources. For example Resolution 1515 (XV) of 15 December 1960, provides, as we have seen, for "the sovereign right of every State to dispose of its wealth and its natural resources." Resolution 3281(XXIX) (CERDS) of 12 December 1974 provides in Article 2(1) that "Every State has and shall freely exercise full permanent sovereignty...." These resolutions define the State as the sovereign power with the right to exercise permanent sovereignty over natural wealth and resources.⁷⁰ This interpretation leaves the position of colonial territories out of consideration, for even the statist view of the concept of permanent sovereignty of peoples and nations would, in practice, preclude the exercise of State power by colonial authorities while the territory's status remained unchanged, with that power reviving upon the territory achieving independence.⁷¹

According to Crawford, the notion that the "permanent sovereignty" is a sovereignty of "peoples" adds another dimension as follows.

If those "peoples" constitute a part only of the population of the State, then the notion of permanent sovereignty presumably limits the power of the national government freely to dispose of the natural resources of the region without the consent (or against the wishes or contrary to the interests) of the "people" in question. Alternatively, if the "people" is the whole population of the State, the principle apparently establishes that transactions

69 *ILM* 21 (1982) 59-68.

70 Gess, 415.

71 *Ibid.* See also Hyde 856.

entered into by or on behalf of the State and involving the disposal of natural resources are subject to subsequent scrutiny, and to invalidation or avoidance, if these turn out not to have been in the interests of the population...⁷²

In my opinion, permanent sovereignty over natural resources is the right of the people as a whole. But in normal circumstances, as it is impractical for the people to exercise this right, it is exercised on their behalf by the government of the State concerned. Thus Paragraph 5 of Resolution 1803(XVII) of 14 December 1962 provides for "the free and beneficial exercise of the right of permanent sovereignty of peoples and nations over their natural resources."

The wording of "peoples and nations" implies that people who have not yet acquired the status of a State may entertain the right of permanent sovereignty. This leads to the very difficult question of when such peoples may be in such a position, and becomes a political problem of self determination as a human right.

(4) The Status of Permanent Sovereignty over Natural Resources in International Law

The principle of permanent sovereignty over natural resources has been recognized by General Assembly resolutions, by international law conferences, by treaties and in practice. However, the status of this principle has given rise to a range of controversies. It conflicts directly with the interests of capital exporting countries, and highlights the opposing interests of Third World countries over such issues as nationalization, the standard for compensation and settlement of disputes. A further controversy arises as capital exporting countries attempt to impose references to investment agreements in international law, so as to incorporate the law as applicable to private companies. Third World countries naturally oppose such a reference, maintaining that such agreements apply to sovereign States only, and that international law cannot govern a relation between foreign company and a State.

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J Crawford, *The Rights of Peoples; Peoples or Governments*, in J Crawford (ed), *The Rights of Peoples* (1988) 64.

In this section I will discuss the legal effect of General Assembly resolutions, both in general and specifically in the context of resolutions on the principle of permanent sovereignty. Then I will look at the support for permanent sovereignty in international law and finally I will discuss the binding force of investment agreements and concessions.

(1) The Legal Effect of General Assembly Resolutions

General Assembly resolutions in general have no binding effect on member states. But these resolutions may reflect important principles among the international community. Lauterpacht made it clear that even if they were not legally binding on members of the States as treaties (except in certain organisational matters) they could be admissible as evidence in the absence of evidence before international arbitral tribunals and before the International Court of Justice. He said:

It would be wholly inconsistent with the sound principles of interpretation as well as with high international interests, which can never be legally irrelevant, to reduce the value of the Resolutions of the General Assembly -- one of the principal instrumentalities of the formation of the collective will and judgement of the community of nations represented by the United Nations -- and to treat them... as nominal, insignificant and as having no claim to influence the conduct of the Members. International interest demands that no judicial support, however indirect, be given to any such conception of the resolutions of the General Assembly as being of no consequence.⁷³

Brownlie goes even further:

The fact that in principle resolutions as a class are not binding has led to no little confusion and it is sometimes said that the General Assembly resolutions "have no legislative effect". In one sense this is correct: as such the resolutions do not make new law. However, if it is inferred that such resolutions can have no effect on the shaping of international law this is a capital error. The circumstances in which a particular resolution is adopted, the statements of delegations in the debate, the voting, the explanation of votes and the content of the resolution itself, are all indicators of the *evidential* significance of the individual

resolution. The key to the problem is the fact that the proceedings of the General Assembly, as of any international conference, are a vehicle for the formulation and expression of the practice of States in matters pertaining to international law. Thus the proceedings and the resolution themselves, constitute *evidence* of the formation of rules of customary (or general) international law.⁷⁴

Thus although the resolutions of the United Nations are not legally binding, this statement is by no means the equivalent of a negative answer to the question whether a resolution of the General Assembly has legal force.⁷⁵

In the Charter there is no express undertaking to accept the recommendations of the General Assembly, but it cannot be said that the Charter specifically negates such an obligation. For example Lauterpacht has argued "that the Charter imposes a legal obligation upon the members to respect human rights though there is no express provision by which the members so agree".⁷⁶ Sloan concludes that the non-obligatory status of recommendations "is far from being as definitely established as has been assumed by most writers. The most that can be said is that there is a presumption against these recommendations possessing binding legal force."⁷⁷ Sloan further suggests three circumstances when recommendations of the General Assembly may be legally binding. The first is where the parties have agreed to accept a recommendation as binding.

States can ... agree in advance to be bound by Assembly recommendations; and with respect to States parties to such an agreement, such recommendations will be so effective as if they were laws enacted by an international legislature with powers similar to a national legislative body.⁷⁸

The second is where recommendations may achieve legal effect through the growth of a customary rule of international law.⁷⁹ While the General Assembly

74 I Brownlie, *Recueil des Cours*, 1 (1979) 260.

75 B Sloan, *The Binding Force of A 'Recommendation' of the General Assembly of the United Nations*, *BYIL* 25 (1948) 1.

76 H Lauterpacht, *Report of the Human Rights Committee to the Brussels Conference of the International Law Association* (1948) 13, quoted by Sloan, 14.

77 Sloan, 16.

78 *Ibid.*

79 *Ibid.*

cannot as such enact new law, it has often adopted resolutions declaring what it regards as existing rules of international law.⁸⁰ An important example is its declaration "that genocide is an international crime". Here "it might even be argued that such a statement was an expression of a general principle of law recognized by civilized nations".⁸¹

The third concerns the authority inherent in the position of the General Assembly as a representative organ of the world community. Here Sloan contends that there is an inherent power in the General Assembly, and perceives it as having "a dual role", first as "an organ of an entity having a separate legal personality" and secondly, as a congress of the member nations none of which "lose the legal capacity which they possess at other times".⁸²

This analysis is consistent with, and was further reinforced by, the decision of the International Court of Justice in the *Nicaragua Case* (1986). Nicaragua claimed that the United States had violated three major obligations under customary international law, including the obligations not to use force in international relations except in certain narrowly defined cases, and not to intervene in the internal affairs of Nicaragua. The Court derived customary international law (in the absence of jurisdiction to apply the United Nations Charter) from General Assembly resolutions, including especially Resolution 2625 (XXV) of 24 October 1970, the Declaration on the Principles of International law concerning Friendly Relations and Co-operation among States, and Resolution 2131 (XX) of 21 February 1965, the Declaration on the Inadmissibility of Intervention in the Domestic Affairs of States and the Protection of their Independence and Sovereignty.⁸³ Thus the Court concluded that Nicaragua claims were supported by General Assembly Resolutions which were for these purposes declaratory of customary international law.

General Assembly resolutions have a wide range of effects, in a variety of areas, among which is their impact on oil concession agreement disputes.

80 Id, 24.

81 Id, 25.

82 Id, 22.

83 *Nicaragua v United States*, ICJ Reports 17, 19, 45, 53, 151, 107.

International tribunals have referred to General Assembly resolutions in recent cases, in the *Texaco Case* (1977),⁸⁴ the *Liamco Case* (1977),⁸⁵ and the *Aminoil Case* (1982).⁸⁶

For example, in the *Texaco* case with Libya, sole arbitrator Dupuy analyzed the effect of the nationalization provisions of the Charter of Economic Rights and Duties of States 3281 (XXIX) of 12 December 1974 (CERDS) (Article 2) and in the Resolutions on the New International Economic Order (3201 and 3202), 1 May 1974 (Article 4, paragraph (e)).⁸⁷ He said:

The general question of the legal validity of the resolutions of the United Nations has been widely discussed by the writers. This tribunal will recall first that, under Article 10 of the UN Charter, the General Assembly only issues "recommendations" which have long appeared to be texts having no binding force and carrying no obligations for the member States... Refusal to recognise any legal validity of United Nations resolutions must, however, be qualified according to the various texts enacted by the United Nations. These are very different and have varying legal value, but it is impossible to deny that the United Nations' activities have had a significant influence on the content of contemporary international law. In appraising the legal validity of the above-mentioned resolutions, this tribunal will take account of the criteria usually taken into consideration, ie. the examination of voting conditions and the analysis of the provisions concerned.⁸⁸

The arbitrator concluded that the lack of agreement in the vote on the two resolutions indicated a lack of binding obligation. He pointed out:

The conditions under which resolution 3281 (XXIX) proclaiming the Charter of Economic Rights and Duties of States, was adopted also show unambiguously that there was no general consensus of the States with respect to the most important provisions and in particular those concerning nationalization...⁸⁹

84 Arbitral award *Libya & Texaco* 19 January 1977, *ILM* 17 (1978) 27-31.

85 Arbitral award, *Libya & Liamco* 12 April, 1977, *ILM* 20 (1981) 51-3.

86 Arbitral award, *Kuwait & Aminoil* 24 March (1982) *ILM* 21 (1982) 1032-3.

87 See RP Brown JR, "Changing the Rules: International Law and the Developing Countries", *International Lawyer*, 12, No.1 (1978) 270.

88 *Texaco Case*, Finding No. 83.

89 *Id.*, Finding No. 85.

And further:

While it is now possible to recognize that resolutions of the United Nations have a certain legal value, this legal value differs considerably, depending on the type of resolution and the conditions attached to its adoption and its provisions. Even under the assumption that they are resolutions of a declaratory nature, which is the case of the Charter of Economic Rights and Duties of States, the legal value is variable. Ambassador Castaneda, who was chairman of the working group entrusted with the task of preparing this charter, admitted that 'it is extremely difficult to determine with certainty the legal force of declaratory resolutions' that it is 'impossible to lay down a general rule in this respect', and that 'the legal value of the declaratory resolutions therefore includes an immense gamut of nuances.'⁹⁰

In reference to the legal effect of resolutions, Jiménez de Aréchaga stated:

The determination of [the legal effect of resolutions] is a matter requiring careful analysis in each case and with respect to each provision and paragraph of a given resolution, taking into account *inter alia*, the drafting of the text: the voting strength it obtained, the statements made by members during the process of deliberation and the subsequent conduct of States [and of the United Nations itself] in respect of each resolution.⁹¹

The first issue to consider in determining its effect is its authority as the most representative body of the international community of States. The important factor here is its status and capacity and the validity of the resolution itself. The second factor is the nature and content of a resolution, whether it relies on traditional sources of international law and whether there is a reasonable relationship with existing circumstances.⁹² Other factors include the time and circumstances in which the resolution was made, how it was prepared and how the resolution is drafted. Also the intent of the Assembly needs to be considered, and the strength of support a resolution obtains.⁹³ As Sir Kenneth

90 Id, Finding No. 86.

91 Jiménez de Aréchaga, *Hague Recueil*, 159 (1978 1) 31, quoted by B Sloan, *General Assembly Resolutions Revisited*, *BYIL* 58 (1987) 125.

92 Sloan (1987) 126.

93 Id, 129.

Bailey stated: "If a resolution is accepted by unanimity and is generally followed by practice, it may quickly acquire obligatory character."⁹⁴ And also whether it is accepted by the external practice accompanied by opinion of jurists alone which creates the law and "that the resolution is only the stimulus".⁹⁵

The weight of these factors will vary according to the circumstances surrounding each resolution, though resolutions can be divided into three categories: decisions, recommendations and declarations.⁹⁶ The former can be seen to have the most binding effect to the extent "from a practical point of view agreement or acceptance may be material even with respect to legally binding decisions."⁹⁷ Recommendations carry obligations of co-operation and good faith: this applies, it has been said...

to all validly adopted recommendations, without special regard to the size of the vote. The hortatory effect of recommendations will be strengthened by unanimity or near unanimity. Recommendations will also have value as precedents and may gain binding force through acceptance or estoppel.⁹⁸

The status of a declaration depends on many factors:⁹⁹

If the declaration is adopted by a majority vote it's evidentiary value is to be weighed in the light of all relevant factors. It would in any event be part of the material sources of customary law and would constitute an expression of *opinio juris*, or a lack of *opinio juris* for conflicting norms, of those States voting for the resolution.¹⁰⁰

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- 94 K Bailey, "Making International Law in the United Nations", *ASIL Proceedings* 61 (1967) 235, quoted by Sloan (1987) 133.
- 95 M Akehurst, Custom as a Source of International Law *BYIL* 47 (1974-5) 52.
- 96 Sloan (1987) 139.
- 97 Id, 140.
- 98 Ibid.
- 99 Id, 125.
- 100 Id, 140. On the legal Status of General Assembly resolutions, in addition to the works already cited, see also K Skubiszewski, International Legislation, *Encyclopedia of Public International Law*, vol.5, p.97; R Monaco, Source of International Law, id., vol.7, p.425, and works there cited

(2) Legal Effect of General Assembly Resolutions on Permanent Sovereignty

As to Resolution 1803(XVII) of 14 December 1962, the opinion of most United Nations Members at the time, whether expressed in the Permanent Sovereignty Commission or in the General Assembly, was that the resolution intended to express existing law, without it being necessary to claim that the General Assembly could establish "new law" or had any authority to enact "international legislation".¹⁰¹ For example Chile's view was that Resolution 1803 "proposed no modification of the existing principles of law and, in fact, called in two places for the observance of those principles".¹⁰² The United States noted that Resolution 1803 proposed "to state with lasting import the conviction of the General Assembly on fundamental issues".¹⁰³ The instrument was one which "sets forth the rights and duties of States, which affirms their sovereignty and the modalities of the exercise of that sovereignty".¹⁰⁴ For Argentina, Resolution 1803 was a simple resolution in accordance with international law, although it had no binding legal force.¹⁰⁵ For the Philippines, apart from laying down minimum standards there was no question of establishing a new legal obligation for states or of legislating on the conduct of states: "Resolution 1803 was a means of crystallising prevailing views".¹⁰⁶ For Syria, the Resolution 1803 created a "new legal basis" for the relationship between developed and underdeveloped countries. However it was noted that the two of the most important concepts on which the draft resolution was based -- State responsibility and State succession -- were still under consideration by the International Law Commission.¹⁰⁷ Hungary also agreed with the view that Resolution 1803 was a binding instrument and constituted "new law". Hungary stated that the 'smuggling' of the principle of adequate compensation into international law by way of a United Nations resolution "would impose an obligation upon the developing countries".¹⁰⁸

101 Gess, 409.

102 United Nations Document A/C 2/SR. 842, 12.

103 A/PV. 1193, 37.

104 A/PV 1193, 32.

105 United Nations Document A/C 2/SR.859, 14-15.

106 United Nations Document A/C 2/SR. 848, 20.

107 United Nations Document A/C 2/SR 855 13-14 quoted by Gess, 410.

108 Quoted by Gess, 410.

By contrast, France and Japan felt that Resolution 1803 did not express existing international law. According to France, the principle of permanent sovereignty, although based on international law, was connected to the question of State responsibility, which was still under review by the International Law Commission.¹⁰⁹ In some particular aspects, the resolution would modify basic principles of private international law.¹¹⁰ According to Japan, "the concept of permanent sovereignty over natural resources had no legal validity, based as it was on the concept of self-determination which was not yet internationally established or accepted and which the Charter of the United Nations recognised as a principle and not as a right".¹¹¹ Likewise the United States representative thought it "unlikely" that the Resolution 1803 was intended to make a substantial change in international law: such a step would, in any case, be unwise.¹¹² However, most Members did agree that Resolution 1803 was...

intended to set forth, within the solemn vehicle of a declaration, the basic principles and modalities of the exercise of permanent sovereignty over natural resources, subject to the overriding requirement that both principles and modalities of exercise be in conformity with the rights and duties of States under existing international law, and further, that the principles set forth reflect minimum standards.¹¹³

According to Gess, the General Assembly Resolution 1803 (XVII) is a positive reaffirmation of certain 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.¹¹⁴

109 United Nations Document A/C 2/SR 859, 13-14.

110 A/C 2/SR 857, 3.

111 United Nations General Assembly, 32nd session, 1178th meeting, 172.

112 Id, 176.

113 Gess, 411.

114 Id, 448.

These principles define the concept of permanent sovereignty: it is evident that the General Assembly Resolution 1803 did not reflect the small voting strength of the world's capital exporting countries, but rather reflected "the position of a majority of the capital importing and underdeveloped countries acting in enlightened self-interest".¹¹⁵

(3) Other Material supporting Permanent Sovereignty over Natural Resources in International Law

General Assembly resolutions are by no means the only basis for arguing that the principle of permanent sovereignty over natural resources is recognized in international law. For example the 1982 Montreal Conference of the International Law Association attempted to give a definition of permanent sovereignty over natural resources as follows:

I. The principle of permanent sovereignty over natural resources, emanating as it does from the *Jus Cogens* principle of self-determination, is a fundamental principle of contemporary international law, and an important instrument for the establishment of a new international economic order.

II. The legal status of some of the corollary rights which stem from this principle, however, need to be clarified by further study.

III. In inter-state relations permanent sovereignty over natural resources is one of the legal expressions of the economic aspect of political sovereignty of States which is a cornerstone of the present organization of the international community. It underlines the domestic jurisdiction of States with regard to the natural resources within their national boundaries, without, however, exempting it from the application of other rules or principles of international law.

IV. The exercise of the right to nationalize or expropriate, as recognized, *inter alia*, by Article 2 (2) (c) of the Charter, is an exercise of sovereignty and such exercise of itself does not constitute an unlawful act so as to engage the State responsibility of the State concerned.

115 Ibid.

V. The exercise of the right to nationalize, recognized, *inter alia*, by Article 2 (2) (c), should be accompanied by the duty to pay appropriate compensation.

VI. The need to consider all pertinent circumstances limits the discretion of the host State in the determination of the quantum of compensation. The discretion of the host State is circumscribed by objective international guidelines.

VII. The legal foundation of the concept of appropriate compensation is to be found in the equitable principle of good faith. The elaboration of the specific contours of these principles, and their legal implications, requires further study.

VIII. Current State practice indicates that a variety of flexible formulae is applicable to the determination of the quantum of compensation upon nationalization or expropriation.

IX. The Charter does not exclude the existence of international dispute settlement in the event of a dispute arising as to the appropriateness of compensation. Both UN General Assembly resolution 1803 and Article 2(2)(c) of the Charter allow for international settlement of disputes on the basis of sovereign equality of States and in accordance with the principle of free choice of means.

X. The principle of good faith applies to all economic relations, covered, *inter alia*, by the Charter, including situations relevant to Article 2(2)(c).¹¹⁶

This is not the place for a full discussion of what constitutes general international law, or of the standard that has to be met to establish a rule of international law.¹¹⁷ It is sufficient for present purposes to say that the level of international support that now exists for the principle of permanent sovereignty over national resources as a principle of international law is quite sufficient and that international lawyers from many traditions and parts of the world recognize this, as we have seen.

116 International Law Association, *Report of the Sixtieth Conference, Montreal (1982)* 197.
 117 See Monaco, 432-4; R Bernhardt, Customary International Law, *Encyclopedia of Public International Law*, vol.7, p.61. See also EV Petiesmann, Charter of Economic Rights and Duties of States, *id.*, vol.8, 71, 74-5 and works there cited.

(4) The Binding Force of Investment Agreements and Concessions

Article 26 of the Vienna Convention on the Law of Treaties provides that:

Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

Likewise paragraph 8 of Resolution 1803 (XVII) of 14 December (1962) affirms that foreign investment agreements "freely entered into by, or between sovereign States shall be observed in good faith." On the other hand Article 2 of the Charter of Economic Rights and Duties of States did not contain any such provision.¹¹⁸ Proposals by the developed countries to incorporate an express reference to investment agreements in the Charter were rejected by developing countries on the grounds that:

The international law governing the relationship between only two states does not recognize the private companies as a part of this relationship, because they are not States.

In other words they insisted that foreign private companies were not directly bound by international law and are not subjects of international law. But this view is by no means confined to Third World. Lord McNair has rejected the idea the international law is applicable to govern a contract or agreement between a State and a private individual or corporation.¹¹⁹

Similarly in the arbitration between the *Saudi Arabia and the Arabian American Oil Company (Aramco)*, the Tribunal rejected the company's claim that the oil concession agreement should be assimilated to an international treaty governed by the law of nations, holding simply that:

As the agreement of 1933 has not been concluded between two States, but between a State and a private American corporation, it is not governed by public international law.¹²⁰

118 Chowdhury, 19-20.

119 McNair, *General Principles of Law recognized by Civilized Nations*, *BYIL* 33 (1957) 19.

120 *Aramco Arbitration ILR* 27 (1963) 165.

In the *Anglo-Iranian Oil Company case*, the International Court did not accept that the contract concluded between the Iranian Government and a foreign oil company should be considered to be assimilated to an international treaty, and asserted that "it could not possibly be considered to lay down the law between two States".¹²¹

However, when the Charter of Economic Rights and Duties did not expressly refer to the principle of good faith it was never intended to mean that a breach of a contract has no legal consequences. The Charter provides in Article 2(2)(c) that a State may "nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid." Thus the matter would be subject to the obligation to fulfil in good faith the arbitration agreement and to pay compensation in an amount to be determined by the appropriate tribunal, taking into account its relevant laws and regulations and other relevant circumstances.¹²² As Jiménez de Aréchaga said:

This is not an obligation resulting from an international treaty: it derives from the contract itself and constitutes an obligation based on the general principles of law, particularly the one requiring a State to observe all its obligations in good faith.¹²³

Also relevant here is the International Bank for Reconstruction and Development (World Bank) Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965. The Convention established an International Centre for the Settlement of Investment Disputes, which seeks to facilitate by negotiation and of necessary by arbitration disputes that might arise between a State and foreign investors. Article 27 of the Convention provides that:

No Contracting State shall... bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

121 *ICJ Rep* 1952, 112-113.

122 Chowdhury, 20.

123 de Aréchaga, *Hague Recueil* 1 (1978) 306, quoted by Chowdhury, 20.

The effect is to enable the investor to defend its own interests, instead of exacerbating inter-state relations by turning private investment disputes into inter-state disputes. In this respect, the machinery of the convention could perhaps be extended to other types of claim concerning treatment of aliens -- although it is doubtful whether individual claimants could afford the very high costs of international arbitration.¹²⁴

5. Permanent Sovereignty under Islamic Shari'ah Law

Before discussing the principle of permanent sovereignty over natural resources under Islamic Shari'ah, some general comments should be made about the status and basic principles of that law, especially in relation to contracts and agreements. This may be particularly helpful to readers of this thesis who are not trained in or familiar with Islamic Shari'ah.

(1) The Principles of Islamic Shari'ah Law

Islamic Shari'ah is of real significance for more than one billion people over the world, especially in the Middle East, Pakistan, Bangladesh, South East Asia and parts of Africa. The Shari'ah clearly embodies the universal maxim of the protection of acquired rights, and respect for contractual arrangements.¹²⁵ It is flexible and not rigid, and is thus capable through interpretation and application to meet any problems which may arise at any time and place. It provides a solution to a number of problems concerned with the relationship of aliens and the state or its citizens, which are at the core of the conflict about permanent sovereignty over natural resources. Muslim jurists have also established new solutions for the problems that are occurring in modern Islamic societies. They do not stand handcuffed towards new problems, but have sought to derive the right solutions from within the canonical law of Islam. The issue of permanent sovereignty over natural resources is one of these problems.

Consent to treaties and conventions is only given by virtue of sovereignty, which allows a State to limit its sovereign rights and to be bound by international

124 See further, Executive Director's Report (1965) para 23.
125 Domke, 585.

legal obligations. In Islam "sovereignty is nominally vested in God and Man acts only as his vicegerent."¹²⁶ In an Islamic State "the sovereign body is not considered to be absolutely supreme because it cannot legislate to do away with the Qur'an and Sunnah."¹²⁷ The law "never conceded to any human being any greater right than that of enforcing his [God's] law and protecting and leading his people."¹²⁸

In practice this confers sovereignty on the persons or institutions in power. However, this sovereignty differs from sovereignty as it is understood in the West. Even the prophet himself as head of the first Muslim State was not allowed to monopolize power and decision-making. "The governance of the *Ummah* [the Muslim Community] thus depended upon the principle of Consultation (*Shura*) and no ruler was free of this obligation."¹²⁹ The Qur'an itself refers to "Those who hearken to their Lord, and establish Regular Prayer, who (Conduct) their affairs by mutual Consultation..."¹³⁰ Though the concept of sovereignty in Islam is limited, the State is able to engage in international relations based on reciprocity. Once this has been done not only the provisions of international law but also those of the Shari'ah enforce the principle that this contract is legally binding.

One starts from the premise that Islamic Shari'ah demands that people keep the obligations arising under their contracts and covenants. Thus when they sign a contract or covenant with a foreigner they have to maintain their pledge. There are a number of verses to this effect from the primary source of Islam, the Holy Qur'an, and from the second source of Islam, the Sunnah, the practice and tradition of the prophet. Thus the Qur'an says:

Ye who believe! Fulfil (all) obligations.¹³¹

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- 126 AA Maududi, "Political Theory of Islam" in K Ahmad (ed), *Islam - Its Meaning and Message* (1976) 160-8, quoted by Hasan Moinuddin, *The Charter of the Islamic Conference and Legal Framework of Economic Co-operation Among its Member States* (1987) 53.
- 127 D Khalid, *Theocracy and the Location of Sovereignty*, *ISI Stud* 11 (1972) 187-209, quoted by Moinuddin, 235.
- 128 CG Weeramantny & M Hidayatullah, *Islamic Jurisprudence. An International Perspective*, (1988) 82.
- 129 *Ibid.*, 83.
- 130 The Holy Qur'an Sura XLII, verse 38.
- 131 The Holy Qur'an, Sura v. verse 1.

This applies comprehensively to all Muslim obligations, contracts and covenants relating to conduct in individual, social and public life, to commercial and social contracts (including marriage). Muslims must faithfully fulfil their pledge in all their obligations. Tabari states:

...this is a command from God that every lawful contract must be observed; and it is not permissible to limit its application without proof of such limitation.¹³²

The Qur'an also provides:

Fulfil the covenant of God when ye have entered into it, and break not your oaths after ye have confirmed them. Indeed ye have made God your surety; for God knoweth all that ye do.¹³³

Qurtubi states that "Be faithful in the covenant of God" is a "general term applicable to all covenants which are made by the tongue and which man takes upon himself",¹³⁴ for in all such the Muslim may be regarded as making God his witness. This verse, Qurtubi affirms, may be regarded as included in the wider verse, "Verily, God commands justice and good work". The reason is that "the law was given to provide relief from the oppressor, and to restore to the oppressed the rights which he had filched."¹³⁵

Again the Qur'an says:

(But the treaties) are not dissolved with those pagans with whom ye have entered into alliance and who have not subsequently failed you in aught, nor aided any one against you. So fulfil your engagements with them to the end of their term; for God loveth the righteous.¹³⁶

132 Tabari, Tafsir, VI 33 (Bulaq 1905-1912, Cairo), quoted by JND Anderson & NJ Coulson, *The Moslem Ruler and Contractual Obligations*, *NYULR* 33 (1958) 923.

133 The Holy Qur'an, Sura XVI, verse 91.

134 Al Qurtubi *Al Jami, li Ahkam Al Qur'an*, VI 33 Cairo 1935, quoted by Anderson & Coulson, 923.

135 Ibid.

136 The Holy Qur'an, Sura IX verse 4.

The Qur'an enjoins all Muslims to keep their obligations with non Muslims until the terms of the obligations are completed "for God loveth the righteous". "Where therefore, the polytheists were faithful and did not betray their trust, the Muslims were commanded to fulfil their undertakings until the full period for which they were concluded should have elapsed, and this is regarded as being of general application".¹³⁷ Further the Qur'an enjoins all Muslims to keep their engagements in good faith and to "fulfil every engagement, for every engagement will be inquired into on the day of reckoning."¹³⁸ These words are to be interpreted in a comprehensive sense. Tabari for instance, gives an entirely general meaning to the words which he interprets as applying to all human contracts.¹³⁹

In another passage the Qur'an says:

The believers must (eventually) win through.
Those who faithfully observe their trusts and their covenants.¹⁴⁰

Qurtubi says that "pledges and covenant include all that is incumbent on a man in regard to his religious and secular life, both in word and deed. It comprises his dealings with his fellow men, his undertakings, and much besides, and the injunction is that he should keep them and perform them. The term pledge is of wider significance than covenant, for every covenant is a pledge."¹⁴¹ The Shari'ah, therefore, recognizes the principle of mutuality between the parties.

The Sunnah contains the practice of the prophet and the body of traditions regarding his life, what he said and did. It is considered as a second source of Islamic Shari'ah, by the consensus of all its schools. Thus Prophet Muhammad says:

Muslims are bound by their stipulations, except a stipulation which makes lawful what is unlawful, or makes unlawful what is lawful.

137 Anderson & Coulson, 924.
138 The Holy Qur'an, Sura XVII verse 34.
139 Tabari, Tafsir XV 61, quoted by Anderson & Coulson, 924.
140 The Holy Qur'an Sura XXIII, verses 1 and 8.
141 Ahkam XII 107, quoted by Anderson & Coulson, 925.

This means that the Muslim does not violate contractual stipulations, but must respect and observe what he has accepted. This is a most important principle in the Muslim community; it remained valid in Islamic Shari'ah even in the Middle Ages.¹⁴²

Muslim leaders and jurists support the doctrine of pledge keeping and the keeping of contracts and covenants according to the injunction of Qur'an and the practice of the Prophet. A few examples must suffice. Umar, the second Caliph, says:

A man's rights are determined by his stipulations. You are entitled, therefore, to what you stipulated.

The Hanbali school jurist Ibn Taimiya says:

God has commanded that contracts be fulfilled, and this is of general application. He has thus commanded us to fulfil the covenant of God and covenants in general, and has included in this the contracts a man takes upon himself. This is proved by the Qur'anic verse: 'They had previously covenanted with God that they would not turn their backs, and of the covenant of God enquiry will be made. This indicates that in the covenant of God is included the contracts a man takes upon himself, even though God has not expressly commanded this particular covenant before, as in the case of an oath or sale, but merely commanded that it be fulfilled.'¹⁴³

Shafi'i, the founder of Shafi'i School (767-820), says:

A contract is never vitiated except by its own terms. It is not vitiated by anything which precedes it or which follows it, nor by fancy or by conjecture as to probabilities. Similarly we do not vitiate any transaction except on the basis of the relevant contract. We do not vitiate sales, for instance, by saying 'This may be a means to some end' or 'This comes of an evil purpose'.¹⁴⁴

142 J Schacht, *Islamic Law in Contemporary States*, *AJCL* 8 (1959) 139-140. Also Anderson & Coulson, 925.

143 *Majmu'at Fatawa*, III 329 (Cairo 1908-1911), quoted by Anderson & Coulson, 927, 928.

144 *Al Umm* VII 270 (Cairo 1903-1908), quoted by Anderson & Coulson 927, 928.

Thus it may be concluded that according to the Holy Qur'an, the practice of the Prophet and the consensus of Islamic schools and Muslim jurists, Muslims are strictly bound by their obligations of whatever kind, including economic agreements. Moreover because in Islamic Shari'ah all people are equal, this general principle should apply to all the Muslim community, whether individuals or rulers.¹⁴⁵

This principle of the sanctity of contracts has emerged from "a deep moral and religious influence." Islamic Shari'ah has a great influence on the observance of contracts as between the parties and the principle of the sanctity of contracts in general. This principle derives from the primary source of Islam, the Holy Qur'an.¹⁴⁶

This attachment to the principle *pacta sunt servanda* has also been noticed by western jurists. For example, according to Wehberg:

For the Islamic peoples, the principle, *pacta sunt servanda*, has also a religious basis: "Muslims must abide by their stipulations". This is clearly expressed by the Qur'an in many places, for example where it is said: "Be you true to the obligations which you have undertaken... your obligations which you have taken in the sight of Allah... for Allah is your witness."¹⁴⁷

Similarly Schacht states:

The rule *pacta sunt servanda* is one of the fundamental principles of Islamic law. It is already enounced in numerous passages in the *Qur'an*: "O ye who believe, fulfil your undertakings"; "And keep the covenant, lo, the covenant will be called (as a witness)"; "And those who keep their pledges and their covenant... these will dwell in Gardens, honored," etc. Its classical formulation in Islamic law is *al-Muslimum 'ala shurutihim*, "the Muslims are bound by their stipulations", or, shorter, *al-shart amlak*, "the stipulation prevails." This maxim had already been formulated at the beginning of the second century of the hegira (early in the 8th century AD), and it has remained valid in Islamic law ever since.¹⁴⁸

145 Anderson & Coulson, 928.

146 Tabari, Tafsir, VI 33, quoted by Anderson & Coulson, 923.

147 H Wehberg, *Pacta Sunt Servanda*, AJIL 53 (1959) 775.

148 Schacht, 139.

Anderson and Coulson state:

It is abundantly clear, then, that there is reiterated authority in the Qur'an, the Traditions, and the writings of the jurists, for the principle that Muslims are strictly bound by every lawful contract or covenant into which they may have entered. This is at times emphasized on grounds of ethics, religion and law as an entirely general proposition; at times it is coupled with the consideration that, provided the enemies of Islam keep their side of a contract, Moslems must keep theirs, right up to the expiry of the prescribed period, and at other times it is conjoined with the observation that the inevitable result of a contrary policy would be loss of confidence on the part of those with whom they may need to have similar relations in the future....¹⁴⁹

(2) Sovereignty over Natural Resources in Islamic Shari'ah Law

Regarding the ownership of natural resources, all four schools in Islam (Hanafi 696-767, Maliki 715-795, Shafi'i 767-820, and Hanbali 780-855) agree in basic principle, although there are differences of opinion in the details. Professor Milliot has observed that:

The regime of mines under Islamic law varies with the different schools, some holding that mines are part of the State domain and others stating that they follow the ownership of surface of the soil.... According to "Droit Musleman of L Milliot" where the mine is part of the State domain its exploitation can be granted under a concession... regulated at the direction of the sovereign.¹⁵⁰

The Hanbali school, like the other schools in Islamic Shari'ah, is dominated by the principal sources, the Holy Qur'an as the word of God and the Sunnah as the practice and traditions of the last of God's messengers, Muhammad. Supplemented by other sources, in particular Ijma (consensus of opinion), and Qiyas (reasoning by analogy), these constitute the Shari'ah. The jurist Ibn Kudamah (1223 AD) summarized the position as follows:

149 Anderson & Coulson, 928.

150 Quoted by Cattani, *The Law of Oil Concessions in the Middle East and North Africa* (1967) 56.

Minerals are free, he who finds a mineral is entitled to take his need thereof by priority to others, after which he must go away to let others satisfy also their needs; he cannot appropriate the vein or mine or deposit except with and as a result of his appropriation of the grounds where such vein or mine or deposit is found; this appropriation may be through an *Iqta* or a grant from the Imam or through occupancy and reclaiming it if it is a *mawat* [dead land], which has no owner...

No one is permitted to collect or dig out a mineral contained in the property of someone else because the ownership of the land comprises the owner of its apparent and hidden parts and layers...

Liquid minerals in particular are according to the prevalent opinion, always free and not liable to be appropriated by '*Iqta*' or occupancy or by whoever owns the ground where they are found if they happen to be found in an owned property...

According to the prevailing opinion in the Hanbali school, liquid minerals whether apparent or hidden are not liable to private appropriation either through discovery and occupancy or through an '*Iqta*' or grant by the ruler...¹⁵¹

On the other hand, Sheikh Muhammad Abuzahra, Professor of Law at Cairo University, gave his opinion in the *Saudi Arabia and Aramco Arbitration* to the effect that the legality of an oil concession can be supported under the Shari'ah by the rules relating to "*Iqta*", or to first discovery. The Sheikh's contention was as follows:

As to its legality [the concession], it is to be considered as coming within an Islamic legal institution known as '*Iqta al Mawat*' (literally, allotting of undeveloped land), or as a grant of the right to take possession of minerals. It is well established that an "*Iqta*" for minerals which are under the ground is recognized by the Shari'ah. In such an "*Iqta*" the leader of the Muslim Community (Imam) grants permission to one or more persons to explore a specified area and to take out whatever minerals he may discover...

It is established and accepted that whoever first takes possession of a buried mineral has the best claim to it. It is his property.

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Ibn Kudamah, *Al Moghni*, 5, 521-528, *Aramco Arbitration*, Transcript of arbitration proceedings, 11, 761.

He has the right to continue to take the mineral and no other person has a right to compete with him for it.¹⁵²

Concerning the "*Ihai Elmowate*" (reclaiming borrowed land), the jurist Ibn Kudamah (d.1223 AD) stated:

To sum up, the apparent [surface] minerals which can be used without difficulty such as salt, sulphur, naphtha and the like, cannot be appropriated by occupation (*Ihia*) by anybody, nor can they be granted (*Iqta*) to anybody by the Imam, for fear of monopoly or undue restriction for which the Muslim Community may suffer. As to inner (subsurface) minerals which could not be reached and extracted except by hard work and expense, such as gold, silver, iron, copper, lead and crystal, if they are apparent, they cannot be appropriated as aforementioned. If they are hidden and a man digs them out, they will not be his property, according to the Hanbali school, the Imam is forbidden from granting the right to appropriate the subsurface mineral. However, the Imam may grant rights over liquid minerals such as tar, naphtha or water, which may or may not be the property of the owner of the grounds in which they are discovered. Although opinion is divided on this matter, the stronger point of view is against ownership of such minerals.¹⁵³

A further opinion was given by Sheikh Abuzahra on the *Saudi Arabia-Aramco Arbitration*, to the effect that:

It is well established that the *Iqta* for minerals which are under the ground is recognized by the Shari'ah law. In such *Iqta* the leader of the Muslim Community, the Imam, grants permission to one or more persons to explore a specific area and to take out whatever minerals he may discover. There is a tradition to the effect that the prophet Muhammed granted to Bilal bin Al Hareth by means of *Iqta* an area of land known as Al Qiblaya, including the hills and valleys in the area but he did not grant him a right which belongs to another Muslim.¹⁵⁴

In this context it is important to note that the Qur'an says:

152 Tashih Al Furu, 3, 846, *Arbitration between Aramco and the Government of Saudi Arabia*, Aramco's first memorial, 351-352.

153 Ibn Kudamah, Al Moghni, 520 (text in Arabic). See Madani, 36.

154 Nail Alawtar 6, 54 (Cairo 1933) quoted by *Aramco Arbitration*, Transcript of arbitration proceedings, Aramco's first memorial, 351.

To God belongeth all that is in the heavens and on earth.¹⁵⁵

Sayyid Qutb explained this verse as follows:

It is the overall ownership as well as being the absolute ownership,... the ownership that is unconditional without a restriction nor exception nor a partnership.. it is a concept of the one God school of thought.. thus the one Allah is the only living one, vigilant one, the sole owner, it is negating the partnership in its form as perceived on the peoples minds and awareness.. as well as being of having a mark on the making of the meaning of ownership and its truth in the people's world. Once shown that the real ownership belongs to Allah, there will be no ownership for the people in the first place, but they will have (temporarily) acquired from the only original owner who owns everything, then they have to abide during the period of their temporary possession by the conditions of the owner passing the possession of such ownership .. and he has shown them the conditions of the owner in his legislation..they are not to deviate from it or else their possession established during the time of their temporary possession would be negated and their actions would become void and these actions would have to be reversed by the believers in Allah on earth..and there we find the marks of the Islamic legislation and the practical sense of life that lies upon it... and when Allah says "To God belongeth all that is in the heavens and on earth" he does not only decide an imagined believed reality but he also lays one of the foundations of the constitution for the life of the humans and the way in which it is tied up as well.¹⁵⁶

The prophet says:

"The people are partners in fuel".

I may conclude from the foregoing that, there is a consensus of opinion that natural resources in the public domain belong to the Islamic community in general. However Islamic Shari'ah gives the sovereign (Imam) full authority and discretion for granting concession on behalf of the Islamic community in dealing with natural resources exploitation and preserving the national benefit. Thus the Islamic Shari'ah serves the welfare of the whole Islamic community.

155 The Holy Qur'an, Sura II, verse 284.

156 Sayyid Qutb, Fi thelal Al Qur'an, part 1-4, (11th edn, 1985) 287-288 (text in Arabic).

On the other hand, the Islamic principle of natural resources seems to be flexible and not rigid in its application. The Imam recognizes individual rights to such resources, but when natural resources are monopolized or if they are scarce, under such circumstances the Islamic Community will suffer. The sovereign (Imam) can then reserve the natural resources for the whole community.¹⁵⁷

The principles of Islamic Shari'ah of natural resources are followed in almost all Muslim countries. Problems which have arisen between Islamic schools with regard to natural resources have largely been solved by mineral and petroleum laws, or in their absence by concession agreements or by custom. Arab, Middle East and North African countries now recognize that petroleum and minerals form an intrinsic part of the State domain where the State has the right to exploit them either on its own or by its permission given in the form of a concession agreement. All terms and conditions of exploitation now are determined by such concession agreements or by statute or both.¹⁵⁸ It may be worth mentioning a few examples:

Article 1 of the Saudi Arabia Mining Code of 1382 AH (1963) which was amended in form but not substance in 1392 AH (1972) provides:

All natural deposits of minerals and quarry deposits in whatever form or composition, whether in the soil or subsoil, anywhere in the State's land and sea territories and all land and sea areas to which the State's jurisdiction extends, are considered the State's exclusive property...

As to minerals excluded from the scope of this Code, Article 2 provides:

Without prejudice to the provisions of Article 1, the following shall be excluded from the scope of this Code.

- (a) petroleum, natural gas, and derivatives thereof;
- (b) pearls, corals, and similar substances;

Article 9 of the Iraqi Interim Constitution of 1965 provides that:

157 See Madani, 37-8.

158 Cattani, 58.

Natural wealth together with its resources and energies shall be the property of the State which shall properly dispose of them.

Article 21 of the Kuwaiti Constitution of 1962 provides that:

All of the natural wealth and resources are the property of the State. The State shall preserve and properly exploit those resources needful of its own security and requisite to the national economy.

Article 11 of the Arab Republic of Egypt Constitution of 1964 provides that, a natural wealth, whether subterranean or within territorial waters, as well as all its resources and energy, are the property of the State. Finally, in accordance with the Indonesian Constitution of 1974, the key features of the law (No 37 of 1960 is as follows):

All minerals found in, on, and under the earth's surface within Indonesian mining jurisdiction in the form of natural deposits are national wealth and controlled by the State.¹⁵⁹

6. Conclusion

In this Chapter I have shown how the concept of permanent sovereignty has polarized the opinions of the developing and the capital exporting countries in international forums. Developing countries, through their increasing participation in the world community have brought about changing opinions with regard to the right of nations to nationalize. They have challenged the traditional notion of international law that reasons of public utility or national interest must be recognized before nationalization is considered valid by the international community. And they have extended the definition of permanent sovereignty to cover not only natural wealth, but also minerals, agriculture and forestry. As a consequence of the development of concept of permanent sovereignty, this concept has dramatically changed the former's concession agreements, modern forms are much more advantageous to national interest.

The influence of developing countries can be seen to be the foundation of the United Nations resolutions, particularly Resolution 1803(XVII) of 14 December 1962. The test of the operative principles set forth in this resolution formed the core of the concept of permanent sovereignty over natural resources, as did the New International Economic Order (NIEO) of 1 May 1974, and Resolution 3281(XXIX), the Charter of Economic Rights and Duties of States, of 12 December 1974.

These resolutions and other United Nations General Assembly resolutions have been important in the development of recognition of Third World opinion. Though the United Nations resolutions do not have binding effect as a treaty, they could be admissible before arbitration or international adjudication as a source of international law. In any case where the question of compensation is emerging as a controversy, it must be settled by the application of the domestic law and its tribunals, unless it is mutually agreed by all states in accordance with the principle of free choice of means.

In Islamic Shari'ah a pledge applies to all contracts, obligations and covenants entered into by an individual. Muslim people must faithfully fulfil their pledge in all their obligations and fulfil their undertakings until the full period for which they were concluded has elapsed. Islamic Shari'ah therefore recognizes the principle of mutuality between contract parties.

Regarding the legal status of natural resources an individual may not appropriate the natural resources, for which the Imam is empowered to grant exploration rights and to take out whatever minerals were discovered, for the benefit of the people.

CHAPTER 7
RENEGOTIATION OF OIL CONCESSION AGREEMENTS:
FUNDAMENTAL CHANGE OF CIRCUMSTANCES IN
INTERNATIONAL LAW

1. Introduction

In this century, and especially in the period since 1945, important changes in political, economic and social conditions have taken place in many societies as a result of increasingly rapid technological and social growth. These changes have been invoked increasingly in support of claims for the revision, termination or replacement of one treaty or agreement by another, on the basis that such changes were unforeseen at the time the agreement was entered into.¹

This process extends beyond international treaties to agreements or concessions between States and foreign private parties. From the beginning of this century, oil producing countries around the world have called on foreign oil companies to revise old concession agreements concluded between them. In support of their claims for these agreements to be revised, the theory of fundamental change of circumstances, which was already established and recognized by international law, has been relied on as if by analogy. This theory is thus of central importance to the stabilization of oil agreements.

My purpose in this chapter is to discuss the doctrine of fundamental change of circumstances, both in international law and in its application to oil concessions and similar agreements. I will discuss first the development of the doctrine in international law (with reference both to its history and its present status), secondly, the right of producing countries to renegotiate contracts according to international law, and thirdly the effect of stabilisation agreements.

1 JW Garner, *The Doctrine of Rebus Sic Stantibus and the Termination of Treaties*, *AJIL* 21 (1927) 509.

2. Fundamental Change of Circumstances and the Termination of Treaties in International Law

(1) Summary of Argument

The origins of the doctrine of fundamental change of circumstances (otherwise known as *rebus sic stantibus*) can be traced to Roman law. The doctrine was further developed in the nineteenth century by international law jurists. Under the doctrine, a vital change of circumstances, which is the foundation of the agreement, may justify a request by one party to be released from the obligation, or to revise or terminate the agreement on the grounds that it is no longer in the interest of the party concerned because of the changed conditions.

The basis of this doctrine, according to the early writers, was the intention of the parties at the time they entered into the agreement, rather than an objective rule of law. It was thus referred to as the *clausula rebus sic stantibus* -- that is, as an implied term. However, in the same way as the English common law rule of frustration of contracts developed from an implied term into an independent rule of law, so the international law doctrine of fundamental change of circumstances developed from a *clausula* into an independent rule, a process completed with the adoption of Article 61 of the Vienna Convention on the Law of Treaties in 1969.

(2) The Notion of Fundamental Change of Circumstances

The term *rebus sic stantibus* means literally "things remaining as they are". Reference is often made to the *clausula rebus sic stantibus*, ie, to an express or implied clause in a treaty conditioning its validity upon the continuance of the circumstances existing at the time when it was made.² As Sir John Fischer Williams (1928) stated:

The doctrine that we set out to consider is the doctrine that treaties, for the duration of whose obligations no special period

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DH Harris, *Cases and Materials on International Law* (4th edn 1991) 800.

is fixed, are not to be understood as binding on the contracting powers in the event of some material change in the conditions with reference to which they were concluded, the word "conditions" in this statement including not only material, but also moral facts. For the purpose of the discussion, the phrase *rebus sic stantibus* is a convenient catchword: treaty obligations, when the treaty itself is silent, are subject to the provision that, if the obligations are to remain, the essential "things", inanimate and animate, material, moral and mental, must remain in the condition in which they were when the treaty was concluded.³

There is much controversy among international law jurists regarding the doctrine of *rebus sic stantibus*. This doctrine has taken several forms over the centuries and has been interpreted, in each historical period, so as to serve specific purposes which have arisen during that period.⁴

In many old treaties a *clausula rebus sic stantibus* was expressly inserted: under it the treaty might be construed as abrogated, when material circumstances on which it rested changed. To bring about this effect it was not necessary that the facts alleged to have changed should have been essential conditions. It was enough if they were strong inducements to the party seeking abrogation. But such an implication came to be read into treaties even without any express provision, on the basis of a necessary inference as to the intention of the parties:

The maxim *conventio omnis intelligitur rebus sic stantibus* is held to apply to all cases in which the reason for a treaty has failed, or there has been such a change of circumstances as to make its performance impracticable except as an unreasonable sacrifice.⁵

At the same time a very broad interpretation was given to the notion of "fundamental conditions" assumed by a treaty. These were taken to extend to all

3 F Williams, *The Permanence of Treaties. The doctrine of Rebus Sic Stantibus*, and article 19 of the Covenant of the League, *AJIL* 22 (1928) 89. To similar effect WE Hall stated:

Neither party to a contract can make its binding effect dependent at his will upon conditions other than those contemplated at the moment when the contract was entered into, and on the other hand, a contract ceases to be binding as soon as anything which formed an implied condition of its obligatory force at the time of its conclusion is essentially altered.

WE Hall, *International Law* (8th edn, 1924) 407.

4 A Vamvoukos, *Termination of Treaties in International Law* (1985) 3.

5 22 Court of Claims (1887) 408.

sorts of "vital interests" of a State, in accordance with prevailing ideas of inherent rights to self-preservation and to security. For example Oppenheim (1905) stated:

When the existence or the vital development of a State stands in unavoidable conflict with its treaty obligations, the latter must give way, for self-preservation and development, in accordance with the growth and the vital requirements of the nation, are the primary duties of every State. No State would consent to any such treaty as would hinder it in the fulfilment of these primary duties. The consent of a State to a treaty presupposes a conviction that it is not fraught with danger to its existence and vital development. For this reason every treaty implies a condition that, if by an unforeseen change of circumstances an obligation stipulated in the treaty should imperil the existence or vital development of one of the parties, it should have a right to demand to be released from the obligation concerned.⁶

Similarly Woolsey (1926) defined vital changes as:

changes which are regarded by authorities as fundamental or vital are those which: take away the very foundation of the engagement, that is, its *raison d'être*; threaten or cause the sacrifice of a State's development or its vital requirements for political or economic existence to the execution of the treaty, that is, make performance impracticable except at an unreasonable sacrifice; are inconsistent with the right of self-preservation, or incompatible with the independence of the State; modify essentially the political relations which produced political treaties, as for example, treaties of alliance, make a treaty really inapplicable, or actually impossible of fulfilment.⁷

The relationship between *rebus sic stantibus* and prevailing ideas of the "natural rights" of States is clear, for example, from Fiore, who stated that:

All treaties are to be looked upon as null which are in any way opposed to the development of the free activity of a nation or which hinders the development of its industry or commerce, which prevents the exercise of any of its natural rights or which offends in any manner against the principles of absolute justice or the supreme law of right.⁸

6 Oppenheim, *International Law I* (4th edn, 1928) 748.

7 LH Woolsey, *The Unilateral Termination of Treaties*, *AJIL* 20 (1926) 349.

8 Quoted by Garner, 512-13. See Hall, 416; GW Keeton, *The Revision Clause in Certain Chinese Treaties*, *BYIL* 10 (1929) 112.

Indeed according to Fiore, a treaty in this case is not merely voidable but is looked upon as null.

German writers in particular adopted the theory that *rebus sic stantibus* was based upon the fundamental rights of the State, and they were followed in this by some American and European writers.⁹ That view was itself open to different interpretations. For example, it could be argued that the doctrine would apply only in those exceptional cases in which a fundamental right of the State is endangered. This view restricted the fundamental rights of the state to self-preservation.¹⁰ A second view, more consistent with the ideas underlying "fundamental rights of the State", opposed the idea that treaty obligations are permanently binding. This concept is related to the idea that a State can be seen as a person in the process of development.¹¹ As a State, unlike an individual, endures for many generations, these future generations should not be bound in perpetuity by treaty obligations which could hinder the progress or development of the State.¹²

Whatever its basis, the doctrine of fundamental change of circumstances was accepted by the early writers on international law, and has thus been regarded as part of international law for three centuries.¹³ Initially, fundamental change of circumstances was based on the intentions of the parties, as Hill (1934) stated:

the doctrine of *rebus sic stantibus* is based juridically upon the intention of the parties. A change of circumstances becomes relevant to the obligatory force of a treaty only in so far as it is related to the wills of the parties to the treaty at the time of the conclusion of the treaty. It is not an objective rule of international law which is imposed upon the parties, but is a rule for carrying the intention of the parties into effect.¹⁴

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- 9 C Hill, *The Doctrine of Rebus Sic Stantibus in International Law*, University of Missouri Studies, IX (1934) 10.
 10 Ibid.
 11 Ibid.
 12 Id, 11.
 13 Law of Treaties, Harvard Research in International Law, *AJIL* 29 (1935) 1098. For further discussion see: A Toth, *The Doctrine of Rebus Stantibus in International Law*, *Jur Rev* 56 (1974) 147, 263.
 14 Hill, 8-10, quoted by OJ Lissitzyn, "Treaties and Changed Circumstances" (*Rebus Sic Stantibus*), *AJIL* 61 (1967) 898.

In the opinion of some writers, the doctrine may have originated at time when it was customary to insert into a treaty, a *clausula rebus sic stantibus* and that the terms of the old and abandoned clause must now be implied. Others express the opinion that the doctrine originated in Roman law on the ground that every contract carried with it the implied condition of *rebus sic stantibus*.¹⁵

Roman law, according to the *Corpus Juris Civilis* of Justinian, did not understand this doctrine in the same way we understand it today. However, the *Corpus Juris Civilis* does discuss the particular rules "which give the party concerned the right of rescission of or withdrawal from the contract on account of supervening changes in the circumstances". The rules differ depending on "the type of transactions to which they apply, the underlying juridical considerations and their legal effects".¹⁶

Whatever its origins, the concept spread rapidly among many writers in the sixteenth century. Jason de Mayno stated the rule that a *clausula rebus sic stantibus* was to be implied in all statutes, wills, contracts, privileges, oaths and sworn declarations of renunciation of rights.¹⁷ At this stage, the idea of a "clausula" was regarded as being equally applicable to private and public law. But because the writers did not analyse the nature and legal effects of the doctrine, it must be seen as still in an early stage of its development.¹⁸

It was the opinion of early writers on international law that a doctrine of *rebus sic stantibus* was accepted as part of the law of treaties.¹⁹ Gentili's opinion was that "the doctrine was a general mental reservation implied in wills, contracts and in any disposition whatever, according to general view."²⁰ Spinoza's theory was that "no one makes a contract for the future except on the hypothesis of certain preceding circumstances. But when these change, the reason underlying the whole position also changes; accordingly every contracting party

15 CG Fenwick, *International Law* (4th edn 1965) 545.

16 Vamvoukos, 7.

17 Mayno, *In Primam Dig Veteris Part*, Comment (1582) Fol 140, 8-10, quoted by Vamvoukos, 10.

18 Id, 10-11.

19 Ibid, 11.

20 *De jure belli Libri Tres* (1612) 365, quoted by Vamvoukos, 11.

retains the right to consult its own interests".²¹ Vattel, the greatest authority of the 18th century, has influenced many later writers. He states that the doctrine is based upon the intention of the parties at the time when the treaty was entered into, and thereby places the whole question of changed circumstances within the field of treaty interpretation:

This question has been proposed and discussed whether promises include in themselves this tacit condition, that the things shall remain in the State where they are, or, if the change that has intervened in the State of things can form an exception to the promise, and even render it null? The principle drawn from the reason of a promise should resolve the question. If it is certain and manifest that the consideration of the present State of things has entered into the reason which caused the promise, that the promise was made in consideration, in consequence of this State of things, it depends on the conservation of the things in the same State. That is evident, since the promise was only made on this supposition. Thus, when the State of things essential to a promise, and without which it certainly would not have been made, changes the promise falls with its foundation... The sole State of things, by reason of which the promise was made, is essential to it; and the change of this State alone can legitimately prevent or suspend the effect of this promise.²²

Further, it was in Spinoza's theories, that the idea of a separation of the private law and international law was first formulated. These theories became most influential in the construction of the doctrine.

Later, Bluntschli (1872) stated that the doctrine is not attached in general to all treaties but is applicable only if "certain circumstances have been assumed as the foundation of the treaty" whether expressly or impliedly.²³ He conceived the doctrine as based upon the intention of the parties and not as an

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- 21 Spinoza, *Political Treatise* III, 17, quoted by H Lauterpacht, *Spinoza and International Law*, *BYIL* 8 (1927) 94.
- 22 *Le droit des gens*, 11, 12, 296, quoted by Hill, 8-9. According to Hill, the following jurists support the idea that the doctrine is based upon the intention of the parties: Grotius (1625), Pufendorff (1672), Bynkershoek (1737), Vattel (1758), Kluber (1819), Wheaton (1836), Heffter (1844), Bluntschli (1868), Hall (1880), Wharton (1884), Davis (1903), L Oppenheim (1905), Westlake (1910), Despagnet (1910), Liszt (1911), Pitt Cobbett (1922), Fenwick (1924), LD Woolsey (1926), Garner (1927), Lauterpacht (1927), Brierly (1927), McNair (1928), Fischer Williams (1928), Anzilotti (1929), Stowell (1931), Hill (1934).
- 23 Bluntschli, *Das moderne volkerrecht der civilisierten staaten als Rechtsbuch dargestellt* (2nd edn 1872) 256, quoted by Vamvoukos, 17.

objective rule of law operating independently.²⁴ An influential interpretation of this period was that of Jellinek, in whose system, the rule of *rebus sic stantibus* could not be dispensed with. In his system, "the doctrine becomes a specific and exclusive rule of international law."²⁵

The doctrine of *rebus sic stantibus* gradually lost its importance in private law, but it became increasingly important in international law, where it was re-interpreted to fit the philosophical and political theories of the 19th century, and ultimately became a central aspect of these theories.²⁶

(3) Fundamental Change of Circumstances in Modern State Practice

The First and Second World Wars profoundly changed the economic and legal relations between countries around the world. As a result of these changes, the emphasis behind the doctrine came to be on the interests of the international community, rather than the interests of individual nations and States. Thus, the doctrine of *rebus sic stantibus* was no longer regarded as being derived from, or based on, the specific nature or fundamental rights of States, doctrines which themselves were generally rejected. Nonetheless, the doctrine itself was quite often relied on, as the following survey shows.

(a) The Termination of the Neutralization of the Black Sea 1870-1

One of the earliest modern examples of reliance on fundamental change of circumstances involved the Treaty of Paris of 1856. The seven parties to the Treaty of Paris had agreed that the Black Sea should be neutralized, and Russia and Turkey agreed on a limitation of their naval armaments in the Black Sea. In 1870, Russia denounced these stipulations and at a conference held in London in 1871 asked for a revision of the treaty by common consent, placing emphasis upon the argument of changed circumstances. Among the changes relied on were changes in the European balance of power and their effects on the political position of Russia, as well as the introduction of iron-clad vessels. Within the

24 Ibid.

25 Id, 17-18.

26 Id, 15-16.

conciliatory tone of the conference, the delegates sanctioned the request made by Russia.

During this dispute, none of the powers denied that a material change of circumstances might serve as a valid ground for demanding modification (or termination) of a treaty. But it was pointed out that the only competent international authority to decide on a question of substantive law of this kind was the community of the States which were party to the treaty concerned and that unilateral denunciation was inadmissible under international law.²⁷

(b) Article 435 of the Treaty of Versailles 1919

An outline of the modern practice must begin with Article 435 of the Treaty of Versailles 1919, which recognized that the stipulations of certain treaties of 1815 were no longer consistent with current conditions. Article 435 of the Treaty of Versailles provided:

The High Contracting Parties, while they recognize the guarantees stipulated by the treaties of 1815, and especially by the act of November 20, 1815, in favour of Switzerland, the said guarantees constituting international obligations for the maintenance of peace, declare nevertheless, that the provisions of these treaties, conventions, declarations and other supplementary acts concerning the neutralized zone of Savoy, as laid down in paragraph 1 of Article 92 of the Final Act of the Congress of Vienna and in paragraph 2 of Article 3 of the Treaty of Paris of November 20, 1915, are no longer consistent with present conditions. For this reason, the High Contracting Parties take note of the agreement reached between the French government and the Swiss government for the abrogation of the stipulations relating to this zone which are and remain abrogated. The High Contracting Parties also agree that the stipulations of the treaties of 1815 and of the other supplementary Acts concerning the Free Zones of Upper Savoy and the Gex district are no longer consistent with present conditions and that it is for France and Switzerland to come to an agreement together with a view to settling between themselves the status of these territories under such conditions as shall be considered suitable by both countries.²⁸

27 The Parties were Austria, France, Great Britain, Prussia, Russia, Sardinia and Turkey. See Hill, 47; Vamvoukos, 67.

28 Williams, 96-7.

Thus the modifications which had been made by France and Switzerland were accepted by the Signatory Powers.²⁹

(c) **Article 19 of the Covenant of the League of Nations**

In the period after 1919 the doctrine "came to be inextricably connected with the most acute political problem of the era", that is, the problem of peaceful change.³⁰ The legal basis for debate was provided by Article 19 of the Covenant of the League of Nations, which was considered by some writers on international law as an application of the doctrine.³¹ Article 19 provided that:

The Assembly may from time to time advise the reconsideration by members of the League of Treaties which have become inapplicable, and the consideration of international conditions whose continuance might endanger the peace of the world.³²

On a number of occasions member States invoked the article before the Assembly of the League of Nations. Bolivia and Peru in 1920 requested the Assembly to reconsider and revise the treaty of 1904 between Bolivia and Chile and the treaty of 1883 between Chile and Peru.³³ In 1921, the General Committee of the Assembly submitted the request of Bolivia to a Committee of Jurists which made the following Report:

...in its present form, the request of Bolivia is not in order, because the Assembly of the League of Nations cannot of itself modify any treaty, the modification of treaties lying solely within the competence of the contracting States.

Thus article 19 did not give the Assembly of the League of Nations itself jurisdiction to modify treaties. The Report continued:

29 Keeton, 115; Williams, 96-7.

30 Vamvoukos, 22.

31 Id. See also Hill, 80.

32 That the doctrine of *rebus sic stantibus* is a rule for the termination of treaties, and not for their revision was the concept of the doctrine held by almost all writers on international law prior to 1919: Hill, 80.

33 Hill, 81; Vamvoukos, 131.

... such advice can only be given in cases where treaties have become inapplicable... when the state of affairs existing at the moment of their conclusion has subsequently undergone, either materially or morally, such radical changes that their application has ceased to be reasonably possible.³⁴

As this conclusion was reached, Bolivia withdrew the request.

In 1925 China proposed a resolution, adopted by the Assembly, which provided that:

The Assembly, having heard with deep interest the Chinese delegate's suggestion regarding the possibility of considering, according to the spirit of the Covenant, the existing international conditions of China; having learned with satisfaction that a conference of the interested States is soon to take place in China to consider the questions involved; expresses the hope that a satisfactory solution may be reached at an early date.³⁵

On 10 September 1929, China submitted a draft resolution "to consider and report on the methods to make effective" Article 19 of the Covenant. The Assembly adopted a resolution which expounded on Article 19 as follows:

A member of the League may on its own responsibility, subject to the rules of procedure of the Assembly, place on the agenda of the Assembly the question whether the Assembly should give advice as contemplated by Article 19 regarding the reconsideration of any treaty or treaties which such member considers to have become inapplicable or the consideration of international conditions the continuance of which might, in its opinion, endanger the peace of the world ... For an application of this kind to be entertained by the Assembly, it must be drawn up in appropriate terms... which are in conformity with Article 19... In the event of an application in such terms being placed upon the agenda of the Assembly, the Assembly shall in accordance with its ordinary procedure, discuss this application, and if it thinks proper, give the advice requested.³⁶

34 Ibid.

35 League of Nations, *Records of Plenary Meetings* (1925) 2, quoted by Hill, 81.

36 League of Nations, *Official Journal*, Special Supplement No. 76, 99-100; League of Nations, *Journal of the Tenth Ordinary Session of the Assembly* (1929) 393-95, quoted by Hill, 82.

But most international lawyers recognized that the doctrine "was as a rule of law inappropriate to solve political problems". Their opinion was that important political solutions should be excluded from the doctrine.³⁷

It would appear then, that the Assembly of League of Nations had no right to modify a treaty by itself, but could only advise the Members of the League concerned, without enforcing any decision in cases where a treaty had become inapplicable, or where "the State of affairs existing at the moment of its conclusion has subsequently undergone, either materially or morally, such radical changes that their application has ceased to be reasonably possible". According to Hill, "this is to reduce the possibility of application of Article 19 to cases of *force majeure*". This is in contrast to the doctrine of *rebus sic stantibus* as generally understood.³⁸

(d) **Former Soviet Doctrine after 1917**

The Russian revolution of 1917 established a new conception in the history of this doctrine. On 25 October 1917, a decree was published by the second All-Russian Congress of Soviets. It declared the abrogation of secret diplomacy and proceeded to the publication of "the secret agreements confirmed or concluded by the Government of Landowners and capitalists from February to October 25, 1917".³⁹ The provisions of those treaties "in so far as they tend to the augmentation of the profits and the privileges of Russian capitalists" or to annexations by the dominant nation were "declared instantly and irrevocably annulled".⁴⁰ Similarly, on 28 January 1918, the former Soviet Government issued a decree annulling State debts, paragraph 3 of which provided:

All foreign loans are hereby annulled, without reserve or exception of any kind whatsoever.⁴¹

37 Vamvoukos, 23.

38 Hill, 83.

39 EA Korovin, Soviet Treaties and International Law, *AJIL* 22 (1928) 762.

40 Ibid.

41 Id, 763.

On 20 April 1922, the Soviet delegation at Geneva presented a memorial containing the reasoning and the motives for this action:

The revolution of 1917 having completely destroyed all the old relationships, economic, social and political, and having replaced the old social order (class divisions) by the new social order, the sovereignty of an insurgent people, turning over the power of the Russian State to a new social class, did by this fact break the succession of those civil obligations which were component elements of the economic relations of the social order now extinct.⁴²

According to the opinion of Soviet writers, this statement was an invocation of the doctrine of *rebus sic stantibus*. Korovin's opinion, was that "the Soviet doctrine appears to be an extension of the principle of *rebus sic stantibus*, while at the same time limiting its field of application by a single circumstance - the social revolution".⁴³ He added:

Every international agreement is the expression of an established social order... So long as this social order endures... the principle *pacta sunt servanda*, must be scrupulously observed. But if in the storm of a social cataclysm one class replaces the other at the helm of the State, for the purpose of reorganizing not only economic ties but the governing principles of internal and external politics... Old agreements which reflected the pre-existing order of things, are destroyed by the revolution, becoming null and void.⁴⁴

A further statement of the former Soviet government published on 2 April 1924, set out their attitude towards treaties concluded by previous Russian governments. The statement said, that some of the treaties had lost their force during and after the war, "while others are regarded as requiring confirmation unless terminated by agreement of the parties in accordance with the doctrine".⁴⁵

More recently, a revised form of the doctrine was readmitted to Soviet literature. The Soviets recognized it as being essential for economic and political

42 Ibid.

43 Ibid.

44 Ibid.

45 Hill, 32.

progress, a necessary exception to the general rule of *pacta sunt servanda*, which was often used to conceal the maintenance of imperialist domination of colonies.⁴⁶

It justifies repudiation by dependent and colonial nations of "unequal" treaties, that is, treaties which are not based on the sovereign equality of both parties in compliance with "generally recognized democratic principles of present day international law."⁴⁷

Thus it was seen as a "progressive" rule of international law.⁴⁸

(e) **The Termination of Slave Trade Treaties 1921-2**

In 1921-2, the British Government gave notice of denunciation of slave trade treaties concluded during the 19th century. It stated, that the general policy of the government was "to abolish obsolete treaty instruments since the circumstances under which these treaties were negotiated are now happily past". Although most of these treaties were of indefinite duration, the other States parties replied that they regarded the treaties as inoperative and announced that they would cease to have effect from the date of acceptance of denunciation. The treaty with the United States which contained a provision for termination upon one years' notice, terminated after one year according to its terms.⁴⁹

(f) **The Washington Treaty of 1922**

On 6 February 1922, the Washington Treaty, concerning the Limitation of Naval Armaments was signed. Article 21 contained an explicit reference to "changed circumstances", as follows:

46 Shurshalov, *Osnovaniia Deistivitel' Nosti Mezhdunarodnykh Dogovorov* (1958) 128, quoted by Vamvoukos, 26

47 Krylov, 70 HR 433-4; Lisovskii, *International Law* (1953), 253; Ramúndo, *Peaceful Co-existence...* 56-7; Erickson, *International Law...* 77-80, all quoted by Vamvoukos, 26-7.

48 Triska & Shusser, *The Theory...* 141; Triska Pas (1959) 299; McWhinney, *Peaceful Co-existence... & Soviet-Western International Law* (1964) 65-6, quoted by Vamvoukos, 27 & see JN Hazard, *Cleansing Soviet International Law of Antimarxist Theories*, *AJIL* 32 (1938) 244.

49 This notice was given to nine states: Brazil, Columbia, United States, Haiti, Chile, Ecuador, Netherlands, Norway, Sweden: 116 *BFSP* 91-92, 118-119, 160-161, 196-197; 10 *LNTS* 408, 418; 11 *LNTS* 462. See Vamvoukos, 80; Hill, 63.

If during the term of the present treaty the requirements of the national security of any Contracting Power in respect of naval defence are, in the opinion of that power, materially affected by any change of circumstances, the Contracting Powers will, at the request of such Power, meet in conference with a view to the reconsideration of the provisions of the treaty and its amendment by mutual agreement...⁵⁰

In fact the Treaty terminated, in accordance with the provisions of Article 23, after notice to that effect had been proven by Japan. No steps were taken under Article 21.⁵¹

(g) The Termination of Capitulations in Turkey 1914-23

Turkey explicitly referred to the doctrine of *rebus sic stantibus* in 1914 and again in 1923 when it unilaterally abrogated the treaties, which provided for capitulations. Although the States possessing treaty rights (the British Empire, France, Italy, Japan and the United States) emphatically denied the right of unilateral termination, they admitted that the regime of capitulations had become unsatisfactory and were willing to consent to termination, provided that agreement could be reached on adequate safeguards for the persons, property and interests of their nationals.⁵² While these States clearly agreed to this revision for political reasons, rather than for reasons of legal obligation, their comments indicate an implicit acceptance of a change of circumstances. For example, the delegate of France believed that the capitulatory regime "was in consonance with archaic ideas" and that the task of the Conference was "to devise a system more suited to modern requirements but which would give adequate guarantees to foreigners".⁵³

(h) The Termination of Extraterritoriality in China 1926-30

As part of its attempt to revise the rights of extraterritoriality of foreign powers in China, China relied upon the doctrine of *rebus sic stantibus*. China

50 McNair, *The Law of Treaties* (1938) 377.

51 Bevens, *2 Treaties and Other International Agreements* 351.

52 Hill, 29.

53 Ibid.

negotiated revised treaties with each foreign power separately. During this process, Belgium admitted the *rebus sic stantibus* rule, whereas Japan denied that there was such a rule in international law.

In fact, the treaties granting extraterritorial rights in China contained provisions for revision at the end of a certain period, and from 1914 it appears that the other States parties were willing to relinquish extraterritorial rights "but only if satisfied that the State of the Chinese laws and their administration warranted them in so doing".⁵⁴ In demanding revision of the treaties, China relied in part upon the revision clauses of the treaties, although they did not give her the right of either revision or termination, and in part upon the argument of changed circumstances. China referred, to the "many momentous political, social and commercial changes" which had taken place both in China and in foreign countries since the conclusion of the treaties, and stated that as a consequence the old treaties had outlived their usefulness and "if allowed to continue to exist in their present form would give rise to difficulties and complications".⁵⁵ China's legal position was that "the general right of revision being admitted, the right of both parties to a treaty to terminate it by notice... is all the more to be recognized".⁵⁶ China felt, she had tried and failed to come to an amicable agreement with foreign States and had no choice but to terminate the treaties.

In response, Belgium admitted *rebus sic stantibus* as a rule,⁵⁷ but condemned the unilateral termination of the treaty as contrary to international law, pointing out that the State invoking the rule must obtain the consent of the other party or appeal to the League of Nations. Eventually, the treaty was abrogated by mutual consent. GW Keeton notes that in the discussions on the Belgian treaty of 1865, the doctrine of *rebus sic stantibus* was mainly used as a lever by China to initiate negotiations for revision of the treaty and was in fact ignored after that early stage.⁵⁸

54 Chinese Customs Treaties, 1, 557. See Vamvoukos, 87-8.

55 Note of 15 November 1928 to Norway, quoted by Vamvoukos, 88.

56 11 *Chinese Review* 1-8 (1927) quoted by Vamvoukos, 89.

57 Hill, 33.

58 Keeton, 128.

These discussions may be contrasted with those between China and Japan. When, in July 1928, China informed Japan that the treaty of 1896 had terminated, Japan replied that the Chinese action was inadmissible and that she would continue negotiations for revision only on condition that China should withdraw the provisional regulations and recognize the validity of the existing treaties. On 27 April 1929, Japan attacked the "principle of altered circumstances". This appears to contradict the implied acceptance of changes of circumstances recognized in Article II of the Commercial Treaty of 1903 between Japan and China which contained promises to relinquish extraterritoriality when the State of Chinese law warranted it.⁵⁹ Despite this Japan stated that the doctrine had no foundation in international law or usage as a rule for revision or lapse of a treaty, and considered that the admission of such a principle would "render almost all treaties liable to repudiation at the pleasure of either contracting party, thus shaking the very foundations of international law".⁶⁰

In the case of the Sino-Portuguese Treaty of 1887, Portugal denied that the treaty had lapsed and stated that "the changes of political, economic or commercial conditions, claimed to have occurred in both countries, are not of a nature to entitle China to dissolve the treaty by unilateral withdrawal".⁶¹ The dispute was settled by negotiation in 1928.

Similarly Great Britain, France, the Netherlands and the United States agreed that extraterritoriality could be relinquished, but only after a reform in the laws and judicial institutions of China and after the laws were properly administered. They were willing to consider gradual revision of the treaties as these improvements were realized.⁶² For instance, Great Britain agreed that from 1 January 1930, "the process of gradual abolition of extraterritoriality should be regarded as having commenced in principle".⁶³ These agreements were in keeping with the British Commercial Treaty of 1902, where Britain gave China the assurance of every assistance in law reform, and willingness to relinquish

59 Chinese Customs Treaties, 11, 662, quoted by Keeton, 118.

60 Hill, 35.

61 *Chinese Review*, 12, (1928) 64-66; 13 (1929) 13-14, quoted by Hill, 36.

62 *The China Critic*, September 19, 1929, 758-760 quoted by Hill, 36.

63 Great Britain, 31 Accounts and Papers, (1929-1930); *Cmd* 3480.

extraterritoriality when the State of China's law warranted it.⁶⁴ A similar process was adopted by the other States.

(i) **The Suspension of the International Load Line Convention 1941**

In 1941, the United States resorted expressly to the doctrine in order to unilaterally suspend the International Load Line Convention which was concluded in 1930. Although the British Government did not accept the suggestion of a temporary suspension as between parties assenting thereto. It considered that because of the war, normal international procedures were no longer available, and thus that the procedure of prior notification and consent did not need to be followed.⁶⁵ On 9 August 1941, the President of the United States proclaimed that the unilateral suspension was based on "changed conditions" which gave the United States "an unquestioned right and privilege under approved principles of international law" to declare the treaty inoperative.⁶⁶ The President was advised by Attorney-General Francis Biddle that "it is a well established principle of international law *rebus sic stantibus* that a treaty ceases to be binding when the basic conditions upon which it was founded have essentially changed. Suspension of the convention in such circumstances is the unquestioned right of a State adversely affected by such essential change".⁶⁷

Initially, Britain rejected the notion that it be suspended. It subsequently accepted the action and eight American States parties also expressed assent to it. No State ever seems to have protested against unilateral suspension.⁶⁸

Though it was criticised from different points of view, notably by Briggs and Hyde, Briggs noted that when it had previously been cited it was because it had been "clearly based juridicially upon the intention of the parties at the time of the conclusion of the treaty", and noted that "the evidence presented by the

64 Chinese Customs Treaties, 1, 557, quoted by Keeton, 118.

65 Vamvoukos, 103-4.

66 *Department of State Bulletin*, V, No 111, August 9 1941, 114-115, quoted by HW Briggs, *The Attorney General invokes Rebus Sic Stantibus AJIL* 36 (1942) 89.

67 Vol 40, No 24, July 28 1941, 119-123. The Attorney General cited Kluber, Phillimore, John Westlake and Fischer Williams.

68 *5 Department of State Bulletin* (1941) 114, quoted by Vamvoukos, 104-5.

Attorney General fails to establish that the parties to the Convention - the purpose of which was to establish minimum safety regulations - intended that the occurrence of war should release the parties from the obligations assumed." He also thought this was not a case of necessity.⁶⁹

Hyde doubted the existence of the doctrine in international law, but appears to agree with the decision of the United States. He stated:

There was doubtless good reason for the United States to proclaim its freedom from the further operation of the international Load Line Convention, at least during the continuance of the war. That reason was in substance, the circumstance that it could not possibly have been the design of the contracting parties when they concluded the convention, that it should remain necessarily binding upon the coming into being of the conditions to which both the acting Attorney General and the president referred; and that when those conditions did come into being, a contracting party confronted with a situation such as that which prevailed in July 1941, might, by appropriate action, free itself, at least for the time being, from the burdens of the arrangement.⁷⁰

This created yet another precedent in favour of the existence of *rebus sic stantibus*.

(4) Case Law

For some considerable time the doctrine had relatively little recognition from international tribunals, although some national court decisions relied on it.

In a decision in 1912, the Permanent Court of Arbitration at the Hague recognized that the obligations of a treaty may be affected, where fulfilment of the obligations would be self destructive to a party. The *Russian Indemnity Case* involved the question whether, by a treaty of 1879, Russia was entitled to interest because of delays in the repayment of indemnities. Turkey pleaded various defences including *force majeure* and argued, that from 1881 to 1902 it was in

69 Briggs, 90-3, quoted by Lissitzyn, 910.

70 CC Hyde, 2 *International Law Chiefly as Interpreted and Applied by the United States* (2nd rev. edn 1945) 1527.

serious financial difficulties. Though the tribunal held that the defence of *force majeure* might be pleaded in public as well as in private international law, it held that the repayment of such a small sum would not compromise Turkey's internal or external situation.⁷¹ This decision is a precedent on *force majeure* rather than on the doctrine of *rebus sic stantibus*.⁷²

The doctrine was more directly supported in a number of municipal decisions.⁷³ For example in *Hooper v United States* in 1887, J Davis stated:

Abrogation of a treaty may occur by change of circumstances, as when a state of things which was the basis of the treaty, and one of its tacit conditions, no longer exists.⁷⁴

The United States Court of Claims there held that "a treaty which contains no clause providing for its termination, may be annulled by one of the parties under certain circumstances",⁷⁵ and declared that the United States had a right under international law to declare terminated in 1798 treaties concluded with France in 1778.

Similarly, in 1882, Lucerne requested that Aargau be held bound to recognize the dissolution of the agreement of 1830, which gave Aargau the right to tax and exercise some powers over a part of Lucerne. The Swiss Federal Tribunal concluded that Lucerne was unjustified in its claim. It noted that "At most a treaty can be unilaterally voided... when there has occurred a change of those circumstances which, according to the evident intent of the parties at the time of the agreement, formed the tacit requirement of the existence of the treaty".⁷⁶

71 Decision of the Permanent Court of Arbitration of 11 November 1912, *Hague Court Reports* (JB Scott, ed, Carnegie Endowment for International Peace, New York, 1916) 297-328.

72 Vamvoukos, 175.

73 HS Zakariya, *Changed Circumstances and the Continued Validity of Mineral Development Contracts* in K Hossain (ed), *Legal Aspects of the New International Economic Order* (1980) 263.

74 22 Court of Claims Reports (1887) 408.

75 Id, 416.

76 Decision of 17 February 1882, *Arrêts du Tribunal Fédéral Suisse en l'année 1882. Recueil officiel*, 8, 43-58. The court cites as authorities Heffter and Jellinek. See Hill, 19-20.

In 1925 the German State of Bremen invoked the doctrine as a ground for terminating some of its obligations from treaties made with Prussia in 1904-1905. It argued, that since the Treaty of Versailles, the relations which formed the basis of the treaty had altered. The German Supreme Court stated, that "the possibility of treaty annulment on account of changed circumstances, the authority of the *clausula rebus sic stantibus*, is recognized in part in a broad sense in international law",⁷⁷ but held that circumstances had not changed so much as to cause the treaties to be annulled.

But the leading international judicial decision on the doctrine is still the *Free Zones Case* between France and Switzerland. In 1932, France argued before the Permanent Court of International Justice that the 1915-1916 treaties, establishing the customs and economic regimes of the Free Zones of Upper Savoy and the District of Gex, should be regarded as terminated. The Court did not consider the case to be within the scope of the doctrine, as it considered that France had not shown that the Zones were in fact established in view of the existence of circumstances which ceased to exist when Swiss federal customs were instituted in 1849. However, it did not question that in principle a change of circumstances could affect the validity of treaties, nor that *rebus sic stantibus* was a recognized rule of international law.⁷⁸ The Court in this case, as Brownlie has pointed out, "assumed that the principle existed while reserving its position on its extent and the precise mode of its application."⁷⁹

In the first phase of the case, France argued that a radical change of circumstances, most significantly the Swiss Federal Customs law of 1849, had served to completely change the objectives of the original treaties and that there was no longer any need for these zones. Switzerland contended, that it would not examine the doctrine because whatever its meaning, it was inapplicable to treaties establishing territorial boundaries. Furthermore, it argued that it was too late to invoke them as France had not done so earlier.

77 German Staatsgerichtshof, Decision of June 29, 1925 quoted by Hill, 21; JM Sweeney, CT Oliver and NE Leech, *The International Legal System, Cases and Materials* (1981) 1014.

78 PCIJ Ser A/B, 46 (1932) 156-8.

79 I Brownlie, *Principles of Public International Law* (4th edn 1990) 620.

In its interpretation of the doctrine, the Court implied that the change must relate strictly to the circumstances in view of which, or because of which, the parties had concluded the treaty.⁸⁰ As we have seen, there was throughout an acceptance of the doctrine in principle.

In his dissenting judgment, Judge Dreyfus stated that Article 435(2) of the Treaty of Versailles partly abrogated and partly was intended to lead the abrogation of the *free zones*. He decided that the treaties had lapsed as a result of changed conditions.⁸¹

The issue was also raised in the *Fisheries Jurisdiction Case* in the International Court of Justice in 1974. In 1972 the Icelandic Parliament had declared that:

Because of the vital interests of the nation and owing to changed circumstances the notes concerning fishery limits exchanged in 1961 are no longer applicable and their provisions do not constitute an obligation for Iceland.⁸²

The Government of Iceland sought to extend its exclusive fisheries jurisdiction from 12 to 50 miles and terminate the Exchange of Notes with the United Kingdom of 1961. It invoked the doctrine of *rebus sic stantibus* as embodied in Article 62 of the Vienna Convention on the Law of Treaties, contending that as it satisfied the two requirements of the doctrine, it could terminate the treaty forthwith.

In relation to the first requirement of this doctrine, that the change must be a fundamental one, Iceland referred to developments in fishing techniques, "to the increased exploitation of the fishery resources in the seas surrounding Iceland and to the danger of still further exploitation because of an increase in the catching capacity of fishing fleets."⁸³ But the Court held that these did not amount to a fundamental change.

80 Vamvoukos, 159-160.

81 *PCIJ Ser AB*, No 46, (1932) 202-205.

82 *ICJ Pleadings, Fisheries Jurisdiction*, 11-89, I. Enclosure 2, 39, quoted by Vamvoukos, 169.

83 *ICJ Rep* 1974, 3.

As to the second requirement, that change must result in "a radical transformation of the extent of the obligation still to be performed,"⁸⁴ and must have increased "the obligations to be executed to the extent of rendering the performance something essentially different from that originally undertaken",⁸⁵ the Court noted that this condition was not wholly satisfied and that the change of circumstances "alleged by Iceland cannot be said to have transformed radically the extent of the jurisdictional obligation which is imposed by the 1961 Exchange of Notes... The present dispute is exactly of the character anticipated in the compromissory clause of the exchange of notes. Not only has the jurisdictional obligation not been radically transformed in this extent; it has remained precisely what it was."⁸⁶

Neither of the applicants (United Kingdom and Federal Republic of Germany) contested that a rule of *rebus sic stantibus* existed in international law. However they contended -- and the Court agreed -- that the changes were not of a vital or fundamental character. The United Kingdom Memorial further asserted that...

the doctrine never operates so as to extinguish a treaty automatically or to allow an unchallengeable unilateral denunciation by a party; it only operates to confer a right to call for termination and, if that call is disputed, to submit the dispute to some organ or body with power to determine whether the conditions for the operation of the doctrine are present.⁸⁷

In this respect, the Court referred to Articles 65 and 66 of the Vienna Convention on the Law of Treaties as forming "the procedural complement to the doctrine of changed circumstances."⁸⁸ But the Court also noted that "in the present case, the procedural complement to the doctrine of changed circumstance is already provided for in the 1961 Exchange of Notes, which specifically calls upon the parties to have recourse to the court in the event of a dispute relating to Iceland's extension of fisheries jurisdiction..."⁸⁹

84 Ibid.

85 Ibid.

86 Ibid.

87 Ibid.

88 *ICJ Rep* 1973, 21.

89 *ICJ Rep* 1974, 3.

In the result, the Court found by ten votes to four that:

The Government of Iceland is not entitled unilaterally to exclude United Kingdom fishing vessels from areas between the fishery limits agreed to in the Exchange of Notes of 11 March 1961 and the limits specified in the Icelandic regulations of 14 July 1972, or unilaterally to impose restrictions on the activities of those vessels in such areas.⁹⁰

The Court held, that both governments were "under mutual obligations to undertake negotiations in good faith for the equitable solution of their differences concerning their respective fishery rights in the areas."⁹¹

Thus, for the first time the International Court expressly accepted the doctrine of *rebus sic stantibus* as incorporated in Article 62 of the Vienna Convention as a statement of customary law. The Court stated:

International law admits that a fundamental change in the circumstances which determined the parties to accept a treaty, if it has resulted in a radical transformation of the extent of the obligations imposed by it, may, under certain conditions, afford the party affected a ground for invoking the termination or suspension of the treaty. This principle, and the conditions and exceptions to which it is subject, have been embodied in Article 62 of the Vienna Convention on the law of treaties, which may in many respects be considered as a codification of existing customary law on the subject of the termination of a treaty relationship on account of change of circumstances.⁹²

In 1985, an arbitration decision again invoked the doctrine. In the dispute between the American company *Questech Inc.* and the Ministry of National Defence Iran, the doctrine of *rebus sic stantibus* was invoked as a principle involving contract termination. The *US-Iran Claims Tribunal* applied the doctrine because of Article V of the Claims Settlement Declaration, which referred to it

90 Ibid.

91 Ibid.

92 *ICJ Rep* 1973, 18.

specifically, and noted that it was a principle justifying contract termination in limited situations involving sensitive governmental contracts.⁹³

(5) The Vienna Convention on the Law of Treaties 1969

The Vienna Convention on the Law of Treaties of 1969 contains several provisions regarding the doctrine of change of circumstances. These provisions are, as OJ Lissitzyn points out, "the most authoritative relevant formulations so far produced in the international community".⁹⁴ Article 62 of the Vienna

93 *Questech Inc. v. Ministry of Nat'l Defence, 9 Iran USCTR* 107 (1985 II) and See JR Crook, *Applicable Law in International Arbitration: the Iran-US Claims Tribunal Experience*, *AJIL* 83 (1989) 298.

94 The doctrine had previously been accepted in several influential statements of the law of treaties. The Harvard Draft Convention on the Law of Treaties was prepared by Harvard Research in International Law in 1935, 1096. Article 28, concerning *rebus sic stantibus*, provides that:

- a. A treaty entered into with reference to the existence of a state of facts, the continued existence of which was envisaged by the parties as a determining factor moving them to undertake the obligations stipulated, may be declared by a competent international tribunal or authority to have ceased to be binding, in the sense of calling for further performance, when that state of facts has been essentially changed.
- b. Pending agreement by the parties upon and decision by a competent international tribunal or authority, the party which seeks such a declaration may provisionally suspend performance of its obligations under the treaty.
- c. A provisional suspension of performance by the party seeking such a declaration will not be justified definitively until a decision to this effect has been rendered by the competent international tribunal or authority.

In 1962, the Restatement (Second) of the Foreign Relations Law of the United States formulated the doctrine *rebus sic stantibus* under the topic of "special problems of interpretation" as follows:

- Section 153. Rule of *rebus sic stantibus*. Substantial change of circumstances.
- (1) An international agreement is subject to the implied condition that a substantial change of a temporary or permanent nature, in a state of facts existing at the time when the agreement became effective, suspends or terminate, as the case may be, the obligations of the parties under the agreement to the extent that the continuation of the state of facts was of such importance to the achievement of the objectives of the agreement that the parties would not have intended the obligations to be applicable under the changed circumstances.
 - (2) A party may rely on an interpretation of the agreement as indicated in subsection (1) as a basis for suspending or terminating performance of the obligations in question only if it did not cause the change in the state of facts by action inconsistent with the purpose of the agreement and has otherwise acted in good faith.
 - (3) When the conditions specified in subsection (1) apply only to a separable portion of the agreement, suspension or termination applies only to that portion.

In 1986, the Restatement (Third) of the Foreign Relations Law of the United States provided in section 336 rule of fundamental change of circumstances. This section adopts Article 63(1) of the Vienna Convention.

Convention on the Law of Treaties of 1969 provides that:

- (1) A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:
 - (a) The existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
 - (b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

Article 62 further provides that:

2. A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty;
 - (a) if the treaty establishes a boundary, or
 - (b) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.
3. If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending the operation of the treaty.

Article 62 was the product of extensive discussion within the International Law Commission. Initially, the Special Rapporteur, Sir Gerald Fitzmaurice, identified three juridical basic theories underlying the doctrine:

1. The "implied term" theory which deduces the *rebus sic stantibus* clause from the presumed intention of the parties;
2. *Rebus sic stantibus* is an objective rule of law, not dependent on any presumed or implied term of the treaty but imposed *ab extra*;

3. The doctrine as an objective rule of law which imports forcibly into the treaty, regardless of the intention of the parties.⁹⁵

The second of these interpretations of the doctrine was preferred by the Special Rapporteur, on the basis that the principle is an objective rule of law and "a device by which the rules as to absolute contracts are reconciled with a special exception which justice demands".⁹⁶ Thus the International Law Commission accepted the doctrine as an objective rule of law:⁹⁷

The theory of an implied term must be rejected and the doctrine formulated as an objective rule of law by which, on grounds of equity and justice, a fundamental change of circumstances may, under certain conditions, be invoked by a party as a ground for terminating the treaty.⁹⁸

But this conclusion was a qualified one, as Sir Humphrey Waldock, a later Special Rapporteur, stated:

Although the doctrine is properly to be regarded as an objective rule of law, its application in any given case cannot be divorced from the intentions of the parties at the time of entering into the treaty; for the rationale of the rule is that the change of circumstances makes the treaty obligations today something essentially different from the obligations originally undertaken. The problem is to define the relation which the change of circumstances must have to the original intentions of the parties and the extent to which that change must have affected the fulfilment of those intentions.⁹⁹

Although the Commission decided, in order to avoid any doctrinal implication, not to use the term *rebus sic stantibus* either in the text or even in the title of the article on fundamental change,¹⁰⁰ it clearly took the view that its scope should not be narrowly limited to particular classes of treaties.¹⁰¹ The Commission's commentary stated:

95 (1957) *ILCY* (II) 58-59.
 96 (1957) *ILCY* (II) 59; and see Vamvoukos, 143.
 97 Lissitzyn, 914.
 98 (1963) *ILCY* (II) 82-83.
 99 *Id.*, 83-84.
 100 Lissitzyn, 913.
 101 Sweeney, Oliver and Leech, 1016.

Almost all modern jurists, however reluctantly, admit the existence in international law of the principle with which this article is concerned and which is commonly spoken of as the doctrine of *rebus sic stantibus*. Just as many systems of municipal law recognise that, quite apart from any actual impossibility of performance, contracts may become inapplicable through a fundamental change of circumstances, so also treaties may become inapplicable for the same reason... it shows a wide acceptance of the view that a fundamental change of circumstances may justify a demand for the termination or revision of a treaty, but also shows a strong disposition to question the right of a party to denounce a treaty unilaterally on this ground... The evidence of the acceptance of the doctrine in international law is so considerable that it seems to indicate a recognition of a need for this safety valve in the law of treaties.¹⁰²

(6) *Rebus Sic Stantibus* as a General Principle of Law

As this passage suggests an important influence on the development of the doctrine was the concept of "general principles of law", recognized by Article 38(1)(c) of the Statute of the Permanent Court of International Justice. This encouraged lawyers to investigate the question of *rebus sic stantibus* by looking again at private law notions.¹⁰³ Thus, H Lauterpacht concluded that the doctrine had validity in international as a general principle of law within the meaning of Article 38(1)(c), since it had emerged from the various private law systems of civilized nations.¹⁰⁴ Other international lawyers identified the "general principles of law" as the principles of "good faith", "equity" and "justice", and so it can be said that the doctrine of *rebus sic stantibus* came to be regarded as based on independent legal doctrine rather than on implied consent.¹⁰⁵ As H Lauterpacht maintained:

The rule that compacts must be kept is certainly one of the bases of the legal relations between the members of any community. But at the same time the notion that in certain

102 (1966) *ILCY* (II) 257. Further, Article 14 of the Havana Convention on the Law of Treaties which was concluded in 1928 between six American States provided that a treaty ceases to be effective among them "when it becomes incapable of execution". See MO Hudson, *International Legislation* (4th ed, 1931) 2378.

103 Hill, 15.

104 H Lauterpacht, *Private Law Sources and Analogies of International Law* (1927) 167.

105 Vamvoukos, 25, and see JW Garner, 511.

cases the law will refuse to continue to give effect to originally valid contracts, is common to all systems of jurisprudence.¹⁰⁶

He illustrated this argument by municipal law examples, such as article 323 of the German Civil Code, the French Code Civil, the various manifestations of the doctrine of frustration or supervening impossibility of performance in English law, and the express reference to changed conditions in the Austrian Civil Code, concluding that although...

the protection of the right to rely upon the contract is fundamental, there is nevertheless a relatively small segment of cases in which the law will recognize that the contract has, as the result of an unforeseen change of circumstances, failed to realize the true will of the parties and that it cannot be maintained wholly or in part.¹⁰⁷

In this examination of different legal systems, he found that despite inconsistencies in the rules applying in different systems, "their cumulative effect is to give expression to the fact that the law, in some form or other takes cognizance of the change of conditions subsequent to the creation of the obligation",¹⁰⁸ and that "the Court has the power of adjusting the contract to changed circumstances if good faith so requires".¹⁰⁹

Thus, today, most writers consider the doctrine of *rebus sic stantibus* to be well established as a general principle of law, and that there are exceptional cases when either party has a moral, if not a legal, right to demand that a treaty be revised, replaced or terminated. This right is said to be based on considerations of equity and justice, such that if the obligation were the result of a private contract the courts would not hesitate to grant relief to the complaining party.¹¹⁰

106 H Lauterpacht, *The Function of Law in the International Community* (1933) 273.
 107 Id, 275.
 108 Id, 276.
 109 Vamvoukos, 43.
 110 Ibid.

As H Lauterpacht has shown, *rebus sic stantibus* or equivalent doctrines are also found in contracts between private persons.¹¹¹ There is thus every ground for arguing, that it is a general principle of law, quite apart from its acceptance as part of positive international law in Article 62 of the Vienna Convention on the Law of Treaties.

(7) Conclusion: The Status of the Doctrine in Modern International Law

So far I have discussed the history of the *rebus sic stantibus* doctrine, which was originally a private law concept existing in Roman law, then its acceptance by writers of the 16th and 17th centuries. Then, in the 19th century, it developed into a characteristic rule of the law of nations, while, in the aftermath of World War II, it was reinforced in international law in the form of a "general principle of law recognized by civilized nations". Despite differences of opinion about the definition of change of circumstances, there are no differences among the majority of the writers on international law regarding the following points:

1. The revision and termination of an agreement, when the circumstances have changed or if the agreement was based upon an inequality, is justifiable.
2. Not every change of circumstances can terminate the binding force of an agreement. A change must relate to an essential or vital aspect of the agreement.
3. The doctrine of change of circumstances applies only when the fundamental conditions or circumstances existing at the time of the conclusion of the treaty have changed. The dissatisfied party then has the right to demand the other treaty party to terminate or revise the treaty. This right must be exercised in good faith.
4. The doctrine is not a result of the implied intention of the parties, but is an objective rule of law.
5. Many writers have analysed the doctrine of fundamental change of circumstances under different systems of law to show that the

111 For example, Article 610 of the German Civil Code provides provision for remaking a loan if there has been a rapid deterioration in the financial position of the other party. Article 2-615 of the United States Uniform Commercial Code provides for non-delivery in part or whole by a seller; if something has occurred, which the parties to the treaty assumed would not occur when the treaty was signed, which has made performance of the sale impracticable. Sweeney, Oliver and Leech, 1016.

doctrine is widely accepted as a general principle of law to which contractual obligations are subject, even though this doctrine sometimes has a different name.

Thus, the modern view is, that the doctrine is an objective rule of law operating independently of the intention of the parties.¹¹² This tendency culminated in the codifying work of the International Law Commission relating to the law of treaties, resulting in the Vienna Convention of 1969. The doctrine has now completed its development and is accepted by modern jurists of international law as an objective rule of law.¹¹³

(8) Application and procedural aspect of the doctrine of *Rebus Sic Stantibus*

Despite this agreement, there are differences of opinion concerning the application of the doctrine. One question is whether a treaty can be cancelled or suspended without mutual consent of the treaty parties, or whether the dissatisfied party must approach the other and seek its consent to termination. In other words the question is whether the doctrine of fundamental change of circumstances gives rise to a unilateral right to terminate the treaty, or whether one of the parties merely has a right to demand to be released from its treaty obligations. "That is to say that the doctrine creates no exception to the overriding principle that no State should be the judge in its own case".¹¹⁴ According to this view, the application of *rebus sic stantibus* to international agreements is limited to a large degree. It does not confer upon a party to a treaty any right to act unilaterally to terminate or suspend obligations where disputes occur involving the doctrine. Rather, international law requires that the parties co-operate in seeking an impartial resolution of their controversy.¹¹⁵

According to Hill:

Despite any theoretical objections to the contrary, it remains true that customary international law lays down the rule that a party who seeks release from a treaty on the ground of a change

112 Brownlie, 18; and see DP O'Connell, *International Law* (2nd edn 1970) 1, 278.

113 Vamoukos, 27-28; Brownlie, 621.

114 SH Amin, *The Theory of Changed Circumstances in International Trade* 4, *Lloyd's Maritime & Commercial Law Quarterly* (1982) 578.

115 *Ibid.*

of circumstances has no right to terminate the treaty unilaterally, and that recognition that the doctrine is applicable must be obtained either from the parties to the treaty or from some competent international authority.¹¹⁶

On the other hand, Fischer Williams's opinion, was that a vital change of essential conditions automatically terminated the treaty from the date of the change and did not depend on the specific consent of the other party. He stated that, in case of a vital change of circumstances, "The treaty in this event is, in fact, not voidable, but dead or 'obsolete' if that word be preferred".¹¹⁷ He added "in the event of a change of essential conditions, it ceases to be binding as from the date of the change, or we may say that *naturaliter*, from the very nature of the case, a contract made with reference to certain conditions disappears when the conditions are gone".¹¹⁸ Similarly, the opinion of most of the earlier writers (Heffter, Fiore, Treitschke, Jellinek) was that when the change of circumstances which is the foundation of the rule, has taken place, the treaty is henceforth to be regarded as obsolete and no longer binding upon the dissatisfied party, and such party may repudiate it or terminate it, by a unilateral act.¹¹⁹

Other writers state that, if the other party or parties refuse to consider a request of the dissatisfied party for the revision, termination or replacement of the treaty, the dissatisfied party may then unilaterally terminate the treaty. Thus Garner states:

To deny the right of a State to denounce and terminate such a treaty in these circumstances would be to deny it the right to rid itself of an incubus upon its independence and sovereignty to which it never consented and which the other party never meant to impose upon it.¹²⁰

A similar view was held by Scelle, that the dissatisfied party ought first to endeavour to come to an agreement with the other parties "but if it cannot convince them that the principle of *rebus sic stantibus* requires a modification of

116 Hill, 78.
 117 Williams, 91.
 118 Id, 93.
 119 Garner, 514.
 120 Id, 516.

the treaty, it is no longer bound to consider the treaty as binding upon it and it may therefore denounce it."¹²¹

Despite this, overall the balance of opinion prior to the Vienna Convention was that if the other parties disagree with the demands of the dissatisfied party to the termination or revision of the treaty, the only permissible method of applying the doctrine is by submission to a competent international authority.¹²² This issue is not squarely resolved by the Vienna Convention, Article 65(3) of which merely provides that if an "objection has been raised by any other party, the parties shall seek a solution through the means indicated in Article 33 of the Charter of the United Nations."¹²³

The practice of States with regard to the procedure to be followed when the doctrine is invoked, was first laid down in the Declaration of London in 1871.¹²⁴ This Declaration can be interpreted to mean that where a treaty contains no provision for its termination, suspension or revision, it can, in the absence of any valid ground of termination or revision by operation of law, be brought to an end or modified only with the consent of the contracting parties. Where, however, there is a valid ground for a review of the contract, this notion of consent implies only that the parties recognize that the objective rule of law invoked applies to the case in hand. It follows that in the case of a multilateral treaty the "consent" of all the contracting parties is not required, and that a majority decision is sufficient.

Before the Vienna Convention was concluded, it was thus arguable that customary international law laid down the following rules of procedure:

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- 121 Scelle, 20 *Rev Générale de Droit International Public* 490 quoted by Garner, 516. See further Harvard Research in International Law of Treaties, 1102.
- 122 Hill, 15.
- 123 Article 33 of the Charter of the United Nations provides as follows:
1. The parties to any dispute, the continuance of which is likely to endanger the maintenance of international peace and security, shall, first of all, seek a solution by negotiation, enquiry, mediation, conciliation, arbitration, judicial settlement, resort to regional agencies or arrangements or other peaceful means of their own choice.
 2. The Security Council shall, when it deems necessary, call upon the parties to settle their dispute by such means.
- 124 The declaration of London of 17 January 1871 signed by representatives of Germany, Austria-Hungaria, Great Britain, France, Italy, Prussia, Russia and Turkey. 72 *PP* (1871), 127; 61 *BFSP* (1193) quoted by Vamvoukos 207.

A State claiming a change of circumstances has no right to unilaterally terminate, suspend or modify a treaty. It must first exercise its legal right to seek recognition that its claim is legitimate. A corresponding obligation on the other State is to enter into negotiations in good faith.¹²⁵

If a change of circumstances can be mutually established to have occurred, the treaty can be terminated by the doctrine of *rebus sic stantibus* an objective rule of law. If the other parties ignore the demands of the claimant party or do not object to it, or refuse to enter into it, the party relying on the doctrine can lawfully terminate the treaty or suspend its operation... If negotiations fail to reach agreement, the State invoking the doctrine must seek a solution, as indicated by article 33 of the United Nations Charter, and submit the case to arbitration or judicial settlement by an international authority.

If the other party refuses to do so, the State invoking the doctrine will have a legitimate right to terminate or suspend the treaty.¹²⁶

It was, however, emphasized in London in 1871 that "it is an essential principle of the law of nations that no power can liberate itself from the engagements of a treaty nor modify the stipulations thereof, unless with the consent of the contracting powers, by means of an amicable arrangement".¹²⁷

Although, this specific issue is not clearly resolved by the Vienna Convention of 1969, Articles 65-68 of the Convention establish general procedures to be followed in cases of invalidity, termination, withdrawal from or suspension of the operation of a treaty (including under Article 62). Article 65(1) makes provision for a party to notify other parties of its claim and to indicate the measures proposed to be taken. Article 65(2) provides that if no objections are raised after the expiry of a period of not less than three months the measures may be carried out. Article 65(3) provides that if objection is raised, a solution is to be found by the means specified in Article 33 of the United Nations Charter. These clauses do not affect the rights or obligations of the parties under any provision in force between them with regard to the settlement of disputes.

125 Id, 210-1.

126 Id, 212-3.

127 See Woolsey, 349; Keeton 116.

(9) **Limitations upon the doctrine**

A number of limitations upon the application of the doctrine have been proposed or stipulated. These should be briefly referred to.

(a) **Treaties "of Indefinite Duration"**

At one time, it was argued that the doctrine was applicable only to treaties whose duration is not fixed or implied but are of "indefinite or perpetual duration", and which do not contain provision for termination or revision. Thus in *Hooper v United States* the court held that...

A treaty, which on its face is of indefinite duration and which contains no clause providing for its termination, may be annulled by one of the parties under certain circumstances.¹²⁸

But the International Law Commission did not accept this view, and the limitations of the doctrine to so-called "perpetual treaties" or those which do not contain provision for termination, has not been confirmed by international treaties or by State practice.¹²⁹

(b) **Boundary Treaties**

However, certain more limited exceptions from the rule have been established. Article 62(2) of the Vienna Convention provides:

A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty:

(a) if the treaty establishes a boundary...

The reason for that exclusion was not that provisions of those treaties were "executed provisions, but that treaties of that type were intended to create a stable position".¹³⁰ During the debate on Article 62(2), some representatives

128 22 Court of Claims Reports (1887) 408.

129 (1966) *ILCY* (II) 259.

130 Lissitzyn, 917.

from the Third World argued for the deletion of subparagraph 2(a). Mr Tabibi (Afghanistan) argued that "this principle was incompatible with the principle of peaceful relations among States, since undue rigidity was a source of disputes" and "that a [boundary] treaty imposed... for colonial or military reasons should not be exempted from the rule".¹³¹ However, this view was not accepted.¹³²

(c) **Extent of Change Required**

As we have seen Article 62 of the Vienna Convention provides that a fundamental change of circumstances, which has occurred...

since the time the treaty was entered into, and which was unforeseen by the parties may be invoked if

- (a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and
- (b) the effect of the change is radically to transform the scope of obligations still to be performed under the treaty.

But other opinions extend the application of the change of circumstances to cases where the change of circumstances, was not "unforeseen" in an absolute sense. The possibility of change may have been anticipated by the parties who nonetheless failed to provide for it expressly.¹³³ It is also argued that the doctrine should also be extended to cases where there is a need for relief against onerous obligations generally.

From the above it can be seen that the doctrine of *rebus sic stantibus* has a limited application in international law, as it does not confer a party with the right to unilaterally terminate a contract; rather it demands the parties seek impartial resolution of the conflict. Yet, if there has been a fundamental change of circumstances, the parties are under an obligation to renegotiate the contract in good faith, and if the other party refuses to enter into negotiations in these circumstances, then the contract may be terminated or suspended.

131 Official Records: First Session, 373. Quoted by RD Kearney and RE Dalton, *The Treaty on Treaties*, *AJIL* 64 (1970) 543.

132 Id, 544.

133 Lissitzyn, 912.

(d) **Effect of Invocation of the Doctrine**

It is clear that the effect of a fundamental change of circumstances is suspension of or termination of only those portions of the treaty which remain to be fulfilled and does not effect those portions which have been executed.¹³⁴

3. Fundamental Change of Circumstances and Termination or Revision of Concessions

The doctrine of fundamental change of circumstances or some analogous doctrine is found not only in international law, but in Islamic Shari'ah, as well as in the common law and the civil law. Consequently, the right to renegotiate an agreement in certain circumstances is recognized in these different legal systems, as we have seen. The doctrine has also been recognized in transnational arbitrations involving multinational corporations.

In this section I will mention the doctrine in the common and civil law systems and in the next chapter I will discuss the doctrine in Islamic Shari'ah.

(1) **The Common Law Doctrine of Frustration**

The doctrine of frustration of contract in English law is very close to the doctrine of *rebus sic stantibus* in international law. The determining feature in both cases is an unforeseen external event or series of events or a gradual change of circumstances.¹³⁵ Concerning the theoretical basis of this doctrine, there are three different views:

1. The theory of "implied term" according to which there is an implied term in every contract, that performance is to be made only if it remains reasonably possible in accordance with what the parties of the contract contemplated.
2. The theory of "material change" according to which, since the contract is based on consent, a party is not bound to perform if

134 Hill, 14.

135 Williams, 93.

conditions arise, other than which were consented to when the contract was signed.

3. That the doctrine is a device by which the rules of the contract which are expressed in absolute terms can be reconciled by the court to bring it into line with what justice demand. It enables the court to intervene to supply a just and reasonable solution in situations which the initial contract could not have anticipated.¹³⁶

Despite earlier dicta of Lord Sumner in the Privy Council,¹³⁷ the third of these views is now generally accepted.

In the United States, the 1979 Second Restatement of the Law of Contracts provided as follows:

Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.¹³⁸

This rule is subject to the limitation that "it applies only when the frustration is without the fault of the party who seeks to take advantage of the rule, and it does not apply if the language or circumstances indicate the contrary". Frustration as a result of circumstances existing at the time of the making of the contract rather than as a result of supervening circumstances is governed by a similar rule stated in section 266(2).¹³⁹

(2) The Civil Law Doctrine of *Imprévision*

The doctrine of *imprévision*, which is found in French law, was developed by the French administrative courts during and after the 1914-1918 War. It is applicable to contracts between private persons and the government and has

136 Amin, 579.

137 *Hirji Mulji and others v. Cheong Yue SS Co. Ltd* [1926] AC 509. See Fischer Williams, 92. Harvard Research in International Law of Treaties, 1111.

138 *Restatement of the Law Second, Contracts* (1979) vol 2, Section 265, 264-265.

139 Id, 335.

been recognized by the Council of State,¹⁴⁰ but it has not been recognized by the Court of Cassation as applicable to private contracts between individuals. It gives a right to the modification of contract terms in case of an unforeseen change in circumstances.

The Council of State stated in *Gaz de Bordeaux* in 1916 that "a party has the right to demand a revision of the terms of a contract of concession whenever the equilibrium between the profits which it earns and the cost of manufacture has been upset by an unforeseen change of conditions, such as an increase in the cost of coal or other commodities used in the manufacture of gas."¹⁴¹

On the other hand, the doctrine of *imprévision* provides only for the revision of the contract under the new conditions, while the doctrine of *rebus sic stantibus* provides both for revision and the termination of the obligation.¹⁴² The doctrine of *imprévision* has found its way into the private law codes of certain countries (for example, Article 269 of the Polish Civil Code of 1932, Article 1467 of the Italian Civil Code of 1946 and Article 147 of the Egyptian Civil Code of 1948).¹⁴³

The doctrines of *imprévision* and frustration are similar, but as Mitchell pointed out there is one major difference:

while the English theory recognizes the termination of the contract and adjusts the position of the parties in view of this fact, the doctrine of *imprévision* on the contrary is founded upon the continuation of the contract. It was designed, in the first place, as a means of surmounting temporary obstacles to the continuity of performance. The similarity of the two doctrines lies in the circumstances which give grants for their application. The French doctrine depends upon the existence of unforeseen circumstances which result in "*bouleversement de l'économie du contrat*", a phrase which is very close to Lord Wright's phrase - the "frustration of the commercial purpose".¹⁴⁴

140 Harvard Research in International Law of Treaties, 1112.

141 Sirey, *Recueil*, 1916, 111-17 quoted by Harvard Research in International Law of Treaties, 1112.

142 Ibid. See further Hill, 19.

143 Zakariya, 272.

144 JDB Mitchell, *The Contracts of Public Authorities. A Comparative Study* (1954) 190.

In a discussion of frustration of contract Friedmann notes that:

A vital change of circumstances may lead sometimes to the complete discharge and sometimes to the judicial modification of the terms of contract. The major effect of the doctrine...is the substantial limitation of the sphere of breach of contract, and, with it, the diminution, of the value of contract as a measure of security against economic risks.... The doctrine of frustration, while mainly a judicial code has also been incorporated into the Greek Civil Code.¹⁴⁵

4. Effects of Stabilization Clauses on the Invocation of the Doctrine

The purpose of a stabilization clause, in a concession agreement is to prevent the State party from making any alteration in the contract without the agreement of the private party. Historically, it was intended to give added security to the private party's investment under the contract, and to act as a counterweight to the sovereign power of the State.¹⁴⁶ Asante states that such clauses are in particular directed against:

1. The raising of taxes beyond the rates operating at the time of the agreement or otherwise stipulated in the agreement;
2. The imposing of any fiscal changes in the general industrial or commercial sectors in excess of the fiscal charges provided in the agreement;
3. The amendment of the laws such as corporate and tax laws, which were in force on the date of the agreement...
4. Expropriation, nationalization and any other form of intervention in the enterprise.¹⁴⁷

Its effect, if successful, was to make the contractual provisions rigid and inflexible.¹⁴⁸ The two legal bases for the validity of stabilization clauses in

145 W Friedmann, Changing Functions of Contract in the Common Law, *University of Toronto Law Journal* IX (1951) 39.

146 A Redfern, The Arbitration between the government of *Kuwait and Aminoil*, *BYIL* 55 (1984) 98.

147 SKB Asante, The Concept of Stability of Contractual Relations in The Transnational Investment Process, in Hossain (ed.), 245.

148 SR Chowdhury, Permanent Sovereignty and its Impact on Stabilization Clauses, Standard of Compensation and Patterns of Development Co-operation, in Hossain and Chowdhury (eds), *Permanent Sovereignty Over Natural Resources in International Law* (1984) 48.

contracts are the theories of "acquired rights" and *pacta sunt servanda*.¹⁴⁹ Verwey and Schrijver state that:

...the right to nationalize as such is no longer the subject of controversy, but the exercise of the right will be invalid if the taking of foreign property is contrary (1) to a treaty or contract which provides for "stabilization clauses" or "unassailability clauses" and (2) not supported by a public purpose...¹⁵⁰

Thus there are differences of opinion as to whether the stabilization clause can be interpreted as a renunciation of the State's right to nationalize private property for public purpose. To examine the status and effects of stabilization clauses, I will look at three awards relating to the Libyan oil nationalization of 1974 and the *Aminoil-Kuwait* arbitration award of 1986.

(1) The Three Libyan Awards

Three Libyan arbitral awards - involving *BP*¹⁵¹, *Texaco*,¹⁵² and *Liamco*¹⁵³ - are at the heart of the controversy over the effect of stabilization clauses on concessions. The cases involved a common clause, clause 16 of the respective concession agreements, which in its final form after amendment in 1965 provided that:

1. The Government of Libya, the Commission and the appropriate provincial authorities shall take steps necessary to ensure company's enjoyment of all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties.
2. This concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the regulations in force on the date of the execution of the agreement of amendment by which this paragraph (2) was incorporated into this concession agreement. Any amendment to and repeal of such

149 Ibid.

150 WD Verwey & NJ Schrijver, *The Taking of Foreign Property under International Law. A New Legal Perspective*, Meeting at the Peace Palace, The Hague. September 1984, 4. See also Chowdhury, 52-3.

151 Arbitration between the Government of Libya & *BP* *ILR* 53 (1979) 297.

152 Arbitration between the Government of Libya & *Texaco* *ILM* 17 (1978) 1.

153 Arbitration between the Government of Libya & *Liamco* *ILM* 20 (1981) 1.

regulations shall not affect the contractual rights of the company without its consent.

However the interpretation of the stabilization clause in the three Libyan cases was inconsistent, leading to no clear conclusion.

The purpose of clause 16 was to ensure that concession holders could maintain their rights unless they agreed otherwise, and the effect of the clause was to ensure a commitment to the contract by the State.¹⁵⁴ Arbitrator Mahmassani in the *Liamco Arbitration* discussed this point as follows:

To strengthen this contractual character in *Liamco's* and similar other concession agreements as a precaution against the fact that one of the parties is the State, it was deemed necessary to ensure a certain protection for the contractual rights of the concessionaire. Usually foreign investors before taking the risk of investing substantial amounts of money and labor for 'working' their concessions, are anxious to seek sufficient assurance for the respect of the principle of the sanctity of contracts... any such alteration or abrogation of concession agreements should be made by mutual consent of the parties. To ensure such protection in *Liamco's* concessions, a specific provision has been inserted to that effect in clause 16 of its agreements.¹⁵⁵

While the right of nationalization was not questioned, it was not considered an unlimited power, but entailed under international law an obligation by the State to recognize the terms and conditions of the agreement with a contracting party.

Further, under Islamic Shari'ah, a source of Libyan law, parties must fulfil their contractual obligations. As Arbitrator Dupuy stated:

Thus under the Shari'ah, nobody, neither the sovereign nor any official, is exempted as a matter of privilege. If, in conformity with the *Siyasa* doctrine, the sovereign has large discretionary powers as regards the promotion of public interest, he must

154 Clause 16, which was modified by a December 1961 Royal Decree, was characterized as "a fundamental provision emphasizing the sanctity of contract": Qasem, *Libya's New Oil Policy*, *World Petroleum*, September 1962, 49-90.

155 *Liamco Award ILM* 20 (1981) 58. See RB von Mehren & PN Kourides, *International Arbitrations between States and Foreign Private Parties. The Libyan Nationalization Cases*, *AJIL* 75 (1981) 480.

nonetheless abide by the commands of the supreme law, and then Ibn Quadama (a Hanbali School jurist) states that "a breach of a commitment on the part of the Imam is more serious and more heinous than a breach committed by anybody else, because of its baneful consequences." Now, it is accepted that this rule covers also agreements entered into with non-Muslims.¹⁵⁶

He also referred to the famous precept of Islamic Shari'ah found in the Holy Qur'an: "O ye believers, perform your contracts", and to Articles 147 and 148 of the Libyan Civil Code, which confirms that contracts must be performed in good faith in accordance with their terms.¹⁵⁷ Therefore, as we will see in Chapters 8-9, unless the doctrine of *Durura* - the principle of necessity - can be invoked, the onus under Islamic Shari'ah is on the parties to abide by the contract.

In the *Liamco Arbitration*, Arbitrator Mahmassani made these comments regarding Islamic Shari'ah and Libyan law:

The principle of the respect for agreements is thus applicable to ordinary contracts and concession agreements. It is binding on individuals as well as governments. The same is admitted in Islamic law, as is evidenced by many historical precedents. For instance, no less than the Great Caliphs Umar Ibn Al-Khattab and Imam Ali accepted to abide by their agreements and to appear before the Cadis [Judges] as ordinary litigants without feeling that this conduct was against their sovereign dignity...¹⁵⁸

International law came to the same principle: "The State as a sovereign entity possesses the power to grant rights and bind itself to agreed terms. To permit a State to use its sovereignty to disregard commitments that it freely undertook through the exercise of that very sovereignty would be anomalous. Such a result would undermine and destroy the legal framework of the international order."¹⁵⁹ Arbitrator Mahmassani noted that "international custom and case law had always sustained the proposition of '*pacta sunt servanda*'".¹⁶⁰ Similarly, Arbitrator Dupuy noted that, while the effect of clause 16 was to stabilize the position of the

156 Quoted by von Mehren & Kourides, 517.

157 Id, 514.

158 *Liamco Award*, *ILM* 20 (1981) 110-1. See von Mehren & Kourides, 518.

159 Quoted by von Mehren & Kourides, 518.

160 Id, 518-9.

contracting parties, it "does not in principle, impair the sovereignty of the Libyan State..."¹⁶¹

In the *Liamco Arbitration* Arbitrator Mahmassani also confirmed the effect of clause 16:

To ensure such protection in *Liamco's* concessions, a specific provision has been inserted to that effect in clause 16 of its agreements. That clause has been legally authorized by and modelled upon the same standard clause of schedule 11 annexed to the petroleum laws of 1955 and 1965... The above clause 16 comes under what has been termed "stabilization" and "intangibility" clause, which have been considered as legally binding under international law....¹⁶²

Arbitrator Dupuy concluded that a State which has exercised its sovereignty to enter into a contract with a foreign private party cannot disregard these commitments by invoking its sovereignty to terminate the contract, and that while the right of a State to nationalize is internationally recognized, it cannot disregard its commitments in the contract, especially if it has accepted the inclusion of a stabilization clause.¹⁶³

In the *BP* case, clause 16 was held to be ineffective to nullify the nationalization measures taken by Libya, even though they were taken for overtly political reasons. But the Arbitrator held that the nationalization was arbitrary, discriminatory and amounted to a confiscation of property, and that damages would need to be paid. In the *Liamco* case the nationalization was not seen as discriminatory or wrongful, but there was liability for compensation for premature termination, and equitable compensation would need to be paid. However, in the *Texaco* case, the nationalization was held to be a contravention of the contract, so that clause 16 had the effect of "stabilizing" the petroleum legislation at the date of the execution of the agreement. The effect of these decisions varied from an interpretation that invalidated Libya's right to

161 Id, 519.

162 *Liamco Award ILM* 20 (1981) 58-9.

163 von Mehren & Kourides, 519.

nationalize to one that resulted in an obligation by the State to pay equitable compensation for nationalized property.¹⁶⁴

(2) **The Aminoil Arbitration**

In 1977, the Kuwait Government acted unilaterally to terminate the American owned Aminoil Company's concession in Kuwait and to nationalize the company. This concession, which had been granted in 1948, was to run for a period of 60 years, and the price to be paid was a fixed royalty of US\$2.50 for every ton of petroleum. There was no provision under which the Ruler would obtain a higher return if oil prices increased. It was expressly stated in the agreement that no changes were to be made in the terms of the agreement "by either the Sheikh or the Company" unless both agreed that such changes were "desirable in the interest of both parties" (Article 17).¹⁶⁵

However many changes were made to this agreement, following earlier Saudi Arabian practice. In 1961, Aminoil became subject to Kuwait's income tax decrees, and in 1973 the payments due from Aminoil were increased. Following the war in the Middle East, in October 1973, the price of oil increased dramatically and OPEC announced that the average government "take" from operating oil companies would be \$10.12 per barrel from January 1975, and that the revenues left to operating oil companies would be only 22 cents per barrel. Aminoil, fearing it would be driven out of business, requested negotiations with the Government.¹⁶⁶

The failure to reach agreement led to a Decree Law No 124 of 19 September 1977, which enacted that Aminoil's concessions would be terminated, that Aminoil's assets in Kuwait should return to the State and that fair compensation should be paid to Aminoil.¹⁶⁷ Aminoil's refusal to take part in the compensation committee led to an arbitration agreement between the parties in Kuwait on 23 July 1979. The arbitration tribunal of three members met in Paris.

164 Chowdhury, 50.

165 Redfern, 65-9.

166 Id, 72.

167 Ibid.

In the arbitration, Kuwait argued that "during the thirty years which had passed since the concession had been granted, there had been major political, economic and social changes both within its own territory and in the world outside. These changes were reflected in developed public international law and in particular, in those resolutions of the United Nations which concerned State sovereignty over natural resources and the new international economic order".¹⁶⁸ The company argued "that it had paid a fair price for its concession and that, under the principle of *pacta sunt servanda*, the company should have been entitled to go on operating the oil-fields until its contract to do so ran out, in the year 2008".¹⁶⁹

The positions of both parties were quite clear. The Government suggested, that as its agreement with Aminoil was a State contract, the tribunal should follow the normal rule and apply the law of the State party to the contract. Aminoil contended that the contract should not be considered a state law and should be internationalized. It argued that "*pacta sunt servanda*" was a fundamental principle of law and that a State could not lawfully abrogate a contract with a foreign party where it had expressly agreed not to do so. It placed heavy reliance on the stabilization clauses in the concession agreement. The Government argued that the stabilization clauses themselves could not be expected to survive the dramatic changes which had taken place since 1948. These included the declared independence of Kuwait; the promulgation of a new Constitution for the State and major revisions to the concession agreement itself.

In its final decision, the Tribunal seemed to attach most importance to the "metamorphosis in the whole character of the concession" as a result of changes brought about with at least the tacit acceptance of the company, which entered neither reservations nor objections in respect to them. It recognized that times had changed since the making of the original agreement, and that its provisions would be out of touch with these changes, if they construed the agreement or the stabilization clauses it contained as an absolute prohibition against nationalization. The Tribunal stated that:

168 Id, 74.

169 Ibid.

this concession, in its origin a mining concession granted by a State whose institutions were still incomplete and directed to narrow patrimonial ends became one of the essential instruments in the economic and social progress of a national community in full process of development.¹⁷⁰

As this transformation took place, so did the contract of concession change its character.

The Kuwait Government had, firstly, argued that the Article 17 was a colonial type of stabilization clause. This argument was rejected as Kuwait had reconfirmed these agreements as late as 1973 after Kuwait's independence and the promulgation of a new constitution. The Award also rejected the Government's argument "that the constitution had annulled the clauses and that in any event they were invalidated by a rule of jus cogens in international law whereby a State is prohibited from restricting its sovereignty over its natural resources." The Award stated:

This contention lacks all foundation. Even if Assembly Resolution 1803 (XVII) adopted in 1962, is to be regarded, by reason of the circumstance of its adoption, as reflecting the then State of international law, such is not the case with subsequent resolutions which have not had the same degree of authority. Even if some of their provisions can be regarded as codifying rules that reflect international practice, it would not be possible from this to deduce the existence of a rule of international law prohibiting a State from undertaking not to proceed to a nationalization during a limited period of time. It may indeed well be eminently useful that 'host' States should, if they so desire, be able to pledge themselves not to nationalize given foreign undertakings within a limited period; and no rule of public international law prevents them from doing so.¹⁷¹

On the other hand Aminoil had claimed that:

1. International law applies to the relations between the parties.

170 Id, 103.

171 G Marston, "The Aminoil-Kuwait Arbitration", *JWTL*, 17 (1983) 180-1.

2. Present international law forbids the State to nationalize when it has agreed to stabilize the legal situation of the foreign investor.¹⁷²

Further Aminoil argued "that stabilization clauses did no more than embody general principles of law and therefore they did not change what would have been in any event the company's legal position."¹⁷³ The tribunal rejected these arguments, noting that the stabilization clauses had the effect of specifically protecting the concessionaire, and was "a well-known principle in the interpretation of contractual undertakings".¹⁷⁴

The third argument of the Government was that while a State was entitled to limit its legislative freedom for a limited period it could not do so for the whole life of the agreement.¹⁷⁵ Again, the tribunal stated there was no law which could prevent a State from pledging not to nationalize foreign property undertakings. They said:

it would not be possible... to deduce the existence of a rule of international law prohibiting a State from undertaking not to proceed to a nationalisation during a limited period of time.¹⁷⁶

However, the Tribunal did not attempt to define what was a limited period of time, and stated that they were not prepared to interpret the clause so as to prohibit nationalization. Thus the Tribunal concluded that "it refused to view the stabilization clauses as a renunciation by the State to its right to nationalize,"¹⁷⁷ and interpreted it to be specifically directed against "anything which, by reason of its confiscatory character, might cause serious financial prejudice to the interests of the company."¹⁷⁸ Therefore the stabilization clauses were interpreted as being a commitment to ensuring that nationalization did not have a confiscatory character and as reinforcing "the necessity for a proper

172 FR Tesón, "State Contracts and Oil Expropriations. The *Aminoil-Kuwait Arbitration*", *Virginia Journal of International Law*, 24 (1984) 340.

173 Id, 340-341.

174 Ibid.

175 Redfern, 102.

176 Ibid.

177 Tesón, 344.

178 Redfern, 104.

indemnification as a condition of it".¹⁷⁹ Sir Gerald Fitzmaurice disagreed with this interpretation, noting that "...although the nationalization of Aminoil's undertaking may otherwise have been perfectly lawful, considered simply in its aspect of being an act of the State, it was nevertheless irreconcilable with the stabilisation clauses of a concession that was still in force at the moment of the takeover".¹⁸⁰

Thus, the stabilization clauses had to be read in the light of developments which had taken place both in international law and in the relationship of the parties since the original grant of the concession. The majority of the arbitrators indicated that "such a pledge, to be valid, would have to be for a limited period only".¹⁸¹ In the result, compensation was assessed as the sum due as fair compensation for a legitimate act of nationalization.

The Kuwait ruling indicates that stabilization clauses do not prohibit nationalization, but rather serve as a factor to consider when deciding on proper indemnification.

(3) The Views of Writers

There are three main themes in the writing on stabilization clauses; the first two opposing each other and the third, an attempt to integrate these views and provide a practical solution to the status of the clause.

Weil claims, that as a State can restrict the use of its prerogatives through a treaty, so it can also do it by a contract. He concludes, that such "clauses" deprive the host State of the power to terminate a concession without a private party's consent. He bases his conclusion on the ground that a contract which contains a stabilization clause is governed by international law rather than

179 Ibid.

180 Ibid.

181 Id, 102. Further, in the *Anglo-Iranian Oil Company Case* before the International Court of Justice 1952, Judge Alvarez referred in his dissenting opinion to the doctrine of *rebus sic stantibus* as a "well-known rule in the law of nations". However, the doctrine was not invoked by the Government of Iran before the International Court of Justice. See *ICJ Rep* 1952, 93, 124, 126.

the law of the contracting State.¹⁸² Writers taking this approach see the stabilization clause as providing added protection to the security of a contract.

Verwey and Schrijver claim that while the right to nationalize is no longer a matter of controversy, the right will be invalid if it is contrary "to a treaty or contract which provides for a 'stabilization clause' or 'unassailability clauses', and not supported by a public purpose.... They claim that the violation of a contractual guarantee provided for in a treaty or concession amount to a violation of international law".¹⁸³

Others claim, that such clauses are invalid as they limit the ability of states to control their future legislative freedom, such claims maintain that there is no international customary rule which would allow stabilization clauses to become a special case for the assessment of the legality of unilateral termination of a contract.¹⁸⁴

A modern position of compromise is stated by Jiménez de Aréchaga who sees the clause as a factor to be considered in determining the appropriate compensation. He notes:

This does not mean that stabilization clauses have no legal effect. An anticipated cancellation in violation of such a contractual stipulation would give rise to a special right to compensation; the amount of the indemnity would have to be much higher than in normal cases because the existence of such a clause is a most pertinent condition which must be taken into account in determining the appropriate compensation. For instance, there would be a duty to compensate for the prospective gains (*lucrum cessans*) to be obtained by the private party during the period that the concession still has to run.¹⁸⁵

182 P. Weil, *Les clauses de stabilisation ou d'intangibilité insérées dans les Accords de développement Economique*, in *Melanges, Offerts à Charles Rousseau* (1974), quoted by J de Aréchaga, *State responsibility for the nationalization of foreign-owned property*, *NYUJILP*, 11 (1978) 191.

183 Verwey & Schrijver, 4.

184 EJ Paasivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes* (Cambridge PhD Thesis, 1988) 136.

185 de Aréchaga, 192.

Such a position supports a State's right to nationalize while safeguarding the economic investment of the parties' interest in the contract.

In this context, it is also interesting to note the conclusions of a Report of a Committee of the Australian Branch of the International Law Association regarding "stabilization clauses". The Committee concluded that:

- (a) Economic development agreement (EDA's) by their very nature cannot realistically be seen to be immutable;
- (b) Practice through the use of renegotiation and reliance on renegotiation clauses will tend to ensure that EDA's will henceforth be variable.¹⁸⁶

After discussing the views of Weil and Aréchaga on the effect of stabilization clauses in municipal and international law, the Report observes:

Perhaps the advantage of stabilization clause is therefore political or moral rather than legal. While the stabilization clauses will be of little effect in municipal law, at least in English and Australian municipal law, it is hard to see that it could have any greater effect in international law unless the contract itself can be said to be subject to a non-State legal system. Our evaluation of arguments in support of such delocalization of EDA's suggests that this is unlikely, or that even if it occurs, such agreements are not immutable.¹⁸⁷

(4) Conclusion

In my opinion, with regard to the conflict between the right of the State to nationalize foreign property and the principle of stabilization clauses in concession agreements, international law has recognized the right of the State to nationalize foreign property. Thus the Aminoil award rightly recognized that the principle of stabilization may validly limit the right to nationalize, but did not expressly prohibit it.¹⁸⁸ The right to nationalize has been recognized in many United Nations resolutions beginning from Resolution 1803 in 1962. This right

186 Australian Branch Report Ch.4, 163, 180. See Chowdhury, 53, 4, 5.

187 Ibid.

188 Marston, 180.

is to be based on grounds of public utility, security or the national interest. However, the State cannot invoke its sovereignty to disregard its contract with private foreign companies, in its termination or amendment of any contract, without the agreement of the party where it had agreed not to do so. The State must keep to its commitment.

International law recognizes the principle of *pacta sunt servanda* both in Article 26 of the Vienna Convention on the Law of Treaties and as a fundamental principle of law by which contracting parties must keep their commitments. On the other hand international law also recognizes the principle of *rebus sic stantibus* or change of circumstances in Article 62 of the Vienna Convention. Thus the revision or termination of an agreement is proper in cases where circumstances have changed or where the agreement was based upon an inequality.

In my opinion a resolution to the conflict between *rebus sic stantibus* and *pacta sunt servanda* may be found in the fundamental principles of international law. In the case where a State breaches its contract with a private foreign company before the termination date by nationalization of the private foreign company, and where the contract was signed as a long term agreement and if, this nationalization causes the private foreign company damages, as a result of the takeover, the company has the right to claim compensation and the State is obliged to pay this compensation according to the standard of international law. In this way it may be possible to arrive at a reconciliation of the two principles.

Thus *rebus sic stantibus* is not in conflict with *pacta sunt servanda*. It simply begins to operate once the conditions for *pacta sunt servanda* cease to operate. It will begin at the lower limit when parties to a contract agree at the time of signing that certain conditions exist and may be terminated if those circumstances change. This may lead to the implication that such changes have made continuation incompatible with the original intention of the parties. Stabilization clauses - as noted in the Aminoil case - could not be expected to survive the dramatic changes that may have occurred. It was the implicit or, in the above case, explicit, recognition of these changes that led to the use of the *rebus sic stantibus* doctrine.

CHAPTER 8

RENEGOTIATION OF OIL CONCESSION AGREEMENTS: FUNDAMENTAL CHANGE OF CIRCUMSTANCES AND THE TERMINATION OF TREATIES IN ISLAMIC SHARI'AH LAW

1. Introduction

The purpose of this chapter is to discuss the theory of fundamental change of circumstances according to the opinion of Islamic jurists. This is relevant, both because those opinions must form part of the body of learning which goes to constitute "general principles of law recognized by civilized nations" (as referred to in Article 38(1)(c) of the Statute of the International Court of Justice) but also, because a concession agreement involving natural resources in an Islamic country, whatever its proper law, must take account of the law of that country as the law of the place where the concession is to be performed. Some understanding of the Islamic Shari'ah on the point is thus essential.

Although this is not a work of Islamic history, it is necessary first to mention some important elements in the Islamic religion as a background to the following discussion. Then I will discuss the basic rules of change of circumstances, i.e. the effect of the changes in circumstances on the parties' commitments as one of the excuses which justify the termination or the amendment of the contract. In particular I will consider the definition of the excuse, its scope, and the relationship between *force majeure* and change of circumstances. Particular cases which have had a significant effect on the development of the doctrine in Islamic law will then be referred to: in particular the "*waqf*" endowment problems which arose in the Ottoman Empire in 1303 AH (1893), and the recent resolution of Council of Higher Scholars Committee in the Kingdom of Saudi Arabia 1402 AH (1982) concerning the possibility of increasing the rental charges stated in the old "*waqf*" contracts in case of a change of circumstances. Finally, I will discuss the procedures which Islamic law dictates should be followed in the case of contractual and treaty amendment or termination on grounds of change of circumstances.

2. Historical Background

(1) Sources of Islamic Shari'ah Law

There are basically four sources of Islamic Shari'ah. These are:

1. The Holy Qur'an (the word of god).
2. The Sunnah (The practice and traditions of the last of God's Messengers, Muhammad).
3. *Ijma* (Consensus of opinion).
4. *Qiyas* (Reasoning by analogy).

There are also several minor sources which developed later as products of search by Muslim jurists for solutions to contemporary matters. These are:

1. *Al-Istihsan*, which is "the deviation, on a certain issue, from the rule of a precedent to another rule for a more relevant legal reason that requires such deviation".
2. *Al-Istislah*, which is "the unprecedented Judgment motivated by public interest to which neither to Qur'an nor the Sunnah explicitly refer".
3. *Al-Urf*, or local custom, and usage.¹

These sources are not of equal importance. In fact the first two sources (the Holy Qur'an and the Sunnah) are basic sources of Islamic Shari'ah, and there is no controversy among Muslim jurists (*Al-Fugaha*) about this position. The second two sources, *Ijma* (consensus of opinion) and *Qiyas* (reasoning by analogy) follow. After these four great sources the other minor sources follow in turn.

However, with the exception of Holy Qur'an and the Sunnah each of the other sources has been a matter of controversy among Muslim jurists: these controversies have related to the very existence, legality and definition of the lesser sources. As is normal after the termination of revelation, these controversies have raged ever since Muslim jurists started to build up their

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S Ramadan, *Islamic Law, Its Scope and Equity* (1961) 23.

individual opinions (*Ra'y*), after the prophet Muhammad's death and the completion of the principles of the Islamic religion.

(2) Schools of Jurisprudence in Islamic Shari'ah

There are four Schools of Jurisprudence in Islamic Shari'ah. In this chapter I will discuss their attitude towards the theory of change of circumstances in Islamic Shari'ah. The basis for these divergencies is the statement of the Prophet Muhammad that "The disagreement of my people is a mercy from Allah."² The character of this controversy and discussion was, and in a sense remains, theological: different opinions have been established among the Muslim world in the form of *Al-Ijtihad* (individual opinions) on the basis of the two great sources of Islam, the Qur'an and the Sunnah.

During the second and third centuries of the Islamic era (the eighth and ninth of the Christian era), according to Iqbal "not less than nineteen schools of law and legal opinion appeared in Islam. This fact alone is sufficient to show how incessantly our early doctors of law worked in order to meet the necessities of a growing civilization".³ However, no particular school dominated among the Muslim communities. Eventually four great schools of jurisprudence in Islamic Shari'ah were established as orthodox in the fourth century of the Hijrah,⁴ the Islamic era. Each was named after its jurist founder and each now prevails in a different country.⁵ They are:

1. The Hanafi School, founded by Imam Abu Hanifa (696-767 AD), is influential in Iran, Syria, lower Egypt, Lebanon, Turkey, Afghanistan, India, Pakistan, the Balkan countries, Cyprus, Rhodes, and China.⁶

2 See M Khadduri, *War and Peace in the Law of Islam* (1960) (1955) 35; NJ Coulson, *A History of Islamic Law*, (1971) (1964) 182.

3 Iqbal, *The Reconstruction of Religious Thought in Islam* (1951) 165, quoted by Ramadan, 79.

4 Hijrah or anno Hegirae (AH), is the date when God ordered the prophet Muhammad to emigrate from Makkah to Medina in 622 AD, from which the Arabian and Islamic era started.

5 See further information, see M Khadduri & HJ Liebesny (eds), *Law in the Middle East*, 1 (1955) 57.

6 The notion of judgment upon reasoning adopted by Abu Hanifah and is termed *al-qiyas*.

2. The Maliki School, founded by Imam Malik, (715-795 AD), spread in North and West Africa, upper Egypt, Sudan, Eritrea, Somaliland, Libya, Tunisia, Algeria, Morocco, West of French, Gambia and Nigeria.
3. The Shafi'i School (767-820 AD), founded by Imam Al Shafi'i, spread in lower Egypt, Al-Yaman, part of Eritrea, and Somaliland, Tanganyika, Kenya, Indonesia, Malaya, Siam, and Philippines (Sulu).
4. The Hanbali School (780-855 AD), founded by Ahmad Ibn Hanbal, was dominant in Saudi Arabia, the Arab states of the Gulf, Syria, Palestine and Iraq.

Since each school shares a single doctrine of sources of law, there are no differences in fundamentals, but they differ in several points through interpretation. Therefore, every Muslim can change his preference from one school to another during his lifetime without any restriction or criticism from Muslim communities. On the other hand, there is no permission to jump from school to school to find an easy interpretation or solution to the problems which every Muslim faces. There must be some commitment to the school which has been chosen.

Those schools do not have the same opinion regarding the theory of change of circumstances. While all of them accept it as a principle, there are differences in its interpretation and application, as I will analyse later.

(3) Difficulties of language

In the case of Islamic Shari'ah, translating from the Arabic is especially difficult because the Qur'an has an extremely complex language and a linguistic form totally different from western languages. There is thus both a problem of translation and of the different interpretation of legal expressions. As Justice Robert Jackson said:

The barrier of language presents more than the usual difficulty of comparative law studies in the case of Islamic law. A competent scholar engaged in translating for English readers what Muslims hold to be the meaning of the words of the Qur'an despaired of the effort to convey its spirit and declared that the Qur'an cannot be translated so as to be made plain to

one who disbelieves its inspiration and its message. I suspect that the same difficulty of communication carries over into the effort to expound Islamic law to American readers. The writers of this work, as those of all others I have seen, find it necessary to use many word which probably convey to the Muslim a whole complex of meaning, a cluster of ideas, but which do not have an English equivalent. In course of time it is the custom that legal expressions come to carry a whole bundle of ideas to the initiate as do our phrases "due process of law" "equity jurisprudence" "trial by jury" or "judicial review". It appears to be true of many Islamic legal terms that they wrap volumes of meaning into a single word, which may be expounded to us, but we not having the same concept in our law have no legal term to fit it.⁷

3 The Basic Rules of Change of Circumstances

(1) *Al-Ijtihad*, or "Individual reasoning"

The most important of the works of Islamic Jurists (*Al-Fuqaha*) is *Al-Ijtihad* or "individual reasoning".

Al-Ijtihad is derived from an Arabic verb *Ijtihad*, which literally means "to exert oneself": over the centuries this term has come to denote a large body of legal definitions and conditions. It was originally used, with a legal reference during the life of the prophet Muhammad in an account traditionally assigned to Mu'adh Ibn Jabal. The latter was appointed as a Judge to the Al Yaman by the prophet. Before he left, the prophet asked him, "According to what shalt thou Judge?" He replied, "According to the Book of God". "And if thou findest nought therein?" "According to the Sunnah of the prophet of God" "And if thou findest nought therein?" "Then I will exert myself to form my own Judgment" And thereupon the prophet said: "praise be to God who has guided the messenger of his prophet to that which pleases his prophet".⁸

This concept of "*Al-Ijtihad*" as stated in the words of Mu'adh Ibn Jabal "then I will exert myself to form my own Judgment" allows a certain amount of flexibility in the application of Islamic Shari'ah. According to tradition

7 Quoted by Khadduri & Liebesny, viii.

8 Quoted by Ramadan, 64.

of Prophet Muhammad permitted the exercise of *Al-Ijtihad* as a source of Shari'ah,⁹ enabling jurists to deduce new principles on the basis of revelation and to apply them to new facts facing modern Islamic society. It is, as Iqbal has said "the principle of movement in the structure of Islam".¹⁰

Caliph 'Umar Ibn Al-Khattab applied the prophetic tradition "Sunnah" when he gave his instruction to Abu Musa al-Ash'ari, *Gadi*, (Judge) of Basra in Iraq, specifying three sources to be used in decisions, namely, the Qur'an, the prevailing Sunnah, and reason.¹¹

Similarly Ibn al Qayyim al Jawzyya Jurist of the Hanbali School tried to establish three conditions for the course and validity of individual opinion:

- (1) that it may be resorted to only in the absence of an applicable text of the Shari'ah:
- (2) that in no way should it contravene the Shari'ah: and
- (3) that the course of reasoning should not become entangled in any kind of sophistry or complication of expression which might affect the people's direct attachment to the Shari'ah or distort the brilliant clarity thereof.¹²

But as Coulson has stated:

Appreciation of the terms of the Shari'ah is, of course, a process of human thought, whether this takes the form of the simple recognition of the manifest meaning of a Qur'anic rule or lies in the derivation of a novel rule by analogy. Both the nature and the effect of this whole process of appreciation of the divine law, which is properly termed *Ijtihad* (literally, the "effort" of one's own Judgment) are regulated by the legal theory. In the first place the course which *Ijtihad* must follow is defined. The *mujtahid* (or person exercising *Ijtihad*) should first seek the solution of legal problems in the specific terms of the Qur'an and the Sunnah, applying thereto the accepted canons of interpretation and construction, including the doctrine of repeal or abrogation (*naskh*). Thus the classical theory adopts the doctrine of ash-Shafi: by integrating the Qur'an and the Sunnah

9 Khadduri, 28.

10 Ramadan, 73.

11 Khadduri, 28.

12 Quoted by Ramadan, 68.

as material sources of divine revelation. But the dominant position of the Sunnah has an even greater emphasis in the classical theory: for as well as explaining the Qur'an the Sunnah may also repeal it. Where a problem is not specifically regulated by the Qur'an or Sunnah, the method of analogical reasoning must then be used to extend the principles inherent in the divine revelation to cover new cases. The second function of the legal theory is the evaluation of the results of such *Ijtihad* in terms of the authority which is to be attributed to them as expressions of the divine will. A moment's reflection will bring to light the fundamental nature of the whole problem of the authority of the law in Islam. It was not merely a case of the values which were to be attached to the various possible interpretations of the Qur'an and Sunnah and the results of Juristic reasoning in general: there was also the primary question of the authority of the recognized sources of the divine will themselves, what, in fact, guaranteed the validity of the whole scheme of *usul*? These questions find their answer in the concept of "*Ijma*" or consensus".¹³

In fact, Muslim jurists agree that *Al-Ijtihad* (individual reasoning) is a significant factor in assisting them to extract a solution for any serious issue which may arise in the modern Islamic society.

(2) **Alteration of the formal legal opinion "*Fatwa*" with change of circumstances.**

We have discussed already the basic Islamic principles of justice, equality, the fulfilment of promises and the execution of contracts, without distinguishing whether such contracts were between two Muslims or between Muslim and non-Muslim. The Islamic Shari'ah is based upon justice among people without distinction and without violations of the commitments established by contract or agreement, whether between Muslims themselves or between Muslims and non-Muslims. Basic principles of the Islamic Shari'ah include respect for vested rights, the prohibition of unjust enrichment or theft, and justice and equality among people. Accordingly, the Islamic Shari'ah is considered as applicable universally, and as not limited to any particular place, condition or time. The formal legal Islamic opinion "*fatwa*" is changeable as the places, times, conditions, persons and objectives change through independent judgment ("*Al-*

Ijtihad") in the application of rules, but the basic rules themselves are not changeable.

The level of flexibility that can exist is shown by the formal Islamic legal rule (*Fatwa*) changing according to changes in place, time, condition or persons. For example, the postponing of punishment for a temporary reason is found in the Islamic Shari'ah. There are the cases of pregnant women and foster mothers who, during extreme cold or hot weather or during sickness may be exempted from their duties under Islamic Shari'ah, e.g. from fasting during the month of Ramadan.¹⁴

(3) The Effect on Contracts of Changes in Circumstances

The Muslim jurists have discussed the problem of unforeseen changes after a contract has been agreed, which might affect the parties' commitments. Under the Hanafi School, Abu Hanifah Al-Nua'man, one of the four famous Muslim jurists, defined an excuse as "the agreed party's disability to keep the contract without bearing extra harm not required in the contract".¹⁵ In fact a distinction was drawn in this context between *force majeure* and change in circumstances.

(a) *Force Majeure*:

The definition of *force majeure* is given in the Islamic "*Fiqh*". For example, Ibn Kudamah (d 1223 AD) of the Hanbali School said "the *force majeure* is any disaster which is made by none of mankind".¹⁶ From the Maliki School Khalil said "the *force majeure* is whatsoever which cannot be avoided".¹⁷ It is also stated in the Sunnah:

14 A research prepared by the Permanent Committee for Scientific Researches and Ifta in the Kingdom of Saudi Arabia concerning the old quitrents issue depending upon what was decided by the Council of the Higher Scholars Committee in its seventeenth circle held in Riyadh in 1401 AH (1981) (unpublished) 5.

15 Quoted by S Al-Thnayyan, *Force Majeure* and their provisions in the Islamic Fiqh. Imam Muhammad Ibn Saud University, College of Religion [Shari'ah], Kingdom of Saudi Arabia, 1407 AH (1987) 313 (text in Arabic). Here and elsewhere in this Chapter translations are by the author unless otherwise stated.

16 Ibn Kudamah : *Al-Moghni*, 4, 119. Quoted by Al-Thnayyan, 36.

17 Moktsr Ibn Khalil, 3, 185, quoted by Al-Thnayyan, 31.

The prophet Muhammad stated the *force majeure* clearly to be legitimate by negating the seller's liability for the value of the thing sold from the buyer if such thing faced *force majeure* before it had been received by the buyer. The prophet Muhammad said in the Hadieth "If you bought dates from your brother and they met *force majeure*, it is forbidden for you to receive *anything* from him. Why do you take your brother's money without right?"¹⁸

The notion of *force majeure* linguistically has a wider meaning than the meaning in the Islamic "*Fiqh*". The linguists extend the meaning of *force majeure* to "destruction and loss of all money".¹⁹ Accordingly the prophet Muhammad confirmed the illegitimacy of taking money without any right.

(b) Change of Circumstances

If it is sought to rely on changed circumstances from those existing at the time of the contract or agreement, the circumstances must be unpredictable and unforeseeable, and the change must be fundamental. The change must affect the substance of the contract. For it to be an acceptable excuse for contract termination according to the Islamic "*Fiqh*", the bad effects which may result from the continuity of the contract must be greater than the benefits as a result of the changes in circumstances.²⁰

This is consistent with what has been recently found in international law concerning the principle of change of circumstances. The evidence for this view, as a matter of Islamic Shari'ah, includes the following:

- * The prophet Muhammad said "No harm and no causing harm [to others] ... Whoever hurts [others], God will hurt him, and whoever makes it difficult [for others], God will make it difficult for him".²¹
- * The principle or rule of legal decision (*Fatwa*) is changed according to the changes of times, places, circumstances and persons. This rule confirms that the provisions should be adapted to the people's benefits and needs which are changeable according to changes in circumstances.

18 This is a *Hadieth* narrated in succession by various narrators. See Al-Thnayyan, 105.

19 Al-Thnayyan, 2-26.

20 Research prepared by the Permanent Committee for Scientific Researches and Ifta, 72.

21 Al-Mustadrak and its summary, 2, 57-8. Al' Bayhaqi Sunnan 6, 69, quoted by Al-Thnayyan, 342.

This will assist the independent opinion maker to settle problems and disputes among people at any time or place.

- * The rule of "the difficulty brings the need for facility".²²
- * The rule of "contract termination because the benefit cannot be obtained".
- * "Custom is authoritative"
- * "Public usage is conclusive and action may be taken in accordance therewith"
- * "What is customary amongst merchants is deemed as if agreed upon between them"
- * "A matter established by custom is like a matter established by law"

There is agreement among Islamic schools concerning the reasons which prevent contractual provisions having full effect or which cause a lease contract to be terminated.²³ For example, in hiring a person to pull out a painful tooth, if the pain in the tooth stops the hiring contract should be terminated because the tooth cannot be pulled out at that time. Similarly if the matter related to a lease, and the benefit of the lease decreased for any reason, the lease value should be reduced by an equal amount to the decreased benefit. Ibn Taimiya from Hanbali School (d 1328 AD) said:

If something of public benefit is hired, such as a hotel...and such known benefit is decreased because the circumstances change, the hiring charge should be reduced by an amount equal to the deducted part of the known benefit.²⁴

Even where the changes do not affect the lease holder alone but also concern third parties, the lease holder may be prevented from gaining the benefit agreed for, but the benefit itself may be retained. Such excuses allow the lease holder to terminate the lease contract, according to most jurists, although the Shafi'yyah's (followers of Al-Shafi'i) say that a contract of lease should not be

22 Al-Sayuti, 76. Ibn Najeeim, 75, both quoted by Al-Thnayyan, 324.

23 Id, 56.

24 Majmu'at Fatawa, 30, 311.

terminated in this case, because there is no termination while the leased object survives.²⁵

Concerning changes in circumstances affecting only the parties but not affecting third parties, jurists did not agree. The majority view was that the contract could lawfully be terminated as between the parties. On the other hand, the Shafi'i School say that a lease contract cannot be terminated unless there is some really significant impact on the benefits agreed on. This suggests a very restrictive view as to change of circumstances, relying on the reading in the Holy Qur'an recitation:

O Ye who believe, fulfil (all) obligations.²⁶

But another view (adopted by the Hanafi School) relies on the argument that "if we oblige the excused party to keep the contract, we will oblige him to accept harm not required under the contract".²⁷ This opinion is adopted by some jurists of the Maliki and the Shafi'i Schools.

The concept of change of circumstances could apply where (1) the change of circumstances is beyond expectation; (2) the change is fundamental; (3) execution of the agreement, because of the change, will result in difficulties or damage to some party. In such cases the damage should be avoided for the benefit of both parties. This can be seen from the following survey of jurists' opinions:

(1) The Hanafi School jurists consider that if the excuses happened to one of two parties causing harm resulting from the change of circumstances, the injured party has the right to terminate the contract. Among the harms to the lease holder are the following: "if he faces bankruptcy and leaves the market, if he wants to travel, if he wants to change his work style from handcrafting into

25 See Al-Mabsoot, 16, 2,4; Al Sunnan, 16, 191; Al-Bahjah Fi Sharh Al-Tuhfa, 2, 178-9; Al-Mughni, 5, 456; Majmu'at Fatawa 30/290 (the opinion of the majority of jurists). But see Raodah El-Talibin, 5, 239-240 relating to Al-Shafi'i opinion. See Al-Thnayyan, 313-5.

26 The Holy Qur'an, Sura V, verse 1.

27 Badai'a Al-Sanai'a, 4, 197-8, quoted by Al-Thnayyan, 318.

farming or vice versa".²⁸ Among the excuses which the lessor might rely on is "facing great debt which he cannot repay other than the leased value".²⁹ This implies a sort of limitation of liability. The underlying argument is that:

if the one who faces an excuse is obliged to keep the contract, he should face harms not obliged under the contract.³⁰

(2) The Hanafi School asserts that if the rental over leased property is raised as a result of changed circumstances, this increase should be proportionate to other similar rental charges. However, if the other party disputes the lessor in relation to the increase in the charge and succeeds, the increase becomes void.³¹

(3) The Maliki School shares the Hanafi School's position in accepting some of these excuses. Thus Al-Tasawuli said:

if the hotel lease holder's income is decreased or he does not find residents because of the changes in the circumstances, he should not pay the rental charges.³²

Similarly Muhammad Aulaish said:

in the case of property rental charges increasing because of changed circumstances from those under which the lease was agreed, the contract should be terminated and the leased property should be rented by the present similar rental charge.³³

(4) Ibn Al-Salah, from the Shafi'i School, states that

if due to changed circumstances the agreed rental charge changes, the unexpected increase should be considered temporary in character and contingent on the continuance of the change of circumstances. Should the circumstances remain changed and the increase in rental charge remain, the contract

28 Badai'a Al-Sanai'a, 4, 197; Al-Mabsoot, 16, 2,7, quoted by Al-Thnayyan, 52.

29 Ibid.

30 Al-Mabsoot, 16, 2,7, quoted by Al-Thnayyan, 318.

31 Research prepared by the Permanent Committee for Scientific Researches and Ifta (unpublished) 60-72.

32 Al-Bahjah Fi Sharh Al-Tuhfa, 2, 23, quoted by Al-Thnayyan, 53.

33 Research prepared by the Permanent Committee for Scientific Researches and Ifta (unpublished) 72.

should be terminated and the leased property should be rented again at a fair rental.³⁴

(5) If a property is rented at a comparable price to similar properties, and then rentals generally increase as a result of changed situations, the position depends on whether or not the rented property is occupied at that time by the lessee. If not the incidental increase on that property should be paid by the lease holder. If he accepts such an increase, the contract remains valid. If he does not, the owner should have the right to terminate the contract. On the other hand, if the rental property is occupied by the lease holder's things (e.g. if the leased property is a plot of land planted by the lease holder or land occupied by building constructed by the lease holder), whatever has been done by the lease holder should be taken into consideration in an agreed settlement: one important factor to be taken into account is whether such increase in rental values happened as a result of the improvements made by the lease holder.³⁵

There is no consensus among jurists concerning the proportionate amount of the increase in the rental value which would give the owner the right to terminate the contract. But that a minor or insignificant increase is not sufficient for this purpose is agreed by all jurists.³⁶

In the case of quitrent contracts, where two parties contract for long term benefits, the party which owns the property may demand certain benefits in kind on a regular basis in exchange for the other party's use of the property for a specified period of time. Should the situation change, such as a general increase in the rental charges for similar properties, the original owner may by invoking the "change of circumstances" doctrine, reclaim the property and sell it, or revise the conditions of the original quitrent. If the quitrent land is sold or inherited, the new owner also inherits the quitrent. No one has the right to remove the quitrent. Ibn Taimiya from the Hanbali School said, "if the quitrent

34 Id, 61, 72.

35 Abdulrahman Al-Jezeri, *The Fiqh according to the Four Muslim Rites* (Cairo, 1969) 3, 120.

36 Ibid.

land is sold or inherited, the quitrent should be imposed on the buyer and the inheritor".³⁷

(7) Problems can arise regarding the settlement of quitrents involving property which is under long term lease. In a case where the property was sold before completion of the rental contract period because of changed circumstances, a dispute arose in Unaizah, in Saudi Arabia, and the notary public (an officer of justice in the Saudi Arabian system) refused to approve the selling of lands on which there are quitrents unless the quitrent owners agreed to such sales. The matter was then raised before the Higher Jurisdiction Council, and the Permanent Committee in the Kingdom of Saudi Arabia issued Resolution No. 57 of 15/2/1396 AH (corresponding to 1978).³⁸ The resolution, after establishing the basis of settlement, emphasised the legitimate right to sell such property even before the rental contract period is completed, in case of a change of circumstances.

(8) Similarly, a dispute arose concerning certain leased properties forming part of a religious "*waqf*" endowment,³⁹ when their rental increased because of changed circumstances. The decree promulgated in order to solve the *waqf* problems, issued by the Ottoman Empire in 1303 AH (1893), stated the following rules:

37 A letter sent by Sheikh Muhammad Ibn Ibrahim, the Mufti of the Kingdom of Saudi Arabia formerly, to the Head of the Islamic Shari'ah court in Al-Madinah Al-Munawwarah No. 726 dated 10/11/1375 AH, corresponding to 1955, quoted in the Research prepared by the Permanent Committee for Scientific Researches and Ifta (unpublished) 57.

38 Higher Jurisdiction Council Resolution, Permanent Committee in Saudi Arabia, issued with No. 57 on 15/2/1396 AH, corresponding to 1976.

39 A *waqf* is...

analogous to the English trust system but was developed more than a thousand years ago before the birth of the doctrine of uses and trusts in England. "Waqf" (plural *awqaf*) which permits an owner to settle his property for the use of specified beneficiaries in perpetuity and the owner thereby ceases to be the owner of the property and the property and its income is then administered by a trustee. The definition of *waqf* according to the Hanafi School is "the detention of the corpus from the ownership of any person and the gift of its income or usufruct either presently or in the future, to some charitable purpose". The *waqf* began as a charitable trust but there are also family *waqf* or a combination of the two, but the same legal rules apply to their administration. The Trustee is responsible for following the wishes of the donor and for providing the beneficiaries with the income from the property, be they the donor's descendants or another specified person or a charitable institution which is named as the inheritor.

See Khadduri & Liebesny, 203.

No. 281: If the rental charge is increased because of a great increase in demand during the lease period, the lease holder is requested to accept such increase. If he accepts that, he has a priority right to re-lease for the second time the new rental charge and for the same limited period.

No. 282: If the leaseholder does not accept the incidental increase in the rental charge during the lease period, provided that increase is substantial the contract should be terminated and the property rented to another party, unless the rented object is otherwise occupied by the leaseholder's plantings. If this is the case, there should be a delay until the crops are harvested and the increase should be imposed from that date until the harvest is finished, and then the contract should be terminated.

No. 336: Quitrenting is not allowed unless the quitrent involves a similar rental charge, and the charge should increase or decrease according to the circumstances of place and time.

No. 339: If the rentals value has increased because of the quitrent holder building or planting, such increase should not be imposed on him. On the other hand if it has increased greatly in itself the increase will be obligatory...

No. 340: The quitrent holder is entitled to rely on the statement that the rental charge which he is paying is the appropriate rental charge for such a property and the *waqf* keeper should prove the increase with evidence.⁴⁰

- (9) The Council of Higher Scholars Committee in Saudi Arabia issued the following decision No. 96 dated 16/11/1402 AH (1982).

The Council of Higher Scholars Committee reviewed the subject of the *waqfs* quitrented at low rentals which do not match present property values.... The Council decided to refer the case to the Permanent Committee for Scientific Research and Legal Opinions "*Ifta*"... In 1402 AH (corresponding to 1982) the Council rediscussed the subject and reviewed those matters. Their final decision was: it is not possible to include all these matters in on verdict because of their time and place variations, *waqf* holders' words and objectives which make each matter need to be reviewed on its own merits. Accordingly the Council decided by a majority that the *waqf* matter, whether they are quitrented or not, is the Shari'ah court's responsibility...⁴¹

40 Quoted by Research prepared by the Permanent Committee for Scientific Researches and *Ifta* (unpublished) 63.

41 The resolution of Higher Scholars Committee Council No. 96 dated 16/11/1402 AH, corresponding to 1982 (text in Arabic).

The point is that the effect of changes of circumstances on the rental values of such properties quitrented under long term contracts at low values was considered relevant in principle. This shows that Muslim jurists in Saudi Arabia, where the Hanbali School is predominant, do not reject the principle of change of circumstances, but that they require the particular circumstances of each case to be taken into account. Thus the Muslim jurists allowed rental charges to be increased before the end of the contract period if the circumstances had changed from those existing at the time of the agreement: if the leaseholder refused to pay such increased charges, the owner should have the right to terminate the contract and rent the property to another party. It is also clear that the owner who alleges that the circumstances have changed resulting in an increase in rental value cannot simply terminate the contract unilaterally: the matter should be negotiated with the leaseholder. If he accepts such increment in the rental charge, a new contract should be agreed with him, including that increment. Only if the leaseholder refuses, does the owner have the right to terminate the contract. It is also obvious that the request for contract termination is not to be applied without reason, but that there should be changes in the circumstances which justify the increment in the rental charge value.

The Islamic Juristic Assembly Council of the Islamic World League Decision No. (7) in its fifth session held between 8-16 Rabie Awal 1402 AH (1982) in Makkah Al-Mukaramah, Kingdom of Saudi Arabia, due to the changing circumstances has stipulated the following:-

1. In contracts with delayed execution (such as supply, leases, custody and other contracts) if the contracting conditions have substantially changed so as to change situations, costs and prices due to incidental reasons which were unforeseen at the time of contracting, and the performance of the contractual obligation would cause the undertaking parts gross and unusual losses from prices fluctuation in trade routes, and that was not a result of negligence or default by that party in executing his obligations, in this case the judge should have the right in disputes and according to a claim for altering the contractual rights and obligations in a way that distributes the exceeding amount of contracted loss between the contracting parties, and also he is allowed to terminate the contract in that part unexecuted if he sees that the termination thereof is best and easier

in the case submitted to him, provided a fair compensation to the other party who has the right in execution, that restores him a reasonable part of the loss that befalls him as a result of contract termination, so that they both have fairness without any suppression of the part of the committed and in implementing all these considerations, he should consult the experts and the trustworthy.

2. The judge has also the right to ignore the committed if he found out the incidental reason is vanishable in a short time and that the committed shall not be determined by such concession.

The Juristic Assembly Council considers this solution derived from Shari'ah principles in realization to the required justice between both parties and to prevent the suppression to any of the contractees by a reason out of his reach and such solution shall be similar to the wise lawful jurisdiction and nearest to Shari'ah principles and to its general intents and to its justice.

4. The Change of Circumstances Principle in the Laws of Islamic Countries

These principles are widely accepted in the laws of countries influenced by Islamic Shari'ah. For example, the Egyptian Civil Code 1948 makes it clear that the concept of changed circumstances applies to contracts generally and is not limited to administrative contracts. Article 147(2) provides:

However, if by reason of exceptional and unforeseeable circumstances of a general nature, the execution of a contractual obligation, though not impossible, becomes onerous to the debtor so as to threaten him with an exorbitant loss, the Judge may, in accordance with circumstances and after weighing between the interests of the parties, reduce the onerous obligation to a reasonable level. Any agreement to the contrary shall be void.

The explanatory memorandum to the Egyptian Code prepared by the late Abdul Razzaq Sanhouri, Professor of Law at the University of Cairo, and by the Drafting Committee of the Egyptian Code makes it clear that the concept of changed circumstances, under the Egyptian Code applies to contracts generally,

but that the conditions for it are relatively strict. First, there must be an exceptional change of circumstances of a general and not a particular character; second, the circumstance in question must be unpredictable and unforeseeable; and finally, the circumstance must render the performance of the obligation so onerous that the debtor is threatened with exorbitant loss. If these three conditions are met, the debtor may ask a court to reduce the now excessive obligation to reasonable limits, according to the circumstances and after taking into consideration the interests of both parties. The court is thus empowered, if these further conditions are met, to reduce the obligation, but the court is not empowered to terminate the contract. Moreover, this concept does not permit the party invoking it to suspend performance or to terminate the contract unilaterally.⁴²

Other Arab Civil Codes were modelled on the Egyptian Civil Code of 1948. For example, Article 147(2) of the Libyan Civil Code 1954 is identical to Article 147(2) of the Egyptian Civil Code.⁴³ Article 147(2) of the Egyptian Civil Code was adopted as Article 148 of the Syrian Civil Code, and Article 146 of the Iraqi Civil Code.⁴⁴ The Iranian Civil Code, Article 229, states that: "if an obligant cannot perform his obligation owing to circumstances beyond his control he shall not be liable to damages". Commentators however argue that this is more a reference to *force majeure* rather than the principle of "changed circumstances". Another recent example of an Islamic State which has expressly adopted the principle of change of circumstances is Afghanistan.⁴⁵

5. Treaty Termination and the Principle of Changed Circumstances in Islamic Shari'ah Law

The Islamic Shari'ah requires the keeping of promises and the fulfilment of commitments, as previously explained, but if the circumstances have wholly

42 2 *Al-Qanun Al Madani; Majumat Al-Amal Al-Tahdiriya* (The Civil Code; Collection of Property Works) 278-84 (1949); Sanhoury Al-Wasit, *The Theory of Obligation* (2nd edn, 1964) 717-24 (text in Arabic).

43 MO Ansell & IM Al-Arif, *The Libyan Civil Code* (1954) 30.

44 JND Anderson & NJ Coulson, *The Moslem Ruler and Contractual Obligations*, *NYULR* 33 (1958) 921. See also Henry Cattán, *The Law of Oil Concessions in the Middle East and North Africa* (1967) 128.

45 For details see SH Amin, *The Theory of Changed Circumstances in International Trade, Lloyds Maritime & Commercial Law Quarterly* 4 (1982) 582.

changed, the appropriate Islamic leader (the Imam in this case) will have the right to give priority to Islam and Muslims' benefits by amendment of the treaty or its termination. However, to comply with Islamic Shari'ah, a formal denunciation is necessary. For example, in 1571 Sultan Selim II broke his peace treaty with Venice in order to invade Cyprus, after he obtained a favourable legal opinion from the Mufti, Abu Saud.⁴⁶ The Muslim leader (Imam) can terminate the treaty by his individual will, which stands for the will of the government.

Al-Shafi'i (died 820 AD), who established the Shafi'i School, said, in his book *Al-Umm*, that the theory of changed circumstances is not applicable to limited term treaties, but only to those with an unlimited period.⁴⁷ On the other hand, El-Ghounemi said, in his comment on this matter:

I do not agree with Al-Shafi'i and the way of his followers concerning their belief that changed circumstances make it legal for the injured party to terminate the treaty by his own individual will. I also disagree with him concerning his belief which limits the application of this theory to treaties of unlimited duration. But I would like to clarify that the application of the circumstances changing does not contradict the strict Islamic opinions concerning the fulfilment of agreements.... We cannot say that the treaty which loses its reason for existence will stay such as a means of stability in the relationships because the basic purpose which caused it, to achieve the security and benefits, of the two parties, has totally changed in such a way that it has become difficult for the treaty to play such a role of peace, but even its existence, as obligatory, might result in dispute and hatred between its two parties.⁴⁸

Under this principle treaty amendment or termination should not be limited to treaties of unlimited duration: the decisive factor is not the treaty period but the objective of the treaty and the new circumstances.

To summarize, if the Imam concluded a treaty but through a change of circumstances of a fundamental kind it turned out that he could not fulfil the treaty it could be declared void (*batil*). Even if the treaty were regular but the

46 A Nussbaum, *A Concise History of the Law of Nations* (1964) 53-4.

47 MT El-Ghounemi, *Treaties Rulers in the Islamic Shari'ah* (1977) 133 (text in Arabic).

48 Ibid.

terms could bring harm to the Muslim people, the Imam had the right to declare the termination of such a treaty, providing adequate notice was given to the other party to the treaty informing them of the intention.⁴⁹

In the Islamic Shari'ah mutual consent is seen as the important underlying principle of termination of contract as it is in the signing of a treaty. Thus before the contract is terminated it must be declared terminated by mutual consent. In the words of one author:

The Imam, however, should never agree to a treaty in which only one of the two parties was allowed to terminate the treaty, even if he were the one given the right.⁵⁰

6. Conclusion: The Relevance of the Islamic Doctrine of Changed Circumstances to the Renegotiation of Oil Concession Agreements

From the foregoing analysis it would appear that the Islamic "*Fiqh*" jurisprudence recognizes the principle of change of circumstances. The evidence of this principle is found in the two principal sources of Islamic Shari'ah, the Holy Qur'an and the Sunnah (the practice of the prophet), and in other sources such as the "*Ijma*" (consensus of opinion) and "*Qiyas*" (reasoning by analogy), as well as in other rules which have been adopted in Islamic "*Fiqh*".

There are several verses in the Holy Qur'an which prohibit taking property from people for self interest. For example:

O ye who believe! Eat not up your property among yourselves in vanities. But let there be amongst you traffic and trade by mutual good will...⁵¹

The majority of Muslim jurists consider that if unforeseen changes have so affected one of the contract parties the injured party has the right to terminate the contract even before the time has expired. As the Hanafi School says: "if we

49 See Shaybani, *al Siyar al-Kabir* IV, 66; III, 261; Ibn Kudamah, VIII, 463. See also Khadduri, 220-1.

50 Ibn Kudamah, 8, 461-2, quoted by Khadduri, 221.

51 The Holy Qur'an, Sura IV. Verse 29.

oblige the excused party to keep the contract, we will oblige him for harm not obliged under the contract".

The amendment of a contract as a result of change of circumstances should be done first by negotiation between the contract parties. Only if the other party refuses to accept the harmed party's request to amend the contract, is there a right to terminate the contract by individual action.

Furthermore, the Imam has the right to terminate a treaty with another party before its time if it contains terms that cannot be fulfilled or if it could bring harm to the Muslim community and he gives formal notification of his intention to terminate to the other party to the treaty. Likewise, the Islamic Shari'ah decided on the acceptance of the principle of change of circumstances as applicable to contracts of an economic and political nature.

The relevance of the principle to the renegotiation of the oil concession agreements, is that as Islamic Shari'ah is the law of those Arabian countries which have the world's largest reserves of oil, the principle can be seen as implicit in the arguments of these countries. These countries argued that conditions had changed since the 30s when the original contracts were signed, and that they were now entitled to have control over their own natural resources. An example of such a successful renegotiation of an oil concession agreement was that conducted between the Government of Saudi Arabia and *Aramco* in the seventies, when the Saudi Arabian Government Council of Ministers approved the basic statute of the new Saudi Arabian Oil Company, *Aramco al Saudia* (*Saudi Aramco*) in 1988. As a result of this renegotiation and by mutual consent *Aramco* has recognized the right of the Saudi Arabian Government to control its natural oil resources.

CHAPTER 9

EXPROPRIATION OF FOREIGN-OWNED PROPERTY

1. Introduction

Before the First World War cases of interference with private property by the State were few.¹ The prevailing view was that expropriation was to occur only in exceptional cases of public utility and that full compensation should be paid. But since the First World War the concept of private property has changed. The impact of this change differs depending on the political and economic circumstances and ideology of particular countries. The Mexican Constitution of 1917 and the establishment of a Communist regime in Russia of 1917 were based on the expropriation phenomenon, which swept away the foundations of private property. Underlying these developments was the view that expropriation entails a restoration of the property to the people, and that a State has an unlimited right to expropriate foreign property located on its territories.²

During and after the Second World War several Eastern European and Latin American countries and the newly-independent Third World States adopted laws nationalizing major portions of industry and restoring property in the natural resources of the country to the people. In most cases some level of compensation was provided for.³

Western countries hold that expropriation is lawful only if it is for a public purpose, is non-discriminatory and is accompanied by prompt, adequate and effective compensation. Third World States do not wish to be bound by this strict conception.⁴ According to their economic viewpoint "expropriation is in

1 JES Fawcett, Some Foreign Effects of Nationalization of Property, *BYIL* 27 (1950) 356.
2 A Akinsanya, *The Expropriation of Multinational Property in the Third World* (1980) 29.
See also NR Doman, Postwar Nationalization of Foreign Property in Europe, *Columbia Law Review* 48 (1948) 1125; KS Carlston, Concession Agreements and Nationalization, *AJIL* 52 (1958) 260.

3 Doman, 1126.

4 Developing countries took this position frequently during the preparation of the United Nations resolutions. See R Dolzer, New Foundations of the Law of Expropriation of Alien Property, *AJIL* 75 (1981) 555, 558.

many corners considered to be the (symbolic or real) central issue in the struggle for a new international economic order."⁵ It is their opinion that "the political aspect of sovereignty is a necessary precondition to economic development".⁶

The Third World is here defined as those countries which share a comparatively low degree of economic development and of living standards of their populations. They are relatively non-industrial, technologically less developed and mainly producers of raw materials. They are also referred to as "less developed countries".⁷ Many have only relatively recently become independent of colonizing powers. Since 1960 Third World nations have been successful in changing the concept of the preconditions for the validity of expropriation and the standard of compensation. Their success is reflected in the resolutions adopted by the United Nations General Assembly, as will be seen.

In this chapter I will discuss expropriation under international law, and in particular whether the general rules relating to expropriation may be modified in the case where there are stabilization agreements or other long-term arrangements for the exploitation of natural resources of a State. Since there is much controversy surrounding these topics, I will refer to the opinions of jurists, State practice and international conventions, and since there is a difference between international law and Islamic Shari'ah regarding the principle of expropriation I will also discuss expropriation under Islamic Shari'ah.

2. General International Law and the Expropriation of Property

In this section I will define expropriation, nationalization, confiscation, requisition and other related terms. I conclude that the terms "expropriation" and "nationalization" can be used interchangeably for the purposes of this thesis. I will look at the development of these terms, from the Roman times to the modern era and show the development of the acceptance that, providing certain conditions are met, a State has the legal right to expropriate property. I will look

5 Ibid.

6 Virally, *La Charte des Droits et Devoirs économiques des états*, 20 *Annuaire Francais de Droit International* (1974) 67, quoted by Dolzer, 556.

7 Akinsanya, 8-12.

at how the concept of acquired rights to property has been successfully challenged by Third World writers who hold that State sovereignty is the overriding principle in determining matters of property ownership.

I will then look at the ways in which a State's desire to nationalize has been dealt with and outline the General Assembly resolutions which have been a major force in changing the legal position of nationalization and the legality of expropriation under international law.

(1) Definitions

Before examining State practice in relation to expropriation and its legality or otherwise under international law, it is convenient to discuss the terminology which host States use when they take alien property within its territory. There are many terms usually used for this purpose, including expropriation, nationalization, confiscation, requisition, and liquidation.

(a) Expropriation

According to Rood:

Expropriation is the original broad term meaning the taking of property by the government for its own use...⁸

The term "expropriation", though, is "usually applied to measures taken in individual cases."⁹

(b) Nationalization

Many different definitions have been given of the term "nationalization". According to Rood:

8 LL Rood, Compensation for Takeover in Africa, *Journal of International Law and Economics* 11 (1977) 526.

9 M Domke, Foreign Nationalizations: Some Aspects of Contemporary International Law *AJIL* 55 (1961) 588. See also GA Van Hecke, Confiscation, Expropriation and the Conflict of Laws, *International Law Quarterly* 4 (1951) 345.

Nationalization is the newer term meaning the taking by the government of a natural resource of a category of industry as a part of a social or economical reform.¹⁰

Thus, nationalisation could be defined "as a measure of general change in the State's economic and social life."¹¹ But other definitions stress the generality of the term, or the range of motives that may be involved. The *Institut de Droit International* in 1952 adopted a tentative definition as follows:

Nationalization is the transfer to the State, by a legislative act and in the public interest, of property or private rights of a designated character with a view to their exploitation or control by the State, or to their direction to a new objective by the State.¹²

Katzarov stated a similar definition as follows:

Nationalization is the transformation in the public interest of higher order, of a specific property or of a particular activity which is or may be a means of production or of exchange in the wider sense of the term, into property or activity of the collectivity -- State, community or cooperative -- in view of their immediate or future utilization in the general, and no longer private, interest.¹³

The *Aminoil* Tribunal defined nationalization as a "transfer, in the public interest, of property from the private to the public sector, thus realizing a programme of economic development."¹⁴ But Foighel's definition is more restricted:

Nationalization may be defined as the compulsory transfer to the State of private property dictated by economic motives and having as its purpose the continued and essentially unaltered exploitation of the particular property.¹⁵

10 Rood, 526.

11 Domke, 587-8.

12 44 *Annuaire de l'Institut de Droit International Session de Sienne* (1952) 283.

13 K Katzarov, *The Theory of Nationalization* (1964) 226.

14 Award, para 84, 87; *ILM* 21 (1982) 976, 1018-9 quoted by PY Tschanz, *The Contributions of the Aminoil Award to the Law of State Contracts*, *International Lawyer* 18 (1984) 272.

15 Isi Foighel, *Nationalization* (1957) 9.

On the other hand, some international jurists claim that the motivation for nationalization may be more political than economic. Charles de Visscher referred to "an internal measure of the State dictated by reasons that are more political than economic. In principle, its legality is not to be determined by any international criterion."¹⁶

The position is surely, as Mikdashi concludes, that the reasons for nationalization may be economic or political or some complex relationship between the two:

...whether political, ideological, or economic development, have not existed in isolation. Moreover, the division between the two classes of reasons is theoretical, depending on the country and the time ...¹⁷

For these reasons it seems that there is no clear distinction between expropriation and nationalization in international law. As Domke states:

The doctrinal viewpoint of distinguishing "nationalization" from "expropriation" may indeed have little practical effect in the reality of international legal relations.¹⁸

(c) Confiscation

Confiscation is the taking of private property by the State without compensation, in whatever form it may be or under what name it may be carried out.¹⁹ International jurists tend to support this view.²⁰ In 1938 Hull on behalf of the United States asserted the traditional view that "the taking of property without compensation is not expropriation, it is confiscation."²¹ But even according to traditional views confiscation was not always unlawful. Confiscation also occurs in cases where the State has the right to seize property which is

16 *Theory and Reality in Public International Law* (1957) 193, quoted by S Toriguian, *Legal Aspects of Oil Concessions in the Middle East* (1972) 170.

17 Z Mikdashi, *The International Politics of Natural Resources* (1976) 148.

18 Domke, 588.

19 Van Hecke, 345.

20 Fawcett, 368.

21 *Id.*, 369.

involved in a contravention of that State's law. As an example international tribunals recognize the right to confiscate ships engaged in activities prohibited by local laws such as customs regulations, or where they pose a military threat to the State.²²

(d) **Requisition**

Requisition has been defined as...

the manifestation of the unilateral will of the authorities exercising their powers of employing the resources found within the country for purposes of national defence. It finds sufficient justification in the necessity created by the war.²³

This definition has been expanded so that requisition can be defined as the taking of property for the use by the State in its own defence, whether the belligerent parties have been formally recognized or not.²⁴

In 1928 the Turco-Greek Mixed Arbitral Tribunal said:

Requisition is the manifestation of the unilateral will of the authorities exercising their power to press into the service of the national defence all resources to be found in the country... it is sufficiently justified by the necessity occasioned by the war. By attempting to place requisition in one of the categories of law created for a situation of an entirely different character, a juridical construction would be adopted which would violate the nature of the act in question... The requisition no doubt creates a right for the benefit of the person injuriously affected by it, but this right is not in the nature of a contract.²⁵

22 S Friedman, *Expropriation in International Law*, 1953, 1. See ED Re, *Foreign Confiscation* (1951).
 23 Bin Cheng, *General Principles of Laws as Applied by International Courts and Tribunals* (1987) 40.
 24 Ibid.
 25 *Photiadis v Turkish Government*, Annual Digest 1929-30 No 236, quoted by Fawcett, 366-7.

(e) Conclusion

These are not the only terms used for State action which has the effect of a taking of property. Another example is the term "liquidation", which has been given many interpretations, but which for practical purposes may be taken to mean the dissolution or final extinction of a corporate entity, with its associated distribution of property to claimants (who may include the State itself).²⁶

For international law purposes it is dangerous to derive too much from the term used in assessing the legality of particular action. Thus it might be preferable to use the more general term "taking of property". The *Second Restatement of Foreign Relations Law of the United States* (1965) stated:

Generally, any conduct attributable to a foreign state which is intended to and does effectively deprive an alien of substantially all the benefit of his interest in property, constitutes a taking of that property.²⁷

The *Third Restatement* (1986) takes "essentially the same substantive positions as the previous restatement".²⁸

Thus, the distinction between expropriation and nationalization has little practical effect under international law. As Rood said, "the two terms are often used almost interchangeably in legislation and legal writing."²⁹ The two terms will be used interchangeably here.

As we have seen, the term nationalization means the taking of property, whether owned by nationals or foreigners, by the State. But there are various other means by which the State can take property through the exercise of "public powers", for example: in the regulation of the morals, health or safety of the

26 Fawcett, 356.

27 *Restatement (Second) of Foreign Relations Law of the United States* (1965) 192.

28 *Restatement (Third) of Foreign Relations Law of the United States* (1986) 712.

29 Rood, 526.

community, in suppressing or controlling by licensing such enterprises as the liquor trade, lotteries or prostitution. It is well established, in the words of CP Anderson, that the exercise of the "police powers of the State in the regulation of the morals, health and safety of the community presents a fundamentally different question from confiscation of private property as a national policy..."³⁰ The fundamental distinction between confiscatory legislation in the exercise of "eminent domain" and the exercise of "police power" is the motive which inspires or is thought to inspire the legislation.³¹ When exercising its police power to take private property no compensation is required,³² although it is evident that this could not legitimise a spurious act of police power with the real motive of enriching the State's finances.³³

A further difficulty in receiving compensation in disputed cases of nationalization may be procedural. In the 1962 Case of *Barcelona Traction, Light and Power Company Ltd*,³⁴ the Belgian Government court claimed reparation for damages allegedly sustained by Belgian nationals, shareholders in the *Barcelona Traction Company*,³⁵ when the Spanish government claimed that as the company was bankrupt and that the structure of the group and the relationship between its members were used "to the detriment both of the interests of the creditors and of the economy and law of Spain, the country in which the undertaking was to carry on all its business."³⁶

The Judgment stated that the Court was not of the opinion that, "in the particular circumstances of the present case, *jus standi* is conferred on the Belgian Government by considerations of equity."³⁷ The company was incorporated in Canada and had registered offices there. It had been incorporated under Canadian law for 50 years and had a close and permanent connection with Canada. That connection, the Court held, "was in no way

30 CP Anderson in the *AJIL* 21 (1927) 525, quoted by F William, *International Law and the Property of Aliens*, *BYIL* 9 (1928) 23.

31 Williams, 26.

32 A Akinsanya, 4.

33 FA Mann, *State Contracts and State Responsibility*, *AJIL* 54 (1960) 584; A Akinsanya, 4.

34 (1970) *ICJ Report* 3.

35 *Id.*, 7.

36 *Id.*, 15.

37 *Id.*, 50.

weakened by the fact that the company engaged from the very outset in commercial activities outside Canada."³⁸

This procedural problem was noted by a subsequent declaration made by Judge Lachs, who noted that the "Canadian government's right of protection in respect of the *Barcelona Traction Company* has remained unaffected by the proceedings now closed", and that this fact was an "essential premise in the Court's reasoning".³⁹

On the other hand, in recent years we have seen the phenomenon of "creeping expropriation" in the utilization of a State's police power against foreign investors or a particular foreign investment.⁴⁰ In this context harassment, discrimination, confiscatory taxes, fines, currency devaluation, regulation of prices or utility rates, refusal to renew residence permits, withdrawal of residence permits and licenses, limitations on profits or limitations on the right to transfer or remit profits, and limitations on imports and the use of foreign exchange earnings have all been used.⁴¹

While creeping nationalization has been called "a disguised discriminatory taxation regime",⁴² it is extremely difficult to define when normal regulation ends and expropriation begins.⁴³ For example, there is no legal basis

38 Id, 42.

39 Id, 52-53.

40 G Gainer, Nationalization. The Dichotomy between Western and Third World Perspectives in International Law, *Howard Law Journal* 26 (1983) 1551.

41 Akinsanya, 5; I Brownlie, *Principles of Public International Law* (4th edn, 1990) 523. F Francioni, Compensation for Nationalization of Foreign Property, *ICLQ* 24 (1975) 257, states that "creeping expropriation" excludes the problem of liability for war damage or acts of confiscation enacted in the exercise of police power, such as sanitary measures or penalties which are collateral to a criminal conviction. See also Mendes, The Canadian National Energy Program. An Example of Assertion of Economic Sovereignty of "Creeping Expropriation" in International Law, *14 Vand J Transnat'l L* (1981) 506-7: "The imposition of taxation policies should not be regarded as amounting to creeping expropriation in international law, unless such taxation measures are unprofitable in the short and long term. On the other hand, the use of incentive payment schemes or direct grants by government to lessen the impact of a non-discriminatory taxation regime on national corporations should not be regarded as a facet of creeping expropriation. If the government is using the incentive payment scheme or direct grants in bad faith to implement a disguised discriminatory taxation regime that would make only the foreign controlled corporations unprofitable. Such measures should be regarded as creeping expropriation", quoted by Gainer, 1552-3.

42 Gainer, 1553.

43 Akinsanya, 5.

in international law to object to a State exercising its rights to taxation providing it is non-discriminatory, and it is the responsibility of the party who feels discriminated against to prove that this is so.

(2) The Meaning of "Property"

If international law limits in some respects the "taking" of property, it is necessary to define the latter term as much as the former. According to Staker "'Property' or the 'ownership' of specific objects is the legal status which is created by the municipal law of each State".⁴⁴ There are two kinds of property rights: those of tangible property with which we are concerned here and intangible property.

Tangible property rights are determined in international law by the use of the *Lex situs* rule: the State of the present *situs* may decide who has property rights in any tangible on its territory, and those rights will be recognized elsewhere subject to international public policy.⁴⁵

Staker notes that:

The fact that States do have conflicts rules which recognize property interests conferred by other States should therefore be seen as State practice evidencing an international law rule...⁴⁶

And further...

international law rules on compensation...presuppose an international law definition of property which other States have a duty to recognize.⁴⁷

Property which is the subject matter of expropriation may be defined as:

44 C Staker, Public International Law and the *Lex Situs* Rule in Property Conflicts and Foreign Expropriations. *BYIL* 58 (1987) 155.
 45 *Id.*, 251.
 46 *Id.*, 162.
 47 *Id.*, 190.

(1) Foreign property owned by natural or juridical persons who do not enjoy the nationality of the expropriating State.

(2) National property where owned by natural or juridical persons who enjoy the nationality of expropriating State. This property is not subject to the international law rule as it is not concerned with the relation between two States.⁴⁸

The expression property in investment terms means money, bonds, funds, land, machinery, securities, equipment, raw materials, spare parts, means of transport, products and such rights as patents and trademarks.⁴⁹ In the context of natural resources, it means oil or other mineral resources, or the development of an uncultivated area for the purposes of agriculture or forestry.⁵⁰ But Herz notes that property also comprises rights, "above all contractual rights, such as rights arising from contracts of concession, purchases, loans" etc.⁵¹

Property (*mal* in Islamic Shari'ah) covers not just physical objects but also a wide range of ideas. It is

That which can be hoarded or secured for use and enjoyment at a time of need or that to which a man's desires incline and which men are in the habit of giving away... and of excluding others therefrom.⁵²

However, certain things, notably air, light, fire, grass, sea water, rivers, public roads, and common pasturing grounds can not be exclusively appropriated or disposed of.⁵³

48 Akinsanya, 8.

49 Ibid.

50 McNair, *The General Principles of Law Recognized by Civilized Nations*, *BYIL* 33 (1957), 1.

51 JH Herz, *Expropriation of Foreign Property*, *AJIL* 35 (1941) 245. See further Friedman, 145.

52 A Rahim, *Muhammadan Jurisprudence* (1982) 207, quoted by H Moinuddin, *The Charter of the Islamic Conference and Legal Framework of Economic Co-operation Among Its Member States* (1987) 55.

53 Ibid.

(3) The History of Expropriation

The history of expropriation is important as it indicates that there is a generally accepted tradition whereby property is subject to expropriation. Although throughout history much has been said about the inalienable right of a man to his own property, in practice "at all stages of history the individual owner was liable to have his property taken from him."⁵⁴

The Roman theory of property which could be interpreted as "the limitless right of ownership" has been shown by Schulz not to differ greatly from modern laws.⁵⁵ Both jurists and Article 544 of the Code Civil, the *Declaration des Droits de l'Homme* of 28 August 1789 and many other Constitutions recognize "that the right of property merely confers powers upon the owner."⁵⁶

Grotius was probably the first to state that it is by virtue of the State's sovereignty in constitutional law that it has the power to take private property.⁵⁷ In England, this right was regarded as self-evident. The feudal system was based on the idea that the lord owned the residual property in the land. In practice the feudal kings were ruthless in their seizure of land.⁵⁸

In 1876 in *Kohl v. United States*, it was stated that the right of expropriation "is the offspring of political necessity and it is inseparable from sovereignty, unless denied to it by its fundamental law."⁵⁹ Indeed legal history regarding property is more concerned with the limitation of State power. The sovereign right of the State in the first place has been taken for granted.⁶⁰ In Greek classical laws expropriation without compensation "was regarded as inconsistent with the nature of the institution of property."⁶¹ In Rome, expropriation occurred "only in the most exceptional circumstances."⁶² English law has been extremely influential in its concern for protection of property: from

54 FA Mann, *Outlines of History of Expropriation*, *Law Quarterly Review* 75 (1959) 189.

55 Schulz, *Principles of Roman Law* (1936) 151, quoted by Mann, 189.

56 Mann, 190.

57 *Id.*, 192.

58 *Ibid.*

59 *Kohl v. United States* (1876) 91 *US* 449, 451, quoted by Mann, 193.

60 Mann, 193.

61 JW Jones, *The Law and Legal Theory of the Greeks* (1955) 198, quoted by Mann, 193.

62 Schulz, 161, quoted by Mann, 193.

the 13th century property could only be taken *per legem terrae*, by "parliamentary legislation, by the owner's consent vicariously given in parliament".⁶³ In 1215 the Great Charter guaranteed that "no freeman shall be... disseized of this freeholds or liberties or free customs... but... by the law of the land", and contained provisions imposing the duty of payment for royal requisitions.⁶⁴

In 1541 the English Parliament enacted the first case of compulsory acquisition of land, for water conduits in Gloucester. It carefully made provision for compensation in case of injury to private owners.⁶⁵ In 1543 the first London Water Act gave London similar powers.⁶⁶ The Port of Chichester Act of 1575 contained more elaborate provisions and for the next 200 years, such laws invariably provided for the independent assessment of compensation.⁶⁷ In 1766 Lord Camden stated that "the Sovereign Authority... cannot take away any man's private property without making him a compensation."⁶⁸

At about the same time, Blackstone said that even though some public work may be extremely beneficial "the law permits no man, or set of men, to do this without consent of the owner of the land."⁶⁹ For the first time in the history of English law, the theory was propounded that expropriation involves "a compulsory contract", an idea which continues to be influential in England.⁷⁰

In 1845 the Lands Clauses Consolidation Act provided a streamlined "Code for Compensation".⁷¹ Of course, the British Parliament is not subject to any basic or fundamental law, and its statutes are not subject to judicial review. Thus "Parliament could provide for the taking of property without compensation".⁷² But according to Mann, English history "does not furnish an instance of this kind":⁷³ persons are protected by what has been described as "the

63 F Kern, *Kingship and Law in the Middle Ages*, (1939) 185, 186, 192, quoted by Mann, 196.
 64 Mann, 194.
 65 Ibid.
 66 Ibid.
 67 Id, 195.
 68 *Parliamentary History*, XVI, 168, quoted by Mann, 195.
 69 Ibid.
 70 Id, 196.
 71 Id, 198.
 72 Id, 199.
 73 *Vanhorn's Lessee v Dorrance* (1795) 2 Dall 304 (Patterson J), quoted by Mann, 199.

English equivalent of a Bill of Rights".⁷⁴ The English legacy in this area is evident in the constitutions of the Commonwealth countries.

A further legacy of the English law is its insistence upon independent assessment of payment for compensation. In 1845 the Land Clauses Consolidation Act introduced a jury system, while in more recent legislation compensation is assessed by a lands tribunal or by the courts.⁷⁵

To summarize, since the 13th century it has been recognized that there are restrictions on the taking of property, and as a result of "the influence of Baldus, the payment of pretium came to be recognized as a further condition."⁷⁶ Both Gierke and Ullmann concur that "only public policy permits interference with private rights which must be accompanied by the payment of compensation."⁷⁷ Support for this has been found in the writing of Lucas de Penna in the 14th century. Writers such as Zasius and Vasquius in the 16th century agreed that the principle "that an individual can be deprived of his property only *ex justa causa* and against compensation."⁷⁸

It appears from instances in France, Germany, Austria, Switzerland and Italy that these principles were applied in practice.⁷⁹ Naturally, in practice there were problems applying these principles, notably in France prior to the revolution. It was here "that expropriation came to be classified as a case of purchase and sale, of *vente forcée* of compulsory acquisition."⁸⁰ Blackstone took this doctrine and so it found its way into English and American law. In Germany, because the individual could take the State to court "it was useful to classify expropriation as a compulsory purchase; then the State could be sued for the payment of the price."⁸¹ From the late 18th century the law of expropriation was put on the formal basis of legislation.⁸²

74 Mann, 199.

75 Established by the Land Tribunal Act 1949, quoted by Mann, 200.

76 Mann, 201.

77 Mann, 202.

78 George Meyer, *Das Recht der Expropriation* (1868) 116, quoted by Mann, 202.

79 Mann, 203, 204.

80 Id, 204.

81 Id, 206.

82 Id, 207.

In the United States the Fifth Amendment provided that "no person shall... be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use without just compensation." American courts "have admitted an exception to, or qualification of, the general rule when the measure challenged can be considered to be an exercise of what is called the "police power"⁸³ Blackstone in the 18th century gave the name of "public police and economy" to the "due regulation and domestic order of the kingdom." In 1872 the Supreme Court of the United States gave it the name of "the police power" which it stated to be "incapable of any very exact definition or limitation."⁸⁴

In 1789, the French Constituent Assembly required that public necessity be "*légalement constatée*" with compensation being "*préalable*."⁸⁵ From 1789 these achievements in France and America were spread to other countries in three ways.⁸⁶

First, there are now many written constitutions in different countries which state "that property cannot be taken except for public purposes and against payment of compensation." Secondly, the taking of property will be regulated by legislation. For example, in France the assessment of compensation is left to a "*commission arbitrale d'évaluation*" from which appeals may be lodged with formal bodies. Thirdly, there is a clear distinction between expropriation, which is the taking of property for public purpose, and confiscation, which is seen as "punishment, and presupposes conviction of a criminal offence and is limited to the loss of the *instrumenta* or *producta sceleris*."⁸⁷ While the criminal law of the world has many provisions to allow property which is the subject matter of crime to be forfeited, "they are now contrary to established conception of human rights."⁸⁸

83 Williams, 23.
 84 Ibid.
 85 Mann, 207.
 86 Id, 208.
 87 Id, 210-11.
 88 Id, 211, 212.

However, in some countries laws have been passed dealing with confiscation of property which is the subject of proceeds of criminal action. For example, in Australia the Confiscation of Proceeds of Crime Act 1989 has as its principal objects:

- (a) to deprive persons of the proceeds of, and benefits derived from, the commission of offences against certain laws of the State; and
- (b) to provide for the forfeiture of property used in or in connection with the commission of such offences; and
- (c) to enable law enforcement authorities effectively to trace such proceeds, benefits and property; and
- (d) to provide for the enforcement in the state of forfeiture orders, pecuniary penalty orders and restraining orders made in respect of offences against the laws of other States.

In 1952 in the Human Rights Commission of the United Nations, the issue of permanent sovereignty over natural resources arose. This happened as a result of the desire of the Third World to control its own natural resources, especially when many countries had gained their independence and demanded the sole right to exploit their natural resources. Since that time, the General Assembly has issued a series of resolutions confirming the right of a State to expropriate its natural wealth and resources. These resolutions developed a new conception of the nature of expropriation, especially since 1970 when the relationships between oil producing countries and foreign companies were challenged and changed as oil producing countries asserted control over their natural resources. The most important development since 1952 was a result of the confrontation between the Third World and western countries over the concept of compensation which needed to be paid to foreign companies. This will be discussed in Chapter 10.

On the other hand, the history of expropriation in Islamic Shari'ah dates from more than 1412 years ago, when the Holy Qur'an asserted respect for private property, and did not recognize the expropriation of private property as a rule. But expropriation is allowed if it is in the public interest within very

narrow limits and with full compensation.⁸⁹ This issue will be discussed in detail later in this Chapter.

(4) The Traditional Law: The Principle of Acquired Rights

One of the major underpinnings of the traditional law relating to expropriation was the concept of acquired rights. That concept has been applied by international tribunals "with a view to condemning interference with the rights of foreigners by means of expropriation".⁹⁰ Traditional international law emphasized the sanctity of private property which was to a significant degree immune from expropriation in the exercise of State sovereignty.

This view was reflected by the International Law Association, which in 1958 at its 48th Conference adopted a resolution providing that:

The principles of international law establishing the sanctity of a State's undertakings and respect for the "acquired rights" of aliens require... that the parties to a contract between a State and an alien are bound to perform their undertakings in good faith.⁹¹

This view was also expressed in the *Arbitration Award between Saudi Arabia and the Arabian American Oil Company* (the *Aramco Arbitration*) where the Tribunal asserted that:

The principle of respect for "acquired rights" prevents the State from derogating...⁹² from the responsibilities it incurs when it enters into a contract with a concessionaire.

Historically, the principle of acquired rights had its origins in the law of State succession, where it sought to ensure some measure of continuity of private property rights after a change of sovereignty. It was not specifically concerned with the question of expropriation. For example in 1923 the Permanent Court

89 J Schacht, *Islamic law in Contemporary States*, *AJCL* 8 (1959) 141-142.

90 Friedman, 120.

91 Report of the Forty-Eighth Conference, (1958) xi, quoted by Domke, 598.

92 Award 61, *NILR*. 6 1959, 125, 87, 109, quoted by Domke, 598.

in its Advisory Opinion on *German Settlers in Poland*, a case involving questions of State succession, held that:

private rights acquired under existing law do not cease on a change of sovereignty.⁹³

In this the Court was only echoing the words of Justice Marshall in the United States Supreme Court a century earlier, when he said that on a change of sovereignty...

The people change their allegiance; their relation to their ancient sovereign is dissolved; but their relations to each other; and their rights of property, remain undisturbed.⁹⁴

In 1929, MJG Guerrero was appointed by the Council of the League of Nations, to determine the position of the Sopron-Koszeg local railway company, from the former Austro-Hungarian monarchy. By a unanimous decision the tribunal noted:

In principle, the rights which a private company derives from a deed of concession cannot be nullified or affected by the mere fact of a change in the nationality of the territory on which the public service conceded is operated... most authorities and the international judgments which conform most nearly to modern views of international law take this view...⁹⁵

This principle has been supported in the past by jurists such as Anzilotti, Verdross, Anderson, Scelle, Doman, Hyde, Woolsey, Charles Rousseau, McNair, Mosler, and Bindschedler.⁹⁶

But modern international jurists have attacked the principle of acquired rights as a "relic of the past."⁹⁷ The evident reason for this is that with the

93 *PCIJ Series B, No.6* (1923) 36, quoted by McNair, 18. McNair also stated that acquired rights is "one of the general principles of law recognized by civilized nations", id, 16.

94 *US v. Percheman* 32 *US* (7 Pet) 51, 87 (1833) quoted by SC Jain, Legal "Dichotomy" of Concessions, *Indian Journal of International Law* 9 (1969) 518.

95 *AJIL* 24 (1930) 164-74, quoted by McNair, 18.

96 Jain, 520.

97 *Ibid.*

emergence of the developing nations there came a demand to ensure their development. It was felt that the maintenance of acquired rights would result in the stagnation of the new societies, and that the "the application of traditional law after the emergence of new States will be out of context with the socio-economic system prevailing in the world."⁹⁸ At the same time scholars attacked the concept as vague and unrealistic. For example Foighel stated that:

It must be reasonable to assume that the maxim of the protection of vested rights -- already as a consequence of the change in the conditions and circumstances underlying the existence of the maxim is of no importance in deciding what minimum standard in international law is to be observed unconditionally in their dealings with foreigners.⁹⁹

Similarly Friedman argued that:

The concept of acquired rights is especially uncertain, both in definition and application, and its emotional appeal alone would seem to explain its persistence and the fact that it is continually invoked by statesmen.¹⁰⁰

The International Court of Justice in the *Fisheries Case (United Kingdom v Norway)* held that:

It should be observed in this connection that international arbitration is now entering a new phase. It is not enough to stress the general principles of law recognized by civilized nations; regard must also be had to the modifications which these principles may have undergone as a result of the great changes which have occurred in international life, and the principles must be adopted to the new conditions of international life.¹⁰¹

Consistently with this observation the concept of acquired rights in international law has been discarded by Jiménez de Aréchaga:

98 Ibid.
 99 Foighel, 54.
 100 Friedman, 122-123.
 101 *ICJ Rep* 1951 116.

Traditional international law considered any interference by a State with foreign-owned property a violation of acquired rights which were internationally protected, and thus an unlawful act. Today, measures of nationalization or expropriation constitute the exercise of a sovereign right of the State and are consequently entirely lawful. This fundamental change of approach significantly affects the application of the rules of State responsibility, particularly in regard to the existence and scope of the duty to compensate aliens whose property has been nationalized or expropriated.¹⁰²

Thus Third World writers, maintaining State sovereignty as an overriding principle reject the doctrine of acquired rights, and directly challenge traditional western opinions.¹⁰³

(5) Proposals for the Protection of Private Property

A major consideration of foreign investors when deciding where and how much to invest in a foreign State, is a guarantee of the security of his property and investment. The act of nationalization without fair and adequate compensation would make investors afraid to invest in developing countries.¹⁰⁴ Thus since the First World War, several suggestions have been made to negotiate a multilateral treaty aimed "at the protection of private foreign investment."¹⁰⁵ In 1957 the International Chamber of Commerce sought to lay down "in advance in an agreed and binding form under United Nations auspices the treatment to be applied to foreign capital in their territories..."¹⁰⁶ The advantage of such guidelines was seen to be to encourage and protect investments especially in developing countries.

Similarly, the International Industrial Development Conference in 1957 discussed means of stimulating the flow of private capital to the less developed

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- 102 Jiménez de Aréchaga, *State Responsibility for the Nationalization of Foreign Owned Property*, *NYUJ ILP*, 11 (1978) 180.
- 103 WD Verwey & NJ Schrijver, *Taking of Foreign Property under International Law and New Legal Perspectives*, Meeting at the Peace Palace, The Hague (1984) 18. See also KN Gess, *Permanent Sovereignty over Natural Resources*, *ICLQ* 13 (1964) 442, regarding the question of the position of acquired right in newly-independent states.
- 104 EL Nwogugu, *The Legal Problems of Foreign Investment* (1965) 130.
- 105 AS Miller, *Protection of Private Foreign Investment by Multilateral Convention*, *AJIL* 53 (1959) 371.
- 106 Resolution of the 16th Congress of the ICC, May, 1957, printed in its Brochure No. 193, quoted by Miller, 372.

areas of the world.¹⁰⁷ In 1956 ECOSOC urged governments "to continue their efforts to develop international confidence conducive to private investment."¹⁰⁸ In a code drafted by the German Society,¹⁰⁹ three main points were proposed:

- (1) The protection of the business activities of foreign investors;
- (2) The establishment of international tribunals to deal with disputes;
- (3) The use of sanctions to ensure enforcement.¹¹⁰

Articles IV - VIII provided for the protection of foreign investment, subject to limitations "only with respect to public utilities and like activities of vital importance to the State in question."¹¹¹ One guarantee that went with these rights was that expropriation of foreign assets would be prevented for 30 years: if it took place, compensation would have to be adequate and prompt.¹¹²

In a few cases international conventions which provide procedures for the protection of private property were specially concluded. The Organization for Economic Co-operation and Development Convention of 1967 on the Protection of Foreign Property¹¹³ stated that, on the condition that it was in the public purpose, property or investments could be either expropriated or directly or indirectly affected. But it provided that such measures must not be discriminatory and that just compensation must be paid.¹¹⁴ Less directly, the International Bank for Reconstruction and Development in 1965 promoted a Convention to deal with the settlement of investment disputes.¹¹⁵ The *IBRD*

107 The Conference was held under the joint auspices of Time-Life, Inc. and the Stanford Research Institute, quoted by Miller, 372.

108 Resolution 619 (XXII) entitled "Financing of Economic Development" UN Doc. E/2929 ECOSOC 22nd Sess. Official Record Supp. No.1. Aug. 17, 1956, quoted by Miller, 372.

109 The German Society, a group of German businessmen, published a draft Code called "International Convention for the Mutual Protection of Private Property Rights in Foreign Countries" in 1957. This society, dedicated to the protection of private foreign investment, was officially known as the *Gesellschaft zur Forderung des Schutzes von Auslandsinvestitionen*: Miller, 371.

110 Id, 373.

111 Article V.

112 Article VI.

113 See G Schwarzenberger, *Foreign Investment and International Law* (1969) 154.

114 Ibid.

115 Id, 135,153.

Convention has been into force since 14 October 1966: it established the Centre for the Settlement of Investment Disputes between the contracting parties and nationals of other States. Article 42 (1) provides that an *ICSID* arbitral tribunal is to apply "such rules of international law as may be applicable."¹¹⁶

However attempts to deal directly with the issue of expropriation by multilateral treaty have usually failed. For example Article III of the *Abs-Shawcross Draft Convention* of 1959 on the protection of private property provided:

No party shall take any measures against nationals of another party to deprive them directly or indirectly of their property except under due process of law and provided that such measures are not discriminatory or contrary to undertakings given by that party and are accompanied by the payment of just and effective compensation. Adequate provisions shall have been made at or prior to the time of deprivation for the prompt determination and payment of such compensation, which shall represent the genuine value of the property affected, and be made in transferable form and be paid without undue delay.¹¹⁷

The Draft Convention never came into force: according to Francioni, this is because it failed to take into account the political implications for Third World nations in accepting foreign investment.¹¹⁸

(6) Expropriation under United Nations General Assembly Resolutions

The Permanent Court of International Justice in the *Chorzow Factory Case*¹¹⁹ held that nationalization would only be illegal if it contravened a treaty regulation. The usual and legal nationalization would have resulted in a demand that compensation be paid for direct losses while the illegal nationalization in the *Chorzow Factory Case* meant that full restitution was due.

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Id.

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9 *JPL* (1960) 116.

118

Francioni, 265.

119

Chorzow Factory Case (1928) *PCIJ Ser. A No. 17*, 46-7.

Thus it can be accepted that if a State is subject to a treaty obligation concluded by that State with respect to the protection of private property, the treaty provision prevails. But the question is: what is the position, apart from any such treaty. In discussing this question it is necessary first to outline the General Assembly resolutions which have been a major force in changing the legal position.

The issue of expropriation was discussed in December 1952 in the Second Committee of the General Assembly, under an item relating to the right of the undeveloped countries to exploit their natural wealth and resources. The Committee discussed a Uruguayan draft resolution concerning the right of any State to expropriate its natural resources.¹²⁰ On 21 December 1952 the General Assembly adopted Resolution 626 which approved the right of underdeveloped countries to control and exploit freely their natural wealth and resources. This resolution established the principle of economic self-determination. It provides that:

the right of peoples freely to use and exploit their natural wealth and resources is inherent in their sovereignty and is in accordance with the purposes and principles of the Charter of the United Nations.

Further, it recommended restraint from any "act, direct or indirect, designed to impede the exercise of the sovereignty of any State over its natural resources".

In 1955 the Third Committee of the General Assembly adopted a draft Convention on Human Rights which gave more emphasis to the principle of economic self-determination by developing countries. This proposal was adopted by the General Assembly in 1955 at its twenty-ninth session.

Since this time the General Assembly has issued a series of resolutions relating to permanent sovereignty over natural resources and giving the State the right to expropriate foreign property. Some of the more important resolutions are as follows:

120 *Yearbook of United Nations* (1952) 387, 390.

* On 14 December 1962, the United Nations General Assembly adopted Resolution 1803 (XVII) on Permanent Sovereignty over Natural Resources. It affirmed the right of the State to expropriate private property, both domestic and foreign, within its territory. The resolution affirmed also "the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national interests."

* Resolution 2158 (XXI) of 25 November 1966 emphasized the "inalienable right of all countries to exercise permanent sovereignty over their natural resources."

* The Charter of Economic Right and Duties of States of 1974 expanded the concept of permanent sovereignty of a State over its natural wealth and resources to recognize that a State's right to possess, use and dispose of its natural resources is inherent in its economic and social development. Further, Article 2(c) provides that every State has the right "to nationalize, expropriate or transfer ownership of foreign property..."

Thus various United Nations General Assembly Resolutions on permanent sovereignty over natural wealth and resources have recognized the right of States to expropriate private property located in its territory whether its foreign or national. The question is: what impact have these resolutions and other developments had on general international law?

(7) **The Legality of Expropriation under General International Law**

Both traditional and modern international jurists emphasize the right of the State to expropriate foreign property located within its territory. Thus Friedman stated in 1953 that:

States subject to contrary provisions in treaties or other rules of positive international law, possess the right to expropriate in the manner and form they consider best. They are entitled to organise their system of property, whether movable or immovable, according to their particular national genius, to maintain a liberal economy or to replace it by a controlled or planned economy. They may preserve the private ownership of all or part of the national wealth or suppress it either wholly or in part, in order to introduce collectivist forms of ownership or

to establish State control in certain sectors of economic life, States enjoy complete freedom, in this field.¹²¹

Similarly Jiménez de Aréchaga said in 1978 that:

Contemporary international law recognizes the right of every State to nationalize foreign-owned property, even if a predecessor State or a previous government engaged itself by treaty or by contract, not to do so. This is a corollary of the principle of permanent sovereignty of the State over all its wealth, natural resources and economic activities, as proclaimed in successive General Assembly resolutions.¹²²

The right of a State to expropriate foreign property has been generally recognized as emerging from the legal concept of sovereign rights. The United States in a note of 7 September 1948 to Rumania protesting about the discriminatory character of the Rumanian nationalization of American property "recognized the right of a sovereign power to expropriate property subject to its jurisdiction and belonging to American nationals ...".¹²³ The Governments of France, the United Kingdom, and the United States jointly issued statements regarding the nationalization of the Suez Canal Company by Egypt, at the Suez Canal Conference in London on 2 August 1956, conceding Egypt's right to nationalize the Company.¹²⁴

In regard to the expropriation of American property in the Mexico 1938, United States Secretary of State Hull stated in his note of 3 April 1940:

The Government of the United States readily recognizes the right of a sovereign State to expropriate property for public purposes...¹²⁵

The right of a State to expropriate foreign property located within its territory has also been recognized by international conventions. For example, the Geneva Convention of 1922, concluded between Germany and Poland,

121 Friedman, 134.

122 de Aréchaga, 179.

123 Department of State Bulletin 19 (1948) 408.

124 8 Whiteman, *Digest of International Law* (1967) 1106.

125 See Akinsanya, 206.

established Poland's right to expropriate in *Polish Upper Silesia* certain property of German nationals.¹²⁶

But under traditional international law, there were distinct limits on a State's right to expropriate. For example the Harvard Draft Convention on the International Responsibility of States provided in article 10 that three types of taking of property were unlawful:

- (1) those which are uncompensated; (2) those effected other than for public purposes, even if compensation is paid; and (3) those effected in violation of treaty, even if compensation is paid. The remedies provided were, however, different. In the first instance, damages were to be the proper reparation for a taking made wrongful by the failure to pay compensation: in the other two cases restitution was the ordinary remedy.¹²⁷

Thus according to this view, which can be taken to represent the traditional international law position, an expropriation is lawful if and only if:

- (1) The expropriation is in the public interest or for a public purpose;
- (2) The expropriation must be taken without discrimination against aliens;
- (3) The expropriation must be accompanied by adequate compensation.

These three conditions will be dealt with consecutively.

(a) **The Public Interest or Public Purpose Requirement**

The conception of public interest or public purpose or public utility is found in the constitutions of many countries. For example, section 29 of the Constitution of Thailand of 3 August 1952 provides that:

...Expropriation of private property by the State is prohibited unless necessary for the purpose of public utility...¹²⁸

126 *PCIJ Series A No 7 (1926) 22.*

127 *AJIL 55 (1961) quoted by JG Castel, International Law (1976) 1118.*

128 Quoted by A Akinsanya, 19.

But this "public interest" requirement is also contained in many of the international authorities. The Permanent Court of Arbitration recognized the right of expropriation of any property for reasons for public utility in the *Norwegian Claims Case* 1922. The right was described by the Court as...

the power of a sovereign State to expropriate, take or authorise the taking of any property within its jurisdiction which may be required for the "public good" or for the general welfare.¹²⁹

A similar view was expressed by the International Tribunal in the *Walter F Smith Case* in 1929.¹³⁰ United Nations Resolution 1803 (XVII) of 14 December 1962 provided that nationalization measures must be based on ground or reasons of public utility, security or the national interest. Article 9 ("Act of Expropriation") proposed in 1957 by FV Garcia Amador, the International Law Commission's Special Rapporteur on State Responsibility, would have provided that:

The State is responsible for the injuries caused to an alien by the expropriation of his property, save in so far as the measure in question is justified on grounds of public interest and the alien receives adequate compensation.¹³¹

Many writers support this opinion.¹³² For example, Bin Cheng asserted that:

The public welfare of the community is considered by international law to be of such overriding importance that it is allowed to derogate from the principle of respect of private rights. Such derogation is, however, conditional upon the presence of a genuine public need, and is governed by the principle of good faith.¹³³

This suggests that the right of a State "to expropriate is not only founded on, but also strictly circumscribed by, the public interest."¹³⁴

129 Scott, 11 *Hague Court Reports* 66.

130 *AJIL* 24 (1930).

131 *Yearbook of the International Law Commission* 11 (1957) 117.

132 See Toriguian, 186.

133 Cheng, 39, 40..

134 *Ibid*, 38.

By contrast the Harvard Draft No 10 of 1 May 1959 could not limit..

Takings to those for a "public purpose", for in modern times there are very few limits to what a State may consider necessary for general benefit, if there are no other reasons, the State can always rely on the needs of the national economy or on requirements of social welfare. An international authority would hardly be competent to pass judgment on the adequacy of such a purpose... [I]t is extremely difficult to conceive of a situation where an international tribunal would undertake to review a State's determination of what is a dominating public purpose except in a situation so flagrant that the procedure involves a manifest denial of procedural justice.¹³⁵

In the arbitration between Kuwait and *Aminoil* in 1979, the Tribunal did not agree that the nationalization "took the form of a single measure not directed to any object of general interest." It found this interest to be the future development, in successive stages, of the country's oil industry.¹³⁶ The implication is that the future development of the oil industry being in the public interest was a factor in concluding that the nationalization was legitimate.

Although the principle of public welfare in international law overrides the principle of respect of private rights,¹³⁷ it does not follow that there is a substantive requirement in international law that an expropriation be a matter of "public utility". International law does not have its own definition of "public utility". A definition could perhaps be found in the practice of nations,¹³⁸ for example, in the building of highways, and railroads, military barracks and public cemeteries, or the secularisation of religious property, or the mobilisation of commercial and industrial resources for the prosecution of a war.¹³⁹ But the definition of "public utility" must be the responsibility of the State, as only the State can decide what is in its true interests for the welfare of its people. As there is no definition of "public utility" in international law any such requirement

135 Preliminary Draft with Explanatory Note, 1 May 1959, 66, quoted by Domke, 590, 591.
136 Award, para 85, quoted by A Redfern, *The Arbitration between the Government of Kuwait and Aminoil*, *BYIL* 55 (1984) 97.

137 Cheng, 39,40.

138 *Ibid.*

139 *Ibid.*

would be very difficult to challenge, unless it "were wholly beyond any reasonable limit."¹⁴⁰

(b) The Non-Discrimination Requirement

It is often asserted, as a principle of State responsibility, that the State is under an obligation to treat aliens who reside within its territory equally with its nationals. This principle relates to the protection of the life and property of aliens under local law, and requires some remedy under international law for injury to the property of aliens which results from measures in the application of which there is discrimination between aliens and nationals of the State without any justifiable reason. Therefore, according to this view of international law, if alien property has been nationalized by the State separately from the property of its nationals without reasonable excuse, the measure is discriminatory. But if national property has been nationalized at the same time, the measure is non-discriminatory and no compensation is payable.

But it is often the case that property of the relevant kind (e.g. rights under concessions or mining leases) is owned only by foreigners. International law and General Assembly resolutions have recognized each State's sovereignty over its natural resources and its right to expropriate alien property within its territory, in the pursuit of public interests of an economic or social nature. The view that "a nationalization measure is discriminatory simply because it is directed against foreign nationals"¹⁴¹ is not acceptable. In regard to the justification of discriminatory expropriations where aliens only are affected, Brownlie states that:

The test of discrimination is the intention of the government. The fact that only aliens are affected may be accidental, and, if the taking is based on economic and social policies, it is not directed against particular groups simply because they own the property involved.¹⁴²

140 Domke, 590. See also Herz, 253.

141 Akinsanya, 21.

142 Brownlie, 538.

Applying the criteria of discrimination, Brownlie concludes that measures "are discriminatory [if they are] aimed at persons of particular racial groups or nationals of particular States, or concern property owned by a foreign State and dedicated to official State purposes."¹⁴³

The writer accepts that discrimination can be claimed in expropriation cases where the discrimination is "aimed at persons of particular racial groups or nationals of particular States". This is in agreement, with scholars and with State practice and with State and international jurisprudence.¹⁴⁴ For example the Government of Cuba's Nationalization Law No 851 of 6 July 1960 was directed exclusively against enterprises owned by nationals of the United States. Article 1 provided for:

the nationalization, through expropriation, of the properties or concerns belonging to natural or juridical persons nationals of the United States of America or the concerns in which said persons have a majority interest or participation even though they be organized under the laws of Cuba.¹⁴⁵

The United States protested against this law and described its discriminatory character as follows:

This law is manifestly in violation of those principles of international law which have long been accepted by the free countries of the West. It is in its essence discriminatory, arbitrary and confiscatory.¹⁴⁶

In *Banco Nacional de Cuba v Sabbatino* the Cuban nationalization was deemed illegal on the basis of its discriminatory character. The New York Supreme Court stated that:

The act classifies United States nationals separately from all other nationals and provides no reasonable basis for such a classification. The decree does not justify the classification on the basis of the conduct of the owners in managing and

143 Ibid.

144 Akinsanya, 21.

145 *AJIL* 55 (1961) 823.

146 43 Dept. of State Bulletin 171 (1960), quoted by Domke, 602.

exploiting their properties or on the basis of the importance to the security of the State where ownership of the property resides. The justification is simply reprisal against another government. Doubtless the measures which States may employ in their rivalries are of great variety but they do not include the taking of the property of the nationals of the rival government.¹⁴⁷

Similarly, an Amsterdam appellate court considered the Indonesian nationalization of Dutch property "a manifestly discriminating measure which in a very sharp manner attacks the rights and interests exclusively of nationals of the State of the Netherlands, though a State of war does not exist between Indonesia and that Country."¹⁴⁸

In these cases, the claim of discrimination was upheld. But the claim has not always been accepted as a general rule, and has depended on the facts of particular situations. For example in *Aminoil v Kuwait* (1979) *Aminoil* claimed that as a Japanese owned Arabian Oil Company (AOC) had not been simultaneously nationalized, discrimination could be claimed. However the claim was not accepted by the Tribunal, which held that at no time had the American nationality of the *Aminoil* company been a factor in the nationalization process.¹⁴⁹ Further, the Minister for Oil had given the following reasons for the non-nationalization of AOC:

AOC's high-cost off-shore production operations are such as to give it a special position which requires a high degree of expertise. At the same time, it is working within the framework of a concession granted by both Kuwait and Saudi Arabia, so its position is completely different. Any modification of the concession must be agreed to by both countries.¹⁵⁰

The Tribunal held that "there was nothing that would prima facie prevent recognition of the validity of the nationalization".¹⁵¹ In consequence the claim of discrimination could not be applied.

147 12 *APP. Div* 2d 506, 207, *NYS*, 2d 288 (2d). Dep. Nov. 14, 1960, quoted by Domke, 603.
 148 Quoted by M Domke, Indonesian Nationalization Measures before Foreign Courts, *AJIL* 54 (1960) 316.
 149 Redfern, 97.
 150 *Ibid.*
 151 *Id.*, 98.

It may be concluded that expropriations of property will be unlawful if they are a measure of retaliation against a foreign State and not against the private property of its nationals, or if they are directed without independent justification against nationals of a particular State or against particular racial groups. An expropriation may be discriminatory even if undertaken for public purposes. For example the expropriation of BP by the Libyan Government was considered illegal by the arbitrators.¹⁵² Both the United States Department of State and United Nations Resolution 3202 (S-VI) of 1 May 1974 are very critical of Israeli expropriations in Arab and occupied territories. According to Akinsanya:

Some expropriations carried out by the Israeli government on Israeli territory were discriminatory while all expropriations carried out in Arab-occupied territories were clearly illegal because Israeli authority is governed by the law of belligerent occupation, the fact that they are directed against particular racial groups constituting an additional element of illegality.¹⁵³

(c) **The Requirement of Adequate Compensation**

International law and United Nations resolutions have recognized that when the State exercises its sovereign right to expropriate property whether of nationals or foreigner, it should be accompanied with the duty to pay adequate compensation. The expropriation of property without compensation is against the rule of international law and will be unlawful.

However, there is much controversy about the terms and standard of compensation. Western countries hold that "appropriate compensation" can only mean "prompt, adequate, and effective compensation", or "full and fair" compensation".¹⁵⁴ In Chapter 10 I discuss in more detail the principle and the standard of compensation according to Western and Third World opinion.

152 FR Tesón, *State Contracts and Oil Expropriations: the Aminoil-Kuwait Arbitration*, *Virginia Journal of International Law* 24 (1984) 337.

153 Akinsanya, 23.

154 Gess, 427.

(d) Conclusion

As has been noted an expropriation is recognized as lawful, if it satisfies three conditions: (1) public interest or utility (2) non-discrimination (3) adequate compensation. However, there are differing opinions regarding the requirements of public interest and non-discrimination. The problem with defining public interest is that "there is little authority in international law establishing any useful criteria by which a State's assertion of public purpose can be questioned... [T]here appear to be few, if any cases in which a taking has been held unlawful under international law on the sole and specific ground that it was not for a public purpose".¹⁵⁵

General Assembly Resolution 3281 (XXIX) of 12 December 1974, the Charter of Economic Rights and Duties of States, submits the expropriation of foreign property to domestic law. Article 2 (a)(6) totally disregards both the principle of public purpose and also the principle of non-discrimination. In effect the Charter uses the language of non-discrimination to widen the governmental power of Third World countries. Further Article 2 provides that no State shall be compelled to grant preferential treatment to foreign investment. These provisions can be seen to reflect the opinions of Third World and former colonial countries that "they are not bound by existing international law on expropriation because it was formulated for the benefit of western States".¹⁵⁶

It is the opinion of this writer that the concept of public interest or utility does not have any satisfactory definition in international law. It is the responsibility of the expropriating State to consider what is necessary and useful for the benefit of its people. This argument has historical validity. Before the French Revolution, the King had to decide what was the public interest "and there was no court of law which would have the jurisdiction or power to review the reasons for and the justifiability of the royal determination".¹⁵⁷

155 BH Weston, *The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-owned Wealth*, *AJIL* 75 (1981) 440.

156 Quoted by Gainer, 1565. See also Guha-Roy, *Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law*, *AJIL* 55 (1961) 866.

157 Mann, 204.

Nor can the concept of discrimination prevent a State from taking nationalization measures, even if these measures adversely affect foreigners. If the discrimination "is caused for developmental purposes it is assumed to be justified".¹⁵⁸ Neither the principle of public interest nor discrimination are universally accepted in international law: both have been criticized by Third World countries, and both principles have been ignored in the Charter of Economic Rights and Duties of States.

(8) The Territoriality of Expropriation

As we have seen, a State has the right to expropriate foreign property located within its territory, a right which always proceeds from its sovereignty. The question is whether the right to expropriate has any effect outside the territory of the State. Friedman argues that...

the general rule is that expropriation which is derived from the jurisdiction exercised by the State in virtue of its territory and its public services, can only affect property situated within such territory as defined by international law.¹⁵⁹

In the *Lotus Case*, the basic premise of territoriality was stated as follows:

the first and foremost restriction imposed by international law upon a State is that... it may not exercise its power in any form in the territory of another State.¹⁶⁰

In practice "the courts of other states need not and generally do not give effect to nationalizations of assets located outside the jurisdiction of the nationalizing State, since a State has no jurisdiction and therefore no power to transfer title to property located outside of its territory".¹⁶¹

158 FV Garcia-Amador, *The Proposed New International Economic Order. A New Approach to the Law Governing Nationalization and Compensation*, *Lawyer of the Americas* 12 (1980) 27. See Gainer, 1564.

159 Friedman, 161.

160 *PCIJ* 1927 Ser A, No 10, 18-19.

161 R Delson, *Nationalization of the Suez Canal Company. Issues of Public and Private International Law*, *Columbia Law Review* 57 (1957) 778.

Laws of some countries emphasise that nationalization take effect inside their territory. For example the law nationalizing the oil industry of Iran in 1951 provided that "the oil industry throughout all parts of the country, without exception, be nationalized".¹⁶² This principle is also found in the laws of other countries such as Indonesia and Cuba.¹⁶³

By contrast the Egyptian decree on the nationalization of the Suez Canal Company of 26 July 1956 provided for the taking of the company's assets outside of Egypt: "all its assets, rights and obligation are transferred to the nation". But the extraterritorial effect of the Egyptian rationalization decree was not recognized. The Suez Canal Settlement Agreement provided that the government of Egypt "shall leave the assets outside Egypt" to the company.¹⁶⁴ However, in computing the amount of the settlement sum, the value of the external assets of the company may have been taken into account.¹⁶⁵

Where extraterritorial effects have been accepted they appear as special solutions to problems of a political nature. For example two notable exceptions to the principle of territoriality are:

- (a) The Litvinov Agreement of 16 November 1933 by which the United States agreed to the application of nationalization measures of the Soviet Union to assets located within the United States;¹⁶⁶
- (b) In *US v Pink*, a special treaty was signed which compelled the courts to accept Russian confiscatory decrees in the Soviet Union.¹⁶⁷

Writers with experience in socialist States hold the view that the external assets of foreign-owned companies should be included in nationalization measures because "the entire property of the nationalized subjects is affected as an *universitas rerum*"; or "such of the assets as are located outside the taking country

162 AW Ford, *The Anglo-Iranian Oil Dispute of 1951-1952* (1954) 268.

163 Domke (1961), 598.

164 United Nations Docs A/3898, S/4089, of 23 September 1958, *AJIL* 54 (1960) 498, 502 quoted by Domke (1961), 599.

165 Rauschnig, *Die Abwicklung des Suez Kanal Konfliktes*, 8 *Jahrbuch für Internationales Recht* (1959) 267, quoted by Domke (1961), 599.

166 Domke (1961), 599.

167 *AJIL* 36 (1942) 309; 315 *US* 203, 220 (1942).

should share the fate of the entity in its country of origin".¹⁶⁸ Katzarov states that "the jurisprudence relating to the territorial effect of nationalization... has only a very restricted theoretical creative value".¹⁶⁹

It appears that certain instances of acquiring property outside the taking State's territory can be recognized in international law, where such acquisition can be seen as a simple consequence of an effective acquisition, e.g. of shares, within the foreign State. Such an instance occurred in *Williams and Humbert Ltd. v W&H Trade Marks (Jersey) Ltd* in 1985.¹⁷⁰ In 1983 W & H, a Spanish company, was nationalized by the Spanish Government. This was accomplished by the passing of a special law, under which, "all the shares in, and control of, the Spanish Company and its subsidiaries were vested in the Spanish State."¹⁷¹ The plaintiff was an English company marketing for the company and owning the trademarks "Dry Sack". Following the acquisition by the Spanish Government the English company became in effect a "subsidiary" of the parent company. Action was brought over ownership and right to use certain trademarks. The House of Lords, citing *Luther v Sagor* and *Princess Paley Olga v Weisz*, held:

These authorities illustrate the principle that an English court will recognize the compulsory acquisition law of a foreign State and will recognize the change of title to property which has come under the control of the foreign State and will recognize the consequences of that change of title. The English court will decline to consider the merits of compulsory acquisition.¹⁷²

Lord Templeman also noted that "English law and international law must recognize the Spanish law and accept its consequences."¹⁷³

It should be noted that there was no evidence that the compulsory acquisition of shares in the company violated international law. There was no

168 Knapp, *International Law Association, Report of the Forty Eighth Conference* (1958) 177, quoted by Domke (1961), 600.
 169 K Katzarov, "The Validity of the Act of Nationalization in International Law", *MLR* 22 (1959) 646.
 170 (1986) *AC* 368.
 171 *BYIL*, 56 (1985) 317.
 172 *BYIL*, 57 (1986) 440.
 173 *Id.*, 441.

international law obstacle to holding that the shares, and therefore control in the companies, vested in Spain.¹⁷⁴

3. The Effect of Stabilization Clauses

In order to encourage investments in developing countries, States have sometimes given assurances of security to foreign property owners, which at times came into conflict with their desire to nationalize. The main area of conflict, for the host countries, was that they feared that the price to be paid for economic investment was an unacceptable degree of interference in their economic and political sovereignty which would influence their cultural activities, and economic and financial institution. "Also the government feels that it will lose its sovereignty as a result of the operations of multinational firms which is closely associated with the issue of extraterritoriality."¹⁷⁵

However, the Third World desperately needs the foreign capital or foreign talent to assist in developing the country, and has entered into agreements which created contractual rights for the investor and obligations for the host countries. These agreements, which provided protection for the investor in accordance with international law against any prejudicial act, have sometimes generated conflict with the State's right to expropriate foreign property. For example, Article 3(2) of the Treaty for the Promotion and Protection of Investments of 25 November 1959 between the Federal Republic of Germany and Pakistan provides:

Nationals or companies of either party shall not be subjected to expropriation of their investments in the territory of the other party except for the public benefit against compensation, which shall represent the equivalent of the investments affected.¹⁷⁶

Some Third World countries expressly state that expropriation of industry is not the policy of the government. For example, the policy statement of Guinea declares that:

174 *BYIL* 56 (1985) 317.

175 AI Litvak, *Foreign Investment* (1970) 23, 25.

176 Quoted by Akinsanya, 32.

Those who are ready to invest in the Republic of Guinea and who accept to participate in the economic development of our country, must be able to count on flawless social stability and benefits from guarantees protecting their capital from all arbitrary acts and ensuring fair interests.¹⁷⁷

Furthermore, some agreements contain provisions preventing expropriation for a defined period of time. For example, in 1953 India made an agreement with three foreign oil companies to build refineries. This agreement stated that there would be no nationalization for 25 years: if the enterprise was expropriated after that time, reasonable compensation was to be paid.¹⁷⁸

In 1967 three Japanese companies signed a contract with the Ruler of Abu Dhabi which provided "The mutual consent of the Ruler and the Companies shall be required to annul, or modify, the provisions of this agreement."¹⁷⁹

The Concession Agreement of 1933 between Iran and the *Anglo-Iranian Oil Company* stated that government legislation could not alter either the concession or the terms of the concession.¹⁸⁰

In 1973 the Sultan of Oman and the Sun Group signed an agreement which stated that the Sultan could not amend the agreement, but that with the written consent of the Sun Group the provisions of the agreement could be annulled, amended or modified, and also the Sultan could not pass laws which would discriminate against the operations of the Sun Group.¹⁸¹

In June 1975 the government of Liberia and Liberia Iron and Steel Corporation signed an agreement which stated in Article 21:

177 Ibid.

178 Narayanan, India, in Wolfgang Friedmann (ed), *Legal Aspects of Foreign Investment* (1959) 249, 261.

179 Selected Document of the International Petroleum Industry (1967) 137, quoted by EJ Paasivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes* (Cambridge PhD Thesis 1988) 131.

180 (1952) *ICJ Reports*, 86.

181 GR Delaume, *Transnational Contracts: Applicable Law and Settlement of Disputes. Law and Practice*, Binder 1, Booklet 3.1., 25, 1983; quoted by Paasivirta, 131.

This Concession agreement shall be governed, construed and interpreted in accordance with the laws of the Republic of Liberia excluding, however, any enactment passed or brought into force in the Republic of Liberia before or after the date of this concession agreement which is inconsistent with or contrary to the terms hereof.¹⁸²

It has often been argued that international law recognizes that, according to the principle *pacta sunt servanda*, a contract concluded between two States or by a State with a national of another State, must be respected, and that in consequence expropriation of private property in situations where the property is specifically protected by an agreement is contrary to international law. For example in 1958 the following resolution was adopted by an International Bar Association Committee on Protection of Foreign Property in Time of Peace:

International law recognises that the principle *pacta sunt servanda* applies to the specific engagement of States towards other States or the nationals of other States, and that in consequence a taking of private property in violation of a specific State contract is contrary to international law.¹⁸³

Similarly in the *Losinger and Company Case* Switzerland argued that:

The principle of *pacta sunt servanda* must be applicable not only to agreements directly concluded between States, but also to those between a State and foreigners.¹⁸⁴

But there has in modern times been a metamorphosis in the whole nature of *pacta sunt servanda* as it relates to expropriation. In the case of *Kuwait v Aminoil* in 1977, the principle *pacta sunt servanda* was interpreted so as not to interfere with changes in the contract "brought about by time, and the acquiescence and conduct of the parties."¹⁸⁵ Thus because of the principle *pacta sunt servanda*, the contract was still valid, but it became a different contract. Thus the principle which restricted the right of a State to nationalize property

182 *CICRI*, 1, 113.

183 International Bar Association, *Seventh Conference Report, Cologne* (1958) 485.

184 *PCIJ Series C No 78* (1936) 32.

185 Award, Paragraph 101; *ILM* 21 (1984) 1023. See Tszchanz, 277.

specifically protected by an agreement or contract was no longer considered valid.

The right of a State to expropriate its natural resources is a corollary of the right of permanent sovereignty, a right which exists and may be exercised "even if the predecessor State or a previous government engaged itself by a treaty or a contract not to do so".¹⁸⁶ Thus stabilization agreements will not prevent the State from exercising its rights to expropriate its natural resources.

Furthermore, the stabilization function cannot be achieved as there is no international law preventing nationalization, providing compensation is paid, and because "international law does not possess adequate rules governing contracts of this nature".¹⁸⁷ When it became necessary to adjust some long term agreements, such as the oil concession agreements of the 1930s, this was done using the more flexible institutions of municipal contractual law. If international law had demanded rigid adherence to stabilization agreements, it could have resulted in a total severance of any kind of contractual agreement.¹⁸⁸

4. The Expropriation of Property in Islamic Shari'ah Law

Islamic Shari'ah respects private property. Property is not only a right but also a responsibility. The Holy Qur'an, the basic source of Islamic Shari'ah prohibits unjust enrichment (*akl al-amwal baynakum*) (*bil-batil*). In the Qur'an there are several verses dealing with this issue. For example the Qur'an says:

O ye who believe. Eat not up your property among yourselves in vanities. But let there be amongst you traffic and trade by mutual good-will...¹⁸⁹

O orphans restore their property (when they reach their age) nor substitute [your] worthless things for [their] good ones; and devour not their substance [by mixing it up] with your own. For this is indeed a great sin.¹⁹⁰

186 de Aréchaga, 179.
 187 Id, 193.
 188 Ibid.
 189 Holy Qur'an sura IV verse 29.
 190 Id, verse 2.

Similarly Prophet Muhammad said:

O ye people; your blood and money are as sacred to you until you meet your God, as the sacredness of this day and month.

He who is killed in defence of his property is a martyr.

The inviolability of private property is affirmed in the Holy Qur'an, which disapproved of usury¹⁹¹ and prohibited interest.¹⁹² "The sanctity of property is an absolute rule for all schools of law, both between private persons and in their relationship with the State."¹⁹³ Moreover, this is the case without any discrimination between alien and citizen regarding their religion: all are equal before the law in respect of their right to protect their property.

On the other hand, Muslim jurists have established many new solutions for the new problems that have occurred in modern Islamic societies. They did not stand handcuffed towards these new problems but managed to derive appropriate solutions from within the rules of Islam. In the economic domain in particular Muslim jurists have lately arrived at a solution to the question of an interest-based economy (which is rejected by the Islamic Shari'ah) by improvising the so-called Islamic Banks based on money management without interest. Such banks are spreading over the world.¹⁹⁴

In the second century of the Hijrah (8th century AD) Abu Yusuf, a famous jurist in a treatise written at the command of the Caliph Harun al Rashid (the Imam) on revenue and other matters of government said:

It is neither lawful for the Imam [the head of the Muslim State], nor has he the power, to give as a concession to anyone that which belongs to a Muslim or to a protected person, or to deprive them of anything which they possess, except if he has a

191 The Holy Qur'an, sura IV verse 161.

192 The Holy Qur'an sura II verse 279.

193 Schacht, 140.

194 "Islamic banking turning popular", in *Muslim World News*, a weekly newspaper published by the Muslim World League, Makkah Al-Mukarramah No 969 14 April 1986, Sha'ban 5, 1406H.

legal claim against them; in this case he may exact from them that to which he has the right.¹⁹⁵

This bears out Schacht's statement that:

Islamic law in all its schools gives clear-cut decisions on a number of problems concerned with the relationship of individual and State, problems which... have become a subject of much interest to western legal thought. The solutions provided by Islamic law go decisively and consistently in favour of the rights of the individual, of the sanctity of contracts, and of private property, and they put severe limits to the action of the State in these matters...¹⁹⁶

Therefore, Islamic Shari'ah does not recognize the nationalization of private property, whether foreign or national, as a rule, because in neither the basic source of Islamic Shari'ah, the Holy Qur'an, nor in the Sunnah, the practice of the prophet, is their provision for the nationalization of private property.

Islamic Shari'ah has the great doctrine of *Durura*, necessity or *force majeure*, which is derived from the Holy Qur'an. This doctrine provides for the disregarding of a law, even of an economic or political nature, if the basis for so doing is the protection of the property of a State, or its very existence, or the protection of life. This doctrine applies to both religious and secular life.¹⁹⁷

195 Kitab al-Kharaj, Bulag, Cairo 1302, 34 quoted by Joseph Schacht, 140.

196 Schacht, 138.

197 *Durura* The Principle of Necessity in Islamic Shari'ah outlines five elements which it is vital to preserve for the spiritual and temporal well-being of the Muslim. These five elements are

1. That one must keep the religion
2. That one must preserve one's own life
3. That one must preserve one's own mind
4. That one must not prevent or harm future generations
5. That one must preserve one's personal possessions.

Durura states that no activity can be engaged in which would interfere with a man preserving these elements, and further that extraordinary measures may be taken if necessity requires it, in order to ensure the preservation. *Durura* recognises the importance of these elements to man's spiritual and temporal affairs and claims that should such elements be lost, a man's spiritual and temporal world will also be lost. El Ghouneimi, *Treaties Rules in the Islamic Shari'ah*. (1977) 127 (text in Arabic). See also Abd Al Hamed Mutwally, *Islamic Shari'ah as the Basic Source of the Constitution*, (1975) 130-1 (text in Arabic); M. Muslehuddin, *Islamic Jurisprudence and the Rule of Necessity and Need*, *ISI Stud* 12 (1973).

However, Islamic Shari'ah allows expropriation of private property in the public interest only within very narrow limits.¹⁹⁸ In the case of the compulsory sale of land for public roads or cemeteries, full compensation must be paid by the public treasury. So also in the case of the compulsory sale of property to repay debts.¹⁹⁹

On the subject of the seizing of belongings in the public interest, the Islamic Juristic Assembly Council announced in its Fourth Conference at Jeddah in Saudi Arabia, in a session held from 18 to 23 Jumad Thani 1408 (AH) - 6 to 22 February 1988 - under the reference number D4-80-88, and according to the Islamic Shari'ah the following:

First; the individual ownership should be respected and protected against any assault, and its range should not be tightened or restricted. The proprietor is the master of his property with which he can do whatever he likes, and fully benefit of it.

Second; it is allowed to expropriate an estate for public interest. This should be done under the following legal guideline:

- 1 - In return for taking over an estate, an immediate and fair compensation should be paid.
- 2 - The person who takes it should be the person in charge or his deputy.
- 3 - The seizure should be for the purpose of serving a public interest required by a general necessity such as mosques, roads, bridges and arches.
- 4 - The seized estate should not be used for public or private investments, and the taking over process should not be accelerated.

Any infringement of these conditions makes the seizure of an estate an oppression that God and his Prophet have prohibited.

Therefore, while private property is considered protected in Islamic Shari'ah, the demands of society have led to the clarifying of the doctrine of *Durura* as it applies to control of natural resources. Based on the principle of

198 Schacht, 142.
199 Ibid.

necessity, Islamic society sees its development as a modern State imperative. For this reason it condones the reclaiming of its own natural resources and considers this agreement terminated. Article 97 of the "*Majallah*", the Ottoman Civil Code, stated that:

One is not allowed to take another's property without legal cause.²⁰⁰

Moinuddin stated that...

Thus violation of contractual obligations which are committed by the State under the compulsion of necessity and within the public interest cannot be considered to be an expropriation of ownership of property, which is in any case vested in the State, but a breach of a private contract in the form of a premature termination of a concessionary contract that entails the obligation to pay compensation.²⁰¹

On the other side, the reading of the Islamic Shari'ah texts has shown that ownership - as much as it is complete, steady and permanent in terms of owning, possessing and running it under the Islamic Shari'ah - should not contradict the public interest of all Muslims by any absolute character that may be asserted for it. And if a contravention occurs, the public interest is to be given priority over the private interest, but the private right should be protected through a fair compensation. Thus Ibn al Qayyim al Jawzyyya Jurist of the Hanbali School said: "For the sake of the probable interest, it is allowed to impound belongings from owners, after paying for their values." What is meant here by probable interest is the public interest.²⁰²

The compensation must be paid according to Islamic principles, as is explained in Chapter 10.

200 *ILM* 20 (1981) 47.

201 Moinuddin, 62.

202 Quoted by B Abuzied, *Al Muthamanh Fi Al Akar* 1411 AH (1991) 35 (text in Arabic).

5. Conclusions

As I have shown, expropriation or nationalization are terms used for the transfer of property to the State for the benefit of the State and its citizens. These terms are not to be confused with confiscation, as nationalization or expropriation involves the payment of compensation, whereas confiscation is used to describe the taking of private property without compensation.

I have shown that although traditional international law by way of the principle of "acquired rights" demanded the protection of private property, and by way of the principle *pacta sunt servanda* considered unlawful any interference with contractual rights, these traditional principles have been challenged, especially since the 1917 Revolution in Russia. The sanctity of the right to hold private property has been diminished in cases where it is seen to conflict with the benefit of the people of a State.

Since 1952 the expropriation of foreign property has been considered especially by Third World writers to be a matter concerned with the sovereignty of a State, and this new conception has been recognized by General Assembly resolutions and by international law. One conception is that expropriation is to be considered lawful in international law providing three criteria are met, viz:

- (1) The expropriation is in the public interest;
- (2) The expropriation must occur without discrimination;
- (3) The expropriation must be accompanied by adequate compensation.

But there remains a considerable amount of controversy surrounding the definition and legal status of public interest and non-discrimination.

In particular the concept of non-discrimination has been criticised by Third World writers, who consider it doubtful because it is not assumed to be the source of an international obligation, and because in the words of Francioni, in this respect "international law experience is far from being consistent."²⁰³

Regarding the element of public interest, there is no agreed definition of the term in international law, and it is now considered to be the responsibility of the expropriating State to determine what is necessary and useful for the benefit of its people. Thus it is significant that the concepts of non-discrimination and public interest were ignored by the key General Assembly resolution, Resolution 3281(XXIX) of 12 December 1974.

Finally, under Islamic Shari'ah, as provided in its sources, the great Islamic doctrine known in Arabic as "*Durura*" holds that necessity or *force majeure* permits the state to disregard the law, for both religious or secular reasons, and allows expropriation, always against compensation, in special cases of necessity.

CHAPTER 10

COMPENSATION FOR EXPROPRIATION

1. Introduction

There is much controversy in international law regarding the issue of compensation for expropriated property. The traditional international law principle was that full compensation was payable in cases of the expropriation of foreign property,¹ and that this was particularly the case if the expropriation was in violation of a treaty, was discriminatory or was in breach of an express commitment not to expropriate.² The compensation controversy emerged clearly after the First World War, as a consequence of the Russian Revolution of 1917, the expropriation of foreign property by the Mexican government in 1938, and the Chinese expropriation of 1940.

According to the Western view, it is often stated that the expropriation of foreign property is a violation of international law unless the expropriating State pays just compensation. This requirement of compensation plays a dominating role in any discussion of the international rules relating to the expropriation of foreign property. The principle of compensation is founded in the general principle of law condemning unjustified enrichment.³ The principle of unjust enrichment has been recognized by jurists as embodied in most legal systems, whether civil law or common law.⁴ This principle may be applied in international law, as a means of preventing the nationalizing State from benefiting unjustly from those whose property is expropriated, and to protect property owners from arbitrary expropriation.⁵ The principle is sometimes equated with the traditional doctrine of respect for acquired rights on the basis that the act of expropriation is a violation of the acquired rights of the owner of the foreign property. That means when a certain legal right has been acquired

1 W. Friedmann, Some Impacts of Social Organization on International Law, *AJIL* 50 (1956) 475-504.
 2 JH Herz, Expropriation of Foreign Property, *AJIL* 35 (1941) 249.
 3 A A Fatouros, *Government Guarantees to Foreign Investors* (1962) 271.
 4 W Friedmann, *The Changing Structure of International Law* (1964) 206.
 5 JH Herz, 249.

under the national law of a State, that legal right must be respected as a matter of international obligation.⁶

Thus there is an international duty to provide compensation over and above any provisions of municipal law.⁷ But there is as yet no unanimous opinion among writers when dealing with the problem of compensation. There appear to be three major points of view, which often depend on whether the authors belong to the developed or developing world. Western writers and Western state practice maintain that the act of taking private property gives rise to an obligation on the part of the State to pay full damages in a "prompt, effective and adequate manner". Third World writers claim, that if a State is pursuing a broad scale economic and social reform, no compensation at all is legally due. A further opinion, also expressed by writers of developing States, is that there is an obligation to compensate, but that there is no obligation that it be "prompt, adequate and effective".⁸

The requirement of "prompt, adequate and effective compensation" has been frequently affirmed by the United States,⁹ for example in notes to the Cuban government,¹⁰ and is also embodied in treaties made by the United States,¹¹ and other States such as the Federal Republic of Germany and Pakistan.¹²

On the other hand, the use of nationalization measures by countries in the past World War I era has generally been a means to bring about sweeping economic and social changes. If a country was forced to pay full compensation, it would impose an obligation on the nationalizing State, which either could not be met at all, or which would cause the national budget considerable hardship. This obligation would interfere with the right of a State to undertake pressing

6 F Francioni, Compensation for Nationalization of Foreign Property, *ICLQ* 24 (1975) 259.

7 T Huang, Some International and Legal Aspects of the Suez Canal Question, *AJIL* 51 (1957) 306.

8 Francioni, 255-6.

9 M Domke, Foreign Nationalizations. Some Aspect of Contemporary International Law, *AJIL* 55 (1961) 604.

10 *Ibid.*

11 *Ibid.*

12 *Ibid.*

social reform. In such cases the demands of compensation directly conflict with the sovereignty of a State.¹³

The conflict between the developed and the Third World is evident. The developed world maintains that the standard of compensation be determined by the Hull rule of "prompt adequate and effective compensation". The Third World maintains that a nationalization decree demands that compensation be determined by the State's own legislation, which will naturally be adapted to the wishes of the nationalizing government.¹⁴

Resolution 1803(XVII) of 14 December 1962 on Permanent Sovereignty over Natural Resources, and Resolution 3281(XXIX) of 12 December 1974, the Charter of Economic Rights and Duties of States, and other General Assembly resolutions state that in the case of the expropriation of foreign property appropriate compensation should be paid. In these forums the traditional requirement of "prompt, adequate and effective compensation" has been dropped. On the other hand it can be said that the payment of *some* compensation is recognized in the State practice of Western, Eastern and Third World nations alike: despite the fact that communist nations maintain there is no obligation to make reparation for expropriation, they have in practice generally agreed to pay compensation.¹⁵

In this chapter, I analyze the Western concept of compensation as embodied in the Hull formula "prompt, adequate and effective compensation", and the Third World conception, which refers to "appropriate compensation" as a standard rule. I next discuss the measure of compensation, giving examples of decisions on compensation, and of modern State practice in the Third World, and referring also to the question of special treatment for expropriation as a result of social reconstruction. Against this background I discuss the question of compensation in the case where there are specific undertakings by the State (eg. stabilization agreements).

13 R Delson, Nationalization of the Suez Canal Company, *Colombia Law Review* 57 (1957) 760-766.

14 Ibid.

15 LL Rood, Nationalization and Indigenization in Africa, *Journal of Modern African Studies* 14 (1976) 441.

2. The Traditional International Law Position

(1) The Minimum Standard of the Treatment of Aliens

In discussions of the standard of treatment of aliens in matters of compensation, a contrast is usually drawn between an international minimum standard set by international law and the principle of non-discrimination as a standard for the protection of foreign-owned property. Thus Piper states that the...

national treatment of aliens cannot fall below the minimum standard of justice prescribed for the treatment of aliens by international law, regardless of the standard treatment received by nationals. Aliens consequently may be entitled to preferential treatment if such preferential treatment is necessary to meet the minimum standard.¹⁶

Supporters of this view argue that there is no clear definition of the principle of non-discrimination and that it has limited support in practice.¹⁷ On the other hand the traditional western view of expropriation itself relies in part on a non-discrimination test. For example, in January 1972 President Nixon stated that the United States "had the right to expect that any taking of American property would be non-discriminatory."¹⁸ However, this was in the context of a taking which discriminated against United States nationals specifically, and controversy remains about this principle of non-discrimination as between aliens and nationals, when a State exercises its right to nationalize. This controversy highlights the different positions of western and developing countries. According to Francioni:

From the point of view of international equity the assumption was that in the case of conflict between the pecuniary interests of a foreign individual or company and the need for the host countries to nationalize those interests in the pursuit of the

16 Piper, *New Directions in the Protection of American-Owned Property Abroad*, *ILJ*, 4 (1978-79) 317, quoted by G Gainer, *Nationalization, The Dichotomy Between Western and Third World Perspectives in International Law*, *Howard Law Journal* 26 (1983) 1563.

17 *Id.*, 1563.

18 *Id.*, 1563-7.

general economic and social progress of the nation, the latter had to be given priority.¹⁹

Moreover the Western position on an international standard of justice "further presumes that this standard is its own enunciation of that law".²⁰ It derives from and relies heavily on its own traditions as the legal basis for the standard of treatment of aliens.²¹

(2) The "Prompt, Adequate and Effective" Standard of Compensation.

The rule of prompt, adequate and effective compensation initially emerged as the result of the Mexican agrarian and petroleum expropriations of 1938. The dispute between the United States and Mexico was not concerned with the Mexican action of expropriating American property within its territory for public purpose, as the United States recognized Mexico's right to do this. The dispute on the Mexican government's refusal to pay compensation for the expropriation according to the concepts of western international law.²² In 1938 the Secretary of State Hull, wrote to the Mexican Ambassador in Washington:

We cannot question the right of a foreign government to treat its own nationals in this fashion if it so desires. This is a matter of domestic concern. But we cannot admit a foreign government may take property of American nationals in disregard of the rule of compensation under international law.²³

On 3 April 1940 he wrote another note to the Ambassador saying:

19 Francioni, 268.

20 Gainer, 1565.

21 Ibid. Further, Article II of the French Civil Code provides that "Aliens should enjoy in France the same civil rights which are or shall be accorded to Frenchmen by the treaties of the nation to which that alien belongs": see EM Borchard, *The Diplomatic Protection of Citizens Abroad* (1927) 36. Article 11(2) of the Treaty of the Benelux Economic Union (1958) states that the nationals of each High Contracting Party "shall enjoy the same treatment as nationals of that State as regards: (a) freedom of movement, sojourn and settlement; (b) freedom to carry on a trade or occupation, including the rendering of services; (c) capital transactions; (d) conditions of employment; (e) social security benefits; (f) taxes and charges of any kind; (g) exercise of civil rights as well as legal and judicial protection of their person, individual rights and interests." AH Robertson, *European Institutions, Co-operation, Integration and Unification* (1966), 405 quoted by Z Kronfol, *Protection of Foreign Investment* (1972) 15.

22 Department of State Press Release, 3 August 1938.

23 3 Hackworth, *Digest of International Law* 1942, 656.

The right to expropriate property is coupled with and conditioned on the obligation to make adequate, effective and prompt compensation. The legality of an expropriation is in fact dependent upon the observance of this requirement.²⁴

By contrast the Mexican Foreign Minister in his replies of 3 August and 1 September 1938 said:

...there is in international law no rule universally accepted in theory nor carried out in practice which makes obligatory the payment of immediate compensation nor even of deferred compensation, for expropriations of a general and impersonal character...²⁵

In 1941 a Report was made jointly by experts appointed by the United States and Mexican governments, which evaluated the losses incurred by the United States in the process of nationalization and stated the terms by which such compensation was to be repaid.²⁶ Thereafter the rule of "prompt, adequate and effective" compensation for the taking of foreign property became the basic formula used by western developed countries in their compensation demands.

This rule was again applied in 1960 by the United States government in challenging the legality of the Cuban expropriation of property belonging to American citizens, in 1963 by the United States in the Ceylonese nationalizations and by the United Kingdom in 1951 in the Anglo-Iranian oil dispute.²⁷ But the rule was by no means entirely novel: it was supported by the Permanent Court's judgment in the *Chorzow Factory* case, which provided that an expropriation not accompanied by payment of prompt, adequate and effective compensation is invalid under international law, and by the Permanent Court of Arbitration in the *Norwegian Shipowners* case.²⁸ The Hull formulation was supported also by jurists such as Shawcross, who saw the failure to pay full, adequate and effective compensation as making an act of expropriation invalid.²⁹

24 Ibid. See also CC Hyde, Compensation for Expropriation, *AJIL* 33 (1939) 108.

25 Delson, 763.

26 KS Carlston, Concession Agreements and Nationalization, *AJIL* 52 (1958) 273.

27 Francioni, 263, 264.

28 R Dolzer, New Foundations of the Law of Expropriation of Alien Property, *AJIL* 75 (1981) 558.

29 Delson, 763.

Some writers distinguish between cases where full compensation should be paid and those which result from fundamental social and economic reforms where partial compensation would be adequate.³⁰

(3) Treaties and State Practice supporting the Hull Formula

The traditional view of international law regarding the rule of "prompt, adequate and effective compensation" is found in State practice. The western countries have tried to create a legal basis for this rule by introducing (sometimes by imposing) it in their treaty practice with some Third World countries.³¹ Many treaties which have been concluded between different States make provision for the payment of compensation in cases where foreign property has been expropriated. In particular since the Second World War the United States has concluded many treaties of friendship, commerce and navigation, which include provision for compensation claims based on the principle of prompt, adequate and effective compensation.

For example Article VI(3) of the Treaty with Japan of 2 April 1953, provides as follows:

Property of nationals and companies of either party shall not be taken within the territories of the other party... without the prompt payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken; and adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof.³²

Similarly Article 6(4) of the Treaty of Friendship and Commerce of 12 November 1959 between the United States and Pakistan provides that: "property ... shall not be taken without the prompt payment of just compensation."³³ This

30 This view was held by P Guggenheim, H Lauterpacht, JN Hyde, Friedmann and Isi Foighel. See further, S Toriguian, *Legal Aspects of Oil Concessions in the Middle East* (1972) 218-9.

31 Francioni, 264.

32 *U.S. Treaties and Other International Agreements* 4, Part 2, 1953, 2068-9. Further, Article IV(2) of the Treaty of Amity, Economic Relations between U.S. and Iran of 1955 provides that, "property... shall not be taken without the prompt payment of just compensation." *Id.* Vol.8, Part 1, 1957, 903.

33 A Akinsanya, *The Expropriation of Multinational Property in the Third World* (1980) 31.

formula has been consistently relied on by the State Department. For example, in a Note to the Government of Guatemala concerning the taking of certain real property of the United Fruit Company, it stated that:

Just compensation may be defined as that compensation which, as indicated in the previous Aide-Memoire of the United States on the present subject, is "prompt", is "adequate" and is "effective" - otherwise the payment is not "just"..."³⁴

Similarly, regarding the expropriation of the American Oil Company in Ceylon in 1961, Stephen Schwebel said on behalf of the United States' government that:

His government did not question the right of a sovereign nation to nationalize property belonging to United States' citizens or companies provided that adequate compensation was promptly paid in accordance with international law.³⁵

The United Kingdom has also concluded many treaties with different countries in this field. For example, in the Agreement of 29 July 1963 on Commercial and Economic Co-operation with the Republic of Cameroon, it appears that "the protection of investments under the treaty is based on the combined application of the standard of equitable treatment and the minimum standard."³⁶ Article 5(2) provides...

...in accordance with international law, [the parties shall] make provision for the payment of adequate and effective compensation. Such compensation shall be paid without undue delay to those entitled to it. Measures of expropriation, nationalization or confiscation shall not be discriminatory or contrary to a specific undertaking.³⁷

Article 15 of the Treaty of Commerce of 11 March 1959 between the United Kingdom and Iran provided that nationals of each State party would in

34 29 *Department of State Bulletin*, 14 September 1953, 359, 360, quoted by JN Hyde, *Permanent Sovereignty over Natural Wealth and Resources*, *AJIL* 50 (1956) 864.

35 KN Gess, *Permanent Sovereignty Over Natural Resources*, *ICLQ* 13 (1964) 428.

36 G Schwarzenberger, *Foreign Investments and International Law* (1969) 35.

37 Article 5(2), Cmnd 2133 (1963) 3 quoted by Schwarzenberger, 36.

case of restriction or expropriation affecting their property "receive prompt, adequate and effective compensation."³⁸

In practice, the elements constituting just compensation are neither fixed nor precise, but it is the common view of developed countries that the compensation paid must be equivalent to the value of the property taken and that it must be paid from the time when the property is taken in an economically useful form. If compensation cannot be paid at that time, interest must be paid. It is further maintained that exceptional circumstances which could cause a deviation from this rule must be decided by international law. The use of other, apparently more flexible formulas on some occasions does not involve any withdrawal of the basic United States' position, as Domke points out:

Fair compensation is similar to the terms "equitable", reasonable or "just" as being an equivalent to "adequate" compensation.³⁹

This definition is effectively the same as that which is defined by the Hull rule as prompt, adequate and effective compensation.

3. The Legal Position of Third World Countries

(1) The Minimum Standard of Treatment of Aliens

As noted above, there is no universally accepted minimum standard of treatment of aliens. The Third World position lays most of its emphasis on the national treatment standard, and treats State responsibility for aliens in other respects as outside the scope of international law.⁴⁰

This position had its origins in the Calvo doctrine, which rejected an international minimum standard, holding that aliens within the borders of a State should be governed by the same standards and laws that govern its own

38 Akinsanya, 32.

39 Domke, 608.

40 FV Garcia-Amador, *The Proposed New International Economic Order: A New Approach to the Law Governing Nationalization and Compensation*, *Lawyer of the Americas* 12 (1980) 27. See Gainer, 1564.

nationals. Calvo had stated "that aliens are not entitled to rights and privileges not accorded to nationals, and that therefore they may seek redress for grievances only before local authorities."⁴¹ Thus the Third World view is that municipal law should apply to determine the issue of compensation, and they recognize only the obligation to treat aliens equally with nationals, on the basis that foreigners could not claim any superior justification for the public taking of their property, since they could not have a better claim than or different rights from nationals.

For example in 1938, the Mexican government emphasized that its international obligation was confined to ensuring that aliens were treated equally with Mexican citizens. Replying to the United States' government on 3 August 1938 it stated that:

The jurisdiction of the States within the limits of the national territory is applicable to all inhabitants, nationals and foreigners who are under the same protection of the national legislation and authorities the foreigners cannot claim rights different from or more extensive than national [*sic*]... as your government is not unaware that our government finds itself unable to pay the indemnity to all affected by the Agrarian reform, by insisting on payment to American landholders, it demands in reality, a special privileged treatment which no one is receiving in Mexico.⁴²

In 1953, Guatemala adopted a similar position after it nationalized American owned property.

41 Shea, *The Calvo Clause* (1955) 19. This doctrine was first espoused in 1868 in an international law treatise of Carlos Calvo, Argentine diplomat and publicist. The result of this doctrine is that the alien is entitled to national treatment and no more, thus negating the concept that, whatever a State does to its nationals, it must treat aliens permitted to enter in accordance with the rules of international law, setting a minimum standard for such treatment. 5 Hackworth, *Digest of International Law* (1943) 635. There is another similar doctrine, the Drago doctrine from Argentina (1902). It rejects specifically the threat of external force to collect public debts. This doctrine is postulated on the same derivation from concepts of sovereignty, independence and absolute equality of States as is the Calvo doctrine. JM Sweeney, CT Oliver, NE Leech, *The International Legal System Cases and Materials* (1981) 1112.

42 Department of State press release, 3 August 1938, quoted by Francioni, 269.

The rule of equal treatment for nationals and aliens was also adopted by a League of Nations Report on the Responsibility of Governments⁴³ and subsequently in 1957 in Article I of the International Law Commission Draft Articles on State Responsibility.⁴⁴

A second and related aspect of the Third World approach to this problem is the rejection of customary law processes which were created and used to the disadvantage of capital importing countries. Third World jurists argue that the use of customary international law cannot be valid when the original international community consisted of only a few nations outside Europe,⁴⁵ whereas since 1945 this community has extended to include many former colonies of European States which are now independent nations. For example, Syatauw noted that:

There are indeed good reasons for Asian States to resent traditional international law. It has often been an obstacle rather than a help for their national aspirations. The position of a colony under international law was minimized and the transition of such a territory into an independent State met with great barriers of doctrines of international law.⁴⁶

Thus, it is argued, that the law of nationalization was formulated to benefit the western States, without considering the circumstances in which the property in question may have been acquired or the way in which it may have been used. They contend that all the past circumstances and the conduct of the foreign investor "should be taken into consideration in determining compensation."⁴⁷

(2) The "Appropriate Compensation" Standard

After the Second World War, and especially after 1952, the international climate changed: increasingly the argument was heard that the traditional

43 Francioni, 270.

44 The Second Report to the International Law Commission on the International Responsibility of States, United Nations Document A/CN.4 (1957) 106.

45 Gainer, 1565.

46 Syatauw, *Some Newly Established Asian States and the Development of International Law* (1961), quoted by Gainer, 1565.

47 Girvan, *Expropriating the Expropriators. Compensation Criteria from a Third World Viewpoint* (1973) 155, 156 quoted by Gainer, 1566.

doctrine on the question of payment of "prompt, adequate and effective" compensation in the nationalization of foreign property had lost its relevance in view of the development of the right of States to permanent sovereignty over their natural resources. Instead, the preferred formula was one of "appropriate compensation", which allowed for a range of solutions depending on the special circumstances of each case. Factors such as political and economic necessity, balance of power and ability to pay have resulted in different kinds of compensation agreements, and in particular, lump-sum agreements.⁴⁸

As early as the 1952 Siena Session of the Institute of International Law there was a body of opinion to the effect that "a nationalizing State fulfils its obligations as to the payment of compensation by the payment of such compensation as is reasonable in the circumstances, taking into consideration the whole of its national economy."⁴⁹

However, the principle of the permanent sovereignty of the State over its natural wealth and resources which has been articulated in United Nations General Assembly resolutions is the principal basis for this new trend. The United Nations provided a new forum for the creation of customary rules of international law upholding the right to expropriate foreign property, and a more flexible standard of compensation. This effectively began in 1952. General Assembly Resolution 626(VII) of 21 December 1952 provided that:

The right of peoples freely to use and exploit their natural wealth and resources is inherent in their sovereignty...⁵⁰

In 1962 the General Assembly adopted Resolution 1803 (XVII) on Permanent Sovereignty over Natural Resources. The debate between the capital exporting and Third World countries (along with the former Communist bloc)

48 Montreal Report 93, quoted by SR Chowdhury, *Permanent Sovereignty and Its Impact on Stabilization Clauses. Standard of Compensation and Patterns of Development Co-operation*, in K Hossain & SR Chowdhury (eds), *Permanent Sovereignty Over Natural Resources in International Law* (1984) 57.

49 44 *Annuaire de l'Institut de Droit International. Session de Sienne* (1952/II) 251, 323, quoted by Huang, 306-7.

50 General Assembly Resolution 626(VII) of 21 December 1952.

centred primarily on the issue of the standard of compensation. Paragraph 4 of Resolution 1803 provides:

...in such cases [of nationalization] the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law...

The view of the capital exporting countries throughout the debate was that "appropriate compensation" was ambiguous since it was not clear what exactly "appropriate" meant.⁵¹ The United States submitted an amendment which held "appropriate compensation" to mean "prompt, adequate and effective compensation".⁵² The United States withdrew its amendment, but after the adoption of the draft resolution by the Second Committee, the United States noted that in its view the word "appropriate" was the equivalent of "prompt, adequate and effective" in the event of expropriation.⁵³

Some credence to this view was given by the rejection of the former Soviet Union's proposed amendment to paragraph 4 of the draft, which read:

The question of compensation for the owners shall in such cases be decided in accordance with the national law of the country taking these measures in the exercise of its sovereignty.⁵⁴

The former Soviet Union amendment was rejected by a vote of 39 to 28 with 21 abstentions.⁵⁵ Egypt and Afghanistan had also submitted an amendment which provided for the payment of "adequate compensation when and where appropriate".⁵⁶ This amendment was withdrawn.

By contrast General Assembly Resolution 3281(XXIX) of 12 December 1974, the Charter of Economic Rights and Duties of States, adopted a position

51 SK Banerjee, *The Concept of Permanent Sovereignty over Natural Resources - An Analysis*, *Indian Journal of International Law* 8 (1968) 529.
 52 *Ibid.*
 53 United Nations Document A/C 2/SR 850 7.
 54 United Nations Document A/C 2/L 670.
 55 United Nations Document A/C 2/SR 858 13.
 56 United Nations Document A/AC 97/L2. United Nations Document A/AC 97/SR.27.5,6.

which closely reflected this proposal. Article 2(2)(c) provides that in the case of expropriation "... appropriate compensation should be paid by the States adopting such measures taking into account its relevant laws and regulation and all circumstance that the State considers pertinent..." General Assembly Resolution 3171 (XXVIII) of 17 December 1973 adopted the expression "possible compensation" in case of expropriation.

Thus, these resolutions provide that the owners of nationalized property are entitled to "appropriate compensation" or possible compensation instead of just or adequate compensation. Moreover, there are important differences between Resolution 1803 and Resolution 3281, as was seen in the previous Chapter. For present purposes the major difference is that, while Resolution 1803 provides in paragraph 4 that compensation is to be determined in accordance with the law of the State in question and in accordance with international law, Article 2(2)(c) of the Charter does not make any references to international law, but merely provides that compensation is to be determined by the expropriating State in accordance with its municipal law and taking account of its particular circumstances, thus rejecting by implication any obligation of compensation under international law. In the words of Jiménez de Aréchaga:

...the phrase "in accordance with international law" was eliminated because of Third World countries suspicions as to what western countries expect from international law... [O]nce it is established that the alleged customary rule of "prompt, adequate and effective" compensation is no longer accepted by the vast majority of the international community, the reference to international law lost the meaning intended by the developed countries.⁵⁷

Thus the notion of appropriate compensation is a flexible one, which allows those determining the scale of compensation to take account, for example,

57 Jiménez de Aréchaga, *State Responsibility for the Nationalization of Foreign Owned Property*, *NYU JILP* 11 (1978) 186. The ECOSOC "Group of Eminent Persons" Report on *Multinational Corporations*, issued in New York in 1974, recommended that nationalizing States "...should ensure that the compensation is fair and adequate and determined according to due process of law of the country concerned..." It is unclear whether this implies a minimum standard of treatment. See JG Castel, *International Law* (1976) 1118.

of any unjust enrichment that may have been involved in the investment.⁵⁸ In accordance with this approach the following factors, it has been suggested, should be considered as pertinent: (1) the ability of the host State to pay; (2) the extent to which the resources have been exploited by the party nationalized; (3) its policies as to re-investment; (4) the extent of profits that will be lost by the party that is nationalized despite any stabilization clause; (5) whether the initial investment has been recovered; (6) whether there has been undue enrichment as a result of a colonial situation; (7) whether the profits obtained have been excessive; (8) the contribution of the enterprise to the economic and social development of the country and its respect for labour law and its reinvestment policies.⁵⁹

4. The Principle of Compensation in Islam

In Islamic Shari'ah, if a State terminates a private concession agreement, acting in the interests and social good of the community, it is obliged to pay compensation, except in cases where the property in question was wrongly acquired by individuals.⁶⁰

While Islamic Shari'ah accepts the legal obligation to pay compensation, it has disputed western demands prescribing the amount to be paid. The amount of compensation should be linked to the value of the property taken, in order to be "just" and "due". Since "harm cannot be removed by the infliction of harm", the compensation payable for property taken cannot be less than what is fair and equitable.⁶¹

Article 2 of the main agreement between the Saudi Arabia Government and Aramco of 31 January 1977 relating to the takeover of Aramco made provision for the amount of compensation which the Saudi Arabian government must pay for assets. Further the principle of Islamic Shari'ah agrees with the

58 Falk, *The New States and International Legal Order*, 118 *Recueil des Cours Academie de Droit International*, 129 (1966), quoted by de Aréchaga, 185.

59 de Aréchaga, 185. See also Chowdhury, 16-7.

60 H Moinuddin, *The Charter of The Islamic Conference and Legal Framework of Economic Co-operation Among Its Member States* (1987) 61.

61 *Ibid.*, 63.

demands of Third World countries who claim that compensation for expropriation should be calculated on the basis of the net book value of the assets.⁶²

5. Compensation for Expropriation: An Analysis of State Practice and Decided Cases

In deciding on the present extent of the obligation to compensate for expropriated property in international law, it is necessary to review the various disputes and decided cases, looking first at the earlier precedents, secondly, at the question of compensation for expropriation as result of social reconstruction, and thirdly, at recent Third World practice.

(1) Earlier Compensation Cases

Before the First World War there were very few cases of interference by a State with private property which had international repercussions. The following are examples of these cases which are often cited. I conclude that it is very difficult to find any precise formula for standards of compensation in these cases, though in all cases compensation was given.

(a) *The Delagoa Bay Railway Case (1900)*

This case was arbitrated between England, America and Portugal. The Portuguese government had annulled concession agreement granted for the construction of a railway from Lourenco Marques to the Transvaal frontier. The Portuguese government's right to expropriate was in no way challenged. After the negotiation the Portuguese government admitted its liability to pay compensation according to the international standard.⁶³

62 FR Tesón, *State Contracts and Oil Expropriations: The Aminoil-Kuwait Arbitration*, *Virginia Journal of International Law* 24 (1984) 351.

63 Moore, 11 *Digest of International Arbitrations* (1865-1898). See NR Doman, *Postwar Nationalization of Foreign Property in Europe*, *Columbia Law Review* 48 (1948) 1133. See also AP Fachiri, *Expropriation and International Law*, *BYIL* 6 (1925) 165-166.

(b) *The Italian Life Insurance Monopoly Case (1911)*

Italy initially claimed that no compensation could be claimed by existing insurance companies for damage suffered in the creation of a National Institute, which was to take over complete control of Italian life insurance business. No compensation was to be paid for pecuniary damage suffered by existing life insurance businesses. Protests were made by the governments of all countries with interests in this area in Italy, and as a consequence amendments were made to the original bill, which allowed foreign insurance companies to continue business for ten years on certain conditions. As a consequence of the prohibition on continuing business, the foreign companies then had time to dispose of their property in what has been described as "fair conditions".⁶⁴

(c) *The Chorzow Factory Case (1928)*

In the *Chorzow Factory* case the Permanent Court of International Justice held that the expropriation was unlawful, because of an express treaty obligation forbidding it, and required compensation to be paid for the value taken.⁶⁵

The expropriation of German property in Upper Silesia was regulated by Article 6 of the Geneva Convention of 5 May 1922. It stated that:

Except as provided in these clauses the property, rights and interests of German nationals may not be liquidated in Polish upper Silesia.⁶⁶

When on July 14, 1920 the Polish law led to the expropriation of the *Chorzow Factory*, Germany claimed in the Permanent Court of International Justice that the attitude of the Polish Government was not in conformity with the Articles of the Geneva Convention and was therefore illegal.

64 Fachiri, 166, 167.
65 *PCIJ Series A. No.17, (1928) 46-7.*
66 *Id.*, 21.

The case relied entirely on the interpretation of the Peace Treaties and the Geneva Convention, and the Court held that the Polish action was contrary to the Geneva Convention and therefore illegal. In its judgment the Court noted:

The essential principle contained in the actual notion of an illegal act - a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals - is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would in all probability, have existed if that act had not been committed. Restitution in kind, or if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear; the award, if need be, of damages for loss sustained which would not be covered by restitution in kind or payment in place of it - such are the principles which should serve to determine the amount of compensation due for an act contrary to International Law.⁶⁷

In its ruling the Court distinguished between legal and illegal expropriation. And as Herz points out, the case can be distinguished because of its reliance on a specific treaty obligation:

According to this case, the breach of an express treaty obligation forbidding expropriation made the act a wrongful one for which restitution in kind (or if impossible, full payment of value plus losses sustained) was due. But the Court further stated that ordinary, lawful expropriation would have brought about merely the obligation to pay cash compensation for direct losses.⁶⁸

(d) *Portuguese Religious Properties Case (1920)*

In 1920 Britain argued that Portugal, by taking possession of religious property legally acquired by British nationals, had acted contrary to the principles of international law.⁶⁹ However, as Friedman notes:

67 Id, 47.

68 Herz, 253.

69 *PCA Award 16, 1 RIAA 7*, quoted by S Friedman, *Expropriation in International Law* (1953) 70.

far from denying these principles... the Portuguese government... accepted them without reserve... The Tribunal did not therefore really have to decide a point of law at all.⁷⁰

(e) **Conclusion**

It appears that it is difficult to find in these cases, precedents, which cannot be explained in terms of diplomatic pressure, or the facts of the original agreement, or resulting from specific treaty provisions imposing a given solution. *The Delagoa Bay Railway Case* and the *Portuguese Religious Case* properties indicate that the question of the right of nationalisation had already been settled and that Portugal early admitted its duty to pay compensation. This could in principle be seen to have been concluded by the original agreement which had already settled the question of law. The *Chorzow Factory Case* is considered to have established the principle of respect for private property, in international law. However it can be seen as an example of a case decided by the application of a specific treaty provision.

(2) **Compensation for Expropriation as Result of Social Reconstruction**

The expropriation measures undertaken in Eastern Europe after the Second World War occurred as a consequence of the social and political repercussions of that war. The impetus for the expropriations was the replacement of a capitalist system with a centrally-controlled socialist State. But it was facilitated by the earlier Nazi expropriation of properties, which after the German defeat were left ownerless: by this time practical difficulties made the return of such property seemingly impractical. As the following survey shows, compensation was generally calculated by reference to economic and political considerations rather than the value of the expropriated property.⁷¹

70 Friedman, 71.
71 See Friedman, 29; Doman, 1140.

(a) Poland

The Polish nationalizations occurred by means of a Polish Act of Nationalization of 3 January 1946. Two categories of nationalization occurred: (1) where property was transferred to the State without compensation (this concerned property which formerly belonged to the people of the German Reich or the former free City of Danzig or to people who fled Poland to join the enemy); (2) where property was transferred with compensation. This compensation was to be determined by a special tribunal: Article 7 of the Polish Act of nationalization provided that the Treasury would pay compensation one year from the determination of the amount. Compensation to foreigners was designed to facilitate normal political relationships and negotiations were made with individual nations affected. Americans were paid in respect of their dollar investments, either in dollars or a convertible currency.⁷²

(b) Czechoslovakia

The Czech Nationalization law went into effect on 27 October 1945. The Czech State acquired ownership of all the nationalized enterprises, including all their property, assets and rights. The new national enterprises could petition for the abolition or correction of so-called "economically unjustifiable" obligations.⁷³ The basis of compensation was the official value of the property on 27 October 1945, and compensation was paid through the issue of interest-bearing securities. The State guaranteed the payment of interest and the redemption of securities. Where foreign capital was invested, negotiations were to be opened with the government of the owners.⁷⁴

(c) Yugoslavia

On 5 December 1946 Yugoslavia declared a nationalization law which was to be the basis for the nationalization of private enterprises in 48 different

72 *Journal of Laws* No.3, February 5 (1946) 17. See Doman, 1146.

73 *Id.*, 1143.

74 *16 State Department Bulletin*, 367 (1947), quoted by Domań, 1143.

industries.⁷⁵ A procedure for compensation was established, whereby the State paid the owners of nationalized enterprises on the basis of the net value of the property on the day of nationalization. Payment was made in Government bonds payable to the bearer.⁷⁶ In principle the Government expressed a willingness to return foreign property to the legitimate owners under certain conditions, and conducted separate negotiations with the governments of countries with property, to arrive at compensation amounts.⁷⁷

(d) Hungary

Nationalization occurred under the Hungarian Act XXV of 1948, by which the State acquired ownership of the shares of all nationalized companies. However foreign citizens or foreign legal persons could retain ownership of shares in nationalized companies. Any contractual obligations existing in favour of Hungarian citizens were annulled. Compensation was to be decided upon by a separate Act of Parliament. Thus nationalization only affected the rights and interests of Hungarian nationals.⁷⁸ The nationalization law was issued by reference to the Treaty of Peace with Hungary which became effective on 15 September 1947.⁷⁹

(e) Rumania

The Constitution adopted by Rumania on 13 April 1948 provided the basis for nationalization, but the main Law affecting the Basic Industries was enacted on 11 June 1948.⁸⁰ The Law accepted the principle of compensation except in the cases of persons enriched in an illegal manner. Commitments assumed by the old enterprise could be avoided if they did not benefit the

75 *Official Gazette of the Federal People's Republic of Yugoslavia*. No 98.6 December 1946, quoted by Doman, 1150.

76 *Ibid.*

77 *Id.*, 1152.

78 *Ibid.*

79 *United States Treaty Series* No 1651 (1947), quoted by Doman, 1153.

80 Published by the Ministry of Arts and Information, Bucharest (1948), quoted by NR Doman, 1155.

enterprise itself.⁸¹ Compensation was to be established by commissions consisting of three magistrates appointed by the Ministry of Justice.⁸²

(f) **Bulgaria**

Article 7 and 11 of the Bulgarian Constitution of 4 December 1947 provided for the nationalization of enterprises in certain branches of industry.⁸³ The former owners of nationalized property were compensated for the capital invested in the property, but not the property itself.⁸⁴ Compensation was to be in State bonds, paid over a long period.⁸⁵ The property of foreign individuals and associations was also nationalized. Compensation was denied those politically incriminated.⁸⁶ The banking system was also nationalized, but not those banks which belonged to foreign States.⁸⁷

(3) **Modern Case Studies in the Third World Countries**

I examine here various expropriation measures carried out in different Third World countries. A number of these countries were strongly influenced by OPEC which was formed in September 1960 to protect the interests of oil producing States. In 1968 OPEC adopting a resolution stating that in the interest of national development all nations had the right of permanent sovereignty over their natural resources,⁸⁸ and that the nationalization of the oil industry was the aim of its policy. It is thus appropriate to look at the Middle East, which was particularly affected by this approach, first.

(a) **The Middle East**

The Middle East has been very important for many centuries because of its strategic geographic position between Europe, Asia and Africa. It was

81 Ibid.
 82 Id, 1156.
 83 Friedman, 46.
 84 Doman, 1157.
 85 Friedman, 47.
 86 Doman, 1157.
 87 Ibid.
 88 OPEC, *General Information and Chronology* (February 1986) 36.

important for religion, trading, navigation and shipping during the fifteenth and sixteenth centuries. But by the beginning of the twentieth century the Middle East became more important than at any other time because the world's largest petroleum reserves lie in it. Oil is the most important single commodity in the economic life of the industrialized and industrializing countries.⁸⁹

(i) **Iran**

(A) *Anglo-Iranian Oil Company Ltd (1933)*

In 1909 the first oil well was discovered by D'Arcy; as a result the Anglo-Persian Oil Company was established. (In 1935 its name was changed to the Anglo-Iranian Oil Company (AIOC) when the name of the country was changed by Reza Shah from "Persia" to Iran.) In 1912 the first oil shipment was completed from the port of Abadan. A refinery was built at the same time.⁹⁰

In May 1951 the Mossadegh Government terminated the Anglo-Iranian Oil Company's concession agreement of 1933, and nationalized the oil industry in Iran. This nationalization was the first instance in the Middle East. However, the nationalization of the Iranian oil company was unsuccessful because the Mossadegh Government was faced with very difficult internal problems. On 13 August 1953 the Government collapsed and was removed from power: the Shah of Iran was returned to the throne with the backing and support of the United States and the United Kingdom.⁹¹ Negotiations thereafter took place between the Iranian Government and NIOC on the one hand and a consortium of eight international oil companies including Anglo-Iranian Oil Company Limited (AIOC). These resulted in the conclusion of a new Concession Agreement of 19 September 1954 with these companies for a minimum period of twenty-five years subject to extension. This Agreement revoked the Anglo-Iranian Oil Company concession of 1933. According to Article 1 of Part II of the Agreement Iran

89 RJ Barnet, *Middle East Oil, The Beginning* (1975) 5.

90 "Oil was first discovered by M. de Morgan in the province of Kermanshah. The result of his explorations were published in Paris in 1882." AW Ford, *The Anglo-Iranian Oil Dispute of 1951-1952* (1954) 15.

91 B Shwadran, *Middle East Oil* (1977) 59.

agreed to pay 25 million pounds sterling to AIOC in compensation, to be paid in ten equal annual instalments beginning on 1 January 1957.⁹²

The new Concession Agreement appears to have been regarded in part as a re-affirmation and sharing of the rights and privileges of the earlier concession. On 29 October, 1954 it was announced that the seven other oil company parties had agreed to pay AIOC a sum which would amount to more than \$600,000,000 for its share in the concession.⁹³

(B) *INA Corporation and the Government of the Islamic Republic of Iran (1985)*

In the *INA Corporation and the Government of the Islamic Republic of Iran* case, the Tribunal ruled that the compensation should be equal to the fair market value of its shares, rather than "prompt adequate and effective compensation",⁹⁴ as INA had demanded. It noted that there had been a reappraisal of what constituted adequate compensation in the case of lawful large scale nationalizations, but this appeared to be balanced against the fact that the case involved "the investment of a rather small amount shortly before nationalization",⁹⁵ and before the corporation had time to reap any benefits from its investment. It therefore concluded "the full equivalent of the property taken entitles the claimant to be granted compensation equal to the fair market value of its shares...assessed as of the date of nationalization".⁹⁶

(C) *Starrett Housing Corporation and the Government of the Islamic Republic of Iran (1983 - 1987)*

In the *Starrett Housing Corporation and the Government of the Islamic Republic of Iran Award*, the Starrett Corporation were found to have been denied

92 Ford, 180-9; Carlston, 273-4.

93 *New York Times*, 30 October 1954, 6 col 3.

94 Award No 184-161 - 1, 12 August (1985), reprinted in 8 *Iran - U.S.C.T.R.* 371 quoted by G Lagergren, Five important cases on Nationalization of foreign property, decided by the Iran - United States Claims Tribunal Report No 5, Raoul Wallenberg Institute of Human Rights and Humanitarian Law, LUND (1988) 11.

95 *Id.*, 8.

96 *Id.*

effective use and control of their property interests in Iran, but that they had exaggerated the length of time they had been subject to the loss. In assessing compensations they employed an expert who assessed the value of the Starrett project at \$41 million. This assessment was based on the hypothetical projection of what Iranian businessmen fully aware of the relevant circumstances would have paid for the project on 31 January 1980.

The Tribunal, while accepting the methods and procedure used by the expert, "made a number of modifications which decreased the value"⁹⁷ of the compensation to \$36.5 million. This decrease was to do with recognizing loans the Iranian government had made to the corporation. Further it rejected the corporations request for compound interest and awarded a simple rate of 8.5 percent as reasonable in this case.⁹⁸

(D) *Foremost Tehran Inc. and Government of the Islamic Republic of Iran (1986)*⁹⁹

The Tribunal in this case decided that the combined effect of certain acts and omissions by the Iranian partners was such that their impact deprived Foremost of its rights as 31% owner of the Pak Dairy Corporation. In reviewing the history of the case it stated "on balance that the interference with the substance of foremost's rights did not by 19 January 1981, and still less by 27 May 1980, amount to an expropriation",¹⁰⁰ even though it conceded foreign personnel had been asked to leave Iran. It did however, state that the company should be compensated for the loss of enjoyment of the property in question, particularly the failure of Pak Dairy to pay declared dividends to Foremost. The compensation was to be the amount of cash dividends that should have been paid in 1979 and 1980 plus interest at 10%.¹⁰¹

97 Award No ITL 32 - 24 - 1 (19th December 1983) reprinted in 4 *Iran - U.S.C.T.R.* 122, and Final Award No 314 - 24-1, 14 August, 1987, quoted by Lagergren, 24

98 Id, 25,26.

99 Award No 220 - 37/231-1, 11 April 1986, reprinted in 10 *Iran - U.S.C.T.R.* 229, quoted by Lagergren, 29.

100 Id, 34.

101 Id, 35.

(E) *Sea - Land Service Inc, and the Islamic Republic of Iran (1984)*

In the arbitration between *Sea - Land Service Inc* and the Government of Iran and its Port and Shipping Organization (*PSO*), the Tribunal ruled that the finding of expropriation would require at least that there was deliberate government interference with the conduct of *Sea - Land's* operation,¹⁰² and that this could not be proved. However \$750,000.00 was awarded, as an approximation of the unjust enrichment which would have accrued to Iran, for the use and benefit of facilities *Sea - Land* had built, prior to the date when by contractual agreement they were to be handed back to the *P.S.O.* It noted that the theory of unjust enrichment "does not permit the tribunal to compensate *Sea - Land* for the loss of unpaid debts, freight charges and termination expenses, non of which resulted in the enrichment of *P.S.O.* or the Government".¹⁰³

(ii) **Iraq**

In March 1925 the Iraqi Government granted their first concession to the *Anglo-French Turkish Petroleum Company*. In October 1927 the large Kirkuk well was discovered. In 1929 the name of the company was later changed to the *Iraq Petroleum Company (IPC)*. The Iraqi Government developed the industrialization of petroleum in the country by granting concessions to other foreign companies.¹⁰⁴ In 1972 the Iraqi Government nationalized *IPC*. It agreed in principle (as stated in Law 69 of June 1972) to pay compensation for the book value of the company. However, it claimed that *IPC* had failed to develop the oil fields it had discovered and was therefore not entitled to the compensation. So, although Iraq felt justified in withholding compensation it accepted the duty to pay compensation in principle.¹⁰⁵

102 Award No 135 - 31 - 1, 20th June 1984, reprinted in 6 *Iran - U.S.C.T.R.* 149, quoted by Lagergren, 38.

103 Id, 44.

104 See further, *Aramco Handbook, Oil and the Middle East* (1968) 93.

105 Schwarzenberger, 96.

(iii) Kuwait

On 23 December 1934 the Kuwait Oil Company (KOC) was formed when the Gulf Kuwait Company joined with British Petroleum (Kuwait) Ltd. It discovered oil in Kuwait in April 1938.¹⁰⁶ Later, other companies were granted concessions to drill oil in Kuwait, including the Neutral Zone between Kuwait and Saudi Arabia. American Independent Oil (Aminoil) was one of those companies. In 1946 Kuwait oil production increased, until it was the largest producer of crude oil in the Middle East.¹⁰⁷

On 19 September 1977 the Kuwait Government moved to terminate its concession agreement of 1948 with Aminoil. The Government explained that nationalization had become necessary because of Aminoil's failure to comply with the Government's demands, which were that Aminoil comply with the Abu Dhabi formula of 1974, under which royalty levels on oil were 20% and tax levels were 85%. Aminoil rejected the takeover. In 1979 Kuwait and Aminoil agreed to submit the dispute between the parties to arbitration in Paris.¹⁰⁸

Aminoil asked that it be compensated for the loss of its assets as well as profits lost before the decree law. Kuwait claimed Aminoil should pay for damage caused to the Company and for failure to make certain capital expenditures.¹⁰⁹ The Arbitration Award (*American Independent Oil Company v Kuwait*) was conciliatory, recognizing the changes that had taken place in the Middle East since the General Assembly Resolutions on Permanent Sovereignty over Natural Resources which referred to a State's right to nationalize its property with "appropriate compensation". The Tribunal's ruling on the amount of compensation (including expectation of future profits) by the company to be nationalized and the claims of the oil producing countries to use the Abu Dhabi formula: in the result it calculated a reasonable rate of return to be \$10 million a year, on the basis of an interest rate of 7.5% and an inflation rate of 10%.¹¹⁰ In deciding on the appropriate amount of compensation to be paid the tribunal

106 *Aramco Handbook* (1960) 123.

107 *Aramco Handbook* (1968) 98.

108 *ILM* 21 (1982) 997-8-9

109 Tesón, 326-7.

110 *ILM*, 21 (1982) 997-1041.

looked at the balance sheet of the financial rights and obligations of the parties as at 19th September 1977, and decided \$179,750,764 was to be awarded to Aminoil payable on 1 July 1982.¹¹¹

The decision has been praised as one "which could become the source of a consensus for solutions"¹¹² for these kinds of contracts. Not only did both parties participate fully in the negotiations, but the Kuwait Government carried out the award without any reservations.¹¹³

(iv) **Saudi Arabia's Takeover of Aramco**

Negotiations between the *Saudi Arabian Government and the Standard Oil Company of California (SOCAL)* began in mid-February 1933 and a concession agreement was signed on 29 May 1933. Article 1 of this Agreement provided:

The Government hereby grants to the company on the terms and conditions hereinafter mentioned and with respect to the area defined below, the exclusive right, for a period of sixty years from the effective date hereof, to explore, prospect, drill for, extract, treat, manufacture transport, deal with, carry away and export petroleum, asphalt, naphtha, natural greases, ozokerite and other hydrocarbons and the derivatives of all such products It is understood, however, that such right does not include the exclusive right to sell crude or refined products within the area described below or within Saudi Arabia.¹¹⁴

Several months after the agreement was signed, the Standard Oil Company of California (SOCAL) established the California Arabian Standard Oil Company (CASOC). CASOC's name was changed in 1944 to the Arabian American Oil Company (Aramco).

111 Ibid., 1042.

112 P-Y Tschanz, *The Contribution of the Aminoil Award to the law of State Contracts, International Lawyer* 18 (1984) 245.

113 Ibid.

114 *Agreements between the Saudi Arabian Government & the Arabian Oil Company (Aramco)* (Government Press, 1384 AH (1964)).

In March 1938 oil was discovered in the east of Saudi Arabia in large quantities and on 1 May 1939, King Abdal-Aziz Al Sa'ud turned the valve to begin the loading of the first tanker to transport a cargo of Saudi Arabian crude oil. Saudi Arabian oil reserves proved extremely large. Between 1946 and 1948 there was a call for greater market outlets and this development needed enormous capital investment. The Texas Oil Company (now Texaco Inc), Socony Vacuum Oil Company (now Mobil Oil Company) and the Standard Oil Company (New Jersey)) combined with the California Arabian Standard Oil Company (CASOC) to become the owners of the Arabian American Oil Company (Aramco) in 1948.¹¹⁵

The Saudi Arabian Government's intention to gradually take over Aramco has been evident since 1973. In that year it signed a participation agreement with Aramco by which it would own 25% of the company. This percentage was increased to 60% during the following year.¹¹⁶ In 1977 the Saudi Arabia Government completed negotiations with Aramco for the takeover, but the arrangements were not finalized. The preamble to the Main Agreement of 31 January 1977 recites that "the government of the Kingdom of Saudi Arabia... desires to exercise full rights of ownership and effective control of the natural reserves covered by, the Aramco concession in Saudi Arabia"., and provides for the transfer of substantially all Aramco's assets, against compensation as determined by the Agreement. In 1980, the Saudi Arabian Government paid compensation for all the holdings of Aramco.

By Decree No. 40 dated 29/3/1409 AH 8/11/1988, the Saudi Arabian Council of Ministers approved the basic statute of the new "Saudi Aramco Oil Company", "Aramco Al Saudia", which culminated in the Royal decree No. M/8 dated 4/4/1409 AH (13/11/1988). See Appendix No 2, below, for the text of the decree.

On this basis of mutual respect and good faith problems have been and will continue to be solved by co-operation and mutual consent. In particular

115 *Aramco Handbook* (1968) 107. *Petromin Bulletin* 2, No 7 (1988) 10 (in Arabic).

116 *MEES* (12/1/1974). *Asharq Al-Awsat*. International Daily Newspaper of the Arab. Vol. 11. No. 3636 2/3/1409 (11/11/1988). In Arabic.

Aramco has recognized the right of Saudi Arabia to have sovereignty over its natural oil resources, without dispute.

(b) **Other Arab Countries**

(i) **The Arab Republic of Egypt and the Nationalization of the Suez Canal**

The Suez Canal Company was nationalized according to Decree 185 of 26 July 1956 by the Government of the Arab Republic of Egypt. Article 1 of this Decree provided:

The Universal Company of the Suez Maritime Canal (Egyptian Joint-Stock Company) is hereby nationalized all its assets, rights and obligations which are transferred to the nation...

Egypt claimed that the nationalization was for a public purpose and was accompanied by an offer to pay compensation. The governments of the United States, France and the United Kingdom, while agreeing in principle to the right of Egypt to nationalize, challenged what it saw as an arbitrary and unilateral manner of exercising that right. They also claimed the Suez Canal was subject to international, not domestic, law.

The compensation claims were referred to arbitration. On the 13 July 1958 the *Compagnie Financiere de Suez* was formed: the Agreement stated that Egypt undertook to pay in seven instalments 28 million Egyptian pounds to the *Compagnie Financiere de Suez*.¹¹⁷

The basis of compensation, was reached for pragmatic reasons rather than those of a completely equitable settlement. It was based on the principle of the territoriality of nationalization and the new recognition of any extra-territorial effects of the Egyptian Nationalization law. In Britain, it became evident after 1958 that it would be impossible for claimants to pursue their individual claims against the Egyptian government, and that a lump-sum

117 Schwarzenberger, 84. For further information about the dispute see RO Matthews, 21 *International Organisation* (1967) 80.

settlement payment by Egypt would be administered, assessed and paid by United Kingdom authorities in sterling.

The Chancellor of the Exchequer (Mr Amory) explained the agreement as follows:

First, it provides for the return to the owners British property in Egypt which has been under sequestration. This and the resumption of normal trade are the chief advantages... secure under the agreement... where property has been taken over by the Egyptian authorities... Egyptianised or has suffered damage during sequestration, compensation will be paid from the lump sum of £27½ million sterling....¹¹⁸

The value of the property to be returned to Egypt was valued by the owners at about 130 Million pounds, a difference that reflected the desire of the nations with differing interests in Egypt, to allow the nationalization, settle the armed conflict between Egypt, and the United Kingdom and France to America and Russia's satisfaction.

(ii) **Libya**

When Libya obtained its independence in 1951 there were almost no known natural resources. But oil was discovered in 1959 in commercial quantities and the first petroleum export started in 1961. By 1969 petroleum production had moved forward rapidly.

Libya was the first oil producing country to nationalize its oil resources after the collapse of the Mossadegh Government in Iran (1953). In 1971 Libya expropriated the assets of the BP Exploration Company, then in 1973 the Nelson Bunker Hunt Oil Company. Perhaps the major motivating factor in these nationalizations, was political, a protest against the Iranian occupation of three islands in the Arabian Gulf, which was seen by Libya as a collusion between

Britain and Iran, and a warning to the United States to end its aggressive policy towards the Arab nation due to America's support of Israel.¹¹⁹

Initially Libya demanded a 51% ownership share but the majority of companies which had concessions in Libya rejected the principle of participation. In response the Libyan Government expropriated all the assets of other oil companies.¹²⁰ Libya asserted that compensation should be for the book value of the affected companies rather than the value of their assets as a going concern. Texaco, California Asiatic Oil and Atlantic Richfield refused to accept these conditions and demanded arbitration.

When the subsequent ruling favoured the companies, Libya ignored it, claiming that the right to nationalize was not an arbitral issue, but compensated them on the assessed book value.¹²¹ In May 1975 the Nelson Banker Hunt Oil Company entered into a settlement agreement with the Libyan Government for compensation of approximately \$19,000,000.¹²² Hunt is now seeking to recover the proceeds realized by the companies which bought oil from the nationalized company prior to 1975, thus indicating his discontent with the Libyan assessed "net book value".¹²³

(iii) Algeria

During the Second World War the French government searched directly for oil within France and territories regarded as part of or belonging to France. Later the French government searched in the Sahara area and proved the existence of the Algerian oil reserves. The commercial exploitation of oil coincided with the beginnings of the Algerian War of Independence in 1955. In 1962 the Algerian War was concluded by the Evian Agreements. Since Algeria obtained independence, agreements have been made for the full development of

119 R Weisberg, *The Politics of Crude Oil Pricing in the Middle East* (1977) 82. For further details see L Turner, *The Oil Company in the International System* (1978) 133; J Fawcett and A Perry, *Law and the international Resource Conflicts* (1981) 118.

120 Ibid. See further R von Mehren & N Kourides, *International Arbitrations between States and Foreign Private Parties. The Libyan Nationalization Cases*, *AJIL* 75 (1981) 476.

121 *Texaco Arbitration*, *ILM* 17 (1978) 5-6, 31-37.

122 See further Sweeney, Oliver and Leech, 402.

123 Id.

the production of gas and oil reserves for industries and the rebuilding of the country after the war.

In the 1960's Algeria began to nationalize the oil industry in stages, and by 1969 the government controlled 25% of production. In 1971 it nationalized all gas deposits and land pipes, agreeing to supply France with oil at the world price. France was not satisfied with this attempt at compensation and withdrew all engineers and technicians from the wells. Algeria then agreed to pay compensation for the expropriated shares to the French subsidiary.

The subsidiary company Total Algeria received an appropriate share of the oil produced, the company was required to invest certain amounts and received benefits if the amounts specified were exceeded.

It is important to note that though initially Algeria refused compensation, it later accepted in principle the right of France to receive appropriate compensation for its nationalized property.¹²⁴

(c) **Other Third World Countries**

(i) **Mexico**

The Mexican nationalization measures stem from the revolution of 1910 which resulted in heightened nationalism and radical agrarian reform. On 23 November 1936 Mexico enacted an expropriation law, and on 18 March 1938 the properties of seventeen foreign oil companies were expropriated by decree. A compensation settlement was not reached until 1941 after a difficult negotiation. This has been discussed previously. Mexico initially refused to pay compensation claiming that the demands of internal development superseded those of foreign countries for payment. However, later this decision was reversed and Mexico agreed both in principle and in practice to pay compensation.¹²⁵

124 A Jones, *Oil: The Missed Opportunity* (1981) 142-4. See also L Turner, 133; YA Sayigh, *The Economics of the Arab World* (1978) 551.

125 Francioni, 266; PM Brown, *Mexican Land Laws*, *AJIL* 21 (1927) 294, *AJIL* 20 (1926) 519; Carlston, 272.

(ii) Cuba

The Cuban expropriations were directed mainly against enterprises owned by the United States, which was seen to have colluded with the previous Batista regime in committing crimes against the "national economy" or the "public treasury" and in keeping Cuba in an underdeveloped State. The expropriation in Cuba began on 4 March 1959 with the Cuban Telephone Company, but interference with the American property began on 6 August 1960 according to Nationalization Law No 851 of 6 July 1960. Resolution No 1 provided for the "compulsory expropriation... of all property and enterprises... and rights and interests" of 26 enterprises wholly or principally owned by "nationals of the United States of America".¹²⁶ This was followed by United States action on 6 July 1960 to amend the Sugar Act 1948 so as to permit the President to reduce the Cuban sugar import quota. As a result the Cuban sugar quota was set at nil for 1961.¹²⁷ Akinsanya argues that as "the basic reasons for Law No 851 was to retaliate against the reduction of the Cuban sugar quota, it could be argued that the expropriation of US-owned enterprises under Executive Resolution No 1 of 6 August 1960 was necessary 'for the defense of the national sovereignty' and more importantly to force the aliens' home government to alter its policies in a way consistent with national interests".¹²⁸ However this may be, the Cuban government continued to expropriate property owned by United States nationals. The claims of many United States citizens for compensation remain unsettled.

(iii) Peru

Peruvian nationalization measures were prompted by nationalism, advocated by the President Velasco, whose coming to power was facilitated because of the unwillingness of the people to accept the concessions granted to the international petroleum company. The refineries were expropriated on 8 October 1968, and this was followed by expropriation effecting banks, agrarian reform, sugar refineries, mining companies and the telecommunication industry. Compensation agreements proved difficult, but separate agreements were made

126 *ILM* 3 (1964) 383.

127 *AJIL* 56 (1962) 1104.

128 Akinsanya, 125.

with United States nationals and United States-Peruvian relations were normalized. The Peruvian nationalization of private property was again compensated for both in principle and in practice, despite the huge internal development demands.¹²⁹

(iv) **Chile**

The Chilean Copper expropriations of July 1971, although primarily affecting the interests of United States nationals, were not an anti-American political act but rather part of a process of "economic nationalism".¹³⁰ The process of nationalization continued under the Allende Government, who was eventually brought down the American opposition. A compensation agreement for the Copper expropriations was reached in September 1973. Anaconda and Kennecott the Companies who had owned 80% of Chile's most important foreign exchange earner, Copper, were compensated for their assets that were expropriated in July 1971.¹³¹ Prior to this many claims of United States nationals had been settled.¹³²

(v) **Tanzania**

From 1967 Tanzania began a process of nationalization of major industries, resources, banks and businesses. However, some foreign owned firms were allowed to continue and some joint ventures were set up between the government and foreign investors. In such cases the Government recognized its obligation to pay "full and fair compensation for the assets acquired" and promised to act "honestly and fairly" towards deprived foreign investment. Thus provision was made for indemnification in the acquisition of Sisal Estates.

Subsequently, provisions were made to compensate the owners of Sisal Estates, but it was decided that as the industry was in decline it would not accept the liabilities of those plantations. Compensation was paid for landed rental

129 D.A Gantz, The United States-Peruvian Claims Agreement of 1974, *International Lawyer* 10, (1976) 390.

130 Akinsanya, 133.

131 *ILM* 13 (1974) 1189

132 See Akinsanya, 140.

properties, Caltex assets, Bata Shoe Company, The Banks, Insurance Firms, and Coffee Plantations expropriated between 1967 and 1973.

However, a dispute arose later with the United Kingdom over the Acquisition of Buildings Act 1971, as the British Government claimed its nationals were being deprived of \$4 million without compensation. Tanzania justified its action by claiming that by the terms of the Act no compensation was to be paid on buildings ten years old. This issue was unresolved, as has the nationalizing of marketing properties belonging to Caltex and Singer Sewing Machine of Kenya, without compensation.¹³³ Pressure was brought to bear on Tanzania through the failure of the International Development Association to provide loans. Again the motivation for these nationalizations was the desire to create a more equitable socialist State and to prevent capital leaving the country.¹³⁴

(vi) **Zambia**

On 11 August 1969, the Zambian Government decided to nationalize or acquire 51% of the assets of foreign owned Copper Mining Enterprises. In compensation the Roan Selection Trust, Ltd. (RST) received \$150 million in compensation, together with a ten year sales and management contract. A similar arrangement was made with the other major Copper Enterprise, the Zambian Anglo-American Trust (Zamanglo) with compensation at \$175 million. It has been noted that the sales and management contracts, made as part of these settlement turned out to be disastrous for Zambia.¹³⁵ However, as a consequence of the compensation agreements the Zambian Government has made a good investment climate for foreign investors, as was evident in the 1979 agreement with a West German Company to prospect for uranium.¹³⁶

133 *ILM* 11 (1972) 106-8 and see Akinsanya, 149.

134 Akinsanya, 150.

135 *Id.*, 152.

136 EA Umzurike, Nationalization of Foreign-Owned Property and Economic Self Determination, *East African Law Journal* 6 (1970) 95-96, quoted by Akinsanya 154.

(vii) Indonesia

In 1958 almost all foreign enterprises were expropriated by the Indonesian government. Indonesia did not implement the promise of payment contained in its nationalization laws and later decreed that where enterprises had been owned by the Dutch "they would not be compensated at all".¹³⁷

With the end of the Sukarno era and the accession of Suharto, this policy was reversed and on 14 December 1966 President Suharto requested that all government departments take appropriate measures to return all foreign assets, previously nationalized during the last two years of Sukarno's rule.¹³⁸ Further, Indonesia agreed to pay the Netherlands DFl.683 million by 2003.¹³⁹ The expropriations in Indonesia were motivated by nationalistic and political forces. By providing for the payment of compensation, Suharto was perhaps motivated by the desire to encourage private foreign capital investment.¹⁴⁰

(viii) Sri Lanka

In April, May and June 1962 Sri Lanka terminated the operations of foreign oil companies involved in the distribution of oil products, including the assets of Esso, Texaco, Caltex and Shell. In response the United States imposed foreign aid sanctions, and claimed that Sri Lanka's refusal to pay prompt, adequate and effective compensation violated international law. In spite of this the Sri Lankan Government continued its policy of nationalizing foreign property in 1964 and 1970.

In fact after three years the oil companies resolved their compensation disputes.¹⁴¹ That it took such a lengthy period had the effect of discouraging

137 Domke, 604.

138 Akinsanya, 170.

139 GNJ Van Wees, Compensation for Dutch Property Nationalised in East European Countries, *NYIL* 3 (1972) 92.

140 DN Smith & LT Wells, Conflict Avoidance in Concession Agreements, *Howard International Law Journal* 17 (1976); 59.

141 Akinsanya, 172.

foreign investment in the country. In 1972 attempts were made to give incentives to attract again foreign investors.¹⁴²

(4) **Conclusion: The Scope of the Duty to Compensate in International Law.**

It must be admitted that there continues to be some authority and some state practice in favour of a relatively strict standard of compensation in international law. Thus the Iran-United States Claims Tribunal in *American International Group v Islamic Republic of Iran* declared that foreign nationals were entitled to "the value of the property taken" which was to be "the going concern or fair market value" of the property.¹⁴³ Similarly in *Sedco Inc v Islamic Republic of Iran* (1986), the Tribunal's award stated that Sedco was entitled to be compensated, as it had claimed, for the full value, if any, of its equity interest in Sediran. A subsequent award would determine the amount of compensation and the rate of interest.¹⁴⁴ In a separate opinion, Judge Brower stated that the tribunal had abundantly re-confirmed that "customary international law continues to mandate without qualification that full compensation be given for expropriation".¹⁴⁵ Other cases between these parties have reached similar results,¹⁴⁶ although these can be explained, at least in part, by the bilateral treaty guarantee of full compensation and by the intention of the Algiers Accord itself to provide a substantial measure of compensation.

On the other hand even the United States Supreme Court has recognized the impossibility of defining a standard of just compensation that would suit all circumstances, and that no definite standards of fairness can be mandated that would always be appropriate.¹⁴⁷ However, it has accepted that in normal practice "for the purposes of the Fifth Amendment, just compensation is normally to be measured by the "market value of the property at the time of the taking contemporaneously paid in money".¹⁴⁸

142 Id.

143 *ILM* 25 (1986) 646.

144 10 Iran-United States Claims Tribunal Reports (1987) 189.

145 *ILM* 25 (1986) 636.

146 E.g. *Iran Chevron Oil Company v Government of the Islamic Republic of Iran* (1986) 10 Iran-United States Claims Tribunal Reports (1987) 357.

147 *Restatement Third of the Foreign Relations Law of the United States* (1986) vol 2, section 712, 206-8.

148 Id.

As a matter of international law, however, the evidence tends strongly against the traditional standard of prompt, adequate and effective compensation as a norm of international law. Thus Jiménez de Aréchaga stated that "the classical doctrine does not represent the general consensus of States. Consequently, it cannot be considered as a rule of customary law".¹⁴⁹ Similarly the Rapporteur of the Australian Branch of the International Law Association, concluded that, "in the light of practice, it is difficult to continue to argue that prompt, adequate and effective compensation is a norm of international law, if indeed it ever was... there is no evidence that the Hull rule continues to exist as part of the customary international law in the post-World War II period".¹⁵⁰

Therefore the traditional principle of prompt, adequate and effective compensation for nationalized foreign property is no longer relevant to the economic and political reality of Post World War I.¹⁵¹ The recognition of a States right to nationalize, and the rapid economic development of capital importing countries, has resulted in the lapse of any earlier international law principles for assessing compensation. But this does not mean that no international standards survive. It is generally held that the principle of "unjust enrichment" validly applies, so as to require the parties to reach equitable settlements. Thus Jiménez de Aréchaga stated that:

...if the nationalizing State were to grant no compensation when nationalizing alien property, it would enrich itself without justification at the expense of a foreign State... The nationalizing State would be depriving an alien community of the wealth represented by the investments it has made on foreign soil...¹⁵²

This principle makes it the duty of the nationalizing State to provide compensation, a duty which has in practice been adopted by nationalizing nations since 1945.

149 de Aréchaga, 184.

150 Australian Branch Report, 180-1, 936, quoted by Chowdhury, 57, note 48.

151 Castel, 1150.

152 de Aréchaga, 182.

6. The Measure of Compensation

While the principle of the compensation is accepted by international law and United Nations resolutions there is much controversy surrounding the procedures for determining compensation. Three issues need to be referred to here.

(1) The Amount of Compensation

According to the sources already referred to, the amount of compensation must be assessed in accordance with the conditions in the expropriating State.¹⁵³ But this leads to controversy about the extent to which those conditions can effectively negate any obligation of compensation. Friedman has stated that:

The assessment of the quantum of compensation has given rise to considerable difficulties and it has so far been impossible to bring it within the limits of a precise formula.¹⁵⁴

The Draft Convention of the Organization of Economic Co-operation and Development (O.E.C.D.) proposed in 1967 that compensation should represent the genuine value of the property affected without undue delay.¹⁵⁵ Implied in the doctrine of acquired rights is that the expropriated alien should be compensated for all the elements of the loss sustained. Similarly the model Bilateral International Treaty (*BIT*) provides that:

Compensation would be equivalent to the fair market value of the investment paid without delay... and effectively realizable.¹⁵⁶

On this basis the following items must be taken into account: (1) the value of both the material and immaterial assets of which the alien has been deprived; (2) the interest on capital where payment has been deferred; (3)

153 Domke, 608.

154 Friedman, 215.

155 Schwarzenberger, 153..

156 Barovick, *Bilateral Treatment Treaties Ensuring Fair Treatment for U.S. Investors in the Third World*, *BuS, AM3*, (Aug, 23 1982) 5, quoted by Gainer, 1569.

indirect damages such as when loss is sustained as a result of incidental termination of related contracts; (4) goodwill and future profits.¹⁵⁷ But these principles tend to conflict with the demands of Third World Countries, who claim that compensation for expropriation of foreign property should be calculated on the basis of net book value of the assets, i.e. the value of the assets as registered on the company's books for tax purposes.¹⁵⁸

The right of the nationalizing State to demand that payment of compensation be in accordance with the laws, regulations and circumstances it considers pertinent appears to be an important trend within the international community. In practice there is a tendency to compromise, with many governments unilaterally determining an amount of compensation, which if considered unacceptable is then negotiated on the company's behalf by its government.

In almost all cases the compensation paid represents an equitable compromise taking into account the economic and social circumstances of the developing countries.

The amount of compensation is determined on the basis of equity during the negotiations on a bilateral compromise, taking into account the social function of property as a development in internal law which has obviously affected international law and which is in the final analysis justified by the economic and social circumstances of developing countries.¹⁵⁹

This practice is reflected in General Assembly resolutions. Resolution 1803 which confirmed the inalienable right of States to control the disposition of their natural resources, but provided that the expropriating State should pay "appropriate compensation" in accordance with its own law and international law. However this resolution did not mention the amount of compensation to be paid.

Resolution 88(XII) adopted by the United Nations Conference on Trade and Development Board (UNCTAD) of 19 October 1972 provided that:

157 Francioni, 261-2.

158 Tesón, 351.

159 O de Rivero, *New Economic Order and International Development Law* (1980) 107.

...Such measures of nationalization as States may adopt in order to recover their natural resources are the expression of a sovereign power in virtue of which it is for each State to fix the amount of compensation and the procedure for these measures and any dispute which may arise in the connection falls within the sole jurisdiction of its courts...¹⁶⁰

Resolution 3171 (XXVIII) of 17 December 1973 on Permanent Sovereignty over Natural Resources provided that:

...each State is entitled to determine the amount of possible compensation and the mode of payment...¹⁶¹

The amount of compensation should be appropriate to the situation. By definition appropriateness requires taking all the circumstances of the case into considerations. The most important among these is the ability of the State to pay, without undue difficulty. The amount should also take the social and historical conditions of the country into account. There is not and possibly will never be a formula for determining the amount of compensation. The amount must be determined on the facts of each case.

(2) **Lump-Sum Agreements**

In practice many international claims arising out of nationalizations have been settled by lump-sum payments to the claimant State. However, these agreements under which less than full compensation "is accepted are based on political and economic reasons, prospects of further trade relations and other motives".¹⁶² Early examples are the Peace Treaties of 1947 providing for a rate of compensation for loss suffered as a result of World War II on the part of allied property in the amount of two thirds of the sum necessary to make good the loss suffered. The delegates of the Great Powers at the Peace Conference emphasised that:

160 United Nations Document, TD/B423 (1973).

161 United Nations Document, A/RES 3171 (XXVIII)(1974).

162 Domke, 609.

as a matter of legal principle, full compensation ought to be paid and... their departure from that principle was due to political and economic considerations only.¹⁶³

Western countries have always maintained in practice that the conclusion of a lump-sum agreement did not imply a departure from or abdication of the traditional international law principle of prompt, adequate and effective compensation. This view has been taken, for example, in the practice of the United Kingdom and the United States.¹⁶⁴ In their view the principle of lump-sum payments does not compromise the principle of prompt, adequate and effective compensation, since the conclusion of such agreements is "not unconnected with political and economic reasons".¹⁶⁵ There were many examples of the use of lump-sum payments in the period 1945-1950, following large scale nationalization in France, Italy, Czechoslovakia, Yugoslavia, Poland, England, Hungary and Rumania. But the practice has continued to the present time: according to Dolzer...

The terms of the treaty between the United States and China, entered into 1979... indicate that the general thinking on lump-sum payments... has not changed considerably over the past three decades".¹⁶⁶

Writers within the Western tradition of International law similarly insist that the practice of concluding lump-sum agreements does not modify the established compensation standard. Stevenson stated:

The lump-sum settlements following post-war nationalization programs of the Eastern European countries were negotiated compromises and as such do not constitute a departure from the traditional international law principle.¹⁶⁷

Some support for this position can also be gained from the statement of the International Court of Justice in the *Barcelona Traction* case that:

163 A Martin, Private Property, Rights and Interests in the Paris Peace Treaties, *BYIL* 24 (1947) 284.
 164 Domke, 609.
 165 Akinsanya, 47.
 166 Dolzer, 559.
 167 American Society of International Law Proceedings 54 (1960) 112.

Lump-sum agreements are merely specific agreements... reached to meet specific situations.¹⁶⁸

But despite the debate as to whether these qualify as "evidence of a general practice accepted as law",¹⁶⁹ the practice they represent is now common. They should "be treated no differently than any other expression of international law".¹⁷⁰

For Third World countries the payment of a lump-sum is a preferred form of compensation payment, providing the terms of payment of the lump-sum are such that the country does not suffer undue hardship paying. Lump-sum payments are attractive in that they immediately resolve the issue, and tend to be arrived at on the basis of appropriate rather than full compensation. Lump-sum agreements were also the usual made of settlement in the nationalizations which took place in the Middle Eastern oil producing countries in the early 1970.¹⁷¹

But the question remains what is their juridical significance. According to Akinsanya:

It may well be that those States that reject the view that lump-sum settlements constitute strong evidence of State practice and indeed, an emerging principle of international law... do so merely to bolster and reaffirm their claims to nothing short of full compensation.¹⁷²

(3) The Form of Payment

As a consequence of the trend to rely on the principle of unjust enrichment in compensation cases, the two notions of (a) prompt payment and (b) the currency of payment have been brought into dispute.

168 AA Fatouros, *International Claims. Their Settlement by Lump-Sum Agreements*, *AJIL* 71 (1977) 363.
 169 *Id.*, 364.
 170 RB Lillich & BH Weston, *International Claims: their Settlement by Lump-Sum Agreements* (Charlottesville, University Press of Virginia, 1975) 11, quoted by Fatouros, 364.
 171 EJ Paasivirta, *Participation of States in International Contracts and the Arbitral Settlement of Disputes* (Cambridge, PhD Thesis, 1988), 199.
 172 Akinsanya, 48.

(a) Prompt Payment

In the past, deferred payment was the exception rather than the rule.¹⁷³ The United States only accepted deferred payments with regard to the Mexican land expropriations on the understanding that this was not to constitute a precedent.¹⁷⁴ But the requirement of 'promptness' has not been followed in modern State practice. The principle of unjust enrichment demands that compensation be paid but does not impose time restrictions. Therefore, a deferred payment is the rule and prompt payment or payment without undue delay in cash is an exception.¹⁷⁵ This is shown by several compensation agreements signed by the various western powers in connection with post War Eastern European nationalizations and by the Egyptian, Indonesian and Cuban nationalizations, referred to already.¹⁷⁶ It has in practice become the usual means of meeting compensation payments.

(b) Currency of Payment

There is debate as to the desirable currency to use to cover compensation payments. Section 190 of the *Restatement Second of the Foreign Relations Law of the United States* stated that compensation "must be in the form of cash or property readily convertible to cash" and if not "must be convertible into such currency and withdrawable" where the currency was that of the expropriated State.¹⁷⁷

Section 712 of the *Third Restatement* of 1986 does not specify that compensation must be in cash. It indicates that compensation "must be paid

173 Doman, 1139.

174 Ibid. The United Nations International Law Commission stated that:
It is clear that the time limit for the payment of the agreed compensation necessarily depends on the circumstances in each case and in particular on the expropriating states' resources and actual capacity to pay. Even in the case of "partial" compensation very few states have in practice been in a sufficiently strong economic and financial position to be able to pay the agreed compensation immediately and in full.

Fourth Report on International Responsibility (Rapporteur, FV Garcia Amador) (A/CN.4/119) (1959) 59.

175 Francioni, 282.

176 Ibid.

177 See Akinsanya, 45.

equivalent to the value of the property taken and must be paid...in an economically useful form". Further it noticed that "it should be in convertible currency but bonds may satisfy."¹⁷⁸

This rule would in effect require agreement of the foreign investor, and would depend on the economic conditions of the expropriating State. However, Metzger contends that "there is no international law rule requiring that any other than the local currency of the local State, whether it is convertible into foreign exchange or not, be paid for taken property".¹⁷⁹ In practice many expropriating States maintain that compensation can be paid in public bonds of the expropriating State with interest paid annually. Recent State practice in Latin America, Asia and Africa reveals many cases where foreign companies were compensated through interest bearing public bonds redeemable in five to ten years.¹⁸⁰

Negotiations in September 1954, between the Iranian government and the Anglo-Iranian Oil Company resulted in Iran agreeing to pay compensation to the company in ten annual instalments.¹⁸¹ Similarly the Cuban Agrarian Reform Law of 1959 provided in Article 3:

The indemnity shall be paid in redeemable bonds... bonds shall be floated in such amount, and under such terms and conditions, as may be fixed in due time. The bonds shall be called 'Agrarian Reform Bonds'... The issue or issues shall be floated for a period of twenty years, with annual interest not exceeding four and one-half per cent.¹⁸²

However, these bonds have never been issued and no compensation has been paid.¹⁸³

178 Third Restatement (1986) 198-9.

179 SD Metzger, Property in International Law, *Virginia Law Review* 50 (1964) 594, 603.

180 Akinsanya, 45.

181 Carlston, 273-274. See further, Ford, 180.

182 Domke, 605.

183 Ibid.

Others assert that the expropriating State may choose to pay in any reliable form and even in kind.¹⁸⁴ The Cuban Nationalization Law of 1960 included a system of compensation linked to sugar exports to the United States. In the case of the nationalization of the Bolivian Gulf properties in 1969, the compensation was through the sale of gas to foreign countries.¹⁸⁵ Another illustration was Libya's offer of oil instead of money to compensate American oil companies.¹⁸⁶

Thus each case must be determined by the circumstances of the case: although developing countries are supported by General Assembly Resolution 3171 (XXVIII) of 17 December 1973 which provides that "each State is entitled to determine the... mode of payment", in practice the form of payment tends to be a compromise between the interested parties.

7. Stabilization Clauses and the Quantum of Compensation

There are many differing opinions about the consequence of a stabilization clause, in the case of expropriation when the concession agreement provides that the agreement will not be changed during its term without the consent of the parties. However there appears to be some agreement that the stabilization clause may create an obligation on the part of the host country to pay a higher level of compensation for the termination of the agreement and expropriation of the property. Here the stabilization clause takes on a financial function. Jiménez de Aréchaga stated that in such cases "the amount of the indemnity would have to be much higher than in normal cases since the existence of such a clause constitutes a most pertinent circumstance which must be taken into account in determining the appropriate compensation."¹⁸⁷ The special obligations imposed by the stabilization clauses may mean, for example, that the foreign party has a right to claim compensation for future loss of profits, during the time the concession had to run.¹⁸⁸

184 Francioni, 282.

185 Ibid.

186 Dolzer, 560.

187 International Law in the Past Third of a Century, 159 *Hague Recueil* (1978, 1) 1, 308 quoted by Paasivirta, 137.

188 de Aréchaga, 192.

However, Jiménez de Aréchaga has argued that such clauses "are unnecessary because international law is always applicable to the cancellation of a contract or the nationalization of an enterprise without the payment of appropriate compensation".¹⁸⁹ In other respects it has been noted that the rigid obligations imposed by stabilization clauses in international law could lead "to a complete breakdown of the contractual link",¹⁹⁰ and that in cases of fundamental change of circumstances, contracts must be susceptible to review, a review which can in the nature of things only occur under municipal law. In practice, the huge investment of resources by corporations intending to invest in a foreign country has led some to conclude that there "is perhaps an implicit *clausula rebus sic stantibus*" in such economic development agreements.¹⁹¹ According to this view it appears the value of a stabilization clause to be political or moral rather than legal.¹⁹²

8. Conclusions

As we have seen, until the First World War the traditional conception was that when property was expropriated, it must be accompanied by full compensation. But there were few cases in which a State interfered with private property in circumstances which had international repercussions or which were subject to international adjudication. One example is the famous principle of the Permanent Court of International Justice in the *Chorzow Factory Case* to the effect that the breach of an express treaty obligation forbidding expropriation made the act a wrongful one for which restitution in kind or if possible full payment of value plus losses sustained was due.¹⁹³ But even apart from treaty the standard of compensation held by western countries was stated in the Hull rule, which was formulated to explain the United States' position regarding the expropriation of its property in Mexico in 1938. This rule stated that the standard of compensation required was that it be "prompt, adequate and effective". This implies that the compensation which an investor deserves should

189 Ibid.

190 Id, 193.

191 D Flint, *Foreign Investment and the New International Economic Order* in Hossain & Chowdhury (eds) 166.

192 Id, 163.

193 *PCIJ Series A No. 17 (1928) 46-7.*

take into account not only the updated value of the physical assets but also the loss of expected earnings.¹⁹⁴

Yet partly as a result of pressure caused by the changing international climate and in part as a result of the influence of the newly developing countries, there arose a modified rule, stated for example in Resolution 1803 (XVII) of 14 December 1962 which called for "appropriate compensation" only, avoiding and mention of the precise amount to be paid. As a result of this and similar resolutions such as Resolution 3281 (XXIX) of 12 December 1974, the Chapter of Economic Rights and Duties of States, and of extensive state practice providing for less than full compensation for expropriation (especially through lump-sum agreements), the standard of "appropriate compensation" has now become a customary rule of international law. Moreover Third World countries use the "net book value" or the value of the assets as registered in the companies books for tax purposes, as the measure of determining "appropriate compensation".¹⁹⁵ They further claim that a State should be entitled to decide on the way payment is made, considering all the circumstances.

Thus the Hull rule is no longer the applicable rule of customary international law. There is a trend to balance this new standard of "appropriate compensation" with the principle of unjust enrichment, with the latter, if not itself a customary rule of international law, at least providing the underpinning in principle for the new developments.¹⁹⁶

194 Tesón, 351.

195 Ibid.

196 de Aréchaga, 185.

CHAPTER 11

CONCLUSION

The problem of the law governing concession agreements and the permanent sovereignty of States over their natural resources is, by its very nature, not subject to a single comprehensive solution. But a general approach to the problem may, however, be found in the norms of modern international law.

Until the Second World War, concession agreements were created as a legacy of the colonial world. Oil producing states were economically, politically and militarily tied to the interests of more powerful independent states, generally the superpowers. However, by 1952, these States had begun to assert their rights to control their own natural resources. From this time on, developing nations have taken an active and successful interest in the creation of new principles and rules of national and international law regulating these questions.

This became evident, in the Sixth Session of the United Nations General Assembly in 1952, when Resolution 545 was passed. This asserted the right of all peoples and nations to self-determination, a right which involved a number of economic and social aspects. In particular, it was accepted that political independence required economic independence, and that the acquiring of this right included a nation's sovereignty over its own natural wealth and resources.

From this time the issue of permanent sovereignty was raised many times in the United Nations. On 14 December 1962 the operative principles which were to form the core of the doctrine on permanent sovereignty over natural resources were adopted by the General Assembly with a remarkable degree of consensus. Resolution 1803 (XVII) and subsequent similar resolutions, which were strongly supported by developing countries, are considered the cornerstone of the doctrine of permanent sovereignty over natural resources. But these resolutions recognize that this right is qualified by corresponding obligations and duties arising out of international law.¹

1

See Chapter 6.

In Chapter One we have seen that a concession agreement involves the granting of a franchise, license, patent, charter, monopoly or privilege to a national or foreign company by a state within an exclusive area of its territory for a period of time. This definition has been accepted by international jurists to include economic and political concessions, although only the former are dealt with in this thesis.

In Chapter Two, I argued that there is an inherent conflict between oil importing and oil producing states, the former preferring international law, the latter municipal law, as the basis for concession arrangements. This conflict is at present most successfully contained by the use of arbitration. Further, the validity of choice of forum clauses has been accepted by international law and most courts as a valid grant of jurisdiction. However, Third World countries are more likely to protect themselves by stipulating national forums for the settlement of disputes. This position of third world countries has been reflected in United Nations resolutions since 1952, and international conventions. I also demonstrated that Islamic Shari'ah covers both religious jurisprudence and the jurisprudence of the State and produces similar results to international law.

In Chapter Three, I showed how some oil producing states have established their own dispute settlement mechanisms. Two important bodies are OPEC, established in 1960, and OAPEC, established in 1968. OAPEC has a functioning judicial tribunal to settle disputes between member countries, and also between member countries and foreign oil companies. The establishment of these bodies ensures that the interests of oil producing States are considered and that their laws rather than the laws of other countries are used to settle disputes.

Chapter Four examines limitations on the choice of law and choice of forum which are recognized by conventions, courts, and tribunals, despite the recognition of the freedom of parties to choose the applicable law and forum. In summary, the relevant conventions have allowed for effect to be given to the mandatory rules of countries which have a close connection with the case, while legislative restrictions include cases where the contract is contrary to public policy

cases, where it is illegal by the proper law and some cases where it is illegal under interstate or foreign law.

Chapter Five argues that in principle the national law of the oil producing State should govern the substance of an oil concession agreement, but that if this principle is not submitted to, then other laws, including international law, can be chosen by the parties as the applicable law. Further, there has been a trend in recent years to the express or implicit internationalization of oil concession agreements.

Chapter Six examines the development of the concept of permanent sovereignty over natural resources. It argues that the history of permanent sovereignty is concurrent with the history of the struggle between capital exporting and importing countries, and the economic development of the latter. The consequence of the acceptance of this concept, as is evident in United Nations resolutions between 1952 and 1974, is that developing States should acquire a higher degree of control over foreign enterprises involved in their States. This should allow them to share the benefits of this control among the people of the State. This right was, however, qualified by corresponding obligations and duties arising out of international law. General Assembly resolutions in general have no binding effect on member States. However, these resolutions support the third world demand to control their own natural resources. Chapter Six also discusses:

- * the consequences of the acceptance of this principle in the new international economic order.
- * in particular, its use in the renegotiation and revision of the older concession agreements.

I argued:

- * that one result is that concession agreements granted after 1952 are of much shorter duration than the older agreements.

- * that the area covered by these agreements has become more limited, and includes relinquishment and joint-venture clauses.
- * that the principle has allowed progressively greater State control over the control and management of foreign oil companies.

The second major issue arising from the principle of permanent sovereignty was the right of States to nationalize foreign oil companies. Nationalization was regarded as one of the means of exercising that sovereignty. Here, I argued that:

- * Nationalization, the right of a people to control their natural resources, has now been recognized as a right, providing adequate compensation is paid.
- * Disputes arising from the above issues should be dealt with in accordance with the law of the State unless by mutual agreement, recourse to arbitration or international adjudication is made.
- * Permanent sovereignty over natural resources is the right of a people as a whole.
- * There are limits on the power of the State. In particular, the relations between States and foreign investors are governed by the principle of good faith.

I argued that pre-independence and post-independence concessions should not be treated at the same level, and that as the former were not based on the sovereign equality of States, they conflicted with various United Nations resolutions and were against the spirit of decolonization. The concept of permanent sovereignty is now established in international law. Its acceptance has altered the nature of concession agreements, in ways which are much more favourable to the exporting State's interests.

The concept of permanent sovereignty is also evident in Islamic Shari'ah. Consent to treaties and conventions is only given by virtue of sovereignty whereby the State chooses to limit its sovereign rights and to be bound by international legal obligations. Although sovereignty is nominally vested in God, an Imam is empowered to grant exploration rights, and to take out whatever minerals are discovered, for the benefit of the people. In Islamic Shari'ah a pledge applies to all contracts, obligations and covenants entered into by an individual.

In Chapter Seven, I looked at the theory of fundamental change of circumstances, which has been relied on by many oil producing countries around the world to claims to revision of existing oil concession agreements. I showed that the majority of writers on international law are in agreement that *rebus sic stantibus* is an objective rule of law operating independently of the intention of the parties. It allows that the revision and termination of an agreement, when the circumstances have changed or if the agreement was based upon inequality, is justifiable. However, it does not give one party the right to act unilaterally to terminate or suspend obligations where disputes occur involving the doctrine. It requires that parties co-operate in seeking an impartial resolution of their controversy.

I went on to argue that in a conflict between the right of the State to nationalize foreign property and the principle of stabilization clauses in concession agreements, international law recognizes the right of the State to nationalize foreign property. However, a State cannot entirely disregard its contractual obligations with private foreign companies in terminating or amending a contract. Where a State terminates a contract with a private foreign company, compensation may be payable according to the standard of international law. I concluded that the doctrine of *pacta sunt servanda* begins to operate once the conditions for *rebus sic stantibus* cease to operate.

In Chapter Eight, I discussed the theory of fundamental change of circumstances according to the opinion of Islamic jurists, and the procedures which should be followed under Islamic Shari'ah in the case of contractual and treaty amendment or termination on grounds of change of circumstances. I showed that the concept of change of circumstances could apply where the

change is fundamental, where it is unexpected, and where the execution of the agreement will result in substantial difficulty or damage to some party. This interpretation is found in both the principal sources of Islamic Shari'ah, the Holy Qur'an and the Sunnah (the practice and tradition of the last of God's messengers, Muhammad).

As the domestic law of many oil producing States, Islamic Shari'ah supports the use of the doctrine of *rebus sic stantibus* when seeking renegotiation or amendments to existing oil concession agreements, especially where these agreements spanned a considerable period of time and where circumstances have changed since the signing of the agreement.

In Chapter Nine, I noted how, due to the influence of third world nations, the traditional view that expropriation should occur only in exceptional cases of public utility and should be accompanied by prompt, adequate and effective compensation, had changed. I showed the historical development of a State's legal right to expropriate property, based on the principle of permanent sovereignty. I showed that in modern times expropriation is to be considered lawful in international law, providing the expropriation is in the public interest, without discrimination, and is accompanied by adequate compensation.

However, there is an implicit conflict of interest in the definition of the terms non-discrimination and public interest. This interest reflects the conflicting economic concerns of oil producing States and foreign companies. The right of a State to expropriate its natural resources is a corollary of the right of permanent sovereignty. The stabilization clauses will not prevent the State from exercising its right to expropriate its natural resources. The stabilization clauses only means that the State is not legally allowed to expropriate private property without compensation.²

In Islamic Shari'ah the doctrine of *Durura* allows for the disregarding of a law, even of an economic or political nature, if the basis for doing so is the protection of the property of a State, or its very existence, or the protection of

2 FR Tesón, *State Contracts and Oil Expropriations; The Aminoil-Kuwait Arbitration*, *Virginia Journal of International Law* 24 (1984) 344.

life. The State has the right to intervene in the economic life of the people, as part of ...

the changing conditions of modern economic life which is becoming more complex and interdependent.³

Should contractual obligations be terminated by the State, under the doctrine of *Durura*, it is not considered an expropriation of private property, as this is not recognized in Islamic Shari'ah.

In Chapter Ten, I examined the compensation controversy that emerged during the early twentieth century. Here the conflict between Third World opinion and that of the industrial western world clearly emerges. The western concept of compensation is embodied in the Hull formula of "prompt, adequate and effect" compensation; the Third World's view in the concept of "appropriate" compensation. Appropriate compensation considers the ability of the host State to pay, whether there has been undue enrichment as a result of the colonial situation, and the contribution of the enterprise to the economic and social development of the country and its respect for labour law and its reinvestment policies, among the factors to be considered when determining the amount of compensation.

In discussing a range of nationalization cases, I conclude that it is impossible to define a standard of just compensation that will suit all circumstances, and that no definite standards of fairness can be mandated that will be universally appropriate. It follows that there is no sufficient evidence that the Hull rule became a part of customary international law. No foreign oil company has received full or adequate compensation as defined by that rule. The standard of appropriate compensation has become a rule of customary international law, and is recognized among the States of third world as such. A further feature of this period is that lump sum agreements, providing for partial

3 MN Siddiqi, *Muslim Economic Thinking. A Survey of Contemporary Literature*, in K Ahmad (ed), *Studies in Islamic Economies* (1980) 211, quoted by H Moinuddin, *The Charter of the Islamic Conference and Legal Framework of Economic Co-operation Among Its Member States* (1987) 56.

circumstances, have regularly been made. Thus, what can be said is that the principle of "unjust enrichment" validly applies and requires parties in a nationalization dispute to reach equitable settlements. Thus compensation must be paid and the amount must be assessed in accordance with the conditions in the expropriating State.

In Islamic Shari'ah compensation for expropriation of property is considered an obligation. The amount to be paid depends principally on the value of the property taken, since Islamic Shari'ah adopts a fairly strict standard of compensation.

To conclude, international law has changed substantially during this century, to reflect more clearly the interests of oil-exporting States in retaining, and in many cases regaining, control over their natural resources. Principles relating to the choice of law in concession contracts, the termination or modification of such contracts and of treaties protecting foreign investment, the law relating to expropriation of natural resources and the level of compensation payable - all these have changed, so that the present position reflects a more equitable balance between the interests of the various countries and parties involved. This more equitable situation also more clearly reflects and corresponds to the principles of Islamic Shari'ah. But underlying all these changes there is also the constant principle of good faith, on both sides, again reflected in Islamic Shari'ah.

APPENDIX NO. 1

The Jurisdiction of the Judicial Tribunal of OAPEC

1. The OAPEC Agreement.

Article 23, provides in the first paragraph that the Judicial Tribunal has the following jurisdiction.

- (a) The disputes which are related to the interpretation and application of this agreement and the execution of obligations due.
- (b) Disputes which arise between two or more members of the organization in the field of oil activity.
- (c) The disputes, decided by the Council that are in the Tribunal's Jurisdiction.

In the second paragraph this article provides that the Tribunal has the optional jurisdiction, subject to the approval of the parties as following:

- (a) The disputes between any member, and the petroleum companies which are working in that member's territory.
- (b) The disputes between a member and another member petroleum company.
- (c) The disputes between two or more members of the organization except that mentioned in paragraph (1) of this article.

2. The Judicial Tribunal Protocol, Article 24.

1 - The Tribunal has the right of jurisdiction in:-

- (a) The disputes which are related to the interpretation and application of the agreement, and the execution of obligations due. All member countries, organizations and companies connected to the organizations are accepted as parties of the disputes.
 - Between two or more of the member countries.

- Between two or more of the companies that are connected to the organization.
 - Between the member countries and those companies.
 - Between the organizations of any member country or the above mentioned companies.
- (b) The disputes that exist between two or more members of the organization, relating to the field of petroleum activity, on the condition that it is not related in any way to the territorial sovereignty of the member countries, participating in the disputes.
- (c) The disputes that the OAPEC Council decides are the jurisdiction of the Tribunal are outlined above in paragraph (B).
- 2 - In accordance with the agreement between the parties of the disputes, the following disputes may be submitted to the Tribunal for judgement.
- (a) The disputes between any member, and the petroleum companies which are working in that member's territory.
 - (b) The disputes between a member and another member petroleum company.
 - (c) The disputes between two or more members of the organization except that mentioned in section (1) of this article.

Article 25:

The Tribunal may give a consultation in legal problems referred to it by approval of the Minister's Council. The rules of procedure show the rules of applying and reviewing a request and giving the consultation.

Article 26:

The Tribunal derives its authority to judge the disputes that are mentioned in article (24) in the first paragraph of this protocol, from the Islamic Shari'ah and the International law which is applicable in this matter.

- (a) The organization's agreement and the international convention which oblige the dispute's parties.
- (b) The customs internationally compulsive.
- (c) The general principles of law applied in the international society.
- (d) The general principles in the countries members' laws.
- (e) The court's judgements and the trend of the great jurists in the public law in all the countries members is to be drawn on as required.

For those disputes which are included in article (24) the Tribunal is to judge them according to the most suitable law, to govern what it believes to be the dispute.

Article 27:

The judgements of the Tribunal is considered final, and parties to its disputes are obliged to abide by its decisions, and further it has executive power in member countries.

Following judgement, the parties concerned should present the judgement to those local authorities with the power to enforce the decision. The local authority should ascertain that the presented document is authentic before enforcing the judgement.

APPENDIX NO. 2

Saudi Arabia's Takeover of Aramco

In January 1984 a senior Saudi employee of Aramco Mr. Ali Al Naemy was nominated as the first Saudi president of the Aramco company. This position was renegotiated in April 1987 when it was assumed by the Saudi Minister of Petroleum and Mineral Resources Mr. Hisham Nazer, and Ali Al Naemy was nominated as executive president.

By No 40, [Date 29/3/1409 AH] 8/11/1988, the Saudi Arabian Council of Ministers approved the basic statute of the new "*Saudi Aramco Company*", "*Aramco Al Saudia*". "*Saudi Aramco*" which culminated in the royal decree No. M/8 [date 4/4/1409 AH] 13/11 1988 as follows:

"The Council approved the basic statute of the Saudi Arabian Oil Company. ...This basic statute defines the organizational structure of the petroleum utilities earlier owned by the Kingdom. The system does not constitute any change in the situation or privileges of Saudi employees and contractors. The technical, administrative and marketing relations with petroleum companies will continue.

Negotiations with some companies on joint projects have entered their final stage and some agreements will be concluded soon. The monarch issued directions to Mr. Hisham Nazer (Minister of Petroleum and Mineral Resources) to resume efforts to enable the Kingdom to participate in the marketing process in a way that secures enough supplies for consumers. He noted that joint projects enhance relations and peace among nations."

The main points in the speech by the Minister of Petroleum and Mineral Resources, Mr. Hisham Nazer to the editors of Saudi Newspaper and Magazines on [26/3/1409 AH], 5/11/1988, are as follows:

- First: 1 The System of Saudi ARabia Oil Company. The purpose of issuing this system is to provide the foundations for a legal basis which will facilitate the administration previously owned by the Arabian American Oil Company, thereby rectifying the current situation.

- 2 Special considerations in the company's formation.¹
To depart from the current situation of the company and to be rid of the restrictions of the American rules and regulations, which when it was an American company limited it.² To have the freedom to market Saudi-marketing body which would work in the interest of the Kingdom.

Second: Important points which should be considered when referring to the company.

- 1 This company has been established not to extricate from our previous partners, but to continue to co-operate with the foreign companies to progress, and to promote the company more widely in a variety of areas.
- 2 We can't do without the advanced technical experience which these companies offer, and especially American technology in the fields of exploration and drilling.
- 3 This subject should not be given more importance than it warrants, and that it not be formulated in terms of a radical national movement.³

The Saudi Arabia is to control 50% of *Texaco Company*.

A joint venture was accordingly signed on 10 November 1988 with the *Texaco Oil Company*. In return for allowing *Texaco* to purchase 600,000 barrels of crude oil a day at regular market prices. Saudi Arabia will pay \$US 812 million to control 50% of its oil refineries and distribution network in twenty three states in America.

Saudi Arabia's Minister of Petroleum and Mineral Resources, Mr Hisham Nazer said in London on 10 November following the signature of the *Saudi-Texaco agreement*:

...when we started restructuring the oil industry in Saudi Arabia two years ago, we began by defining the functions of our various oil entities such as *Aramco*, Petroleum which is the organization

1 Asharq Al Awsat, International Daily Newspaper of the Arab, Vol 11, No 3636 2/31/1409 AH (11/11/1988) (in Arabic).

2 Official Gazette of the Kingdom of Saudi Arabia No 3236, 18/4/1409 AH (11/25/1988). Translation quoted by Riyadh Newspaper, Vol IV, No 144, 1/4/1409 AH (10/12/88).

3 Information provided by Ministry of Petroleum and Mineral Resources of Saudi ARabia 1988 (translated by the author).

responsible for industrializing the oil related products and refining and product distribution within the Kingdom, and other related industrial enterprises. With regard to Aramco the first step we took was to create a marketing subsidiary known as Saudi Petroleum International and then a refining subsidiary known as Saudi Refining International which has just signed its first major venture in the business. Each of these is owned by subsidiaries of *Saudi Aramco*. You have no doubt heard that a couple of days ago the Saudi Arabian Council of Ministers approved the Charter of the new *Saudi Aramco* which will be managing the assets which the Kingdom bought a few years ago.

Now, the creation of this *Saudi National Company* will not have any impact on the current administrative and technical relationship between the new company and the ex-*Aramco* partners. On the contrary, as you have seen, we have already embarked with one of the partners - *Texaco* - on a very major step which is very important for the fulfilment of the objectives I have just outlined.

What we will do from now on is to continue to get into the market, in order to secure for the Kingdom of Saudi Arabia its proper share in the world market. We will continue, in the efficient management of the oil industry in Saudi Arabia. Probably, right now Saudi Arabia has the lowest cost of production, and we will continued to cut that cost even further as far as we can and we will continue the process of training Saudi nationals to assume more and greater responsibility - as is already happening in *Saudi Aramco*, *Saudi Petroleum International* and *Saudi Refining International*.

A summary of the speech of the Minister of Petroleum and Mineral Resources to the editors of Saudi Newspaper and Magazines of [26/31/1409 AH] 5/11/1988 regarding the participated transaction with *Texaco*, is as follows;

The target of this transaction between *Saudi Arabia and Texaco Company* is to achieve an integration in the manufacturing of Saudi oil

The most important features of this transaction are:

- (1) To guarantee marketing 600 barrels of Saudi raw oil and to enter other similar projects which will assist a full marketing guarantee for the Kingdom.
- (2) To compensate for a part of the national income, in case of a decrease in the price of raw oil, in comparison with that of the refined production market which is frequently more constant and stable.

- (3) The importance of the integration of the states in oil manufacture, starting from drilling and production up to its transportation and marketing until it reaches the consumer. It is important to achieve the greatest possible revenue so that historically this step will be an important one for the Kingdom of Saudi Arabia.
- (4) The time and the situation in which this transaction is being made is a rare and good opportunity for the Kingdom of Saudi Arabia.
- (5) The American market is very important for the Kingdom of Saudi Arabia as America is its most developed market. This is because it is likely that an increase in the orders for products will come from that market.

Therefore this transaction is considered to be a way of entering the market. The Minister also noted some important points in talking and writing about this transaction.

1. It should be apparent that the Kingdom does not intend at all to create a petroleum market monopoly and there is no suggestion that the Kingdom has this intention and further to do so would result in many problems as there are American rules against monopoly and flooding.
2. The Kingdom does not seek beyond the participation, to control the oil price or the product.
3. This transaction will promote the traditional relationship between the United States and the Kingdom, where the American market is the greatest consumer and the Kingdom reserves all necessary supplies for this market. Thus, this transaction will strengthen the exchange of common interests.
4. This transaction will promote the fruitful historical relationship between American oil companies and the Kingdom.⁴

The new Agreement between the Government of *Saudi Arabia and Aramco* concluded on 1/31/1977 reflects the bond between these parties, the foundations of which were laid in their Agreement in 1933.

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