Economic Development Agreements

Part II

AGREEMENTS BETWEEN STATES AND ALIENS; CHOICE OF LAW AND REMEDY

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AN EARLIER article in this series¹ posed the general problem of the necessity for foreign developmental assistance to the under-developed parts of the world, and dealt with the questions of choice of law and remedy applicable to economic development loan agreements made with these States by other States or by international organizations.

Numerous policy declarations by spokesmen of States of the western world indicate that a substantial portion of the funds for economic development must come from private sources.² From the free world perspective, an important reason in support of substantial private assistance to less developed countries is that private investment tends, though not invariably, to associate with private areas of the economy in the recipient State. This association may serve to establish and sustain the type of mixed public-private economy that western States have found conducive to maintaining a large degree of individual choice in political and economic matters. At the same time, it provides the modicum of governmental participation that seems essential for planning on a long-range national scale and assisting the economy during extreme fluctuations in the business cycle.

If we conclude that private investment in the less developed countries is both an economic necessity and a desired policy approach, then it would appear desirable to identify means of encouraging its flow and assuring the performance of agreements by which such assistance is extended.

A variety of means of protecting private investments in underdeveloped areas have been advanced from numerous quarters in the last decade.

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¹ Olmstead, *Economic Development Loan Agreements Part I—Public Economic Development Loan Agreements; Choice of Law and Remedy*, 48 CALIF. L. REV. 424 (1960).

² See, e.g., *The Promotion of the International Flow of Private Capital*, U.N. Doc. No. E/3325, Feb. 26, 1960, U.N. Doc. No. E/3492, May 18, 1961.

Such means range from government guarantee programs³ to conventions between States.⁴ Both types of proposals require agreements on a State to State basis to establish the system of protection.⁵ There has been some resistance on the part of certain underdeveloped countries to the investment guaranty program on two grounds: First, the approach tends to convert disputes of a commercial nature between the private investor and the recipient State into disputes of a quasi-political nature between States; second, the request by the United States to the recipient State for the underlying agreement that establishes the guaranty program is said to evidence a lack of confidence in such State to carry out its agreements with investors.⁶

Perhaps a realistic and practical approach to the problem of protection of private investments lies in clarification of (1) the terms of the investment agreement between the private investor and the recipient State and

³ See U.N. Doc. No. E/3325, Feb. 26, 1960, at 66-69. In fact, steps in this direction have already been taken by the United States, as part of the Mutual Security Act of 1954. 68 Stat. 846-48 (1954). The creation of a guaranty fund on a multilateral basis is also being considered by a number of European States. See U.N. Doc. No. E/3492, May 18, 1961, at 98-100.

⁴ See Draft Convention on Investments Abroad (1959); Convention on the International Responsibility of States for Injuries to Aliens, Draft No. 12, Harvard Law School, April 15, 1961; PARLIAMENTARY GROUP FOR WORLD GOVERNMENT, A WORLD INVESTMENT CONVENTION? (1959); U.N. Doc. No. E/3325, Feb. 26, 1960, at 70-76.

⁵ While individual guaranty programs will differ in some respects, they are generally similar. Under its program, the Government of the United States, in substance, insures the investment against certain defined risks, including expropriation, to insulate the investor from the non-business hazards of his investment. As a corollary to the insurance, the insurer State enters into a supporting agreement with the recipient State in which the insurer State undertakes to limit its guarantee to projects approved by the recipient Government. The latter agrees to subrogate the insurer State to the claims of any investor which the insurer State may have satisfied under the guarantee. The agreement contains no promise by the recipient State that the risk insured against will not occur; however, remedies such as arbitration are provided. On the other hand, the German type agreement does contain some assurances. See Budget Law of 1959, Fed. Rep. of Germany, art. 13, para. 1 (Law of July 6, 1959, Official Gazette, Part H, p. 793).

Typical of the various recommendations advocating conventions between States is the Convention on Investments Abroad (Draft 1959), more widely known as the Abs Convention, whereby the contracting States agree to "ensure fair and equitable treatment to the property of the nationals of the other Parties" (Art. I), to refrain from depriving nationals of the other Parties of their property without due process of law, including just compensation (Art. III), and to submit to arbitration all disputes concerning the interpretation or application of the Convention, the tribunal to be selected in accordance with other provisions in the agreement. (Art. VII). Such a convention is presently being considered on a multilateral basis by the Organization for European Economic Cooperation (OEEC). U.N. Doc. No. E/3492, May 18, 1961, at 92-93.

⁶ As a result, the United States is considering abandoning its requirement of a supporting treaty and extending insurance to investments in all underdeveloped countries irrespective of such agreements. Speech by Secretary of Commerce Luther Hodges before U.S. Chamber of Commerce, May 1, 1961. N.Y. Times, May 2, 1961, p. 10, col. 2.

(2) the choice of law and remedy applicable in the event of disputes arising under it. Attention here will be addressed to choice of law and remedy problems that may arise from foreign economic investment agreements between aliens and States.⁷ Such agreements are sometimes termed concessions and more lately "economic development agreements."⁸ Concessions and economic development agreements usually deal with the discovery, production, and sale of mineral or oil resources of the contracting State by the alien investor. In this article the term foreign investment agreement also includes, for example, loans, foreign bond agreements, and contracts with aliens for the provision of technical skills, services, and goods. The element that distinguishes this type of agreement from others with a State is the essentially foreign nature of the transaction.

I

VALIDITY OF FOREIGN ECONOMIC INVESTMENT AGREEMENTS

Initially, as in the case of any agreement, the question of essential validity is presented. Although extensive authority is directed to questions of the validity of agreements between States and between States and international organizations,⁹ there is an appalling absence of authority on such questions where foreign investment agreements between aliens and States are involved.¹⁰ The paucity of authority on this point, as well as on other

⁷ Foreign investment agreements differ from the ordinary contractual agreement. They are entered into by a State and a foreign national with the avowed purpose of developing that State's natural resources, industry, communications, or the like. The investor is generally given great leeway in conducting the enterprise and is promised the cooperation and protection of the State.

The agreement is usually a self-sufficient entity—governing the relationship between the parties in all aspects, including the remedies in case of dispute or breach. Rarely need the parties go beyond the document to determine their rights and obligations. See Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 5 (1960).

When a State breaches a contract with an alien, the latter theoretically has available, as in the case of private contracting parties, whatever local remedies are afforded by the law of the State. In addition, unlike private contracts, conduct by the State may violate international law. Such violation occurs when the act by the State departs from the international standard of substantive or procedural justice or is in contravention of an international agreement. RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 103-05 (Tent. Draft No. 5, 1961). Since only States have rights under international law, the injury of an alien creates a claim in favor of the State of his nationality, and it is the State which puts forward the international claim. *Id.* § 109.

⁸ McNair, *The General Principles of Law Recognized by Civilized Nations*, 33 BRIT. Y. B. INT'L LAW 1 (1958).

⁹ See RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 101-09 (Tent. Draft No. 3, 1959); 5 HACKWORTH, DIGEST OF INTERNATIONAL LAW 153-64 (1943).

¹⁰ See Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 12-13 (1960).

questions arising from these agreements, may result from their hybrid character. Agreements between States and aliens are considered neither international agreements nor private contracts; consequently, they seem to fall between consideration by public international law authorities, on the one hand, and private international law authorities, on the other. It would appear, however, that many of the general principles applicable to elements of the more classical types of agreements, including validity, would be equally applicable to foreign economic investment agreements.

Because of their nature as quasi-international agreements, we may, to determine their validity, draw in part upon the principles applicable to the validity of international agreements. As a State is a party to the foreign investment agreement, rules of general international law cast light upon its status.¹¹ Consequently, such agreements are limited in subject matter to the extent that the terms must not provide for performance inconsistent with international standards of conduct or in conflict with the Charter of the United Nations.¹² A choice of law or terms by the parties to a foreign investment agreement could not validate an agreement that ran counter to those international limitations. Without entering the realm of fantasy it is difficult to postulate a foreign investment agreement whose terms would violate basic standards of international conduct or the Charter.¹³

On the other hand, the subject matter of the agreement may well conflict with the law of the State party. For example, the law of the State may prohibit aliens from obtaining any interest in land in the State. If the alien party knew or should have known of the prohibition, an agreement under which he was to receive an interest in land would normally be invalid.¹⁴

Similarly, questions may arise concerning the authority of the persons acting on behalf of the State and the alien foreign investor to conclude the particular agreement. As to the authority of the former, principles of general international law offer a thoroughly satisfactory answer; the domestic law of the State party will determine the authority of a person to conclude a particular foreign investment agreement.¹⁵ Further, since under both international and domestic law a person may be held out to another as having

¹¹ Cf. RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 102 (Tent. Draft No. 3, 1959).

¹² *Ibid.*

¹³ Conceivably, a violation of international law could occur if X, a national of State A, entered into a contract with State B to develop and manage the domestic slave trade or to execute genocide edicts promulgated by State B.

¹⁴ This principle is similar to the rule of corporation law respecting ultra vires activity of a corporation. See *Rowan County Freestone Co. v. Chesapeake & O. Ry. Co.*, 264 Ky. 785, 95 S.W.2d 575 (1936); 7 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 3426 (1931); Carpenter, *Should the Doctrine of Ultra Vires Be Discarded?*, 33 YALE L.J. 49, 65 (1923).

¹⁵ RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 103(1) (Tent. Draft No. 3, 1959).

authority to conclude an agreement when in fact there is no such authority, a foreign investment agreement concluded in such circumstances may be valid as to both the State and the alien provided the other party neither knew of, nor was reasonably chargeable with knowledge of, an absence of actual authority.¹⁶

Conceivably, other questions of the validity of such agreements might arise; however, it does not seem profitable to exhaust that problem here.

II

CHOICE OF REMEDY

Basic concepts of fair play common to all civilized human relationships demand that there be a form of tribunal to resolve conflicts that arise from such relationships. Recorded history bears witness to a great diversity of judging institutions, some primitive in organization and procedure, but all devoted to the task of resolving human disputes in an objective manner. In the wake of such a trend, it is indeed anomalous that so much uncertainty and doubt exist about the provision of an accessible and independent tribunal to which the foreign investor and the State may proceed with a dispute. Compared with the confidence that a foreign investor and a State manifest in one another by entering into a foreign investment agreement, the reluctance of some States to agree to reasonable and independent remedies for disputes is difficult to explain.

Such reluctance has been sustained by the historical doctrine of State or sovereign immunity.¹⁷ Whatever justification or rationale there was for such a doctrine in an "Age of Kings," today in most States the trend, with both domestic and international claims against a State, is to limit sharply its scope of application.¹⁸ A majority of States presently recognizes a claim to sovereign immunity by another State only in cases which properly may be termed *jure imperii*—the exercise of a sovereign or public act.

¹⁶ *Id.* § 103(2). See Legal Status of Eastern Greenland, P.C.I.J., ser. A/B, No. 53 (1933). This rule, as applied to the private party, is nothing more than the principle of apparent authority in agency law. RESTATEMENT (SECOND), AGENCY § 27, comment *b*, § 125, comment *b* (1960).

¹⁷ For a discussion of sovereign immunity in this context see Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 6-8 (1960).

¹⁸ Illustrative of this new trend is the now famous Tate letter, 26 DEP'T STATE BULL. 984 (1952), which announced that the Department of State was adopting the so-called "restrictive theory of sovereign immunity" whereby commercial activities of sovereign States would no longer come under the protective cloak of sovereign immunity. Likewise, on the domestic scene, the Federal Tort Claims Act, ch. 753, 60 Stat. 842 (1946) (codified in scattered sections of 28 U.S.C.) bears testimony of the decreasing utilization of the old doctrine by the State.

It would be contrary to this trend for a State to avoid submitting to independent adjudication a dispute with a foreign investor arising from an essentially commercial agreement.

In considering a choice of remedy for disputes arising out of foreign investment agreements, one faces two general situations: First, where the parties have expressly set forth a method of remedy within the agreement; second, where they have not. Our analysis will consider them in order.

Many foreign investment agreements with States provide, in various terms, for the submission of disputes to a method of adjudication or arbitration. A typical arbitration clause provides that if a dispute under the foreign investment agreement is not resolved by the parties, it shall be submitted to two arbitrators, one to be chosen by each of the parties, and a referee to be chosen by the arbitrators. If the arbitrators fail to choose a referee, the President of the International Court of Justice,¹⁹ the Secretary-General of the United Nations, or some other high ranking international official shall be requested to make the choice. The agreements go on to provide that the decision of the arbitral body shall be final.²⁰

Assuming that the foreign investment agreement contains such an arbitration clause, what is its legal significance? Does it have any greater effect as a binding obligation than does any other provision of the agreement?

There is an abundance of authority in support of the position that all agreements, including those between aliens and States, are to be performed.²¹ However, examination of any law reporter will bear elaborate witness that all agreements are not performed and breaches do occur. It is not our intention here to discuss the binding nature of foreign investment agreements, but to consider remedies when there has been a breach.

Certainly an arbitration clause in a foreign investment agreement binds

¹⁹ *E.g.*, Petroleum Law of Libya, 5 Official Gazette, No. 4, Second Schedule, Clause 28, p. 72 (1955); Agreement Between Saudi Arab Government and Arabian American Oil Co., art. 31, May 29, 1933, found in Arbitration Between the Government of Saudi Arabia and Arabian American Oil Co., (First) Memorial of Arabian American Oil Co., annex 1, p. 12 (1956).

²⁰ Agreement Between Saudi Arab Government and Arabian American Oil Co., *supra* note 19.

²¹ According to some commentators, the failure of a State to perform its obligations under a contract with an alien may violate international law, by analogy to the principle of *pacta sunt servanda*, under which breach of an international agreement violates international law. *E.g.*, Wadmond, *The Sanctity of Contract Between a Sovereign and a Foreign National*, ABA SECTION OF MINERAL AND NATURAL RESOURCES LAW 1957 PROCEEDINGS 177; Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 36-42 (1960). See Olmstead, *Nationalization of Foreign Property Interests, Particularly Those Subject to Agreements With the State*, 32 N.Y.U.L. REV. 1122, 1136 (1957). Other authorities, while refusing to apply *pacta sunt servanda*, nevertheless recognize that international responsibility may arise where a breach is arbitrary, is in connection with essentially foreign transactions, or is without compensation. RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 311, comment *d* (Tent. Draft No. 5, 1961).

both the alien and the State to adhere to its terms. Indeed, a number of States have accepted the principle that disputes with foreign investors are to be submitted to independent arbitration.²² And it is encouraging to observe that States are adhering to their agreements to arbitrate disputes with foreign investors.²³

Nevertheless, a situation may occur under a foreign investment agreement in which the foreign investor claims that the State has breached or otherwise failed to perform its obligations and the State refuses to adhere to an arbitration provision of such agreement. What remedy, if any, will be available to the foreign investor?

A request for a decree requiring specific performance of the arbitration agreement would not appear to be a practical remedy against the State because at present there is no tribunal in which such a decree could be rendered in favor of the foreign investor. Practically, the foreign investor in such circumstances should be considered to be in a position to call upon his State of nationality to espouse the claim without regard to the exhaustion of local remedies rule.

Normally, an alien who claims injury by a State in circumstances constituting a violation of international law is required to seek redress pursuant to the local remedies provided under the law of such State.²⁴ This local remedies rule is designed to give the State an opportunity to afford an alien a fair and just means for determination of the claim on a non-political basis. However, since the rule is primarily for the benefit of the State, it may waive the rule by manifesting an intention to do so.²⁵ The inclusion of an arbitration clause in a foreign investment agreement may indicate a waiver of the local remedies rule, but the question ultimately depends upon the intention of the parties.

In cases of agreements between States providing that nationals of each

²² The laws of Libya and Somalia exemplify this growing practice. Petroleum Law of Libya, 5 Official Gazette, No. 4, art. 20 (1955); Foreign Investment Law of Somalia (Law No. 10), Feb. 18, 1960, art. 16. See also U.N. Doc. No. E/3325, Feb. 26, 1960, at 76-81.

²³ *E.g.*, Award Arbitration Between the Government of Saudi Arabia and Arabian American Oil Co. (1958), where the State agreed to and did submit a dispute to arbitration, consenting to be bound by the results.

²⁴ "The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law . . ." *Interhandel Case*, [1959] I.C.J. Rep. 6, 27. See RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 601 (Tent. Draft No. 5, 1961).

²⁵ States have often concluded international agreements expressly waiving the exhaustion requirement. See, *e.g.*, Convention between United States and Mexico for Reciprocal Settlement of Claims, Sept. 8, 1923, art. V, 43 Stat. 1734, T.S. No. 678; Convention between United States and Panama for Reciprocal Settlement of Claims, July 28, 1926, art. V, 47 Stat. 1920, T.S. No. 842.

State may take disputes with the other State to an arbitration tribunal for decision, a similar question of the effect of the agreement on the availability of local remedies arises. Although there is some authority to the contrary,²⁶ the better view is that such an agreement between States manifests, in the absence of contrary indications, an intention to submit disputes to arbitration without requiring the exhaustion of local remedies.²⁷

There appears to be no reason why the same view would not apply to arbitration agreements between aliens and States. Consequently, if in an appropriate case the foreign investor complies with the terms of an arbitration clause but the State declines to do so, the foreign investor's State of nationality may assert an international claim on his behalf without regard to the exhaustion of local remedies rule.²⁸ There is a growing body of practice indicating that States recognize their obligation to abide by arbitration agreements with foreign investors and do not invoke the exhaustion of local remedies rule in cases involving such agreements.²⁹

Finding a method of remedy in cases of foreign investment agreements which do not include arbitration provisions presents a difficult problem. Although most modern foreign investment agreements provide for arbitration, it is probable that some agreements without such provisions do exist. Complete analysis requires us to examine the nature of the remedy when the agreement fails to provide for arbitration. Even though the foreign investment agreement does not provide for arbitration of disputes, the opportunity to establish an *ad hoc* arbitral body should not be ignored if a dispute occurs.

In a similar context, it has been said that "all law has the object of assuring the coexistence of interests worthy of legal protection."³⁰ Surely, a State that enters into a foreign investment agreement with an alien considers the interests thereby established to be "worthy of legal protection" by a reasonable and independent remedy in the event of dispute. Indeed, it may be argued that implicit in the mutuality of obligation essential to the validity of an agreement is the principle that the parties will submit

²⁶ See, e.g., *George J. Salem (United States v. Egypt)*, U.S. DEP'T OF STATE, ARBITRATION SERIES 4(6), at 43 (1933).

²⁷ *Crutchett's Case*, (*Great Britain v. United States*, 1871), 4 MOORE, INTERNATIONAL ARBITRATIONS 3734 (1898). See RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 604, comment *b* (Tent. Draft No. 5, 1961).

²⁸ RESTATEMENT, FOREIGN RELATIONS LAW OF THE UNITED STATES § 604, comment *c* (Tent. Draft No. 5, 1961).

²⁹ See, e.g., *Award Arbitration Between the Government of Saudi Arabia and Arabian American Oil Co.* (1958).

³⁰ *Great Britain-Spain, Arbitration on Basis of Agreement of May 29, 1923*, in BRIGGS, THE LAW OF NATIONS 601, 603 (2d ed. 1952).

any dispute to an independent tribunal and abide by its decision.³¹ If such a self-evident, but unarticulated, principle is accepted, our problem becomes one of identification of an accessible independent tribunal.

In the absence of an agreement to the contrary, an alien or property of an alien present in the territory of a State is subject to its law and judicial processes.³² However, this principle is limited by the international standard of justice which, *inter alia*, provides that the exercise of enforcement jurisdiction by a State over an alien or his property must comply with certain minimum safeguards.³³

The courts of the State party merit primary consideration in the search for an available and independent tribunal for the determination of disputes arising out of foreign investment agreements that do not contain arbitration clauses. This approach is guided by the international standard of procedural justice. Basic to this standard is the right of an alien to access to an appropriate tribunal for determination of his claim.³⁴ Of course, a State may invoke sovereign immunity against such a claim although, as is indicated heretofore,³⁵ the trend is otherwise. If the State asserts sovereign immunity in foreign investment agreement cases, it may be concluded that the judiciary of the party State does not afford the accessible and independent tribunal that the implied commitments of the parties contemplate.³⁶ Also, although there are a number of relevant factors to be considered in determining whether an alien is afforded a fair trial,³⁷ it is essential in satis-

³¹ The principle of mutuality of obligation, whatever its outer limits, would certainly seem to require that both parties be bound by the agreement. See, e.g., *Willard, Sutherland & Co. v. United States*, 262 U.S. 489 (1923); 1 CORBIN, *CONTRACTS* § 152 (1950). If, in a contract between a State and an alien, the latter has no tribunal in which he can seek a fair hearing upon a controversy, then the obligation of the State is illusory. It is only colorably bound, since performance is subject to its absolute whim and caprice. Thus, in such a situation, there would be no contract. Viewed in this perspective, it is reasonable to infer that the parties intended to make a binding contract, and as a necessary corollary, impliedly provided that disputes would be submitted to an impartial tribunal.

³² See *Church v. Hubbard*, 6 U.S. (2 Cranch) 187, 234 (1804); *M. Salimoff & Co. v. Standard Oil Co.*, 237 App. Div. 686, 692, 262 N.Y. Supp. 693, 699-700 (Sup. Ct. 1933), *aff'd*, 262 N.Y. 220, 186 N.E. 679 (1933). See also STORY, *CONFLICT OF LAWS* 756, 768 (1883).

³³ Case concerning certain German interests in Polish Upper Silesia (The Merits), P.C.I.J., ser. A, No. 7, at 22 (1926); *Treatment of Polish Nationals in Danzig*, P.C.I.J., ser. A/B, No. 44, at 24-25 (1932). See RESTATEMENT, *FOREIGN RELATIONS LAW OF THE UNITED STATES* §§ 103, 201-05 (Tent. Draft No. 5, 1961).

³⁴ RESTATEMENT, *FOREIGN RELATIONS LAW OF THE UNITED STATES* § 203 (Tent. Draft. No. 5, 1961).

³⁵ See note 18 *supra* and accompanying text.

³⁶ Dismissal of an alien's claim on the basis of sovereign immunity in a case in which the action of the State was in violation of international law would give rise to a diplomatic claim against such state by the State of the alien's nationality. RESTATEMENT, *FOREIGN RELATIONS LAW OF THE UNITED STATES* § 203(2), comment b (Tent. Draft No. 5, 1961).

³⁷ *Id.* § 204.

fyng the international standard of procedural justice that a determination of an alien's claim not be manifestly unjust.³⁸ Granted that the determination must be so outrageous that bad faith on the part of the tribunal is apparent, the concept does support the view that an independent tribunal is a requirement of international law in proceedings between an alien and a State. Indeed, if the standard of procedural justice is violated with respect to an alien, it is a wrong under international law for which the State is responsible.³⁹

The practical difficulty in applying the standard of procedural justice to determine the accessibility and independence of a State's judicial system is that the determination should be made before the alien is required to submit to its enforcement jurisdiction. If the State's judicial system has a tradition and history of independence from the political departments of government, there is no reason why that system should not afford an appropriate choice of remedy in the absence of other agreement between the alien and the State.⁴⁰ On the other hand, in cases of States that have a merger of the political and judicial divisions of government or in which there is no tradition, history, or pretense of judicial independence, the implications to be drawn from the mutuality principle of the foreign investment agreement should include the obligation to submit to a form of international arbitration.

III

CHOICE OF LAW

The problem of the law to be applied to decide a question involving a foreign investment agreement is divided into two situations: First, where the agreement specifies the applicable law; second, where it does not. Basic policy objectives demand that the choice of forum not determine the decision on the merits.⁴¹ Thus, the choice of forum, whether a domestic court of the State party or an international tribunal is chosen as the appropriate independent decision-maker, should not determine the result of the claim.⁴²

A choice of law provision in a foreign investment agreement between an alien and a State raises many of the same questions of binding effect as are raised by such provisions in other contexts. Much has been written on the

³⁸ *Id.* § 205.

³⁹ *Id.* § 103(1) (a).

⁴⁰ If such a tribunal should ultimately depart from international standards of justice, the State would still be subject to international responsibility. *Id.* §§ 103, 106.

⁴¹ GOODRICH, *CONFLICT OF LAWS* 7 (1949).

⁴² This assumes, of course, that both forums would fairly apply relevant domestic as well as international law.

question of the binding nature of these provisions;⁴³ we do not here propose to reexamine completely, but only to consider, the situation where the State and the alien bring their dispute before an appropriate independent tribunal.

Although in the past foreign investment agreements have only rarely specified the law to be applied in the settlement of disputes,⁴⁴ such specifications are beginning to appear in varying forms. A recent agreement for a loan of a substantial dollar sum by an American firm to a foreign government-owned corporation for a housing development provides that delivery of the notes and payments shall be made to the American firm at its principal place of business in the United States and that the law of the state of this principal office shall govern construction and enforcement of such agreement.⁴⁵

The Petroleum Law of Libya⁴⁶ provides that concessions may be granted in accordance with a schedule which states

(7) This Concession shall be governed by and interpreted in accordance with the Laws of Libya and such principles and rules of international law as may be relevant, and the umpire or sole arbitrator shall base his award upon those laws, principles, and rules.⁴⁷

These illustrations should be sufficient to indicate that the use of such choice of law provisions may become more common. Consideration should therefore be given to their efficacy.

Drawing upon principles of both public and private international law, we concluded earlier that choice of law provisions in economic development agreements between States and between international organizations and States are valid provided they do not contravene basic principles of international law.⁴⁸ An eminent authority, in considering the general law applicable to agreements such as foreign investment agreements, has concluded that because of the nature of the parties and their undertakings, interna-

⁴³ E.g., 5 HACKWORTH, *DIGEST OF INTERNATIONAL LAW* 610 (1943); Olmstead, *Nationalization of Foreign Property Interests, Particularly Those Subject to Agreements With the State*, 32 N.Y.U.L. REV. 1122 (1957); Ray, *Law Governing Contracts Between States and Foreign Nationals*, 2 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 24-42 (1960). See Convention on the International Responsibility of States for Injuries to Aliens, Article 12, and explanatory notes, pp. 122-34, Draft No. 12, Harvard Law School, April 15, 1961.

⁴⁴ Mann, *The Law Governing State Contracts*, 21 BRIT. Y.B. INT'L L. 11, 12-13 (1944).

⁴⁵ No permission was given to make the agreement public but the author was permitted to examine it.

⁴⁶ 5 Official Gazette, No. 4, art. 9, p. 46 (1955).

⁴⁷ *Id.* Second Schedule, Clause 28(7), p. 73. Strictly speaking, as international law is not thought to be applicable to relations between individuals and States, the phrase "international law as may be relevant" should be interpreted to mean, as if both of the parties are subject to international law.

⁴⁸ See Part I of this series, *supra* note 1, at 429-34.

tional law and at least two systems of domestic law, presumably including conflict of laws, may be applicable.⁴⁹

Against the background of applicable law, we may conclude that choice of a law whose application would violate basic principles of international law would not be given effect because, first, a State is a party to the agreement and, second, since the transaction is transnational in nature, international law establishes limitations upon the agreement itself.⁵⁰ Assuming that the choice of law provision complies with the broad terms of general international law,⁵¹ let us consider its validity under various concepts of conflict of laws. Indeed, there is no reason why normal conflict of laws rules should not be applied.

The validity of the choice of law of the State and the alien should be given effect unless the foreign investment agreement has "no substantial relationship" with the law chosen and "there is no other reasonable basis for the parties' choice."⁵² The choices of law referred to previously⁵³ appear to satisfy this test. In the case of the loan agreement of the American firm with the foreign government corporation, the law of the state of the United States there indicated certainly bears a "substantial relationship" to the transaction. The Libyan provision⁵⁴ for choice of law in petroleum concessions is similarly related, though double choice of Libyan law and international law might raise difficulty in determining which law is to be applied to resolve specific disputes.⁵⁵

Choice of governing law to be applied in the absence of party choice presents a more difficult problem, but not an insuperable one. In a recent article, Lord McNair concludes that to consider this problem in a rational way, we must rid ourselves of the idea that the only alternatives are public international law or the municipal law of the State party.⁵⁶ He concludes

⁴⁹ JESSUP, *TRANSNATIONAL LAW* ch. 3 (1956).

⁵⁰ RESTATEMENT, *FOREIGN RELATIONS LAW OF THE UNITED STATES* § 102 (Tent. Draft No. 3, 1959).

⁵¹ For a discussion of this point see Part I of this series, *supra* note 1, at 431.

⁵² RESTATEMENT (SECOND), *CONFLICT OF LAWS* § 332a (Tent. Draft No. 6, 1960). For a detailed discussion of this section see Part I, *supra* note 1, at 431-34.

⁵³ See text following note 44 *supra*.

⁵⁴ See text at note 46 *supra*.

⁵⁵ In the event of a conflict between applicable provisions of municipal law and international law, a municipal forum of the State may apply its own law. See, e.g., *Mortensen v. Peters*, [1906] Sess. Cas. 93 (Scot., Ct. of Justiciary). However, international courts have repeatedly held that a State cannot avoid the application of international law on the ground of conflict with municipal law. See, e.g., *Case concerning certain German interests in Polish Upper Silesia (The Merits)*, P.C.I.J., ser. A, No. 7 (1926); *Case of the Free Zones of Upper Savoy and the District of Gex*, P.C.I.J., ser. A, No. 24, at 12 (1930), ser. A/B, No. 46, at 167 (1932).

⁵⁶ McNair, *The General Principles of Law Recognized by Civilized Nations*, 33 BRIT. Y.B. INT'L L. 1, 4 (1958).

that such agreements are to be governed by "the general principles of law recognized by civilized nations."⁵⁷

We may remind ourselves that Professor Jessup has concluded that international or municipal law or both may be applicable.⁵⁸ That being the case, in choosing an applicable law to determine a dispute in the absence of party choice, we can resort to a well accepted principle of conflict of laws for guidance. In cases where the intention of the parties is unclear, courts frequently consider as an important factor the principle that the choice should be the law which will permit the carrying out of the obligations of the parties under the contract.⁵⁹ The objective is to give effect to the reasonable and justified expectations that the parties had upon conclusion of the agreement. One of those expectations is that both sides will reasonably perform within the terms of the agreement. Thus, the principle will require reference to a law which will uphold an agreement in preference to one which would invalidate it.

By applying the choice of law rule to effectuate the agreement, and by utilizing the broad choices suggested by the authorities referred to above,⁶⁰ we have a flexible and workable means of doing justice. In some cases, the choice will be the municipal law of the State party or of the foreign investor. In others, the choice will be "the general principles of law recognized by civilized nations," or perhaps, in an appropriate case, the law of some third State.

CONCLUSION

Although significant progress has been made with plans for foreign investment codes and tribunals to be established by conventions between States, it is believed that such plans are premature and largely unacceptable to many capital exporting and capital receiving States. On the other hand, the inclusion of arbitration provisions in foreign investment agreements establishes an economical and appropriate form of remedy which leaves the matter in the area of the free choice of the parties. Similarly, the parties can greatly facilitate the settlement of any unresolved disputes that might arise by setting out within the agreement a clear statement of the law to be applied. Because of the uncertainties of the quagmire of foreign investment agreements, careful and precise planning can go far to reduce the risk of the investor being without a remedy or without an adequate system of law in the event of dispute.

⁵⁷ *Id.* at 6, 10. See STATUTE OF THE PERMANENT COURT OF INTERNATIONAL JUSTICE, art. 38(c) (1920). See also Mann, *The Law Governing State Contracts*, 21 BRIT. Y.B. INT'L L. 11 (1944).

⁵⁸ See note 49 *supra* and accompanying text.

⁵⁹ RESTATEMENT (SECOND), CONFLICT OF LAWS § 332b, comment b (Tent. Draft No. 6, 1960). *Cf.* Pritchard v. Norton, 106 U.S. 124 (1882); *Teas v. Kimball*, 257 F.2d 817 (5th Cir. 1958).

⁶⁰ See notes 49, 56, and 57 *supra* and accompanying text.