
Phillipe Kahn
Centre National de la Recherche Scientifique

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THE LAW APPLICABLE TO FOREIGN INVESTMENTS: THE CONTRIBUTION OF THE WORLD BANK CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES

PHILLIPE KAHN†

(Translated from the French by ARTHUR M. FELL††)

The creation of the International Centre for the Settlement of Investment Disputes, under the auspices of the International Bank for Reconstruction and Development (World Bank), is the first step toward a solution of numerous problems raised by private investment in foreign countries, particularly in the underdeveloped nations. More than just a solution of practical problems is involved. The Convention of the Settlement of Investment Disputes between States and Nationals of Other States of March 18, 1965, which created the Centre, finds its place within an existing international juridical structure and to some extent it modifies that structure, while bringing into focus certain aspects of the structure which were not clearly discernible until now. To understand

†Chargé de recherche, Centre National de la Recherche Scientifique, Paris, France.
††Jervey Fellow in Comparative Law, Columbia University School of Law; Member of the New York and Indiana Bars.

1. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, (hereinafter cited as Convention) entered into force on October 14, 1965. By September 25, 1967 it had been signed by 55 states and ratified by the following 36 states: Cameroon, Central African Republic, Chad, Congo (Brazzaville), Cyprus, Dahomey, France, Gabon, Ghana, Iceland, Ivory Coast, Jamaica, Japan, Kenya, Korea, Malagasy Republic, Malawi, Malaysia, Mauritania, Morocco, Netherlands, Niger, Nigeria, Norway, Pakistan, Senegal, Sierra Leone, Sweden, Togo, Trinidad and Tobago, Tunisia, Uganda, United Kingdom, United States, Upper Volta, and Yugoslavia.

fully the system finally adopted, the Convention must be put in its context.

The facts are well known. Before they may even consider catching up with their industrialized neighbors, a large number of nations need substantial amounts of capital to provide decent standards of living for their populations. Local savings certainly furnish a large part of the required capital, but they are insufficient in view of the immensity of the need. The call for foreign capital is therefore extremely important, if not absolutely necessary. A large part of the outside capital presently forthcoming stems from public funds (gifts, loans, technical assistance), but these are insufficient in amount and their utilization is often subject to political, economic and administrative conditions which reduce their effectiveness. Foreign private investment, therefore, constitutes an extremely significant contribution to development, as a supplement to public aid and as a factor which injects flexibility.

However, holders of foreign capital show much reluctance to invest in developing nations and this reluctance is understandable on several grounds. Some investments will not be made because their profitability is uncertain. Here, the law can make no contribution. Many other outlays are not made because investors fear their interests will be expropriated or discriminated against, or that they and their capital will be trapped in the host State. Several widely publicized instances such as the Cuban nationalizations, the Suez Canal and the Iranian oil cases, together with a certain political instability in the capital-seeking nations, have provoked distrust which attempts are now being made to allay. To this end, three means can be utilized, with more or less success.

First, one may attempt to establish substantive rules of law designed to govern private investments in foreign countries. The existence of

3. "Although the developed nations added some 300 billion dollars to their combined gross national product from 1961 to 1966, the net total of public aid did not go much above the level of six billion dollars attained in 1961. With respect to national incomes, it dropped below 0.6%." Speech by George D. Woods, President of the World Bank Group, before the Association of Swedish Bankers, October 27, 1967.
clear and complete rules of international law, making possible the invocation of the rules of international responsibility of States, would reassure private investors and would encourage them either to proceed with new investments or to refrain from withdrawing investments already made. Thus, many draft multilateral conventions for the protection and fair treatment of foreign investments have been prepared. Until now, however, all of these projects have been unsuccessful. For the most part, they have been drawn up unilaterally by organizations or individuals from capital-exporting countries. They have erected rigid systems for the protection of foreign investments, without taking into account the interests or even the requirements of development in the host countries, and they have not taken into consideration the date at which the investments were made, thereby ignoring problems of decolonization. Although this kind of solution has not been completely abandoned—the project of the Organization for Economic Cooperation and Development (OECD) was recently approved by the Organization's Council—it no longer arouses the excitement that it did a few years ago. It appears now only as a far-off ideal.

The second means presently under study consists of the institution of an international insurance system which would protect private foreign investors against the risk of expropriation or destruction of their property in case of civil war and against the risk of non-transferability of capital and profits. About ten countries which export capital, including the United States, have national investment insurance programs. The Entente Group in Africa (Ivory Coast, Dahomey, Upper Volta, Niger, and Togo), a group of capital-importing countries, has created a regional loan insurance fund. A draft of a multilateral investment insurance plan was drawn up by the OECD and submitted to the World Bank in 1965.


5. See its text and the related resolution of the OECD Council in 7 Int'l L. Materials 117 (1968).
The World Bank studied it and prepared a second draft which was transmitted to the member governments for their consideration in November, 1966. Considering the technical complexity of such a system and the political problems that it raises, such as national aid to national exporters of capital versus anonymous international aid, and intervention of capital-importing countries in the management of the insurance fund, it is difficult to predict whether the plan will succeed and, if so, when.

A third means, arbitration, which is less ambitious but more pragmatic than the others, has been suggested. This suggestion takes cognizance of two basic facts. First, some disputes are bound to arise between the investor and the host State. Either the fears of the investor mentioned above are realized and a serious disagreement develops, or more generally and simply, the complexity of the transactions generated by the investment raises problems of interpretation or of liability concerning the obligations assumed by the parties. Such disputes, already sufficiently difficult to settle in themselves, are rendered more complicated by the status of the parties: a private investor, on the one hand, a State, on the other.

Second, there is no jurisdiction which is indisputably competent to settle the dispute. The International Court of Justice is not open to private parties, and thus cannot directly assume jurisdiction in an action between the investor and the host State. The courts of the host State, which normally would be jurisdictionally competent, are viewed with suspicion by the investors who may doubt their impartiality or who find that they function within a structure which may lead them to give priority to the interests of the host State over those of the private investor. The courts of the investor's State are viewed with at least the same amount of suspicion by the host State. Courts of some third State would lack sufficient standing to intervene and would be powerless in the face of limitations on jurisdiction and execution. Although the idea of an International Economic Court has been suggested, its realization is quite distant. It is therefore necessary to find a procedure, acceptable to both parties, which brings a judicial or quasi-judicial solution to these very special disputes.

Given the present state of the international community, only arbitration can alleviate the lack of judicial organization in the strict sense. Resting on the consent of the parties, it preserves their freedom or their sovereignty because they themselves choose their own judges and can determine, as they wish, the judges' mandate. Arbitration has in fact rendered great service in the area of investment and certain decisions
have acquired well-deserved celebrity. Although these decisions were able to point at the solution of difficult problems, the conditions under which they were rendered show that arbitration still constitutes an imperfect method for settling international investment disputes. The difficulties in setting up the arbitration tribunal have been clearly brought to light, as has the prevailing uncertainty about the law applicable in arbitration proceedings and to investments, and the obstacles to the execution of the decision.

The intervention of the World Bank rests on the two-fold determination that the existence of a jurisdiction, which is both impartial and attuned to economic problems, constitutes one of the most efficient means for encouraging private foreign investments in the developing countries, and that that jurisdiction can only be arbitral in character. The immediate goal of the World Bank Convention is to set up the International Centre for the Settlement of Investment Disputes and put it at the disposition of the contracting States and investors.

The jurisdiction of the Centre is based purely on consent and results from the agreement of the parties to invoke it by means of a *compromis* (agreement to submit to arbitration), an arbitral clause, or a unilateral declaration by the State followed by acceptance by the investor. The drafters of the Convention tried to limit themselves to the creation of a procedural organ. However, in such a complex matter it is not possible to retain a purely passive attitude. An attempt had to be made to resolve the problems which had arisen in earlier arbitrations; otherwise, the creation of the Centre would not have constituted progress. Specifically, in view of the uncertainty which exists as to the substantive law applicable to foreign investments and the methods of determining

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7. Several arbitration institutions have become interested in investment arbitration. However, the principal, and initially the sole, purpose of one of them, the Permanent Court of Arbitration at the Hague remains the arbitration of disputes between States. Others, including the Arbitration Court of the International Chamber of Commerce and the Arbitration Court of the American Arbitration Association, retain as their main purpose the arbitration of commercial disputes between private persons. The increase of disputes relative to sales of equipment where a State agency is a party tends to direct a large part of their activity towards the arbitration of disputes involving investments. However, the structure of these institutions and their rules are conceived with respect to traditional commercial actions, and their connections with business groups, whatever may be the value and impartiality of their arbitrators, prevents them from being ideal arbitration institutions for investments.
it, the drafters of the Convention had to provide precise guidelines on this subject. Provision of such guidelines is the purpose of Article 42 which was inserted in the section devoted to the powers and functions of the arbitral tribunal (Section 3).

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 to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

(2) The Tribunal may not bring in a finding of non liquet on the ground of silence or obscurity of the law.

(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute ex aequo et bono if the parties so agree.

Paragraph (1) is most interesting in that it fails to take definite positions on several controversies which have divided international lawyers, while paragraphs (2) and (3) merely elaborate on the provisions of paragraph (1). Investment is placed under a legal system which accords priority to the freedom of choice of the parties. The arbitrator must first determine whether the parties intended to submit their transactions to a given legal system; only in the absence of such a choice does the Convention establish objective tests which are then binding on the arbitrator. A study of the contribution of the Convention to choice of law with respect to investments must begin with recognition of this fact.

I. Rules of Law Adopted by the Parties

By giving priority to the rules of law adopted by the parties, the drafters of the Convention were faithful to their general scheme of granting a primary role in the functioning of the arbitration to the will or consent of the parties. In addition, their views coincide with those of the drafters of the European Convention on International Commercial Arbitration signed at Geneva, April 21, 1961 and the Hague

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8. The Centre is not competent unless the parties agreed to submit their dispute to it. Convention art. 25, para. 1. The Centre functions according to given rules except upon agreement to the contrary by the parties. Convention arts. 35, 37, 43, 44, 46, and 47.
1. The parties shall be free to determine, by agreement, the law to be applied by the arbitrators to the substance of the dispute. Failing any
Convention on the Law Applicable to International Sales of Goods, which was signed in 1955 and went into effect in 1964.\textsuperscript{10}

A further point should be made concerning the parties to the dispute. Apart from an international convention and without taking into account a customary law of investments, two kinds of juridical instruments may contain references to choice of law. In a number of cases, the investment is negotiated between the host State and the foreign investor. These negotiations lead to the signing of a contract, a loan contract or, if it is a direct investment, a concession or a\textit{ convention d'établissement}.\textsuperscript{11} All of these contracts can be grouped under the name, economic development agreements. There is a true bargain and an exchange of consent, expressed by the signing of the contract by representatives of the host State and the investor. In this type of agreement the substantive provisions established by the agreement are frequently supplemented by a specific provision specifying the law applicable to it. These provisions are generally tied to an arbitral clause (\textit{clause compromissoire}) providing for international arbitration in case of a dispute relating to the performance of the agreement. Such economic development agreements, however, are still few in number because they are only concluded in the case of large investments.\textsuperscript{12}

The majority of investments, at least as far as direct investments are concerned, are not governed by a contractual system. In the underdeveloped nations in particular, statutes establish an investment regime generally favoring foreigners (\textit{e.g.}, through fiscal advantages) which is available to those who apply and who satisfy the regulatory requirements. This system is usually a purely administrative one and the decree certifying that an applicant qualifies does not contain any provision as to the applicable law, any more than does the basic investment law or code. On the other hand, such legislation often contains provisions regarding arbitration in case of a dispute.\textsuperscript{13} In this event, when the dispute arises

\begin{itemize}
  \item indication by the parties as to the applicable law, the arbitrators shall apply the proper law under the rule of conflict that the arbitrators deem applicable.
  \item In both cases the arbitrators shall take into account the terms of the contract and trade usage. 484 U.N.T.S. 374.
  \item Article 2. "A sale is governed by the internal law of the country designated by the contracting parties. . . ." 1 AM. J. Comp. L. 275 (1952).
  \item Article 3. "In default of a law declared applicable by the parties. . . . a sale is governed by. . . ." 1 AM. J. Comp. L. 275 (1952).
  \item For a definition of investment see Kahn, supra note 4.
  \item Examples are found in Delaume, \textit{Des stipulations de droit applicable dans les accords de prêts et de développement économique et leur rôle}, REVUE BELGE DE DROIT INTERNATIONAL 12 (1968); Kahn, \textit{Problèmes juridiques de l'investissement dans les pays de l'ancienne Afrique Française}, 92 JOURNAL DU DROIT INTERNATIONAL 338 (1965).
  \item For example the AFGHANISTAN LAW OF INVESTMENTS (Journal Officiel, February 20, 1967, art. 19) provides for arbitration by the Centre. This is not an isolated case.
\end{itemize}
and an agreement to arbitrate is concluded (since there was no contract between the parties, there could have been no arbitral clause) it is not impossible, although it is improbable, that the State and the investor will be able to agree on the law that should be applied to govern their relations.\(^{14}\)

The language of Article 42, read literally, may permit the parties to adopt rules of law up to the time the Centre assumes authority, and perhaps even during the course of the arbitration proceedings—since the competence of the Centre is founded on the presence of a dispute, not the legal regime under which the investment was made. Nevertheless, it remains true that normally only the parties to an economic development agreement will have chosen the rules of law applicable to a dispute. The discussion which follows will proceed on the understanding that such an agreement exists.

In such cases, two problems appear most important: the first relates to the expression of the choice by the parties, the second to the object of their choice.

A. The Manifestation of the Choice

The arbitral tribunal will apply the rules of law agreed to by the parties, (in the equally authentic French text “adoptées par les parties”) but the Convention does not specify under what conditions the tribunal will determine that a given rule was agreed to. A question arises as to whether in order to bind the arbitrator the agreement must result from an express clause or whether it can be implied from other indications.\(^{15}\)

This is an important question because much of the effectiveness of Article 42 depends on the answer.

In the typical current international development agreement, particularly one concerned with direct investments, the parties often do not clearly stipulate a specific controlling legal system. Rather, certain elements of the contractual provisions as a whole merely infer an intention to link the agreement to one system or to exclude the application of another. As an illustration one might cite the arbitral award in the

\(\text{INVESTMENT CODES of Cameroon (art. 31), Congo (art. 41), Ivory Coast (art. 10), Dahomey (art. 38), and Gabon (art. 47).}\)

\(14.\) In reality things are more complex. There is almost always a discussion between the foreign investor and the competent agencies of the host State. The decree only puts into administrative form the fruits of a true agreement. There are even cases where besides the administrative act which is published officially, an unofficial, illegal contract is signed which develops in detail the obligations assumed by both parties. To the author's knowledge, there has never been a judicial or arbitration case which involved the two documents.

\(15.\) It should be noted that in putting substantive rules of law into their contract (or through administrative stipulations), the parties adopt rules of law and their choice is unambiguous. It remains to be seen whether those rules have been validly adopted.
dispute concerning an oil concession between Sapphire International Petroleum Ltd. (Sapphire), a Canadian oil company, and the National Iranian Oil Company (NIOC), an Iranian public company. The arbitrator decided that, given its context, the arbitration clause indicated "a negative intention, namely to reject the exclusive application of Iranian law"; he found support for this result in another clause calling for the parties to carry out the contract "according to the principles of good faith and good will." To the arbitrator, such a clause was scarcely compatible with the strict application of the internal law of a particular country. It much more often calls for the application of general principles of law, based upon reason and upon the common practice of civilized countries. . . .

From an examination of various other elements in the contract, the arbitrator deduced the juridical system which he felt constrained to apply to settle the dispute.

Since agreements of the above type are common, if the interpretation given to Article 42 were to require an express manifestation of intent, in most cases the second alternative would control, resulting in the application of the law of the host State. There are arguments in favor of this interpretation and excluding the reasoning process used by the arbitrator in the Sapphire case to discover the applicable law. The French text of the Report of the Executive Directors of the World Bank refers to the law "designated by the parties"; ("désigné par les parties") this seems to imply, if not an express reference to a juridical system, at least a clear choice. Furthermore, the notion of legal certainty and the particular resonance it assumes when State interests are at stake, suggests a requirement of express or otherwise clear reference to the legal system chosen.

However, it cannot be assumed that parties which proceed in the manner of the Sapphire agreement do so because of negligence or ignorance of the problem. Such an agreement is, more likely, an expression of compromise between a State which does not wish to officially renounce the application of its own law to the whole transaction, and a private investor, by hypothesis powerful, who does not wish to accept

16. These grounds were taken from Lalive, Un recent arbitrage Suisse entre un organisme d'etat et une société privee estrangere (Sapphire International Petroleum Limited v. National Iranian Oil Company) 21 Annuaire Suisse de Droit International 273-302 (1964). See also Lalive, Contracts Between a State or a State Agency and a Foreign Company, 13 Int'l Comp. L.Q. 987 (1964).
18. Id. at 1013.
total submission to a legal system that is controlled entirely by the other party. If paragraph (1) were to preclude a practice which allows this needed compromise the parties might well prefer to forego arbitration by the Centre—a result clearly at odds with the overall goal sought.

The only thing which is certain, for the moment, is the vagueness of Article 42 as to the form which the adoption of the governing law by the parties should take. No interpretation of it has been ventured by arbitrators but it may be useful to recall that the same problem was posed in the neighboring field of international sales. During the drafting of the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods, opened for signature at the Hague on July 1, 1964, the question arose whether the buyer could choose a legal system other than that instituted by the Convention and, if so, in what manner the choice might be specified. The special commission which prepared the preliminary draft had proposed that the parties should be able to exclude application of the uniform law provided they quoted in the contract the foreign rules agreed upon or indicated precisely. It was proposed that the reference be expressly included in a clause or clearly discernible from the provisions of the contract. This system had been finally adopted by the Hague Convention of June 15, 1955 on the law applicable to international sales: The parties could choose the law governing their sale but “such designation [had to be] the subject of an express clause or [had to] result without any doubt from the provisions of the contract.” After extensive discussion, the drafters of the 1964 Uniform Law Convention rejected the system proposed by the special commission and decided that the exclusion of the uniform law could be express or implied. The draftsmen of the earlier Convention sought to establish a rule whose application would not lead to controversy and which would accord a great deal of freedom to the parties provided they were sufficiently explicit. The draftsmen of the 1964 convention preferred to obtain a flexibility in application which would respect established practices and would not lead buyers and sellers to exclude systematically its application.

These two conventions show clearly how the form a rule of law takes can have an important practical impact. It can only be regretted that the drafters of the Convention on the Settlement of Investment Disputes did not indicate with greater precision how the parties should express their choice of law, particularly in view of the fact that the substantive law of investment is controversial and uncertain, and consequently the factors which may lead to its application are equally so.

20. Supra note 10.
In this respect, the Convention's vagueness reflects an excess of pragmatism.

B. The Object of the Parties' Choice

Article 42 refers to the adoption by the parties of "rules of law." This expression is unusual if it simply refers to a designation by the parties of the law of the State which will govern their transaction. The preliminary draft of the Convention, which was submitted to various regional conferences, employed a more traditional formula: "In the absence of agreement between the parties concerning the law to be applied..." The change in terminology is not fortuitous and it complicates further the substantive position generally embodied in the Convention, which might be termed a wait-and-see position. The language adopted permits a very wide range of interpretation, and would thus allow adoption of varying ideas now hotly debated on the doctrinal and practical levels. This liberalism, although not total, should be underscored because it constitutes one of the most positive contributions of the Convention. However, to the extent that the expression "rules of law" admits of several interpretations, it gives rise to uncertainty.

While matters are not always as clear-cut as they may appear in the following assertion, it may be recalled, with some oversimplification, that international investments—like other international contracts—may be governed by the internal law of a State, by public international law, by an international commercial law which is still being formed, or, in accordance with the theory of contract without law, by no law at all. The parties' choice may be exercised from among these different options.

That the parties can choose the law of any State to govern the investment does not appear to raise any particular difficulty, for such is the normal prerogative of the parties under the classical system for settling contractual conflict of laws. Of course, it has been debated whether the contract must have some contact with the State whose law is chosen, but this controversy appears to be nearing settlement.


23. Thus, the various Hague conventions on the international sale of goods, already noted in the text, accord the parties the greatest freedom despite the reticence expressed during the debates. The Czechoslovak law of December 4, 1963 on international private law recognizes the parties' right to choose the law of a state without requiring a connection between the chosen law and contract. This involved a change from previous legislation requiring such a connection. As international commerce becomes more and more institutionalized, the danger of fraud is not too important.
and in the present context is not of relevance. The requirement that a contract have minimal contacts with the state whose law is to be applied tended to prevent fraudulent evasion of the law of the State which would have jurisdiction in the absence of a choice by the parties. According to the traditional approach set out by the Permanent Court of International Justice in the case of *Serbian Loans and Brazilian Federal Loans*, it is presumed that a contract to which a State is a party will be governed by the law of that State. However, if the State itself renounces application of its own law to the contract, there is no fear of fraud and no reason why the parties may not choose the law of the State which seems most appropriate to them.

Of course, notwithstanding a State's consent to have the law of another jurisdiction applied to some aspects of an agreement, the presumption may still be valid that the host State did not intend the other system of law to apply to every aspect of the agreement, and that aspects of the agreement which are immediately linked to the law of the host State should continue to be governed by that law. Thus, there remains the extremely complex problem of ascertaining which laws of the jurisdiction chosen by the parties should be invoked and which laws of the host State remain applicable. The difficulty is particularly acute because in the area of investment law there are numerous laws and regulations which may have immediate application: for example, exchange restrictions, real property laws, and labor codes. Although a judge from one State can, when he has jurisdiction, sort these out by applying his own national legal system, with which he is most familiar, an international arbitrator, such as the Convention envisages, is poorly equipped to make such an apportionment between the laws and fundamental interests of the two States.

The problem assumes different forms depending upon whether the investment is direct or in the form of a loan. Where the choice of law was made in the contract, there exists a great difference between a contract relating to a direct investment and all other international contracts. In a transportation or a sales contract, the obligations of the parties are relatively simple. By contrast, in the investment contract the investor undertakes to carry out a given investment under prescribed conditions and the host State, for its part, guarantees the application to it of a certain legal regime. To fulfill his obligation the investor will

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and it can always be dealt with under the doctrines of fraud or evasion of the law. On the other hand, a restrictive system can impede benefits from experience acquired in other countries and will not lead to placing the relations involved under an adequate system.

enter into a series of contracts, involving such matters as sales, purchases, construction, and hiring of personnel, each of which will have its own legal status and the majority of which will be performed in the host State. The investment contract constitutes the basic document of direction and synthesis of these other contracts. As for the host State, the obligations it undertakes depend on its State powers in the narrow sense of the term: for example, tax arrangements and exemptions, customs tariffs, expropriations or real property concessions for the benefit of the investor, and financial transfers abroad. The application of a law other than the host State's, even if such other law were chosen by the parties, would be most difficult—even dismissing other reasons for rejecting such law. In fact, the parties seldom choose the law of a State other than that of the host State. After studying eighty such agreements, M. Delaume does not cite a single clause adopting the law of a third State. The author has never encountered any. On the other hand, the law of the host State is quite often chosen. M. Delaume enumerates about fifty instances. It should be added that a rather large number of investment codes and laws provide, at least tacitly, for the application of the law of the host State to agreements concluded under them.

In contrast, when the investment is not direct but takes the form of a loan, stipulations as to choice of law of some State other than the host State are much more common. It has become almost customary to adopt the law of the State from which a loan issues rather than the law of the borrowing State or of the State of which the borrower is a subordinate agency. Traditional conflict of law rules are for the most part still applicable to loan contracts since a loan contract more closely resembles the traditional kind of contract than it does the complex direct investment agreement.

The real problem, therefore, concerns investment agreements, the majority of which, as the preceding discussion indicates, do not refer to a specific state law. In their attempts to determine the applicable legal system, some authors maintain that agreements concluded between a

25. Delaume, supra note 12.
26. In such cases, the law includes provisions as to arbitration, but on the one hand it provides that the arbitration will come into play if a dispute arises concerning the interpretation of the law and, on the other hand it is specified how the arbitration procedure will take place (designation of arbitrators, delays, force and execution of the decision) without any reference to international law, equity, amiable composition, etc.
28. This thesis was set forth in its most complete form by Verdross, Protection of Private Property under Quasi-International Agreements, VARIA JURIS GENTIUM. LIBER AMICORUM PRESENTED TO JEAN-PIERRE ADRIEN FRANCOIS 355 (1959).
State and a private investor constitute "quasi-international agreements" because—at least considering the balance of forces existing at the time the theory was set forth—they are agreements between equals. From this premise Verdross draws an initial negative conclusion that, because of the equality of the contracting parties, these agreements are not governed by the internal law of the State and that they are not international treaties, since the investor is not a subject of international law. He then draws a second, positive, conclusion: These agreements are characterized by the fact that they are governed by a new juridical order created by the concurrence of the parties' wills (the agreed lex contractus). "The lex contractus created by a quasi-international agreement is an independent legal order, regulating the relation between the parties exhaustively."

Article 42 of the Convention seems to exclude such a system. Delaume, who has made the most exhaustive commentary on the Convention to date considers it certain that by the expression "rules of law" the drafters meant to submit the investment to a particular legal order. Confirmation of this may be found in the method for determining the governing legal system when the parties do not express a choice. The author shares this opinion, but the limits of the exclusion of the contract without law concept must be carefully indicated because that theory is often confused with the theory which asserts that an international commercial law is in the process of formation.

The theory of contract without law, which has been accepted, in effect, by a few courts and has been argued before international jurisdictions, was born out of the difficulties in applying State laws for the regulation of economic relations caused by the laws' insufficiency or backwardness in relation to technical developments. These difficulties, very obvious in the case of the principal international contracts, are even more acute in the area of investment for two reasons: the complex nature of this new notion of investment as opposed to the archaic local law of under-developed countries (it is dealt with in rather an elementary manner in most other countries as well); and the fact that the parties concerned are a State and a private party, which means that

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29. This terminology was introduced by G. Schwarzenberger, I International Law Applied by International Courts and Tribunals 578 (1957).
30. Verdross, supra note 28, at 358.
31. Supra note 2, at 44.
34. See the ARAMCO case, supra note 6.
neither public international law nor private international law gives satisfactory solutions. Verdross' remarks in this respect are perfectly justified. Starting with these diverse findings and utilizing the resources of contractual freedom recognized by nearly all legal systems on the international level, the practitioners of international commerce have constructed highly developed contractual formulas and have had their disputes settled not by State judges but by arbitrators. Some writers have concluded from this that we are dealing with a contract without law, reflecting only the will of the parties. Without going into detail on a subject which merits detailed study, it must be said that this conclusion is excessive. All one can affirm, based on the practices in effect, is that the contracts are not governed by a particular State law, not that they are outside all juridical systems. At any rate, the contract must be executed within the structure of a social environment, and the solidarity which must exist therein forbids an isolation as complete as thought possible by those who embrace the theory of contract without law. There is at the very least a confrontation between the will of the parties and the public social order (international or internal), even without considering the problem of filling in the gaps of the contract and the problems resulting from obsolescence of contractual provisions.

The question remains whether certain references to international law made in investment contracts are valid within the framework of the Convention. In a rather large number of investment agreements at least a partial submission to public international law is variously provided for. For instance, in the agreement between the Ivory Coast and the Société Ivoirienne de Ciments et de Matériaux (S.I.C.M.) it is provided that in case of a dispute the World Bank's Arbitration Centre will have competence, but there is no express stipulation as to the law the arbitrators should apply. However, the body of the agreement contains provisions from which one can draw several interesting indications. For example, the government assures the stockholders of S.I.C.M. that it has no intention to nationalize the property of the company, but that if circumstances compel nationalization it will grant them "according to international law, prior payment of an indemnity to be determined on the basis of the surrender value of the shares as prescribed by the by-laws of S.I.C.M." Although less precise, clauses 26 and 27 of the same agreement on the stabilization of legislation and non-discrimination are understandable only from an international law perspective. In contrast, the clause concerning relations in the actual administration of the agreement stipulates the internal legislation of Ivory Coast as the immediately applicable law.

It must be further noted that in many "establishment conventions"
and economic development agreements, one finds some elements governed by international law and others by the law of the contracting State, while in the arbitration clause it is indicated that the arbitrators will act as *amiable compositeurs*. The meaning of such a clause is quite controversial\(^6\) and this issue will not be treated herein. However, the whole of such a contract is so complete and precise that it could not be reasonably maintained that the clause destroys this whole ordering and authorizes the arbitrators to judge according to their intuition and a vague idea of equity. The clause might more readily be seen as a means, whatever its worth may be, for rejecting the application of internal State law which would have been required by the mechanical play of traditional conflict of laws theory.

The distinction is well drawn in a contract between COMILOG and Gabon. The arbitration clause contains the reference to *amiable composition* (friendly mediation). But the general agreement also includes an annex which determines how and at what price manganese ore, whose exploitation is the object of the investment, will be allocated between COMILOG and United States Steel; disputes arising under this annex agreement are to be settled by a different arbitration proceeding and the applicable law is French law.

Finally, a third type of formula which is frequently used is the reference to general principles of law recognized by civilized nations. The clause is common in petroleum contracts. It was widely discussed at the time of the *Sheik of Abu Dhabi*, ARAMCO and *Sapphire* arbitration cases\(^7\) and is therefore well known.

In the light of this important trend in practice, and the positive reception given by arbitrators to the above cited provisions, strong doctrinal opposition has been expressed. It is based on two principal arguments, one theoretical, the other practical.

The theoretical argument is very simple: public international law is designed to govern relations between States, and, if necessary between States and international organizations, not to govern juridical relations involving private persons.\(^8\) The argument would be valid if the fact that an international relation which involved a private person is governed by international law could lead to that person's acquiring status as a subject of that law; *i.e.*, if concepts of public international law were deformed. However, insofar as public international law establishes substantive rules

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37. Cases cited note 6 supra.
of law and subordinates legal relations to them, there is no logical or metaphysical difficulty preventing reference to that body of law, provided the rules set up are technically satisfactory.

However, as a practical matter rules of public international law may not be satisfactory. Because public international law developed principally to govern relations between States, it is poorly adapted to the role it is asked to play in investments; it has many lacunae and investment agreements were not a consideration in its evolution. However, whether the contract is not linked to any law or is linked to public international law, the result is the same: a juridical void appears. The practical argument against the use of public international law has a real but relative value. The gaps can be filled by various means. For example, expanding the notion of international law is one means. In this respect, the World Bank Convention makes some positive contributions.

First, the Convention undoubtedly was meant to ratify practical usages and to grant the possibility that the parties might adopt international law to control their agreement. In addition to the broad character of the notion of "rules of law," Article 42 provides for the application of the principles of international law side by side with the law of the State party to the dispute when the parties have not adopted any rules of law. It would be completely illogical if the parties could not themselves adopt a system of law which the Convention imposes on them if they remain silent as to the applicable law.

Second, Article 42(2) provides that the arbitral tribunal cannot refuse to make a decision on the pretext of silence or obscurity of the law. This provision is intended to settle the controversy as to whether the arbitrator can (or must) refuse to rule when the applicable law is insufficient or obscure and thus eliminate the possibility of an interruption in the arbitration proceedings or a refusal by a party to obey a decision on the grounds that the arbitrator abused his grant of power when he decided on the basis of a broad interpretation of a law. At the same time, however, it creates a mechanism for regulations and adaptation, by giving to the arbitrator the power to create a rule of law or to interpret broadly the rules provided by the Convention. Arbitrators have already shown this spirit of research in the petroleum decisions cited above, and have even displayed a creative spirit: In a lesser known decision handed down in an arbitration between a French public

39. This is so, at least in the monist conception which recognizes a privileged position to international law. See Scelle, Precis de Droit des Gens (1932).
40. See in agreement, Delaume, supra note 2.
41. See L. Siorat, supra note 36.
42. See note 6 supra.
works company and the Yugoslav government, the arbitrators held that, in an unexecuted, long-term contract calling for deferred payments, an exchange guarantee existed. In the author's opinion, the World Bank Convention ratifies the practices previously followed by arbitrators, or at least by some arbitrators, giving these practices a degree of certainty which they lacked until now. It is submitted that the parties can link their investment to public international law even without necessarily making a distinction between traditional (public) international law and (public) international economic and social law.

However, the question remains whether the authors of the Convention meant to give status to a new theory known in Europe as "the doctrine of the New Law Merchant," which resembles to a degree the ideas of Philip C. Jessup in his celebrated work, *Transnational Law*. This doctrine in some respects occupies a middle ground between the theory of contract without law and the theory which would put investment law under (public) international economic law. Its point of departure is that legal relations concerned with international commercial law (in the large sense: sales and accessory contracts, financial relations, and investments) in addition to being governed by national laws, are governed by substantive rules of law whose sources are principally contracts and general conditions elaborated by practitioners, and also bilateral and multilateral treaties, arbitration awards, etc. These rules are applicable not only to private persons who participate in international commercial transactions but also to public persons (States, agencies of States, and international organizations) when they participate in such transactions. In engaging in these transactions, public persons contribute to the elaboration of these rules.

The doctrine of the New Law Merchant differs from the theory of contract without law in the method of elaboration of the rule of law: it does not grow out of individual contractual relations but out of a multiplicity of relations in a relatively closed environment wherein the members habitually engage in international commercial transactions. They also differ in place and duration: there exists an extensive body of more or less coherent rules, the extent and other features of which are

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43. Société Européene d'Etudes et d'Entreprise v. Republique Populaire Federale de Yougoslavie, 86 J. Droit Int'l (Clunet) 1074 (1959). The arbitral tribunal was composed of M.M. Ripert and Panchaud.
44. For this distinction see the Introduction to P. Vellas, *I Droit International Economique et Social* (1965).
45. Its principal representatives are, according to Kegel: Goldman, Schmitthoff, Kahn, Langen, Recket, Goldstjan; Fouchard should now be added to the list. The following of the school has greatly increased since 1964, the date of Kegel's course at The Hague.
in themselves a proper subject for separate study, which applies to all international transactions and it is only within the framework of this body of rules that the parties' rather broad freedom of will is exercised.

The doctrine differs also from the theory which links international commercial operations involving a State to public international law, even international economic law. For the doctrine of the New Law Merchant, the participation of a State in an international commercial transaction certainly poses specific problems but it does not fundamentally modify the technical legal mechanisms applied to the transaction. It is not necessary, therefore, to make a sharp division between commercial transactions which involve a State and those which do not. An international economic law, composed essentially of substantive law but also of conflict rules, may thus coexist with public international law. As a new body of law in the course of formation, it is necessarily incomplete and sometimes uncertain, but it is developing, at least in the opinion of those who propose that it be recognized.

Although no express reference is made to this body of law, which has not yet even received a name, numerous clauses can be correctly interpreted only by admitting the existence of such law. Such is the case for most clauses referring to equity, amiable composition (friendly mediation), good faith, general principles of law, and customary professional practices, in contracts whose other provisions are often nothing more than applications of this international economic law. Here, too, the few recent decisions are very valuable because they permit us to see how the notion is being assimilated. An example is the Sapphire decision\(^\text{47}\) where the arbitrator decided to interpret the contract according to general principles of law:

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

\[^{47}\text{See Lalive, supra note 17.}\]
Finally, they being contracts *sui generis* which cannot be classified as one of the contracts specially regulated by the codes, only the general rules concerning performance or lack of performance of a contract can usefully be applied.48

Clearly, public international law is not the sole basis of the decision since the arbitrator refers to the law of contracts. Elsewhere in his opinion he clearly emphasizes the special character of investment contracts which depend on public and private law in the traditional sense. The existence of an international commercial or economic law allows a more exact synthesis of relevant international phenomena. In the author's opinion Article 42 does not prevent the parties from choosing such a legal system since it truly does constitute a system, but the manner in which the choice must be made will evidently play a preponderant role. One cannot emphasize too much the fact that international commercial law is in the course of formation, already well elaborated in certain branches such as sales and transport, but still in its infancy in the area of investments. As was emphasized at the beginning of this study, the principles established by the capital-exporting countries are often pure and simple reproductions of the demands of private investors and are not accepted by the capital-importing countries. It would be wrong to think that an economic law still being formed can find its sources in texts which have not been able to obtain a consensus. A long period of research is opening with respect to investments which will establish the principles which should be applied in the interest of both private investors and the developing countries. It is largely because international law does not reflect consideration for the needs of the developing countries and has not yet sufficiently evolved that its authority is disputed; and it is disputed particularly in the area of investments. The Latin American States did not want to ratify the World Bank Convention because they feared an infringement on their sovereignty through a broad interpretation of its provisions. With respect to choice of law, there is a definite danger of interpretations leading to an abusive and clumsy protection of individual investors, which might ultimately harm such investors if the States refuse to arbitrate.

II. The Applicable Law in the Absence of a Manifestation of Choice by the Parties

When the parties have not adopted rules of law, the arbitrators must apply the mandatory system set out in the second part of the first paragraph of Article 42, *i.e.*, the law of the State party to the contract,

48. *Id.* at 1015.
including its rules of conflict of laws, and such principles of international law as may be applicable. This mandatory system is in direct contrast to the preliminary draft of the Convention which gave arbitrators the power to choose from among rules of national or international law those that they felt appropriate. The flexible formula in the preliminary draft was similar to that used by the European Convention on International Commercial Arbitration signed at Geneva in 1961, but the wide liberty of choice given to the arbitrators was rather violently criticized. Consequently the final text embodies mandatory rules. In principle, the final text appears superior to the preliminary draft. While it is desirable that the parties be given the widest freedom compatible with international solidarity to arrange their legal relations, including the choice of applicable law, it is also necessary that the parties know in advance that their silence as to the applicable law will bring about the application of a well determined legal system.

Involved is not only a question of legal certainty, which would apply to any convention containing provisions as to choice of law in a contract, but also a consideration tied to the participation of the States in international economic life: Any relinquishment of sovereignty should be made under the clearest conditions, so that the State can weigh exactly what it is entering into in relation to the interests at stake, and only then will the undertaking merit respect. This point is of great significance since the disposition provided in the absence of a choice by the parties will be used often, either because the parties remained silent or did not express their wishes clearly, or because the procedure employed in investing was non-contractual. Although Article 42 seems to treat with equality the law of the contracting State and the principles of international law, and thus a problem of hierarchy or combination arises, each of these two terms will first be analyzed individually.

A. Application of the Law of the Contracting State

The application of the law of the contracting State constitutes the positive law established by the Convention. To be appreciated fully, this solution should be studied by examining both its theoretical justification and its technical functioning.

1. Justifications

The justifications for this solution are numerous, and even if each of them is not entirely convincing by itself, together they make an impressive bundle of arguments in favor of the law of the contracting State.

49. See Broches, *supra* note 21, at 13-14.
First, it has long been admitted in theory, and has been proclaimed by the Permanent Court of International Justice, that there is a presumption favoring the law of the contracting State in a contract between a State and a private party. This judgment of the Permanent Court may not have exactly the meaning that has been attached to it by some. In fact, the court did not answer the arguments of the parties who attempted to distinguish between contracts where the State intervenes as a public person and contracts where it intervenes as a private person, contending that the presumption existed only in the former case. Moreover, with respect to the question of to which of these two categories the loan contract belonged, the Permanent Court was content to say that the borrower was "a sovereign State which can not be presumed to have submitted the substance of its debt and the validity of its engagements to any law other than its own." Whether the court intended to apply the presumption to all contracts or only to those which depend specially on public authority, such as the loan contract, is not clear. Numerous high courts have since rejected the presumption. It is questioned on both the ground that the notion of State sovereignty is obsolete and should be limited to the defense of essential State interests, and the ground that international commerce needs more flexibility. Nonetheless, the presumption is still defended in many countries.

It has been specifically emphasized in opposition to the reasoning of the Permanent Court and of those authors who approve its doctrine, that the value of the notion of sovereignty in the area of investments is questionable. Until now most investment agreements have been made between relatively weak States and powerful international companies. Indeed, it is this fact which led Verdross to maintain his theory of quasi-treaty. Viewed in this perspective State sovereignty is a pure abstraction which does not take into account the balance of forces between the parties. However, granting that this criticism possesses some validity it is, nonetheless, of only relative merit. Within the structure of the World Bank Convention, arbitration may occur between private persons and developing countries or industrialized countries. For example, the United States has declared its intention to submit all of its investment litigation to the Centre. From another standpoint, as the developing nations progress, their power and their bargaining strength will grow. Moreover, although until now economic theory has accorded the most

51. Id. at 125.
important role at the take-off stage to large investments which can only be made by large companies, a reversal seems to be taking place, and the value of agricultural investments and of medium-sized industrial investments which permit the transfer of technology is becoming apparent. The diversification of production and the adaptation of economic theories should bring about in the near future the conclusion of more contracts relating to small and moderate-sized investments made by less powerful companies. Thus in the years to come, the instances in which a weak State faces a more powerful party will be fewer.

It is difficult to maintain that the regulation of investments and their submission to a given legal regime does not involve the notion of public authority. Economic development is vital for the host State, and the link between investment and development assumes special importance in view of that fact. Public authority appears in the engagements of the State since these engagements impinge on fiscal matters, customs, monetary transfers, land expropriations, stabilization of legislation, and other matters. These remarks are not intended as an argument for the proposition that the sovereignty of the host State necessarily justifies the application of its law. To justify the application or non-application of its law by invoking or denying State sovereignty, or the exercise of public authority, is not a proper approach because it does not lead to a realistic understanding of the interests at stake.

From another viewpoint, by admitting that the investment was made pursuant to a contract between the host State and the private investor and that the contract qualifies as a private law contract, the traditional conflict of laws approach, as it is adopted in almost all countries, leads in the majority of cases to the application of the law of the host State. In fact, it is most often the host State in which the investment contract is concluded and in which the investment is carried out in performance of the contract. However, the performance in question is not directly related to the contribution of the capital. It is often argued that the monetary performance does not have great weight in determining the place of a contract, except in the case of a loan, because it is neutral and is expressed in most bilateral contracts in the form of a price, a rent, or a percentage return. It is the non-monetary counter-performance which gives every contract its individuality. But here this otherwise valid proposition becomes questionable, for it is the existence of the foreign capital which, in the absence of sufficient local capital, will permit the investment to be made at all, and the true importance of this fact elides, or at least limits, the weight given to the place where the

53. Kahn, supra note 4, at 395.
non-monetary performance is situated. The investor furnishes monetary payment which is transformed into a non-monetary performance, while the State, at least in the case of direct investments, furnishes authorizations and advantages. Once more the traditional formulas are poorly adapted to the realities of investment. The problem is simpler when the investment is made in the form of a loan, but from a practical standpoint, it might be added that even here some problems can arise when an investment made in the form of a loan covers several States, for instance, when a mine straddles two States, or a bridge is constructed on a boundary river.

Although the justifications proposed are not, on final analysis, completely convincing, the adoption of the law of the host State to govern the investment, at least in part, must be approved, primarily for practical reasons. It is most important that the parties be able to adopt a legal system which seems to them best capable of satisfying their needs. If they did not do so, or could not agree, and the investor has, nevertheless, persevered in the project, the factor which becomes important is predictability. The law of the host State is the one which is most easily known to both parties. In any case, it will be applied to a large number of transactions entered into by the investor in the host State either because they are of an internal character, or because they are immediately governed by the law of the host State despite their international flavor. It is preferable to have a single law govern the investment to the extent possible, but reference to the law of the contracting State must permit the application of international law where appropriate. This question would not arise but for the fact that in the Convention the reference to the law of the contracting State includes not only its substantive law but also its conflict of laws rules.

2. Functioning

The functioning of the Convention's system will be more or less complex depending on how one interprets its conflict of laws rules. The first possible interpretation is that since the parties have not adopted rules of law to govern their relations, the conflict rules of the host State will determine the applicable law: The substantive law of that country should control if it is designated by the country's own private international law; the law of another country or legal system should control if the country's conflicts rule leads to such a solution. In any case the laws of immediate application should be applied, no matter what solution the conflicts rules lead to. Thus, the formula of Article 42, calling for application of the host State law including its conflict of laws rules, can be so construed as to result in an apportionment between substantive
law and conflict of laws rules.

However, the foregoing interpretation cannot be maintained. First, on the purely literal level, primacy is given to the substantive law of the host State. Conflict of laws rules are mentioned to specify, not to contradict, the usual interpretation according to which designation of the applicable law equals designation of its substantive law. In addition, had it been desired to give primacy to conflict of laws rules, it would have been sufficient to refer only to the conflict rules. Moreover, as already emphasized, it is doubtful that at the moment a system of conflicts of laws functions with sufficient certainty in the area of investments. Many of the disputes concerning investments result from this very uncertainty in the substantive law of investments and in the processes through which that substantive law is found. Finally, arbitrators are poorly equipped to recognize the laws of immediate application of a given country.

One is thus led to a second interpretation which envisages a case of contractual renvoi. We will not take up here the old controversy concerning renvoi, but only make one or two remarks. Not long ago, a French author made a plea in favor of renvoi, in which, after thorough study, he showed that on final analysis the justification for renvoi is not theoretical and that renvoi is not an essential doctrine in international private law, but it should be retained for its practical value. The pragmatism of the Convention's draftsmen indicates that this is the position which ought to be adopted.

Renvoi was justified unambiguously by Delaume: the presumption which favors the internal law of the host State would be contrary to usages and practices followed, if not for all investments, at least for international loans. He found that often the law of the borrowing State, including the case law of its courts, determines that the law applicable to a loan contract is that of the issuing country. On the basis of this determination, which is entirely correct, Professor Schwarzenberger concludes that, "[t]o limit the reference to the substantive law of the State party to the dispute would mean to be more insistent on the application of that law than would be the municipal courts of that State." Delaume adds that the play of the conflict of laws rules appears very simple. These two statements appear questionable.

Professor Schwarzenberger's argument disregards the modalities

55. Delaume, supra note 2, at 46.
of the operation of conflict of laws rules as these rules are traditionally understood and the change of perspective that the Convention offers. In fact, if the investment were an ordinary legal transaction, a court in the host State would take jurisdiction by virtue of some rule of competence. Then, having determined that the transaction submitted to it was international, it would apply the guidelines of its own national conflict of laws rules to determine what legal system had the most contracts with the transaction, the internal law of the host State, or the internal law of another State. However, under the Convention, the determination that the dispute concerns an international investment establishes the competence of the Centre, assuming the other necessary conditions, such as consent of the parties, are present. Since there is no longer an applicable national conflicts system, it was necessary that the Convention specify how the law applicable to the dispute would be found. It could have specified a substantive law, national or international or a conflict of laws rule, national or ad hoc. If only the internal law of the contracting State had been designated, this would not constitute a more cavalier attitude than that of jurisdictions which sometimes designate their own internal law, and sometimes that of another State; it would have been a choice between possible solutions in favor of the one best qualified to govern an international investment. The drafters of the Convention combined the two methods so as to limit the application of the internal law of the host State for the sake of exactitude and simplicity.

Delaume’s reasoning rests on an implicit alternative: direct investments, which at present constitute the majority of private investments, are governed by the substantive law of the host State for reasons explained earlier, while investments in the form of loans must be governed by the host State’s system of conflicts rules which for the most part will refer to the internal law of a country other than the borrowing country. But the concept of investment is complex and includes more than two categories. It is necessary to add medium and long term export credits, and technical aid such as grants of patent licenses, transfer of know-how, and engineering and study contracts. Given the very general terms of the Convention, one must ask whether it will be the substantive law or the conflicts law of the host State which will be applied in each special case, taking into account the type of investment involved.

How will renvoi come into play? Most authors, even those most favorable to renvoi, conclude that it is an unnecessary complication in
the contractual area. The Hague Convention on Conflicts of Laws in Sales strictly forbids it. In comparative law, it is rarely defended in the area of contracts. In sum, we do not have enough experience to justify or facilitate the introduction of such a complex technique into a subject area which is already complex in itself. What would make matters ever worse is the possibility that the Convention might be interpreted as introducing a system of second degree renvoi.

In reality, the Convention's authors tried to fill one of the largest gaps in the Convention: the absence of any definition of investment or of an enumeration of investments. This was not an involuntary omission but rather the result of disagreement over the definition or definitions to be adopted. Where the parties have expressed their desires, this gap can be filled. However, in other cases, the pragmatism of the Convention's authors is checkmated by the necessity of giving general rules applicable to all investments when coverage of only a single type of investment is sought. The provisions of Article 42 furnish a good example. It would have been relatively easy to give the most appropriate points of contact for each type of investment and to determine the substantive law applicable to each type. For lack of these necessary distinctions, the draftsmen of the Convention had to use the general theory of private international law which is applicable to all kinds of investments to resolve the special problem of loans. This choice introduces a large complication and is quite surprising since it goes contrary to the evolution of classical conflict of laws rules for contracts: it was attempted at first to find criteria valid for all contracts, but the current tendency has been to establish tests depending on the kind of contract. In the area of investments concrete solutions should be sought even more than elsewhere.

B. The Principles of International Law

In the absence of a choice by the parties, the arbitral tribunal will also apply such principles of international law as may be applicable. Two questions arise: the hierarchy of sources and the content of those principles.

1. The Hierarchy of Sources

The arbitral tribunal must apply the law of the State party to the dispute and the principles of international law: Should it apply the latter only in case of gaps in the former, or should the law of the State be

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57. H. Batifol, Traité Élémentaire de Droit International Privé 357 (3d ed. 1959); P. Fouchard, L'Arbitrage Commercial International 545 (1965); for a more subtle position, see Goldman, Les conflits de lois dans l'arbitrage international de droit privé, Recueil des Cours de l'Academie de Droit International 377 (1963).
subordinated to the principles of international law, the arbitrators being authorized to refuse application of a provision of internal law which does not conform with international law? It may be asked whether there is a sufficient differentiation in their fields of application to permit simultaneous application of the two laws in a compromise feasible in practice though not in theory. There was some unwillingness on the part of some countries to permit reference to the norms of international law in the Convention. The text in its present formulation would indicate if taken literally, simultaneous application of the two laws, but the reference to the law of the State should counsel prudence to arbitrators and guide them to call on the more general rules of international law only where the State law is not well adapted to settlement of the dispute or in case of flagrant violation of the law of nations. Obviously, this supposes that the content of the principles of international law will permit such a construction.

2. The Content of the Principles of International Law

In its final form, the Convention, contrary to the preliminary draft, does not give any definition of the international law principles in question. However, the Report of the Executive Directors of the World Bank indicates that what was meant was the rules of international law relevant to the case and that international law is the law whose sources are indicated in Article 38 of the Statute of the Permanent Court of International Justice, with the well understood reservation of necessary adaptations since that Statute only refers to inter-State disputes. What must therefore be determined is which are the appropriate rules of international law.

These will first of all be found in investment treaties. There is by now a rather large number of bilateral agreements whose object is to establish a system for investments by nationals of the two States.

58. See Broches, supra note 21, at 13-14.
59. Article 38 of the Statute of the International Court of Justice: The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
   a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
   b. international custom, as evidence of a general practice accepted as law;
   c. the general principles of law recognized by civilized nations;
   d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. See REPORT, supra note 19.
60. The Role of Private Enterprise in Investments and Export Promotion in Developing Countries (UN Conference on Trade and Development), Document T/35/ Supp. 1, November 17, 1967, No. 124 (Stikker Report) lists up to July 31, 1967, thirty-five treaties concluded by the Federal Republic of (West) Germany, sixteen by Switzerland, four by the Netherlands, two by Belgium, and one by the United Kingdom.
It is clear that certain guidelines are beginning to develop from these texts, and they are bound to grow stronger with time. However, the first treaty of this type was the German-Pakistan agreement concluded in 1959, and the related practice is still too young to affirm the existence of a custom within the meaning of Article 38 of the Statute of the Permanent Court of International Justice. Rather, a custom is in the process of developing. On the other hand, there are no other multilateral conventions or treaty-laws establishing a legal regime for foreign investments. GATT, and the treaties establishing OECD and the European Economic Community contain provisions relating to the movement of capital, but these are both vague and limited. The World Bank Convention is the only multilateral convention with provisions on the law of investment.

The question of the existence of general principles on this subject was discussed and commented upon at the time of the landmark arbitrations cited earlier. The examples provided by Lord Shawcross in his lecture at the Hague Academy of International Law may be cited. He recognizes the right of a State to expropriate foreign property but only for public purposes, without discrimination and against the payment of immediate, adequate and effective indemnity; he also considers *pacta sunt servanda* an applicable general principle. However, the scope of these principles is controversial and their interpretation and application raise great difficulties. The principles are also insufficient because they are narrowly and particularly concerned with the protection of the private investor, and do not establish true long-term relations for the purpose of economic development.

It would be much more useful, for example, to have principles of international law pertinent to such problems as defects vitiating consent of either party in contracts between a host State and foreign investors, the tests for determining the nationality of investing companies, the sanctions for non-execution of obligations either by the private investor or by the host State, and the modification of contracts because of changed circumstances. These are the problems which arise daily in relations between foreign investors and host States—not expropriations without compensation, which, despite the publicity given them, are quite exceptional, save in times of crisis. Indeed the development of a well-balanced law of international economic relations might be the best

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To these treaties must be added numerous commercial, shipping, and establishment treaties which have provisions on investments.


way to avoid or reduce the problem of nationalizations. Even with respect to the protection of foreign property, Dirk Stikker, in his report to U.N.C.T.A.D. dealing with the primacy of law, recognizes that, while sovereignty is exercised within limits determined by law, the content of the applicable law is rather imprecise and controversial. He cites as evidence the United Nations General Assembly Resolution on permanent sovereignty over natural wealth and resources. Here again principles are in the process of being established to govern relations between States and private foreign persons, but they cannot be considered as constituting positive law within the meaning of Article 38 of the Statute of the Permanent Court of International Justice. It is submitted, however, that the Centre's arbitrators can, within the structure of the powers conferred on them by paragraph 2 of Article 42, seek inspiration in the provisions of bilateral treaties. It should also be noted that the parties themselves have a wider range of choice than the arbitrators since the only limit on their freedom seems to be that they must link their relations to a legal system.

The practice of a State in a series of analogous contracts constitutes an even more interesting source, even though it is difficult to classify it within the enumeration of Article 38. Perhaps the use of such a practice is an adaptation of the accepted doctrine as to sources which the specific character of the relations in question makes necessary. A good example is provided by the Sapphire case already cited. To determine the applicable substantive law, the arbitrator looked not only at the provisions of the agreement concluded between the Canadian company and NIOC, but also at agreements between NIOC and other oil companies, such as the International Oil Consortium (IOC) and Agip Mineraria. In the agreement with IOC there was a provision on applicable law not found in the other agreements. The arbitrator then concluded

... the essential character of all of these contracts is the same; they all have the same object and the same character as is evidenced by the complete similarity of several of their clauses, particularly those dealing with performance and arbitration. By virtue of the principle of good faith, NIOC cannot claim that the absence of an express provision regarding the law applicable should be interpreted as a denial of a principle contained in previous agreements which had the same object.

63. Stikker Report, supra note 60, para. 108.
66. Lalive, supra note 17, at 1014.
The example cited relates to the law adopted by the parties, but what is important is the influence of provisions in previous or contemporary agreements as interpretation aids on points either poorly treated or not treated at all in a contract. This implies that repeated entry into similar contracts can create obligatory norms. It is in the repetition of investment laws and investment contracts rather than from the sources enumerated in Article 38 that a specific international economic law is going to be created. We are thus brought back to the idea of an international economic law which is in the course of formation and to which the parties may refer, although this law in its present state seems to be precluded from the subsidiary references established by the Convention in the absence of a choice of law by the parties. Finally, while the international law in this area is still very uncertain and of limited scope, its importance will grow with the corresponding development of the law of investment.

Conclusions

In concluding his study of Article 42 Professor Schwarzenberger asserted: “In its present formation, it [Article 42] creates a state of uncertainty and ambiguity which, given the limitation under which the draftsmen worked, is unavoidable.” The author would not be as severe as Professor Schwarzenberger is. Despite the reservations of a technical nature formulated in this study, the author believes that the Convention possesses several very positive features.

First, there now exists a system—perhaps a controversial one—for determining the law applicable to investments, which is accepted by many States within this novel structure of relations between States and private persons. Second, the role attributed to freedom of the parties is satisfactory, since the parties can truly choose the legal system that suits them best, and since, in this connection, the most daring developments are allowed even if they are not expressly encouraged. If the parties do not take advantage of their freedom to choose, the international legislator can not be blamed. An additional positive feature, in the author’s view, is the conferral of power on the arbitrators to fill in the gaps in the law of investment and to assume the role of amiables compositeurs with the authorization of the parties.

On the other hand, the subsidiary references operative in the absence of a choice by the parties are less well conceived because of conservatism in defining the international law of investment and because of the excessive technicality of the reference to the law of the host State. In

67. Schwarzenberger, supra note 56, at 225.
defense of the text's authors, it must be recognized that this is a complex subject, the interests at stake are great, and the precedents are controversial. Since the margin for interpretation is considerable, one must give a favorable initial judgment to Article 42 and await the first arbitrations to see how the parties to the disputes and the arbitrators will use it. Literal interpretation before any litigation can clarify some difficulties and can even create some out of whole cloth. However, on such a new and complex subject as investments and with respect to a Convention whose principal purpose is to aid in settling disputes, it is only after consideration of concrete results that a value judgment should be made. Will the Centre become popular as an institution, reduce the volume of certain kinds of legal disputes, and bring about the realization that most disputes are not any more important than the ordinary disputes in private business, and that they should have no consequences on the relations between the parties other than a judicial settlement? The near future will give a clear answer to these questions.