Iran’s Sovereignty Over Its Natural Resources and the Application of Municipal Law

پدیدآورنده (ها) : Homayoun Mafi

علوم سیاسی :: نشریه (ISC) ۳ - Number ۲ ,Volume ۲۰۱۱ :: Autumn (Iranian Review of Foreign Affairs

صفحات : از ۱۳۵ تا ۱۷۲

آدرس ثابت : https://www.noormags.ir/view/fa/articlepage/969910

عناوین مشابه

- Assessment and Analysis of Rural Women’s Indigenous Ecological Knowledge and its Use in Sustaining Natural resources: A Case Study of Villages in the Counties of Nishapur and Firuzeh
- the age of globalization and its impact on asia``s agricultural trade: an application of a "chain" comparative advantage index
- Natural environment and its vital impact on patient women hospitalized in the maternity wards of Tehran`s ganeral hospitals
- The Cognitive Principle of Relevance and its Application toAnti Iraq War Posters
- The Impact of Sanctions on Iran’s Oil and Natural Gas Exportation: Swot Analysis
- Effects of long-term municipal waste compost application on the concentrations of macro elements and yield of rice
- Execution of Oil Contracts on the Basis of Environmental Standards in the U.S.A. and Iran’s Law
- A Socioeconomic Analysis of Piracy in the Northern Indian Ocean and its Solutions under International Law
- Illegal, Unreported and Unregulated Fishing in the Exclusive Economic Zone; Legal Analysis of the International Tribunal for Law of the Sea’s Approach in Its Advisory Opinion of ۲ April ۲۰۱۵
- Effect of technology application in enhancing the weaknesses of market access, financial resources, and supplier resources on the aluminum industry

Iran's Sovereignty Over Its Natural Resources and the Application of Municipal Law

Homayoun Mafi*

Abstract

In this article, the first issue that is tackled is related to Iran's sovereignty over its natural resources. In the area of natural resources, a host state acting to preserve the interests of its people may adopt legal measures running counter to the terms of a pre-agreed contract. Therefore, a state may not abide by some provisions of a contract that has been entered into with foreign companies in order to protect the legitimate interests of the country. Under international law, states have the right to nationalize their own natural resources subject to the obligation to compensate the foreign investors. However, the question of whether a state may invoke its sovereign right to disregard its contractual obligations in the presence of a stabilization clause arises. The role of international law will also be examined in order to determine its application to state contracts. It can be gleaned from the material referred to in this article that international law does not have a sufficiently developed body of rules to regulate foreign investments. The second part touches upon a discussion on the applicable law of the contract with regard to the practices of Iran. In so far as the appropriate mechanisms for the settlement of disputes are concerned, foreign corporations that intend to sign agreements with the Iranian public sector must accept the respective Iranian law in their international transactions at inception. The chief justification for adopting this approach relies on the fact that the contracts entered into by the public sector corporations involve the State of Iran and consequently impinge upon its responsibilities. It is the purpose of this study to reflect on these issues and to explore the bases on which they are founded and advanced.

Keywords: Sovereignty, National Resources, Stabilization Clause, Internationalization, Applicable Law.

* Assistant Professor of International Law, Mazandaran University.

Iranian Review of Foreign Affairs, Vol. 2, No. 3, Fall 2011, pp. 135-172

Introduction

Under international law, there is no dispute as regards the existence of the principle of permanent sovereignty. It embodies the right of the states to dispose freely of their natural resources. This principle has been formulated and developed by various resolutions of the UN General Assembly. The first resolution, which used the notion of permanent sovereignty over natural resources, was Resolution 626 (VII) of 21 December 1952 that stressed on the right of people to exploit their natural wealth and resources. The idea was strengthened by other relevant resolutions which were adopted by the UN General Assembly in subsequent years. Those include Resolution 1803 (XVII) of 14 December 1962 that emphasized the right of states to nationalize their property for public purposes. In 1974, UN Resolution 3201 (S-VI), regarding the Declaration on the Establishment of a New International Economic Order, reaffirmed that a state has the right to nationalize its resources without being prevented from exercising that right. On 26 July, the General Assembly Resolution entitled "the Charter of Economic Rights and Duties of states" was adopted by an overwhelming vote of 120 to 6 with 10 abstentions. With respect to the economic rights and duties of states, the Charter is one of the most comprehensive documents stipulating that any dispute regarding compensation for nationalization of foreign-owned property is subject to the domestic laws of the state. A major source of conflict between the host states and multinational corporations derives from the fact that the latter insist on stability of contractual relations and the former's demand for

renegotiation and review as an integral aspect of the investment process. It is argued that any investment agreement between a host state and a foreign investor makes it analogous to an international agreement and subject to international law. Obviously, such an agreement does not enjoy the status of an international agreement. On the basis of principles of private international law such an agreement is not governed by international law but by the law of the host state. It is the purpose of this article to survey selected aspects of the principle of sovereignty as has been practiced by Iran. It also attempts to answer the questions posed by the consideration of the matter.

I. Sovereignty over Natural Resources

The right to permanent sovereignty over natural resources is relied upon by the oil-producing developing countries in order to assert their ownership and control over their resources while preventing foreign powers from unauthorized exploitation of those resources.[1] The emphasis on economic sovereignty, according to Friedmann,[2] is to some extent the reaction of the developing countries to the decades and centuries of economic exploitation either by virtue of colonial power, or by virtue of economic domination in the interests of foreign countries. Sovereignty as a right is defined as legal or constitutional independence.[3] The concept of independence has been defined in *the Island of Palmas case* as follows:

Sovereignty in the relations between states signifies independence. Independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other state, the functions of a state.[4]

Article 2 of the Iranian Oil Act of 1987 declares the natural resources as public property and wealth under the control of the Iranian Government. Thus, the power to exercise sovereignty and proprietorship over oil resources belongs to the Iranian Government. The strength of the idea of ownership is to evoke the "sense of

political gratification and euphoria associated with the attainment of political independence".[5] Sovereignty is now acknowledged to be meaningless without having economic power. Therefore, ownership would not be significant in economic terms, unless translated into effective control of national resources.[6] As a well-recognized principle of international law, the right of permanent sovereignty over natural resources has found its premise in several General Assembly resolutions, as stated above. The right of permanent sovereignty is derived from the territorial sovereignty of states and operates on the substratum of the principle of self-determination of nations. The territorial sovereignty of States is an essential part of the legal personality of a state demonstrating that no other state may exercise any right over the natural resources of that state without its consent.[7]

For the principle of permanent sovereignty over natural resources basically purports to establish exclusive jurisdiction of states (or People) over natural resources in areas where they can exercise sovereignty rights ...[8]

The right to permanent sovereignty is subject to the rules of international law, which places limits upon the territorial conception of jurisdiction. The judgment of the Permanent Court of International Justice in *the case of S.S. Lotus* of 1927[9]is a clear example that sovereign acts are not territorially unlimited. It was held: "all that can be required of a state is that it should not overstep the limits which international law places upon its jurisdiction; within these limits, its title to exercise jurisdiction rests in the sovereignty ... each state may regulate its legislation at its discretion, provided that in so doing it does not come in conflict with a restriction imposed by international law". Paragraph 1 of General Assembly Resolution 1803 (XVII), 14 December 1962 states:

The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and at the well-being of the people of the state concerned.[10]

The question is whether the state is entitled to natural resources as the property of that state via territorial sovereignty. In the *Texaco/Libya Arbitration* the arbitrator examined whether the right to permanent sovereignty is inalienable, and concluded that a state cannot deprive itself of its sovereign rights over its natural sources or alienating such sovereignty over them. But a state may by contract agree to a partial limitation of the exercise of sovereignty for a limited time.[11] Recognition of the right of permanent sovereignty over natural resources, whether as a rule of general international law or even as a norm of *jus cogens* would exclude the possibility of a state alienating its sovereignty over its natural resources by agreement.[12] The principle that a sovereign state has the power to control its natural resources has been amplified in the Declaration on the Establishment of a New International Economic Order.[13] Article 13 of the Vienna Convention on Succession of states in respect of Treaties (1978) states: nothing in the present Convention shall affect the principle of international law affirming the permanent sovereignty of every people and every state over its natural wealth and resources.[14] The right of permanent sovereignty over natural resources has been recognized in *International Association of Machinists and Aerospace Workers v. Organization of Petroleum Exporting Countries (OPEC)*.[15] In the same case, the District Court of the United states held further that: "The control over a nation's natural resources stems from the nature of sovereignty. By necessity and by traditional recognition, each nation is its own master in respect to its physical attributes. The defendants' control over their natural resources is an especially sovereign function because oil, as their primary, if not sole, revenue-producing resource, is crucial to the welfare of their nations' people". In the Declaration of Lima, the Developing states proclaimed that: "every country has the sovereign right to freely dispose of its natural resources in the interests of the economic development and well-being of its own people". Any external political or economic measures or pressures brought to bear on the exercise of this right is a flagrant violation of the principles of

self-determination of peoples and of non-intervention, as set forth in the Charter of the United Nations and, if pursued, could constitute a threat to international peace and security.Undoubtedly, unrestricted access to natural resources of the developing countries by foreign interests deprives these countries of an important factor of economic development.

It is in this respect that the developing countries have vigorously asserted the exclusive sovereignty over their natural resources. That was why Resolution 626 (VII) of 21 December 1952 declared: "the people may for their own needs, freely dispose of their natural wealth and resources ... in no case may a people be deprived of its own means of subsistence".16There remains the important issue of legal effect of General Assembly resolutions. Can it be argued that these resolutions reiterate a set of recognized rules of customary international law? There is a preponderant argument that the Declaration on Permanent Sovereignty over Natural Resources expresses the opinio juris with respect to nationalization of foreign property under the principles of international law. In the Liamco case,17 the sole arbitrator Mahmassani reached the conclusion that the General Assembly resolutions, if not a unanimous source of law, are evidence of the current dominant trend of international opinion regarding states' sovereign rights over their natural resources. Therefore, the United Nations resolutions have an impact of providing evidence of customary law. The effect of the UN General Assembly resolutions is to establish the competence of states to exercise their sovereignty over their natural resources. According to Brownlie18 the General Assembly's resolutions are vehicles for the evolution of state practice which have to be weighted in evidential terms, according to their merits. In the North Sea Continental Shelf cases, the International Court of Justice (ICJ) stated that for a new customary rule to be formed, the acts concerned must "amount to a settled practice" and they must also be accompanied by the opinio juris sive necessitatis.19 When the resolutions are in accordance with

notions of law such as sovereignty, it could be argued that these resolutions qualify to be considered as law. On the legal relevance of UN resolutions the Iran-United States Claims Tribunal in the Sedco case held that:

"United Nations General Assembly Resolutions are not directly binding upon states and generally are not evidence of customary law. Nevertheless, it is generally accepted that such resolutions in certain specified circumstances may be regarded as evidence of customary international law or can contribute-among other factors-to the creation of such law.[20]"

a. Stabilization Clause: The stability of contractual relations has long been a major source of debate between developing countries and foreign companies. The stabilization clauses are inserted in the contracts between a host government and a foreign company to ensure that future changes in the national laws of the host country do not have any effect upon the terms of the contract. To what extent can it be argued that the stabilization clauses limit states' legislative and regulatory competence?

As far as the nature and scope of the stabilization clauses are concerned, such clauses not only protect the foreign companies against any modifications of law governing the contract, but also strengthen the legal position of these companies in the event of nationalization. A stabilization clause which freezes the legislation competence of the contracting state is not valid.

A Host Country acting to preserve the interests of its citizens could, because of that sovereignty, adopt legal and administrative measures running counter to the terms of existing contracts ... An oil producing nation, by the law of civilized nations may clearly, in a proper case, modify or eliminate provisions of an existing petroleum concession which have become substantially contrary to the best interests of its citizens.[21]

When the general interest of the country is at stake, no state can promise to maintain the *status quo* of the contracts. Indeed, such

power of the state is part of the *jus cogens*. A typical stabilization clause was involved in Article 41 (b) of the Iran-Consortium Agreement (1954) reading as follows:

"No general or special administrative measures or any other act whatsoever of or emanating from Iran or any governmental authority in Iran (whether central or local) shall annul this Agreement, amend or modify its provisions or prevent or hinder the due and effective performance of its terms. Such annulment, amendment or modification shall not take place except by agreement of the parties to this Agreement."[22]

Another example of a stabilization clause was involved in Article 21 of the Anglo-Persian Oil Concession of 1933 as follows: concession shall not be annulled by the Government and the terms therein contained shall not be altered either by general or special legislation in the future or by administrative measures or any other acts whatever of the executive authorities. Article 29 of the Sales and Purchase Agreement of 1973 between Iran and the Consortium provided: this Agreement shall be interpreted in accordance with the laws of Iran. The rights and obligations of the Parties shall be governed by and according to the provisions of this Agreement. Termination before expiry date or any alteration of this Agreement shall be subject to the mutual agreement of the Parties.

The legal significance of such clauses is controversial since these clauses involve a tension between the sovereign state and its public purpose demanding more flexible contractual relations and the preoccupation of multinational corporations (MNCs) with stability and predictability of contractual regimes.[23] There is also a plethora of evidence to suggest that a stabilization clause is incapable of denying the right of a state to vary or terminate a contract by a subsequent legislative act. [24]Under international law, a minimum regulatory power is vested in the state. The *Aminoil* award explicitly recognized the regulatory powers of states' by stating that "they can either emanate from the legislative or regulatory power of the state, or embodied in

the contracts of Concession".[25] While rejecting the reasoning of the sole arbitrator (Dupuy) in the *Topco* award, Brownlie argues that in the domestic legal systems of many capital exporting countries, state contracts are susceptible to legal modifications and annulment by the government.[26] To argue otherwise, the public interest of the state will be subordinated to the interest of a single private party, a prospect which is considered as repugnant and untenable.[27] While referring to the principle of permanent sovereignty over natural resources, De Aréchaga argues that:

. the description of this sovereignty as permanent signifies that the territorial state can never lose its legal capacity to change the destination or the method of exploitation of those resources, whatever arrangements have been made for their exploitation and administration.[28]

White pointed out that " the effect of the stabilization clause is not to fetter the ability of the host state to expropriate, but it does mean that any expropriation being a breach of the international law of contracts …". Under international law, stabilization clauses may be void or not enforceable in cases where their application would run counter to the principle of permanent sovereignty of states over their natural resources. [29]Recognizing the fact that stabilization clauses are of doubtful effect, Chowdhury[30] argues that a contractual relationship for a long time should contain mechanisms for revision or renegotiation adjustment. If the position is taken that stability clauses are binding on the host country, then it follows that any unilateral change by the host state in the terms of the contract is a breach of contract contrary to international law.[31] The stability of the relationship may run counter to the principle of permanent sovereignty over natural resources if such a clause prevents a state from exercising its sovereign power for the public purpose.[32] The public interest is based on the fact that natural resources are irreplaceable.[33] The report of the Secretary-General of the United Nations on 7 May 1981 on permanent sovereignty over natural

resources states:

Some of the freezing clauses negotiated at present tie the hands of the Government for a very long period. Long and comprehensive freezing clauses seem to run counter to the principle of permanent sovereignty over natural resources.[34]

It is contended that in cases where the obligations assumed under a stabilization clause were limited in substance and time, the international tribunals have refused to sustain objections against the legal validity of such a clause.[35] International legal doctrines such as the principle *pacta sunt servanda* have been relied on by jurists from capital exporting countries to justify the binding effect of the stabilization clauses in an investment agreement. However, it has been contended that the principle does not have a rigid meaning in any of the legal systems in the world.[36] There are certain considerations which place limits upon the extent of the principle *pacta sunt servanda,* including good faith, equity and the inherent overriding powers of the government, so far as public contracts are concerned.[37]Would a stabilization clause preclude a host state from pleading the revision or termination of the agreement on the basis of unexpected circumstances? Long-term contracts are based on good faith and co-operation. Likewise, such contracts should be permitted to evolve with a change of circumstances. In fact, the clause *rebus sic stantibus* is implied in all contracts. It is therefore profoundly unjust to maintain a contract in the face of unforeseeable exceptional circumstances which are not imputable to the host state. Long-term agreements are apt to encounter unforeseen circumstances that upset the economic or financial balance of a transaction and inflict serious damages on the involved parties.[38]

Another view is that unilateral action by the host state is invalid as a consequence of an international delict imposed by public international law. If this reasoning is accepted then the host country would not be in a position to renegotiate or abrogate contracts with foreign companies. However, no international responsibility will be

incurred by a state if it pays the required compensation and its action is not otherwise unlawful as by denial of justice or discrimination. The stabilization clauses postulate foreign investors on an equal footing with the host state. This argument, however, ignores the fact that only one of the parties to the contract is a sovereign state.[39] Does this mean that stabilization clauses have no legal effect? In the *Aminoil Arbitration*[40] the arbitral Tribunal recognized that the stabilization clauses of the contract cannot prohibit a state "from undertaking not to proceed with nationalization during a limited period of time". Therefore, stabilization clauses are not considered a guarantee against nationalization. As a matter of international law, the case of nationalization imposes an obligation to pay appropriate compensation on the state. The logical consequence to be drawn from the above is that an anticipated cancellation in violation of the contractual relationship would give rise to a duty to pay compensation.[41]

As a result of recent developments, the rigidity of stabilization clauses may prove both excessive and self-defeating, since in the long-run, they may be incapable of achieving their objective.[42] To this end, new contractual arrangements aim at promoting the readjustment of contracts through consultation by taking into account the evolving character of long-term investment contracts that may occur as a result of technological, economic, social or other developments.[43]

b. Internationalization of State Contracts: Internationalization of the contract between a state and a foreign national is one of the recent developments in international law meaning that proper law is to be totally or partially based on a juridical order other than the host country's municipal legal system.[44] In this context, the concept of internationalization denotes that the state contracts are subject to public international law and not the domestic law of any state. The fact that the developing countries lack the enormous capital, experience, managerial and technical capabilities as well as the advanced technology needed for the exploitation of their petroleum

resources has given rise to the proliferation of international contracts[45] by which these countries restrict their sovereignty. Rapid industrialization and economic growth have primarily been responsible for underdeveloped countries to enter into a contractual relationship with foreign concerns.[46]

In *Revere Copper and Brass Inc. v. Overseas Private Investment Corporation*[47] the Tribunal supported the application of the theory of international contract law to the long-term economic development agreements. It was maintained:

The reason for this is that such contracts, while not made between governments and therefore wholly international, are basically international in that they are entered into as part of a contemporary international process of economic development, particularly in the less developed countries. The very reason for their existence is that the private parties entering into such agreements and committing large amounts of capital over a long period of time require contractual guarantees for their security; governments of developing countries in turn are willing to provide such guarantees in order to promote much needed economic development.[48]

The trend of internationalization of economic development agreements confers some protection on foreign corporations with regard to capital investment, and assures them of a continuous flow of cheap raw materials into their countries.[49] In this sense, the effect of internationalization is to achieve protection for private property. It is still a controversial issue whether an internationalized contract is subject to changes by the legislative power of the host state.[50]Sornarajah[51] argues that the evolution of the concept of permanent sovereignty over natural resources means that municipal law is the first reference in any dispute relating to such resources; hence, there is no scope for an international law contract requiring the dispute to be settled by an foreign arbitral tribunal applying general principles of law. The acceptance of the theory of internationalization of investment contracts conflicts with the

principle of permanent sovereignty over natural resources, since it raises the problem that such sovereignty cannot be alienated from a state. Mann states that the existence and fate of international law would be immune from possible variations by domestic law in the same way as in the case of a treaty involving two international persons.[52] In *Amin Rashid Shipping Corp. v. Kuwait Insurance Co.*, Lord Diplock rejected the argument that a contract might be internationalized:

My lords, contracts are incapable of existing in a legal vacuum. They are mere pieces of paper devoid of all legal effect unless they were made by reference to some system of private law which defines the obligations assumed by the parties to the contract by their use of particular forms of words and prescribes the remedies enforceable in a court of justice for failure to perform any of those obligations; and this must be so however widespread geographically the use of a contract employing a particular form of words to express the obligations assumed by the parties may be.[53]

A reference to rules of public international law does not mean exclusion of the host country's municipal law as the law primarily applicable. The function of public international law in this context is to provide a test or a controlling standard according to which the application of the municipal legal system can be sustained, only if its rules are based on common principles forming the basis of public international law.[54] Friedmann[55] considered that "contracts cannot be the subject of international disputes since international law contains no rules respecting their form and effect". It has been argued that when contracts provide for an arbitration mechanism or stabilization clause there is the possibility for such contracts to be internationalized.[56] Fatouros has recently shown that the presence of an arbitration clause should not be construed as necessarily a sign of internationalization of the contract.[57] It is, moreover, true that an arbitration clause has in mind the jurisdiction, not choice of law, and that, therefore, it normally does not affect the applicability of the

municipal legal system and there is no inherent reason why arbitrators should not apply the domestic legal system.The question is whether the contract for economic development may justify the internationalization of state contracts between the host state and a foreign investor. It has been argued that a contract between a developing country and a foreign company does not enjoy the status of an international contract. Looked at from this point of view, such a contract should be governed by the domestic law of the host state. According to Schwarzenberger[58] the typical intention of the contracting parties to public contracts is to subject such contracts to the law of the host state and not to international law, unless there is overriding evidence to the contrary. In a number of cases, the notion of an international contract law has been considered by reference to, general principles of laws, or *force majeure*. By way of example, Article 48 of the Iranian Oil Consortium Agreement of 1954 refers to "principles of law recognized by civilized nations in general, including such of those principles as may have been applied by international tribunals". Moreover, note that Article 13 of the Iranian Petroleum Act of 1957 states: 'Force majeure occurrences' as used in this Act means occurrences which are recognized as such by the principles of international law.Since one version of the theory of international contract law is built on the general principles of law, some have argued that the use of such principles is indistinct from public international law.[59] Next, there is the question of how it is possible to apply a contractual claim by reference to general principles of law. It is argued that an attempt to make general principles of law the applicable law of contracts does not *ipso facto* denote any submission to public international law.[60] Due to the fact that general principles of law do not constitute a readily identifiable and comprehensive system of rules, they are not suitable for international investment arbitration.[61] The stipulation of a clause in the contract that the proper law of the contract is international law or general principles of law does not transform the contract into an international contract as

provided by the Vienna Convention on the Law of Treaties.[62] It would follow that such a contractual clause authorizes an arbitrator only to have recourse to cognate rules of international law or general principles of law that may be applicable to the contract.[63] From the forgoing it would appear that only a recognized legal system should be chosen as the proper law of the contract.

Referring to the cooperation agreement concluded between AGIP Mineraria of Italy with NIOC on August 3rd 1957, Sereni pointed out that this agreement was not an international agreement in as much as AGIP Mineraria was not a subject of international law and did not act in the capacity of an agent of the government of Italy.[64] In *Sapphire International Petroleum Co. v. NIOC* (1963)[65], the agreement did not contain an express choice-of-law and the arbitrator inferred from the evidence in the contract that the parties intended to apply the principles of law generally recognized by civilized nations and thus excluded the application of Iranian Law. In reaching his conclusion, the arbitrator concluded that the parties agreed to carry out the agreement according to the principles of good faith and good will.[66] Delaume[67] pointed out that a "neutral observer can hardly see in reference to "good faith" or "good will" more than the statement of a basic principle of fair dealing, or a remainder of an elementary rule of contract law". In order to sustain his findings, Cavin, the arbitrator in *Sapphire arbitration*, went on to say that Paragraph 2 of Article 37 of the agreement provided that *force majeure* as used in the agreement was to be interpreted according to the principles of international law.[68] In this connection, Justice Cavin as arbitrator "not only over-extended the scope of this particular rule but also committed - from a private international law point of view - the serious mistake of having misconstrued what was an incorporation (by reference) into the agreement for a choice of governing law".[69]

In *the Topco/Calasiatic case*[70] the arbitrator took the view that contracts between states and foreign investors can, under certain circumstances, come within the scope of a new branch of

international law; that is to say, international law of contracts.

Schachter[71] argues that apart from the dicta in the *Topco case* it is hard to find any evidence in state practice that customary law imposes an implied condition of international protection into concession or economic development contracts between host states and foreign private enterprises.[72]

Now the question is raised as to what extent the arbitration clauses of state contracts provide for the settlement of disputes by means of international arbitration. In the *Topco* award, the arbitrator concluded that the inclusion of an arbitration clause provides for a reference to the rules of international law.[73] It was held that "the reference to international arbitration is sufficient to internationalize a contract, in other words, to situate it within a specific legal order; the order of the international law of contracts".[74] According to Delaume, the recourse to arbitration in current international contracts coexists with express stipulation of applicable law of the host country's domestic law. He argues that the reasoning of the *Topco* award concerning arbitration as an element of internationalization is both unwarranted and unsupported by contractual practice.[75] A contractual clause that provides for arbitration by an international procedure does not require that the applicable law to arbitration should be international law.[76] In this sense, international law is the least convenient solution.[77] According to Mann[78], a reference may only be made in international contracts to public international law when such contracts do not specify domestic law as the applicable law. One could argue that international law might be applicable, but not as the proper law of the agreement rather as standards that are not subject to international changes by the host state.[79]

Some scholars express doubt about the existence of international contract law by saying that the effectiveness of internationalization provisions is open to serious doubt, unless a consensus of opinions can be achieved regarding the applicable rules of international law to the contractual relationship between host states

and foreign companies.[80]

Article 42 (1) of the ICSID Convention, while dealing with the applicable law, does not provide a conclusive solution to the lingering question concerning the law applicable to state contracts.[81] Article 42(1) of the Convention on the Settlement of International Disputes between states and Nationals of other states (1965) reads as follows: 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. The question may arise as what is the role of international law under Article 42(1) vis-à-vis domestic law of the host state? The Ad Hoc Committee Annulment Decision of 16 May 1986 in the *Amco case*[82] expressly stated that international law had a "supplemental and corrective role in relation to the law of the host state as substantive applicable law".[83] According to the Tribunal:

It seems to the ad hoc Committee worth noting that Article 42(1) of the Convention authorizes an ICSID tribunal to apply rules of international law only to fill up lacunae in the applicable domestic law and to ensure precedence to international law norms where the rules of the applicable domestic law are in collision with such norms.[84]

For international law to fill lacunae in national law there must be a sufficiently developed body of law within international law to claim a modicum of credibility with respect to private contracts[85]. From a practical point of view, international law is deficient in that it has not yet developed a meaningful and complete body of law sufficient to deal with the complexities of modern trade law. Irrespective of the non-existence of an exhaustive set of principles relating to international law, another reason for the failure of international law is the fact that "the foreign investor lacked any personality in positivist international law".[86] The foregoing reasons tend to support the view that the parties to a state contract should not be expected to base

their contractual relationship on rules that are, at best, abstract, and at worse, unformulated.[87]

The idea of international contract law was rejected in the well-known dictum of the Permanent Court of Justice in the case of *the Serbian and Brazilian Loans (1929),* where it was submitted:

Any contract which is not a contract between states in their capacity as subjects of international law is based on the municipal law of some country.[88]

The dictum remained a serious obstacle for the internationalization of contracts. Meanwhile, the more recent decision in *Aminoil Arbitration* rejected the notion that state contracts are exclusively governed by international law.[89] The Iran-United States Claims Tribunal, while stating that a state has the duty to respect agreements freely concluded with a foreign party, held that this does not suggest that sovereign states are bound by agreements with private companies exactly as they are bound by treaties with other sovereign states. This would be completely devoid of any basis in law or equity and would go much further than any state has ever permitted in its own municipal law.[90]

II.Applicable Law of the Contract

*a. Choice-of-law rules of Iranian law***:** It is a normal practice in international commercial transactions to designate the legal system to govern substantial issues. The principle of contractual autonomy recognizes the right of the parties to expressly choose the rules governing the contract. The main consideration for elaborating this point on party autonomy is to give the parties a natural urge and reasonable interest in choosing the proper law governing the agreement.[91] The doctrine of party autonomy will result in a greater degree of predictability that is an essential element in international economic transactions.[92] The principle of autonomy of the parties has been recognized by international bodies[93]. In the Topco/Calasiatic case[94] the arbitrator held:

unless one were to concede that, in the initial stage where the parties are to choose the applicable law, the relevant contractual stipulation may depend solely on their choice, it is necessary to determine the legal system in which the clause designating the applicable law is found and from which that same clause will draw its binding force.

Under the general rule of private international law, parties to a contract can choose the applicable law of the contract. A more complex situation arises when the parties cannot agree on the rules of applicable law. If the parties fail to make a choice to designate the governing law of the contract, the contractual relationship would, under the principles of private international law, be subject to the law of the state where the contract is made and performed and with witch it has the closest links.As far as Iranian law is concerned, there is disagreement among Iranian jurists on whether the parties can choose the governing law of the contract. Although the party's choice of law applicable to the substance of the contract is believed to be superior, it does not mean that the freedom of an Iranian national to make such a choice is unrestricted.[95] Article 968 of the Iranian Civil Code restricts the freedom of an Iranian national to make a contract contrary to the conflict laws rule of Iran by stating that obligations arising out of contracts are subject to the laws of the place where the contract was concluded, except where the contracting parties are foreign nationals and have expressly or impliedly subjected the contract to another law.

The conclusion of an agreement in Iran renders Iranian law as the applicable law. If the mandatory character of Article 968 is accepted, there is no room at all for an Iranian national to select a law other than Iranian law as the applicable law of a contract. Failing any indication of the law to which the parties subjected the arbitral contract, the validity of the contract has to be assessed according to the laws of the country where the award was made.[96] This interpretation has the effect of marginalizing the laws of Iran as the

place of arbitration.[97] Under Iranian law, however, when the parties are silent on the applicable law to the arbitral agreement, this would automatically bring the laws of Iran into play.[98]

One of the most difficult issues in international commercial arbitration is the impact of mandatory rules of law that are required to be applied, or at least regarded, as *ius cogens* irrespective of the governing law.[99] What would the legal consequence of making an award contrary to the national public policy be? Where an arbitral tribunal rejects the relevance of the public policy rules of the place of arbitration and disregards any mandatory restrictions placed on the selection of the proper law of contract, then it must have strong incentives with a view to securing the enforceability of the award.[100]

Iran, by adhering to the notion of territoriality, sovereignty and territorial exclusivity, is not willing to give up its privileged rights as a sovereign independent state.[101] As far as the issue of jurisdiction is concerned, the Court of Khurramshahr (Iran) in a leading case by reference to the Civil Procedure Code 1939 (Article 633)[102] on the law of arbitration states:

As according to Article 633 of the Civil Procedure Code, parties may not agree on a foreign arbitrator, it is by way of precedence clear that it is not allowed (for an Iranian National) to consent to the jurisdiction of a foreign court.

The principle of territorial supremacy in international law mandates that unless international law creates its own standard, all individuals and property - including those of foreigners - within a state are under its jurisdiction. As the rule of conflict of law Article 5 of the Civil Code of Iran states that: all inhabitants of Iran, whether Iranian or foreign nationals shall be subject to the laws of Iran except in cases where the law expressly provides otherwise. Wherever an Iranian public sector enterprise or body is a party to a transaction, Iran's courts are competent to hear the case while imposing its own national law and jurisdiction to the said transaction.

Assuming that Iranian law would be the law governing the

arbitral agreement, the question may arise as to what extent Iranian law would, as a matter of public policy, limit the freedom of parties to choose a system of law applicable to their contractual relationship?[103] The provisions of Article 27 of the International Commercial Arbitration Act of Iran cannot be interpreted as authorizing the contracting parties to make a choice of law applicable to the substance, but only a license to respect such a selection if validly made according to the law governing the arbitral agreement.[104] Article 27 reads as follows:

1- The arbitrator shall take a decision under the legal rules which the parties have selected in respect of merit of the dispute.

Determination of law or legal system of one certain state in any way made, shall be considered as a reference to substantive rules of that state, the conflict of laws rules shall not include this rule, unless the parties have agreed otherwise.

2- In case of lack of determination of the applicable law by the parties, the arbitrator shall legally examine the merit of dispute that he recognizes it as appropriate under the conflict laws of Iran.

3- The arbitrator may decide according to what is just and good (*ex aequo et bono*), if the parties have explicitly allowed it.

4- The arbitrator shall take a decision in all cases under the contractual clauses and shall take into consideration the commercial usages of the subject of issue.

Whatever the proper law of the contract may be, the application of the mandatory public law rules which influence on contractual rights and obligations has been regarded as being outside the scope of the proper law selected by the contracting parties by virtue of a truly general principle of private international law. The underlying reason is that such rules are basically of a public nature and therefore cannot be subject to a choice of law by the contracting parties.[105]

b. Legal Bases for Applying Iranian Law: A contract is a concept of law, the effect of which comes from the law governing it.[106] To this end, every contract is necessarily governed by a special legal system.

To put it differently, an understanding which is not subject to a special legal order is not a contract. It is a recognized system of law which confers the equality of a legally binding contract upon the understanding between the contracting parties.[107] As a matter of principle, contracts which are concluded between states and foreign companies are considered to be based on the municipal law of the host state.[108] The rationale is that such contracts not only regulate the rights and duties of foreign companies, but also affect the interests of host countries. Inevitably, applying different legal systems to a contract will have a potential effect on the economic interests of the parties. The question arises as which law should be applicable to the merits of oil investment disputes. Oil contracts are of a public nature which relate to the permanent sovereignty of the state. As such, they are subject to the jurisdiction and laws of the host state. An oil development contract is usually concluded in close conformity with the provisions of a specific law of the host state which would reveal that the applicable law to the contract is the law of that state. The prevailing opinion and practice of host states is that municipal law is the proper law of the contract. In the *Letco case* (1987)[109] concerning a concession agreement between Letco and the Republic of Liberia, the ICSID tribunal stated that "in the view of the Tribunal, there is no doubt as to the applicability of Liberian law. No other system or rules of law were chosen by the parties; and even if (leaving aside the opening words of the Concession Agreement itself) there was no express choice of Liberian law by the parties, it is plain that the Tribunal must apply Liberian law to the present dispute". In the *Amoco* award (1987)[110] in rejecting the arguments of the claimant that the agreement belongs to a special category of international agreements known as economic development contracts, the Iran-United States Claims Tribunal stated that the Khemco agreement between the Amoco and the Iranian National Petrochemical Company (INPC) is not to be characterized as a contract governed by international law by its nature. On the basis of its interpretation of the

Khemco agreement, the Tribunal concluded that it cannot accept that Iranian law plays only a subordinate role. Such a construction is contrary to the plain meaning of Article 30 by virtue of which the parties chose Iranian law as the law of the agreement and no reason appears for reading the terms of this Article otherwise.[111] The choice of the parties relating to the law of the Khemco agreement is specified in Article 30, headed "Applicable Laws", which reads as follows:

1- This Agreement shall be construed and interpreted in accordance with the plain meaning of its terms, but subject thereto, shall be governed and construed in accordance with the laws of Iran.

2- The provisions of any current laws and regulations which may be wholly or partially inconsistent with the provisions of this Agreement shall, to the extent of any such inconsistency, be of no effect in respect of the provisions of this Agreement. With respect to the settlement of investment disputes, the member states of the Organization of Petroleum Exporting Countries (OPEC) adopted a Declaratory Statement of Petroleum Policy in 1968 (Resolution 16/90) according to which: Except as otherwise provided for in the legal system of a Member Country, all disputes arising between the Government and operators shall fall exclusively within the jurisdiction of the competent national courts or special regional courts, as and when established.

Reference should also be made to the *Wintershall* award (1988)[112] concerning the breach of an oil agreement between foreign companies and the Government of Qatar. After reviewing the deposited authorities on public international law, the Tribunal stated that public international law is not independently relevant to the issues before it in the partial award on liability and that the governing substantive law will be the law of Qatar.[113]

It is a generally accepted view that a private party submits himself to the municipal jurisdiction of a foreign state, when he chooses to reside or conduct his business operations, or engage in

transactions agreed to be governed by municipal law.[114] Under the Iranian legal system, there is a basic mandatory legal principle which requires the application of Iranian law to all oil agreements. The reason is that the Iranian oil contracts are subjected to "public policy and political consideration".[115] Some scholars point out that the whole theory of choice of law rule is defective[116] from its foundations as far as the conflict resolution in international business is concerned.[117] According to McLachlan[118] the proper law approach is both a unifying and a simplifying concept whose purpose is to reduce the real conflicts of laws by seeking to subject a contract to a single legal system thereby reducing the range of conflicts. In general, various laws have been suggested as to be applicable to an international oil contract. Some advocated the idea that economic development agreements do not come within the domain of private international law, because it raises no issue regarding choice of law.[119] Even if it were within the ambit of private international law, the use of conflict law methods would also suggest that the law of the host state is applicable[120] as having a multitude of contacts with the contract. There are some legal bases for applying Iranian law. The first test concerns the sovereignty of the state. The permanent sovereignty of Iran over its natural resources indicate that municipal law should have primacy in cases involving exploitation of natural resources. Any sovereign state which permits a foreign investor to conduct business in its territory must be able to exercise its sovereign rights and jurisdiction to control the operation of the contract.[121] According to Sornarajah[122]an agreement between a sovereign state and a foreign national is not the concern of international law but of national law of the sovereign state. No sovereign state today accepts the applicability of foreign law to its petroleum agreements. It may be plausible to argue that "even if, theoretically, one can envisage the choice of a foreign law, it would be negated by the laws pertaining to public order or to immediate application which in this particular field would encompass almost every aspect of petroleum activity".[123] In the

Serbian Loan case[124] the Permanent Court of International Justice concluded that "in this case it is a sovereign state which cannot be presumed to have made the substance of its debt and validity of the obligations accepted by it in respect thereof, subject to any law other than its own".

A second test indicates that the Iranian law to be applied is the nature of the subject matter. As a matter of fact, exploitation of oil contracts are an economic activity involving a right in immovable property or a right to use immovable property and as such is governed by the law of the place where the subject matter is situated. According to Article 966 of the Iranian Civil Code "possession, ownership and other movable or immovable properties are subject to the laws of the country in which they are situated ..."

The third test relates to *lex loci contractus* or the place where the contract was concluded. According to Article 968 of the Iranian Civil Code "obligations arising of the contracts are subject to the laws of the place where the contract was concluded, except where the contracting parties are foreign nationals and have expressly or impliedly subjected the contract to another law". In view of the complete control exercised by the host state over the oil operations conducted in its territory, it is difficult to conceive, on both legal and practical grounds, that such operations could be conducted outside of its laws and regulations.[125]

The fourth test pertains to the principle of the most real connection. A contract will be governed by the law of the country with which it is most closely connected. The purpose of a connecting factor, is to connect the legal issue with a geographical location and with the legal system of one country. This would be the case where the law applicable to the contract has not been chosen. Applying this principle to a oil contract, the most important nexus is with the host state in which both the subject matter of contract and the place of performance are situated. By Article 3 (1) of the EC Convention on the Law Applicable to Contractual Obligations (1980) "a contract

shall be governed by the law chosen by the parties. The choice must be expressed or demonstrated with reasonable certainty by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or a part only of the contract". In *Compagnie Européenne des Pétroles S.A. v. Sensor Nederland B.V.* (1982),[126] the President of the District Court of the Hague accepted this view by holding that:

In the event of failure by the parties to make such a choice, an international contract is governed by the law of the country with which it is most closely connected.The fifth test for the application of Iranian law is the nature of oil contracts which brings them under the definition of administrative contracts. As such, they are subject to the regulatory powers of Iran as a sovereign independent nation state.From the forgoing it would appear that the applicable law in the contractual relationship between Iran and a foreign company is the municipal law of Iran as a mandatory legal principle. Thus, the proper law of oil contracts under Iran's choice of mechanism for dispute settlement is Iranian substantive law. This is because natural resources deal with aspects of the sovereignty of the state and play a dominating role in the Iranian economy.

Conclusion

The right to exercise sovereignty over oil resources derives from the fact that these resources deal closely with both the state's sovereignty and its economic interests. The crucial test as to the validity of a contract is, therefore, whether such a contract benefits the people as a whole. Where a state concluded a contract with a foreign company for the exploitation of natural resources, it has an inherent right to revise the contract in pursuing the public interests of the people of the country.The recent contractual developments reveal that the internationalization of state contracts is a "concept in judicial retreat" and therefore there is good reason to believe that the negotiation and implementation of these contracts should be conducted and carried

out in a business-like manner.[127] It may be generally observed that with the changes in the financial and economic circumstances which affect legal relationships:

A solution seems to lie less in strictly adhering to the traditional notion of rigid "sanctity of contract", but to seek out the ground for an eventual consensus. Such a consensus must accommodate development conditioned constraints of developing countries and the concept of "Permanent Sovereignty over Natural Resources and Economic Policy" and investors legitimate demand for sufficient predictability of investment conditions. The notion of "dynamic stability" as developed seems to provide a useful approach. It is directed in principle at a marriage of adaptation and stability rules to make a project's legal regime at the same time capable to respond to changing requirements and to the predictability conditions necessary for long-term commitments in development cooperation. The notion of dynamic stability would primarily be actualized through appropriate contractual methods and mechanisms.[128]

It was the purpose of this study to show that in state contracts, the axiomatic rule of sanctity of contracts is not absolute in the sense that all major legal systems require a higher degree of flexibility by reference to the objective standard which is not traceable to the will of the contracting parties.[129]Although the notion of international contract law has been considered in a number of cases, these cases represent - at best - the subsidiary sources of international law.[130] Modern international law lacks any coherent body of principles on foreign investment in order to provide any sound juristic foundations in disputes between a state and a private person. Since there are strong reasons for rethinking the soundness of a rigid adherence to the existence of a body of supra-national law regulating the contractual relationship between the host state and a foreign investor, it would seem reasonable to discern new trends in the states' practice and shape norms and standards that would be in accordance with prevailing practice of community objectives[131].

A contract for the exploitation of mineral resources between a host state and a foreign company should be governed by the domestic legal system of the host state since such a contract finds a viable basis and solid anchorage on the assumption that international law can only regulate contracts between two sovereigns. On well-settled principles of private international law, the municipal law of the host state remains the more suitable mechanism for the regulation of oil development contracts. It would follow that the determination of the applicable law to oil development agreements is effected by the rules of private international law which direct that the governing law of the contract is the law designated by the contracting parties. Such a law also conforms to objective localization of the agreement.[132] Owing to the infinite variety of legal problems raised by international agreements in general, and state contracts in particular, it is plainly apparent that there is no escape from applying a municipal law which, logically and realistically, cannot but be the law of the host contracting state.[133]

Notes

1. See J.E. Fawcett & Audrey Parry, Law and International Resource Conflicts, Oxford, 1981, p 135.

2. W. Friedmann, General Course in Public International Law, Hague Recueil des Cours (1969 II) 127, p 177.

3. Karen T. Litfin, Sovereignty in World Ecopolitics, In Mershon Int'l Stud. Review, Vol.41, Supp.2, November 1997, p 171.

4. Permanent Court of Arbitration, 4 April 1928, UN Reports of International Arbitral Awards, Vol. 2 pp 829, 838; Cited by Passivirta, Internationalization and Stabilization of Contracts Versus State Sovereignty, 60 BYIL 1989., p 331.

5. Samuel K.B. Asante, Restructuring Transnational Mineral Agreements, 73 AJIL (1979), p 369.

6. Ibid.

7. Rainer Lagoni, Oil And Gas Deposits Across National Frontiers, 73 AJIL (1979) p 216.

8. Nico J. Schrijver, Permanent Sovereignty over Natural Resources Versus the Common Heritage of Mankind, in International Law and Development, De Waard, Peters & Denters (eds.), Dordrecht, etc, 1988, p 87.

9. See PCIJ., Ser. A. No .9, p 19.

10. Cited by I. Brownlie, Legal Status of Natural Resources in International Law (Some Aspects), Hague Recueil des Cours (1979 I) 162, pp 256, 258.

11. 17 ILM 1 (1978), at para.77.

12. Stephen I. Pogany, Economic Development Agreements, 7 ICSID Rev.-FILJ 1 (1992), p 17.

13. General Assembly Resolution 3201 (S-VII), 1 May 1974, UNGAOR. 6th Special Sess. supp. 1 (A/9559), 1974, p 3 .

14. Cited in I. Brownlie, Legal Status of Natural Resources in International Law (Some Aspects), p 270.

15. (9th Cir.1981), as cited by Georges R. Delaume, Economic Development and Sovereign Immunity, 79 AJIL 1985, p 324.

16. UN.Doc. A/C.3/L, 489.

17. 62 ILR 141 (1982), at 189.

18. Ian Brownlie, Principles of Public International Law, Oxford, 1990, p 542.

19. See *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States) (Merits)*, 76 ILR 349 (1987), at para.207.

20. Cited by M. Pellonpää & M. Fitzmaurice, Taking of Property in the Practice of the Iran-United States Claims Tribunal, NYIL, Vol. XXXV (1988), p 110.

21. El Chiati, Protection of Investment in the Context of Petroleum Agreements, Hague Recueil des Cours (1987 IV) 204, pp 150,163.

22. Brownlie,op.cit, p 551.

23. Igbowke,op.cit, p 122.

24. Cited in E.I. Nwogugu, The Legal Problems of Foreign Investment in Developing Countries, op.cit., p 169.

25. Cited by El-Kosheri, Ahmed S. & Tarek F. Riad, The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process, 1 *ICSID Rev.-FILJ* 257 (1986), p 284 .

26. Ian Brownlie, Legal Status of Natural Resources in International Law, op.cit, p 309.

27. Ibid.

28. Robin C.A White, Expropriation of the Libyan Oil Concessions – Two Conflicting International Arbitrations, 30 *ICLQ* 1981.

29. Cited by Igbokwe, op.cit, p 122.

30. Subrata Roy Chowdhury, Permanent Sovereignty over Natural Resources, in International Law and Development, De Waart, Peters & Denters (eds.), 1988, p 71.

31. See Brownlie, op.cit., p 551; According to Geiger non-consensual modifications of contract may result from the unilateral action of the host State in the public interest or a fundamental change of circumstances rendering the performance of the agreement wholly or partially fruitless; Rainer Geiger, The Unilateral Change of Economic Development Agreements, 23 *ICLQ* 1974, p 78.

32. See Chowdury, pp 71,81; He writes that a stabilization clause is not incompatible with the principle of permanent sovereignty when it is "limited in time, area and scope, aimed at maintaining certain material terms and the fiscal regime for a reasonable period"; Ibid.

33. El Chiati, op.cit., p 39, note 31.

34. Esa Paasivirta, op,cit, p 331.

35. Jaenicke, The Prospects for International Arbitration: Disputes Between States and Private Enterprises, in International Arbitration: Past and Prospects, A.H.A. Soons (ed.), Martinus Nijhof Publishers, Dordrecht,1990., p 160. In the Aminoil award concerning the unilateral termination of a concession the Tribunal held that "No doubt contractual limitations on the State's right to nationalize are juridically possible, but what that would involve would be a particularly serious undertaking which would have to be expressly stipulated for, and be within the regulations governing the conclusion of State contracts; and it is to be expected that it should cover only a relatively limited period". The Government of the State of Kuwait and the American Independent Oil Company (AMINOIL), 21 ILM 976 (1982), at para.95.

36. See Geiger, p 78.

37. El-Chiati., p 94; It has been argued that "there is a growing trend in the doctrine to allow for the mutability of contracts in certain circumstances as there is a discernible tendency in the courts to do so whenever justice commands to deflect the rigidity of the binding force of the contract". Ibid.

38. O. Schachter, International Law in Theory and Practice, Hague Recueil des Cours (1982 V) 178, p 314.

39. M. Sornarajah, The Pursuit of Nationalized Property, Dordrecht,1986, p 94; In Topco/Calasiatic the sole arbitrator while discussing the effect of stabilization clause of the deeds of concession considered that the stabilization clause did not impair the sovereignty of Libya; See Topco/Calasiatic, para.71.

40. *The Government of Kuwait v. the American Independent Oil Company (AMINOIL),* March 24, 1982, 21 ILM (1982) 976, pp 1022-1023.

41. E. Jiménez De Aréchaga, International Law in the Past Third of a Century, Hague Recueil des Cours 1978 (I) 159, p 307; Robin C.A. White, Expropriation of the Libyan Oil Concessions-Two Conflicting International Arbitrations, 30 ICLQ 1 (1981), p 12.

42. Georges R. Delaume, The Proper Law of State Contracts Revisited, 12 ICSID Rev., FILJ 1 (1997), p 25.

43. Ibid., p 26.

44. El-Kosheri & Riad, op.cit., p 275.

45. Ramazani, Rohollah K., Choice of Law Problems and International Oil Contracts: A Case Study, 11 *ICLQ* 1962., p 503.

46. Ibid.

47. (1980) 56 ILR 258.

48. Ibid., pp 271-272.

49. Sornarajah, The Myth of International Contract law, 15 JWT 3 (1981), p 188.

50. Igbokwe, Virtoos Chiato, Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes, Has the Last Word Said? 14 *J. Int'l Arb.* 1 (1997), p 104.

51. Sornarajah, p 210.

52. Mann, The Proper Law of Contracts Concluded By International Persons, 25 BYIL (1959), p 43; According to Garcia-Amador "as in the case of treaties, when a contract or concession is governed by international law or by international principles, or provides for a mode of settlement of a genuinely international chamber, the rights of aliens derive from an 'international' source and the obligations of the State are necessarily also international. It follows that the mere non-performance of these obligations directly and immediately gives rise to state responsibility; Garcia-Amador, Further Report on State Responsibility, Doc. A/CN.4/119, YILC (1959), Vol. 2, p 32, para. 127.

53. [1983] 3 W.L.R.241 (249-250).

54. El-Kosheri & Riad, op.cit., p 269.

55. Friedman, Expropriation in International Law, op.cit., p 156.

56. Sornarajah, op.cit., p 80,84.
57. A.A. Fatouros, International Law and the Internationalized Contract, AJIL 74 (1980), p 136
58. George Schwarzenberger, International Law I (1957), pp 147,149.
59. M. Sornarajah, Power and Justice in Foreign Investment Arbitration, 14 Int'l Arb.3 (1977), p 114.
60. E.H. Wall, The Iranian-Italian Oil Agreement of 1957, 7 ICLQ 1958, p 751, (note).
61. Virtus Chitoo Igbokwe, Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes, op.cit., p 107.
62. O. Schachter, op.cit., p 306; The determination of typical questions relating to the contract law by recourse to analogous principles of law familiar to civilized nations, can be a dounting and frustrating exercise. Ibid.
63. Ibid.
64. Angelo Piero Sereni, International Economic Institutions and the Municipal Law of States, Hague Recueil des cours (1959 I), p 181.
65. 35 ILR (1967) 136.
66. Ibid., p 172.
67. Georges R. Delaume, Transnational Commercial Arbitration, N.Y., 1978, chapter 14, para. 14.6; Cited by Amin, Commercial Arbitration in Islamic And Iranian Law, Tehran,1988, p 800; Delaume, State Contracts and Transnational Arbitration, op.cit., p 800.
68. Lalive, Jean –Flavien, Contracts Between a State Or a State Agency and a Foreign Company, 13 ICLQ 1964, p 1013.
69. Amin, op.cit., pp 278-279.
70. (1978) 17 ILM 1, at 13
71. O. Schachter, op.cit., p 307.
72. Ibid.
73. Topco, at para. 44.
74. Ibid.
75. Georges R. Delaume, The Proper Law of State Contrats and the Lex Mercatoria: A Reappraisal, 3 ICSID Rev.-FILJ 79 (1988), p 88.
76. O. Schachter, op.cit., p 306.
77. Ibid.
78. Mann, op.cit., pp 41-56.
79. Martin Bartels, Contractual Adaptation and Conflict Resolution, Deventer, etc, 1985, p 110.
80. Delaume, Transnational Contracts, op.cit., pp 15-16.
81. Virtus Chitoo Igbokwe, Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes, op.cit., p 102.
82. *Amco Asja Corp., Pan American Development Ltd. and P.T. Amco Indonesia v. Republic of Indonesia*, 24 ILM 1022 (1985). The *AMCO* award has

been partially annulled. For the decision of the Ad Hoc Committee see 25 ILM 1439 (1986).

83. Ibid., at para. 22. Cited by Nagla Nassar, Internationalization of State Contracts: ICSID, The Last Citadel, 14 J. Int'l Arb.3 (1997), p 185, at p 205.

84. Ibid., para. 20. Nassar, op.cit., pp 205-206.

85. M. Sornarajah, Power and Justice in Foreign Investment Arbitration, op.cit., pp 113, 120.

86. Sornarajah, op.cit., p 119.

87. Okezie Chukwumerije, Choice of Law in International Commercial Arbitration, Connecticut, 1994, p 162, cited by Virtus Chitoo Igbokwe, op.cit., p 105.

88. 1929) PCIJ Rep. Ser. A, No. 20; In this case the issue was "whether loans raised by the Serbian government in France through the issue of bonds to French citizens was governed by French law, or by Serbian law". See Sornarajah, The Myth of International Contract Law, op.cit., p 196.

89. Nagla Nassar, Internationalization of State Contracts, op.cit., p 3.

90. 27 ILM 1314 (1988), pp 1357-1358.

91. See *Elf Aquitaine Iran v. National Iranian Oil Company*, Preliminary Award, 14 January 1982, Gomard (Sole Arbitrator), 96 ILR 1994, p 252, at p 262, para. 15.

92. Charles M.Spofford, Third Party Judgement and International Economic Transactions, *Hague Recueil des Cours* (1964-III) 113.

93. E.g. Article 28 (1) of the UNCITRAL Model Law states: The arbitral Tribunal shall decide the dispute in accordance with such rules of law as are chosen by the parties as applicable to the substance of the dispute. Any designation of the law or legal system of a given state shall be construed, unless otherwise expressed, as directly reflecting to the substantive law of that state and not to its conflict of laws rules. Article 28 (2) further states that "in all cases, the arbitral Tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction"; As regards the will of the parties on the rules of law governing the arbitral proceedings Article 2 of the Geneva Protocol on Arbitration Clauses of 24 September 1923 states: the arbitral procedure, including the constitution of the arbitral tribunal, shall be governed by the will of the parties and by the law of the country in whose territory the arbitration takes place. Likewise, Article 11 of the International Chamber of Commerce (ICC) Rules on Conciliation and Arbitration (1975) reads as follows:

- "The rules governing the proceedings before the arbitrator shall be those resulting from these rules, and where these rules are silent, any rules which the parties (or, failing them, the arbitrator) may settle, whether or not reference is made thereby to a municipal procedural law to be applied in the arbitration."
- See also Article IV of the European Convention on International Commercial Arbitration of 21 April 1961. As regards the principle of contractual autonomy on the rules of substantive law see Article 33 (1) of the UNCITRAL Arbitration Rules (1976), Article 13 of the International Chamber of Commerce (ICC) Rules of Arbitration (1988), Article 42 (1) of the International Convention on the Settlement of Investment

Disputes between States and Nationals of other States (1965) and Article VII of the European Convention on International Arbitration.

94. (1978) 17 ILM 1, at 12. Jamal Seifi, The New International Commercial Arbitration Act of Iran, Towards Harmony with the UNCITRAL Model Law, 15 J. Int'l Arb.2 (1998), p 28.

95. Jamal Seifi, The New International Commercial Arbitration Act of Iran, Towards Harmony with the UNCITRAL Model Law, 15 J. Int'l Arb.2 (1998), p 28.

96. Albert Jan van den Berg, The New York Arbitration Convention of 1958, London, 1981, at pp 293-294, cited by Seifi, op.cit., p 17.

97. Seifi, ibid.

98. Ibid., pp 17-18

99. Marc Blessing, Choice of Substantive Law in International Arbitration, 14 J. Int'l Arb.2 (1997), p 64.

100. Seifi, op.cit., p 29.

101. S.H. Amin, Commercial Arbitration in Islamic and Iranian Law, Tehran (1988), p 159. Article 2 of the Convention on the Status of Aliens adopted in Havana on February 20, 1928 provides: "Foreigners are subject as are nationals to local jurisdiction and laws". Article 9 of the Convention on the Rights and Duties of States, December 26, 1933 states: "Jurisdiction of States within in the limits of national territory applies to all the inhabitants. Nationals and foreigners may not claim rights other or more extensive than those of the nationals". See Tang An, The Law Applicable to a Transnational Economic Development Contract, 21 JWT 4 (1987), pp 128-129.

102. Cited by S.H. Amin. Commercial Arbitration in Islamic and Iranian Law, op.cit., p 161. The date of the decision by the Court of Khurramshahr was not mentioned by the author. "By Article 633 (existing article 456), transacting parties may, either in the transaction itself or by virtue of an independent agreement, bind themselves to resolve their disputes by way of arbitration in case there arises a dispute between them; they may also specify their arbitrator or arbitrators before the occurrence of a dispute. However, in the case of transactions between an Iranian national and a foreign national the Iranian party cannot, as long as a dispute has not arisen, bind himself in any manner whatsoever that in case of occurrence of a dispute it shall be resolved by way of arbitration conducted by one or more persons or by a Board of Arbitrators such person or Board having the same nationality as that of the other party to the transaction. Any agreement in contradiction to this provision shall be null and void in that part which is contradictory". S.H. Amin, op.cit., p 111.

103. Seifi, op.cit., p 28.

104. Ibid., p 29.

105. El-Kosheri & Riad, The Law Governing a New Generation of Petroleum Agreements, op.cit., p 274.

106. Tang An, The Law Applicable to a Transnational Economic Development Contract, op.cit, p 108.

107. F.A. Mann, Further Studies in International law, Oxford, 1990, p 264.

108. See the decision of the Permanent Court of Justice in Serbian and Brazilian Loans case (1929) PCIJ Rep. Ser. A, No.20.

109. *Liberian Eastern Timber Corporation (LETCO) v. the Government of the Republic of Liberia*, 26 ILM 647 (1987), p 658; Reprinted in 89 ILR 313 (1992).

110. *Amoco International Finance Corporation v. Islamic Republic of Iran*, Award of July 14, 1987, 27 ILM 1314 (1988), pp 1352-1353.

111. Ibid.

112. *Wintershall A.G. et al v. the Government of Qatar*, Partial Award and Final Award of February 5, 1988 and May 31, 1988, 28 ILM 795 (1989).

113. Ibid., p 802.

114. Rosalyn Higgins, The Taking of Property by the State, Recent Developments in International Law, *Hague Recueil des Cours* (1982) III, p 285.

115. S.H. Amin, Commercial Arbitration in Islamic and Iranian Law, op.cit., p 303.

116. Ian F.G. Baxter, International Business and Choice of Law, 36 ICLQ 1987, pp 111-12; He argued that a "new direction is needed in the legal system of the world's major commercial centres - to depart from the choice of legal system techniques and to develop rules within the foreign legal system that are specially designed for situations of modern transnational business and for the practice and expectations of the parties involved".

117. Ibid., pp 112-13.

118. Campbell McLachlan, Splitting the Proper Law in Private International Law, 61 BYIL 1990, pp 312, 335.

119. Tang An, op.cit., p 131.

120. Ibid.

121. Paul Peters, Dispute Settlement Arrangements in Investment Treaties, NYIL, Vol. XXII (1991), p 130.

122. Sornarajah, The Myth of International Contract Law, op.cit., p 196.

123. El Chiati, op.cit., p 121.

124. (1929) PCIJ, Ser.A.No.20/21, p 41.

125. El Chiati, p 121.

126. 22 ILM (1983) 66.

127. Georges R. Delaume, The Proper Law of State Contracts Revisited, op.cit., pp 1-2.

128. Thomas W. Wälde, North/South Economic Cooperation and International Economic Development Law: Legal Process and Institutional Considerations, 23 GYIL 1980, p 72.

129. Greig, The Unilateral Change of Economic Development Agreements, op.cit., pp 78, 86; Asante, Stability of Contractual Relations in the Transnational Investment Process, op.cit., p 406. According to Greig "the theory of absolute sanctity of international concession agreements is supported neither by the traditional law of co-existence between sovereign States nor by the emerging international law of economic co-

operation based on general principles recognized by the representative legal system of the world". Ibid., p 99. See also Article 59 of the International Law Commissions' Draft Articles of the law of Treaties, 7 ILM (1968), 798.

130. M. Sornarajah, Power and Justice in Foreign Investment Arbitration, op.cit., p 110.

131. M. Sornarajah, The Myth of International Contract Law, op.cit., pp 194-195. There is little in international law as to the formation of private foreign investment contracts, rules as to the performance of the contract and rules as to remedies in the event of a breach. Ibid., Power and Justice in Foreign Investment Arbitration, op.cit., pp 120-124. Martin Wolff also on the issue of deficiency of international law states "What is the influence of mistake in international law? Does it render the contract void or voidable, or neither? Is set-off allowed and in what circumstances? ... International law gives no answer to such questions". Martin Wolff, Some Observations on the Autonomy of Contracting Parties in Conflict of Laws, 35 Grotius Transactions, 143, 1950, at p. 152, cited by Virtus Chitoo Igbokwe, Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes, op.cit., p 105.

132. See El Chiati, op.cit., pp 133, 144.

133. El Chiati, op.cit., p 135.

References

- Amin, S.H.,(1987) Commercial Arbitration in Islamic and Iranian Law, Tehran, 1988.
- An, Tang, The Law Applicable to a Transnational Economic Development Contract, 21 JWT 4.
- Asante, Samuel K.B.(1979), Restructuring Transnational Mineral Agreements, 73 AJIL .
- Bartels, Martin, (1985)Contractual Adaptation and Conflict Resolution, Deventer.
- Baxter, Ian F.G, (1987)International Business and Choice of Law, 36 ICLQ.
- Blessing, Marc,(1997) Choice of Substantive Law in International Arbitration, 14 J. of Int'l Arb. 2.
- Brownlie, Ian,(1979) Legal Status of Natural Resources in International Law (Some Aspects), Hague Recueil des Cours 162.
- Brownlie, Ian, (1990)Principles of Public International Law, Fourth Edition, Clarendon Press, Oxford, 1990.
- Chowdhury,Subrata,Roy,(1990) Permanent Sovereignty over Natural Resources, in International Law and Development, De Waart, Peters & Denters (eds.).
- De Aréchaga, E. Jiménez(1978 I), International Law in the Past Third of a Century, Hague Recueil des Cours 159.
- Delaume, Georges R.,(1985) Economic Development and Sovereign Immunity, 79 AJIL.
- Delaume, Georges R(1997)., The Proper Law of State Contracts Revisited, 12 ICSID Rev.-FILJ .
- Delaume, Georges R.(1988), The Proper law of State Contracts and the Lex Mercatoria: A Reappraisal, 3 ICSID Rev.-FILJ 79.

- El Chiati, A.Z. (1987 IV), Protection of Investment in the Context of Petroleum Agreements, Hague Recueil des Cours 204.
- El-Kosheri, Ahmed S. & Tarek F. Riad, The Law Governing a New Generation of Petroleum Agreements: Changes in the Arbitration Process, 1 ICSID Rev.-FILJ 257 (1986).
- Fatouros,A.A., (1980). International Law and the Internationalized Contract, AJIL 74.
-Fawcett,J.E. & Audrey Parry(1981), Law and International Resource Conflicts, Oxford.
- Freidmann, W., General(1969) Course in Public International Law, Hague Recueil des Cours 127.
- Geiger, Rainer,(1974) The Unilateral Change of Economic Development Agreements, 23 ICLQ.
- Higgins, Rosalyn,(1982) The Taking of Property by the State: Recent Developments in International Law, Hague Recueil des Cours.
- Igbokwe, Virtus Chitoo,(1997) Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes, Has the Last Word Said? 14 J. Int'l Arb. 1.
- Jennings, R.Y.(1961), State Contracts in International Law, 37 BYIL.
- Lagoni,Rainer.(1979), Oil And Gas Deposits Across National Frontiers, 73 AJIL
- Lalive, Jean –Flavien(1964), Contracts Between a State Or a State Agency and a Foreign Company, 13 ICLQ.
- Litfin,Karen,T.(1997), Sovereignty in World Ecopolitics, In Mershon Int'l Stud. Review, Vol.41, Supp.2.
- Mann, F.A.,(1959) The Proper Law of Contracts Concluded by International Persons, BYIL (XXV).
- Mann, F.A.(1990), Further Studies in International Law, Clarendon Press, Oxford.
- McLachlan, Campbell, Splitting the Proper Law in Private International Law, 61 BYIL 1990.
- Nassar, Nagla(1997), Internationalization of State Contracts: ICSID, The Last Citadel, 14 J. Int'l Arb. 3.
- Nwogugu, E.I.(1965), The Legal Problems of Foreign Investment in Developing Countries, Manchester University Press U.S.A, Oceana Publications Inc.
Paasivirta, Esa, (1989)Internationalization and Stabilization of Contracts Versus State Sovereignty, 60 BYIL.
- Pellonpää,M., & M. Fitzmaurice,(1988) Taking of Property in the Practice of the Iran-United States Claims Tribunal, NYIL, Vol. XXXV.
- Peters, Paul,(1991) Dispute Settlement Arrangements in Investment Treaties, NYIL, Vol. XXII.
- Pogany, Stephen,I(1992).,Economic Development Agreements, 7 ICSID Rev.-FILJ 1
- Ramazani, Rohollah K(1962)., Choice of Law Problems and International Oil Contracts: A Case Study, 11 ICLQ
- 36-Schachter, Oscar, International Law in Theory and Practice, Hague Recueil des Cours

(1982 V) 178.
- Schrijver,Nico,J(1988)., Permanent Sovereignty over Natural Resources Versus the Common Heritage of Mankind, in International Law and Development, De Waard, Peters & Denters (eds.), Dordrecht.
- Schwarzenberger, George(1957), International Law I.
- Seifi, Jamal, (1998). The New International Commercial Arbitration Act of Iran, Towards Harmony with the UNCITRAL MODEL LAW, 15 J. of Int'l Arb. 2 .
- Sereni, Angelo Piero(1959 I), International Economic Institutions and the Municipal law of States, Hague Recueil des Cours .
- Soons, A.H.A.(1990), International Arbitration: Past and Prospects, Martinus Nijhof Publishers, Dordrecht, etc.
- Sornarajah, M., Power and Justice in Foreign Investment Arbitration, 14 J. Int'l Arb. 3 (1997) Problems in Applying the Restrictive Theory of Sovereign Immunity, 31 ICLQ 1982.
- Sornarajah, M., (1981). The Myth of International Contract Law, 15 JWT 3.
- Sornarajah, M. 1986., The Pursuit of Nationalized Property, Dordrecht, etc.
- 45-Spofford, Charles M. (1964), Third Party Judgement and International Economic Transactions, Hague Recueil des Cours 113.
- Wälde,Thomas W,(1980) North/South Economic Cooperation and International Economic Development Law: Legal Process and Institutional Considerations, 23 GYIL
- Wall, E.H.(1985), The Iranian-Italian Oil Agreement of 1957, 7 ICLQ 1958.
- White, Robin C.A., (1981). Expropriation of the Libyan Oil Concessions – Two Conflicting International Arbitrations, 30 ICLQ