CONTRACTS BETWEEN A STATE AND A FOREIGN PRIVATE COMPANY[1]

Reflections on the Effectiveness of the Arbitration Process

*By Francis M. Ssekandi**

The title of this paper does not quite express what I wish to convey in the subsequent paragraphs. For this reason, an explanation may not be inopportune.

The award by Sir Leslie Scott (later Lord Justice Scott) in the Lena Goldfields Arbitration in 1930,[2] a case I shall discuss at length later, precipitated a controversy that a noted scholar[3] in the field has referred to as having . . . "Assumed mammoth proportions and produced a flood of literature. It has been the subject of many books, innumerable articles, and draft Conventions prepared by national and International legal associations in large numbers." Specifically Professor Friedmann was referring to the debate on the status, under International Law, of Agreements (to be referred to as contracts in this paper) entered into between a government or public corporation and a foreign private company or individual. This question gives rise to problems of legal safeguards to the foreign interests against unilateral breaches of the contract by the government. Also, what measure of compensation, if any, should be afforded the injured innocent party.[4]

I do not wish to join this debate which has engaged the attention of some eminent International lawyers such as Lord McNair[5] and James N. Hyde.[6] It is my submission that the problem today is not, whether governments or states regard themselves as not bound by these contracts,[7] or whether principles of International Law can properly be applied to them,[8] but whether a satisfactory Arbitration procedure

*LL.B. (Hons.) London, University College, Dar es Salaam; LL.M. Columbia University School of Law.

1. I prefer to use "Contract" rather than either "Concession Agreement" or "Economic Development Agreement" in classifying agreement between a state and a private foreign company. Although I agree with Lord McNair's reasons for discarding the use of "Concession Agreements": The General Principles of Law Recognised by Civilised Nations; 33 B.Y.B.I.L. (1957); his alternative classification "Economic Development Agreements" is still inapt: (for reasons why I use "Contract" see Lalive: 13 I C.L.Q. p. 987 (footnotes)).
2. Reported in Annual Digest, 1929-30; *London Times* 3rd September, 1930; Cornell L.Q. 30 (1950) and 45 Col. L.Q. 530.
3. Professor Friedmann's *Changing Structure of International Law.* p. 180.
4. *Ibid.* 3. p. 176; for a recent publication on the topic; E. Nwogugu *The Legal Problems of Foreign Investment in Developing Countries.*
5. 33 B.Y.B.I.L. (1957).
6. 105 Hague Recueil (1962), p. 271.
7. Proof of this statement is shown by the seriousness with which Agreements like: LAMCO, The Iranian Consortium and The Ghana Valco Agreement 1960; and The India-Vacuum Oil Co. Agreement, have been treated by the respective governments involved. [Also the U.N. Resolution on the Permanent Sovereignty over Natural Resources — states agree to honour contracts freely entered into.]

that would ". . . offer the under-developed countries the guarantees they may rightfully expect"[9] as well as safeguard the private investor, in case of controversies, exists and if not whether it can be evolved. It has been pointed out,[10] and I cannot emphasize it more that the corner-stone to the collaboration between a state and the private investor is "an atmosphere of trust and mutual understanding of the interests involved".[11] It is this aspect that just does not exist when parties to a contract, freely entered into, are engaged in a dispute and the sole purpose of an Arbitration process should be to maintain this or if this is not possible, ensure that in the settlement of the dispute the varying interests of the parties will be weighed and decided upon fairly. These interests often escape being included in the contract for fear that the negotiations would collapse. (Bourquin mentions this in his exposition on the subject in 15 *Business Lawyer* 860).

The purpose of this paper is to examine the various Arbitral Awards decided after Lena Goldfields and trace the developments of the arbitration process and determine how far the adopted procedure in the individual case has often affected the decision on the substantive issue. It is my feeling that so much attention has been focused on the problem of the applicable law that there has been little realisation that the core of the controversy in the individual case has not been that of the applicable law but that of what set of facts would be taken as controlling. The question of what "law" applies has often been used to press a particular outlook in the facts i.e. If International Law does not apply then a local confiscatory statute is unchallengeable under local law. In this respect it makes a world of difference: 1) who constitutes the arbitration tribunal, 2) whether the decision is unanimous or is by a majority vote or even 3) what terms of reference the tribunal was given and how it interpreted the scope of its jurisdiction. It is these factors that have been ignored. The attention has been focussed on emphasizing the binding force of International Law[12] and on the

8. The almost classic conclusion by Sir Leslie Scott in Lena Goldfields, that Article 38 of The Statute of the P.C.I.J should form the "Proper law of the contract" has been widely applied in subsequent Arbitral Awards, and it is at least accepted that General Principles of law recognised by Civilised Nations apply: Friedmann *Changing Structure of International Law*, p. 187-210. For a similar conclusion see *The Rules of Abu Dhabi Arbitration* (1951) I.C.L.Q. (1952) p. 251. Award by Lord Asquith of Bishopstone.
9. Maurice Bourquin: *Arbitration and Economic Development Agreements;* 15 Business Lawyer, p. 861.
10. Friedmann and Pugh *Legal Aspects of Foreign Investment.*
11. M. Bourquin: 15 Business Lawyer, p. 861.
12. The greater part of E. Nwogugu's book, rf. 4 above, is devoted to hammering this fact home in some paternal way to developing countries; for contrary arguments: Hendrix in *Platt's Oilgram News Service* (N.Y.) 28 April, 1959. But for a more analytical approach: Fatouros' *Government Guarantees* which is highly criticised in Alfred Drucker's review of the book: 13 I.C.L.Q. 311, his thesis being that Fatouros' political sociological as well as legal approach, "would convert legal analysis into a Sociological study of power relations and make the development of the law on state contracts even more difficult". To the contrary I think such approach would clear the present confusion caused by the tendency of writers on the subject to project their prior state or national interests dictated by ideological differences: e.g., *International Bar Association Draft Convention of the protection of Foreign Investment.*

means of enforcing the subsequent Award, without attempting to achieve an acceptable decision to both parties. For these reasons, the usefulness of known arbitration Awards in this field has been weakened by the fact that in the majority of them the government party either boycotted the proceedings altogether[13] or did not participate in the delivered opinion of the Tribunal.[14] This aspect deprived the tribunal either of the submission of the government party or of the views in the subsequent opinion of the government representative on the tribunal. In fact, often the private company had to resort to the diplomatic intervention of its government, which meant fresh negotiations and ensuing compromise. It is my submission that the Award must reflect the necessary political, social and economic as well as legal factors that dictate the necessity to weigh the conflicting interests involved in the dispute, during the diplomatic negotiations.[15]

I wish to start my case-study with the oldest of the reported cases on this subject and one which has been widely discussed and relied on by commentators and Tribunals as supporting the view that contracts of this kind are governed by International Law. This is the case of *The Lena Goldfields Arbitration.*[16] The Lena Goldfields Company entered into a contract with the Russian government in 1925. The company was granted the right to extract gold, copper, iron, and other minerals in the Lena-Vitim area and in other districts of Asiatic Russia, to navigate the Lena River, to operate a number of branch railroad lines, and to conduct various subsidiary enterprises. This was a typical contract, similar to many others familiar to us today.[17] It contained an Arbitration clause that read as follow[18]: —

I. All disputes and misunderstandings in regard to the construction or fulfillment of this agreement and of all Schedules thereto, on the declaration of either of the parties, are examined and settled by the court of Arbitration.

---

13. The Russian government boycotted the proceedings in the Lena Goldfields Arbitration.
14. The Iran Public Corporation did not participate in the decision in the NIOC-Sapphire Arbitration: and the Saudi Arabian Arbitrator dissented in the Aramco arbitration.
15. The approach I am applying in the study of these cases follows closely Karl Llewellyn's approach adopted in his *The Common Law Tradition,* though I probably do not state it as precisely as he does. I fear Lord McNair does not adopt in his brilliant analysis of the cases in order to point out that they all applied "The General Principles of Law recognised by civilised nations" and cites some cases often cited in State Succession rather than in these Contract problems. The idea is to move away from examining the case for its 'holding' and instead investigate what the tribunal decided were the relevant facts and determine how far this affected the subsequent decision, i.e., not to follow what the courts say they are doing but study what they actually do.
16. The Award was published in the *London Times,* September 3, 1930; briefly by Lauterpacht in the *Annual Digest* 1929-30; these reports contain the findings of the Tribunal which proceeded without any submissions by the Soviet party. The facts as presented by the Russians were published in the Central Concessions Committee of the U.S.S.R. Some of this report appears in an article by Evsey S. Rashba in 45 Col. L.R. 539-40.
17. The Iranian Oil Agreement (1954) or even the Ghana-Valco Agreement.

II. The court of Arbitration shall consist of 3 (three) members, of which one shall be elected by the Government and the other by Lena, and the third — the super-Arbitrator — shall be elected by both parties by mutual agreement.

III. If such agreement cannot be reached within 30 (thirty) days from the day of receipt by the defendant party of a summons in writing to attend the court of Arbitration, setting out the matters in dispute and stating the member of the court of Arbitration appointed by the plaintiff, the Government within the period of 2 (two) weeks shall appoint 6 (six) candidates from among the professors of the Freiberg Mining Academy or the Royal High Technical School of Stockholm, from among whom within a period of 2 (two) weeks Lena shall elect one, who will be the super-arbitrator.

IV & V. . . . .

VI. If on receipt of the summons from the super-arbitrator appointing the time and place of the first session, one of the parties in the absence of insurmountable obstacles to such action does not send its arbitrator or if the latter refuses to take part in the court of arbitration, then, at the request of the other party, the matter in dispute is settled by the super-arbitrator and the other member of the court, on condition that such decision is unanimous.[19]

The choice of law provision (Article 89) provided that: "the parties base their relations with regard to this agreement on the principle of good will and good faith, as well as on reasonable interpretation of the terms of the Agreement.[20]

The Tribunal found[21] that in 1929, four years after the Agreement was concluded, the government formulated the Five-Year Plan which replaced the prevailing N.E.P. under which private investment was encouraged. Under the new policy, the government withheld from Lena performances in part of a vital nature, owed under the concession contract. . . This was followed by a class war against the Lena employees, as serving a capitalist enterprise. Thereupon the company's staff resigned in large numbers and as a result the company was disorganised (Award No. 21 (f) and (g)). On the night of December 15, 1929 the government, through the O.G.P.U. carried out a formidable raid at practically all of Lena's many establishments which were separated from each other by thousands of miles (Award No. 21 (h)). The employees, among them leading officials, managers, etc.,

---

18. Art. 90 see p. 42 of 36 Cornell L.Q. (1950).

19. Art. 44 of the Iranian Oil Agreement contains almost similar provisions.

20. This clause too has parallels in: Clause 17 of the Agreement between The Ruler of Abu Dhabi and Petroleum Development Ltd. It read: "The Ruler and the Company both declare that they base their work in this Agreement on good will and sincerity of belief and on the interpretation of this Agreement in a fashion consistent with reason." (Interpretation by the Counsel for the Ruler, reported in (1952) I.C.L.Q. p. 247-61).

21. Report in 36 Cornell L.Q. p. 32 and *The Times* (London), September 3, 1930, p. 13, col. 2.

were seized and searched and their plans and reports of a technical character taken away together with confidential documents. Twelve officials were arrested and prosecuted on charges of counter-revolutionary activity and espionage.

On February 12, 1930 Lena sent a telegram to the Soviet government which reads as follows: "Change of legislation and economic policy and administrative practice and the attitude of the government have created for Lena undue difficulties and interferences and in fact the impossibility as regards performing its part of the concession agreement." The company demanded submission of this allegation to Arbitration in accordance with Article 90 and if found to be true "What compensation is due to Lena from the government for preventing the company carrying out the concession Agreement."[22]

The Tribunal was duly constituted with Sir Leslie Scott, P.C.K.C. (formerly Solicitor-General) for the English party; Dr. S. B. Chlenov for the Soviet party and Professor Otto Stutzer, of the Mining Academy in Freiberg, as umpire. At the request of both parties,[23] the Chairman fixed the session for May 9, 1930 but the Soviet Arbitrator and Counsel for the government did not attend.

It was disclosed later, in Moscow that before the Tribunal convened Lena sent a telegram to the Soviet government, declaring that it had received further disturbing news from Russia, that it would be impossible for it to resume work there, that it declined responsibility for the concession property and that it was recalling the powers of Attorney of its representatives.[24] The report in Moscow continued: "the Soviet government was advised by its legal experts,[25] and it took the position that this telegram by Lena amounted to a termination of the contract in advance of the expiration date, that this was not permissible except in pursuance of an arbitration award, and that, in these circumstances the court of arbitration must be regarded as having lost its reason for existence." This line of action was in accordance with the provisions of the contract for Article 86 provided that: "The concession shall only be terminated before its time by a decision of the arbitration court." The contract provided for the arbitration only of disputes concerning its "interpretation or execution" and not of disputes relating to its "suspension or annulment"; the argument of the Soviet legal experts continued: "if it had been contemplated that the arbitrators were to pass on questions which did not pertain to performance of the contract, but which involved solely the assessment of the amount due as compensation for Lena resulting from suspension of the contract, the parties would scarcely have chosen, as they did, an eminent geologist as umpire, but would probably have selected a more appropriate specialist"; they further argued, among other things, that in any event

22. The contents of the telegram were disclosed in Moscow by the Central Concession Committee.
23. Telegram of April 27, 1930.
24. Reported p. 540 in 45 Col. L.R.
25. They were in particular, Professor M. J. Pergament and Professor V. N. Shreter, Legal Adviser to the Soviet Supreme Council.

the arbitrators as a matter of law did not have capacity to determine the extent of their own competence. (As if intended to counteract the last argument by the Soviet experts the Draft Convention on the Settlement of Investment Disputes between states and Nationals of other States, 1965 — provided (Article 41(1)) "The Tribunal shall be the judge of its own competence".)[26]

Pursuant to the above reasoning by the Soviet government, a telegram dated May 5, 1930 was sent to the Chairman of the Tribunal and to Lena communicating her reasons for the view that Lena had dissolved the Concession Agreement by the withdrawal of its technical experts. Under these circumstances, the government said, the arbitration tribunal "had ceased to function".

The other two Arbitrators, however, convened on May 9, 1930 and heard Lena's submissions. They took the view that Article 90 (vi) governed the situation, declaring that the tribunal was competent to proceed without the Soviet party participating. It, however, conceded that: "The terms of reference defining the scope of the court's jurisdiction and the issues which, by accepting their arbitral office, the members of the court became bound to try, are defined by three telegrams", i.e., the telegram by Lena requesting Arbitration sent on February 12, 1930, the Soviet Government's reply of February 25, 1930[27] and the telegram of April 27, 1930, by both parties requesting the Chairman to fix the date for hearing on May 9, 1930. In order to sustain its competence, despite further developments which had not been jointly submitted to the tribunal to decide,[28] the Tribunal held that the concession was still operative and "the jurisdiction of the court remains unaffected".[29]

The Tribunal then proceeded to hear evidence from Lena and entered an award for Lena to the amount of £12,965,000. The actual loss suffered by Lena was estimated by the English government to have been £3,500,000. The award was repudiated by the Soviet government for reasons apparent in my statement of facts and objected to any references to it during the diplomatic negotiations that ensued with the British government.

The above facts of the case, I think constitute the crucial part of the case. What followed later was a decision by Sir Leslie Scott[30] former

26. This draft Convention was submitted by the Executive Directors of the World Bank: March 18, 1965; to the states for signature and ratification. It had been signed by 22 states by October 1st 1965 and ratified by Nigeria.
27. This telegram met the allegations by Lena in her telegram of February 12, 1930, by setting up a defence and counterclaim that Lena, by failure to perform its obligations in regard to payment of royalties, and in regard to programmes of production and expenditure and development laid down in the Agreement.
28. The actions by Lena which amounted to a breach of the Agreement: Recalling of technical experts and withdrawal of power of Attorney from its representatives.
29. Text of the arbitration reproduced: p. 42 36 Cornell L.Q. (1950).
30. Dr. Stutzer, the umpire was a mining engineer, whereas the issues argued before the court were more of a legal nature. My view is that once it was determined that the court was competent to deal with the case, it was almost impossible for the Tribunal to decide as a matter of law the Government had not violated the contract, without hearing the submission of the government side and without its representative on the court.

British Solicitor-General and appointee of Lena to the Tribunal. He was the lawyer of the two and the legal conclusions may be attributed to him. The decision was based on facts solely presented and argued by Lena's Counsel. The Umpire concurred in the decision.

Lord McNair summarised the legal findings of the tribunal as follows[31]: "The tribunal of arbitration, consisting of Dr. Stutzer as Umpire and Sir Leslie Scott (later Lord Justice Scott), accepted the argument of the Lena Company to the effect that, while on all domestic matters in the U.S.S.R., Soviet law should apply except where it was excluded by the Agreement, for other purposes the 'General Principles of law recognised by Civilized Nations', referred to in Article 38 of the Statute of the Permanent Court of International Justice, should be regarded as the 'proper law' of the concession"; the Tribunal found the principle of unjust enrichment to be such a 'general principle', and awarded compensation to the Lena Company. This part of the decision became a landmark in Arbitration Awards on the contracts under discussion and few would challenge the legal conclusions of the learned Lord Justice. I have reservations, however, on the way he applied those principles,[32] to the peculiar facts of the case as stated above. According to Lena's first telegram which in all fairness formed the terms of reference for the tribunal, Lena's allegations were of certain breaches and asked for appropriate compensation and not dissolution of the contract, which would have justified the method of the measure of damages used. Lena's property was taken over, if at all, only after Lena had withdrawn all its staff from Moscow, and this was in May, 1930.

The crucial difference between my conclusion and that of the tribunal lies on what the latter found as the material facts and what I consider these to be. Much of the evidence included in my statement of the sequence of events was rejected by the tribunal when it held itself competent to proceed on May 9, 1930. This approach has been defended and followed by a notable commentator on the case, Arthur Nussbaum who discussed the case in detail[33] I think a solution to this would have been, adopting the view at the outset, that the parties agree to another tribunal if necessary to determine the effect of the last action by Lena, that of withdrawing its powers of Attorney from its representatives, on the contract. Despite the discrepancies I have pointed out, very crucial in my view to the effect of the decision on subsequent cases, the opinion of the court has been hailed as a landmark in International law and has been quoted extensively in subsequent Awards for its 'holding'.

---

31. 33 B.Y.B.I.L. pp. 10-15.

32. A commentator on the case; Arthur Nussbaum has said: "The substantive law aspects of the Lena case present much less legal interest. Breach of contract and unjust enrichment, bases of the Lena claims, have long been recognised as legitimate causes of action under the various systems of law, including International Law." 36 Cornell L.Q. 41. I am not sure the statement is quite correct because the court spent much of its time trying to prove that actually the principle of unjust enrichment was a) known to English Law, and b) therefore a General Principle under Act 38 of the Statute of the P.C.I.J., since it was known under other systems. A similar approach has been taken by Dr. Friedmann (now Professor Friedmann) in 16 Can. B.R. 243. This may be true today but, I am not sure it was in 1950.

I shall now move to the examination of other Awards and then try to compare the various approaches to the problems I have raised above affecting the Arbitration process. Two cases were decided in 1950 and 1951 and involved a state and a private company. These were: *The Ruler of Qatar v. Petroleum Development Qatar Company; Ruler of Abu Dhabi v. Petroleum Development (Trucial Coast) Ltd.* Both these cases involved the interpretation of very broad concessions granted by the Ruler, to Anglo-Persian Companies, conferring rights to prospect and extract oil on their territory. One such Concession read as follows: "The area covered by the exclusive rights described in Article 2 shall include all of the sea-bed and subsoil underlying the waters of the Persian Gulf which fall within the jurisdiction and control of the Ruler of Qatar and which lie beyond the territorial waters, contiguous to the main land and islands of Qatar."

The question to be decided by the Tribunal in each of the cases was whether such concession conferred to the company, rights to oil under the continental shelf (referred to as 'an area of the sea-bed and subsoil lying beneath the high seas of the Persian Gulf contiguous to the territorial waters of Qatar').[35] In each of these cases the super-Arbitrator concluded that the concessions did not include such area. Although both arrived at the same conclusion: Lord Radcliffe in *Ruler of Qatar v. Petroleum Development Qatar Co.* and Lord Asquith of Bishopstone in *Ruler of Abu Dhabi v. Petroleum Development (Trucial Coast) Ltd.*[36] the latter's opinion is the more elaborate and the one that gives the reasons for which the Arbitrator decided as he did. The Learned Law Lord interpreted the provision in the Agreement: Clause 17

> "The Ruler and the company both declare that they base their work in this agreement on goodwill and sincerity of belief and on the interpretation of this agreement in a fashion consistent with reason."

as follows: "The terms of that clause invite, indeed prescribe, the application of Principles rooted in the good sense and common practice of the generality of civilised nations. . . a sort of 'Modern law of Nature'." The Arbitrator concluded that the English principle requiring a literal interpretation of the written instrument, was such a principle. He then concluded: "Directed, as I apprehend I am to apply a simple and broad jurisprudence to the construction of this *contract*[37] it seems to me that it would be most artificial refinement to read back into the contract the

---

33. His comment in 36 Cornell L.Q. pp. 31-5. He in fact brushes aside Evsey S. Rashba's findings of facts (45 Col. L.R. 539-40) in the following words: "The new version (of facts as published by Moscow) proves but one thing: its Author felt that the change in the Government's attitude needed justification. He has tried to furnish that justification, but has failed", p. 39. I find that the reasons he gives to disapprove Mr. Rashba's report quite unconvincing.
34. Article 3 of 1935 Agreement between Ruler of Qatar and Petroleum Development Qatar Co. Ltd.
35. Article 2 of 1949 Agreement between Rules of Qatar and another company "International Marine Oil Company Ltd".
36. The Award reported in 1952 I.C.L.Q. 247 and 1953 I.L.R.
37. This is his own word; my emphasis is to indicate my use of the term before.

implication of a doctrine (sovereignty over the Continental shelf) not mooted till seven years later, . . . not even today admitted to the canon of International Law."[38]

These two cases together with the third decided in 1953 by Sir Alfred Bucknill (umpire): *The Ruler of Qatar v. International Marine,* offer much interest, to the aspect of International Arbitration I am pursuing in this paper. The main question in the International Marine case also involved interpretation of the contract between the Ruler and the company, especially provisions relating to the payment of sums of money by the company to the Ruler. It should be noted that in each of these cases both the company and the Ruler agreed to Arbitration. Both parties selected their Arbitrators who in turn agreed on an umpire. The umpire in each case was a prominent judge in England, and he in fact delivered the opinion, after submissions by both parties. The most interesting aspect of all is that the Sheikhdoms of Qatar and Abu Dhabi were both under British protection and although the prevailing law was Islamic law English law was relevant, and this explains why (a) Counsel for both parties were prominent English International lawyers,[39] (b) the Super-Arbitrator was a prominent member of the English Judiciary.[40] The above facts may have contributed to the high level of impartiality that was exhibited in the opinions (tribute was actually paid to the learning of counsel on both sides in the Abu Dhabi case), which contributes to their value in the development of law in this field.

In view of the above facts, the cases stand out in broad contrast with the other reported cases on this subject. Here we do not come across difference of philosophies, as we experience in the Lena Goldfields case. The companies did not allege discrimination based on ideological differences, but complained against abridgement of their rights resulting from different interpretations of the contract. The spirit of collaboration still existed, even to the time of arbitration.. In *Lena Goldfields,* the spirit of collaboration had broken down and the gap of differences widened when the Arbitration court failed to suppress their political leanings when deciding on matters that had high political flavour. The opinion is coloured by references that reveal an anti-socialist policy.

The remaining cases that I shall review shortly suffer from this handicap too. Where the differences between the company and the state stem from a difference in philosophies, on what the proper role of government in commercial matters should be, it is the more important that the tribunal approaches the issues at stake without preconceptions. Future Arbitrations are likely to be more of this nature in view of the fact that the majority of contracts are now between dveloping countries (in the process of establishing a socialist economy) and companies owned and controlled by nationals of developed countries (with an established capitalist economy). In such cases the arbitration procedure must be

38. This has now been accepted: The Geneva Convention on the Continental Shelf, 1958.

39. The names are given after the opinion in 1952 I.C.L.Q. Prof. Lauterpacht and Warldock participated in the Abu Dhabi case.

40. Sir Alfred Bucknill: Lord Justice of Appeal, Lord Asquith of Bishopstone: House of Lords and Lord Radcliffe; House of Lords.

so constructed as to give maximum protection to both parties but especially the state. The view has always been that the company must be protected from the might of the state. But, it is now no longer true; companies like 'Shell' are such complete systems that their financial power gives them sufficiently strong a position to dictate terms to developing countries which need capital and foreign exchange badly. Besides, in case of disputes the decision in *Sapphire-NIOC* and in *Lena Goldfields* would indicate that Super Arbitrators selected from developed countries, are likely to pay little regard to the economic aspirations of developing countries and would sacrifice these for 'pure' doctrines of law that are recognised by Civilized Nations.

In situations like the one just described a decision of three arbitrators must be either unanimous or be left to a sole Arbitrator selected and agreed upon by both parties at the time of Arbitration. The decision should in all cases be after both sides have been heard. The problem of one party defaulting is of course a problem but this can be solved by attempting to achieve a compromise on the issue of initial controversy. In this respect I refer to the case in Lena when the company should have agreed to the Soviet demand that a new Arbitration tribunal be set up to decide whether Lena's withdrawal of technical experts did not amount to a unilateral termination of the agreement. The Soviet argument that a mining expert as Chairman when deciding legal aspects — breach of the contract — was inappropriate, appears to me to be sound.

The next Awards I shall examine are: *The Government of Saudi Arabia v. The Arabian American Oil Co.* (1958) and *The Sapphire-NIOC Arbitration* (1963), which I think will in some respects support some of my contentions above.

The *Saudi Arabia v. Arabian American Oil Company* was decided in August, 1958 by a mixed tribunal of three, composed of: Sauser-Hall of Switzerland, referee; Badawi-Hassan,[41] for Saudi Arabia, and Habachy for ARAMCO. By a contract made on May 29, 1933 between the government of the state of Saudi Arabia and Standard Oil Company of California (the company assigned it to California Arabian Standard Oil Company, which later changed it name to Arabian American Oil Co.), the latter company was granted an exclusive oil exploitation concession for sixty years in the eastern part of Saudi Arabia.[42] The contract was supplemented by several mutually accepted amendments and Royal Decrees which for purpose of this report had the effect of confirming the company's exclusive rights to control the oil industry in Saudi Arabia.[43]

---

41. Dr. Badawi died during the proceedings and was succeeded by H.E. Mahmoud Hassan.

42. The case is reported in 27. I.L.R. 117.

43. e.g., Article 4 of one of such supplementary agreements: The Offshore Agreement of 1948 read: "Government agrees that Aramco's exclusive right described in Art. 1 of the Convention of 1933, the duration of which has heretofore been prolonged, applies to the whole of the offshore area as herein defined and Government further agree that exclusive area of Aramco's concession as described in Article 2 of the Convention of 1933 and in Art. 5(a) of the Supplemental Agreement of 1939 extends to the whole of the offshore area as herein defined."

During the period 1933 when the principal agreement was signed and 1954 when the dispute between the company and the government arose, Aramco evolved a comprehensive system by which oil was extracted and transported to the ports of Saudi Arabia for final disposition, f.o.b. to various customers all over the world. The tribunal summarised the system as follows: "Aramco itself did not own or charter any tankers. For the export and transport of its oil and oil products, it made use of the different forms of sale current in maritime law. It concluded c.i.f. contracts (cost, insurance, freight), c.f. contracts (cost and freight) and in the majority of cases, f.o.b. contracts (free on board), the latter class of sales being the most widely used in the oil industry."

In 1954 the government of Saudi Arabia concluded an Agreement, by which Mr. A. S. Onassis was authorised to handle all transportation of Saudi Arabian oil in ships carrying the national flag of Saudi Arabia. This Agreement was considered by the company (Aramco) as a derogation from the government's contractual obligation with the company which granted Aramco exclusive rights in the oil industry. It interpreted its contractual rights under the agreement to include the aspect of making its own arrangements for the transportation of the oil it had mined.

The progress of the case after this disagreement was referred to by the tribunal in the following words: "In a spirit of conciliation and justice, to which the Tribunal feels in duty bound to pay tribute, the Government suggested a solution of the dispute by arbitration,". Resort to arbitration had been provided for in the Principal agreement by Article 31. The company agreed to submit to the arbitration procedure and both parties met and drew up a comprehensive arbitration agreement. The arbitration agreement that was drawn up is a valuable document in the arbitration process in this field of international contract law and a progressive step to future developments and leads to clarification of this confused aspect of international arbitration. The agreement later provided the basis of the award because it was comprehensive and acceptable to both parties. It provided for the applicable law and the procedure to be followed during the hearings: Articles IV and VI. On the method of arriving at a decision, the agreement provided in Article VIII:

> "All decisions and the award of the tribunal shall be by a majority vote and shall contain the reasons therefore, and shall be made as soon as conveniently possible. The award of the arbitration tribunal, shall be final and binding on the parties."

On the choice of arbitrators, it was provided in Article I:

> "The arbitration tribunal in these proceedings shall consist of two arbitrators, one of whom shall be chosen by each party, and a referee who shall be chosen by the arbitrators."

The arbitration provisions in this case are fairly similar to those contained in the contract between Lena Goldfields Co. Ltd. and the Soviet Government. Yet, the Tribunal in this Aramco case functioned better than in the Lena Goldfields case, at least in so far as in the former case both parties participated in the submission of evidence to the tribunal and though the government's representative on it dissented, the government abided by the ensuing award. I think the key difference lies

in the fact that throughout the dispute, both parties in the Aramco case were prepared to negotiate and a spirit of conciliation noted by the tribunal was maintained all along. The result was that an agreement was reached on what terms of reference the tribunal would operate on; and what procedure would be followed by the tribunal in deciding the case. Each party appointed its representative to the tribunal and both appointees agreed on a suitable referee. In this case the results were encouraging. The tribunal turned out a well reasoned and elaborate opinion that impresses one as a result of careful weighing and balancing of the conflicting interests involved on either side. Since my interest is centred on the arbitration process rather than the choice of law aspect of these international contracts,[44] I shall not deal with the way the tribunal dealt with the choice of law clause, Article IV:

> "The arbitration tribunal shall decide this dispute a) in accordance with the Saudi Arabia law, as hereinafter defined, in so far as matters within the jurisdiction of Saudi Arabia are concerned; b) in accordance with the law deemed by the arbitration tribunal to be applicable in so far as matters beyond the jurisdiction of Saudi Arabia are concerned.
>
> "Saudi Arabian law, as used herein, is the Moslem Law: a) as taught by the school of Imam Ahmed Ibu Hanibal, b) as applied in Saudi Arabia."

The opinion on this aspect should be of very great interest in Private International Law and comparative jurisprudence. On the facts of the case the tribunal, a majority of two and H. E. Hassan, government appointee dissenting decided that:

> "In view of the exclusive right conferred upon Aramco, which has the character of an acquired right, Saudi Arabia may not compel Aramco to recognise a right of priority or preference to tankers flying any flag whatsoever, irrespective of any consideration of the economic consequences of this right or of whether, in particular the cost of transportation is going to be less or more than the current freight or equal to it."

The dissenting judgement by Hassan dwelt on differences of interpretation of various provisions in the Principal Agreement. It does not consider the economic and political or even social issues that seem to have led the government to enter into the Onassis agreement. The government's counsel also chose to plead from the legal aspect of the case; interpreting the contract as not providing expressly the right for the company to establish its own transportation system of the oil acquired in Saudi Arabia.

The majority, however, balances these issues carefully together with legal principles regarding acquired rights and comes to a decision favouring respect for acquired rights rather than considerations of national

---

44. This aspect has been discussed briefly by David Suratgar, in The Indian Journal of International Law. Vol. II No. 3 and Dr. Mann: 21 B.Y.B.I.L. II and in 36 B.Y.B.I.L. (1960) 34.

pride (using ships that fly a national flag) or economic advantages for the government.

In view of the fact that the majority opinion was delivered by the referee on whom both parties agreed, the final decision between conflicting values must be respected and especially when the government representatives did not quite develop their side of this issue sufficiently. It is worth noting that in this case the award was honoured by the government of Saudi Arabia.

The next case: *Sapphire-NIOC Arbitration* (1963) is a good example of what happens when the spirit of collaboration that prevails at the time of contracting, breaks down. This case is not quite similar to those I have already dealt with because it involved a Public Corporation (NIOC), not a government, and a private company. However, it is classified as an international Award because NIOC was owned by the government of Iran which showed keen interest in the development of the dispute.

A commentary on the case appears in 13 I.C.L.Q. p. 987 but the writer, Jean-Flavien Lalive, who was more interested in the substantive law aspect of the case rather than the procedural issue, omitted that part of the Tribunal's opinion dealing with the arbitral procedure. Since I have not been able to get the copy of the award in time I shall not include the opinion of learned arbitrator dealing with the procedural aspects of the arbitration process which he analysed at length.

The facts of the case and the issues involved appear to me to have been simple, though the arbitrator's opinion is several pages long. The facts of the case were that a Canadian company: Sapphire International Petroleums Ltd., entered into a joint business venture for the prospecting and exploitation of oil in Iran, with the National Iranian Oil Company; a public corporation. The agreement entered into was of a standard type similar to a number of Agreements NIOC had entered into with other oil companies: for example The International Consortium of 1954. Of interest, were a number of "dispute" Articles (39-41) and the provision in the Agreement that conferred on Sapphire "full exclusive and effective management and control" of operations, subject to the obligation to prepare the plan of operations in consultation with NIOC, and to submit to the latter detailed reports on the progress of the work.

Article 38, one of the "dispute articles" provided that the parties undertake to carry out its provisions according to the principles of good faith and good will, and to respect the spirit as well as the letter of the agreement.

After five years of operations disagreements arose between the company and the corporation on the interpretation of the provision requiring "consultation" between the parties before plans are executed by Sapphire. The company contended that this provision required mere notification whereas NIOC interpreted it to require its consent. Sapphire, therefore, decided to go to arbitration and to claim not only the reimbursement of the contractual penalty of $350,000, retained by NIOC, indemnification for damages suffered (some $1,175,000), but also the amount of loss of speculative profits estimated at $5,000,000.

The arbitration agreement provided that each party should appoint one arbitrator and the two of them jointly the umpire, as President of the Arbitration Tribunal. Failing agreement on this latter point, or failing appointment of their arbitrator by either party, the umpire, or the sole arbitrator, should be appointed by the President of the Swiss Federal Tribunal (or, alternatively, the President of the highest court of Denmark, Sweden or Brazil). Since both parties could not agree on the arbitration procedure, Sapphire decided to call upon the President of the Swiss Federal Tribunal to appoint a sole arbitrator. The President appointed Mr. Justice Cavin, Judge of the Supreme Court of Switzerland. It is a handicap that the report does not say whether NIOC submitted its case before the arbitrator. If by "default" the report meant that NIOC abstained from the proceedings altogether, the opinion of the arbitrator may be undersandable. Otherwise, I find it hard to believe that (a) the English word "consult" would only mean "notify" as the tribunal held it did. Or, (b) that all the major systems of law in the world recognise the enunciated rule that:

"According to generally held view, the object of damages is to place the party to whom they are awarded in the same pecuniary position that they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion." For this principle the Learned Arbitrator cited certain provisions in the Swiss and French Codes and some cases in what he termed Anglo-American law. An authoritative book on English Contract Law: Cheshire and Fifoot contains a whole Chapter on Damages and my understanding of that Chapter is that it supports the principle that damages are aimed at putting the parties in the same position as they would have been in if they had not contracted at all. There is no doubt that cases may be found in the English precedents supporting Judge Cavin's rule but many more can be cited holding the other way. In the circumstances therefore, I doubt whether the law on this aspect is as clear as we are led to believe at least in English law. The same problem arose in Lena Goldfields when the principle of "Unjust enrichment" was applied and clearly the principle had not been fully developed in English law (16 *Can. Bar. Review* 243) and it was strenuously argued by Sir Leslie Scott that it was, for the purpose of holding it to be a "General Principle recognised by all the Civilised Systems of Law".

The tribunal in Sapphire-NIOC applying the rule quoted above awarded the Canadian company damages for loss of future profits amounting to $2,000,000. It is startling because the demand for the final dissolution of the agreement was made by the company which was again compensated for such dissolution.

The misfortune of Sapphire and the ensuing frustration caused by NIOC's insistence on a bureaucratic administration (that NIOC be consulted at every stage and her consent be sought before plans are executed) at the time when oil had just been sighted after long and trying days of prospecting, may draw sympathy from capital exporting countries. However understandable this feeling may be, I doubt whether arbitrations coloured by such considerations would encourage developing countries to resort to arbitration when (a) the sole arbitrator is from the countries

labouring to internationalise their municipal rules of law or (b) a mixed tribunal that would deliver a decision by majority vote (or the sole Arbitrator) is composed of a majority of nationals of capital-exporting countries, unless assurances that the interests of economically weak nations will be considered, are made. A joint venture requires a maximum of trust and co-operation from both parties and not domination by the party that brings in the capital.

There have been attempts all along the years since the Award in Lena Goldfields, by National and International Organisations, to rectify the faults in the system which permitted states to repudiate Arbitration Awards that they had not consented to. The striking similarity between the Draft Conventions preceding the latest one by the World Bank, was that they all aimed at pinning down developing states to adhering to what the drafters considered a universal standard of justice in the treatment of private investors. This aspect has been brought out clearly in Fatouros' brilliant survey of the draft codes on this subject, reported in 14 *University of Toronto Law Journal* (1961) p. 77.[45] He concludes at p 101: "Most of the draft codes are one-sided. . . They provide for the protection of the investors' interests without attempting to safeguard the host state's interests."

It is not, therefore, surprising that most of the attempts at a universal investment code have failed. At times, of course, the convention was found unworkable because of tremendous compromises coached by vague and ambiguous phrases that turned out to protect neither side. Oscar Schachter,[46] Director of the General Legal Division of the United Nations in his article "Private Foreign Investment and International Organisation, of 1960" had a similar comment to make on this matter: "In both the case of the Havana Charter and the Bogota Economic Agreement 1948, the proposals for the protection of Investment were so whittled down in the negotiations and subjected to reservations that the provisions which emerged were vague and ambiguous, offering little security to either the private investor or the capital-importing government." He predicted at the time that the solution might lie in bilateral agreements or voluntary machineries for settlement of invesment disputes under the auspices of the United Nations Organisations. Since then there have been successful attempts by the United States which has incorporated investment guarantees in its Treaties of Friendship, Commerce, and Navigation.[47]

On the International level, the World Bank, through its Executive Directors has published a Draft Convention on the Settlement of Investment disputes between states and nationals of other states, opened for signature and ratification by member states of the Bank, on March 18th,

---

45. "An International code to protect private Investment — proposals and prospectives": Fatouros cites the "Solidarity convention" entered into primarily as an instrument to exert pressure for inducing third countries to accept a charter of fair treatment for Foreign Investments.
46. The Article appears in 45 Cornell Law Quarterly p. 415.
47. e.g., Article VI of the F.C.N. with Japan.

1965. The Draft Convention is an ambitious attempt by the World Bank to offer its good offices as a forum where states and nationals of other states may seek conciliatory or arbitral procedures to settle disputes arising from investment agreements. While it does not attempt to codify the law on the subject it still sets out various principles that have achieved a minimum of consensus to govern the arbitration process in a mandatory form for those who elect to use its arbitration procedure. It is of interest to note that while the arbitration procedure is voluntary, in so far as consent by either party is necessary, (Article 28(3) and 36(3)) once the consent (which may be implied from the contract between the parties and adherence to the convention) is given:

(a) It cannot be unilaterally withdrawn (art. 25(1)).

(b) In case of a deadlock in the selection of arbitrators, the Chairman shall appoint the arbitrator or arbitrators (art. 38).

(c) The tribunal once constituted shall be the judge of its own competence (art. 41).

(d) Though failure of a party to appear or to present his case does not mean admission of the other party's assertions, (art. 45(1)); if a party fails to appear or to present his case the Tribunal shall deal with the question submitted to it by the other party and render an award (art. 45(2)).

(e) The Tribunal shall decide questions by a majority of votes of all its members (art. 48(1)).

(f) The award shall be binding on the parties and shall not be subject to any appeal.

The six points above represent the core of my criticism of the arbitration procedures adopted in the cases I have reviewed. The Draft fails to offer any rectification to the very procedures which caused the break-down of collaboration between the state and the private company resulting in eventual repudiation of the ensuing Award. (See e.g., Lena Goldfields, where the problem was similar to (a), (c), (d) and (e)). Instead the Draft constructs a comprehensive legal system of Arbitration, which the World Bank will enforce using all its financial power over developing countries, applying the sanction of non-participation embodied in its Charter. (Art. VI(2)). In view of the present state of International law, with its complete lack of sanctions against "stubborn" states and especially major powers, it may be questionable whether it is desirable to evolve a separate legal system for economically weak nations with sanctions imposed by a world body dominated by capital-exporting countries. The same fear or scepticism has been expressed by Oscar Schachter: "It has . . . come to be realized that the major capital-exporting countries might not be able to accept the same restrictions upon their authority similar to those that have been suggested for developing countries. . . ." In this respect he cites the United States in connection with "eminent domain", in the control of foreign capital.

The draft convention, however, contains some very useful provisions regarding this field of international contracts. The draft provides for conciliation machinery in Chapter Three, which will go a long way in

promoting the necessary spirit of collaboration between states and investors, if put to sufficient use. The procedure provided is informal and flexible to allow continual dialogue between the parties in disputes until they come to an agreement. (See Articles 33-35).

There is also Article 42 which provides: "The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed to 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 principles of International law referred to are such as are referred to in Article 38(1) of the Statute of I.C.J.[48] The general consensus now favours this version of the rules applicable in contracts between states and private companies.[49] Although the use of "General Principles recognised by Civilised Nations" will still continue to provide a good source of the rules applicable to these contracts,[50] Article 42(3) of the Draft might prove more useful and probably more acceptable to developing countries. The Article reads as follows:

> "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."

A similar provision appears in the statute of the I.C.J. Article 38(2). It is my submission that in disputes between a state and a private investor (at least those that are serious enough to lead to a termination of a lucrative economic contract) the questions at issue are not only legal and therefore requiring only a legal solution, in the sense we use the phrase in municipal law, but also that political, social, economic as well as legal issues get intertwined together in such disputes. The solution, therefore, cannot only be the application of legal norms, extracted from the major legal systems of civilised nations; the arbitrator must be allowed the latitude to articulate all the issues involved and weigh the conflicting interests (that may be economic, social, political and legal) of the parties involved and then pass a judgment that is fair and just in the circumstances. It is apparent from the various opinions analysed that even where the arbitrator attempted to "apply" only legal norms to the case, there was sufficient discretion left to apply his notions of justice.[51]

The draft convention had been signed by 22 states as of October, 1st 1965, and ratified by Nigeria. It will enter into force when it has been ratified by 20 states. Despite some of the loopholes I have indicated, the convention should be fruitful in offering a forum for arbitration

---

48. p. 13. Explanation by the Directors found in the report published March 18, 1965.
49. McNair: 33 B.Y.B.I.L. I; Hyde 105 Hague 105 Hague Recueil, and Sir Leslie Scott in "Lena Goldfields Arbitration". My objections are directed on the use of General principles to appy national laws under the cover.
50. See Friedmann: *Changing Structure of International Law* Ch. 12.
51. This point has been made by some realists and in Llewellyn's *The Common Law Tradition*. See also *Jurisprudence* by same author p. 56 point 6 of what realists stand for.

and promoting harmony between states and private investors, especially in so far as it guards against unilateral and discriminatory breaches of investment contracts. Such breaches are generally held to be illegal in international law even by the most outspoken supporters of the view that states be allowed flexibility in the execution of such contracts.

There is not *the* solution to the problems I have posed in this paper, even if I provided what I thought are more acceptable solutions. Despite my criticisms, I am quite aware of the difficulty in arriving at a universally satisfactory solution to all parties involved. My objective has been to project another point of view, which I believe in, and I hope an exchange of views be promoted between developing countries and capital-exporting countries before the law in this field is codified.[52]

---

52. Oscar Schachter has proposed a similar approach in the article in 45 Cornell L.Q.