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# Some Legal Problems of State Trading in Southeast Asia

Chittharanjan F. Amerasinghe\*

## I. INTRODUCTION

State trading—trade conducted internationally by a state or public agency—has become a feature of the mixed economies of southeast Asia. With the growing importance of economic planning and the increase of state intervention (often tantamount to absolute control) in areas of the economy of individual southeast Asian countries, there has been an expansion of international trading functions by states or public agencies. Much of this trade is conducted at a state to state level, *i.e.*, on a bilateral basis. This kind of infrastructure is attributable in part to the fact that the Communist bloc countries generally either have no place for the private trader or else regard him with particular caution. Ceylon's bilateral trade is a result of its market instability and its search for economic independence. Although its dealings are largely with Communist China, it is unlikely that Ceylon will make a permanent shift out of world markets in favor of total bilateral trade. India's trade with the Soviet bloc, on the other hand, is motivated largely by the desire to display economic and political neutrality by opening its gates to trade with all countries. In the case of Burma, expansion of markets for rice at a time when it was having difficulty selling in its traditional markets was, perhaps, the crucial factor. The situation of Indonesia, whose position in the world market for primary products was particularly strong, is more difficult to explain. It is possible that the Sino-Soviet bloc found in Indonesia a useful source for much needed materials and offered her especially attractive terms for her industrial development in return for those materials; in addition, a good deal of political sympathy for Communist China within Indonesia led to a certain acquiescence in bilateralism, even though the nature of the Indonesian economy did not warrant any such predisposition.<sup>1</sup>

Bilateral trading of this variety creates economic problems for both developing countries and free economies in spite of whatever ad-

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1. For an examination of bilateral trading in southeast Asia see, *inter alia*, Behrman, *State Trading by Undeveloped Countries*, 24 LAW & CONTEMP. PROB. 454 (1959).

vantages it may have. Similarly it raises legal problems specifically connected with the operation of the most favoured nation clause, even within the framework of the General Agreement on Tariffs and Trade. Even so, it is not this kind of bilateral trade that gives rise to significant legal problems of international interest in connection with state trading in southeast Asia; rather it is the trade between state or public enterprises and foreign individuals or non-state bodies.

There are several public enterprises which have commercial trading powers in the countries of southeast Asia. In India, it is the function of the two airline corporations to provide safe, efficient, economical and co-ordinated air transport, internal or international or both.<sup>2</sup> This involves not only contracts of carriage with foreigners, but also contracts for the purchase of airplanes and other equipment. In Ceylon, section 5 of the Ceylon Petroleum Corporation Act of 1961 states that:

The general objects of the Corporation shall be—

- (a) to carry on business as an importer, exporter, seller, supplier or distributor of petroleum; and
- (b) to carry on any such other business as may be incidental or conducive to the attainment of the objects referred to in paragraph (a).

A subsequent statute gave this public corporation a monopoly in regard to the petroleum business in Ceylon. It has the power to purchase petroleum products from foreign countries; and, although at present purchases are made from foreign state sources, there is much business done in the field of lubricants with American business enterprises. In the future the proposed state oil refinery will probably find itself dealing with private foreign-crude-oil sources. Another example of a state trading enterprise is the Cooperative Wholesale Establishment of Ceylon, which has power to import goods for the purpose of supplying the needs of the co-operative societies.<sup>3</sup> Such goods would include anything from pins to heavy machinery such as tractors. The public business corporation is also to be found in other countries of southeast Asia, including Burma, Indonesia and even Malaysia. Apart from the public corporation, there may be circumstances in which the state directly engages in the import or export of goods, but this a rarer phenomenon.

The international legal problems created by the entry of the public corporation into the field of commerce in southeast Asia are, perhaps, no different in kind from those created by the presence of the public trading corporation in Western democracies. These problems

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2. GLEDHILL, *India*, in 6 *THE BRITISH COMMONWEALTH: THE DEVELOPMENT OF ITS LAWS AND CONSTITUTIONS* 352 (1964).

3. Cooperative Wholesale Establishment Act, Act No. 47 of 1949, § 2(2) (Ceylon).

may take a more acute form in southeast Asia, however, as a result of political factors and the clash of interests arising from the fact that the states involved are poorer or less developed. Also, economic difficulties no doubt serve to highlight legal problems. Thus, when a change in government causes embarrassment in diplomatic relations with the national state of the foreign contracting party, the state entity may desire to disregard already existing contractual relations at the expense of the foreign contracting party or at the expense of a crisis in the balance of trade. In addition, exchange and other financial conditions may lead to hardship in fulfilling contractual obligations. Such factors may in strict legal terms have little bearing on state contractual relations. Nevertheless, the solution of these problems creates especially acute difficulties for the foreign contractor.

The legal problems that do arise from the phenomenon of state trading may be said to concern (1) the foreign individual or private corporation, and (2) the most suitable protection of his or its interests against the generally more powerful and privileged position of the state trader. These legal problems are generally less severe in trade with foreign individuals than in trade with private corporations. Ultimately, however, the issue revolves around the protection of human rights against the power of the state entity. Further legal difficulties for the state entity may result from political changes or economic deficiencies within its own state, which generally have little to do with the position of the other contracting party.

Viewed from the converse, state trading has repercussions on the nationals of southeast Asian states. Nationals of Ceylon, India, and others trade with the Communist bloc both in the export and import markets. Automobiles are imported from Czechoslovakian state trading entities by private Ceylonese firms; Chinese textiles are imported by Indonesian dealers; and private firms export Ceylonese tea to China. Thus, the private entities in southeast Asian states, though to a lesser extent than private entities outside such states, often contract with foreign state traders. As such, the protection of these private entities may well be at stake in the resolution of state trading legal difficulties.

The international legal problems which arise where one party in the trading transaction is the state or a state entity may be discussed under the following heads: the problem of the immunity of the state from the jurisdiction of municipal courts; the problem of the association of public entities with the state for the purpose of the above immunity; the problem of a non-municipal jurisdiction and law for the contractual nexus; and the problem of protection by national states.

## II. THE IMMUNITY OF THE STATE FROM THE JURISDICTION OF MUNICIPAL COURTS

### A. *Resolution of Disputes in the State Trader's Courts*

P, an Indian, contracting with a Soviet trade organization may wish to have any disputes settled in a Soviet court; or X, an American, may wish to have any problems under his contract with the Ceylon government resolved by a Ceylonese court. Both of these situations raise the issue of sovereign immunity of the state trader within that state itself. Because the foreigner may find it more advantageous to have a decision of the state trader's judiciary to support him, the question of sovereign immunity is of practical importance.

In most southeast Asian states, the state is not immune from the jurisdiction of its courts with respect to contracts;<sup>4</sup> therefore, the foreigner will find the courts of southeast Asian state traders to be a possible forum for settling disputes. The southeast Asian courts will not always be available, however, where the foreign contractor wishes to frame his case in tort against the state. The law of Ceylon, perhaps unique in southeast Asia, grants the state immunity in tort actions.<sup>5</sup> There also can be no execution against the state in Ceylon. In regard to public corporations engaged in trade, the Ceylonese position is different. These corporations generally enjoy no immunities either with respect to actions or execution, provided they have a separate legal personality from the state (as is generally the case). Thus, the Ceylon Petroleum Corporation, which has a separate legal personality as a body corporate, may be sued in its own name and execution can be levied against it. Corporations which do not have such a separate legal personality, though, would stand in the same position as the state.

Where the state trader is not a southeast Asian state and the other contracting party is a national of a southeast Asian state, the same sort of problem arises. The answer varies with the particular state involved. Suffice it to note that Anglo-American notions of sovereign immunity have undergone some measure of change since 1940,<sup>6</sup> while in the Soviet Union the only legal entities capable of entering into foreign trading relations are subject to the Foreign Trade Arbitra-

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4. For Ceylon see *Jayawardene v. Queen's Advocate*, 4 S.C.C. 77 (1881). Sections 299 and 300 of the Indian Constitution contemplate actions against the state.

5 See *A.-G. v. Nadaraja*, 59 N.L.R. 136 (1956).

6. See, *e.g.*, The Crown Proceedings Act, 1947, 10 & 11 Geo. 6, ch. 44, § 1 in England.

tion Commission.<sup>7</sup> In Anglo-American law execution against the state as such would be precluded.

B. *Resolution of Disputes in Courts Other Than Those of the State Trader*

The nonstate contracting party may find it to his advantage to seek settlement of his dispute in courts other than those of the state trader for a variety of reasons. The issue that arises is whether state A, in whose courts the action is brought against the state trader, will assume jurisdiction over the dispute. The nonstate contracting party, it must be remembered, may be a national of a southeast Asian state or of another state, while the state trader seeking immunity from the jurisdiction of state courts may or may not be a southeast Asian state. Also the state whose jurisdiction the nonstate contracting party seeks to invoke may or may not be a southeast Asian state.

Whether the courts of state A will assume jurisdiction depends upon their attitude toward the doctrine of sovereign immunity.<sup>8</sup> There are two possible views that a state may take regarding jurisdictional immunity of foreign states in connection with trading activities. On the one hand, there is the absolutist view, which regards the foreign state's jurisdictional immunity as unqualified, irrespective of the fact that it engages in trading activity. This view is reflected in the case of *The Porto Alexandro*<sup>9</sup> in England and is generally supported by the Soviet Union. Although it has been criticized by certain members of the House of Lords,<sup>10</sup> the *Porto* decision has never been overruled. It is possible that the Commonwealth courts in southeast Asia might follow this view.<sup>11</sup> The other view is that immunity is restricted rather than absolute. This approach has sprung up largely as a result of increased participation by the state in economic activities.<sup>12</sup> It is

7. See Ramzaitsev, *The Application of Private International Law in Soviet Foreign Trade Practice*, 1961 J. Bus. L. 343.

8. The choice of view has been regarded as a matter largely within the discretion of the courts of individual states, though in fact the choice should turn on some compelling norm of international law since the matter concerns international relations. The practice of state courts is not regarded as having created any single norm of international law of a universally binding nature. On the contrary, the limits of discretion have been generally regarded as unusually wide.

9. [1920] P. 30. See also *Compañía Mercantil Argentina v. United States Shipping Bd.*, 40 T.L.R. 601 (1924).

10. See *Compañía Naviera Vascongado v. "Cristina" S.S.*, [1938] A.C. 485, at 496 (Lord Thankerton), 521 (Lord Maugham).

11. There are other states outside the Commonwealth, that might take this view. See Collins, *Effectiveness of the Restrictive Theory of Sovereign Immunity*, 4 COLUM. J. TRANSNAT'L L. 119, 120 (1965).

12. See Fensterwald, *Sovereign Immunity and Soviet State Trading*, 63 HARV. L. REV. 614, 627 (1950); Reeves, *Leviathan Bound—Sovereign Immunity in a Modern World*, 43 VA. L. REV. 529 (1957).

based upon a distinction between activities of the state done *iure imperii* (in its sovereign or public capacity) and those done *iure gestionis* (in its private capacity) and has been variously interpreted by the courts of different states, including Italy, Belgium, Austria, Switzerland and Germany.<sup>13</sup> The United States apparently adheres to a restrictive view of immunity.<sup>14</sup> But, as has been pointed out by Lauterpacht, the distinction is difficult to apply and has led to contradictory decisions in similar situations in different states.<sup>15</sup> In any event, the potentialities of the distinction in bringing the trading activities of states within the purview of state courts would seem to be dependent too much upon the vagaries of judicial predeliction. Recently it was held by a Dutch court that the activities of the state in refining and marketing petroleum could not be classified as acts done *iure imperii*.<sup>16</sup> Hence, even where courts adopt a restrictive view of immunity along traditional lines, there is no guarantee that a party trading with a state trader will find a receptive forum.

Furthermore, a clause in the contract by which the state trader undertakes to submit to a particular jurisdiction will not be operative as a waiver of immunity before English courts,<sup>17</sup> nor possibly before the courts of other states which adopt English precedents. Even where a municipal court assumes jurisdiction over a dispute in which a state trader is involved, there is no guarantee that it will necessarily permit execution against such state trader.<sup>18</sup> This factor is a further limitation on the individual's opportunities of using municipal resources for the satisfaction of his claims.

State practice, as it presently stands, does not hold out particularly sanguine hopes for the individual who engages in business with states. There is no guarantee he will have his disputes satisfactorily settled through the courts of states other than the one with which he trades. As long as the courts of states, whether in southeast Asia or elsewhere, are likely to proceed along established lines, municipal settlement by a non-party to the transaction would not seem to be particularly helpful at present. Perhaps, the solution lies in a doctrine under which the type of function or activity determines the immunity; hence, a trading activity would per se be excluded from the operation

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13. SUCHARITKUL, *STATE IMMUNITIES AND TRADING ACTIVITIES* 218, 233, 242 (1959); SWEENEY, *INTERNATIONAL LAW OF SOVEREIGN IMMUNITY* 26 (1963).

14. See SUCHARITKUL, *op. cit. supra* note 13, at 182; Collins, *supra* note 11, at 121.

15. Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States*, 28 BRIT. YB. INT'L L. 220 (1951).

16. *Cabotent v. National Iranian Oil Co.* (1965), 5 INT'L LEGAL MATERIALS 477 (1966).

17. *Duff Dev. Co. v. Kelantan*, [1924] A.C. 797.

18. *Dexter & Carpenter, Inc. v. Jarnvagsstyrelsen*, 43 F.2d 705 (2d Cir. 1930); *Duff Dev. Co. v. Kelantan*, *supra* note 17.

of immunity regarding both adjudication over the dispute and execution.<sup>19</sup> Since it cannot be ignored that convenience, effectiveness, and economy may dictate the choice of a municipal forum by an individual who has relations with a state trader, the law of foreign sovereign immunity can usefully be reformed to suit the demands of modern international society.

### III. THE IMMUNITY OF PUBLIC ENTITIES FROM THE JURISDICTION OF MUNICIPAL COURTS

The government trading corporation, an institution that has developed in a large number of countries and which combines the power of government with the flexibility and initiative of a private enterprise, also creates problems in regard to immunity from jurisdiction. Such a corporation generally has a distinct legal personality of a corporate nature under the municipal law of the incorporating state, as does, for example, the Ceylon Petroleum Corporation or the Indian Airline Corporation. The Ceylon Petroleum Corporation Act states in section 3 that the corporation shall "be a body corporate and shall have perpetual succession and a common seal and may sue and be sued in such name." While a corporation of this kind may have a separate legal personality in municipal law, the government sometimes has extensive power to control its activities. In the Ceylon Petroleum Corporation Act, for instance, it is stated in section 7 that the Minister of Trade and Commerce of the government may give the Board of Directors "general or special directions in writing as to the exercise of the powers of the Corporation, and such Board shall give effect to such directions." In spite of the separation of corporate legal personality from that of the incorporating state, it would seem that generally corporations of this kind are firmly under the control of the government.<sup>20</sup> The problem that arises is whether these corporations can be sued in the municipal courts of states.

In regard to the courts of the state in which the corporation is incorporated, there seems to be no problem. The incorporating statute ordinarily gives the corporation the power to sue and be sued; hence, it is subject to the jurisdiction of the courts of the incorporating state. It would seem that these corporations are also treated in the same way as private corporations regarding execution.

The problem arises in connection with the courts of states other than the state of incorporation. The question is whether these courts

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19. See Friedmann, *Changing Social Arrangements in State-Trading States and Their Effect on International Law*, 24 *LAW & CONTEMP. PROB.* 350, 354 (1959).

20. See *Baccus S.R.L. v. Servicio Nacional del Trigo*, [1957] 1 Q.B. 438, where the position of the Spanish *Servicio Nacional del Trigo*, which had corporate status under Spanish law, was in issue.

will regard such corporations as immune from jurisdiction. The answer depends, to some extent, on whether such courts adopt a restrictive or absolute theory of immunity. In England, where the courts are generally understood to follow an absolute view of immunity, a Spanish government corporation with separate legal personality which was engaged in the import and export of grain for the government was held to be entitled to immunity—apparently because it was substantially under the control of the Spanish Minister of Agriculture.<sup>21</sup> In another English decision, in which it was held that the Soviet Tass Agency was not a separate legal corporation but a part of the Soviet government machinery, it was stated obiter by Lord Justice Cohen that:

A sovereign government may so incorporate a particular department of State as to make it plain that it is to be an ordinary trading, commercial or business activity and not to be part of the State so that it can claim immunity, but . . . I should not, without further argument, be prepared to accept the view, that it necessarily followed that, because a department of State was granted incorporation it was deprived thereby of the right to assert its sovereign immunity in foreign courts.<sup>22</sup>

Thus, it would seem clear under the view of the English courts which are regarded as the chief proponents of the absolutist theory of sovereign immunity, that mere incorporation as a separate legal entity, according to the law of the state concerned, will not suffice to deprive a public trading corporation of its immunity as a state trader. It is difficult to speculate what test would be applied by such courts to determine whether a legal entity separate from the state is to be entitled to the immunity of the state. It is not clear, for instance, whether the distinction is between the public corporation, to which immunity will be granted, and the joint-stock company controlled by government, which will not be covered by the immunity, or whether it is between the corporation that is controlled in some sense by the government (immune) and one that is not so controlled (not immune).<sup>23</sup>

Even in those states where the restrictive view of immunity is accepted, the fact that a trader is a separate legal entity from the state

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21. *Id.* at 466.

22. *Krajina v. Tass Agency*, [1949] 2 All E.R. 274, 281.

23. Wedderburn thinks that the latter is the proper one. Wedderburn, *Sovereign Immunity of Foreign Public Corporations*, 6 INT'L & COMP. L.Q. 290 (1957). For a discussion of the problem see also Cohn, *Immunity of Foreign Trading Government Departments*, 73 L.Q. REV. 29 (1957); Fawcett, *Legal Aspects of State Trading*, 25 BRIT. YB. INT'L L. 34 (1948); Fensterwald, *supra* note 12; Kuhn, *The Extension of Sovereign Immunity to Government-Owned Commercial Corporations*, 39 AM. J. INT'L L. 772 (1945); Schmitthoff, *The Claim of Sovereign Immunity In the Law of International Trade*, 7 INT'L & COMP. L.Q. 452 (1958); de Visscher, *La Protection Diplomatique des Personnes Morales*, 102 HAGUE RECUEIL DES COURS 399 (1961).

does not seem to be the sole criterion determining whether such a public corporation should be amenable to the jurisdiction of the courts. Thus in the Netherlands, the National Iranian Oil Company was recently held to be entitled to immunity, although it was a separate legal entity, on the ground that it was performing the functions of the state *iure imperii*.<sup>24</sup> This decision illustrates how elusive the distinction between acts *iure imperii* and acts *iure gestionis* can be. In some states, however, courts have had little difficulty in holding that separate legal entities which engage in trade are not entitled to immunity.<sup>25</sup> The practice of the United States courts seems to be that public corporations with legal personalities separate from the state will be deprived of their immunity when engaging in trade.<sup>25</sup>

It is clear that the approach taken by the adherents of the absolutist theory of immunity is unsatisfactory in that it fails to recognize social realities; however, the *iure gestionis/iure imperii distinction of the public commercial enterprises*,<sup>27</sup> whether directly government-controlled or not, cannot be denied. The answer to the question whether international law should permit public trading entities with separate legal personalities to claim immunity from the jurisdiction of state courts should rest on the development of rules which will ensure the general equilibrium of rights and responsibilities among states with differing social, political and economic organizations. Excluding a public corporation which engages in trade from the jurisdiction of state courts is illogical because such a corporation holds itself out as legally separate from the state and engages in an activity which should normally be subject to the adjudication of state courts. It would seem improper to place it above the legal framework which governs ordinary commercial relations between individuals, even though it may be performing functions on behalf of the state. The problem is not one which should be solved on the basis of a distinction between acts done *iure gestionis* and acts done *iure imperii* or on the basis of a concept of control by the government, *i.e.*, the executive arm of the state; but rather on the principle that any commercial function should be subject to municipal jurisdiction, including commercial activity by the state itself. The accident of public control of a commercial operation, then, would not confer on a legal entity a specially privileged

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24. *Cabotent v. National Iranian Oil Co.*, *supra* note 16.

25. *E.g.*, France. SUCHARITKUL, *op. cit. supra* note 13, at 136.

26. See SUCHARITKUL, *op. cit. supra* note 13, at 120. *Contra*, Friedmann, *supra* note 19, at 359.

27. See the General Agreement on Tariffs and Trade. For discussion of this term see SEYID MUHAMMAD, *THE LEGAL FRAMEWORK OF WORLD TRADE* 229 (1959); Friedmann, *International Public Corporations*, 6 *MODERN L. REV.* 185 (1943), in *PUBLIC ENTERPRISE* 11 (Hanson ed. 1955), and in *THE PUBLIC CORPORATION* 539 (Friedmann ed. 1954).

status through exemption from legal jurisdiction. It is probable that trading in southeast Asia would experience benefits rather than setbacks by the acceptance of such a principle.

#### IV. A NON-MUNICIPAL LAW AND JURISDICTION FOR THE CONTRACTUAL NEXUS

What law and jurisdiction can govern a contract between a state trader and an alien?<sup>28</sup> The recently discovered proposition, dependent on practice, that there may be other principles of law governing a contract between state and alien than the municipal law of the state-party to the contract raises acutely the problem of the proper law of the contract. An accompanying issue is that of jurisdiction over disputes arising out of the contract. The situation of the state trader in southeast Asia or of the southeast Asian national trading with other states may very well give rise to these problems by virtue of the balance of bargaining power.

##### A. *Jurisdiction Conferred on Tribunals of a "Transnational" Legal System*

To take the issue of jurisdiction first, the problem arises when the parties to the contract purport to confer jurisdiction on a tribunal which is apparently unconnected with an identifiable municipal legal system.

As to the object of this device, it is probably intended that the jurisdiction of the municipal courts of the state-party to the contract should be excluded and that the remedies should be provided by an independent tribunal not connected with that legal system. The parties realize that the municipal courts of the state-party would be bound to give effect to their own law, including both the conflict rules pertaining to choice of law governing the contract, which might be unfavourable to the alien, and, more particularly, the legislation of that state which might even alter the character of the contract.<sup>29</sup>

28. For a more detailed analysis and discussion of this problem see chapter 3 of a book by the present author entitled *STATE RESPONSIBILITY FOR INJURIES TO ALIENS*, to be published shortly by the Oxford University Press, England.

29. *The Sapphire Int'l Petroleum Ltd.-National Iranian Oil Co.* (Switz. 1963), in 13 *INT'L & COMP. L.Q.* 1011 (1964) [hereinafter cited throughout as the *Sapphire-NIOC arbitration*]. Discussions of agreements of this kind between state or state-owned agency and aliens may be found in VERDROSS, *VARIA JURIS GENTIUM* 355 (1959); Bourquin, *Arbitration and Economic Development Agreements*, 15 *BUS. LAW* 860 (1960); Carabiber, *L'Arbitrage International entre Gouvernements et Particuliers*, 76 *HAGUE RECUEIL DES COURS* 221 (1950); Carabiber, *L'Évolution de l'Arbitrage Commercial International*, 99 *HAGUE RECUEIL DES COURS* 119 (1960); Delaume, *The Proper Law of Loans Concluded by International Persons: A Restatement and a Forecast*, 56

What effect shall be given to such a device is a more difficult question to answer. In general, legal thinking has confined itself to postulating two kinds of legal systems: the international legal system and the municipal legal system. The choice between these alternatives, however, may not always produce a solution. For example, if the arbitrators are to be appointed by agreement between the parties and it is not otherwise apparent that the contract is subject to a municipal system, it might be difficult to locate a municipal system with jurisdiction. Where it is apparent that no specific municipal system has jurisdiction, the presumption is that jurisdiction is to be attributed to the municipal system of the state party to the contract; or if this system does not permit the assumption of jurisdiction, it is presumed that the contract has not created legal relations. Neither alternative is attractive for it is clear that in these cases as in others the parties are intent on creating legal relations, although they may wish to void the municipal system of the state party.

A solution would seem to lie in postulating a third kind of legal system which is dependent to some extent on the choice of the parties for its relevance. It may conveniently be called a "transnational"<sup>30</sup> system, the tribunal which has jurisdiction being a tribunal of this system. Such a system could not be said to be identical with the international legal system as presently conceived since it would involve a state and an individual in the absence of state-to-state relations. On the other hand, it would seem to approximate a municipal system of a simple nature; thus, it may be regarded as belonging to the same genre as municipal systems.

This "transnational" system has several main characteristics: (1) resort to it is dependent entirely upon choice by the parties to the contract, whereas resort to municipal courts and tribunals might not be; (2) such choice has a binding nature apart from the contract itself; (3) at present it consists of tribunals created by the parties which are generally *ad hoc*; and (4) it does not have any organized system of enforcement, the system of law which its tribunals admin-

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AM. J. INT'L L. 63 (1962); Hyde, *Economic Development Agreements*, 105 HAGUE RECUEIL DES COURS 269 (1962); Lalive, *Contracts Between a State or a State Agency and a Foreign Country*, 13 INT'L & COMP. L.Q. 987 (1964); Ramazani, *Choice-of-Law Problems and International Oil Contracts: A Case Study*, 11 INT'L & COMP. L.Q. 503 (1962); Verdross, *The Status of Foreign Private Interests Stemming from Economic Development Agreements with Arbitration Clauses*, 18 ZEITSCHRIFT FÜR AUSLÄNDISCHES ÖFFENTLICHES RECHT UND VOLKERRECHT (Ger.) 635 (1959); Wall, *The Iranian-Italian Oil Agreement of 1957*, 7 INT'L & COMP. L.Q. 736 (1957). It is to be noted that the fact that a state-owned agency and not a state is party to the contract does not change the character of the contract as a state contract. The state-owned agency is to be identified with the state for this purpose.

30. For the use of this term in connection with the proper law of the contract, see Lalive, *supra* note 29, at 998.

ister being of a special kind.<sup>31</sup>

There are two cases which lend support to this type of system, namely *Saudi Arabia v. Arabian American Oil Co. (Aramco)*<sup>32</sup> and the *Sapphire-NIOC* arbitration.<sup>33</sup> The only other direct evidence that such a system is used is found in the *ad hoc* tribunals which operate in isolation from any other municipal system and do not satisfy the requirements for being characterized as tribunals of the international legal system. Where a state accepts arbitration by a transnational tribunal, it is conceivable that this may operate as a waiver of the rule of local remedies.

### B. Choice of the Proper Law of the Contract

The choice of the proper law of the contract will naturally depend upon the forum which has jurisdiction in the case. It must be conceded, however, that most forums would apply a conflicts rule based either on the "objectivist" or "subjectivist" theory of the proper law. Generally either theory could lead to the same result.

Two questions arise here: what choice of law rules should transnational tribunals adopt, and what is the proper law that may be chosen. In the *Sapphire-NIOC* arbitration, the arbitrator adverted to the first problem. He referred to the conflict between the view that the arbitrator must apply the private international law of the seat of the arbitration and the view that he was not so bound but had to discover the common intention of the parties by the use of connecting factors generally used in doctrine and case law without reference to national peculiarities.<sup>34</sup> He also indicated that the latter argument had special force where the parties had merely indicated the authority who should appoint the umpire or sole arbitrator and had not chosen a specific seat for the tribunal.<sup>35</sup> He found it unnecessary to choose between the two views, however, because he found that the choice of law rule of the seat of the arbitration satisfied the test propounded by the other view.

It is submitted that the second view is the better one, not merely in the case where the parties have not specifically chosen a seat for the arbitration, but in all cases where it is clear that the tribunal is of a transnational nature. The appropriate question is whether the

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31. The "quasi-international" system which is implied in the views of certain writers is of a somewhat different nature. For these views see VERDROSS, *op. cit. supra* note 29, at 355; Bourquin, *supra* note 29.

32. 27 Int'l L. Rep. 117, 165 (1958).

33. *Supra* note 29.

34. *Ibid.* The latter view is supported by BATTIFOL, *REVUE DE L'ARBITRAGE* 111 (1957), and CARABIBER, *L'ARBITRAGE INTERNATIONAL DE DROIT PRIVÉ* 50, 92 (1960).

35. *Supra* note 29.

tribunal belongs to a specific municipal legal system or to the transnational system. The answer to this will depend upon all the circumstances of the case. Generally, if the tribunal is disconnected from a specific municipal legal system, the tribunal will be a transnational one.

In both *Saudi Arabia v. Arabian American Oil Co.*<sup>36</sup> and the *Sapphire-NIOC* arbitration<sup>37</sup> the tribunals, being transnational, seem to have applied choice of law rules which were not necessarily those of a given municipal system. These rules were more in accordance with the view that effect must be given to the common intention of the parties by the use of connecting factors generally used in doctrine and case law without reference to national peculiarities.

In the former case, both Saudi Arabian law and general principles of law were held to govern the contract according to this test. In the latter case, although Iran was the *locus contractus* and *locus solutionis* of the contract, it was found for various reasons that Iranian law was not chosen by the parties; but general principles of law, based upon reason and the common practice of civilized nations, were held to govern.

Modern trends have also raised problems in connection with the law that a tribunal may use to govern the substance of the contract, whether it be a tribunal of a municipal system or the transnational system.<sup>38</sup> The fact that the municipal law of the state, or more than one state may be chosen as the proper law offers no problem. Difficulties arise, however, when other systems are put in issue as competitors in the choice of the proper law. Thus, it may be argued that the proper law may be supplied by three other systems, individually or in combination: (1) the legal systems set up by the contract itself and thus *sui generis*, (2) international law, or (3) transnational law.

Some authorities contend that important international contracts create a legal system of their own—an independent legal order—which regulates the relations between the parties exhaustively. Such a system is said to result from their concordant wills.<sup>39</sup> This argument was used by Aramco in *Saudi Arabia v. Arabian American Oil Co.*<sup>40</sup>

36. *Supra* note 32, at 165. The fact that the tribunal preferred to apply the "objective" theory, *supra* note 32, at 167, does not change the view taken here, since the practical effect of both theories would appear to be the same where there is no express choice of law.

37. *Supra* note 29.

38. See especially Lalive, *supra* note 29, at 991; Mann, *The Proper Law of Contracts Concluded by International Persons*, 35 BRIT. YB. INT'L L. 34, 41 (1959); McNair, *The General Principles of Law Recognized by Civilized Nations*, 33 BRIT. YB. INT'L L. 1 (1957); Ramazani, *supra* note 29, at 506.

39. See Bourquin, *supra* note 29; Verdross, *supra* note 29.

40. See Lalive, *supra* note 29, at 997.

As pointed out by Lalive, however, this theory is not satisfactory because it appears artificial and begs the question. A contract cannot remain in a vacuum; it must be inserted into a pre-existing legal order, such legal order being either clearly defined or ascertainable by way of legal or judicial interpretation.<sup>41</sup>

International law has often been expressly referred to as the governing law in contracts.<sup>42</sup> As stated by the tribunal in *Saudi Arabia v. Arabian American Oil Co.*, however, a contract between a state and a private corporation cannot be governed by public international law.<sup>43</sup> This is true because the contract does not become one which belongs to the international legal system.

However, the reference to international law must be given meaning, and the only meaning it can have is that *principles* of international law become applicable. A similar effect is brought about when there is a reference to "general principles of law," or when the general circumstances of the contract point to such general principles of law as being applicable. When "international law" or "general principles law" are chosen as the proper law of the contract, it would appear that a specific legal system is being invoked which may be called "transnational law."<sup>44</sup> It is in this sense that Lord Asquith's resort to the general principles of law as a modern law of nature<sup>45</sup> in the *Abu Dhabi* arbitration must be understood. The term "transnational" is novel, but it is a satisfactory denomination for the law which the above reference covers.

This "transnational law" constitutes a category of legal system which is not public international law nor a peculiar municipal law. As Lord McNair has stated, such a system which is appropriate to certain international contracts "is not public international law, but shares with public international law a common source of recruitment and inspiration, namely the general principles of law recognized by civilized nations."<sup>46</sup> However, it is worth emphasizing that its status is more like that of municipal legal systems.

This system of law was resorted to, in effect, though not *sub eo nomine*, as the proper law of the contract in the *Sapphire-NIOC* arbitration. In determining whether breach by one party gave the other party both the right to be released from its obligations and a right to damages (including assessment of the amount of damages),<sup>47</sup>

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41. *Id.* at 998.

42. *Id.* at 999.

43. *Supra* note 32. *Contra*, Mann, *supra* note 38, at 41.

44. See Lalive, *supra* note 29, at 988, for a fuller discussion of this.

45. Arbitration Between Petroleum Dev. Ltd. and Abu Dhabi (1951), in 1 INT'L & COMP. L.Q. 247, 251 (1952).

46. McNair, *supra* note 38, at 6.

47. See the *Sapphire-NIOC* arbitration, *supra* note 29, at 1015.

the arbitrator used general principles of law. In *Saudi Arabia v. Arabian American Oil Co.* general principles of law were also applied as the proper law.

The justification for postulating such a system would seem to lie in the fact that practice seems to have led to the choice of a system of this kind as the governing law. It would seem that there are certain kinds of contracts made between states and private entities or individuals in which the parties do seriously contemplate that some system of law other than a specific national system should be applicable. Some contracts concerned with complex economic relations may fall into this category. The main reason for the parties contemplating such a neutral system as the governing law would appear to rest on the alien's fear that, if the law of the state-party were used, legislative changes might affect the contract. Perhaps the contract could not have been concluded had no protection been given to the alien's interest in having an assurance of some legal security against such legislative changes by the state-party.<sup>48</sup>

The content of this law in its bearing on contracts can, of course, only be determined by comparative studies of the existing legal systems for the purpose of extracting general principles. In practice it appears that much would depend on the finding of principles common to the municipal systems of the parties to the contract.<sup>49</sup>

The conclusion would seem to be inevitable that "transnational law," as defined above, is an appropriate competitor for the choice as to the proper law of a state trading with an alien.

## V. THE PROBLEM OF PROTECTION BY NATIONAL STATES

### A. *Recognizing the Individual as an International Person*

It may be argued that the individual should be given an international personality for the purposes of the law concerning contracts with state trading entities as part of the law of alien treatment. Then the individual would have both substantive and remedial rights at international law. It would be possible to regard injury to an individual which is a breach of international law as a violation of the international rights of the individual. The remedial rights would also be vested in the individual, though the actual procedure of enforcing such rights before international tribunals may still be dependent upon the consent of the immediate parties to the dispute and the constitution of the tribunal concerned. The individual would have the right of bringing his own claim against the foreign state at international law.

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48. *Id.* at 1012.

49. This question clearly needs careful study and deeper analysis.

The reason for giving the individual such recognition is that the realities of the situation point to such a position. It is eminently clear that it is the individual's interests that are primarily affected where state responsibility is incurred in connection with state trading contracts. The logical extension of this reality would be to give the individual legal personality. Such recognition is highly desirable, but the states may not be really ready to take this step because they are more concerned about protecting their own interests as respondents than they are about protecting the interests of aliens.

Recognition of the individual's legal personality would bring about several changes in the actual law relating to state responsibility for injuries to aliens. The whole basis of diplomatic protection would have to be revised, and one question which would have to be answered is whether the state's interest as the indirect victim of an illegality committed upon an alien should be recognized in addition to the interest of the alien. Among other things, a Calvo Clause<sup>50</sup> would certainly have the effect of taking away the individual's international right of recourse to an international tribunal. This would be so regardless of the lack of effect on the possible interest of the alien's national state which interest would then have to be divorced from that of the alien in its content. To take another example, the rules relating to nationality of claims<sup>51</sup> would not apply to the bringing of a claim by an individual alien. It would also be possible for the alien effectively to agree to a waiver of the rule of local remedies; hence, a dispute may be brought directly before an international forum.

Since the states are not yet prepared to face such far-reaching changes, improvement of the law may have to be contemplated within a more limited framework. Short of full recognition being given to the alien as a subject of international law, there are innovations which will help to improve his position. Yet even innovation will require the recognition of the interests of the alien as such.

The bringing of a claim in an international tribunal arising out of the responsibility of a state for an injury to an alien is in reality a means of enforcing protection of the alien's interests. Nevertheless, today the claim has to be brought within the framework of diplomatic protection—a framework which postulates an injury to the alien's national state. The law relating to the bringing of claims arising from injuries to aliens is an amalgam of rules deriving from a variety of principles, including the principle that an injury to the alien is no more nor less than an injury to his national state.

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50. For a discussion of this clause see SHEA, *THE CALVO CLAUSE* (1955).

51. On these rules see VAN PANHUY, *THE ROLE OF NATIONALITY IN INTERNATIONAL LAW* 59 (1959).

In view of the fact that there is little logical consistency in the present rules, an attempt may be made to give more prominence to the interests of the alien while still recognizing the framework upon which the present law rests. Further, logical inconsistency would result if the basic premise is the principle that it is a state's right that is violated by an injury to an alien. But logical inconsistency is often justified on the grounds of social policy and convenience.

It is submitted that states may be prepared to accept the position where, although an injury to an alien is regarded as an injury to his national state, it is also recognized that the alien's substantive rights are infringed though his procedural rights may be limited. On this basis it may be suggested that as long as the alien has the nationality of some state other than the respondent state at the time of the injury, he may bring a claim in his own right at international law before an international tribunal without any need for espousal of his claim by his state. Although his national state would also have a right of redress in the appropriate circumstances as at present, the alien's right to remedial action would not be dependent upon the exercise of that state's right.

Under this theory stateless persons will still not receive protection. However, this is a defect of the present law which will be difficult to remedy unless states are fully prepared to recognize the international personality of the individual. It cannot be remedied as long as the principle that the injury to an alien is an injury to his national state is considered to be basic.

The proposed rule does, however, eliminate many of the limitations of the nationality-of-claims rule, such as the requirement that there must be continuous nationality. The fact that the alien also has the nationality of the respondent state should not make any difference. But there a modification may be introduced: only if the alien is more closely connected with another state of nationality than the respondent state should the injury be regarded as having been done to an alien for the purpose of giving him the right to bring a claim.

The forum will be an international tribunal; but like all international tribunals, its constitution and jurisdiction will depend upon consent. Consent must be given both by the alien or the state whose nationality he enjoys at the time of the injury and by the respondent state. The necessary consent may be given either before or after the wrong. If a tribunal has not been previously constituted, it would be better if the alien and not his national state has the power of consent, for he will then not be dependent upon its goodwill for a remedy. Such an innovation would not necessarily affect the rule of local remedies.

Garcia Amador in his Revised Draft for the Interuational Law

Commission of 1961 does recognize that the alien should have certain rights to bring international claims for the injury to him, while not denying that his national state also has certain rights to bring a claim.<sup>52</sup> If a tribunal has been constituted by agreement between the respondent state and the alien, the alien may submit a claim to such tribunal without the consent of his national state.

The Convention for the Settlement of Investment Disputes sponsored by the World Bank also contains provisions which give the alien the right to submit a claim to the Centre.<sup>53</sup> This right is dependent upon the condition that his national state and the respondent state have signed the Convention, and that there is an agreement between him and the respondent state to submit the dispute to the Centre. The jurisdiction of the Centre extends only to legal disputes arising directly out of an investment.

In the past, moreover, there have been examples of individuals' being permitted to bring claims before special arbitral tribunals constituted by agreements between their national states and respondent states.<sup>54</sup> In many instances, though not in all, the jurisdiction of the tribunal has been based upon the traditional rules relating to nationality of claims.

Also worthy of mention are the various "transnational" tribunals which have exercised jurisdiction. Because these have not been conceded the status of tribunals of the international legal system, however, they remain quasi-municipal tribunals.

The trend seems to be towards giving recognition of some kind to the individual as an international person, though there has been no systematic acceptance of this position. Even so, in the case of Garcia Amador's Revised Draft it is not clear to what extent the traditional rules relating to the nationality of claims have been rejected. Although the World Bank Convention is more explicit in its rejection of these traditional rules it uses a criterion different from the one submitted above.<sup>55</sup>

It cannot be doubted that the World Bank Convention is clearly an advance in an important but limited field in which aliens are involved.

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52. Articles 21 and 22, 2 INT'L L. COMM'N YB. 46, 49 (1961).

53. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, March 18, 1965, art. 25, in 4 INT'L LEGAL MATERIALS 532, 536 (1965) [hereinafter cited as World Bank Convention].

54. See, e.g., the Central American Court of Justice (1907-1917); arbitral tribunals set up under the Treaty of Versailles (1919-20), arts. 297 and 304; The Arbitral Tribunal of Upper Silesia (1922); the Court of the European Coal and Steel Community, set up in chapter IV of the Treaty of 1951.

55. Article 25(2) requires nationality of a contracting state and absence of nationality of the respondent state on the date on which the parties consented to submit the dispute to the Centre and on the date of the registration of the request. World Bank Convention, art. 25(2).

García Amador's Revised Draft may also be an advance. But it is submitted that concession of personality to the alien could be explicitly independent of the traditional rules relating to nationality of claims. The criterion adopted by the World Bank Convention does not, perhaps, go far enough.<sup>56</sup>

### B. *Treating Breach of Contract as a Breach of International Law*

The recognition of the personality of the alien can also have effects in the substantive sphere of the law. Particularly in the field of contracts (including trading contracts) between aliens and states, modern trends have shown a general dissatisfaction with the traditional view that a breach of a state contract with an alien is not per se a breach of international law.<sup>57</sup> As a result of this view, state responsibility for breach of contract which does not involve a breach of international law is contingent upon the satisfaction of other requirements. Such contracts, therefore, exist at a municipal level and generally have been subject to the municipal courts and the law of the contracting state.

Although this position prejudiced aliens to the extent that they could not avoid the peculiarities of the municipal law of the state-party and its legislative changes and were not directly protected by international law, it has been somewhat mitigated by modern trends. The acceptance of transnational jurisdiction and a transnational law to which a contract between a state and an alien may be subject has achieved for the alien a certain immunity from the law of the state-party and from its legislative changes. This does not in any way prejudice the equitable interests of the state-party, since both parties are subjected to the same system of law, and since transnational law can certainly give value to the special interests of states to the same extent as can the international legal system.

The development does not, however, go far enough, perhaps, in so far as the alien is still not given the direct protection of international law by the elevation of his contractual relations to the international level. But the creation of a transnational jurisdiction may also appear to be the creation of an unnecessary fifth wheel. Were the alien to be given international personality for contractual purposes, contracts between an alien and a state would automatically exist at an international level and directly within the international legal

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56. Also, adequate rules to improve on those already in existence have to be developed to deal with juristic persons. See World Bank Convention, art. 25(2). On the existing law see Jones, *Claims on Behalf of Nationals Who are Shareholders in Foreign Companies*, 26 BRIT. YB. INT'L L. 225 (1949).

57. See Amerasinghe, *State Breaches of Contracts with Aliens and International Law*, 58 AM. J. INT'L L. 881 (1964).

system. Both parties would then have rights and duties under international law.

Breach of contract by either party would then become a breach of international law and would be subject to international adjudication, irrespective of the question of the proper law of the contract. The governing law of the contract might turn out to be a municipal law, international law, or a combination of these. This international adjudication would also be separate from the need to exhaust local remedies—which would remain as a procedural requirement, unless waived. The point is that an international tribunal could adjudicate on a dispute arising from the contract as a direct breach of contract and not merely as a question whether, for instance, justice has been denied or remedies have not been provided.

The recognition of the alien's international personality for contractual purposes, therefore, would place the alien in a position of contractual equality with the state within the international legal system. Such recognition does not necessarily deprive the state of any special rights it may have at international law in connection with contracts with aliens.<sup>58</sup>

### C. *Invoking the Rule of Local Remedies*

The rule of local remedies relates to the procedure of international claims. It is clear that in its essence the rule is a concession to the respondent state, for it permits the state-party to settle the dispute by its own judicial means before the proper tribunals of the international legal system can exercise jurisdiction over any aspect of the dispute which arises from the violation of international law.

This unusual privilege may seem rather anomalous in the context of abstract juristic theory. It may be questioned whether a party to a dispute should even be given the privilege of righting its wrong in its own way, before an appropriate tribunal of the legal system is permitted to adjudicate the dispute. Looked at in this way, the nature of the concession involved in the rule becomes eminently clear. It is the result of exceptional sanctity being attached to state sovereignty or to the state as a sovereign entity.

At the same time, these considerations point to the importance of limitations being placed on the application of the rule so that the ends of international justice are not frustrated. Hence, the requirement that only judicial methods are contemplated by the rule cannot

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58. The view that a contract may be internationalized under the present law is not acceptable. See *ibid.* The so-called "internationalization" which is said to take place under the present law, see Mann, *supra* note 38, at 43, can only be brought about by the above theoretical and practical adjustment which is fundamental. What happens today is different.

be underestimated if an equitable balance is to be maintained. Other limitations, such as those emanating from the concepts of jurisdictional connection and direct injury, and those relating to the exhaustion of procedural remedies, are equally effective means of preventing the rule from becoming a weapon of partiality.

Ideally speaking, from the point of view of the integrity of the legal system, it may appear that a rule of this kind tends to detract from the appropriate powers of the international legal system and is, therefore, detrimental to the community interest. But this kind of logic is not likely to be appreciated in a community where the interests of the sovereign state are still the measure of legal efficacy. Such a submission must certainly point up the less-developed nature of the international legal system.

However desirable it may be that, in the interests of the maturity of the international legal system, the rule of local remedies should be dispensed with, it is unlikely that the rule will lose its strength. Even the World Bank Convention contains a reference to the requirement that local remedies should be exhausted as a condition precedent to the jurisdiction of the Centre, if a state accepts the Centre's jurisdiction on this condition.<sup>59</sup> But it is equally interesting to note that the Convention is based upon the position that the rule is excluded unless it is expressly invoked. This may be considered some kind of an advance towards more open recognition of the proper adjudicatory rights of international organs.

As long as the rule exists, the privileged position of the state as a respondent must be recognized. Although it may appear that the alien is merely being equated to the national of that state, the fact is that the position of the alien is somewhat different from that of a national—he is an alien, and his position brings into play an international or non-national element which *vis-à-vis* the state may properly require special treatment by that very fact. It would not be a correct assessment of the situation to regard him as a full member of the state to which he has come so that he must be put in a position similar to that of nationals.

The fact that the rule is likely to be invoked by respondent states wherever possible warrants the caution that it should be kept within its proper bounds. The stage has not been reached when its applicability can be totally or categorically rejected. It must, therefore, be used in accordance with the limits of its purpose.

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59. World Bank Convention, art. 26.

