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# Negotiating for Dispute Settlement in Transnational Mineral Contracts: Current Practice, Trends, and an Evaluation from the Host Country's Perspective

## Keywords

Contracts, Regulation

# ARTICLES

## Negotiating for Dispute Settlement in Transnational Mineral Contracts: Current Practice, Trends, and an Evaluation from the Host Country's Perspective

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### I. INTRODUCTION: TRANSNATIONAL MINERAL CONTRACTS

Transnational investment contracts between transnational enterprises<sup>1</sup> (TNEs) and host countries, particularly developing countries, have been shrouded in a veil of secrecy for a long time. Such secrecy may have been due mainly to the often one-sided distribution of benefits, favoring the TNE at the cost of the host country. Host countries often had comparatively weak bargaining power and little experience in negotiating the complex and comprehensive contractual and legislative regime for large-scale investment projects. This secrecy is gradually disappearing particularly in the area of natural resources development, which is the focus of the present paper.<sup>2</sup>

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Much of the author's analysis is based upon an examination of approximately 200 large-scale mineral contracts, some public, some confidential, dealing with petroleum and nonfuel mineral development. Because of the confidentiality of many of the documents, no reference can be made to their source. The author has also relied upon a series of interviews with negotiators from mining companies, international institutions, and host countries. For their assistance and criticism, the author is especially grateful to Charles Lipton, Esq., and Eric Bergsten, Esq., as well as to his colleagues at the United Nations and the Institute.

1. For the use of the term "transnational" instead of either "multinational" or "international," see P. JESSUP, *TRANSNATIONAL LAW* (1956). In the official terminology of the United Nations corporations formerly called "multinational" are presently termed "transnational." See E.S.C. Res. 1913, 57 U.N. ESCOR, Special Intersessional Committee (1931st mtg.), U.N. Doc. E/5599 (1974). A transnational investment contract means, for the purposes of this study, a contract between a transnational corporation (enterprise) and a host country or a host country entity relating to investment.

2. See Wälde, *Lifting the Veil from Transnational Mineral Contracts: A Review of Recent Literature*, 1 NAT. RES. FORUM 277 (1977).

Traditionally, information on such agreements has come to light only from the few surfacing and published international arbitration cases.<sup>3</sup> At present, information concerning their actual texts derives mainly from publication in official gazettes and from the Security and Exchange Commission's publicly available files, while information concerning the main elements of such agreements appears also in trade journals and commercial information services.<sup>4</sup> Additionally, the political sensitivity of natural resources exploitation in developing countries and the evolution of the right of host states to permanent sovereignty over natural resources<sup>5</sup> have stimulated research in this area from the legal, economic, and political science perspectives.<sup>6</sup>

The transnational mineral agreements to be discussed here involve economic and political interests of great weight, *i.e.*, the interests of consuming nations in maintaining a steady flow of raw materials necessary for the functioning of their industrial systems and the interests of developing countries in using their natural resources to obtain the substantial funds

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3. Reports of these arbitration cases are repeatedly encountered. In the prewar period, the major cases were *Lena Goldfields*, I ANNUAL DIGEST OF INT'L LAW CASES, nos. 1 & 258 (1930), and *Société Rialet*, VIII RECUEIL DES DECISIONS DES TAM 742 (1929). For postwar cases, see *Saudi Arabia v. Aramco*, 27 INT'L L. REP. 272 (1958); *Ruler of Qatar v. International Marine Oil Co.*, 20 INT'L L. REP. 534 (1953); *Petroleum Development, Ltd. v. Sheikh of Abu Dhabi*, 18 INT'L L. REP. 144 (1951); the *Sapphire* arbitration, *extracted in* ANNUAIRE SUISSE DE DROIT INTERNATIONAL 273 (1952); *Sentence arbitrale du 19 janvier 1977, L'Arbitre Unique, René-Jean Dupuy (Fr.)*, reprinted in 104 JOURNAL DU DROIT INTERNATIONAL 350 (1977) (*Un Grand Arbitrage Pétrolier, Texaco/Calasiatic c/ Gouvernement Libyen*); *Imperial Ethiopian Government v. Baruch-Foster Corp.*, 535 F.2d 334 (5th Cir. 1976). See generally Weil, *Problèmes relatifs aux contrats passés entre un état et un particulier*, 1969-III RECUEIL DES COURS 95, 164 (1969); J. Kuusi, *State Contracts with Foreigners: Considerations on Law and Policy* (1976) (unpublished Ph.D. thesis, Oxford University).

4. See *Development of an Information System* 12, U.N. Doc. E/C.10/28 (1977).

5. For recent action, see G.A. Res. 3171, 28 U.N. GAOR, Supp. (No. 30) 52, U.N. Doc. A/RES/3171 (1973). For relevant resolutions concerning the New Economic Order see also G.A. Res. 3202, 6 U.N. GAOR, Report of the Ad Hoc Committee of the Sixth Special Session (Agenda Item 7), U.N. Doc. A/RES/3202 (1974); G.A. Res. 3281, 29 U.N. GAOR, Report of the Second Committee (Agenda Item 48), U.N. Doc. A/RES/3281 (1975). For an analysis of the development until 1966, see M. MUGHRABY, *PERMANENT SOVEREIGNTY OVER OIL RESOURCES* (1966); for a discussion of the recent evolution of the permanent sovereignty concept within the framework of the New International Economic Order, see RIA KEMPER, *NATIONAL VERFÜGUNG ÜBER NATÜRLICH RESSOURCEN UND DIE NEUE WELTWIRTSCHAFTSORDNUNG DER VEREINTEN NATIONEN* (1976).

6. Wälde, *supra* note 2. Mention should also be made of the recently published study of the COMMONWEALTH SECRETARIAT, *A STUDY ON THE LEGISLATIVE FRAMEWORK, AGREEMENTS AND FINANCIAL IMPOSITIONS AFFECTING THE MINING INDUSTRY IN AFRICAN COMMONWEALTH COUNTRIES* (1977).

necessary to achieve speedy industrialization. In addition, developing countries would like to employ their resource base as a starting point for resource-centered industrialization by processing, refining, and finally fabricating their natural resources and by creating forward and backward linkages. The nonrenewability of most exploited resources raises the fear of exploitation by TNEs to very high levels of concern.

Transnational mineral contracts (TMCs) constitute the legal regime for investment projects of enormous investment volumes. Due to exploitation of low-grade ore bodies, the necessity of exploiting economies of scale to the greatest degree, and rising costs of infrastructure in remote, unexplored, and undeveloped areas of the world, the investments required for many recent individual projects in copper, iron ore, and bauxite often reach the magnitude of \$1 billion. The Carajas iron ore project in Brazil, for example, apparently requires an investment of \$3 billion. Thus, it is not surprising that large-scale mining projects are following the tradition of petroleum exploitation. These operations are undertaken by large consortia encompassing various mining companies, metals trading houses with long term purchase commitments, and lending groups, often consisting of up to forty private banks and development financing institutions.<sup>7</sup>

Accordingly, the negotiation and the final drafting of the legal regime for such large-scale investment projects poses a great challenge. Evolved from simple concession contracts with straightforward royalty provisions and few "frills," the modern transnational mineral contract often constitutes a hybrid combination of contractual alternatives. These include traditional concessions forms, joint ventures, service, management, and technical assistance agreements (with long-ranging commitments), reinvestment, expansion into processing, and long term purchase obligations. A complex array of legal forms is designed to cover the multifaceted interests of the host country related to the mining venture. The complete dependence of some producer countries on the mining project along with the inevitable clash between the TNEs worldwide, oligopolistic, and integrated planning system and the host country's escalating demands do not facilitate the negotiation.

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7. See Zorn, *New Developments in Third World Mining Agreements*, 1 NAT. RES. FORUM 239 (1977).

Research on the various issues of negotiation for TMCs requires an interdisciplinary approach, combining legal, business, economic, and political skills. The objectives of such research depend on the audience to which it is directed. For instance, if the TNE is the addressee, research is intended to assist the TNE to find a contractual regime which accounts for probable political upheavals. Additionally, a thorough understanding of the political risk involved<sup>8</sup> as well as the needs, interests, and perceptions of the host country may help to design contractual forms less visible, less antagonistic, and more viable for the specific situation of the host country.<sup>9</sup> Research for home governments may point to the alternatives best securing a steady flow of raw materials, *e.g.*, through either indirect support of operations of TNEs or by direct or mediated relationships with the producer countries. Finally, the mere collection of information and research on transnational mineral contracts will probably be of assistance to developing host countries.<sup>10</sup> This collection and analysis of contract-related information will assist host states in gaining the necessary experience in order to secure a more equal footing with TNEs, to formulate more precisely their own policies in the development of their mining industry,<sup>11</sup> and to implement such policies by effective negotiation with foreign investors. In this area the potential contribution of the UN Centre on Transnational Corporations is of considerable importance—be it in collecting and disseminating relevant information to developing countries or in stimulating cooperation among developing countries for a mutual exchange of relevant experiences with TNEs.<sup>12</sup>

Traditional legal research has focused mainly on the legal issues which arise once a conflict has been brought to an inter-

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8. Kobrin, *The Conditions under which Political Disruption Results in Increased Political Risk* (1977) (working paper, Mass. Inst. Tech.); D. HAENDEL, G. WEST & R. MEADOW, *OVERSEAS INVESTMENT AND POLITICAL RISK* (1975).

9. See Wells, *Negotiating with Third World Governments*, 55 HARV. BUS. REV. 72 (1977).

10. Smith, *Information-Sharing and Bargaining: Institutional Problems and Limitations*, in *THE POLITICAL ECONOMY OF INTERNATIONAL RESOURCES FLOWS* (G. Garvey ed. 1977).

11. R. BOSSON & B. VARON, *THE MINING INDUSTRY AND THE DEVELOPING COUNTRIES* 252 (1977).

12. For the establishment of the United Nations Centre on Transnational Corporations and its duties, see 57 U.N. ESCOR, Supp. (No. 1A) 3, U.N. Doc. E/5570/Add. 1 (1974). See also United Nations, *Programme of Technical Cooperation on Matters Related to Transnational Corporations*, U.N. Doc. E/C.10/29 (1977), for a description of the technical services related to negotiations with TNCs.

national arbitration tribunal for attention.<sup>13</sup> It has rarely been concerned about issues of how to negotiate and draft investment agreements in a way which takes full account of the objectives of developing countries and which contributes towards a maintenance of the investment relationship that is advantageous to the developing countries and acceptable to the TNE. The traditional perspective dominating most of the literature on dispute settlement in concessions agreements is due partly to the fact that most commentators come from Western legal systems and accordingly will be more likely to defend legal positions favorable to TNEs and the capital-exporting states. Perhaps a reorientation of legal research from postdecision analysis of a dispute to conflict avoidance is necessary. Such a reorientation could be representative of the interests of home countries, of TNEs, or of host countries. This new approach will be able to contribute towards a greater stabilization of mutually advantageous investment relationships, to minimize the costs of the often escalating conflicts between investor and host state, and to assist the achievement of the objectives of the New International Economic Order.

The main issues in negotiating TMCs are the fiscal regime of the contract, the determination of the distribution of direct benefits from the projects, and, increasingly, the economic development provisions. Through the latter technique, the host state attempts to increase its indirect benefits, such as local processing, national employment, localization of supply purchases and participation in marketing. The present paper, however, focuses on dispute settlement.

Dispute settlement is the classical area upon which lawyers have focused their interests when negotiating and analyzing such agreements. The abundant literature available on legal issues of international arbitration has had a strong impact on the actual drafting. The negotiation for dispute settlement provisions in agreements is also heavily affected by the strong controversies raging at present on issues of international arbitration and of the internationalization of investment agreements. One of the major thrusts in the evolution of the concept of permanent sovereignty over natural resources<sup>14</sup> has been the

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13. See Weil, *supra* note 3, at 121-25; Lalive, *Contracts Between a State or a State Agency and a Foreign Company*, 13 INT'L & COMP. L.Q. 987, 988-90 (1964).

14. See Mughraby, *supra* note 5.

attempt of developing countries to throw off the burden of international arbitration as an imposition on their national sovereignty. In the current international negotiations being held on the implementation of the New International Economic Order, on the Code of Conduct for Transnational Corporations and on the future shape of an international law of the sea,<sup>15</sup> the scope and form of dispute settlement is very controversial. A focus point is the clash between Western states' policies of protection of foreign investment and the emphasis which the Third World strongly places on economic sovereignty.

The present paper is directed towards filling the gap of information concerning existent transnational mineral contractual practice. As mentioned, information of a larger scale on TMCs has been forthcoming only very recently and mostly in the area of petroleum concessions.<sup>16</sup> These traditional concessions have substantially evolved, first in petroleum, from the joint venture (1957) to the service contract type (1966), with nonfuel mining gradually following this development. Emerging concepts of permanent sovereignty, the energy crisis, and a wave of nationalizations in the 1970s have exercised a strong impact on subsequent negotiations and renegotiation of agreements. These changes, strongly reflected in dispute settlement clauses, have not yet been reflected in the available studies.

An updated survey of recent developments is warranted for various reasons. First, it helps to inform those parties (TNEs and host countries) directly affected by natural resources development about the present context of contractual negotiations. Additionally, it may contribute toward an evolution taking place in the theory of transnational contract law. Legal writers, particularly those from capital-exporting countries, have attempted to "internationalize" investment agreements. This has occurred with a view towards achieving greater investment security by exempting such contracts from

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15. G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1975); G.A. Res. 3202, 6 U.N. GAOR (Special Sess.), Supp. (No. 1) 5, U.N. Doc. A/9559 (1974); G.A. Res. 3201, 6 U.N. GAOR (Special Sess.), Supp. (No. 1) 3, U.N. Doc. A/9559 (1974). See also *THE NEW INTERNATIONAL ECONOMIC ORDER* (K. Sauvart & H. Hasenflug eds. 1977).

16. Relevant literature is reviewed in Wälde, *supra* note 2. For a particularly informative discussion of arbitration provisions in petroleum concessions, see Sarre, *Arbitration Clauses in the Oil Industry in the Middle East*, in *INTERNATIONAL COMMERCIAL ARBITRATION* 336 (C. Schmitthof ed. 1974) [hereinafter cited as *INTERNATIONAL COMMERCIAL ARBITRATION*].



national law and placing them under the protection of a body of international law, which in its traditional form still favors the interests of TNEs. Such internationalization has been hindered by the absence of substantive legal rules to be applied to investment agreements once they are thought to be subject to an "international" or "transnational" law of contracts. Commentators have also looked upon existing contractual practice as a means to furnish some substantive rules.<sup>17</sup> In doing so there is substantial risk that contractual practice of the past, generally more favorable to TNEs, may be relied upon to justify the arguments about a substantive law applicable to agreements. On the other hand, this practice has in the meantime evolved to the considerable advantage of developing countries. Yet, the frequent application of a nonnational law and a nonnational jurisdiction in older agreements has been mistakenly used to construct general principles for submitting investment agreements to principles, rules, and jurisdictions outside the host state.

The present paper intends to give a descriptive survey of current contractual practices as well as some indication of the method that the host countries should use in evaluating the various alternatives of dispute settlement solutions. It does not purport to be a strict guide to negotiations. Indeed, a host country may often be advised to give concessions in the area of dispute settlement if it obtains corresponding benefits in other areas of negotiation. However, for a sophisticated negotiation, a clarification of the maximum objectives in bargaining and a clear idea about possible fallback positions and their evaluation is necessary. Hence, the present paper will attempt to outline some maximum positions achievable in addition to fallback positions for compromise solutions. The position to be agreed upon in the final analysis obviously hinges upon the relative bargaining power and the particular preferences of the TNE and host country. Finally, the present practice may give some clues about future trends. Such trends may lead to solutions which accommodate the security interest of the investor and the sovereignty objective of the host country. The present paper is based on a survey of a large number of recent contracts (dating from 1968 to 1977), in the area of petroleum as well as nonfuel mineral development.<sup>18</sup> A systematic tabular survey

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17. See Weil, *supra* note 3, at 196-99.

18. See generally D. SMITH & L. WELLS, *NEGOTIATING THIRD WORLD MINERAL AGREEMENTS* 123 (1976).

has not been prepared, as such a survey may give a false impression of the extent to which contracts treated here are representative of others.

## II. DISPUTES IN TRANSNATIONAL MINERAL CONTRACTS AND FUNCTIONS OF DISPUTE SETTLEMENT

In transnational mineral contracts relating to large-scale and long term investment projects, the quantity and the intensity of disputes will generally be considerably greater than in traditional sales or equity investment transactions.<sup>19</sup> They relate to issues of broad multifaceted business relationships and involve questions of management, marketing, accounting, reinvestment, and the economic feasibility of a multimillion dollar investment. In particular the worldwide planning system of the TNE, and certain interests of home countries it represents, *e.g.*, to maintain employment in mineral processing and fabricating industries, will certainly confront the development goals of the host country. The characteristic controversies between North and South, as reflected in the discussion for a New International Economic Order, are reflected as well on a micro-level in the disputes between the TNE and the host country. Worldwide profit maximization and home country interests therefore clash with the objective of the host country to use the mining venture as a vehicle for development. Some common reasons for disputes characteristic of natural resources foreign investment are the following:

- (1) the long duration of the projects (historically up to ninety-nine years, now generally between fifteen and thirty-five years) and the great uncertainty of future events bearing upon the projects' economic feasibility (*e.g.*, commodity prices on world markets, inflation, possible substitutes for the minerals extracted, exchange rates, and political instability);
- (2) the long time between the initial heavy investment and the first returns to the investor (often seven to ten years);
- (3) the large number of actors involved, *i.e.*, mining companies, consumers with long term commitments,

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19. C. KIRCHNER, E. SCHANZE, F. VON SCHLABRENDORFF, A. STOCKMAYER, T. WÄLDE, M. FRITZSCHE & R. PATZINA, ROHSTOFFERSCHLIESSUNGSVORHABEN IN ENTWICKLUNGSLÄNDERN 301 (1977) [hereinafter cited as KIRCHNER]. A second volume, scheduled for publication in 1978, will concentrate, amongst other issues, on dispute settlement of transnational mining agreements.

financing institutions, local interests among host country ministries, often compel the contracting parties to elect between contradictory demands—even on the side of the investor and the financing institutions, conflicts among consortium members are rather frequent; and

(4) the high political visibility of natural resource exploitation, *i.e.*, the transportation of nonrenewable resources, the financial scale of the project, the dependence on outside financing, and the typical dependence of the host country on foreign exchange earnings from project revenues.

Disputes in such long term investment relationships may be divided into several categories:

*Disputes of a predominantly technical character.*<sup>20</sup> Disputes concerning technical decisions and expertise are more common and warranted than legal interpretation problems of the contract. Qualification of a dispute as “technical” does not imply minor importance. The decision on the economic feasibility of the exploitation or a processing project may be of primary importance to both parties. But it does not imply that such disputes can automatically be decided in a mechanistic, “neutral” application of technical rules. The issue of inherent biases in technical rule application is discussed below.

*Disputes concerning the interpretation of the agreement and applicable law.* Such disputes may be called “minor” disputes, as they do not question the validity of the agreement as such, but only refer to various constructions of it. This type of dispute is the traditional working ground for legal skills.

*Disputes arising from gaps in the agreement.*<sup>21</sup> Such disputes involve matters which have not been

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20. For an analysis of technical dispute settlement provisions in petroleum concessions, see P. FISCHER, *DIE INTERNATIONALE KONZESSION* 415 (1974).

21. See the PROCEEDINGS OF THE FIFTH INTERNATIONAL ARBITRATION CONGRESS (1975), and in particular the contributions of Holtzmann, *Powers of Arbitrators under United States Law to Fill “Gaps” arising under Long-Term Contracts*, *id.* at C IVh 1-17, and Bernini, *Techniques for Resolving Problems in Forming and Performing Long-Term Contracts*, *id.* at C IVa 1-37. See also H. Holtzmann & G. Bernini, *Arbitration in Long-Term Transactions*, PROCEEDINGS OF THE CONFERENCE OF THE BRITISH INSTITUTE OF INTERNATIONAL AND COMPARATIVE LAW ON INTERNATIONAL COMMERCIAL ARBITRATION (1974).

covered in the agreement and which cannot be resolved by legal reasoning on the basis of an existing authoritative text yet do not involve a demand for complete revision of the contract.

*Disputes arising from one party's desire for a revision of the basic terms of the agreement (particularly the fiscal regime).*<sup>22</sup> This party is often, but not always, the host country. Such demands are caused by changed circumstances, excessive profits, a change in government, or other similar reasons. Such disputes are different in their character and in their amenability to dispute settlement from the "minor" disputes mentioned above. Attempts to transfer settlement mechanisms workable for minor disputes to such major disputes have been a constant cause for dissatisfaction, threatening the utility of arbitration in the area of minor disputes.

The general functions of specific dispute settlement provisions, as opposed to those which impliedly or expressly require submission to a national jurisdiction, are, first, to provide a forum for dispute settlement, which, by its atmosphere and supposedly greater familiarity with the commercial issues involved, is more conducive to amicable settlement. The likelihood of such an amicable settlement promotes the greater readiness of the parties to accept an arbitral award and contributes to the maintenance of the long term relationship even after potentially disruptive disputes have taken place.<sup>23</sup> A second function is to provide a forum for dispute settlement which is not favorably disposed towards one party. The suspicion of partiality of national courts is a major cause for TNEs' insistence on international arbitration tribunals.<sup>24</sup> On the other hand, developing countries often have an equally strong suspicion that international arbitration tribunals have a systemic bias in favor of the causes advanced by investors. This apprehension can be caused by the selection of umpires, by the

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22. A survey prepared by the author of major mining agreements reveals that such major agreements, in particular recent ones dealing with petroleum and bauxite, rarely remain unaltered over a period of more than ten years. See generally Committee on Natural Resources, Permanent Sovereignty over Natural Resources, 4 U.N. ESCOR, U.N. Doc. E/C.7/53 (1975); 29 U.N. ESCOR, U.N. Doc. A/97/6 (1974).

23. See C. Schmitthoff, *Introduction to INTERNATIONAL COMMERCIAL ARBITRATION*, *supra* note 16, at 1-45.

24. See Sarre, *supra* note 16; Wesley, *The Procedural Malaise of Foreign Investment Disputes in Latin America: From Local Tribunals to Factfinding*, 7 *LAW & POL'Y INT'L BUS.* 813 (1975).

inherent effects of procedural rules, or by bias of the decision criteria employed in favor of investment by TNEs, and their suspicion is exacerbated by multiple decisions in favor of the investors in the few reported decisions of international arbitration tribunals.<sup>25</sup> Third, the dispute settlement provisions are meant to provide, particularly in the form of international arbitration, an instrument for the TNE to stabilize the terms of investment initially negotiated. It is recognized that in the initial period before the bulk of the investment is committed, and before any decisions on expansion and reinvestment are taken,<sup>26</sup> the TNE often has considerable superiority in terms of bargaining power, along with its frequent superiority in terms of information, know-how, and experience. Terms negotiated initially will necessarily reflect the TNE's superior bargaining power. Once the investment has been committed and once the operations prove successful, however, the pendulum swings in favor of the host country. Then attempts by the host country to obtain a revision of the unequal terms of the original agreement are rather frequent and often unavoidable.<sup>27</sup> Failure of the TNE to respond may then lead to costly escalation for both parties. The most visible forms of such costs are nationalization on one hand and isolation from international marketing channels on the other. The TNE accordingly will try to build into the contractual regime a number of defenses against later revision along with other defensive measures such as constructing a common front of financing institutions, long term purchasers, and mining competitors.<sup>28</sup> The TNE may also attempt to induce home countries to grant additional protection in the form of diplomatic support, foreign and military aid investment, investment insurance, or bilateral investment protection treaties.<sup>29</sup>

#### One major instrument that bolsters the TNE's defense

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25. The *Baruch-Foster* decision appears to be one of the few exceptions. For reports and analyses of these cases, see sources cited in note 3 *supra*.

26. This issue has been explored in considerable depth in T. MORAN, *MULTINATIONAL CORPORATIONS AND THE POLITICS OF DEPENDENCE* 153 (1975). See also KIRCHNER, *supra* note 19.

27. Sources cited note 22 *supra*.

28. See Moran, *Transnational Strategies of Protection and Defense by Multinational Corporations: Spreading the Risk and Raising the Cost for Nationalization in Natural Resources*, 27 *INT'L ORGANIZATION* 273 (1973); N. GIRVAN, *CORPORATE IMPERIALISM: CONFLICT AND EXPROPRIATION* 52 (1962). As I understand it, OPIC is planning to develop an insurance scheme geared to protect investors against forced alteration of investment contracts.

29. See A. FATOUROS, *GOVERNMENT GUARANTEES TO FOREIGN INVESTORS* (1962); GIRVAN, *supra* note 28.

lines against renegotiation is international arbitration.<sup>30</sup> Judging from the TNEs' present posture supporting such international arbitration, it appears that in TMCs it is not so much the function of amicable settlement but rather the function of investment protection which is at the heart of dispute settlement negotiation. The prospect of a negative award from an international arbitration body and the prospects of the various sanctions implied, *e.g.*, loss of credit rating, of foreign investment, of foreign aid, and isolation from established marketing channels, will often deter host countries from invoking their sovereign power to change contracts by legislative action.<sup>31</sup>

The negotiation of dispute settlement provisions necessarily occurs in the context of the asymmetric relationship between a sovereign, developing state and the TNE, a direct or vicarious holder of economic power often far superior to that of the host country. This asymmetric relationship obviously limits the application of orthodox legal theory related to dispute settlement and international arbitration. Thus, many experiences and considerations valid in international commercial arbitration are therefore not applicable.

It is often remarked that the amount of legal literature devoted to the legal theories surrounding arbitration disproportionately surpasses the small number of actual arbitration cases. My survey of the major contracts in petroleum and non-fuel minerals reveals that in less than one percent of the contracts have the dispute settlement provisions actually been invoked. However, arbitration provisions have an importance which may be considerably greater than the few cases suggest. Submission to nonnational arbitration affects the ongoing bargaining processes which take place among the parties throughout the whole life of the project.<sup>32</sup> This bargaining process may entail constant revision, modification, and implementation of the original contractual document. In this bargaining game the original document and its terms are not without effect. The agreements lays down certain positions, which may be the basis for implicit bargaining, as it provides the parties with leverage against demands from the other side. Such leverage is conferred upon the investor by virtue of a potential appeal to an international arbitration tribunal. As

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30. The investor's perspective is very clearly presented in Schmidt, *Arbitration under the Auspices of the ICSID: Implications of the Decision on Jurisdiction in ALCOA v. Government of Jamaica*, 17 HARV. INT'L L.J. 90 (1976).

31. See GIRVAN, *supra* note 28.

32. KIRCHNER, *supra* note 19, at 301.

the *Jamaica bauxite* cases have shown, such an appeal may not always eliminate a unilateral change of the project's terms by government legislation. However, any party deciding on a unilateral course of action will carefully consider the costs imposed by a negative award.

Apart from their deterrent effect, the dispute settlement provisions will always have an impact on the continuing negotiations for a revision of the terms of the contract. Most contracts do not expire without having been subject to numerous changes.<sup>33</sup> In bargaining for such revisions the TNE has some leverage if it can point to the adverse effects of a potential arbitral award in its favor. Accordingly, it can "sell" its arbitration rights for concessions from the host country. Major recent renegotiations of agreements contain such a retreat by the TNE from institutional arbitration proceedings in exchange for concessions from the host country. The bargaining chip effect of dispute settlement provisions is shaped by the individual traits of the dispute settlement mechanism at issue. Thus, a party will carefully consider the procedural framework, time limits, and the applicable substantive law upon which the selected tribunal (the arbitrators and the prospective umpire) will rely.

### III. INTERNATIONAL ARBITRATION AND NATIONAL SOVEREIGNTY

The main conflict in negotiations for dispute settlement in TMCs evolves around the issue of international or nonnational arbitration. Arbitration between corporations of various nationalities in international business is quite common. Such an arbitration has widely replaced the jurisdiction of national courts and has become recognized by the various national laws recognizing and enforcing foreign arbitral awards.<sup>34</sup>

In the asymmetric relationship of a developing host country and a TNE, however, many of the factors contributing towards the growth of international commercial arbitration are missing, particularly the homogeneity of principles of decision-making, of business outlook, and of comparable structures of organization and attitudes. The issues at stake are different from commercial arbitration. The obligations of a commercial nature are subordinate to public law, the legislative, taxing, and foreign trade authority of the host state. Hence, it is not surprising that governments are very reluctant to submit issues

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33. See sources cited note 22 *supra*.

34. For an examination of the pertinent issues, see INTERNATIONAL COMMERCIAL ARBITRATION, *supra* note 16, *passim*.

involving their national sovereignty to nonnational jurisdiction.

Additionally, Western governments generally do not agree to submit matters involving their legislative powers to a nonnational tribunal. For example, Australian mineral contracts, constituting a very substantial part of the present mineral projects of the world, do not provide for such arbitration. France, as well, has been very reluctant to submit even matters of a merely commercial nature to international arbitration when government-owned enterprises are concerned.<sup>35</sup> Investment agreements of TNCs in Western countries, concluded particularly with the government on the state or municipal level, also do not contain international arbitration. No contract between a TNE and the authorities of a Western host country contains submission to the International Centre for the Settlement of Investments Disputes (ICSID), unlike a large number of agreements in African and some Asian developing countries.<sup>36</sup>

It is therefore more understandable than some Western commentators suggest<sup>37</sup> that developing countries perceive international arbitration as an imposition on their national sovereignty by authorizing a nonnational body to judge their sovereign acts. Latin American countries, in their opposition to nonnational arbitration, rely on the tradition of the Calvo doctrine, whereas several oil producers of great bargaining power (notably Saudi Arabia, Kuwait, Iran, Algeria) rely on strong OPEC recommendations against international arbitration.<sup>38</sup> The United Nations resolutions dealing with permanent sovereignty over natural resources of the 1970s clearly espouse the view that international arbitration, particularly in natural re-

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35. See Battifol, *Arbitration Clauses Concluded Between French Government-Owned Enterprises and Foreign Private Parties*, 7 COLUM. J. TRANSNAT'L L. 32 (1968).

36. Frequently, African countries which were once French colonies submit to ICSID arbitration, e.g., Agreement between Ivory Coast and Uniwax (1968); Agreement between Senegal and Societe Textile (1968); Agreement between Mauritania and AGIP (1971). See generally Delaume, *Excuse for Non-Performance and Force Majeure in Economic Development Agreements*, 10 COLUM. J. TRANSNAT'L L. 242, 261 n.54 (1971).

37. Representative of the view of most Western commentators on the general utility of international arbitration is Wesley, *supra* note 24. Western governments have adopted the same position in the current negotiations for a Code of Conduct of Transnational Corporations. See Annotated Provisional Agenda, U.N. Doc. E/C.10/Ac. 2/1 (1977); Transnational Corporations: Material Relevant to the Formulation of a Code of Conduct, U.N. Doc. E/C.10/18 (1977).

38. See OPEC Res. XVI. 90 (1968), reprinted in 7 INT'L LEGAL MATERIALS 1183 (1968); Vafai, *Conflict Resolution in the International Petroleum Industry*, 5 J. WORLD TRADE L. 427 (1971).



sources, is contrary to the sovereignty of host countries.<sup>39</sup> Yet it remains unclear whether such resolutions serve mainly as a recommendation that host countries abstain from the critical submission to foreign arbitration in natural resources exploitation matters or whether these resolutions imply that submissions are void insofar as sovereignty rights are inalienable.

As far as the actual submission to nonnational arbitration is concerned, one can safely state that the Latin American countries have to a large extent adhered to the Calvo doctrine and refused submission to an international arbitration tribunal (*e.g.*, ICSID or ICC). Occasionally, however, when under pressure to enter an investment contract, complex solutions have evolved. Also, ways have been found to restrict the scope of the Calvo doctrine.

With respect to OPEC countries with strong bargaining power, such as Iran, Kuwait, Libya, Saudi Arabia, and Venezuela, submission to any foreign jurisdiction and any foreign law has become increasingly rare in recent years. Certainly, the strong stance of OPEC on this issue has had some repercussions in actual negotiations. It seems that by now submission to nonnational jurisdiction and foreign law is antiquated in petroleum contracts. In mineral agreements, the trend is slower but points in the same direction. National law is increasingly the only law stipulated as applicable; nonnational arbitration is less frequent. Compromise solutions are national arbitration procedures, according to the contractual provisions or, as observed in countries with an English legal system, according to the national arbitration act.<sup>40</sup> National courts acquire a growing role in matters related to the contract.

Ultimately, the form of arbitration depends on the bargaining power of the parties and the give-and-take peculiar to the contract. A policy of steadfast refusal to submit to international arbitration may, therefore, be broken occasionally. If one is willing to perceive the dispute settlement as an indicator of the relative bargaining power, one will find that TNEs have more bargaining power in licensing and manufacturing contracts than in natural resources agreements. Most manufactur-

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39. See sources cited note 5 *supra*. The position of the developing countries in the negotiations for a Code of Conduct, see note 37, *supra*, is also opposed to international arbitration.

40. For the English Arbitration Act, a model most often used in former English colonies, see INTERNATIONAL COMMERCIAL ARBITRATION, *supra* note 16, at Appendix 21.

ing agreements examined by the author contain international arbitration. An analysis of licensing contracts of a major developing country (114 contracts) showed that forty percent of the dispute settlement provisions are subject to national law and fifty-four percent are submitted to other jurisdictions, generally the licensor's country. Additionally, forty percent are subject to the national jurisdiction, ten percent are subject to the jurisdiction of another country, and fifty percent are submitted to international (mostly ICC) arbitration.<sup>41</sup> In petroleum and nonfuel mineral contracts of the same period, submission to nonnational law or nonnational jurisdiction is considerably less frequent.

#### IV. ALTERNATIVE TYPES OF DISPUTE SETTLEMENT IN TMCs

Dispute settlement provisions in TMCs reflect the distribution of bargaining power and bargaining skill between the parties, their specific interests and preferences, and the various trade-offs in the course of the negotiations leading to the agreement. A considerable evolution in content and sophistication has taken place in recent years, partly prompted by the increasing success of host countries in achieving permanent sovereignty over their natural resources.

The crucial decision in negotiating for dispute settlement is the selection of a specific mechanism to settle disputes generally by arbitration. The parties often stipulate a number of other elements concerning the selection of the arbitrators, the procedure, the choice of applicable law, and issues of enforceability. At first, the selection of arbitration mechanisms is discussed in terms of current practice, trends, and evaluation of the host country's negotiating goals. Occasionally, conciliation is stipulated as a prerequisite to formal arbitration. Express conciliation provisions, however, are rarely found in TMCs. In view of the high costs and long delays in arbitration, the parties have sufficient incentives and opportunities to reach a settlement by informal conciliation without any express stipulations to this effect.

The main forms of contractual dispute settlement are the following:

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41. These data derive from a confidential analysis of agreements for the transfer of technology in a developing country adhering in principle to the Calvo doctrine.

- (1) arbitration by an ad hoc tribunal set up in accordance with the terms of the contract;
- (2) specific settlement procedures for disputes of a primarily technical nature; and
- (3) recourse to an institutionalized arbitration tribunal, such as submission to the International Centre for Settlement of Investment Disputes, the Arbitration Court of the International Chamber of Commerce (ICC), and the Inter-American Arbitration Commission.

A. *Ad Hoc Arbitration*

Ad hoc arbitration according to terms determined by the agreement itself and without recourse to any institutionalized arbitration body is the most flexible instrument of dispute settlement. In earlier transnational contracts this form of arbitration prevailed mostly in a simple and straightforward formulation. Modern contracts use ad hoc arbitration either as the only form of dispute settlement or as a substitute for recourse to ICSID, in case such an arbitration tribunal should not be accessible.

The various terms set forth in the transnational contracts relating to ad hoc arbitration, such as procedure, choice of law, and provisions relating to enforcement, have evolved considerably. However, such rules are not a feature unique to ad hoc arbitration, but will be found also in other forms of institutional arbitration. At the core of ad hoc arbitration is the determination of the arbitrators. The parties also have considerable discretion in the selection of arbitrators in institutionalized arbitration bodies. Yet in contractual ad hoc arbitration, the greatest variance of various models of selection exists.

Generally, the agreement provides for three arbitrators, two chosen respectively by either party and the third, often called "umpire" or "president of the tribunal," named by agreement of the two arbitrators. Failing such an agreement, the contract generally provides for a third, neutral authority to appoint the umpire. The selection of the umpire is of crucial importance for the role of the dispute settlement provision in the bargaining relationship between the parties. His decision is usually decisive, and even the anticipation of such decision will make the parties stronger or weaker in their demands towards each other. Accordingly, the selection of the neutral appointing authority also has a considerable weight. The anticipation of such authority's choice will influence the parties,

when they or the arbitrators named by them attempt to agree by themselves on the person of the umpire. A party, expecting the appointing authority to select a less favorable umpire, will have a strong incentive to reach an agreement with the opponent even on an umpire it would not otherwise accept. Thus, the supposedly rather neutral selection of an appointing authority may have subtle repercussions on later bargaining processes, favoring one party at the expense of another.

It should be emphasized here that the issue of the bias of arbitrators and umpire is a question of the biases inherent in a certain legal, cultural, and political background of the arbitrators, rather than a question of impartiality as understood in legal terminology. The latter question arises in a commercial arbitration between parties coming from the same legal and cultural background. In older concession agreements and in some recent contracts, particularly where the countries are newcomers as minerals or petroleum producers, the appointing authority chosen is the International Chamber of Commerce, the Chairman of the Administrative Council of ICSID (the World Bank President), the President or the most senior judge of the International Court of Justice, the United Nations Secretary-General, or a board of arbitrators named by the chairman of a regional development bank.<sup>42</sup> In recent agreements where the countries have sufficient bargaining power and experience, there is a strong tendency to keep the appointing authority in the host country. Accordingly, the president of the highest national court of Iran or of the Iranian Central Bank, the Saudi Arabian Board of Concessions Appeals,<sup>43</sup> and the National Chamber of Commerce in Colombia<sup>44</sup> have been

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42. See, e.g., the contracts between Indonesia and Freeport (1967); Botswana and Bamangwato (1972); Indonesia and Soriano (1969); Indonesia and Phillips (1975); Central African Republic and CEA (1969); Indonesia and ALCOA (1969); Indonesia and Broken Hill (1971); Egypt and Esso (1974); Papua New Guinea and ARCO (1976); Papua New Guinea and Broken Hill (Dampier) (1976); Papua New Guinea and Bougainville (1974).

43. Among many other agreements, see, e.g., the Agreement between NIOC and Ameranda Hess (1971) (Governor of the Central Bank of Iran); the Agreement between NIOC and Mobil Oil Corp. (1971) (President of the Supreme Court of Iran); the Agreement between Iran and Japanese Oil Companies (1971). Six more recent petroleum service contracts in Iran, dated 1974, follow the same pattern. See also the Agreement between Petromin and AGIP (1967) (Saudi Board of Concessions Appeals). See generally Vafai, *supra* note 38.

44. See the Agreement between Colombia and Hanna (1970); accord, most con-

stipulated as appointing authorities. Within the long range between the British Resident in a traditional gulf coast concession<sup>45</sup> on one hand and the exclusive jurisdiction of the national courts on the other hand,<sup>46</sup> such arbitration provisions oriented towards the host country may be acceptable in the future to host countries.

Agreements also often stipulate qualifications of the umpire, less frequently, those of the arbitrators. Thus, "high reputation in international jurisprudence" and citizenship in a country other than that of the parties at dispute or of a country with an economic interest at stake is required.<sup>47</sup> A Colombian agreement of 1970 requires that the arbitrators and the umpire be attorneys of the Bogota Bar of Colombian nationality. Thus, a further element of localization is inserted into the dispute settlement provisions, reflecting the concern of the Calvo doctrine. One should pay some attention in negotiations to the issues of qualification. As long as traditional international jurisprudence is dominated by jurists of Western background, one might question the value of such qualification. Perhaps qualifications reflecting an active and expert involvement in legal issues pertaining to economic development in developing countries may be of greater importance.

It is not clear whether the arbitrators appointed by the parties should be as impartial as the umpire or whether they should basically be seen as representatives of the parties' interests within the tribunal itself. The position of the ICSID is apparently to require the impartiality of all arbitrators.<sup>48</sup> In order to avoid a court's vacating an award because of substan-

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secutive agreements in petroleum (*e.g.*, Webb, 1973), uranium (*e.g.* Total, 1976), and asbestos and coal (Esso, 1976).

45. *E.g.*, the D'Arcy petroleum concession in Kuwait (1934/1955).

46. See the Agreement between Kuwait and Hispanica de Petroleos (1967). Petroleum agreements in Peru, Argentina, Venezuela, Mexico, Iran, Saudi Arabia, Ecuador, and Colombia exclude any nonnational jurisdiction.

47. See, *e.g.*, the Agreement between Indonesia and Freeport (1967); the Agreement between Papua New Guinea and ARCO (1976); the Agreement between ANCAP (Uruguay) and Chevron (1969); the Agreement between Indonesia and ALCOA (1969); the Agreement between Sierra Leone and Selection Trust (1970); the Agreement between Papua New Guinea and Dampier (1976); the Agreement between Egypt and Esso (1974).

48. See Convention on the Settlement of Investment Disputes between States and Nationals of Other States, *done* Mar. 18, 1965, art. 14, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966).

tial defaults in the procedure, the parties might want to make the arbitrators' position in that respect quite clear.

Sometimes agreements only provide for one arbitrator. Such a solution may be advisable when a rapid decision is sought and when the substantial costs of arbitration should be cut down. It is also possible, as in the OK Tedi contract,<sup>49</sup> to have a sole arbitrator, but a full three-man tribunal if one party so requests. A sole arbitrator may also be appointed, if one party fails to name an arbitrator upon an arbitration request by the opponent. Such a sole-arbitrator solution appears to be better than allowing independent authority to name an arbitrator for the noncooperating party.

Ad hoc arbitration can be an acceptable and effective instrument of dispute settlement, especially in the resolution of minor disputes. It may also be used in third-party decisions in renegotiation clauses, provided the agreement stipulates appropriate rules for the choice of law, the procedure, and the enforceability of the award.

As for the second function of arbitration characteristic of investment contracts in developing countries, ad hoc arbitration appears to offer less stabilization of the initial terms of the investment than do institutionalized arbitration tribunals, the awards of which are bolstered by adverse publicity and the availability of informal sanctions. A number of host countries have already achieved an arbitration mechanism, whereby the inherent biases in favor of the TNE are reduced, the local content of decisionmaking increased, and the imposition of national sovereignty restricted.<sup>50</sup> Such ad hoc arbitration with careful drafting may therefore be a flexible compromise between such opposed positions as the Calvo doctrine on one side and the TNE's insistence on complete international arbitration on the other side. In negotiations, a host country would give away a valuable bargaining chip without adequate compensa-

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49. Agreement between Papua New Guinea and Dampier (1976); Agreement between Papua New Guinea and Esso (1976); Agreement between Sierra Leone and Selection Trust (1970).

50. The Colombian arbitration provisions, providing that Colombian law is to be applied, that the umpire is to be appointed by the Colombian Chamber of Commerce, and that the arbitrators are to be named from Colombian attorneys of the Bogata Bar, are examples of such "localization" of arbitration, which is more acceptable to host countries. See sources cited note 44 *supra*.

tion by not strongly insisting on elimination of all nonnational jurisdiction. Ad hoc arbitration can be an acceptable fallback position if such insistence bars an agreement.

B. *Institutionalized International Arbitration: ICC and ICSID*

Submission to the arbitration provided by the ICC<sup>51</sup> occurs frequently in international commercial transactions and in licensing contracts<sup>52</sup> and is occasionally found in mining agreements. As ICC arbitration is often seen as favoring TNEs' interests over host countries' interests and since it seems to be most appropriate in intrabusiness conflicts, submission to ICC arbitration often indicates the relatively weak bargaining power of the host country. It may be, however, that once host countries have reached a level of bargaining power comparable to the rather homogeneous situation of TNEs among themselves, submission to the ICC will often become acceptable.<sup>53</sup> The advantages of ICC arbitration are the institutional framework provided, the existence of well-tested arbitration rules, and the availability of experienced arbitrators in case the parties do not agree on the umpire. It is claimed that such arbitration, in contrast to ad hoc arbitration, is able to deal with a refusal of the defendant to arbitrate.<sup>54</sup> However, appropriate fashioning of arbitration rules in the agreement, possibly through incorporation of rules along the lines of the new UNCITRAL rules,<sup>55</sup> can also deal with the various issues of non-cooperation of the defendant.

ICC arbitration has been criticized by developing countries<sup>56</sup> for being too costly, for being too far away from the host

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51. For the new ICC arbitration rules, see Eisemann, *Le nouveau règlement d'arbitrage de la Chambre de Commerce Internationale*, DROIT ET PRATIQUE DU COMMERCE INTERNATIONALE 355 (1975). For reference to ICC arbitration clauses, see Delaume, *supra* note 36, at 245, 260. ICC arbitration is also stipulated, for example, in the Falconbridge Agreement with the Dominican Republic (1972), the Agreement between Ghana and HALCO, the Agreement between CVRD and Finsider, as well as various Iranian and Algerian service or long term natural gas purchase agreements.

52. An analysis of 30 licensing and transfer of technology agreements in a major developing country reveals that about 20% of the arbitration clauses stipulate ICC arbitration.

53. This hypothesis may explain the fact that provision for arbitration by the ICC has surfaced again in several recent service and sales agreements in Iran and Algeria.

54. See Eisemann, *supra* note 51, at 355, 357.

55. UNCITRAL Arbitration Rules, U.N. Doc. A/CN.9/127/ Add.1 (1977).

56. This criticism has also been voiced to the author in various interviews with

country, and for taking no account of the restricted means, qualified personnel, and facilities available to developing countries when involved in international arbitration proceedings. Concerning the crucial selection of the umpire or sole arbitrator, many developing countries feel that it is unlikely that the personality chosen will be favorable to the aspirations of developing countries to reform the often lopsided initial terms of an investment by legitimate adjustment. Doubts concerning the suspected systemic bias of ICC umpires and ICC rules traditionally favoring the position of TNEs are not alleviated by the possibility of the parties' agreement upon the umpire. The anticipated appointment by the ICC arbitration court will, as explained above, sway the bargaining process for agreement on the umpire in favor of the investor. It is questionable if consultation of national chambers of commerce in the course of the selection of the umpire (articles 2 and 6 of the ICC rules) will be sufficient to eliminate such suspicions. Accordingly, submission to ICC arbitration, even if it provides effective dispute settlement for minor disputes, may entail a propensity to stabilize the initial contractual terms against demands for renegotiation by the host country.

After the establishment of the ICSID in 1965, submission to this arbitration institution replaced other common forms of dispute settlement.<sup>57</sup> It is found in many transnational mineral contracts with the notable exception of those involving Latin American countries and some other countries with a strong concern for national sovereignty.<sup>58</sup> Insofar as recognition and

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negotiators from developing countries.

57. From 1965 to the present, more than 67 states have become members of the ICSID. Curiously, the quantity of legal literature concerning the ICSID is inversely proportional to the number of cases decided by it. See J. CHERIAN, *INVESTMENT CONTRACTS AND ARBITRATION: THE WORLD BANK CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES* (1975). Seventy-two states have become signatories to the Convention, and 67 have deposited instruments of ratification. ICSID/3/Rev. 18 (1976). For provisions relating to the role of the ICSID in international agreements and national investment laws, see ICSID/9/Rev. 2 (1976). For actions taken by contracting states pursuant to the Convention, see ICSID/8/Rev. 3 (1976). The 1976 Report of the ICSID recites that five cases had been submitted that year, of which three, involving Alcoa, Kaiser, and Reynolds, have meanwhile been withdrawn by the parties following the renegotiation of their agreements in 1976 and 1977.

58. Agreements which refer to the ICSID are the following: the Agreement between Mauritania and SOMIMA (1967); the Agreement between Ivory Coast and UNIWAX (1968); various Indonesian and Liberian agreements of recent date; and the



enforcement are concerned, the ICSID arbitration appears to be more effective than other forms of dispute settlement: a material reexamination of the arbitral award by the courts of member states of the convention is excluded, and a state can no longer raise the objection of sovereign immunity against arbitral proceedings. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 provides a smaller degree of effectiveness.<sup>59</sup> The *Jamaica v. ALCOA* decision rendered by an ICSID tribunal has more-over clearly stated that submission to ICSID creates an irrevocable international obligation which cannot be affected by subsequent withdrawal.<sup>60</sup> As for practical advantages of the ICSID arbitration, questions might be raised concerning the speed of the proceedings.<sup>61</sup> Most of the few cases brought before the ICSID tribunal to the present have been withdrawn after settlement has been reached among the parties. The performance of the ICSID suggests that the tribunal is a mechanism too wieldy and complicated to achieve speedy and amicable decisions which can act as a guideline for the continuing implementation of the contract. Some forms of ad hoc arbitration, such as specific settlement of technical disputes by experts' decisions and even ICC arbitration, may provide faster relief at least in the area of minor disputes. As far as the major disputes are concerned, the specific advantages of

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Agreement between Botswana and Bamangwato (1972). Agreements related to several Latin American countries occasionally contain provisions for arbitration. For example, a Brazilian iron ore contract of 1973 requires submission to the ICC; a Uruguyan contract for petroleum (1975) stipulates to ad hoc arbitration; the Cerro Colorado Agreement (Panama 1974) mandates ICAC arbitration; while Colombian agreements, see sources cited note 44, *supra*, provide for national arbitration. No Latin American agreement providing for submission to the ICSID, however, has come to the attention of the author; most Latin American countries have not acceded to the ICSID Convention.

59. "Recognition and Enforcement of an arbitral award may also be refused if . . . the recognition or enforcement of the award would be contrary to the public policy of that country." Article V(2), U.N. Register of Texts of Conventions and Other Instruments Concerning International Trade Law, U.N. Doc. E/73/v.3/24, 26 (1973).

60. See Schmidt, *supra* note 30; Coll, *United States Enforcement of Arbitral Awards Against Sovereign States: Implications of the ICSID Convention*, 17 HARV. INT'L L.J. 401 (1976).

61. The two ICSID cases reported in the Annual Reports of the ICSID from 1972 to 1976 have, as of the date of the 1976 Annual Report of the ICSID, not yet been resolved. The *Jamaica bauxite* cases have been withdrawn.

an ICSID clause for the investor is the strong incentive for the host country to respect the initial terms of the agreement.<sup>62</sup>

It appears that ICSID submission has a rather strong effect in deterring renegotiation or at least in providing the investor, as in the *Jamaica* case, a bargaining chip vis-à-vis the host country. Arbitral awards issued under the auspices of the World Bank are regarded by developing countries as carrying considerable weight. It is expected that these awards would have adverse effects on future investment, on the credit rating of the host country, and on the World Bank's readiness to grant further financing.<sup>63</sup> The high visibility of ICSID decisions (the "goldfish bowl effect") acts as a strong incentive in stabilizing the initial contract terms. Some recent contracts expressly aim at reaping the benefits of such adverse publicity by stipulating, contrary to all contract and amicable arbitration tradition, that the investor may publish the award. Such a clause<sup>64</sup> is indicative of the stabilizing function ascribed by investors to the ICSID tribunal. The provision reflects rather clearly the preponderance of the function of an "investment protection" in international arbitration over the traditional function of international commercial arbitration, the inducement to achieve a mutually acceptable and nondisruptive settlement.

Lastly, there is some concern in developing countries over the selection of arbitrators by the ICSID. As with the ICC, it is feared that the exercise of the appointing authority by the ICSID will more likely result in the selection of an umpire with a "systemic," not a personal, bias in favor of Western legal concepts and the position of TNEs. It has been suggested<sup>65</sup> that the ICSID roster of personalities contains little reference to legal experts generally representing the developing countries' position in the relevant areas of international business law. (Such a gap is also obviously due to the organizational and

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62. Schmidt, *supra* note 30, perceives stabilization and deterrence against the demands of renegotiation as the major characteristic of arbitration under the ICSID.

63. See Spofford, *Third Party Judgments and Economic Transactions*, 1964-III RECUEIL DES COURS 108, 224. Interviews with negotiators for TNEs confirm that this expectation is one of the major advantages seen to accrue to them from an ICSID arbitration provision.

64. The Agreement between Botswana and Bamangwato (1972), notable for its strong provisions guarding against subsequent legislation by the host country affecting the investment, contains such a clause.

65. Interview with a host country negotiator.

financial weakness of the developing countries' institutions devoted to international legal research as compared to Western countries' institutions.) Developing countries are consequently underrepresented in the often decisive communication processes of the international legal community. An additional factor is the developing countries' dependence on the traditions and institutions of Western legal scholarship, particularly on those of the former colonial mother countries.

In evaluating the ability of the institutional forms of dispute settlement to fulfill the various functions outlined above, we can conclude the following: Insofar as issues of interpretative and technical disputes in the minor conflicts are concerned, the ICSID and the ICC tribunals do not appear to be considerably better equipped than ad hoc arbitration. Such arbitration, which can be drafted to be rapid and closer to the parties, may be expected to produce an atmosphere conducive to amicable settlement. Against noncooperative parties, the institutionalized arbitration may offer certain advantages. A careful drafting of arbitration provisions in ad hoc arbitration and the use of the growing regional arbitration centers may, however, yield similar results. Lastly, the premise that arbitration is always superior to judicial decisionmaking may be questioned. On the contrary, international arbitration may be more expensive and less rapid than judicial proceedings, as one commentator has observed.<sup>66</sup> As is true with large-scale international arbitration cases, neither speed, efficiency, nor inexpensiveness may be particular qualities of this form of dispute settlement.<sup>67</sup> Specific obstacles of international arbitration may include the various factors to be negotiated, the frequent lack of expertise among arbitrators chosen for their high social reputation, the age of arbitrators, and the various possibilities of protracting the proceedings by an uncooperative arbitrator.

The main function of ICC and ICSID arbitration is to preserve the initial contract terms against the contract revision

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66. See Layton, *Arbitration in International Commercial Agreements: The Noose Draws Tighter*, 9 INT'L LAW. 741, 745 (1975).

67. The history of the few large-scale petroleum arbitration cases, such as those involving Abu Dhabi, Qatar, Sapphire and Aramco, see sources cited note 3, *supra*, suggests that speed and economy are not among the principal advantages of international arbitration.

demands by the host country and to bestow an element of bargaining power on the TNE in later renegotiations. Hence it is less the incentive towards amicable settlement and more the strong sanction against host country's attempts to change the rules of the game which is appreciated in such forms of dispute settlement.<sup>68</sup> This assumption is supported by a number of interviews with company negotiators.

### C. *Settlement of Technical Disputes by Experts' Decision*

A very interesting and new development is the quantitative and qualitative expansion of specific procedures to solve disputes of a technical character. Many disputes in mineral agreements are primarily of a technical nature; they cannot be resolved by legal reasoning, but rather by application of professional standards, such as "sound engineering, mining, or accounting practices." A quick resolution of such disputes is of great importance, particularly when a decision is necessary in order to carry out the implementation of a mining project. Technical disputes may also involve substantial financial interests. Accordingly, agreements increasingly provide for the decision of a single expert or a mining, engineering, consulting, or accounting firm in the listed areas:<sup>69</sup>

- (1) application of sound mining and engineering standards in the construction and operation of facilities;
- (2) safeguarding of environmental standards;
- (3) application of "arm's-length standards in intra-company transactions," particularly in pricing of minerals;
- (4) accounting issues, such as deductability and computation of exploration costs; and
- (5) acceptance of a feasibility study.

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68. This probably explains why international arbitration became one of the chief causes for the breakdown of otherwise promising negotiations in a significant negotiation between an Asian host country and a major mining company. It is interesting to note that a later agreement for the exploitation of the mine in question did contain those precise dispute settlement provisions which the host country objected to in its negotiations with the first negotiating partner.

69. For the decisions of experts in older petroleum concessions, see Fischer, *supra* note 20, at 261. Such clauses allowing for the decisions of experts exist in the Agreement between Iran and the Middle East Petroleum Consortium (1954) and the Sapphire Agreement. See Lalive, *supra* note 13, at 1003. A recent Iranian agreement provides for technical settlement of disputes concerning the computation of exploration costs, while a diamond agreement provides the same for accounting issues and arm's-length pricing standards. Also, an Iranian exploration agreement and the Papua New Guinea-Dampier contract of 1976 stipulate decisions by experts on the question of the acceptability of the feasibility study.

Specific settlement of technical disputes may constitute an area where the otherwise exclusive jurisdiction of national courts does not apply, as the necessary technical expertise may often not be available. A host country desiring to maintain its unimpaired national jurisdiction may accordingly consent to submit narrowly defined technical matters to technical arbitration or an expert's decision. Such a solution can accommodate the investor's interest in securing a forum which protects him from the discretionary technical judgements of the government.

The criteria for the experts' decision are usually described by reference to accepted professional standards. The professional reputation of the consulting firm at stake is a strong incentive for the experts to abide by those standards. However, objections are raised against a mere referral to such standards and against a selection of consulting firms as experts, based upon an allegedly inherent bias of such firms and their professional standards in favor of the business practices of TNEs. The professional criteria of experts are geared to the specific needs of business and stockholders, but do not take account of the specific interest of the host country, as reflected in the agreement.<sup>70</sup> As long as the major consulting and engineering firms called in as experts have strong and well-established ties with the major mining companies, they may have a disincentive to decide against them. Even in experts' decisions, the room for value judgement is rather large, as the differences of asset valuation in a major litigation related to mining in Zambia illustrate.<sup>71</sup> Accordingly, negotiators for developing countries have insisted that the host country retain the power to decide on the standards of accounting applicable by issuing pertinent regulations. The recent OK Tedi copper contract sets forth a very interesting set of criteria to be used in arbitration in a dispute concerning the feasibility study. The criteria merit literal quotation:

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70. See U.N. ESCOR, Commission on Transnational Corporations, Some Aspects of Corporate Accounting and Reporting of Special Interest to Developing Host Countries, U.N. Doc. E/C.10/AC.1/4 (1976); U.N. ESCOR Commission on Transnational Corporations, Towards International Standards of Accounting and Reporting for Transnational Corporations: Report of the Secretariat, U.N. Doc. E/C.10/AC.1/2 (1976).

71. *Kohn v. American Metals Climax*, 322 F. Supp. 1331 (E.D. Pa. 1970).

In reaching his decision on any matter referred to him . . . the arbitrator shall judge the reasonableness of any decision of the State having regard to whether the proposals are based on sound mining and engineering practice, take reasonable account of the interests of the people of Papua New Guinea and of employees who will be working on the Project, include reasonable steps to protect the environment, are consistent with securing an equitable return on investment to the Company having regard to the risks associated with the Project and the efficient development and maintenance of the Project and are not inconsistent with the balanced development of the area, recognizing the limited present use of the area, the need for its development, the State's desire for the Project to proceed and be economically viable, and the effect the Project must necessarily have on the environment.

In drafting such standards some reference to the weight of these variant, often conflicting standards should be given. The OK Tedi contract reflects the evolution of standards of social and financial accounting which take account of the special needs of developing countries.<sup>72</sup>

The negotiators should also consider whether the expert's decision is to be final, or, as proposed in a model engineering contract, whether it should be possible to appeal the final decision awarding monetary compensation to the injured party.<sup>73</sup> If technical and legal arbitration is stipulated separately, some thought should be given to ensure an appropriate division of jurisdiction. The awkward situation, familiar in several publicized international arbitration cases, in which legal experts deal with matters of high technical intricacies or when technical experts decide legal issues should be avoided.

#### V. SPECIFIC ISSUES IN NEGOTIATIONS FOR DISPUTE SETTLEMENT PROVISIONS

Besides the choice of the arbitration forum, the contracting parties can stipulate various conditions and rules concerning the arbitration. Such issues can be relevant in all the forms

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72. See sources cited note 70 *supra*.

73. U.N. Industrial Development Organization, Guidelines for Contracting for Industrial Projects in Developing Countries, U.N. Doc. ID/149, at 57 (1975). Other less significant details to be taken into consideration include whether the expert's decision may be overridden by a panel of three experts upon the request of one party, as is the case in a 1968 Ethiopian contract, and how questions of a legal and technical nature are to be separated for arbitration. The Agreement between Algeria and CREPS (1966) apparently permits the party requesting arbitration to select the avenue of dispute settlement. See Fischer, *supra* note 20, at 415.

of arbitration discussed. The method of issue resolution in the transnational contract will have a bearing upon the arbitration and, by anticipation, will affect the parties' behavior in the ongoing bargaining process during the course of the life of the contract.

A. *Place and Language of the Arbitration*

The place stipulated for arbitration is often quite indicative of the power distribution between host country and TNE. The company will favor and possibly obtain locations such as Stockholm, Paris, Zürich, and Geneva, whereas the host country, for reasons of supposed local advantage, but particularly for reasons of lesser costs and increased familiarity, will negotiate for its home capital or at least a neighboring capital. The host country may be at quite a disadvantage in an unfamiliar environment with its limited financial resources and its limited know-how in international business customs. There are a number of compromises available. One agreement provides for the capital of the respective defendant as the place of arbitration, while another grants the investor the right to choose a place other than the host country's capital, providing the investor pays the extra costs involved. Respect for the investor's unwillingness to go to arbitration in the host country capital may lead to stipulation of a neighboring capital or, increasingly, of one of the regional arbitration centers.

The issue of the language of the arbitration is similar. Arbitration in a foreign language proceeding may prove disadvantageous for the host country. Accordingly, it will try to require that its own language be the language in which the proceedings are conducted. Such issues are of interest to the host country's negotiators. One should, however, not pay attention to securing a bargaining victory on one of these more symbolic issues in return for major concessions in areas of financial concern.

B. *Arbitration and the Jurisdiction of Municipal Courts*

Host countries will generally prefer complete national jurisdiction to the exclusion of international arbitration. In petroleum contracts any other solution appears to be antiquated.<sup>74</sup>

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74. Recent arbitration clauses reviewed by the author in Saudi Arabia, Iran, Kuwait, Algeria, Libya, Ecuador, Mexico, and Colombia reflect a quite clear and definite trend toward an exclusive application of national law at least in petroleum contracts.

In nonfuel minerals agreements host countries, particularly in Latin America, have been increasingly successful in insisting on national jurisdiction.<sup>75</sup> OPEC resolutions, the ANCOM decision, Decision 24, various national laws, and international legal instruments prohibit or at least recommend against submission to nonnational jurisdictions.<sup>76</sup> Sometimes when the investor's bargaining power precludes complete national jurisdiction, elaborate theories have been developed to justify submission to international arbitration. One theory restricts the Calvo doctrine to agreements performed within the country and thus exempts agreements containing financing obtained from foreign sources.<sup>77</sup> In the conflict between the objective of complete national sovereignty and the need to attract sufficient foreign capital, a number of intermediate solutions have recently evolved. Such solutions are possible compromises and fall-back positions for the parties in the negotiations. The main characteristic of such arrangements is the division of jurisdictions and of subject matters among municipal courts, national and international arbitration tribunals, and specific proceedings for technical disputes.

The role of settlement of technical disputes has already been discussed. Some agreements allow a request for arbitration only after exhaustion of local remedies. This transfers into contractual terms the traditional doctrine of international law that diplomatic support by the home country requires a previous "denial of justice" by the host country.<sup>78</sup> The Cerro Colo-

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75. Almost all the recent nonfuel agreements known to the author and relating to Latin America, in particular the Peruvian, Chilean, and Colombian copper and nickel contracts, contain provisions requiring complete submission to national law and jurisdiction.

76. See sources cited note 15, *supra*; Organization of Petroleum Exporting Countries, Resolution XVI.90 (1968), reprinted in 7 INT'L LEGAL MATERIALS 1183 (1968); Andean Foreign Investment Code, July 17, 1971, art. 51, reprinted in 11 INT'L LEGAL MATERIALS 126, 141 (1972). The Andean Code was originally adopted on Dec. 31, 1970, by Decision No. 24 of the Commission of the Cartagena Agreement (Acuerdo de Cartagena or Andean Pact), for which see Agreement on Andean Subregional Integration, done May 26, 1969, 8 INT'L LEGAL MATERIALS 910 (1969). See also Danino, *The Andean Code After Five Years*, 8 LAW. AM. 635, 667-68 (1976).

77. Thus, a Peruvian petroleum agreement with certain Japanese companies is expressly subject to Japanese and English law and to the jurisdiction of the courts of Tokyo. The justification for imposition of the Calvo doctrine arises by creating an exception for contracts performed in a foreign country.

78. *E.g.*, the uranium Agreement between Colombia and Total (1976). For the concept that diplomatic intervention is permissible only in the event of a denial of



rado Copper Agreement of 1976 confers on the courts of Panama the jurisdiction to issue execution awards. Additionally, several recent contracts in copper and petroleum from Papua New Guinea require the arbitration tribunal to allow the municipal court to decide on issues of municipal law. Apparently, the tribunal has to stay the proceedings and request a ruling on the municipal law upon which to base its decision on issues of local law raised during arbitration. Other agreements, such as recent Liberian concession contracts and the Bamangwato Agreement of 1972 in Botswana, exempt matters of national law or certain narrowly defined disputes from the tribunal's jurisdiction. In various recent Papua New Guinean contracts and other agreements from anglophonic developing countries, tax disputes are generally excluded from the contractual mechanism for dispute settlement. In Egyptian petroleum concessions disputes with the government are subject to the exclusive jurisdiction of the Egyptian courts, whereas disputes with the national petroleum enterprise are submitted to arbitration.<sup>79</sup>

Accordingly, the host country's strategy for negotiation might be to reduce the procedural role and the subject matter of jurisdiction of the arbitration tribunal. Questions of the interplay between local courts and the tribunal would have to be clarified more than has been done previously in the several recent agreements containing such provisions. If the municipal courts are to be competent for the execution of awards, it is necessary to clarify whether they are exclusively competent or whether the winning party may appeal to other countries' courts to enforce the award. In view of the public policy reservation of article V(2)(d) of the 1958 United Nations Convention exclusive jurisdiction of municipal courts of the host country to enforce an international arbitral award may make quite a difference. If disputes concerning the proper application of municipal law are at issue, the role of the arbitration tribunal must be defined. The intent of the respective clauses is to allow the local courts to decide. One possible solution might be to require the arbitration tribunal to stay its proceedings on the request of one party or at its own discretion, while the compe-

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justice, see Fatouros, *supra* note 29, at 251.

79. See the Agreement between Egypt and Exxon (1974) and other Egyptian petroleum contracts.

tent municipal courts decide on the legal question involved.<sup>80</sup> Another arrangement would be to leave the complete jurisdiction over the operating company incorporated in the host country to the local courts, but stipulate international arbitration for disputes concerning the contract with the foreign parent company.<sup>81</sup>

Finally, it is possible to divide the subject matter of potential disputes into issues where national sovereignty is concerned and other issues where the essence of the investment of the TNE is at stake. The bulk of such disputes may be subject to exclusive national jurisdiction, whereas disputes concerning the "heart" of the investment may be submitted to international arbitration. Such was a proposal put forth by a major mining company in a recent negotiation where arbitration was a controversial issue. The "essence" of the investment requires further clarification. Perhaps only a dispute concerning a claim for damages for material breach of contract after termination could be left as the only major dispute to nonnational arbitration.

Another compromise solution is the "localization" of arbitration as described above. Such national arbitration proceedings could for some disputes (mainly the "minor" ones) provide an atmosphere conducive to amicable settlement without affecting national sovereignty. Innovative and careful drafting of dispute settlement provisions will probably increase in order to take account of the national sovereignty interest as well as of the legitimate interests of investors.

### C. *Applicable Law and Substantive Rules Governing Arbitration*

If parties stipulate legal rules applicable to the contract, either in arbitration or without normal judicial proceedings, three issues may be distinguished: (1) the choice-of-law question; (2) the "freezing" of a particular legal regime; and (3) the insertion of specific rules concerning the substance of

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80. Cf. Treaty Establishing the European Economic Community, March 25, 1957, art. 177, 298 U.N.T.S. 11, also found in 2 COMM. MKT. REP. (CCH) ¶ 4655, at 3853, which requires national courts to submit issues of European law to the European Court in Luxembourg.

81. Such was the proposal put forward by a major mining company in recent negotiations. The company wished to reserve at least the "essence of the investment" for a nonnational tribunal.

the award, substituting existent or nonexistent law of transnational contracts.

The choice-of-law question must be examined before the background of a possible unilateral change of the terms by the host country through legislation. The stipulation of a legal system other than the host country's, or of vaguely defined, generally recognized legal rules of international law, is meant to protect in a doubtful way the legal regime of the project against such alteration. Freezing clauses are addressed to this issue of subsequent unilateral alteration even more directly.

Apart from this background, the choice-of-law question is related to the absence of particular rules appropriate to transnational investment contracts, either in the legal systems of host countries or in the often invoked international law.<sup>82</sup> The specific problems raised by transnational investment have not yet led to an elaboration of rules, standards, and norms applicable either in the national laws and regulations or in international law, which is based primarily on interstate relations. This situation has led to an increase of substantive rules of contract law generated by the contracts themselves. In combination with the growth of specific investment laws<sup>83</sup> and international legal instruments applicable to TNEs and transfer of technology,<sup>84</sup> future rules may slowly bring about a transnational law of investment contracts.<sup>85</sup>

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82. See Weil, *supra* note 3, at 118 and *passim*. International law has developed to the extent of coping adequately with international treaties between states, but not agreements between states and private corporations. The most crucial issue is that of a unilateral alteration of the contract by legislation of a sovereign state. Rules relating to this issue have been proposed by Western jurists in the form of an analogy to the traditional standards governing nationalization. But apart from this problem, many other problems concerning the law of international investment contracts, for example, the calculation of the amount of damages and the impact of changed circumstances, have not yet reached the stage of international consensus which can be characterized as a new "international law of transnational investment contracts."

83. See the survey on National Legislation and Regulations Relating to Transnational Corporations, U.N. Doc. E/C.10/8 (1976).

84. See Commission on Transnational Corporations, Work Related to the Formulation of a Code of Conduct: Report of the Intergovernmental Working Group on the Code of Conduct (3d Sess., Agenda Item 5) 7, U.N. Doc. E/C.10/31 (1977); An International Code of Conduct on the Transfer of Technology, U.N. Doc. TD/B/C.6/AC.1/2 (Supp. 1) (1975).

85. See Kahn, *Problèmes Juridiques de l'Investissement dans les Pays de l'ancienne Afrique française*, 1965 JOURNAL DE DROIT INTERNATIONAL 338; Schachter, *The Evolving International Law of Development*, 15 COLUM. J. TRANSNAT'L L. 1 (1976). See also P. JESSUP, TRANSNATIONAL LAW (1956); Lalive, *supra* note 13.

Traditionally, foreign investors have mostly been able to have a choice-of-law clause reflecting their interests. These choices include the law of a foreign (home) country, international law (however vague), or generally recognized legal principles (emanating from the legal systems of capital-exporting countries). Such choice-of-law solutions also reflect several well-known arbitration cases where a set of rules taken from Western legal systems,<sup>86</sup> rather than from the often nonexistent law of the host country, was applied. Even today, the choice of a foreign law or other nonnational legal rules is predominant in manufacturing, in licensing, and particularly in loan agreements.<sup>87</sup> The development, however, is clearly directed towards exclusive application of national law of the host country.<sup>88</sup> At first, national law is stipulated together with traditional references of a vague content, such as generally recognized principles of international law.<sup>89</sup> In petroleum agreements of major producing countries any reference except to national law is by now antiquated.<sup>90</sup>

The problem of "freezing clauses" is somewhat different. Such clauses contained in a large number of recent agreements and several modern investment laws<sup>91</sup> guarantee the in-

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86. Such as those "generally recognized principles" found in the law common to civilized nations and comparative jurisprudence. See sources cited note 3, *supra*; Suratgar, *Considerations Affecting Choice of Law Clauses in Contracts between Governments and Foreign Nationals*, 2 INDIAN J. INT'L L. 273, 283 (1962); Lalive, *supra* note 13, at 998.

87. This conclusion was reached following an analysis by the author of various large-scale investment finance agreements. See also G. DELAUME, *LEGAL ASPECTS OF INTERNATIONAL LENDING AND ECONOMIC DEVELOPMENT FINANCING* (1967); G. DELAUME, *TRANSNATIONAL CONTRACTS: APPLICABLE LAW AND SETTLEMENT OF DISPUTES* ch. VI (1976).

88. It is possible now to state fairly that the application of national law prevails in most major petroleum producing countries and increasingly in nonfuel mineral agreements as well. *But cf.* Sarre, *Arbitration Clauses in the Oil Industry in the Middle East*, in *INTERNATIONAL COMMERCIAL ARBITRATION*, *supra* note 16, at 336, 341, 344.

89. See the Agreement between Sierra Leone and Selection Trust (1970) and the Agreement between Indonesia and ALCOA (1969). Also, article 42 of the International Convention on the Settlement of Investment Disputes provides that arbitrators are to apply municipal law and international law as appropriate in the event that no specific stipulation exists in the agreement.

90. See note 88 *supra*.

91. A formulation to the effect that only such national law as may be "consistent with the agreement" shall apply is found in the Agreement between Papua New Guinea and Dampier (1976), the Agreement between Liberia and Lamco, the Agreement between Liberia and Bong, and the Agreement between Panama and Texasgulf (1976). Contracts entered into by Francophonic countries in Africa abound with

alterability of the complete contractual and legal regime for the project. This includes certain tax rules, the tax rate, foreign currency exchange, and the overall financial burden. Other provisions guarantee that new taxes will not be imposed or that any subsequent legislation affecting the agreement's financial character will not be applicable. Francophonic African countries have been particularly ready to grant wide and long-ranging privileges to TNEs. In its softer forms the freezing clauses stipulate that municipal law will be applicable only as far as it is consistent with the agreement. In its more severe forms any subsequent legislation affecting the contract is declared to be a material breach giving rise to claims for damages. As modern agreements tend to govern comprehensively all conditions of the mining project, the hands of national legislators would be tied for twenty-five to forty years. It is practically impossible for a developing country to abide by such a freezing clause for the whole life of the contract. Moreover, it is doubtful if such provisions can produce a legally binding effect on the host country's exercise of national sovereignty by subsequent legislation. It is claimed that the host country's right to legislate is inalienable and that provisions stipulating a law different from the host country's laws merely incorporate specific rules contained in another legal system. These rules are amena-

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guarantees that no subsequent legislation will have any effect upon the investment in areas mentioned generally and specifically. The Agreement between Botswana and Bamangwato (1972) is perhaps the most carefully drafted in this respect, for it deems any subsequent change in the legislative regime governing the instrument to be a "material breach of the contract." See also the Agreement between Surinam and ALCOA (1958) and the Brokopondo Agreement.

A number of investment laws also guarantee the tax rate, the overall tax burden, and an exemption from other fiscal exactions for a considerable period of time, often for the entire term of the investment agreement to be concluded. Illustrative is the Chilean Foreign Investment Statute, Decreto Ley No. 1748, Official Gazette (March 18, 1977), which entitles foreign investors to the inclusion of a clause in their agreement freezing taxes for 10 years. Article 8 of the Act states that sales, service, and import tax exemptions will remain unvaried throughout the term of the agreement. It is interesting to note that a number of mineral agreements concluded under the prior investment statute, Decreto Ley No. 600 (1974), during 1976 and 1977 provide for a freezing of the fiscal regime governing the mining project for a period of 30 years following the start of commercial production. A review of legislative changes and renegotiations reveals that such freezing clauses have rarely prevented a revision of the terms of the investment when the government acquires an equality or even superiority in its bargaining position in comparison to its previously inferior position. Wälde, *Revision of Transnational Investment Agreements*, 10 *LAW. AM.* (forthcoming 1978).

ble to alteration by subsequent legislation.<sup>92</sup> Such a view is strongly supported by authoritative statements of the United Nations, particularly the resolutions on the New International Economic Order and the recommendations of the Group of Eminent Persons.<sup>93</sup>

Consequently, the effect of freezing clauses is rather questionable *de facto* as well as *de jure*. They may mainly serve the investors' bargaining position against future expected renegotiation demands. Applying the evolving transnational law of investment contracts, one may suggest that freezing clauses are void and that courts, acting under the public policy reservation of the 1958 United Nations Convention, should refuse to enforce arbitral awards based on such freezing provisions. The evolution of several large-scale concessions suggests that freezing clauses and legal enclaves for natural resource exploitation may be antiquated and that the agreement will increasingly be subject to laws of general application in the host country.<sup>94</sup> The

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92. See Brown, *Choice of Law Provisions in Concession and Related Contracts*, 39 MOD. L. REV. 1, 6 (1976); Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT'L & COMP. L.Q. 73 (1974); Zakharyia, *Impact of Changing Circumstances on the Revision of Petroleum Contracts*, 12 MIDDLE EAST ECON. SURVEY 1 (July 11, 1969 Supp.); Rouhani, *Assignment and Renegotiation*, in NEGOTIATION AND DRAFTING OF MINING AND DEVELOPMENT AGREEMENTS 21 (1976); Suratgar, *supra* note 86, at 305.

However, the most recent arbitration decision recognizes a stabilization clause and declares a subsequent nationalization void. See *Texaco Overseas Petroleum Co. v. Libya*, in 104 JOURNAL DU DROIT INTERNATIONAL 350 (1977), and Lalive, *Un grand arbitrage pétrolier entre un Gouvernement et deux sociétés privées étrangères*. *Id.* at 319. The arbitration took place without the participation of Libya. It is not apparent that the comprehensive protection of foreign investment from nationalization and adjustment of petroleum concession granted by the sole arbitrator, René-Jean Dupuy, is the best way of achieving the international legal principles universally accepted by TNEs and host countries; if the rules evolved by arbitrators reflect only the interests favoring comprehensive protection of TNEs and not the requirements of host countries for flexibility, then such rules do not seem to offer a promise of universal acceptance and thus universal effectiveness.

93. G.A. Res. 3281, 29 U.N. GAOR, Supp. (No. 31) 50, U.N. Doc. A/9631 (1975); G.A. Res. 3202, 6 U.N. GAOR (Special Sess.), Supp. (No. 1) 5, U.N. Doc. A/9559 (1974); Summary of the Hearings Before the Group of Eminent Persons to Study the Impact of Multinational Corporations on Development and on International Relations 37, U.N. Doc. ST/ESA/15 (1974); Commission on Transnational Corporations, Work Related to the Formulation of a Code of Conduct: Report of the Intergovernmental Working Group on the Code of Conduct 7, 3d Sess. (Agenda Item 5), U.N. Doc. E/C.10/31 (1977); UNCTAD, Progress in Implementing Resolution 39 (III), Report by the Secretariat, in 2 Trade and Development Board (Prov. Agenda Item 5) ¶ 12, U.N. Doc. TD/B/AC.11/12 (1972).

94. *E.g.*, such is the development of a traditional concession like the Firestone concession in Liberia, which began in 1926 as a 99 year concession with full enclave

current practice of freezing clauses may, therefore, be interpreted as a reflection of the very weak bargaining power of host countries trying to attract investment at all costs. This course of action will not stop the trend towards submission to national laws once a level of experience and bargaining power has been reached.<sup>95</sup>

Another trend to be examined is the increase of provisions setting down substantive rules for the arbitration tribunal. Such a development stems from the absence of substantive legal rules in international law and in the municipal law of most countries that are able to deal with complex foreign investment contracts of a private and administrative law nature. Additionally, the vagueness of the various choice-of-law provisions and of the legal systems mentioned may motivate the parties to set forth precisely which standards the arbitrators should apply. Some agreements require the tribunal to give the party in default sufficient time to remedy the breach. On the contrary, others allow only final termination of the contract and an award of damages to the party injured. An interesting clause in a recent copper contract limits the amount of possible damage which can be awarded to the total amount of management fees to be paid within eighteen months. It may be expected in the future that the contracts will contain specific legal regimes governing the damages and consequences of default, along with a more precise definition of default and the right of the tribunal to issue interim awards and to order specific performance. Such precise contractual stipulations may reduce risks and increase the predictability for both parties. In addition the more arbitration is governed by precise standards, the less parties will be afraid to submit to an unpredictable, foreign-based insitution.

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status and which was made subject to general taxation in 1976. Developed producer countries, such as South Africa and the provincial governments of Canada and Australia, have progressed on this path to subject the mining industry to general laws much more than have developing countries.

95. Most of the elaborate freezing provisions and guarantees in agreements and investment laws appear to have come from countries with a low level of development and experience, anxious to attract foreign investment at any cost, or from countries with weak bargaining power caused by temporary or permanent, unfavorable economic conditions. Such countries can hardly serve as an indicator of future trends or as an example for the negotiation strategies of host countries.

#### D. *Procedure of Arbitration*

The rules governing the arbitration proceedings may be drafted in the agreement. These include time limits, voting requirements in the case of a three-person tribunal, cost apportionment, decision on default, and other issues. In case an institutional arbitration tribunal is chosen the rules of such an institution as the ICC, the ICSID, or a regional arbitration institution will apply. It is also possible to incorporate the rules of such an institution into ad hoc arbitration clauses. It appears that ICSID rules are more appropriate for large-scale arbitration in important disputes often terminating the agreement, but too cumbersome and time consuming to achieve a speedy settlement. For disputes described as "technical" ICSID arbitration is inappropriate. Developing countries have raised against rules such as the time limits issued by the ICC the objection that they are not responsive to their needs.<sup>96</sup> There are efforts to induce the arbitration centers to respond to those requests and to foster regional arbitration centers in developing countries.<sup>97</sup>

The 1976 UNCITRAL rules for incorporation in ad hoc arbitration clauses are of particular interest for dispute settlement in transnational mineral contracts. These rules have been recommended for US-USSR trade.<sup>98</sup> They appear to be most useful for large-scale arbitration in investment contracts. Some doubts, however, must be raised against article 33(III), where the tribunal is requested to decide "in accordance with the contract." Some modification, such as a clause requiring that the tribunal "shall take into account the terms of contract" may have been more appropriate to a long term investment contract.<sup>99</sup> Perhaps a contractual stipulation to that effect in the dispute settlement clause may be useful in making the UNCITRAL rules appropriate not only for international commercial contracts, but also for long term investment agreements. The UNCITRAL rules also deal with the important

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96. See the Note by the Secretariat on the decision by the Asian-African Committee on International Commercial Arbitration, U.N. Doc. A/CN.9/127 and Add. 1 (1976/1977).

97. *Id.*

98. See Press Release of the American Arbitration Association (January 12, 1977).

99. See, e.g., Article 38 of the Arbitration Rules of the U.N. ECE of 1966, U.N. Register of Texts E/73/V/3 at 106.



practical issue of protraction of the proceedings by one party's appointed arbitrator. One of the major obstacles against a speedy completion of the arbitration proceedings is, in addition to a delay by the obstructing party in its appointment of an arbitrator, the noncooperation of an arbitrator already appointed.<sup>100</sup>

#### E. *Recognition and Enforcement of Arbitral Awards*

The weakness of arbitral awards relative to judicial decisions is often a great difficulty, along with the expenses and time delays involved in enforcing the award. When the defendant is a state, an attempt to execute the award is confronted with the objection of sovereign immunity. As the contracting party from a developing country will most likely be the state, some state agency, or state enterprise, sovereign immunity will often become an issue. This occurs particularly when the new government refuses to comply with the commitments of the former government. Recently, the *Nigerian cement* cases have triggered a lively discussion of these problems.<sup>101</sup> The United Nations Convention of 1958 on Recognition and Enforcement of Arbitral Awards may be of some use in overcoming such obstacles. However, it allows for reservations of public policy and does not deal expressly with sovereign immunity. Efforts are underway to improve the effectiveness of this Convention in light of the growing number of developing countries that have acceded to it.<sup>102</sup> The ICSID probably provides the most effective instruments for the enforcement of its awards.

The parties themselves have the potential to reduce the obstacles against enforcement. They may stipulate that the award may be entered as judgment in any jurisdiction, or they may specify a particular jurisdiction, such as a member state of the United Nations Convention.<sup>103</sup> The host state may waive

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100. See Layton, *supra* note 66.

101. See *National American Corp. v. Nigeria*, 420 F. Supp. 954 (S.D.N.Y. 1976); *Trendtex Trading Corp. v. Central Bank of Nigeria*, [1976] 1 W.L.R. 868; [1976] 3 All E.R. 437; 120 Sol. J. 554; LGE Frankfurt 2.12 (1975), in *DIE AKTIENGESELLSCHAFT* 47 (1976). For recent developments in the area of sovereign immunity, see Delaume, *Public Debt and Sovereign Immunity*, 71 AM. J. INT'L L. 399 (1977). See also the three articles on sovereign immunity, 71 AM. J. INT'L L. 399-460 (1977).

102. For the state of ratification and accession, see U.N. Doc. ACN/9/118 (1976).

103. See Layton, *supra* note 66, at 745. A 1974 petroleum Agreement between Japan and Peru accordingly declares the courts of Tokyo competent to enforce arbitral awards.

its objection of sovereign immunity and declare that the dispute at issue is of a commercial nature. The effect of such stipulations, however, is unclear. Lastly, a number of other solutions are being developed to provide more security in enforcing contractual commitments. Investors and financing institutions increasingly insist that a trust account be held by a trustee abroad (*e.g.*, in New York) for the host country's central bank in order to receive the proceeds from the sale of minerals. Such trust accounts serve to improve the host state's foreign currency position, but, by being potential objects for attachment, they give some additional protection to the investors' security interests. Thus the account provides security for the financing institutions and the TNE. Posting of a security or a guarantee from an investment insurance agency or a home state may also increase the likelihood of prompt compliance with the award.

Increasingly performance bonds are posted by the TNE to secure its compliance with its contractual minimum expenditure obligations, its production requirements, and the contractual program of work. Finally, the more an agreement and the stipulated arbitration are responsive to developing countries' particular problems, the less obstacles will be found to refusing compliance.<sup>104</sup>

#### VI. CONCLUSION: DISPUTE SETTLEMENT AND THE REVISION OF LONG TERM INVESTMENT AGREEMENTS IN DEVELOPING COUNTRIES

A dilemma arises in connection with arbitration provisions in mineral investment contracts. Arbitration and technical decisions may often be a useful instrument to settle interpretative and technical disputes in an amicable way which does not obstruct the further implementation of the agreement. However, the other function of international arbitration, *i.e.*, the stabilization of initially unequal contracts for an excessively long period of time, has led host countries to question the advisability of such provisions. They feel international arbitration bodies serve primarily to police their demands for a change in the rules of the game, thus unilaterally favoring TNEs.

The search for mutually acceptable solutions in this dilemma has led to a number of compromise positions. Perhaps a separation of the clearly useful and acceptable mechanisms

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104. Accordingly, further research is warranted on alternatives of contractual drafting concerning dispute settlement and periodic revision or automatic readjustment of the contractual terms.

to settle the "minor" disputes (technical, interpretative, and gap-filling) from the specific solutions devised for "major" disputes of contract revision could take place. For major disputes concerning a revision of contractual terms, a number of solutions already formulated in agreements but largely still in the phase of discussion<sup>105</sup> should be explored in greater depth.

The United Nations and other international organizations have recently called for principles to guide the revision of unequal terms in long term investment agreements.<sup>106</sup> A number of major long term agreements, particularly in petroleum but also in nonfuel natural resources, *e.g.*, bauxite, copper, or rubber, have been revised to a considerable degree by a more or less voluntary renegotiation.<sup>107</sup> An analysis of the major legal systems shows that adjustment of long term contracts is not as unfamiliar as is often claimed in the criticism levied against the unilateral revision of contractual terms by host countries. Legal doctrines such as frustration and "imprevision" permit some change in long-term contractual relationships once basic circumstances have changed substantially. The concept of the "Wegfall der Geschäftsgrundlage" (lapse of contractual basis) in German law has been applied particularly to cases where

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105. *Cf.* Smith and Wells, *supra* note 18, at 152; Z. MIKHASHI, *THE INTERNATIONAL POLITICS OF NATURAL RESOURCES* 152 (1976); M. MUGHRABY, *PERMANENT SOVEREIGNTY OVER OIL RESOURCES* 174 (1966). For the renegotiation of petroleum concessions during the energy crisis, see Penrose, *The Development of Crisis*, 1975 *DAEDALUS* 52, 53; Johnson, *A Legal Alternative to Instability in International Oil*, 6 *NAT. RES. J.* 368 (1966). See also the various views expounded on the reliance upon such concepts as "change of circumstances" to justify a revision of contractual terms cited in note 92 *supra*.

Analysis of about 200 investment agreements in the area of natural resources demonstrates that from 1971 to 1977 the number of renegotiation clauses (as a periodic review or as a most-favored country clause in favor of the host country) has increased substantially. Also, other contractual provisions designed to adjust the contractual regime, *e.g.*, sliding taxes, relinquishment obligations, and adjustment of prices to reflect world market developments, have been put to increasing use.

106. In particular, see OPEC Resolution XVI.90 (1968), *reprinted in* 7 *INT'L LEGAL MATERIALS* 1183 (1968). As for the United Nations, see the sources cited *supra* note 93.

107. The most glaring example has been in the petroleum industry where complete revisions of participation, state ownership, pricing structures, royalty expenses, and tax rates have occurred, beginning slowly in the 1960s and achieving momentum from 1972 to the present. A similar development has taken place in the bauxite industry in the period from 1973 to 1975 with the introduction of state majority ownership, production levies, and other financial arrangements benefiting the host countries. Less visible have been the large numbers of renegotiations of most long term concession agreements in rubber, timber, and nonfuel minerals.

basic changes occurred and where long term relationships needed judicial adjustment.<sup>108</sup> In international law the *rebus sic stantibus* doctrine may in exceptional circumstances allow for the adjustment of international treaty obligations.

Of particular interest are legal rules permitting a clarification or even an adjustment of contractual terms by the court in cases of exploitation of unequal bargaining power. This is practiced in the German legal system, particularly to control standard adhesion clauses.<sup>109</sup> In the agreements themselves simple renegotiation clauses, most-favored clauses in favor of the TNE or host country, and specific adjustment provisions enhance the flexibility of the long term regime. A number of other provisions, such as divestment, relinquishment, and sliding tax provisions, furthermore "dynamize" the contractual terms to take account of the change of circumstances and the change in the bargaining power among the parties. In addition the final and comprehensive regime for the investment is increasingly no longer negotiated at the onset of prefeasibility studies, where the uncertainty favors the TNE's position. Often simple exploration contracts with some privileges concerning later exploitation are concluded with provision for negotiation of the final conditions after the feasibility study has reduced uncertainty and risk to a considerable degree.

Such devices to reduce the unequal distribution of bargaining power, a source of later instability, and to insert flexibility into the contractual regime must be explored and developed. Not all of them favor the host country. If an acceptable mechanism of "dynamization" can be found, taking due account of the national sovereignty objective of the host country and the reliance of the TNE, mechanisms of third-party decisionmaking for deadlocked renegotiations might be discussed and accepted by both parties. Such third-party decisions would have to emanate from a forum which is not suspected of possessing an inherent bias in favor of one party. The negotiations for the UN Law of the Sea Conference may point out the possi-

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108. See Geiger, *supra* note 92.

109. Sections 242 and 315 III of the German Civil Code have been used by German courts to control the misuse of superior bargaining power and skill in standard adhesion clauses (Allgemeine Geschäftsbedingungen).

ble outlines of such institutional framework for transnational legal issues concerning foreign investment. The present evolution of contractual practice and the slow and gradual development of international legal instruments to regulate the activities of TNEs, such as the Code of Conduct for Transnational Corporations,<sup>110</sup> may bring about a universal set of principles guiding transnational investment contracts. These guidelines will not be the product of a particular set of capital-exporting countries but rather the result of a universal process of bargaining and consensus-finding.

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110. See sources cited note 84 *supra*.

