THE STANDARD INVESTMENT AGREEMENT: TEXT AND COMMENTS

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INTRODUCTION

The legal status of foreign investment in developing countries continues to hold the spotlight despite the extensive work done on the subject. The International Law Association (ILA) became interested in the problem following a report presented by the author, in the name of the French branch, at the Helsinki Congress (1966). The ILA created a committee on foreign investment in developing countries whose task was to examine whether a legal regime on such investments could be created and under what conditions. If the response was positive the committee was to prepare a draft putting such a regime within a specific framework. The preliminary report presented in the name of the committee (1968) contained alternative approaches to what would be the most appropriate legal instrument for such a regime, concluded that the most effective instrument would be a standard set of general conditions of investment. In 1970, after having analyzed the principal solutions set out in current investment contracts, the committee proposed a draft standard investment contract which was slightly modified in 1972 for presentation to the New York Congress. It is this version which is published here.

It appeared to the committee that the draft contract would be adopted

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See also the bibliographical selection mentioned by W. Friedmann and J.P. Beguin in Joint International Business Ventures in Developing Countries (1971).


On August 31, 1972, the Committee was composed as follows: Prof. B. Goldman (France) (Chairman), Philippe Kahn (France) (Secretary), Dr. C. M. Badr (Algeria), H. J. Banaji (India), Dr. M. Bartos (Yugoslavia), R. J. Blair (U.K.), Prof. M. Bos (Netherlands), Prof. E. Cobos (Spain), Me. L. van Dieren (Belgium), Prof. A.A. Fatouros (U.S.A.), Prof. I. Foighel (Denmark), [Alternate: Mrs. B. Poulsen], Dr. I. Halperin (Argentina), Prof. L. Hjerner (Sweden), J. W. Josephus Jitta (Netherlands), Prof. Y. Kanazawa (Japan), Dr. J. Lador-Dederer (Israel), Prof. A. Malintoppi (Italy), Carlyle E. Maw (U.S.A.), Prof. R. Preiswerk (Trinidad), Prof. L. Recczi (Hungary), A. Roselli (Italy), Dr. A. Khairat Said (U.A.R.), D.A.G. Sarre (U.K.), Prof. G. Schwarzenberger (U.K.), Prof. I. Seidel-Hohenverdern (Germany), Prof. G. Simantiras (Greece).


by the New York Congress. This did not happen because the arbitration clause frightened certain Latin American members of the Association as well as certain Anglo-American lawyers who felt that the interests of the developing countries were too well protected to the detriment of private property. In fact, the draft is very moderate and represents, it is submitted, a reasonable compromise between the differing interests concerned. However, because of the unfortunate incident which resulted in the failure to adopt the proposed draft investment contract, a brief introduction to the text of the contract appears necessary.

The basic problem is well known; the developing countries need a considerable amount of capital, both public and private, to ensure the survival and progress of their peoples. Local sources cannot furnish such capital and therefore foreign capital will have to be relied upon for an indefinite period. However, the legal bases upon which relations between investors and host states should be established remain imprecise and controversial. The principal elements of these relations must be indicated if one wishes to understand the choices made in the draft investment contract.

First, in establishing a legal regime of foreign investments one runs up against an initial difficulty which is the complexity and multiplicity of the forms in which a foreign investment may be clothed. These forms include the following: direct investment when the foreign investor himself undertakes an activity in the developing country and keeps the total or partial ownership of the entity created, loans made by either financial organizations (international, such as the World Bank, national, such as the Exim Bank or a normal private bank) or by a parent company to its subsidiary; export credits particularly in the case of sales by great industrial complexes matched by long-term credits; technical assistance in the form of the assignment of patents, licenses or know-how. All these forms may be combined and present development shows an increase of joint ventures of direct investments and technical assistance agreements which constitute a very novel approach to the relations between developing states and investors.

At the International Law Association, we have continued to examine direct investment because, even though it is becoming less and less

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4It is a necessary condition but not sufficient because many elements other than money form part of the development.

7See also T. MENDE, DE L'AIDE A LA RECOLONISATION, LES LECONS D'UN ECHEC (1972); G. MYRDALL, THE CHALLENGE OF WORLD POVERTY, A WORLD ANTI-POVERTY PROGRAM IN OUTLINE (1970).

8See Friedmann and Beguin, supra note 1. See also Beguin, LES ENTREPRISES CONJOINTES INTERNATIONALES DANS LES PAYS EN VOIE DE DEVELOPPEMENT (1972).
acceptable to the developing countries, a great number of investments are still being made under this form. In any case, most of the legal discussion to which we will refer later has been generated by direct investments which remain a kind of common law form of investment. Also, it seemed reasonable to first establish the regulations governing the basic form of investment before attempting to set up the regulations of derivative and complex forms.

In order to find the most concrete way of defining direct investment we have selected the concept of industrial investment. Agricultural investment could have been chosen instead since a great number of development experts now consider that it is most important to achieve a rapid increase of crop cultivation. But agricultural investments raise particular difficulties relating to real property, which are unnecessary to confront in an initial effort.

With the same concern for efficiency, we have decided to consider first the legal problems raised by medium sized investments. Here again, we observe an evolution of development theories. Until a few years ago the large industrial investment was recommended as the best means to a rapid acceleration of development, but it is now being realized that medium size investments, appropriately distributed over a given territory, may: (1) have a greater multiplier effect, (2) facilitate the transfer of technology, and, (3) being more discreet, pose fewer political problems. In fact, and this is a second important consideration, the legal status of foreign investments is a matter where political echoes are very great and where history cannot be neglected.

It is well known that the attention of lawyers was first drawn to the problem of protecting the property and interest owned by an alien in a state other than his own. Attention was focused initially on expropriations in the public interest or certain discriminatory measures (practices which have long been used); since about fifty years ago, however, attention has turned to politically inspired general expropriations and nationalizations which have occurred in almost all the countries, with rare exceptions, whatever their political or economic regime (Soviet nationalizations after 1917, English and French nationalizations of 1945-1946, or Eastern Europe at the same period, and more recently, Egyptian, Cuban, Chilean, Algerian, Iraqi, and other nationalizations). While it may be true that any investment abroad can be expropriated, expropriation is still not inevitable and when it does occur, it is only some time after the completion of the investment.

A legal formula is needed which permits the establishment of a normal regime of foreign investment in a developing country, that is, a system which fixes the relations between the foreign investor and the
host state in the framework of daily life and outside of the system of nationalizations. In any case, this was the objective which the International Law Association set for itself. The role of an association whose members are academics, practicing attorneys or corporate counsel is, indeed, to try to remove uncertainties to prevent litigation. We thus decided to approach the problem from the standpoint of the principles to be used rather than from the standpoint of nationalizations. This approach does not avoid all political problems since a daily legal regime of investment depends on two opposing interests.

On one hand the investor, especially if he is a private investor, is looking for a return on his investment and its security. In a country where the assessment of investment security is not optimistic, the investment will be made only if there is a considerable return. Moreover, experience has shown that even if security is reasonable, expectations of greater profit, lead the investor to look for an exceptional return on his investment. Thus, the regime of investment must assure the investor profit and security.

On the other hand, the host state wishes the investment to contribute to the economic development of the country. The pattern of this development is usually defined in a plan used as a reference for a selective policy of investments and for the obligations the state wishes to impose upon the investor to integrate the micro-economy of the foreign enterprise into the national economy. It should be noted that certain investors, especially the multinational companies so often referred to in the last 4 or 5 years, may have viewpoints different from those of the host state. These investors exercise great economic power which may seem even more real with respect to the structure of states with recent colonial past and its weak economy. Moreover, while welcoming foreign investments, the developing countries desire to maintain their independence.

It is only by taking these imperatives into account and reconciling them that an effective legal regime can be formulated which will be recognized by the foreign investor and host State as a suitable set of regulations to govern their relationship. This was a constant concern during the preparation of the Standard Investment Agreement. Once again, it is not our purpose to reconcile these interests in the abstract but to take into consideration the relation of present forces and attempt to evaluate what they will be in a few years. However, one must be aware that because of the extremely rapid evolution of economic relations, a legal text aimed at governing such relations is obviously dated and can only hope to apply for a few years.

The selection of the legal instrument that seemed best able to support the set of rules to be elaborated must still be justified. In order to
establish the international legal regime of international investment, there were only two alternatives—either formulate a draft of multilateral interstate convention or formulate a model standard contract.

Of course, the multilateral interstate convention has the decided advantage of binding the states on a precise text. Thus, most of the previous attempts to establish an international regime of foreign investments have been based on drafts of a multilateral convention in which the contracting states would make certain promises related to foreign property. None of these drafts of a multilateral convention have been adopted by the states concerned despite the insistence of investors from the industrialized countries. This is probably due to the fact that the drafts were formulated with the aim of totally protecting the foreign investor's interests without taking into account the interests of the host state and without any countervailing advantage for the host state or any participation by the developing countries in the preparation of the drafts. Drawn up in general and abstract terms, they sought to bind newly independent states on a long-term basis without the latter really being able to evaluate the extent of their commitments. They thus created an unfortunate precedent.

Even if a multilateral interstate convention could be drafted whose content would be different from the above-mentioned drafts, we preferred to prepare model general conditions of a standard contract type, since technical reasons reinforced the political reasons to do so. The most important of these technical reasons is the very rudimentary state of the international law on investment although it deals with an already well-worn subject matter. The differences of opinion are still too numerous and too important to be resolved in a general interstate instrument, except for an agreement merely announcing general principles without any practical effect. As we have already mentioned, it is also a matter that is evolving and difficult to stabilize.


General conditions do not present these drawbacks. Designed to serve as a model for the two contracting parties, they do not infringe upon the sovereignty of the states. In fact, they do not generally bind the state since for each contract they can be totally or partially adopted or modified to meet the particular circumstances. The flexibility of the contractual formula enables the adaptation of the parties' commitments to the circumstances without having to amend the basic instrument and without recourse to the long and complicated procedures for the revision of treaties. Through the direct confrontation of the host state and the investor, the interested parties themselves define their obligations.

The draft standard contract that we have prepared has the following characteristics: It is aimed at governing the relations between a foreign investor and a developing country with respect to direct investment of medium size in the textile industry. It is based on the position that the host state, as well as the foreign investor, wish the investment to be successful. In other words, the clauses of the contract set the terms of the investment for the period the investment is being made and during its operation, rather than being merely the rules applicable to the most pathological cases. Thus, the draft standard contract first defines the object of the contract, the duration of the agreement, its stability, states the nationality of the legal person and other such details, and determines the law applicable to the contract. There follows definition of the investor's obligations relating to the execution of the investment, the personnel employed and secondary effects of the investment. The draft also establishes the relationship between the enterprise and the State and the State's commitments relating to the commercial freedom of the investor, State controls, taxes, transfers of funds and characteristics of the legal person. The last part of the draft Standard Agreement deals with the consequences of the nonperformance of obligations, settlement of disputes (arbitration) and the philosophy (good faith) of the relationship.

In preparing the clauses, we endeavored to provide the investor with reasonable freedom of action and a reasonable profit, and to provide the host State with reasonable control over the investor's activities so as to preserve the basic interests of the national community. In doing so, we took very serious account of the practices followed in international contracts other than investment contracts. Thus, the clauses relating to nonperformance and force majeure resemble those to be found in the most modern sales contracts and in the Hague Convention of July 1, 1964 which established a uniform law for international sales. The

clause of applicable law approximates the terms of article 42 of the World Bank Convention of March 18, 1965 concerning arbitration as related to investment matters. We thought it important to facilitate the establishment of international economic law or an economic transnational law by unifying concepts and institutions whenever it was possible.

To conclude this brief introduction, I believe the members of the Committee and myself as secretary, have been conscious that the model proposed—with all the reservations I have just made and those found in the commentary on the articles—may constitute for the present a modest and certainly imperfect solution for the establishment of the legal regime for investment in developing countries. Thus the parties, better informed by our model of the problems that arise and having at their disposal an outline of a solution, will be able to formulate themselves a text best suited to their needs.

STANDARD INVESTMENT AGREEMENT

PREAMBLE

The parties, namely, the Government of the State of ____________, hereinafter referred to as “The Government”, and X company, hereinafter referred to as “The Company”, Recognizing the importance of the establishment of a local cotton textile industry for the development of ____________, Considering that such an industry would make possible the utilization of cotton produced in ____________, the substitution of locally manufactured goods for imported consumer goods, the provision of employment for many local nationals, Considering . . . Seeing that X Company agrees to undertake the production of cotton threads and tissues, Recognizing moreover the importance of the capital needed for such an undertaking, Agrees on the following:

ARTICLE 1

The object of the present agreement is to define the obligations of the Company and of the Government in order to determine the conditions of

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(1) the establishment of the Company
(2) its operation
(3) its contribution to the development of the State

COMMENTS

It appears necessary to set forth at the very start the object of the contract. The basic characteristics of investment contracts in contrast to the typical commercial contracts are that they tend to determine on one hand the conditions and regime of the investor's establishment on an individual basis in the host country and, on the other hand, its consequences with respect to the host State, i.e., its development. The direct investment contract must be considered as the most important of development contracts.

The contract forms the framework of the investor's activity and his relations with the host State. It will serve as authority for concluding the traditional commercial contracts which will lead to solidifying the general objectives sought by the host country and the investor. Thus, a foreword on the objectives sought by the parties, and set forth in the first Article through a more technical statement on the object of the contract, opens the way for a clear interpretation of the wishes of the interested parties.

ARTICLE 2

This agreement is concluded for a duration of ________, starting from the date of its signature by the two parties. To this will be added the time necessary for the construction of plants and installations and for their testing but the delay cannot exceed five years. The testing period will be deemed to have ended when the first commercial sale takes place; the date will be established by an affidavit prepared by the two parties.

If the parties do not decide to terminate the agreement at the end of the said period, their relations will be governed thereafter by the national and international law normally applicable to the treatment of aliens. The change of legal regime is automatic.

COMMENTS

A predetermined duration of the contract is necessary. In fact the return on investment only shows up after a few years. The investor must then be guaranteed that he will be able to benefit from his efforts for a number of years. On the other hand, the integration of an economic activity into a new environment, presumably not ready for it, needs time to allow for the development of secondary effects. Finally, it is in the best interest of the host State to assure the investor, to a certain extent, prolonged development of his business if it wants to avoid the waste that
would represent for the country a too rapid and disorganized exploitation of national wealth, since in such a case the predominant idea of the investor would be to ensure a maximum of profits in the least possible period of time. The reinvestment of benefits and the expansion of the local enterprise require an extended period of time.

However, countries in a period of constant change and in uncertain international climate would find an overlong duration detrimental to good relations between the investor and the host State. The regime established by the contract might be poorly adapted to new realities and cause impatience on both sides. An extremely long contract leads to rough solutions such as nationalizations or harassing measures.

That is why we believe that such a contract should have an average life of 15 years. To this might be added the time necessary for the construction of the planned installations. This is a period during which the investor only assumes costs and before the country's development begins to benefit from the investment (except for the economic activity which the construction of the plant represents.)

At the end of the fixed period, if the parties decide not to extend the contract, the privileged contractual relationships disappear and are replaced by relations governed by the host State's general rules relating to the status of aliens. These general rules include rules of national as well as international law. Of course, the investor remains free to liquidate his investment under the terms set forth by the contract.

**Article 3**

*First solution:*

Total omission

*Second solution:*

Every five years, from the date of entry in force of the present agreement, the parties will meet to review the state of their relationships and to adapt, if necessary, the agreement to new conditions. However, no modification is possible without the express agreement in writing of both parties.

*Third solution:*

In case of profound change in the circumstances existing at the time of the conclusion of the agreement, the parties, at the request of one of them, will proceed to make the necessary adjustments. In case of disagreement, they may have recourse to arbitration procedure. The arbitrators themselves are empowered to make the adjustments they deem necessary.

**Comments**

As was noted under Article 2, the circumstances prevailing at the
signature of the contract may rapidly change, and in any case will certainly change over the long period of 15 years. Three attitudes are available: (1) not to foresee anything and let the parties take day-to-day measures in accordance with events; (2) plan regular meetings to update the contract with the understanding that no modification will occur without the agreement of both parties; (3) make the adaptation of the contract compulsory in case of a fundamental change in circumstances. In the latter case, the parties' disagreement on the adjustment to be made permits recourse to the procedure of settlement of disputes and the arbitration tribunal is empowered to modify the contract.

**ARTICLE 4**

In case of change in the control over the company, that is to say, in the exercise of the power that a physical or juridical person exercises over the company by virtue of ownership or of contractual right, namely concerning prices, investments, markets or commercial policy, the Government will have the right to purchase the Company's local installations on the following basis:

Value of investments and reinvestments at the time they were made, as corrected by the variations in the value of the currency in which they were made between the moment of the completion of the investment and the moment of effective payment, as this value is established in accordance with the regulations of the International Monetary Fund. Payment will be immediate. With respect to currency of transfer, reinvestments will be assimilated pro rata to investments.

In case of extinction of the International Monetary Fund, the value will be determined by agreement of the parties with possible appeal to arbitration in case of disagreement.

The company will therefore inform the Government of any change which may entail a change in the exercise of power. The Government will then have a period of six months to exercise its right of purchase.

**Comments**

The company operating the investment cannot be a matter of indifference to the host State. Political and economic considerations are taken into account to grant privileges to nationals of certain foreign countries in contrast to nationals of other States. Among the political considerations, a negative one is the desire to avoid the possible diplomatic protection a powerful state might grant his own nationals; a positive one is the existence of treaties of friendship or commercial treaties with a particular state giving priority to the nationals of that state. Among the economic considerations, the source of foreign capital and consequently
its retransfer as well as the transfer of profits and savings, might prompt the host State to encourage investments from a particular source and discourage investment from other sources. The credit possibilities in the State of origin and the commercial transactions between the State of origin and the host State constitute elements in the selection of sources of investment. When concluding the contract, the host State has in hand the elements for decision making. Signing means acceptance of the current nationality of the company. If one confines oneself to an examination of the formal criteria of the nationality of corporations (incorporation or siege social), the problem of change of nationality is limited because the most important modifications always happen behind the same facade. Nevertheless experience has proven that in the economic field and in matters of establishment states are seldom satisfied with a formal criterion. They look for a substantial criterion which may give rise to doubts, but results in determining—sometimes by tortuous ways—which country really benefits from the group's activity. This is why changes in the control over a company, despite the same place of incorporation or head office, are often considered as a change in nationality by developing countries.

It seems to us that in view of the importance of the interests concerned, the host State must be informed of any modification in the management and control of a company. It should then be able to state that the new legal entity, in spite of appearances, is too different from the original one for a contract intuitu personae to be maintained. A first solution would be, in case the State refused to accept the change, to terminate the contract and let the investor continue his operations in the framework of general rules of law. This solution presents a serious problem: the investor's calculations are based on the contract, and he should not be penalized because the company has modified itself. Economic life often leads to modifications which are not hostile to the host country.

Another solution appears more practical. This solution allows the host State, in case of substantial change in the control over the company, to purchase the company's installations. We propose a rough but simple way of calculation: the state would pay immediately the entire value of investments and reinvestments in their original currency, even if the reinvestments were made in local currency. The conversion will be based on the evolution of the respective currencies' value in accordance with the International Monetary Fund regulations.

It then becomes necessary to provide the elements for deciding whether there has been a change in the control of a company. The traditional criteria appear poorly adapted to companies investing in developing countries. The developing countries are well aware of this fact since as broad an organization as the "O.C.A.M." (Common Organization of African and Madagascan States) attempted an approach different from the usual ones. For the "O.C.A.M.", any legal entity, establishment, or enterprise, whatever its nationality, is considered an enterprise created or controlled by a foreigner if one or more foreigners hold decision-making power over the management and conduct of the enterprise by virtue of the capital investments that they made.

This definition is evidence of a consciousness that the essential element is the concrete decision-making power over the management and conduct of an enterprise. It appears that this definition can be linked to the trend among writers to consider that the primary element is the place where the decision-making and management are centered. With regard to multinational companies, the determination of this center is essential because even the most autonomous subsidiaries are subordinated to the parent company, or, in any case, to a management center setting the main lines of a unitary and worldwide policy and exerting tight financial control. We believe that the criterion of decision-making center presently represents the most realistic approach to our problem. However, considerable difficulties in putting this system in operation remain; all the more so since this concept is quite new.

It thus seems preferable for the time being to refer to an analogous concept, probably less accurate but easier to use. This is the concept of control as defined in Article 66 of the Treaty governing the European Coal and Steel Community ("E.C.S.C.") and in the application decision No. 25-54 ("J.O.C.E.C.A." 1954).

**ARTICLE 5**

The agreement may be freely assigned by the Company if the assignee is a company belonging to the same group as the contracting Company. In this case the assigning company will guarantee the good execution of its obligations by the assignee. On the other hand, the agreement cannot be assigned to a third company without the authorization of the Government.

Two companies belong to the same group if another company exercises simultaneously, directly or indirectly, by virtue of ownership or contractual relationship, decision-making power over them, namely concerning prices, investments, markets or commercial policy or if one of the two companies exercises this kind of power over the other.
The problem of transfer of the investment contract by the investor is similar to that of change of control over a company. By such an assignment, the host State is openly faced with a new contracting party, without the change of entity necessarily meaning a change of control. It then experiences the same hesitations, which are aggravated by the presence of the new contracting party. However, it appears impossible to prevent transfers or limit them extensively. Experience has shown that over a long period of time a company goes through modifications or is likely to undergo them. It is subject to numerous hazards which may oblige it to review its policy and commitments. As a matter of fact, it is sometimes in the best interests of the host State to have a more solid or competent investor replace an investor having difficulties or less interested than before in his enterprise.

In order to attempt a reconciliation between opposing interests, a distinction should be made between an assigning company linked to the assignee who belongs to the same group, and an assigning company with no links to the assignee. In the first case, the host State must investigate the links of the original investor with other companies, if only to determine its nationality. Anyway the concept of a company group implies a technical distribution of work rather than an entire autonomy of the companies between themselves. Finally, it matters little if during the course of the contract, the group modifies its structures. In fact it is always the same entity operating, and transfers should be entirely open between companies of a same group. It is enough if the assigning company will guarantee the proper performance of its obligations by the assignee.

However, this same liberalism should not be shown when the assignee is a third party and does not belong to the same group as the assigning company. The transfer should not be imposed on the government of the host State without its agreement since it then represents a sort of modification of the contract that cannot be brought about without both parties’ agreement (see Article 3). In case the government should refuse to accept the transfer, there should be no obligation on its part to purchase the installations as was the case for the change of nationality of the company. In a case of change of control over a company, the State, by refusing, injures the company’s operations and its management through the appropriately constituted organs. The entity remains. In the case of transfer of the contract, it is the investor who takes the initiative of contract modification. It is then normal that he should take up the risk himself.
A criterion must be established to determine when two companies belong to the same group. A similar criterion to that proposed in case of a change of control over a company would be equally efficient and should avoid any multiplication of vague concepts which are pretexts for litigation.

**ARTICLE 6**

**Relations between the parties are governed by this agreement, by the professional usages generally admitted in the textile industry, by the law of the host country and by the principles of international law applicable to investments.**

**COMMENTS**

The problem of the law applicable to the investment contract is probably the most difficult one to solve. Whatever solution is proposed will be controversial. The text we have drafted is based on the experience drawn from the legal clauses applicable in the investment contracts and also takes into account the provisions of the International Bank for Reconstruction and Development Convention of March 18, 1965 on the settlement of disputes relating to investments between states and nationals of other states (Art. 42). The acceptance of that Convention by 60 states on April 1, 1971, including its choice of law system, is an important achievement. The most important provisions of Article 42 state:

The Tribunal shall decide a dispute in accordance with such rules or law as may be agreed by the parties. In absence of such agreement between the parties, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.

First of all, in accordance with the spirit of the first part of Article 42, we wished to emphasize that the will of the parties formalized in the contract is the most direct source of the law applicable to the contract in the sense that the substantive law selected by the parties must first be applied and only then, possibly, conflict of law rules.

Second, it seemed important to us to stress the strength and extent of trade practices or customs which play an essential role in the determination of investment specifications, the calculation of cost prices, and the extent of certain services.

Third, the law of the host State plays an important role because the

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contract is often governed by a more general legislation on investments. In any case, police powers or immediately applicable laws which are not contrary to international public policy in the sense of international law are always applicable.

Fourth, it appeared to us essential to submit an international at least in some of its aspects contract signed between a state and an individual entity to the principles of international law applicable to investments. We thus unequivocally reject the theory of quasi-international treaties subject to their own law; a theory known by private law experts as "contract with no applicable law". By principles of international law applicable to investments, we mean the rules of international law, whatever their origin, having direct consequences upon the law of investments, whether they be principles of economic law or those of more general import. Such principles are still not very numerous or coherent, but in the developing international community, it could not be otherwise.

We do not deny that the connection between these four elements is difficult and the role to be played by each one remains undertermined. However, the Committee believes that the principles of international law constitute international public policy, i.e., the public order of the international community in economic relationships. The other rules of law applicable to relations between the parties cannot run counter to the provisions of the public order whose precise function is to prevent this. The parties remain entirely free to set up the legal regulations they want or to submit their relations to any regulation as long as they respect international public policy. If desired, they can also call more widely upon international law.

**Article 7**

1. The company undertakes to construct a factory which will include a unit for spinning and a unit for weaving within a period of ______ from the date of signature of the present agreement.

   [Variant: from the date on which the site for the company's installations was placed at the company's disposal by the local authorities.]

2. The factory will correspond to the following specifications:

   [provision to be made, in particular, for: final production, levels (stages) of production, materials.]

3. Equipment will correspond to the most developed techniques existing at the time of the entry in force of the agreement.

   [Note: Mention of the most developed techniques was included merely for reference. In many cases less developed techniques may be more useful. It is for the parties to specify the techniques they wish to be utilized.]
4. The Company undertakes to invest a minimum of _____ and a maximum of _____, taking into consideration the costs at the time of conclusion of the agreement. The necessary capital will be furnished exclusively by the Company and will be sought outside the local financial market.

[Variant: Local enterprises will participate to the extent of _________.]

5. The factory will be constructed in such a manner as to allow for later extention as market developments dictate. The Company will make the necessary replacements of fixed and movable equipment and the modifications or additions considered desirable or necessary to assure efficient operation of the factory and maintenance of the above mentioned specifications. The provisions of this agreement will apply to these extensions and modifications and to the resulting additional or different production.

COMMENTS

Article 7 defines the most important obligation of the investor, that is the performance of the investment planned.

It is for the parties to establish as precisely as possible the investment specifications. At the same time, we believe it useful to mention some of the difficulties while proposing an outline of a solution.

First of all, it should be emphasized that, while the specifications inevitably remain approximate, it is prudent to specify the quality of the equipment to be installed in the plant. We propose to require that the investor install modern equipment. It is obvious that in certain cases, it may be preferable to utilize simpler and stronger, but less advanced, equipment that will be easier to handle and maintain. Modern equipment has been mentioned primarily for the purpose of prompting the parties to decide for themselves and thus decreasing the likelihood of surprises to the host State. The parties can then select the equipment most appropriate to local necessities.

A financial valuation of the investment is very useful. It makes possible greater appreciation of the concept of quality. It allows a better evaluation of the investor’s effort to seek capital as well as the effort which the host State should foresee necessary to raise foreign currency for the transfer of benefits and retransfer of capital. It allows better planning for return on investment. However, a valuation of the installations at the time of starting work is a necessary complement to that first valuation and determines the real value to the host State.

It is also useful to specify the time period allowed for completing the investment to avoid any dispute on the investor’s execution of his obligations. In fact, such a deadline can be considered as part of the specifica-
tions. The starting point of the time period must be carefully determined. Two dates are important. One is the date the contract is signed. It is determined precisely and is usually the starting date for the parties' commitments. The other is the date the investor can effectively start the construction of the plant, usually at the time the real property problems are solved.

It is advisable to provide for the future in two respects. First to maintain the investment in good working order. Fear might arise that the investor would realize a rapid amortization of his installations. Then, as the date of the expiration of the contract approaches, that he would not care any more for their maintenance and for the improvements normally needed by technical progress. Second, to provide for the possibility of expansion in case the market should develop favorably. A view to the future is an important element of a development policy. As a counterpart, the contractual guarantees granted by the State to the original investment should automatically be applicable to modifications and expansions of the enterprise and to their consequences.

ARTICLE 8

1. The Company will employ persons whose habitual residence is in the host country and will not have recourse to foreign personnel unless it cannot find locally sufficiently qualified persons. When the Company has reached its normal production capacity, as defined in Article 7, it will be able to employ foreign personnel only in the following maximum percentages, calculated on the basis of total personnel:

Staff
X% during the first two years of operation;  
X_1% during the next three years;  
X_2% after that time.

Employees and Laborers
Y% during the first two years;  
Y_1% during the next three years;  
Y_2% after that time.

This provision does not apply to general management and to top-level staff.

2. To facilitate access of local personnel to the positions offered by the firm, the Company undertakes to organize courses of professional training locally within the limits of the above-mentioned proportions.

[Variant: To facilitate access of local personnel to the positions offered by the firm, the Company undertakes to contribute annually to local professional training schools a sum equal to N% of its payroll within the territory of the host State.]
3. The Company agrees to accept every year, if it is so requested, a national of the host State as a paid trainee. The trainee must be a graduate of a secondary school or its equivalent. The training period will not exceed one year.

4. The Company undertakes to establish a medical dispensary corresponding to the needs of the employees of the firm and of their families.

[Variant: In order to contribute to the improvement of the sanitary conditions of its employees, the Company undertakes to pay annually a sum equal to N% of its payroll within the territory of the host State.]

COMMENTS

The investment is meant, not only to industrialize the host State (local manufacturing of imported goods, exploitation of national wealth), but also to provide work to an often superabundant labor force. The difficulty is twofold. Often the local labor force has no professional training. Furthermore, the investor, for psychological reasons, or for reasons relating to routine or economic return, is sometimes inclined to use foreign labor that, while perhaps more expensive, is also more efficient because of its know-how and common language.

Thus, an obligation in principle should at least be imposed upon the investor to employ local personnel each time they are able to render approximately the same services as foreign personnel. In order to make this obligation concrete and effective it seems essential to establish a precise program regarding the number of jobs that could still be filled by nonresidents. In return, the investor must be entirely free to establish the general management (in the broad sense). This obligation in principle and the consequent programming can only be undertaken if the investor undertakes to train local labor. Since we are supposedly dealing with a medium-size investment in a relatively simple industry with local craft background, the requirements for professional training cannot be as great as those required by very large investments. The training should basically be one within the enterprise. If there are adequate schools in the vicinity of the plant, it is preferable that they assume the function. In this case, the enterprise should make a financial contribution and possibly provide teachers from its most qualified personnel. It also would be reasonable for the investor to make a public service contribution in the form of a transfer of administrative or technical management to a high level trainee who, through his experience in the enterprise, could acquire a true knowledge of its mechanisms.

Finally, within its means, the investor should ensure the proper health condition of its personnel by establishing, at least, a first aid dispensary.
This is an obligation frequently assumed by enterprises in developed countries. Here it is all the more necessary since the local labor, coming from the countryside, is out of its usual element and thus more vulnerable, and since local health services are often insufficient. Here as well, the investor should be offered the alternative of making a financial contribution to the operation of local health services.

The financial contribution to professional training as well as to health services should be calculated proportionately to the salaries paid in the host State since these services are linked to the employment. This calculation has the added advantage of being easy to make.

**ARTICLE 9**

1. The Company will have free choice of its suppliers in the host State as well as abroad.

2. However, with respect to products of the same kind and of equal quality, the Company will supply itself in the local market provided that the terms of such supply, and in particular the prices, remain compatible with an economically sound business operation for the investor as well as for the host State.

**COMMENTS**

The foreign investor is not a national of the host State, but a foreign business entity seeking a good return on its investment; consequently there are sacrifices he is not ready to make and that should not be required of him. From this point of view, security of supplies and their quality represent a determining element for the investor. He must then be able to choose freely his suppliers, whether in the host State or abroad.

Two restrictions to this freedom should be envisaged. First, that the investor supply itself in the local market if conditions are equivalent. It is conceivable, of course, that even under equivalent conditions, the investor prefers the foreign suppliers because he has some link with the supplier. But the necessities of development require that the secondary effects of the investment be as great as possible, and under the circumstances, the sacrifice required of the investor is not exceptional. The second restriction is an extension of the first one. Under the requirement for equivalent conditions, should prices be totally equal or could local prices be higher than foreign prices, without removing the investor's obligations to supply itself in the local market? In our opinion, the establishment of a price is always arbitrary. The so-called international prices are often highly artificial. We are inclined to believe that a reasonable difference between local prices and foreign prices does not justify
a recourse to foreign suppliers. All the more since the security of supply is reinforced because of reduced transportation and the absence of administrative barriers.

The difficulty is to find a formula setting the obligation for the investor to supply itself in the local market, even at a price higher than the international price, without jeopardizing the existence of the enterprise itself. This is all the more difficult since the disparity between local prices and international prices can also be artificial. A nonexcessive disparity or a reasonable disparity could have been mentioned. But, in order to state a more concrete formulation of the precise idea we had in mind, we preferred a reference directly related to the enterprise, namely, the economically sound business operation.

**Article 10**

1. The directions of the Company’s sales will conform to the host State’s development policy.

2. However, the Company will have free choice of its individual customers and no prices or other terms of sale will be imposed on it which are not compatible with an economically sound business operation.

**Comments**

Remarks similar to those concerning Article 9 must be made with respect to the relations of the investor with enterprises to which it sells its products. It is normal that the investor be free to choose its customers. Since it bears the risk of the enterprise, it is up to the investor to determine which customer will be given credit and the transactions to be made in the host State as well as abroad. Consequently, it must have free choice of its customers. However, this freedom is only justified with respect to selecting individual customers. In effect, there is a choice to be made on the commercial policy to be followed. Should production be oriented toward export or should it first satisfy the needs of the local market? In a highly industrialized country, one would suppose that the enterprise would be free to choose its commercial policy and that the public authorities will do no more than suggest possible directions. In a developing country, where any waste must be avoided, where there is no competition, and where there is no “natural balance,” the economic options are fundamental and such freedom cannot be granted to the investor. Consequently, the state must establish the main directions of its development policy. In addition, by signing the investment contract, the investor indicates acceptance of participation in the development of the host State. But here again, the State’s intervention must be restricted after taking account of the comments just made above regarding
the choice of individual customers. It must also be emphasized that the States’ constraints in this respect are only justified by the necessities of development and normally should not lead to the liquidation of the enterprise. The investment contract implies recognition of the investor’s interest. The concept of economic exploitation used here, as in Article 9, means that even if the enterprise does not have the assurance of substantial profits, at least the State will not impose on it a policy leading to failure; Article 17 covers situations when exceptions must be made.

ARTICLE 11

1. The Company will submit annually to the Minister:
   (a) a report of its activities;
   (b) the documents which, in accordance with the law applicable to it and with its own charter, it must communicate to its associates.

   After submission of this report and of the aforesaid documents, the Minister may request the clarifications which he deems necessary to make sure that the Company fulfills its obligations.

2. In addition to the powers of inspection which the Government of the host State may have with respect to local enterprises, by virtue of local law, the officials delegated by the Minister of ______ have, until execution of the affidavit provided for in Art. 2 above, access to the enterprise to determine the fulfillment by the investor of his contractual obligations and in particular those provided for in Art. 7.

COMMENTS

Once the investment is carried out, its operation is outside the control of the host State since the latter—unless it has some participation in ownership—has no direct interest in the enterprise. The host State does not conclude any of the sales, purchase or service contracts which are signed exclusively by the investor, nor is it informed of transactions made or planned. It is nevertheless in the best interests of the State to know what is going on. First, for statistical purposes since the investment has important consequences for its economy, and also, as a party to the agreement governing the status of the investor, to determine if the obligations are fulfilled. Niggling controls which are more discouraging than efficient should certainly be avoided, but the State is entitled to a minimum of information. We thus suggest that the investor submit annually a report on the fulfillment of its obligations, accompanied by the documents it must communicate to its associates. The State may then request additional information. However, the company is still subject to the controls which, by virtue of local law, are imposed on local
enterprises with respect to work safety, antipollution measures or tax matters, for example.

At one stage, however, a more severe control is justified. That stage occurs between the time of the signature of the contract and the completion of the investment. In fact, at that point, the investor's main obligation towards the State is fulfilled and the basis for the future is laid. We believe that the State must be able to make sure things develop as planned, by sending inspectors for example.

**Article 12**

1. The Company will be exempted from all customs duties on the importation of essential capital equipment and of the equipment and replacement parts necessary for its operation. To this effect, after conclusion of the present agreement and before completion of plant construction, the Company will establish and submit to the host State’s Government for approval:

   (a) a detailed list of essential equipment to be imported prior to the start of operation of the enterprise, and

   (b) a list of parts and replacement likely to be needed in the future.

   Approval of these lists by the Government will bind the customs and exchange control authorities at the time of importation of the goods. Supplements to the initial lists may be established according to the same procedures.

2. The Company will be exempted from all customs duties on the importation of raw materials necessary for its operation for a period of ________ years. That period may be further extended by agreement for no more than ________ years.

3. For the first five years after the beginning of its operations, the Company will be exempted from all taxation. Beginning with the sixth year, the Company will be subject to all regular taxes and other charges, with the exception of those referred to in para. (1) and (2) of this Article.

4. For every reinvestment of benefits and/or extensions of the enterprise's operation the Company will be able to deduct from its profits and within their annual limits for three years a sum equal to the invested or reinvested capital, provided that the operation has been approved by the Ministry of ________.

5. The company will be subjected for the whole duration of the agreement to the charges stemming from social legislation.

**Comments**

Article 12 deals with the fiscal regime of the investor. We have sought as simple a system as possible based upon the realities perceived by
carefully examining the clauses of the contracts and summarizing the various investigations we have conducted among the circles concerned.

First, it seemed necessary to distinguish between customs duties and other taxes. In fact, in many developing countries, because of the simplicity of the levying of duties and their collection, customs duties, rather than direct or other indirect taxes, play a primary role. This system is very detrimental to the investor because its position, at least on international markets, is jeopardized and its cost price undoubtedly is artificially burdened. This is the reason we give special treatment to customs duties on imports. Provided the investor establishes in advance a list of its needs and this list is approved by the competent authorities of the host State, a total and permanent exemption is provided for imported capital equipment necessary for the operation of the enterprise as well as for replacement parts and equipment. The lists may be added to or modified with the authorities’ agreement. The exemption from customs duties is also provided for raw materials, but on a slightly different basis. Here, prior approved lists are not required since the same abuses as are found in the case of capital equipment are not common. On the other hand, the existence of these facilities should not be permitted to impede the use of local raw materials by the investor by making it too easy to import. Thus, the exemption is limited in time, but can be extended by the parties if local market conditions require.

Further, we proceeded from the idea that the starting period of the enterprise is a period of great difficulties for the investor. These difficulties, which are inherent in the start of any enterprise, are increased by the problems of adapting to a new country, very different from the country of origin and by local and international conditions which are not particularly favorable. Thus, at this stage the assistance, which the State can give, is most important. Consequently, we suggest a total tax exemption during the starting period, arbitrarily set at five years not including the time necessary for the start up of the installations. In normal circumstances when the investment starts to produce a return, it is logical for the State, which has thus far been deprived from any tax participation in the profits, to withdraw the advantages that it granted. In other words, the enterprise becomes subject to local taxes.

It is useful to make sure that the tax provisions encourage the investor to proceed with reinvestments and new investment. Since an exemption analogous to the one proposed for the original investment is technically difficult to realize, it seems preferable to reach a similar objective through a different technique. This consists of deducting the amount of the investment or reinvestments from the realized profits.

On the other hand, we believe that the tax stabilization system should
not be retained. In effect, it binds the sovereignty of the state too deeply and too long, and one should be wary of the difficulties of applying such an extravagant advantage. Advantages, which are too great, lead to an opposite result from that sought. The investor becomes suspicious, profits from the advantages granted in the short period (accelerated depreciation) and does not care for the rest.

However, by the provisions of Article 15, the investor is protected from discriminatory tax measures that would legally or in fact result in its being subject to unwarranted taxation.

It should be noted that this is a general plan that must be adapted in light of the tax system of each country concerned. In particular, the element of double taxation was not taken into consideration. Exemption from taxation in the host State in practice may benefit the country of origin instead of the investor since the investor will be taxed in its country. The exemption then looses all justification and, if there is no double taxation treaty between the host State and the country of origin to avoid this result, another system is probably preferable. Likewise the basic element of the “most favored nation” clause was not taken into account.

Finally, the charges related to social legislation are not deemed to be taxes within the meaning of Article 12.

**ARTICLE 13**

The Government of the host State undertakes to place at the Company’s disposal (at a non-discriminatory exchange rate) the foreign exchange necessary for:

(a) the transfer abroad, in the currency of origin, of the company capital, distributed benefits, possible repurchase compensations, the proceeds of the liquidation of the enterprise in whatever form if the latter occurs at the expiration of the present agreement.

If liquidation occurs earlier, the freedom to transfer remains guaranteed. However, the Government may authorize only transfer of an annual proportion the amount of which will not be inferior to the total sum to be transferred divided by the time remaining until the agreed date of expiration of the agreement.

In the case of liquidation of the enterprise, at whatever time, the Government may limit its transfer authorisation to a sum equal to that which would result from the application of Article 4, paragraph 2.

(b) the amount of its supplies of foreign origin.

(c) the payment, at the agreed dates and in the stipulated currency, of interest and reimbursement of capital of all loans contracted with a view to the fulfillment of the obligations undertaken by virtue of Article
7 of the present agreement as well as of all foreign loans contracted with the consent of the Minister of __________. Such consent will not be required if the loan has been contracted with an international financing agency, such as the International Bank for Reconstruction and Development, the Inter-American Development Bank, the European Investment Bank, etc.

(d) the monthly payment in their respective countries of origin of a maximum of X per cent of remunerations and indemnities acquired in the host State by the foreign members of its personnel as well as the payment of the sums contributed to foreign pension funds by or on behalf of such personnel; and the transfer to their country of origin of local savings accumulated by members of its foreign personnel at the time of their final departure.

The total of authorized transfers to the benefit of a member of the Company personnel cannot exceed Y per cent of the total remunerations and indemnities of which that person has benefited during his period of activity in the service of the Company in the host State.

(e) the transfer of fees and royalties for technical assistance, use of techniques and processes, studies, and cession of industrial property rights due by virtue of contracts approved by the Minister of __________.

COMMENTS

Article 13 is meant to settle one of the problems the solution of which is essential to the investor, that is, transfers of money. If the investor does not receive firm guarantees in this respect, the other guarantees lose their effectiveness. It is useless to assure the investor a possible high return on its capital if, in the short term, the results of the investment are ineffectual or, if in the medium or long-term, capital itself is threatened. Moreover, the necessity for the investor to work with foreign personnel and equipment makes it essential that the necessary foreign exchange be provided. It is obvious of course that the investor is not deprived of the ownership or management of its enterprise, but since it can only enjoy it within the limits of the host State, it is nevertheless subject to a partial expropriation.

In the opposite direction, great liberalism on the part of the host State presents serious disadvantages. First, an unexpected and abrupt outflow of large amounts of currencies is often linked to speculative fluctuations. Then, even in the framework of a correct and normal usage of the freedom of transfer, it leads to an impoverishment of countries whose

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15See also S.E. Rolfe, *The International Corporation* (Background report presented to the Istanbul Conference of the I.C.C., 1969).
indebtedness towards foreign countries is dramatic. Adequate adaptations must be made on the basis of the principle of freedom of transfer.

The registered capital must be freely transferable at the expiration of the agreement. We had considered although more hesitantly, that the proceeds of enterprise liquidation should be treated the same way. Theoretically, if the enterprise was successful, it directly or indirectly brought foreign exchange, and the State had time to foresee the necessary measures. On the other hand, if the disinvestment occurred before the termination of the agreement, it seems that the State, while authorizing the capital transfer, might divide its commitments and proceed to partial transfers spread out over the period remaining until the expiration of the agreement.

However, there must be a special treatment when the liquidation is for the benefit of the State. It means a complete readaptation of the relations between the investor and the State, usually at the State’s request. It is then normal that the capital transfer be made immediately. Possible repurchase compensation that may be granted under certain circumstances (see for example Articles 6 and 17) should be related to the capital resulting from a liquidation for the benefit of the host State. Nevertheless, an option is offered to the authorities for calculating the amounts to be transferred. They can authorize the transfer of the amounts actually granted or the amounts that would correspond to the evaluation of the investment in the manner provided for in Article 4.

The transfers relating to gains, profits and interest must also be authorized. If the State wishes these to remain in the host State, it must provide adequate encouragement measures.

The same solution must be used in regards to the obligations of the investor towards foreign countries, such as fees for industrial property rights, technical assistance, loan interest and capital, and payment of purchases made abroad. However, experience has proven that sometimes the system of “fees” is diverted from its objective of paying for a service, and becomes a means, within a group of companies, to show totally artificial profits or losses without any connection with the real activities of the local enterprise. It thus seemed necessary to only provide freedom of transfer for agreements of technical cooperation subject to a control made operative here by means of the approval of the contracts by the minister concerned.16

**Article 14**

1. If the Company has its headquarters (*siege social*) in the territory

of the host State, it is subjected to that State's legislation concerning companies. However, if changes made to that legislation after the conclusion of the agreement seriously affect the Company's structure and organization, the latter has the right to demand the purchase of its enterprise under the conditions of Article 4, paragraph 2, of the present agreement.

2. If the Company has its headquarters (sége social) outside the territory of the host State, its establishment within that State is subject to all laws of territorial application which are in effect there. However, if changes made to the legislation after the conclusion of the agreement seriously affect the structure and organization of the Company's establishment, the Company has the right to demand its purchase under the conditions of Article 4, paragraph 2, of the present agreement.

3. In no case will the host State intervene in the individual designation of the directors or representatives of the Company or of its establishments, unless this is done by virtue of provisions in effect at the time of conclusion of the agreement.

Comment

Another element plays an important role in the decision of whether or not to invest. It is the position of the government towards the Company as such. The investor wishes to be assured that the legislation relating to the formation, the operation, the liquidation of the Company and, in general, to the relations among partners and between partners and the Company will not undergo modifications that would upset its planning, projects and organization. This real danger for the entirely foreign companies is enhanced for companies controlled by foreign interests but governed by local laws. It is all the more so since legislation in the newly independent countries is still being formed and has not yet reached an equilibrium. Of course the State has to protect public credit and take certain measures. But it should be remembered that at the time of contract negotiations, the State may insist that certain rules be respected. In the compromise that the agreement represents, it seems that this demand by the investors should be satisfied, at least to a certain extent.

The practice most generally followed in investment agreements is the stabilization of the local legislation with respect to companies. It no longer corresponds to developments or in the developing countries, especially newly independent one. More and more of the latter now have

modern company laws. It constitutes a perfect example of false guarantees because of the scope of the stabilization clause and the resulting difficulties of interpretation.

Accordingly, another approach was followed by here. A distinction must be made according to whether or not the investing company has its headquarters in the territory of the host State.

If the Company is headquartered in the territory of the host State, it is subject to local legislation. However, if after the conclusion of the agreement, the changes made in the local legislation are so important as to affect the Company’s structure and organization, the latter as the right to demand the repurchase of the enterprise.

If the Company is not headquartered in the territory of the host State, it is subject to local laws only to the extent the laws of territorial application govern its activities and operation. It logically must be deemed that the Company is aware of these laws of territorial application at the time of signature of the contract and with full knowledge accepts to be subject to them.

Nevertheless, the case had to be considered where, after the conclusion of the investment agreement, the host State modifies its legislation in such an important way that it upsets the investor’s planning related to the conduct and operation of its enterprise. It is not possible to request the State to waive in any way whatsoever the exercise of its legislative power. However, the investor is granted the right to demand that the State repurchase the enterprise under the condition of Article 4.

Similarly, whether or not the Company has its headquarters in the host State, it seemed necessary to assure the freedom of choice of the directors of the Company and of its establishment against interference by the State in accordance to the provisions in effect at the time of conclusion of the agreement.

**Article 15**

The host State’s Government assures the Company generally that the latter will not be the object of any unfavorable discrimination *de facto or dejure*.

**Comments**

The combination of guarantees granted by the State to the investor and forming the bundle of its obligations must be completed by an overall guarantee which would in a way make all the others effective. As we have stressed on several occasions, there are measures that the host State can take which do not constitute a direct attack on its com-
mitments but nevertheless result in negating the agreement. These are measures that, without aiming particularly at the Company, are in fact applicable to it. It would be contrary to good faith not to oppose such practices.

**Article 16**

1. In the case of failure by one of the parties to fulfill its contractual obligations, the arbitral tribunal may either order the performance of the agreement, with or without damages (dommages-intérêts), or allocate damages (dommages-intérêts).

2. If the failure is serious, the arbitral tribunal may, at the request of either party, order rescission of the agreement, with or without damages (dommages-intérêts). In the case of rescission, the arbitral tribunal may order or authorize the purchase of the enterprise by the State and determine the conditions thereof.

3. The arbitral tribunal will have the power to order provisional measures, namely, to suspend the performance of obligations, or, on the contrary, to order performance of such obligations pending its decision, with or without other conditions, etc.

**Comments**

The nonperformance of its obligations by one of the parties raises two sets of difficulties. The first one is general and arises from the differences between the Common Law and the continental law on one hand; and the second set of difficulties relates to state laws and practices followed in international agreements. This second set of difficulties concerns the nature of contractual relations between a state and a foreign private entity and the consequences resulting from the particular nature of these relations.

By following international practice, the proposed penalties are meant to bring about the performance rather than the failure of the investment agreement. Consequently, in the case of nonperformance of its obligations by one of the parties, the arbitration tribunal may order the performance of the agreement, with or without damages. It may simply allocate damages if it deems that specific performance of the obligation is inadequate. Only in case of serious failure can rescission become a possible penalty. This provision can be compared to the provisions of the uniform law on the sales of tangible property which make a distinction as to penalties between basic and minor infringements to the agreement. However, the termination of an investment agreement cannot be

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made as easily as the termination of a sales agreement because of the importance of installations which remain and their role in the development of the country. Thus, the arbitration tribunal has the power to order or authorize the purchase of the enterprise (depending on which party is at fault) under the conditions it deems best adapted to the circumstances and the seriousness of the failure in performance.

It also has the power to order all provisional measures deemed necessary pending its award.

**ARTICLE 17**

1. No liability will attach if the failure has been caused by a case of force majeure.

2. Any event independent of the will of the parties which makes impossible or exceedingly difficult the execution of the agreement constitutes force majeure.

3. In the case of force majeure, the agreement is suspended as long as the situation continues, and it returns in force when the situation is over, its duration being extended by a period of time equal to that of its suspension.

4. If the situation continues for more than X months, the parties, at the request of either of them, will proceed to make the necessary adjustments. In case of disagreement, they may have recourse to arbitration. The arbitral tribunal itself has the power to make the adjustments it deems necessary.

5. To determine whether a case of force majeure exists, the responsibilities of the State to its nationals and to the international community, in particular in case of economic difficulties, political troubles, etc., will be taken into consideration. The arbitral tribunal may accord to the Company an indemnity intended to compensate in whole or in part for losses which it has suffered, whenever it finds such indemnity justified.

**COMMENTS**

There need be no inquiry whether one of the contracting parties committed a fault in the performance of its obligations. It suffices that the nonperformance is certain for the penalties provided under Article 16 to be applied. However, an exemption must be made for the defaulting party when the default is due to force majeure.

We believe that a flexible understanding of the concept should be adopted. There is one point beyond question, at least in principle: the event must be beyond the invoking party's control, that is independent of its will. The application may raise difficulties, for example, a strike
of the investor's personnel or riots. Contrary to a theory often maintained, it does not seem necessary to require that performance of the obligation be rendered absolutely impossible. Apart from exceptional cases, impossibility is always relative. It suffices that the performance be rendered very difficult. Likewise, it does not seem necessary to require that the event be unforeseeable. What is the use of foreseeing an event if it cannot be avoided? At the utmost, the foreseeability of an event must lead the contracting party to take all precautions possible in a commercial context. Thus, foreseeability is only an element of the impossibility or the great difficulty of performance.

If the principal effect of force majeure is to eliminate the responsibility of the party that can no longer perform its obligation because of the occurrence of the force majeure, it nevertheless appears essential to define as precisely as possible its consequences on the performance of the agreement. Indeed, the immediate and complete breach of the contractual relations is usually contrary to the best interests of the parties and the established practice in international economic relations to perform rather than breach an agreement. Thus, the event of force majeure only suspends the performance of the agreement whose duration is extended by a commensurate period—except of course, if the performance is totally impaired. In an investment agreement such a case will be rare. However, after a certain period of time, the parties are invited to negotiate the necessary adjustments. If they do not reach an agreement, at the request of either party, the arbitration tribunal is empowered to make the necessary adjustments.

Considering the special nature of the relations between a State and a private entity, a clarifying remark must be made at this point. In fact, given the general interests for which the State is responsible, it may, due to a combination of circumstances, be forced to take measures which conflict with its commitments. Without acknowledging force majeure in all cases, the special responsibility of the State towards the international community as well as towards its own nationals must be taken into consideration. An indemnity, not based on any concept of fault or liability, but intended to compensate the losses suffered by the investor in the name of public interest and without blame for the State, must be provided for.

**Article 18**

All disputes between the parties concerning the validity of the agreement, its interpretation or its execution will be settled by arbitration.

I. Institutional Arbitration
(a) The parties will submit their dispute to the International Centre for the Settlement of Disputes Relating to Investments created by the Convention on the Settlement of Investment Disputes between States and National of Other States of March 18, 1965.

_Note._ The International Centre for the Settlement of Disputes Relating to Investments is not the only arbitral institution which may be competent to decide investment disputes. The parties may also have resource, for instance, to the International Chamber of Commerce, the American Arbitration Association or the Permanent Court of Arbitration. All these organizations have considerable experience of this kind of dispute.

(b) To this effect, the Government of the State of ______ agrees to consider as fulfilled by the Company and its shareholders the condition of nationality provided by Article XXV (2b) of that Convention because of the control exercised over them by interests of ______ nationality.

_Note._ The International Centre for the Settlement of Disputes Relating to Investments has established models of compromissory clauses adopted to the various situations which may arise. It is better to consult them. The same observation can be made as to the arbitral institutions mentioned in the note accompanying the preceding paragraph of this Article.

II. Ad Hoc Arbitration

1. The party wishing to have recourse to arbitration will notify the other party by registered letter with receipt of delivery.

2. In this letter, the claimant indicates the subject in dispute and designates an arbitrator.

3. The defendant must, within ______ months from the date of receipt of the letter, designate in his turn an arbitrator.

4. The two arbitrators must designate by agreement a third arbitrator (within ______ months after the designation of the second arbitrator) and the three arbitrators will form an arbitral tribunal deciding by majority vote.

5. If the designations are not made by the parties or by the arbitrators within the periods provided for in the preceding paragraphs, the more diligent party may appeal to [the President of the International Center for the Settlement of Disputes Relating to Investments, the President of the International Court of Justice, the President of the Swiss Federal Tribunal, the President of the International Chamber of Commerce or any other person to be designated by the parties] who will be allowed ______ months from receipt of the appeal to make the necessary appointment. He will notify the parties and the arbitrators already appointed by registered letter with receipt of delivery.
6. In the event of objection being taken to an arbitrator, the question will be decided by the person mentioned in para. 5 and he will, in such a case, appoint a substitute.

In case of the death or resignation of the third arbitrator, he will be replaced by agreement of the two other arbitrators within the same period. In the absence of such appointments, the provisions of paragraph 5 will apply.

8. The arbitral tribunal will sit in _______ and will be convened as soon as possible after its constitution at the initiative of the third arbitrator who will preside.

9. The tribunal will freely establish its rules of procedure and may proceed to take any measure for its inquiry (mesure d'instruction) which it may deem necessary. The proceedings will take place in the _______ language.

10. The arbitral award will be made within _______ months from the date the tribunal was seized. This period will be extended by the duration of the measures of inquiry ordered. The award will be binding and without appeal. The State will insure the award's execution within its territory and it waives the invocation of any immunity, in domestic or international law, which might impede the execution.

11. The arbitration expenses will be allocated by the arbitral tribunal.

Comments

There are numerous occasions for litigation. Because of the complexity of the obligations undertaken by the investor and the host State, it is predictable that the parties may disagree on the interpretation of the agreement and the scope of their obligations. In many clauses there are provisions where the intervention of a judge may be necessary for the proper performance of the agreement (cf. for example, Articles 17, 18). In spite of the reservations of some people, we believe that for the foreseeable future arbitration still remains the best adapted procedure for settling disputes. In fact, the arbitration tribunals are equipped to be given tasks precisely adapted to circumstances. Moreover, the parties may select their arbitrator(s) according to the assignment they wish to entrust to him or them. The uncertainty, still connected to the concept of investment and the applicable law, is more easily reduced through arbitration. Because of its flexibility, it is a suitable procedure for undertaking the development of a law of investment. Besides, practice indicates that arbitration is a frequently used procedure.

Should the arbitration phase be preceded by a period for conciliation?
It seemed to us that for a medium-size investment, as rapid and inexpensive a procedure as possible was required. This is why no conciliation has been expressly provided for. However, it is not excluded. On the contrary, it is hoped that the parties will resort to conciliation and seek amicable rather than juridical solutions of their disputes.

This being so, the technical disadvantages and difficulties of putting into effect an *ad hoc* arbitration are well known and need not be reiterated here. Consequently, we recommend institutional arbitration, and primarily, arbitration by the International Centre for the Settlement of Disputes Relating to Investments. This is the first arbitral institution specialized in investment disputes. Moreover, it was created by an interstate convention ratified by many states (60 states as of April 1, 1971). This selection, however, does not eliminate other institutions or even *ad hoc* arbitration which, in certain cases, offers a flexibility and an economy of procedures that cannot be provided by institutional arbitration.

As regards *ad hoc* arbitration, we tried to take into account the experience gained from the some ten important *ad hoc* arbitration cases in matters of investment. That is why, without overloading the text, we carefully planned the terms and conditions for the establishment of the arbitration tribunal and the award. The establishment of the rules of procedure has been left to the arbitrators. Since Article 6 of the investment agreement determines the applicable law with respect to the relations between the parties, it was not necessary to mention it again in the arbitration clause. However, it is appropriate to note that it might be interesting for the parties to provide that the arbitrators shall be "*amiables compositeurs*" or shall judge in equity. This is not expressly provided by Article 6.

**ARTICLE 19**

The present agreement must be executed in good faith.

**Comments**

The last clause of the investment agreement aims at giving general guidelines of conduct to the parties and to the arbitrators with respect to its interpretation and its execution. In effect, precisely in view of the object of the agreement (installation and operation of an enterprise, development of the host State) and of its duration, it is impossible to provide for everything and dangerous to provide for too much without providing for everything. Thus, instead of entering into every detail, we preferred to retain a basic pattern and complete it by indicating that the parties must act in good faith and be guided by the introduction and
Article I for the solution of problems not expressly settled in the agreement. In summary, the behavior of the parties, as regards their actions affecting the performance of the agreement, is subject to good faith.