1. CONTRACTS BETWEEN HOST STATES AND FOREIGN INVESTORS IN THE ABSENCE OF INTERNATIONAL INVESTMENT TREATIES

For decades, legal opinion on a multitude of issues surrounding contracts between host States and foreign investors such as the legal nature of these contracts and the law applicable to them has been widely inconsistent. This unsatisfying situation and its reasons shall be exposed shortly in the present chapter. At the outset, however, it has to be determined what kind of contracts are the subject of this examination and which characteristics make them so difficult to deal with.

A. THE EXISTENCE AND CHARACTERISTICS OF STATE CONTRACTS

I. The Notion of State Contract and Its Legal Nature

Contracts between host States and foreign investors usually have been termed as “state contracts”. This notion is defined by UNCTAD as referring to a contract made between a State or an entity of a State and

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1 See R. Y. Jennings, State Contracts in International Law, BYIL 37 (1961), 156, 156, who declared:

The particular topic of State contracts impinges some of the hardest questions of international law. For it cannot be considered apart from the relationship of international law and municipal law; the relationship of public international law and private international law; the question of the subjects of international law; and the limits of domestic jurisdiction and the reserved domain. Moreover, the opinions of writers on the legal position of State contracts range from the view that the State contract is directly subject to the international law rule of pacta sunt servanda to the view that “contracts cannot be the subject of international disputes since international law contains no rules respecting their form and effect” (footnote omitted).

2 By and large, the terminology is not consistent and is often contingent upon political or legal connotations. Whilst some authors refer exclusively to the term “state contract” when dealing with long-term foreign investment contracts, others prefer the term “Economic Development Agreement” which inherits a certain political attitude. Further use is made of terms such as “foreign investment contract”, “international investment agreement”, or simply “investment contract”. The term most commonly used, however, remains “state contract”.

a foreign national or legal person of foreign nationality. This general definition involves the element of frontier crossing but disregards other aspects which are fundamental to the determination of the term “state contract”. Another more detailed definition describes a state contract “as a contract made between a state or a state entity vested with monopolistic control of a sector of a state's economy and a foreign entity entering that state with the intent of establishing a long term business relationship with the state or the state entity in that economic sector”.4

The peculiar risks that characterize state contracts and differentiate them from commercial transactions are the involvement of a sovereign power as well as the application of public law and the long duration of mutual commitments. Supposedly, state contracts regulate subject matters that are essential to the public interest of the host State such as the provision of infrastructure, the promotion of economic development or the running of essential services. State contracts are not founded exclusively in private law which would lead to the sanctity of commitments and the impossibility of modifying them unilaterally. Nor are they solely grounded in the public law sphere in which the community interests are to prevail over the contractual interests of the private individual. The two conceptions, whose distinction under international law is not always conclusive, may clash and hence, produce the instability which is inherent to state

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5 See, e.g., A. Al Faruque, The Rationale and Instrumentalities for Stability in Long-Term State Contracts—The Context for Petroleum Contracts, JWIT 7 (2006), 85, 90, who referred exclusively to petroleum contracts. Major parts of the doctrine evolved with regard to the regulation of oil exploitation but are likewise applicable to other kinds of state contracts. See also N. Horn, Arbitration and the Protection of Foreign Investment: Concept and Means, in: N. Horn (ed.), Arbitrating Foreign Investment Disputes (2004), 3, 12 et seq. Contra C. Leben, L’Évolution de la Notion de Contrat d’État, Rev. Arb. (2003), 629, 631 et seq., who differentiated between “state contracts” and “administrative contracts”.
6 See, e.g., G. Bermann, Contracts between States and Foreign Nationals: A Reassessment, in: H. Smit et al. (eds.), International Contracts (1981), 183, 195 et seq. See also C. Turpin, Government Contracts (1982), 69 et seq., where the author examined government contracts under various jurisdictions. In several countries such as France and the US, the law applicable differed from those of ordinary commercial contracts.