Of Contracts and Treaties in the Global Market

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I. The Paradoxes of Global Change in the Law

Not long ago teachers of international law used to explain that treaties are like contracts, only between states. Today it is necessary to explain that contracts are like treaties, only between individuals and the state. Paradoxical as it may seem, these different explanations respond to the changing reality underlying the process of globalization of the law. What used to be a useful comparison between international law and a separate domestic legal framework – treaties and contracts – has now become a part of a single legal structure which encompasses both contracts and treaties as well as a host of other instruments.

This phenomenon is of course noticeable in respect of activities that have become to a greater extent globalized, such as trade and investments, but it also relates both actually and potentially to a number of other matters that are following the same path. Examples can be found in Government commitments to the individual creating a legitimate expectation, a question that used to be confined to the realm of domestic law, but that today has gained increasing international recognition and

effect. Environmental covenants and other instruments that have substituted private commitment for governmental regulation are also a matter whose effects are felt far beyond the confines of national borders.

This article seeks to explain the process leading to this profound transformation of the law, with particular reference to the internationalization of contracts and the way how they have begun to interact with treaties. Both private and public international law developments are intertwined in this process to a degree that they become difficult to distinguish. In addition, the influence of *lex mercatoria* provides for a further enlargement of the governing legal framework. All of this leads in turn to a most meaningful role of international arbitration in consolidating the legal trends emerging from this state of flux.

II. The Internationalization of Private Contracts

Internationalization of contracts is not a new phenomenon. In fact, ever since trade crossed over national borders the process of internationalization was present to a greater or lesser extent. It has been appropriately written that "a contract is an international contract when it brings into play the interests of international trade".[1] True enough, international trade and the international sale of goods was the salient feature of this process at a first stage, which was soon followed by the more complex operation of international investments, whether associated to trade or not, and resulting in the global reach of economics and finance that we know today.[2] The overarching effect of the international public regulation of international trade in the framework of the GATT, the WTO and Free Trade Agreements, and the similar effect of the 1965 Convention establishing the International Centre for Settlement of Investment Disputes (ICSID) and the related network of bilateral and multilateral investment treaties that will be discussed below, are not alien to this process of transformation.

The law, however, has been slower to react to the new needs of a globalized economy. There is still an ongoing legal debate about the definition of an international contract as opposed to a domestic contract and the role of the sources of law in establishing a line of separa-

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1 C. Witz, "L'internationalité et le contrat", *Revue Lamy Droit des Affaires* 46 (2002), as reprinted in: Lamy, "Le Contrat International", (2002), 3-6.

2 P. Kahn, "L'internationalité du point de vue de l'ordre transnational", *Revue Lamy Droit des Affaires* 46 (2002), as reprinted in: Lamy, see above.

tion. But, as *Lagarde* has commented, this is a false debate in that the international legal order is the one increasingly governing internal situations by means of a variety of conventions.[3]

The nature of international markets determines that every passing day fewer and fewer transactions can be exclusively considered to be of a purely internal or domestic nature. The very role of the principle of subsidiarity has changed in this context. At the time when transactions were largely domestic international rules were applied as subsidiary, while today, where transactions are mostly international, it is the national rules that are applied as subsidiary. This has no small effect in the scope and nature of the law.

Conventions laying down rules of substantive law soon began to interact with the traditional approaches to private international law, mostly concerned with the identification of jurisdictions and applicable law among competing sovereignties. Conventions on substantive law had of course the advantage of looking at the broader spectrum of international markets and their legal transactions. This is the basis on which these conventions gradually began to prevail over domestic approaches.[4] The larger the degree of internationalization of contractual transactions, the greater the choice the parties had to opt for both the competent jurisdiction and the applicable law, particularly when such developments were coupled with the resort to international arbitration.

Although conventions on substantive or material law appeared somewhat late, they soon gained momentum and there were noticeable changes from one to the other, each leading to a larger degree of internationalization. The so called Hague Conventions of 1964,[5] for example, not only required that buyer and seller be established in different countries but also that there should be some additional element of international significance, such as transportation or delivery of the goods beyond the state where offer and acceptance had materialized in a con-

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3 P. Lagarde, "L'internationalité du point de vue de l'ordre international", *Revue Lamy Droit des Affaires* 46 (2002), as reprinted in: Lamy, see note 1, 1-3.

4 Lagarde, see note 3, 1-6.

5 Convention on the Uniform Law on the International Sale of Goods (1964) (Ulis, UNIDROIT), <www.lexmercatoria.org>; Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (1964) (Ulf, UNIDROIT), <www.lexmercatoria.org>.

tract. The 1980 Vienna Convention[6] did not retain such additional elements and required only that buyer and seller be established in two different countries.[7] A number of other conventions followed this simpler approach, thereby evidencing that internationalization was rapidly gaining ground.[8]

Other developments leading in the same direction have been noted in connection with the UNIDROIT Principles on international commercial contracts,[9] the Principles on an European law of contracts[10] and the studies on an European Civil Code.[11]

The most significant contribution to the internationalization of contracts has been that of international arbitral tribunals, which, as rightly noted, need to settle specific disputes between operators of international trade and are, for the most part, independent from national jurisdictions and state sovereignty.[12] Arbitration under the International Chamber of Commerce has built a powerful body of legal approaches to contemporary trade and financial transactions, most of which has in sight the needs of the effective operation of international markets rather than isolated requirements of national legislation.

Both from the point of view of jurisdiction and the substantive law governing international transactions, legal realities are today very different from those existing up to the 1980's. The new public order governing transactions in international markets is no longer a domestic one

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6 United Nations Convention on Contracts for the International Sale of Goods, 1980, <www.lexmercatoria.org>.

7 Witz, see note 1, 3-6.

8 See, for example, the United Nations Convention on the Limitation Period in the International Sale of Goods 1980 (New York, 1974/ Vienna, 1980); the Convention on Agency in the International Sale of Goods (Geneva, 1983); and the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995), <www.lexmercatoria.org>, and discussion by Witz, see note 1, 3-6, note 21.

9 UNIDROIT Principles of International Commercial Law, 2004, and reference to the 1994 edition by Kahn, see note 2, 2-5, note 8.

10 O. Lando/ H. Beale, *Principles of European Contract Law*, 2000, and discussion by Witz, see note 1, 3-7.

11 C. von Bar, *Le groupe d'études sur un code civil européen*, *Revue Internationale de Droit Comparé* 53 (2001), and discussion by Witz, see note 1, 3-7,8.

12 Kahn, see note 2, 2-5.

but genuinely a globalized legal framework.[13] When these developments are put in perspective the conclusion of an author does not seem farfetched:

> "La prochaine étape, dans le cadre de l'uniformisation du droit applicable aux contrats, entreprise a une échelle mondiale, sera peut-être celle de l'abandon de la distinction entre contrats internes et contrats internationaux".[14]

III. The Internationalization of State Contracts

A parallel line of legal development is found in the case of contracts between the state and individuals involving some form of international relationship. This category of issues is not new as it started most prominently with the concession contracts of the past and evolved into the modern forms of contractual commitments known today, most notably in the field of development contracts, foreign investments and financial transactions. It is in the context of these developments that contracts came yet into closer contact with international law and, eventually, treaties.

Being the state party to such international contracts, the question soon arose whether the breach of the rights of the other party could amount to a breach of international obligations of the state as a subject of international law and hence engage its international responsibility.[15] The view of authors has been sharply divided on how to answer this question. There are those who believe that such contracts are always within the administrative realm of state sovereignty, and at most their breach by the state could give rise to compensation, and those who argue that such contracts are no longer simply national contracts but are now subject to international law. There are also those who have devised intermediate approaches, like a special legal regime giving rise to trans-

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13 P. Lalive, "Ordre Public Transnational (ou réellement international) et arbitrage international", *Revue de l'Arbitrage* 1986/87, 329 et seq., and discussion by Kahn, see note 2, 2-7.

14 Witz, see note 1, 3-9.

15 P. Weil, "Problèmes relatifs aux contrats passés entre un Etat et un particulier", *RdC* 128 (1969), 95 et seq. (101).

national law. These differing views suggest that every possible legal alternative has been explored.[16]

Irrespective of the position taken by each author or tribunal, the fact that stands out is that this category of contracts is, by definition, one where internationalization is still more prominent than that resulting from purely private contracts. Not infrequently this feature is enhanced by the commitment of the state not to alter the contract and to abide by various kinds of stabilization clauses and other legal assurances. In addition, the general safeguards of international law in connection with private rights are always available, particularly in so far as unlawful expropriation, denial of justice and other forms of interference by the state will positively engage its international responsibility and the duty to compensate, among other possible remedies.

The end result of this legal development is that even in the case of a contract which cannot be considered to be governed or subject to international law, and which therefore allows for a greater role of the domestic legal system and national sovereignty, some key aspects of such contract will, nevertheless be subject to the operation of international law either because there are specific clauses to this effect or because the general safeguards of international law will be always at hand. The latter will of course operate independently from the contract to the extent that there is an international wrong.

The question that remains is whether this means that state contracts are treaties, at least from the point of view of their legal effects. The question becomes still more pressing when the state has undertaken a commitment to other states, normally by treaty, making the enforcement of the contract an international legal obligation. The so called "umbrella clauses" or "traités de couverture",[17] because of the higher degree of submission of the contract to international law, have been, on occasions, considered to safeguard the sanctity of the contract and to transform any interference with its enforcement into a treaty violation.[18] The specific implications of this type of clause in recent arbitral decisions concerning foreign investments will be discussed below.

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16 See generally J.F. Lalive, "Contrats entre Etats et personnes privées", *RdC* 182 (1983), 9 et seq., and discussion by H. Grigera Naón, "El Estado y el Arbitraje Internacional con Particulares", *Revista Jurídica de Buenos Aires* II-III (1989), 127 et seq. (130-138).

17 Weil, see note 15, 124, 130.

18 F.V. García-Amador, *The Changing Law of International Claims*, 1984, 387-395.

But it is one thing to strengthen the observance of state contracts by building upon the role of international law, directly or indirectly, and quite another to assimilate contracts to treaties.[19] As concluded by Professor *Weil* in his forward looking course of the Hague Academy of International Law in 1969:

> "l'internationalisation ne signifie ni que le contrat devienne l'equivalent d'un traité international ni que les règles du droit international interétatique soient transposables purement et simplement au domaine des contrats. Le contrat international n'est pas assimilable a un traité, il est simplement un acte international d'un type nouveau. Le droit international qui lui est applicable ne sera pas exactement le même que celui qui régit les rapports entre Etats, et notamment les traités internationaux ...".[20]

Similarly to international contracts, the decisions of arbitral tribunals and other courts, both domestic and international, have been instrumental in clarifying and developing the law applicable to state contracts, including the question of the choice of the appropriate forum to decide on disputes arising from such contracts.

For domestic courts the question has been somewhat more difficult in that many state contracts are made in the form of administrative contracts. Administrative contracts are often considered to be the expression of the powers of administration of the state, thus being closely attached to state sovereignty. This has not been the view of arbitral tribunals and other courts operating under international law, where the distinction between the state operating in its sovereign capacity – *jure imperii* – and the state operating as a commercial or business entity – *jure gestionis* – has been for long admitted.[21] While immunity and other state prerogatives are observed in connection with the first capacity none of it is available if the nature of the activity concerned is purely commercial or business-related.

This very distinction has also gradually permeated the view of a number of domestic courts which have admitted that the state defaulting on its contractual obligations in respect of an individual, national or foreign, engages its responsibility and has, at the very least, the obligation to compensate the resulting damage.[22] Administrative contracts

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19 Weil, see note 15, 158.

20 Weil, see note 15, 188.

21 I. Brownlie, *Principles of Public International Law,* 1990, 326-336.

22 Grigera-Naón, see note 16, 140-155.

have thus lost, to this extent, their connection to sovereignty and have become more contractual in nature.

Because of this evolving framework in connection with state contracts, disputes between an individual and the state have been more often submitted to private international arbitration. The role of the International Court of Arbitration of the International Chamber of Commerce has again been prominent in this respect, in part because of its growing jurisprudence but also in part because states are not treated just like individual private contractors and a special degree of deference is offered to them throughout the proceedings.[23]

IV. The Globalization of Foreign Investment Law

The third major line of development emerged in connection with the protection of foreign investments. Following the conflicting relationship between those who favoured submission of all disputes to domestic courts under some form or other of the "Calvo Clause" and those who would insist on the role of diplomatic protection, and hence of state intervention to protect their investments and other rights, arbitration gradually emerged as the common ground where the interests of all could be satisfied. This was the key turning point of the 1965 Convention establishing the ICSID.[24] No further diplomatic protection, except in unusual situations, no further submission to domestic courts and recourse instead to international arbitration, largely institutionalized under ICSID or UNCITRAL rules, are the core elements of the new balance struck between state sovereignty and international developments.[25]

Although restricted to the field of investments, however largely this may be defined by treaty, national legislation or contract, this particular development covers the most important international transactions of the modern world, which take the form of investments. Developments in the WTO, albeit different, tend to address the other major source of contemporary economic activity which is that concerned with international trade and related matters.

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23 E. Silva Romero, "ICC Arbitration and state Contracts", *Bulletin*, *International Court of Arbitration* 13 (2002), 34 et seq.

24 See generally C. Schreuer, *The ICSID Convention. A Commentary*, 2001.

25 P. Weil, "The state, the Foreign Investor, and International Law: the no longer stormy Relationship of a *Ménage à Trois*", *ICSID Review, Foreign Investment Law Journal* 15 (2000), 401 et seq.

Over 2000 bilateral investment treaties assuring the protection of foreign investments are today in existence, together with a host of multilateral conventions and a number of free trade agreements.[26] They all share the common feature that in spite of being inter-state agreements, individual private investors can avail themselves of the provisions of such instruments both in terms of the standards of treatment and the choice of forum for the settlement of disputes, including most prominently international arbitration.[27]

Most investments, however, are done by means of contracts with the state and it is here where the new connection between contracts and treaties has emerged. Not infrequently, contracts provide for the application of domestic law and for the submission of disputes to domestic courts. How can this be reconciled with the parallel existence of a treaty providing some times for a different governing law, ensuring a substantive treatment under international law which is usually different from that under domestic law, and allowing for the submission of disputes to international arbitration if the investor so chooses?

As in the past, two major approaches have emerged as an answer. For the host state, it is quite naturally the contract and the domestic legal framework that have to prevail. For the investor, it is quite naturally the treaty and the international law governance that have to prevail. And quite naturally too, it has been for the arbitral tribunal where the dispute is taken to settle the issue.[28] Because this is normally a jurisdictional issue its discussion in arbitration tribunals has been inseparable from the determination of the appropriate forum, thereby increasing the link between the conceptual aspects of the matter and the role of international arbitration to a much greater extent than was the case in the past.

The first case that explicitly addressed the matter was *Lanco International Inc. v. The Argentine Republic*.[29] In this case the investor chose

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26 E. Obadia, "ICSID, Investment Treaties and Arbitration: Current and Emerging Issues", in: G. Kaufmann-Kohler/ B. Stucki, *Investment Treaties and Arbitration*, 2002, 67 et seq.

27 J. Paulsson, "Arbitration without Privity", *ICSID Review, Foreign Investment Law Journal* 10 (1995), 232 et seq.

28 I.F.I. Shihata/ A.R. Parra, "The Experience of the International Centre for Settlement of Investment Disputes", *ICSID Review, Foreign Investment Law Journal* 14 (1999), 299 et seq.

29 *Lanco International Inc. v. The Argentine Republic*, Preliminary Decision on Jurisdiction of 8 December 1988, *ILM* 40 (2001), 457 et seq.

to take the dispute to the ICSID under a bilateral investment treaty even though the concession contract executed with Argentina provided for the submission of disputes to local courts. The Tribunal held that consent to arbitration under the treaty prevailed over any other provision to the contrary and that such consent could not be diminished by the submission of a dispute to local courts under the concession contract.[30] In this case, like in *Salini*, it has been held that since parties cannot opt for the jurisdiction of a domestic administrative court because it entails a kind of mandatory jurisdiction, there can be no triggering of the "fork in the road" mechanism in respect of ICSID arbitration.[31]

A distinction between different types of claims in connection with the test of triple identity has also been made. To the extent that a dispute might involve the same parties, object and cause of action it might be considered as the same dispute and if it has been submitted by the investor to domestic courts the "fork in the road" mechanism, by which the investor's choice becomes final, would preclude its submission to international arbitration.[32]

A purely contractual claim would thus normally find difficulty in passing the jurisdictional test of treaty-based tribunals, which will of course require allegation of a specific violation of treaty rights as the foundation of their jurisdiction. As the *ad hoc* Committee held in *Vivendi*, "A treaty cause of action is not the same as a contractual cause of action; it requires a clear showing of conduct which is in the circumstances contrary to the relevant treaty standard".[33]

The question, however, is not easy to resolve in practice as has been evidenced by the discussions of various tribunals. The *Vivendi ad hoc* Committee explained that "In a case where the essential basis of a claim brought before an international tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract".[34] However, to the extent that the fundamental legal basis of a

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30 *Lanco*, ibid., para. 40.

31 *Salini v. Morocco*, Decision on Jurisdiction of 16 July 2001, *ILM* 42 (2003), 606, and see Decision paras 25-27.

32 *Lauder v. Czech Republic*, Final UNCITRAL Award of September 2001, paras 161, 163, as published in <www.mfcr.cz/static/Arbitraz/en/Final Award.pdf>.

33 *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (Case No. ARB/97/3), Decision on Application for Annulment of 3 July 2002, *ILM* 41 (2002), 1135 et seq. (*Vivendi Annulment*), para. 113.

34 *Vivendi Annulment*, ibid., para. 98.

claim is a treaty, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state "cannot operate as a bar to the application of the treaty standard".[35] A similar reasoning applies to the operation of the "fork in the road" mechanism, since the choice of one or other forum will depend on the nature of the dispute submitted and these are not necessarily always incompatible.

This situation was explained by the Annulment Committee in *Wena* in respect of the interplay of leases and treaty claims, the first being contractual and the second arising under a treaty:

> "The leases deal with questions that are by definition of a commercial nature. The IPPA [treaty] deals with questions that are essentially of a governmental nature, namely the standards of treatment accorded by the state to foreign investors … It is therefore apparent that Wena and EHC [Egyptian Hotel Corporation] agreed to a particular contract, the applicable law and the dispute settlement arrangement in respect of one kind of subject, that relating to commercial problems under the leases. It is also apparent that Wena as a national of a Contracting state could invoke the IPPA for the purpose of a different kind of dispute, that concerning the treatment of foreign investors by Egypt. This other mechanism has a separate dispute settlement arrangement and might include a different choice of law provision or make no choice at all … The private and public functions of these various instruments are thus kept separate and distinct".[36]

The difference between contract-based claims and treaty-based claims has also been discussed by several other international arbitral tribunals, as evidenced by the decisions in *Lauder*,[37] *Genin*,[38] *Aguas del*

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35 *Vivendi Annulment*, see note 33, para. 101.

36 *Wena Hotels Ltd. v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Decision on Application for Annulment rendered on 5 February 2002, *ILM* 41 (2002), paras 31, 35, Decision of the Ad-Hoc Committee on Annulment.

37 *Lauder*, see note 32.

38 *Alex Genin and others v. Republic of Estonia* (ICSID Case No. ARB/99/2), Award of the Tribunal of 25 June 2001; Decision on Claimants' Request for Supplementary Decisions and Rectification of 4 April 2002, available at: <http://www.worldbank.org/icsid/cases/conclude.htm>.

Aconquija,[39] *CMS*[40] and *Azurix*[41] and of the *ad hoc* Committee in *Vivendi* explained above.[42] The Tribunal held in *CMS*, referring to this line of decisions, that "as contractual claims are different from treaty claims, even if there had been or there currently was a recourse to the local courts for breach of contract, this would not have prevented submission of the treaty claim to arbitration".[43]

V. "Umbrella Clauses" as a Mechanism of Further Integration between Contracts and Treaties

In the recent case of *SGS v. Pakistan*, the Tribunal came to the conclusion that it did not have jurisdiction over contract claims "which do not also constitute or amount to breaches of the substantive standards of the BIT".[44] In *SGS v. The Philippines*, where contractual claims were more easily distinguishable from treaty claims, the Tribunal referred certain aspects of contractual claims to local jurisdiction while retaining treaty-based jurisdiction.[45]

A further difficulty found by the tribunals in these last two cases was that both treaties contained an "umbrella clause". As noted further above, "umbrella clauses" or "traités de couverture" might potentially transform a contractual obligation of the state into a treaty obligation, thus erasing the distinction between one and the other. To this extent

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39 *Compañia de Aguas del Aconquija S.A. v. The Republic of Argentina* (ICSID Case No. ARB/97/3), Award of 21 November 2000, 16 ICSID Rev.—FILJ 641 (2001).

40 *CMS Gas Transmission Company v. Republic of Argentina* (ICSID Case No. ARB/01/8), Decision on Jurisdiction of 17 July 2003, *ILM* 42 (2003), 788 et seq.

41 *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Decision on Jurisdiction of 8 December 2003, para. 145, International Law in Brief available at <http://www.asil.org/ilib/azurix.pdf>.

42 *Vivendi Annulment*, see note 33.

43 *CMS,* see note 40, para. 80; *Azurix*, see note 41, para. 89.

44 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision on Objections to Jurisdiction of 6 August 2003; 18 ICSID Rev.—FILJ 301 (2003), para. 162.

45 *SGS v. Philippines*, (ICSID Case No. ARB/02/6), Decision on Objections to Jurisdiction of 29 January 2004, para. 163.

contracts might be considered as treaties from the point of view of their legal effects.

However, it must also be noted that the tribunal in *SGS v. Pakistan* was not convinced that umbrella clauses could always have such a broad effect as there would be no further difference between contract-based claims and treaty-based claims; it therefore undertook the task of examining both the legal purport of the clause and the intention of the parties in building this clause into the treaty. The Tribunal recognized that states can agree if they so wish that "all breaches of each state's contracts with investors of the other state are forthwith converted into and to be treated as breaches of the BIT", but that in that particular case there was "no clear and persuasive evidence that such was in fact the intention …".[46]

In *SGS v. The Philippines* the Tribunal took the rather unusual step of criticizing the decision of the Tribunal in *SGS* v. *Pakistan*, concluding that in the treaty concerning the Philippines the umbrella clause "makes it a breach of the BIT for the host state to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the *extent* or *content* of such obligations into an "issue of international law".[47] A claim concerning this issue was one which the Tribunal held should be submitted to local courts while, itself, retaining jurisdiction for the treaty-based aspect of the dispute. Although the reasoning of the Tribunal cannot be easily followed, the fact is that the umbrella clause was assigned a broad effect in the context of that particular treaty.

VI. The Increasing Interaction of Public Law and Private Rights in the Light of Legitimate Expectation

As mentioned above, even though contracts have been increasingly considered as subject to international law and detached from domestic legal constraints this does not mean that they have been transformed into treaties. Similarly, many of the attributes of treaties can be extended to contracts, including *pacta sunt servanda* and observance in

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46 *SGS v. Pakistan*, see note 44, para. 173.

47 *SGS v. Philippines*, see note 45, para. 128.

good faith, but this does not mean that treaties are contracts as they govern a different relationship in the international community.

What is interesting to realize is that the closer the interactions between treaties and contracts the greater the nexus between one and the other that will develop. This is noticeable, for example, when states undertake by means of a fully-fledged and unequivocal "umbrella clause" to treat breaches of contract as a breach of a treaty protecting the rights of investors. This is also the case of the extraordinary development embodied in the ICSID Convention to the extent that states enter into treaties that provide for the consent of host states to international arbitration in respect of unnamed investors who at any point in time may exercise the option of resorting to such arbitral jurisdiction. Investment contracts are thus linked automatically by the treaty to international arbitration and the standards of treatment laid down by the treaty and international law.

While this interaction is today typical of investments and increasingly so in respect of trade and financial transactions in the international market, the question that remains is whether other fields of activity will follow the same path. International contracts, even if purely private, are already pointing in this direction. Will many other contracts be subject to global standards concerning both jurisdiction and substantive rules of applicable law?

It must first be noted that indeed the interactions are increasing. One element has been the interplay of the most favored nation clause in connection with bilateral investment treaties, both in procedural and substantive terms.[48] Another element has been the recognition of the nature of global financial markets and its effect on the law.[49]

The answer in the end is connected to the examination of a broader issue, namely the need to establish limits to the overarching powers and functions of states in respect of the individual. A number of these limits have been established by means of legal safeguards, including the question of controlling the abuse of rights and discretionary powers of the administration, and by the role of domestic courts in ensuring their implementation. However, at least in connection with international legal

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48 *Maffezini v. Spain*, ICSID Award of 13 November 2000. This case came to settle the discussion initiated by both the ICJ and the Commission of Arbitration in the *Ambatielos Claim*, *RIAA* 12 (1963), 87 et seq. (107).

49 *Fedax v. Venezuela*, Decision of the ICSID Tribunal on Objections to Jurisdiction of 11 July 1997.

transactions, this is a task that has also to be undertaken by international law.

It is a well-established principle that states may not act in a manner contrary to treaties and contracts, at least those contracts that are under some form of protection of international law itself.[50] Although the identification of the standard of observance of and compliance with contracts by states has not been easy in a historical perspective, increasingly there is a noticeable influence in domestic and international courts of the standard of legitimate expectation. Whether this has been a development undertaken in express, or, frequently, implied terms, the fact is that what finally counts is the protection of the rights of the individual, not exclusively those of the state, as in the past.

At first this standard was concerned mainly with procedural questions or with the need to take into account a previous policy.[51] In *Preston*, however, the House of Lords ruled that unfairness amounting to an abuse of power could arise from conduct equivalent to the breach of contract or representation.[52] In the recent case *R. v. North and East Devon Health Authority, ex p. Coughlan*[53] the Court of Appeal in England sought to redress the inequality of power between the citizen and the state.[54] In this case it was held that:

> "Where the Court considers that a lawful promise or practice has induced a legitimate expectation of a *benefit which is substantive*, not simply procedural, authority now establishes that here too the court will in a proper case decide whether to frustrate the expectation is so unfair that to take a new and different course will amount to an abuse of power. Here, once the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy".[55]

The Court, having examined prior cases, then added:

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50 R. Higgins, "The Taking of Property by the State: Recent Developments in International Law", *RdC* 177 (1982), 259 et seq. (263).

51 *Associated Provincial Picture Houses Ltd. v. Wednesbury Corp.* (1947) 2 All ER 680, (1948) 1 KB 223.

52 *Preston v. IRC* (1985) 2 All ER 327, (1985) AC 835.

53 *R. v. North and East Devon Health Authority, ex parte Coughlan* (2000) 3 All ER 850.

54 M. Elliott, "Case and Comment, House of Lords Decisions", *CLJ* 59 (2000), 421 et seq.

55 *R. v. North and East Devon Health Authority,* see note 53, para. 57.

> "The court's task in all these cases is not to impede executive activity but to reconcile its continuing need to initiate or respond to change with the legitimate interests or expectations of citizens or strangers who have relied, and have been justified in relying, on a current policy or extant promise".[56]

The reasoning of the court is not only relevant in terms of domestic legal constraints but extends equally to those policies and contracts that have been internationalized. Governments may undertake changes of policy in their continuing need to search for the best choices in the discharge of their functions. However, to the extent that policies earlier in force might have created legitimate expectations both of a procedural and substantive nature for citizens, investors, traders or other persons, these may not be abandoned if the result would be so unfair as to amount to an abuse of power. Discretionary powers of the state, unchecked in the past, are today subject to a legal scrutiny so as to prevent frustration of individual rights.

This approach is also permeating the work of international tribunals. The World Bank Administrative Tribunal, for example, has applied the standard of legitimate expectation in several recent decisions so as to examine the administrative powers of the institution in the light of the rights of the affected individual.[57]

VII. Global Protection under International Law

The implications of this view for international law have not passed unnoticed. Professor *Ian Brownlie*[58] and Lady *Fox*[59] have recently raised the question whether matters giving raise to legitimate expectation on the part of an individual should be included among the exceptions to the law of state immunity. Just as the commercial activity of states has been recognized as a fundamental exception to immunity, so too there might be a need to accommodate the increased supervision of government functions. The underlying rationale for such exception is that ad-

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56 *R. v. North and East Devon Health Authority*, see note 53, para. 65.

57 World Bank Administrative Tribunal, Bigman Reports, 1999, Decision No. 209; Prescott Reports, 2001, Decision No. 253, para. 25.

58 Institut de Droit International, Resolution on Contemporary Aspects concerning Jurisdictional Immunities of States, article 2 (d), Annuaire, (1991) II, 64, 266.

59 H. Fox, *The Law of State Immunity*, 2002, 298-300.

ministrative functions of the state, earlier considered as the essence of *jure imperii* and sovereignty, if affecting the rights of individuals can be considered today to engage contractual commitments that the state is bound to observe and which largely fall within the ambit of *jure gestionis*.

To the extent that individuals are not to be left unprotected from arbitrary or abusive state powers in their global activity, international law will need to develop further the concepts and mechanisms for international protection of such rights. Paradoxically as it may seem, it is for the state itself to observe its obligations in such a manner as to make those developments unnecessary or exempt itself from international scrutiny. Whether more and more kinds of contracts are subject to the protection of treaties and international law will, in fact, depend upon such an equation.

In this light, it can be concluded that treaties and contracts, albeit different, pursue the same objective of ensuring the rule of law and the observance of legal commitments in the international community and are thus called to increasing interaction. To this end, treaties are becoming privatized by allowing a greater role for individuals in their operation, just as contracts are becoming public to the extent that states and international law extend their guarantees to their observance. All of it points towards the need for global protection in a global society, where perhaps the distinction between public and private law will become less meaningful.