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MODIFICATION OF STATE CONTRACTS
BY THE SUCCESSOR STATE

1. THE THEORY DEVELOPED BY O'CONNELL

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12.01 As mentioned above, the general conclusion I have reached regarding contracts signed between private entities is that the successor State is free to adopt legislative changes which may affect these rights. But, importantly, it must do so by respecting a number of fundamental rights of foreign investors existing under international law. The question is whether the solution should be any different in the specific context of a State contract, which involves a State as one of the parties. One important aspect, of course, is the fact that succession will sometimes directly affect the identity of that State party to the contract. In some instances (dissolution, integration, and unification), the predecessor State will cease to exist as an independent State as a result of the changes affecting its territory. In such cases, the question becomes whether the successor State should be bound by the rights and obligations that are contained in a contract that was signed by another State (the predecessor State) that no longer exists. As further discussed below, the question of succession is also complex when the predecessor State continues to exist (such as in cases of secession).

12.02 This important question of State succession to State contracts has surprisingly not been examined by many scholars. Thus, on the one hand, those scholars interested in State contracts and matters related to investment arbitration simply do not address the specific (and rather lateral) question of State succession. On the other hand, authors focusing on questions of State succession only address the specific issue of acquired rights without taking position on the fate of State contracts. In fact, the most detailed account of the question of State succession to State contracts remains to this day that of O'Connell, which was published more than 50 years ago. The following section will expose the interesting evolution of his position on the matter over

119 See, Chapter 10, Section 3.
120 See, Chapter 13, Section 1.
the 30 years he devoted to problems of State succession (Section 1). I will then put forward a new framework of analysis which, in my view, will provide better guidance to solve this complex question (Section 2).

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O’Connell first examined the specific question of State succession to ‘concession agreements’ in an article published in 1950. The conclusion he reached regarding these contracts is no different than the one mentioned above for contracts signed by private persons:

Upon a change of sovereignty the successor state does not automatically inherit the rights and duties comprised in the contract of concession. These come to an end with the extinction of the personality of one of the parties to the contract, or the obliteration of its sovereignty in the territory which is subject to the operations of the concession. To admit the contrary would be to admit the doctrine of universal succession with all its implications. The treatment of the problem of concessions in the law of State succession is not exhausted, however, by an analysis of the effect of the change on the concessionary contract. Consideration must be given to the question whether the successor State incurs an obligation towards the concessionaire on a basis other than contractual. The latter has invested money and performed work, and thus brought into being a certain state of facts. To this extent the concession constitutes more than a mere vinculum juris between him and the State. Apart from his contractual rights, the concessionaire has an equitable interest in his investment and labour. The contractual duty expires with the change of sovereignty, but the equitable interest in the factual situation survives. This interest is described variously as an ‘acquired right’, ‘property right’, or ‘vested right’.122

In other words, according to O’Connell, the successor State is not bound by contracts that were signed by another State (that often ceased to exist). This is because the obligations created under a contract signed by one State (the predecessor) are not transmitted to another (the successor State). The same conclusion is reached by Bedjaoui for whom ‘acquired rights do not exist in the case of State succession’ because ‘a right can be claimed only from the entity which created it – in this case, the predecessor State, which has disappeared’.

121 D.P. O’Connell, ‘Economic Concessions in the Law of State Succession’ (1950) 27 British YIL 94, defining the concept of ‘economic concession’ as follows: An economic concession thus embodies the following characteristics: It is a contract between a public authority and the concessionaire. It involves the investment of capital by the latter in an undertaking for the erection of public works or the exploitation of the public domain. The reward which the concessionaire expects to derive is usually in the form of profits which the public authority, under the terms of the contract, permits him to make.

122 Ibid., 95.
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adding that ‘subrogation of obligations is not a principle that is clearly applicable in relations between States’. But, for O’Connell, while it is undeniable that the successor State does not have any formal obligation to respect the rights and obligations contained in a contract signed by another State, he nevertheless believes that the other party to the original contract still has (after the date of succession) an ‘interest’ arising out of that contract. For O’Connell, such an ‘interest’ constitutes an ‘acquired right’ ‘which the successor State is obliged by international law to respect’. In fact, he argued that the doctrine of acquired rights has long been accepted in international law, and has been sanctioned by a considerable body of decisions of international and municipal tribunals and is, in fact, ‘perhaps one of the few principles firmly established in the law of State succession’.

O’Connell then explained the different options a successor State is faced with in order to respect the ‘interest’ of a foreign investor.

12.05 One option is for the successor State to ‘subrogate itself in the terms of the concession by novation of the contract’. In his 1967 book (at the very end of one chapter dealing with ‘governmental contracts’) he developed the argument further. He believes that ‘perhaps the most scientifically correct scheme of rules to solve the problem of the effect of change of sovereignty on contracts’ is to look at the proper law of that contract (which is often that of the State party to the contract) in order to ascertain if the contract has expired from frustration’. For him, such a situation of ‘frustration’ would occur whenever one of the parties to the contract has disappeared from the place of performance and that, consequently, the ‘contract has lapsed’. O’Connell indicates that ‘in most legal systems the disappearance of the contracting State from the place of performance will have the effect of the frustration of the contract, but if the law of the successor State provides for complete succession the effect

123 ILC, Second Report Bedjaoui, 1969 (n 4) 74.
124 O’Connell, ‘Economic Concessions’ (n 121) 124.
125 Ibid., 97.
126 Ibid., 123.
127 Ibid., 124.
128 See also the analysis in: O’Connell, ‘Recent Problems of State Succession’ (n 41) 155ff.
129 See, Barde (n 45) 114ff, referring to many authors. Interestingly, O’Connell, State Succession, 1967 (n 15) 299, does not explain what to do when a State contract refers to international law as the applicable law. O’Connell simply mentions that in such a case the ‘problem is very much more complex’ but adds that ‘such a situation is rare’ in practice.
130 O’Connell, State Succession, 1967 (n 15) 302, see also at 298.
131 Ibid., 298. See, O’Connell, ‘Recent Problems of State Succession’ (n 41) 155–6: In the simplest case of State Succession one might say that a contract made with a predecessor State and to be performed in the territory subjected to a change of sovereignty lapses with the disappearance of one party thereto, or its incapacity to perform the contract, depending upon whether the predecessor State is totally extinguished or merely expelled.
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will be negatived’. When the domestic law provides for the continuation of the contract, ‘a subrogation of the successor State in the contracts of the predecessor State is brought about, and, indeed, the subrogation consists of no more than a substitution of the name of the successor State for that of the predecessor State’ (adding that ‘everything else continues unaffected’). But, importantly, international law is not helpful in the event that the proper law governing the contract does not provide for such a subrogation. In such a case, ‘there is no contract to perform, for one party thereto has disappeared, and hence international law cannot enjoin performance, even when specific performance was a remedy of the proper law’.

This is where the second option comes in. Thus, ‘since [the successor State] is not bound by the terms of the contract it may expropriate the concession provided that (...) compensation is paid’. He explained this solution in his classic two-volume book on State succession published in 1967 (which further analyzed the issue and distinguished between ‘governmental contracts’, economic ‘concession agreements’, and ‘administrative contracts’). After examining numerous examples of State practice and court decisions with respect to concession agreements, he concluded that ‘the generally consistent practice which has been analysed is clearly based on the principle that the acquired rights of a concessionnaire must be respected by a successor State’. Yet, O’Connell also admits that ‘it is not immediately clear, however, in what exactly the duty of the successor State consists’. As further discussed below, he believes that the solution very much depends on the type of State

133 O’Connell, ‘Recent Problems of State Succession’ (n 41) 157.
134 Ibid., 156–7:

It is necessary to recognize that the initial step in terminating the contract must be taken in municipal law, for international law does not, and cannot, direct as to when contracts are to be made or to terminate, unless, of course, the governing law of such contracts is international law or the general principles of law – which is a possible but exceptional situation. International law merely protects contractual performance in the case of aliens. It cannot enjoin performance when, under the governing law of the contract, there is nothing to perform, or when one of the parties has ceased to be able to perform. International law, in other words, can only enforce contracts, it cannot make, modify or terminate them. (...) International law does not guarantee the performance of all contracts made between governments and alien companies or individuals. It can, at the most, only protect the bargain to the extent to which the bargain is legally enforceable under its proper law. (...) When subrogation of the contract is achieved by its proper law, then the contract subsists, and international law guarantees the local remedies in the case where the contractor is an alien.

135 Ibid., 158.
136 O’Connell, ‘Economic Concessions’ (n 121) 124.
138 Ibid., 345.
139 Ibid., 346.
140 See, Chapter 12, Section 2.
succession involved given that in the context of a cession of territory the emphasis is put on the ‘legal continuity’, while in the case of annexation it is focused on ‘legal disruption’.

His general conclusion is that ‘there is no justification for assuming a transmission of the contract itself’. Yet, he nevertheless believes in ‘the obligation of the successor State to respect the acquired rights of the contractor’. Thus, while O’Connell recognized that all States (including the successor State) are ‘always entitled to revoke concessions and terminate contracts in virtue of [their] general competence to expropriate against compensation’, they can only do so provided that the payment of a ‘reasonable compensation’ is given to the investor. In fact, he goes as far as to say that ‘compensation is the only obligation which international law imposes on the successor State’. According to him, the general guiding principle is the prevention of unjust enrichment (a concept further discussed below).

O’Connell summarized his argument in his 1970 course at The Hague Academy as follows:

141 O’Connell, State Succession, 1967 (n 15) 346:

in some case, the emphasis is thrust upon legal continuity, as in an orderly grant of independence, or a cession of territory without disruption of local administrative autonomy, or a subrogation of the successor States by treaty or contract. The successor State in these cases remains, or becomes, a party to the contract of concession, and the problem that then arises is whether the concession may, in the eyes of international law, be revoked. Where, on the other hand, the emphasis is upon legal disruption, as in the case of annexation, the subrogation of the successor state in the contract could only occur in virtue of a general devolution of rights and obligations pursuant to thesis of universal succession. If this thesis is rejected, then the successor they may not be regarded as a party to the contract which terminates with the change of sovereignty. In such a case, no question of continuing the contract for the terms of its performance can arise.

142 Ibid., 355.
143 Ibid.
144 Ibid., 347. See also:

The argument in favor of the inherent revocability of concession agreement tends to be a fortiori in the case of successor states, which cannot be compelled to carry-on with arrangements made by their predecessor which are either contrary to their public interest or obstructive of the realization of their own ideas of social development. Change of sovereignty often involves change in the economic structure of the concrete which demand that modifications be effected in the exercise of concessionary rights.

See also: Gruber (n 22) 97–8.
145 O’Connell, State Succession, 1967 (n 15) 349.
146 Ibid., 351.
147 See, Chapter 14, Section 4.
148 O’Connell, State Succession, 1967 (n 15) 352. See also, at 298.
149 Ibid., 348–9. Thus, for him,

The function of the concept of unjust enrichment is to restore the economic balance of the parties as at the date of termination of the contract and therefore ‘if the private contractor has created works of value for
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Suppose that a contract made with a State which loses its sovereignty is to be regarded in law, for reasons that will later be explained, as ceasing to subsist. Is there in this case any acquired right, anything for international law to protect? The answer later to be proposed is that the *equities of the factual situation brought about by the contract do subsist, even if the contract no longer does so, and that they constitute an acquired right.* The extent of the successor State’s obligation towards this right is to be measured by reference to the doctrine of unjust enrichment, which creates a *vinculum juris* between the successor State and the contractor. This *vinculum* may not be recognized in the law of the successor State, which derives from that State’s sovereignty, but is part of public international law as a feature of the general principles of law whereby philosophical propositions are translated into jurisprudence.150

Finally, it should be noted that Bedjaoui has been critical of the approach adopted by O’Connell and believes that there exists, in fact, no such right to compensation in situations *not* involving succession of States.151 For him, ‘there are strong grounds for asserting that (…) there is even less reason for recognizing acquired rights or paying compensation’ in the context of State succession.152

which he has not been fully paid, the benefiting successor State is under an equitable obligation to cover his losses (…)

(O’Connell, *Recent Problems of State Succession* (n 41) 159).

150 O’Connell, *Recent Problems of State Succession* (n 41) 140 (emphasis added).
151 ILC, Second Report Bedjaoui, 1969 (n 4) 86:

It is an established fact that, even where the law is amended without change of sovereignty, acquired rights are not recognized either as situations which are absolutely inviolable or as situations which can never be encroached on without compensation. This is indisputable in the case of nationals, for whom there is not – or is not yet – in international law any rule requiring compensation by their own State. Where aliens are concerned, the tendency is simply to assimilate them to nationals. Compensation is not regarded as a right.

152 Ibid.:

*A priori,* recognizing that a State (any State) has the right, for instance, to nationalize or expropriate, means conceding the lawfulness of the action taken by that State. If the act whereby it abolishes acquired rights is regarded as lawful, how can its refusal to pay any compensation be regarded as unlawful, or, in other words, as engaging its responsibility? If the nationalization measure is conceded to be within the natural competence of the State, it is self-evident that it cannot be a wrongful act. In any event, this takes us out of the sphere of State succession into that of the international responsibility of States. (…) it is thus quite difficult to find any justification for compensation. The ‘right’ to compensation, once its fragile underpinning of acquired rights is removed, is seen to be unsubstantial indeed. In any event, ‘acquired rights’ and ‘right to compensation’ cannot legitimately be linked together by arguing that refusal to recognize the former gives rise to the latter. The abolition of ‘acquired rights’ has its basis in the exercise of a competence which international law does not take away from the successor State. It should not therefore entail the granting of compensation.
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12.08 The debate between O'Connell and Bedjaoui on this question seems less relevant these days. There is now a consensus among writers that the rights and obligations under a State contract are simply not transferred from one State (the predecessor) to another one (the successor State). As a matter of principle, a new State is therefore not bound by a State contract signed by another State.\(^{153}\) According to Crawford, ‘as in the case of all rights acquired under the municipal law of the predecessor State, rights deriving from State contracts and concessions are susceptible to change by the new sovereign’.\(^{154}\) For him, ‘territorial changes of itself neither cancels not confers a special status on private rights, they gain no regulatory or other immunity post-succession’.\(^{155}\) The distinction made in the past between State contracts having a ‘public’ or a ‘private’ character does not seem to be endorsed by modern writers.\(^{156}\)

\(^{153}\) A different position seems to have been taken by Verzijl, t. vii (n 43) 68, stating that ‘it is, and always has been, quite normal for treaties of cession to provide in general terms for the maintenance of vested rights’ arising from concession contracts’. His conclusion (at 72) is that ‘on the strength of the precedents quoted, the conclusion may be drawn that the principle of the maintenance of concessions and comparable State contract would seem to be an old and well-established one and to rank among the ‘general principle of (international) law’ adding that the existence of this principle ‘cannot be destroyed by the regrettable fact that a number of, especially new, nations show an increasing tendency to deny its validity on their acquirement of independence’.

\(^{154}\) Crawford, Brownlie’s Principles of Public International Law (n 58) 432. See also:

it will be appreciated that judicial pronouncements to the effect that that mere change of sovereignty does not cancel concession rights do not give support to the acquired rights doctrine in the form that after the change of sovereignty the new sovereign must maintain the property rights of aliens acquired before the change of sovereignty (ibid.)

See also: Gruber (n 22) 97–8.

\(^{155}\) Crawford, Brownlie’s Principles of Public International Law (n 58) 433.

\(^{156}\) Such a distinction was considered to be relevant by Kaeckenbeeck (n 89) 10–11:

There is a substitution of one state for the other as one of the parties to the legal relation, and the principle of public international law that vested rights are unaffected by a change of sovereignty must here cover such a substitution. This is what also happens in the case of concessions granted to individuals or companies by the ceding state. It was long thought doubtful whether international law required the succeeding state to respect them. Such doubts were all the more explicable because the principle of respect for vested rights was here complicated, not only by a change in the person of the state, but also by the fact that concessions are not pure institutions of private law, but present a mixture of private and public legal characters. According as the private or the public character is thought to prevail, the application or rejection of the rule of respect for private rights appears justified. There is no doubt that the weight of opinion is at present in favour of the obligation to respect concessions, but in view of the considerable public importance which some concessions may have, it would be undue optimism to believe that the debate on this question is for ever closed. (…) But, in my opinion, the gist of the matter is rather that the operation of the principle of respect for vested rights is not checked by a change in the person of the state as long as the private law character of the relation prevails, but it is checked when the public character of the legal relation prevails.

See also: ILC, Fourth Report Garcia-Amador, 1959 (n 53) 10:

Acquired or patrimonial rights are commonly classified as ‘private’ rights. However, the question of their true legal nature arises fairly frequently in both theory and practice because some of the rights in question
noted above, this does not mean that the successor State is entirely free to modify or annul rights and obligations contained in State contracts after the date of succession. Crawford explicitly refers to such existing limitations based on international law, including treatment of aliens (the MST) and human rights law.\textsuperscript{157} As mentioned above,\textsuperscript{158} the successor State should also provide compensation to a foreign investor whenever it expropriates its property.

From all of this, it may be suggested that the question of succession to State contracts is ultimately not an issue that should be resolved under any specific rule of State succession. In fact, it could be tempting to conclude that this is not even a question of State succession. Thus, after the date of succession, the matter seems to be one of general international law involving private rights. The question becomes whether or not the successor State will respect the rights contained in State contracts. If it does not, the actions may be considered as an act of expropriation. International law imposes an obligation to provide proper compensation to the investor. In that context, it could be argued that the obligations of the successor State regarding State contracts are simply not different from those of any other State having to deal with such instruments.

Yet, in my view, it would not be appropriate to conceive this question as being completely detached from the field of State succession. In other words, the matter is not just one of expropriation and compensation. In fact, I believe that the question is much more complex than how it was described above. It cannot be reduced to a general denial of succession to contracts combined with another (also general) obligation to respect basic principles of international law. The rest of this chapter is a modest proposal by the present author putting forward a new general framework of analysis, which will help to determine when a successor State should (or should not) be bound by a State contract.

In my view, this question of succession to State contracts cannot be answered in the abstract and in a mechanical manner. There are no black or white (or yes or no) answers applicable to all cases. As pointed out by O’Connell, ‘the question whether change of sovereignty puts an end to a contract made with the predecessor States is one which can only be answered in the concrete

\textsuperscript{157} Crawford, \textit{Brownlie’s Principles of Public International Law} (n 58) 432.
\textsuperscript{158} See, Chapter 10, Section 3.
At first, this may seem like a rather obvious observation. O'Connell also adds that ‘some of the arguments negating any obligation of successor States with respect to the contracts of their predecessors have been so lacking in intellectual subtlety as to be banal’. What is truly interesting in this respect is his reference to this passage from the *Lighthouse Arbitration* case: ‘It is impossible to formulate a general, identical solution for every imaginable hypothesis of territorial succession, and any attempt to formulate such a solution must necessarily fail in view of the extreme diversity of cases of this kind.’ The arbitral tribunal also noted that ‘[i]t is no less unjustifiable to admit the principle of transmission as a general rule than to deny it. It is rather and essentially a question of a kind the answer to which depends on a multitude of concrete factors’. O’Connell does not however further investigate any of these questions.

In my view, there are indeed a number of situations that can be envisaged whereby the successor State should be bound by a State contract. My proposal is to further develop the basic and very general idea that was briefly mentioned by O’Connell and to apply it specifically to the question of State contracts. The aim is to develop a comprehensive framework of analysis that will take into account the level of complexity that surrounds this issue. This new framework is based on the following two general propositions that will be explained in Chapters 13 and 14.

First, the next chapter will explain that the issue of succession to contracts will essentially depend on the type of State succession at hand (Chapter 13). There is no one-fits-it-all answer. The answer to the question simply cannot be the same considering that in certain cases the predecessor State ceases to exist (dissolution) and in others it does not (secession). Evidently, the fact that, in some instances, no new State emerges (cession, integration) must have an impact on the outcome of the survival of contracts. These distinctions are examined in detail below.

Second, the answer to the question of succession to contracts may not be the same depending on a number of different circumstances and factors prevailing
in each case (Chapter 14). In his book, O'Connell identified the principle of unjust enrichment as one important factor that should be taken into account when deciding whether or not the successor State (or in the case of dissolution, which of them) should be responsible for providing compensation under a State contract signed by another State. This is accurate. In fact, in Chapter 14, I will show that many different factors (including the principle of unjust enrichment) should be taken into account in order to determine whether the transfer of any rights and obligations arising from a contract to a new State is justifiable in contemporary international law.