13.3.1 Introduction

Arbitration has played an important role in the elaboration of the legal system applicable to the agreements related to the exploitation of hydrocarbon resources. In this respect, the accumulated wealth of the reported arbitral awards covers a period of over half a century, starting in 1951-53 with the emergence of the first two decisions adjudicating disputes. These concerned the interpretation of two classical concessions granted during the colonial era by the Abu Dhabi Ruler and by the Ruler of Qatar.

The constructive effects of the arbitral precedents multiplied throughout the following five decades, covering various aspects and extending to new types of relationships. These include the recent forms of cooperation agreements between the authorities of the host countries and the foreign entities – mainly belonging to transnational corporations or joint multinational ventures – established to undertake technologically sophisticated, huge oil and gas projects either onshore or offshore.

A comprehensive chronological survey of the arbitral awards rendered in the field of petroleum resources leads to the regrouping of available data into four categories:

- The awards pertaining to the proper interpretation of the first generation of concession agreements. These include the Abu Dhabi award (1951), the Qatar award (1953) and the Aramco award (1958).
- The awards relating to the confrontation period, in which certain host states undertook a policy of abstaining from participating in the arbitration proceedings. This was triggered by the state’s unilateral act of bringing to an end the concessionary relationship. This category covers the Sapphire decision against Iran (1963), as well as the three Libyan cases: BP (October 1973), Texaco (January 1977) and Liamco (April 1977).
- The awards rendered with regard to the impact of concession agreements belonging to the second generation which became subject to arbitral proceedings. These proceedings were marked by full participation of the host state’s authorities in front of properly constituted arbitral panels and with the assistance of able foreign counsels. Positive legal contributions were obtained under such balanced circumstances as a result of adequately pleaded cases. This third category is illustrated by the rulings rendered during the following years either by eminent International Chamber of Commerce (ICC) arbitrators or by equally qualified International Centre for Settlement of Investment Disputes (ICSID) panels (such as in AGIP v. Congo, Case No. ARB/77/1). The case law emerging in the field of petroleum arbitration matured in the detailed reasoning elaborated by the Amin oil Tribunal (1982), and continued to develop in the findings of the Iran/USA claims Tribunal which dealt with the various petroleum claims submitted thereto (1983/1987). It was further developed in the Sunoil case (1985/1987) as well as in the unanimous award rendered in the ICC Grace Petroleum case (1995).
- The fourth and last category is marked by the gradual appearance of a new type of dispute of a more functional nature. These are the disputes opposing the economic interests of public entities contractually committed to provide the natural resources needed within the context of joint operating agreements. These agreements were concluded with the private foreign entities for the exploitation of publicly-owned natural resources and/or the production and supply of electricity power under long-term Build, Operate, Transfer
(BOT) or similar types of production sharing or profit-sharing agreements. The basic particular characteristics of the awards adjudicating disputes within the context of such new types of relationships can be ascertained by focusing on the awards rendered during the last decade. These include instances such as the Wintershall case against the Qatari authorities (1988), Himpurna California Energy, and Patuha Power cases against the Indonesian authorities (1999), as well as in the Karaha Bodas case which equally concerned Indonesia (1999/2000).

The salient features of the aforementioned four categories of arbitral awards are explained below following the same order. For each category there is a sufficient description of the main characteristics together with a summary of the related solutions adopted.

13.3.2 The arbitration precedents pertaining to the interpretation of the classical colonial type of concession agreements

A concession agreement was concluded in 1939 between the Sheik of Abu Dhabi – placed under the British Protectorate – and the Petroleum Development (Trucial Coast) Limited Company. The concession area was described in art. 2 to include “the whole of the lands which belong to the Ruler of Abu Dhabi and its dependencies and all the islands and the sea waters which belong to that area”. Art. 17 provided that: “the Ruler and the company both declare that they intend to execute this agreement in a spirit of good intentions and integrity and to interpret it in a reasonable manner”.

The agreement provided equally that in case of controversy between the two parties, the said controversy had to be settled through arbitration by an umpire appointed by the British Political Resident in charge of the external relations of the Protectorates in the Gulf area.

When issues were raised in 1949 about whether the agreement transferred to the company the right to extract mineral oil from the subsoil of the seabed subjacent to the territorial sea of Abu Dhabi and into the submarine area lying outside the territorial waters (i.e. what became known from 1945 as the “continental shelf”), Lord Asquith of Bishopstone was appointed as umpire in charge of rendering a binding award on the proper interpretation of the territorial scope of the agreement as provided for in art. 2.

In his decision of September 1951, the British Lord rejected the prima facie assumption of the applicability of the law of Abu Dhabi on the grounds that the prevailing Islamic legal traditions were not feasibly applicable to modern transactions. After operating such a negative ‘choice-of-law’, the umpire relied on art. 17 of the agreement in order to base his decision on what he called “principles rooted in the good sense and common practice of the generality of civilized nations” – a sort of ‘modern law of nature’, which in final analysis was embodied in the rules of English law.1

Lord Asquith’s dogmatic a priori elimination of the Islamic law as applicable in Abu Dhabi, under the pretext of a pseudo negative choice-of-law, was largely considered an insult by the Arab jurists, who still – after five decades – invoke that “bad precedent” from time to time to demonstrate the existence of an inherent bias against Islamic law within the western legal community.2

However, it has to be emphasized that, in all fairness, the line of reasoning used in the Abu Dhabi decision of 1951 was not integrally followed two years later by Sir Alfred Bucknill acting as a referee in the sister Qatar case (1953).

The starting point for Sir Alfred Bucknill was to envisage what was “the mental intention of the parties as it exited at the time of contracting”. The referee’s attempt to detect the parties’ tacit intention in the light of all relevant circumstance led him to conclude that: “there is nothing in the Principal or Supplemental Agreements which throws a clear light upon the intention of the parties on this point.” Therefore, he decided in favour of determining the applicable law in reliance upon objective criteria based on the nature of the contract, its main characteristics objectively pointing to, “Islamic law […] being the appropriate law”.3

However, after considering the legal opinions submitted to him by professor Milliot of Paris and professor Anderson of London, both experts in Islamic law, Sir Alfred Bucknill indicated that both experts “agreed that certain parts of the contract, if Islamic

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1 International Law Reports referred to hereinafter as ILR, vol. 18, pp. 145 ff.
2 What mostly hurt the sensitivity of the Arab Jurists was the strong language used by Lord Asquith in dismissing the possibility of applying Abu Dhabi Law by saying “[…] no such law can reasonably be said to exist. The Sheik administers a purely discretionary justice with the assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments” (ILR, vol. 18, p. 61).
law was applicable, would be open to the grave criticism of being invalid”. 4

Hence, in order to maintain the validity of the agreement, the referee in the Qatari case considered that “neither party intended Islamic law to apply”, and considered appropriate the reference to “general principles of law” as applicable guidance.

The painful exclusion of the Islamic law as a possible source of solutions in both the Abu Dhabi and Qatar arbitrations, related to the construction and interpretation of Middle Eastern petroleum concession agreements, was not repeated in any subsequent cases.

Starting with the Aramco/Saudi award of 1958, the said integral exclusion was avoided, since the arbitration agreement of 23 February 1955 provided explicitly in art. IV that the Saudi Arabian law governs “matters within the jurisdiction of Saudi Arabia”, specifying that Saudi Arabian law “is the Muslim law (i) as taught by the school of Imam Ahmed Ibn Hanbal; (ii) as applied in Saudi Arabia”.

Accordingly, the Aramco arbitral Tribunal (composed of Swiss President G. Sauser-Hall, and two Egyptian arbitrators, Mohamed Hassan and Saba Habachi) encountered no difficulty in arriving at the following two basic conclusions: “The Concession Agreement of 29 May 1933 derives its judicial force from the legal system of Saudi Arabia”; “The Concession Agreement is [...] the fundamental law of the parties [...] it fills a gap in the legal system of Saudi Arabia with regard to the oil industry [...]. The concession has the nature of a constitution [...] conferring acquired rights on the contracting parties”.

Nevertheless, as the dispute under consideration related to the interpretation of art. 1 of the concession agreement which provided for granting an “exclusive right, for a period of sixty years [...] to transport, deal with, carry away and export petroleum”, and as Aramco claimed that the agreement concluded in 1954 between Onassis and Saudi Arabia infringed the said exclusive right granted under the concession agreement of 1933, the arbitral Tribunal was bound to seek what system or rules of law governed the arbitration itself. That is, the nature of the concession itself and the extent of the rights conferred thereunder as duly construed in conformity with the appropriate canons of interpretation.

In order to accomplish all these tasks, the arbitral Tribunal adopted inter alia the following three basic rules which became constantly taken as a source of inspiration for a great number of subsequent arbitral awards. These rules were formulated in the following terms:

• “In so far as doubts remain on the content or on the meaning of the agreements of the parties, it is necessary to resort to the general principles of law and to apply them in order to interpret, and even to supplement, the respective rights and obligations of the parties”.

• “Law must, in case of need, be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notions of pure jurisprudence [...]”.

• “Lastly, the Tribunal holds that public international law should be applied to the effects of the Concession, when objective reasons lead it to conclude that certain matters cannot be governed by any rule of the municipal law of any state, as is the case in all matters relating to transport by sea, to the sovereignty of the state over its territorial waters and to the responsibility of the state for the violation of its international obligations”.

Faced with a situation in which there was no claimant and respondent in the technical procedural sense, dealing with a dispute pertinent to an abstract construction of legal issues, the Aramco Tribunal had to render an award of a declaratory nature. In this respect, the main lessons emerging from the award can be summarized as follows: a) within the context of the said dispute – Aramco v. Saudi Arabia – the law governing the arbitration itself, i.e. the lex arbitri, was international law, and not the law where the arbitral proceedings took place. In this way, the award was not subject to the control of the Swiss Courts and needed no registration against payment of fiscal charges; b) in the absence of a lex fori properly speaking in the field of transnational arbitration, and in order to adjudicate the pending legal issues in dispute, the arbitral Tribunal, in view of determining the applicable choice-of-law rules, started by declaring that it was “influenced by the most progressive teachings in that part of private international law which deals with the autonomy of the will”. Accordingly, the Tribunal decided “to follow the solutions prevailing in British and Swiss practice and to apply the law which corresponds best to the nature of the legal relationship between the Parties”.

Thus, the Aramco Tribunal arrived at the decision to apply cumulatively the English and the Swiss conflict-of-law systems which both relied upon objective considerations for the purpose of localizing the contractual relationship. In addition, it declared the applicable “proper law” to be “the law of the country

4 Looking for a reasonable solution, and invoking lex validitatis as a basic argument, the referee proceeded by formulating the following proposition: “I cannot think that the Ruler intended Islamic law to apply to a contract upon which he intended to enter, under which he was to receive considerable sums of money, although Islamic law would declare that the transaction was wholly or partly void”.

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with which the contract has the closest natural and effective connection" - particularly taking into consideration "the economic milieu where the operations are to be carried out"; c) after undertaking a lengthy analysis according to the declared comparative law method of characterization adopted by the Tribunal, the ‘public contract’ characterization of the 1933 concession agreement was dismissed on the basis that the Saudi law does not possess a body of administrative law comparable to the French system; and d) finally, in all matters where the vested contractual rights of Aramco could not be affected unilaterally by the Saudi public authorities, such as the imposition of restrictions on the freedom of maritime transportation by sea going beyond the state’s territorial waters, the case was to be construed by the arbitral Tribunal. For the Aramco award, the responsibility resulting from that violation of rights secured under the concession agreement was accordingly to be governed by international law, and not by the Saudi domestic law.\(^5\)

13.3.3 The different solutions provided for under the arbitral awards rendered in absentia against an expropriating host state

The Aramco award marked a decisive step in the history of petroleum arbitration as well as a definitive improvement from the point of view of legal analysis in comparison with its predecessors, the Abu Dhabi award and the Qatar award rendered within the post-colonial context. However, the Government of Saudi Arabia reacted vigorously on that occasion by adopting a decree prohibiting the conclusion of any future arbitration clause or agreement, except with the approval of the Council of Ministers headed by the King himself on a case to case basis.

The negative Saudi reaction towards the Aramco award could be considered the first sign of a general hostile attitude adopted by certain future members of the Organization of Petroleum Exporting Countries (OPEC) that, during the following era, manifested their distrust in the integrity of the arbitration process by refraining to comply with the arbitration clauses inserted in the agreements they previously concluded with the foreign companies, and by boycotting the arbitral proceedings engaged against them. This was particularly the case of Iran in the Sapphire arbitration case (1963), and of Libya in the three arbitration cases (BP, Texaco, and Liamco) in the years 1973-77.

The National Iranian Oil Company (NIOC)/Sapphire oil development agreement was concluded on 16 June, 1958, following the standard second generation agreements according to which the two parties become partners in a joint undertaking for the prospecting and exploration of oil.

During the first period of exploratory operations and prospecting, the Canadian company Sapphire was to bear all the expenses, and only after the discovery of commercially-exploitable oil field, the two parties were to share in the expenses. The previous expenses of Sapphire were to be reimbursed and the net profit was to be divided, allotting 25% of the profit to the foreign company and 75% to NIOC and to the Government of Iran. Before the discovery of oil, NIOC objected to the plan of operations submitted by Sapphire, and the dispute escalated in a manner that led NIOC to terminate the 1958 agreement in 1961.

In implementing the arbitration clause provided for in the agreement, Sapphire requested the President of the Swiss Federal Tribunal to choose a sole arbitrator to adjudicate the dispute. Swiss Federal Judge Cavin was appointed in spite of NIOC’s objection, and the sole arbitrator heard the dispute without the participation of NIOC.

The award rendered by Judge Cavin on 15 March, 1963, had the following basic characteristics:

- Contrary to the Aramco case, the sole arbitrator subjected the procedures to the domestic procedural laws applicable in the Swiss Canton of Vaud, as Lausanne was the place where the case had been heard.
- Attracted by the old colonial negative choice-of-law approach of Lord Asquith in order to justify excluding the application of the host country’s domestic legal system, the Swiss sole arbitrator decided to freely “determine which system of law should best be applied according to the evidence of the parties’ intention and in particular the evidence to be found in the contract”. In this respect, he indicated that, in spite of the fact that “the lex loci contractus and the lex loci executionis both point to the application of Iranian law”, the opposite point of view should be adopted because “the present agreement is fundamentally different from the usual commercial contract envisaged by the traditional rules of private international law”.
- Thereafter, Judge Cavin tried to formulate a general proposition according to which a special conflict-of-law rule had to be envisaged with regard to the category of ‘development agreements’ in view of protecting the foreign private party from the outright application of the host country’s domestic legal system. More

\(^5\) ILR, vol. 27, pp. 117 ff.
specifically, he ascertained that the mere presence of an arbitration clause implies “a negative intention, namely to reject the exclusive application of Iranian law”, and that the contractual provision according to which the parties undertake to carry out their obligations in good faith has to be construed as evidencing “the intention of the parties not to apply the strict rules of a particular system, but rather, to rely upon the rules of law, based upon reason, which are common to civilized nations”.

- By construing the 1958 agreement as having been intended to be governed by “general principles of law”, the Swiss arbitration held on the merits that NIOC refused to cooperate properly with Sapphire, thus violating the generally recognized rule of *pacta sunt servanda*, and decided that such breach gave rise to the right to pecuniary compensation through allocation of damages covering both the loss suffered (*damnum emergens*) and the profit lost (*lucrum cessans*).

According to the sole Swiss arbitrator, in spite of the fact that Sapphire had ceased activities in the concession area before oil had been found, there had been a strong chance of finding oil, which justified awarding compensation for the “loss of chance”, in reliance on certain European and American precedents.6

About a decade later, events that took place in Libya enriched the legal literature pertaining to petroleum arbitration awards as a result of the differences in approach among three eminent jurists. Each of them acted as a sole arbitrator appointed by the President of the International Court of Justice (ICJ) in one of the three cases involving the nationalization by the Libyan Government of foreign interests previously established in the country for the exploitation of the national petroleum resources. In the three cases the state of Libya and its agencies declined to participate in the arbitral proceedings which were conducted *in absentia*.

The common features characterizing the three instances derive from the fact that the Legal Libyan system was – since the beginning of the 1970s – already in possession of a sufficiently mature modern petroleum legislation composed of standard dispositions which provided adequate rules governing all agreements concluded thereunder; i.e. exactly the opposite of what existed by the middle of the century under the old legal environment that marked the three awards rendered in the *Abu Dhabi, Qatari* and *Aramco* cases.

According to the legal system in place, various concessions were granted following the model contract annexed to the text of the Libyan Law No. 25/1955 on petroleum, which was later amended. These amendments were incorporated into the existing agreements in order to provide equal treatment among the petroleum companies operating in Libya.

More precisely, clause 16 of the model contract as amended in 1966 stipulated: “the Government of Libya will take all steps necessary to ensure that the company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties”.

The model clause continued by ascertaining that: “the concession shall throughout the period of its validity be construed in accordance with the petroleum law and the regulations in force on the date of execution of the agreement of amendment by which this paragraph (2) was incorporated into this concession agreement. Any amendment to or repeal of such regulations shall not affect the contractual rights of the company without its consent”.

Over and above the said “stabilization clause” explicitly provided for in all Libyan concession agreements, the amended model contract contained a choice-of-law provision which reads: “this concession shall be governed by and interpreted in accordance with the principles of the law of Libya common to the principles of international law and in the absence of such common principle then [governed] by and [interpreted] in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals”.

All the concession agreements equally contained an arbitration clause according to which, in case the two parties’ appointed co-arbitrators fail to agree on the third presiding arbitrator, the appointing authority in charge of accomplishing this task is the President of the ICJ.

In the light of the above-stated legal and contractual background, Judge Lagergren of Sweden was named by the President of the ICJ as sole arbitrator adjudicating the *British Petroleum (BP)* case in which the Government of Libya declined to participate. The cause of action was Libya’s expropriation in 1971 of BP’s holdings in reaction to certain political conduct of the United Kingdom (UK) in the Persian Gulf (dispute about the sovereignty over three islands).

Since the sole arbitrator had chosen Copenhagen as the seat of arbitration, he refused to follow the *Aramco* precedent of submitting the arbitral procedures to international law. Judge Lagergren decided that the procedural law of the arbitration had to be Danish law

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6 *ILR*, vol. 35, pp. 136 ff.
as it was the law of the Tribunal’s seat, pointing out that such lex arbitri would enhance the effectiveness of the award rendered.

With regard to the substantive legal issues, Judge Lagergren confirmed the rule according to which: “if the parties to the agreement have not provided otherwise, such an arbitral Tribunal is at liberty to choose the conflicts-of-law rules that it deems applicable, having regard to all the circumstances of the case”.

At the same time, the sole arbitrator relied exclusively upon the domestic law characterization, as stated in the legal opinion submitted by BP’s Libyan law consultant, according to whom: “concession contracts under Libyan law are considered to belong to the category of administrative contracts”.

Judge Lagergren construed the wording of the standard clause 28/7 governing all Libyan concessions as providing for a two-tier system of applicable bodies of law. In the first place, reference has to be made to “the principle of law of Libya common to the principles of international law” and in the second instance, a subsidiary reference is made to the “general principle of law, including such of those principles as may have been applied by international tribunals”.

Hence, the BP arbitrator refused to accept both “the submission that public international law applies”, as well as the argument according to which “BP concession itself constitutes the sole source of law controlling the relationship between the parties”.

Accordingly, Judge Lagergren proceeded by the analysis of both Libyan law and international law and arrived at the conclusion that Libya had acted in violation of both Libyan law and international law by unilaterally terminating the existing agreement.

However, with regard to the appropriate remedy, the BP arbitrator considered that Libyan law was not certain as to whether BP was entitled to specific performance and restitution in integrum. Facing such uncertainty, the careful review of international law on this point led him to the conclusion that Libya was only liable to pay damages.7

Totally opposite conclusions were adopted in the second Libyan arbitration case, usually referred to as Topco/Texaco, in which the sole arbitrator appointed by the President of the ICJ was the late French professor René-Jean Dupuy who rendered his award on 19 January, 1977, with the Government of Libya not participating in the arbitral proceedings which took place in Geneva.

The measures undertaken by the Libyan Government against the Texaco Group initially derived from a partial nationalization decree8 issued on 1 September, 1973 according to which 51% of all the properties, rights and assets of companies were expropriated and transferred to a Libyan public sector company. Few months later, another decree dated 11 February, 1974, extended the taking of property to cover the remaining portion of the Texaco Group’s rights and assets.

Contesting the legality of the said measures, the members of the Texaco Group invoked the arbitration clause contained in all the concession agreements affected by the Libyan measures.

In a preliminary award of 27 November, 1975, professor Dupuy dealt with the issue of his jurisdiction. He ruled that according to the generally accepted rules, an arbitrator has the power to decide on his own jurisdiction, and that an arbitration clause is not invalidated by a unilateral repudiation of the agreement concerned by one of the contracting parties.

Professor Dupuy’s final award concerning this matter, rendered more than twenty months later, on precisely 19 January, 1977, differed radically from the BP award with regard to the following points:

• Concerning the law governing the arbitration, the Texaco arbitrator decided that international law alone governed that issue, pointing out that the involvement of a state as a party made it inappropriate to choose the law of the seat of the Tribunal and that possible problems arising out of the enforcement of the award were not within the concern of the arbitrator.

• Professor Dupuy adopted the doctrinal distinction between the law governing the contract and the legal order from which the contract derives its validity. He concluded in this respect that the law from which the contract stemmed its binding nature was international law and not any domestic legal order.

• Based on a comparative analysis of major legal systems, and not confined to one specific legal system such as the French system, the Texaco arbitrator refused to consider the concept of contrat administratif reflecting a “general principle of law” which is “sufficiently widely and firmly recognized in the leading legal systems of the world”. On the other hand, he invoked the presence of the “stabilization clause” provided for in clause 16.e of the Libyan petroleum concessions, deeming the state of its prerogatives to unilaterally amend the terms and conditions of the concession agreement to consider this as

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negation of the clauses exorbitants du droit commun which constitute a necessary element to confer upon the relationship the character of contrat administratif.

• Professor Dupuy’s analysis of the notion of permanent sovereignty over natural resources as expressed in the various resolutions of the United Nations General Assembly had not affected the traditional customary international law rules pertaining to expropriation. Therefore, the continuing validity of the concessions had to be assumed and the appropriate remedy was restitutio in integrum in the light of the contractual clauses contained in the concessions.9

The third case relates to the Libyan nationalization of Liamco’s concessions resulting from the application of the 1973 decree (covering 51% of the holdings) and the subsequent 1974 decree (covering the remaining 49%) and raised almost identical legal issues in comparison to the aforementioned Topco/Texaco case.

Nevertheless, the award rendered in Geneva on 12 April 1977 by Dr. Sobhi Mahmassani of Lebanon, the sole arbitrator appointed by the President of the ICI, arrived at certain conclusions which are basically different from those provided for in the two preceding BP and Texaco awards. The main particularities of dr. Mahmassani’s reasoning can be summarized as follows:

• In determining the Tribunal’s rules of procedure, the Liamco arbitrator took a completely different approach by choosing to apply the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules. Thus, he avoided engaging himself in the controversy of advocating the direct submission to international law (Aramco and Texaco cases), or to the domestic law of the country where the seat of arbitration is located (Sapphire and BP cases).

• With regard to the characterization of the petroleum concession agreements, dr. Mahmassani opted for a midway solution which reconciled the “predominantly contractual nature” of the deed that, in the same time, “partakes of mixed public and private legal character”.

• The sole Liamco arbitrator relied, to a great extent, on Libyan law in general and Islamic law traditions in particular, to demonstrate the existence of rules and principles common with the principles of international law – either in relation to the legality of the recourse to arbitration, or to sustain the balance between the sanctity of contracts and the safeguard of the public interests. In adjudicating the dispute among the parties in this respect, dr. Mahmassani departed from the concept of total ‘internationalization’, considering that the relevant clause of the concession agreements should be interpreted as merely “excluding any part of the Libyan law which is in conflict with the principles of international law”; thus arriving at the conclusion that Libya’s nationalization was not discriminatory and, therefore, when accompanied by adequate compensation had to be considered lawful.

• Regarding the remedies available, the Liamco arbitrator’s constant line of reasoning led him to rule against the possibility of ordering restitutio in integrum, as it would be “against the respect due for the sovereignty of the nationalizing state”, and also since it would be encountered by an impossibility of performance. Hence, the only remedy available had to be the allocation of pecuniary compensation for the damages sustained.10

Taking into consideration all that has been previously stated, the comparative evaluation of the theoretical reasoning manifested by the sole arbitrators in awards rendered in absentia of the respondent state, represents only part of the reality.

A comprehensive assessment of the effective role which the three BP, Texaco and Liamco awards played in practice requires emphasizing that none of these awards were enforced as such. Invariably, the claimant companies concluded settlement agreements with the Government of Libya, accepting only a fraction of the results obtained in the arbitral proceedings.11

This final result demonstrates the realistic limited impact of the said awards, in spite of the great effort undertaken throughout those arbitrations by the foreign companies to protect their activities against the risk of having the authorities in the host countries exercising unilateral regular powers affecting the stabilization clause. This clause was initially inserted in long-term agreements in order to preserve the contractual balance between the rights and obligations of both parties.

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9 International Legal Materials, referred to hereinafter as ILM, vol. 21, pp. 976 ff.
11 As reported in the Encyclopedia of public international law published under the direction of prof. Bernhart, the BP case was ultimately settled out of Court by an agreement reached on November 20, 1974 (vol. I, p. 506); with regard to the Texaco case “the parties settled their claims by an agreement entered into in September 1977”, (vol. III, p. 218); and concerning the third case “Liamco entered into a compensation Agreement with Libya in March 1981” (vol. III, p. 211).
13.3.4 Case law concerning disputes emerging under the second generation of petroleum agreements

It has to be recalled that profound transformation in energy economics produced a series of crises which permitted the OPEC countries to accelerate bringing to an end the era of relatively cheap and stable ‘posted prices’ that previously gave the upper hand to the major oil companies.

The events marking the post-October 1973 war created a new economic and political reality adequately reflected in legal terms as a manifestation of what an eminent jurist called l’ivresse de la souveraineté, permitting the OPEC members to radically change the structure of the petroleum industry.12

Within this new context and the subsequent implications that took place in other parts of the world – particularly with the Iranian Islamic Revolution and the fall of the Soviet empire – both the nature and the territorial scope of the petroleum arbitration cases greatly changed. New types of disputes emerged outside the Middle East in a variety of subjects going far beyond the traditional pattern of disputes between the authorities of the host country and the foreign transnational giants.

The reported arbitral awards of the last three decades demonstrated the magnitude of the change that materialized in both the Afro-Asian countries and the successors of the former Soviet Union.

One of the early illustrations of this new reality is the arbitration conducted under the auspices of the ICC arbitration rules (Case Nos. 3099 and 3100). These were between an Algerian state enterprise and an African state enterprise. In an award rendered in Lausanne and dated 30 May, 1979, the panel composed of three professors (Swiss President Robert Patry, and Naguya Ndila and Ahmed Mahiou as co-arbitrators) was called to adjudicate a dispute caused by the non-payment of amounts due as penalties, damages and interests under two contracts for the sale of refined oil products and crude oil. The respondent invoked the force majeure clause contained in art. 18 of the contracts – on the basis that the Central Bank of the buyer’s country did not authorize the payments.

The arbitral Tribunal arrived at the conclusion that the concept of force majeure requires the presence of the three characteristics, “externality, unavoidability and unforeseeability”. With regard to the last element, the Tribunal noted that “the foreign exchange regulations were already in force at the moment that the two sales contracts were concluded”, and hence the buyer could not invoke as force majeure his own failure to obtain the required authorization “either at the moment the contracts were concluded, or at the latest before taking delivery of the refinery products or the crude oil”.

Not only did the arbitral Tribunal allocate compensation for damages and interest under the rules of the applicable law, but it equally took into account the losses suffered as a result of “the depreciation of the American dollar” within the time limit requested. This was particularly taken into account since the seller had in the meantime to borrow US dollars bearing interest to make up for the buyer’s non-payments.13

Within a different context, the first ICSID arbitration case related to petroleum involved Agip (Italy) opposing the Government of Congo which nationalized the oil products distribution sector in January 1974, and transferred to a state corporation the assets of a company established in 1962 under Congolese law and in which Agip held 90% of the shares.

In implementing an arbitration clause contained in a protocol of agreement according to which the Government undertook certain guarantees, Agip filed an arbitration request to ICSID on 30 November, 1979. A panel of three arbitrators (Jogen Trolle, acting as Chairman, René-Jean Dupuy and Fuad Rouhani, as co-arbitrators) rendered an award which focused on the legality of the measures undertaken by the Congolese Government both under the domestic law and international law. This was as art. 15 of the relevant agreement provided that the applicable law should be the Congolese law supplemented by the principles of international law.

Particular emphasis was given by the arbitral panel to the legal effect of the “stabilization clause” freely accepted by the Government at the time when it concluded the agreement with Agip. According to the unanimous award rendered by the arbitral panel, the insertion of such a clause did not essentially affect the state’s sovereign legislative and regulatory powers, but simply entailed “that changes in the legislative and regulatory arrangements stipulated in the agreement cannot be invoked against the other contracting party”.

Hence, the arbitral panel arrived at the conclusion that the act of nationalization – which occurred in violation of the said clause – had to be considered irregular under international law, and consequently: “the Government must compensate AGIP for the

12 The expression is due to professor Combacau, in the introduction he devoted to the French Society International Law Colloquium of Caen 1975 addressing: La crise de l’energie et le droit international. 13 Yearbook, vol. VII, pp. 87 ff.
damage it suffered from the nationalization, particularly in respect of the value of its share of the company’s capital and the amount paid by AGIP, or potentially payable by it, in its capacity as guarantor, corresponding to the participation”.

With regard to the determination of the quantum of the compensation due, the Agip arbitral panel relied exclusively on the rules of the Civil Code as applied in the state of Congo. Essentially, attention was paid to the basic rule of art. 1149 which included both the loss suffered (damnum emergens) and the loss of profits (lucrum cessans), as well as the allocation of interest calculated on the basis of arts. 1153 and 2028 of the Civil Code.\textsuperscript{14}

In implementing an arbitration agreement, concluded on the 23 July 1979 between the Government of Kuwait and the American Independent Oil Company, an ad hoc arbitration that took place in Paris marked a decisive step in establishing a general pattern within the context of host country/foreign company relationships emerging under the second generation of petroleum concession agreements.

The award rendered – after extensive pleadings from the lawyers of both parties – on 24 March, 1982 by three eminent jurists (professor Paul Reuter of Paris University as Chairman, Sir Gerald Fitzmaurice, the former President of the ICI, as co-arbitrator, and professor Hamed Sultan of Cairo University, as co-arbitrator) in what is commonly known as Aminoil case, provided valuable contributions on a variety of subjects.

The salient aspects ruled upon can be summarized as follows:

- The arbitration agreement provided that, unless otherwise agreed by the parties, and subject to any mandatory provision of the procedural law of the place in which the arbitration was to be held, the Tribunal was empowered to prescribe the procedure applicable to the arbitration “on the basis of natural justice and of such principles of transnational procedure as it may find applicable”. Accordingly, the Tribunal adopted its own rules of procedure, and these rules were not challenged by either party. With regard to the law governing the substantive issues between the parties, the arbitration agreement merely indicated that it was left to be determined by the Tribunal “having regard to the quality of the parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world”. The Tribunal asserted as a matter of principle that the law of Kuwait applied to many of the matters involved, and at the same time it emphasized that established public international law, including the general principles of law, formed part of the law of Kuwait as provided for in the Kuwaiti Constitution.

- With regard to the characterization of decree law No. 124/1977 which ordered the termination of Aminoil’s concession, the reversion of Aminoil’s assets to the state of Kuwait, and the payment of “fair compensation” to the company, the Tribunal did not hesitate to consider such a legislative act as an exercise of the state’s right to nationalize. Indeed, after taking all relevant factors into consideration, the Tribunal concluded that Kuwait’s “take-over” did not possess any confiscatory character.

- Furthermore, the Aminoil award introduced two basic contributions in the field of the applicable rules pertaining to the conciliation between: firstly, the said legitimate exercise of the right to nationalize; and secondly, the fundamental principle of \textit{pacta sunt servanda}, particularly in presence of a “stabilization clause”. The first fundamental rule relates to the ‘mutability’ of the concession agreement clearly expressed in the following terms: “while attributing its full value to the fundamental principle of \textit{pacta sunt servanda}, the Tribunal has felt obliged to recognize that the contract of concession has undergone great changes since 1948; changes conceded – often unwillingly, but conceded nevertheless – by the company. These changes have not been the consequence of accidental or special factors, but rather of a profound and general transformation in the terms of oil concessions that occurred in the Middle-East, and later throughout the world. These changes took place progressively, with an increasing acceleration, as from 1973. They were introduced into the contractual relations between the Government and Aminoil through the play of art. 9, or else as the result of at least tacit acceptance by the company, which entered neither objections nor reservations in respect of them. These changes must not simply be viewed piece-meal, but on the basis of their total effect – and they brought about a metamorphosis in the whole character of the Concession” (para. 97 of the award). Secondly, taking into account what the Aminoil award characterized as “a change in the nature of the contract itself, brought about by time, and the acquiescence or conduct of the parties”, the Tribunal favoured a restrictive interpretation of the stabilization clause provided for in the initial concession of 1948 and in the supplemental agreement of 1961. It did this by stating in paras.

\textsuperscript{14} Yearbook, vol. VIII, pp. 133 ff.
94, 95 and 96: a) “the case of nationalization is certainly not expressly provided against by the stabilization clauses of the concession”; b) “a limitation on the sovereign right of the state is all the less to be presumed where the concessionaire is in any event in possession of important guarantees regarding its essential interests in the shape of a legal right to eventual compensation”; c) “if the Tribunal thus holds that it cannot interpret Articles 17 and 7(g) – revised 11 – as absolutely forbidding nationalization, it is nevertheless the fact that these provisions are far from having lost all their value and efficacy on that account, since, by impliedly requiring that nationalization shall not have any confiscatory character, they re-inforce the necessity for a proper indemnification as a condition of it”.

- With regard to the quantum of the compensation due as a result of a lawful nationalization, the Aminoil Tribunal primarily excluded the claim for a sum equivalent of restitutio in integrum and opted in favour of allocating what constitutes an “appropriate compensation” in the light of all the relevant circumstances of the case. In two important paras. 148 and 154, the Tribunal formulated its ruling in the following terms: “both parties to the present litigation have invoked the notion of ‘legitimate expectations’ for deciding on compensation. That formula is well-advised, and justifiably brings to mind the fact that, with reference to every long-term contract, especially involving an important investment, there must necessarily be economic calculations, and the weighing-up of rights and obligations, of chances and risks, constituting the contractual equilibrium. This equilibrium cannot be neglected – neither when it is a question of proceeding to necessary transformations, marked by a series of gradual de facto nationalizations of the entire sector, bringing to an end all previous agreements as well as practical arrangements that existed at that time.

- Finally, it has to be noted that the Aminoil Tribunal was concerned with achieving a ‘realistic’ evaluation, taking into account that the owners of Aminoil were entitled to get an amount of compensation capable of generating a purchasing power – if reinvested elsewhere in 1982 when the award was rendered – comparable to that which they would have obtained in 1977 at the time of nationalization.

In search of such equitable a solution, the Tribunal allocated to Aminoil not only a rate of interest amounting to 7.5%, but equally an inflation factor of 10%; i.e. an annual increase of 17.5% as of the date when the take-over took place in 1977.15

Without entering into the particularities of each case among those submitted to the jurisdiction of the Iran/United States claims Tribunal in the field of petroleum related activities, a comprehensive survey of the case law established by Chambers Two and Three of the Tribunal, clearly indicates the influence exercised in this respect by the Aminoil award of March 1982. It also indicates the extent to which the solutions adopted by Aminoil’s three arbitrators paved the way for further elaborations – meeting the requirements of the special circumstances caused by the Revolution in Iran. In fact, the latter led to radical transformations, marked by a series of gradual de facto nationalizations of the entire sector, bringing to an end all previous agreements as well as practical arrangements that existed at that time.

The relevant major achievements of the Iran/United States claims Tribunal can be summarized as follows.

Within the process of adjudicating the Amoco International Finance case, Chamber Three (composed of the late professor Virally as Chairman, Brower and Ansari as members) started by stating that

15 ILM, vol. 21, pp. 976 ff.
the legality of an expropriation had to be determined by international law – namely, the 1955 Treaty of Amity between the United States and Iran – with the rules of customary international law filling in lacunae in the Treaty, ascertaining the meaning of undefined terms, or aiding the interpretation of certain provisions.

After deciding that contract rights included compensation, the Tribunal emphasized the distinction between lawful and unlawful taking – indicating that in the first case, compensation had to be assessed according to the value of the rights on the date of the taking. However, in the latter case, restitution could be claimed and any increase in the value between the date of the taking and the date of the award should be of relevance.

With regard to the issue of whether there was a stabilization clause, following the Aminoil example, it was decided that any limitation on the nation’s right to nationalize must be expressly stipulated, having been approved by the state itself in conformity with its regulations, and covering a relatively limited period of time. In the absence of a stabilization clause, a contract does not bar nationalization, and such nationalization cannot be considered unlawful.

As to the method of evaluating the compensation due, Chamber Three adopted the on-going concern approach for valuing Amoco’s interests, and ruled that the Discounted Cash Flow (DCF) method did not fit within the context of that case, since the projection of damages over a long period opens “a large field of speculation due to the uncertainty inherent in any such projections”.

In conclusion, the Tribunal awarded Amoco 50% of the on-going concern value of Kharg Chemical Co. “without addition of future lost profits beyond such value”.16

The other equally important case is that of Philips Petroleum, which concerned Chamber Two (composed of Robert Briner as Chairman, S. K. Khalilian and George H. Aldrich as members). This case focused on the issue of creeping expropriation in the energy industry through the analysis of NIOC’s escalating requests in: a) repudiating the consortium agreement; b) unilateral setting of the production rates at lower levels; c) the termination of the Joint Structure Agreement (JSA); d) and the subsequent effects of the Single Article Act promulgated by the Iranian Government in January 1980.

After refusing the changed circumstances as an excuse, because “a revolutionary regime may not simply excuse itself from legal obligations by changing governmental policies”, the Tribunal held that force majeure is a general principle of law that may be applied even if the contract is silent on this point. However, in order that force majeure would “have the effect of terminating a contract” it has to “make performance definitively impossible or impossible for a long period of time”. Hence, since the new Government was installed by March 1979, and the oil exports were resumed thereafter, Chamber Two rejected Iran’s claim that the contract was frustrated or terminated by events of force majeure.

On the other hand, within the process of calculating the compensation due to Philips Petroleum, Chamber Two adopted a rather sympathetic attitude towards the DCF method, considering it not as a request for future best profits, but a relevant factor in determining the fair market values. In order to remedy the shortcomings of the DCF method and the risk not taken into account thereby, Chamber Two opted for considering the underlying asset valuation approach in assessing the quantum of Philips Petroleum’s nationalized interest. This included tangible and intangible assets, as well as the profitability of its share in the going concern after deducting its share of liabilities. In other words, the method applied calculated the tangible assets at their depreciated replacement value. This was done by adjusting the book value, and then quantifying the intangible assets – including the profitability of the on-going concern – by determining an appropriate income figure based on historic earnings in function of a multiplier that took into consideration the legitimate expectations in the oil venture.17

In addition to the aforementioned points, special attention has to be given to the Mobil Oil case. In this instance, the Government of Iran and NIOC, raised as the basic argument that the company, as well as the other consortium members, had agreed to the termination of the Sales and Purchase Agreement (SPA), which replaced in 1973 the Consortium Agreement of 1954. In light of the extensive correspondence exchanged, Chamber Three (Virally, Brower and Ansari) refused to consider that the SPA was frustrated or terminated, but found that many important provisions of the SPA were replaced by the end of 1978 with ad hoc or de facto agreements. Consequently, Chamber Three arrived at the conclusion that the parties mutually agreed to terminate the SPA and started to negotiate the issue of compensation when the Revolution took place and interrupted the negotiations. Following the example of the Aminoil Tribunal, Chamber Three deemed it appropriate to determine what the parties could have legitimately expected from good faith negotiations.

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17 Iran-US CTR, vol. 21, pp. 79 ff.
It held that the claimed losses “cannot easily be ascertained with the degree of certainty necessary to allow a finding that the profits claimed were within the legitimate expectations of the parties”.\(^{18}\)

This finding was clearly instrumental in facilitating the resumption of negotiations, since the pending cases of the American Consortium members were all subject to awards by consent of the parties for the purpose of enforcing the amicable settlement agreements via the funding mechanism established in implementation of the Algiers Agreement of January 1981.\(^{19}\)

To complete the picture of the reported awards rendered in relation to the Iranian measures affecting the petroleum sector, it has to be noted that not all arbitrations were filed by American claimants. The French company ELF Aquitaine resorted to arbitration against NIOC in the exercising of an arbitration clause contained in art. 41 of the Exploration and Production Contracting Agreement signed on 27 August 1966. The latter was declared null and void by the special committee created under the Single Article Act of 1980.

As NIOC refused to appoint its arbitrator and raised objections against the recourse to arbitration, the President of the Danish Supreme Court, acting as appointing authority, appointed professor Bernhard Gomard as sole arbitrator. Since there was no agreement concerning the place of arbitration and the applicable procedures, the sole arbitrator decided to hold the arbitration in Copenhagen and to apply Danish procedural law.

After ascertaining that the relevant provisions of agreement 1966 led to the conclusion that the *lex contractus* had been chosen as primary source of the governing rules, and that the arbitrator had the power to rely on “considerations of equity and generally recognized principles of law and in particular international law”, the Danish arbitrator considered that the issue of competence had to be decided on the basis of the principles of international law.

In the exercise of the said power to rule on his own jurisdiction, the arbitrator so concluded:

- “It is a generally recognized principle of the law of international arbitration that arbitration clauses continue to be operative even though an objection is raised by one of the parties that the contract containing the arbitration clause is null and void”.

- “The autonomy of an arbitration clause is a principle of international law that has been consistently applied in decisions rendered in international arbitration, in the writings of the most qualified publicists on international arbitration, in arbitration regulations adopted by international organizations and in treaties”.

- “A contract with a foreign oil company for the exploitation of petroleum in Iran entered into by NIOC cannot be treated differently from a contract signed by the state itself as a party with respect to the obligation under international law to respect agreements on arbitration”.

- “It is a recognized principle of international law that a state is bound by an arbitration clause contained in an agreement entered into by the state itself or by a company owned by the state and cannot thereafter unilaterally set aside the access of the other party to the system envisaged by the parties in their agreement for the settlement of disputes”.\(^{20}\)

### 13.3.5 The new rules conceived by the arbitral Tribunals

Kuwait’s nationalization of Aminoil in 1977 and the ‘takeover’ of petroleum operations resulting from the Iranian Islamic Revolution, which materialized in the years 1978-1980, brought to an end the era of the traditional concessionary system. During that era, the transnational foreign companies had the total or partial ownership of oil and gas resources existing in the host countries.

With the inauguration of a new phase – marked by the joint exploitation of the nationally-owned resources through various types of cooperation agreements – issues and disputes of a different nature started to emerge. These led to arbitration cases mainly focusing on the interpretation of the parties’ respective rights and obligations within the management of the joint operations, or the sale of the products to third parties under changing circumstances.

As an early example of the said new pattern, reference has to be made to the dispute between Deutsche Schachban und Tiefbohrgesellschaft and the Government of Ras Al Khaimah, together with its national company Rakoil. This concerned the operating agreement under which a consortium was to carry out certain seismic work and the drilling of two exploratory wells.

In implementing an ICC arbitration clause, Case No. 3572 was filed. The panel, composed of three

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\(^{18}\) Iran-US CTR, vol. 16, pp. 3 ff.


members (Pierre Follet, Swiss citizen, acting as Chairman, Bjorn Haug of Norway and Cedric Barclay of the United Kingdom, acting as co-arbitrators) rendered an award in 1982 by virtue of which the arbitral Tribunal held “internationally accepted principles of law governing contractual relations to be the proper law applicable to the case”. In addition, the panel awarded the claimant a total amount of US$ 4,135,664, which included accrued interest as well as arbitration and legal costs.21

With regard to the sales of a certain quantity of oil and of oil products on Free On Board (FOB) and Costs and Freight (C&F) terms between the sellers Sojuznefteexport (USSR) and the buyer Joc Oil (Bermuda), the dispute arose as a result of the buyer’s non payment for shipments – allegedly delivered with delay – and the seller’s consequent suspension of further shipments.

In implementing an arbitration clause providing for arbitration at the Foreign Trade Arbitration Commission (FTAC) of the USSR Chamber of Commerce and Industry in Moscow, the panel composed of three Soviet professors (V.S. Pozdnyakov, as Chairman, R.L. Naryshkina and S.N. Bratus, as co-arbitrators) rendered its award on 9 July 1984 (Case No. 109/1980).

As reported, the arbitral Tribunal held that the Soviet sellers “could not claim the contractual price of the goods because the sale contract was invalid as it did not comply with the formalities of Soviet law. However, they were entitled to restitution, equal to the value of the amount of shipments delivered and unpaid”.22

The issue of force majeure within the context of petroleum operations became central in the National Oil Corp (NOC) v. Libyan Sun Oil ICC arbitration (Case No. 4462).

Sun Oil entered into an Exploration and Production Sharing Agreement (EPSA) with the state-owned Libyan corporation NOC dated 20 November 1980. The EPSA provided that it had to be governed and interpreted in accordance with the laws and regulations of Libya – including the Petroleum Law – and that it contained an ICC arbitration clause.

Sun Oil assumed the role of operator and was charged with undertaking a minimum exploration programme estimated at US$ 100 million. Due to the US Government’s sanctions – prohibiting persons using US passports from travelling to Libya, and also prohibiting the export of certain technology without a license – Sun Oil repatriated its US personnel and failed to obtain the license needed. Under these conditions, Sun Oil invoked force majeure to justify its failure to carry out its exploration obligations. NOC challenged the applicability of the force majeure and filed an arbitration request. The arbitral Tribunal (composed of the former First President of the French Court of Cassation, Schmelk, as Chairman, professor Katz of Germany and the US Senator Muskie, as co-arbitrators) rendered in 1985 a first award on the basis of force majeure and a final award in 1987 dealing with remedies consequently allocated to both parties.

In compliance with the rules provided for under art. 360 of the Libya Civil Code, the arbitral Tribunal arrived at the conclusion that the “impossibility” required under the Libya Civil Code “must not be determined subjectively, i.e., by reference to the capabilities and personal means available to the defaulting obligor but rather objectively”. It is because of such meaning that the impossibility is said to be “absolute”. Since other companies were able to perform – by reliance on citizens of other nationalities and using non-US technology – the ICC arbitral Tribunal arrived at the conclusion in its first award, that the US prohibitions did not make it impossible for Sun Oil to perform. Accordingly, it could not properly invoke the force majeure clause.

In its final award of 1987, the arbitral Tribunal ruled that Sun Oil’s invocation of the force majeure clauses did not constitute a withdrawal per se. At the same time, the Tribunal ruled that NOC did not repudiate the EPSA by having taken recourse to arbitration. On the other hand, there was no mutual conduct giving evidence of an implicit agreement to terminate the EPSA.

Based on the language of art. 8.2 of the EPSA, the Tribunal held that “NOC did suffer some loss by losing its chance, within the exploration period, to discover oil in the contract area and, within the exploration period, to obtain all the information and data needed to assess the petroleum resources in the contract area.” However, taking into consideration all the relevant circumstances, including NOC’s failure to mitigate its loss, the arbitral Tribunal exercised the broad discretionary power provided under art. 227.2 of the Libyan Civil Code to allocate a “fair and equitable” compensation of US$ 20 million.23

In the field of exploration, an important ad hoc arbitration case took place between Wintershall, as claimant, and the Government of Qatar, as defendant. The case involved a dispute that emerged under an EPSA concluded in 1976, concerning the right of Wintershall to produce non-associated natural gas pursuant to either: further contractual arrangements to be mutually agreed; or the “go it alone” principles contained in art. XV.3 of the EPSA.

The arbitral Tribunal (composed of US citizen John Stevenson, as Chairman, Bernardo Cremades of Spain and Ian Brownlie of the UK, as co-arbitrators) rendered a partial award dated 5 February 1988 and a final award dated 31 May 1988, which can be summarized as follows:

- As the parties agreed that the arbitration had been conducted according to the UNCITRAL rules, the arbitral Tribunal decided to hold the arbitration at the Hague, in the Netherlands, ruling that the applicable UNCITRAL rules were subject to any mandatory provisions of the Netherlands Arbitration Law, which would prevail in the event of any conflict.

- It should be noted that the Government of Qatar revised preliminary objections about the Tribunal’s lack of jurisdiction because it was not party to the EPSA concluded, and signed only with Qatar General Petroleum Corporation (QGPC). As a result of this, in its partial award, the arbitral Tribunal noted that art. 21.1 of the 1976 UNCITRAL arbitration rule gave it the power to rule on its own jurisdiction. In this respect, the Tribunal held that “a non-restrictive interpretation of the Tribunal’s jurisdiction is appropriate”. Accordingly, the objection to jurisdiction was rejected, and the Government of Qatar was declared as falling under the Tribunal’s jurisdiction, invoking inter alia the following reasons: a) QGPC was acting as an agent of the Government; b) QGPC’s actions were attributed to the Government; c) the Emir appointed the QGPC’s Board of Directors, the majority of whom were officials of Qatar’s department of petroleum affairs – with the Emir being able to remove them at will; and d) the Chairman of the QGPC Board was the Minister of Finance and Petroleum.

- In the absence of a choice-of-law provision in the EPSA, the arbitral Tribunal held that the substantive law to be applied had to be the law of Qatar, due to the close links to that country. Although the Tribunal indicated that public international law – if determined to be relevant – would apply, it decided that, with regard to the issues under consideration, international law was not relevant, and applied only the substantive law of Qatar.

- The basic issue submitted to the arbitral Tribunal related to the extent of Wintershall’s right to go ahead in the process of exploiting the non-associated natural gas discovered in, or transcending, the contract area. The negotiations conducted with regard to the use of natural gas were not successful and no agreement was reached with QGPC. The arbitral Tribunal rejected Wintershall’s claims that Qatar breached or expropriated its rights under the EPSA by not allowing exploration transcending over an adjacent area. This was particularly rejected since Qatar had no legal duty to unitize the area or to accept the proposals for joint development. However, the arbitral Tribunal ruled that Wintershall was entitled to an extension of the relinquishment period provided by the EPSA. By a majority decision this extension was considered as specific performance of the contract. According to the Tribunal’s ruling, Wintershall’s relinquishment period was ordered to be extended for eight years from the date of the award for exercising the “go it alone” rights to develop the natural gas in the contract area. Moreover, the relinquishment term for the structure area would not begin to run until claimsants were permitted to develop that area.

- Furthermore, the arbitral Tribunal provided the proper interpretation of “petroleum costs” of the non-restricted gas allowable under the EPSA provisions, together with the extent of the obligation to off-take natural gas and whether it included residual dry as well as liquid elements.

- In application of art. 81 of the Qatari Civil Code about unjust enrichment, the arbitral Tribunal rejected Wintershall’s claims based on an alleged deprivation of its economic interest in the natural gas discovered and in the field information resulting from the drilling undertaken. According to the Tribunal, Qatar had a “lawful cause”, since the title to the gas in the ground belonged to Qatar, and Wintershall had an implicit duty under the EPSA to report the information obtained to the Government.

- Finally, the Tribunal ruled that in case Wintershall exercised the option provided in the award to extend the EPSA, it would not be required to make rental payments for the period before the date of the award. In other words, rental payments were not required until Wintershall had the ability to use the “go it alone” option as ordered in the final award.24

The impact of the USA’s sanctions against Libya on the petroleum agreements involving American companies returned to the arbitration scene with the ICC Case No. 8035 brought by Grace Petroleum Libya, as claimant, against the Socialist People’s Libyan Arab al-Jamahiriya (Libyan state) and National Oil Corporation of Libya (NOC), as defendants.

The dispute related to an operating agreement covering concessions Nos. 16, 17 and 20, originally

Though the Libyan appointed arbitrator was chosen by both the state and NOC, Libya contested the jurisdiction of any arbitral Tribunal to hear any claims against the state, emphasizing inter alia that the state was not a party to the agreement under which the arbitration had been instituted. The arbitral Tribunal became constituted as the two co-arbitrators initially appointed by the parties (former ICJ President, Judge Stephen Schwebel and the late Judge Ruda of Argentina) agreed on professor Pierre Pescatori of Luxembourg to be the third arbitrator and chairman of the Tribunal. After the resignation of Judge Schwebel and the sudden death of Judge Ruda, the present US Judge at the ICI, professor Burghental and the author of this report became co-arbitrators.

In compliance with the terms of reference elaborated by the arbitral Tribunal in its new composition and agreed upon by the parties, the briefs were exchanged according to the approved time schedule, and the oral hearings took place. The arbitral Tribunal rendered a unanimous final award on 18 December, 1995 which dealt at the same time with both the jurisdictional issue raised by the state of Libya, as well as all the claims and counter-claims submitted by the parties.

The findings of the arbitral Tribunal can be summarized as follows:

- With regard to the issue of whether or not the state of Libya was bound in relation to Grace by the arbitral clause contained in section 5 of the suspension agreement, the Tribunal’s finding was that “Grace has failed to establish the acceptance by Libya of the arbitral clause contained in section 5 of the suspension agreement.” The Tribunal’s finding was based, inter alia, on the fact that NOC “was created as a separate legal entity vested with extensive capacities, rights and functions in the management of Libya’s oil resources”, and “according to the concept of dédoublement fonctionnel”, the dual signature of the suspension agreement by the same person did not make the state a party to the agreement. “The second signature, which appears under the legend Approved and Endorsed, had the purpose of showing that NOC was acting within the scope of its legal powers and accepts whatever NOC will do in relation to Grace in the framework of the Suspension Agreement, including the liabilities NOC may incur in this respect and the legal authority of any solution arrived at as a consequence of recourse to arbitration under section 5.”

- Taking into consideration that the US restrictive measures caused the inoperability of Grace’s concession interests, the Tribunal held that Grace “cannot, therefore, contest in principle the
legitimacy of the agreement entered into with Total by NOC. As long as Grace was prevented from fully exercising its own rights and relieved of its obligations due to suspension, the Libyan authorities were at liberty to manage their oil resources to the best of their interests in the whole of the concessions concerned, not excluding the shares of Grace. Problems arising out of this care-taking action (negotiorum gestio) imposed by circumstances will have to be resolved in case of recommencement, under the conditions indicated hereinafter”.

- The Tribunal’s scrutiny of whether NOC had infringed the guarantees conferred upon Grace – by the suspension agreement led in relation to the substance of the total agreement – concluded that it had to be seen “as the exercise of the right of operation and management reserved to the parties by the participation agreement, with the result that this action has not and cannot have any effect on Grace’s concession interest”. The Tribunal further added that “as long as Grace’s operation rights are paralyzed by the US measures and by the effect of suspension, as noted above, NOC enjoyed unlimited freedom to organize the development of Mabrouk field to the best of its interest. Since the Mabrouk field was in a state of almost complete neglect prior to suspension, Grace was not able to establish that anything in the Total Agreement caused any damage to its vested interests in the concession”.

- In refusing to grant any reparation to Grace for the fact that it was excluded from the negotiations conducted in secrecy with Total, and placed abruptly before an accomplished fact, the Tribunal held that such behaviour was not permissible and that it was inconsistent with Grace’s interest. Although, it stated that the latter “was however not able to establish the existence of any identifiable damage caused to it by the behavior of NOC, considering the circumstances that, at the time when the action of NOC took place, the rights and interests of Grace were dormant due to suspension, whereas NOC, considering the substance, was acting within the bounds of its legitimate rights”.

- Interestingly, despite the fact that the Tribunal rejected all the claims of Grace, including those related to its efforts to seek recommencement, as well as for the sale of its assets in Libya, the arbitral Tribunal condemned NOC to bear the costs of the arbitration, since the latter’s behaviour in keeping Grace uninformed, and its insistence on signing a confidentiality agreement “compel the conclusion that NOC’s actions arose justified suspicions on the part of Grace concerning the extent to which its rights were being protected and, hence, a legitimate interest in obtaining full clarification in this regard.”

In recent years, new types of economic transactions arose aiming to utilize the natural gas resources owned by the state in generating electrical power for local consumption through the conclusion of what became known as BOT or Build, Own, Operate, Transfer (BOOT) with foreign companies able to secure both the technology and the financial resources required. A vast programme within this concept was particularly implemented in Indonesia by the year 1994 through a legal framework composed of three elements:

- The conclusion of an agreement referred to as Energy Sales Contract (ESC) between the foreign investing entity and two Indonesian entities: Pertamina – the well known, wholly owned governmental national company entrusted with Indonesia’s oil and gas resources; and Perusahaan Listrik Negara (PLN), the entity equally wholly owned by the Government and which is in charge of supplying electricity to the people of Indonesia. The ESC type of agreement is structured in a way that encourages the foreign company to accept long-term commitments going up to 30 years. This aims at securing the financial resources and technology required for the exploitation of the gas reservoirs available in the geothermal fields owned by the state, developing the wells, constructing the electrical plants as well as undertaking the infrastructure necessary for the project. In exchange for assuming these long-term obligations, it was agreed that the electricity to be supplied to PLN throughout the period of 30 years had to be priced in terms of US dollars in order to make sure that the foreign investor – who affected the financing in that currency – would not be subjected to exchange rate risks in the case of the local currency undergoing a substantial devaluation.

- At the same time, Pertamina signed a Joint Operation Contract (JOC) with the foreign company, establishing the rules to be applied for the proper conduct and budgeting of the activities undertaken in the development and exploitation of the geothermal fields.

- Both the ESC and the JOC had a signature on the last page by the Minister of Mines and Energy, stating “approved […] on behalf of the Government of the Republic of Indonesia.”

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25 Reported in French translation at Journal de Droit International (Clunet), 197, pp. 1040 ff.
Due to the dramatic devaluation of the Indonesian rupiah which took place during the second half of 1997, the future of such BOTs became uncertain. In addition, the Government caused presidential decrees to interfere in suspending certain projects. This situation led the foreign companies concerned to engage in arbitral proceedings under the arbitration clauses existing in said agreements.

In two leading cases, the claimants filed parallel arbitration request, against the state Electricity Corporation PLN in one instance, and against The Republic of Indonesia in another. These were the cases brought forward by Himpurna California Energy (Bermuda), and by Patuha Power (Bermuda), which were submitted to the same ad hoc arbitral Tribunal composed of Jan Paulson, as Chairman, A.A. de Fina and H. Priyatnor Abduarasyid, as co-arbitrators.

The two cases against PLN led to two final awards dated 4 May 1999, and in the two cases against the Republic of Indonesia the two final awards were rendered on 6 October, 1999.

The findings of the arbitral Tribunal in both twin arbitrations can be summarized as follows:

- With regard to the applicable law governing the substantive issues, the arbitral Tribunal relied on art. 33 of the UNCITRAL rules in order to consider that “the concept of party autonomy is central to international arbitration”. It concluded that, since “the parties agreed to require that all the relevant terms of the ESC should be given effect when deciding a particular matter”.

Therefore, the arbitrators need not apply the otherwise applicable law if it is inconsistent with the “spirit” of the ESC or the “underlying intent” of the parties.

- Concerning the relationship between PLN and the Government of Indonesia, the arbitral Tribunal held that PLN “cannot in fact avoid liability by invoking state action since in the particular circumstances of this case PLN entirely subordinated its will to that of the GOI [Government of Indonesia]”. Over and above this, the Tribunal emphasized that PLN is simply “an instrument of Government policy” as witnessed by the fact that “its tariffs are set by GOI”. In light of art. 9. 2 s.e of the ESC – providing that only the foreign party can claim an act of the Government of Indonesia to be an event of force majeure – the arbitral Tribunal arrived at the conclusion that neither PLN nor Pertamina “may invoke governmental action as an excuse for non-performance, and that therefore it must be held liable for the economic consequence of the failure to perform”.

- After careful study of the factual and legal background pertaining to the change of circumstances resulting from the calamitous economic crises that caused the Indonesian rupiah to lose more than two thirds of its value, the arbitral Tribunal noted the significance in the ESC of pricing in US dollars rather than in Indonesian rupiah. It meant that “the parties unambiguously allocated the risk of a depreciation of the local currency to PLN.” Consequently, the Tribunal clearly stated that “when stipulations like these appear in a long-term agreement like the ESC, with respect to which it is obvious that the surrounding circumstances may change dramatically during the life of the contract, one can only conclude that the allocations of risk is intentional, indeed emphatic”.

- In support of the said ruling, the arbitral Tribunal emphasized that it had no power “to question the motives or judgment of the parties, but to assess their rights and obligations in light of their legally-significant acts or missions,” adding that “to go beyond this role would be to betray the legitimate expectations reflected in the Parties’ agreement to arbitrate, and indeed to impair the international usefulness of the arbitral mechanism.”

- After ordering termination of the ESC for breaches of a fundamental nature by PLN, the arbitral Tribunal addressed the quantification of the compensation to be allocated to the claimants with a preliminary remark according to which “it is impossible to establish damages as a matter of scientific certainty”, which implies that “approximations are inevitable”, and “considerations of fairness” have to be taken into consideration. The arbitral Tribunal proceeded by ascertaining that asking “for the full amount of the future revenue stream when also claiming recoupment of all investments is wanting to have your cake and eat it too”, and hence “when the victim of a breach of contract seeks recovery of sunk costs, confident that it is entitled to its damnum, it may go to seek lost profits only with the provision that its computations reduce future net cash flows by allowing a proper measure of amortization”. The Tribunal further added that “it would be intolerable in the present case to uphold claims for lost profits from investments not yet incurred.”

- Turning to the claims against the Republic of Indonesia, which became subject to two final awards rendered six months later, it has to be noted that a serious incident took place in between. The co-arbitrator appointed by Indonesia was
intercepted at Schiphol airport and returned under escort to Jakarta in order not to attend the Tribunal’s meeting – scheduled to convene two days later at the Peace Palace in The Hague. In reference to the UNCITRAL rules, the doctrinal comments and precedents in this respect, the two members of the truncated Tribunal decided that they had the power to fulfill the Tribunal’s mandate and to render a final award, notwithstanding the non-participation of the third member.

- After lengthy discussion of all the documents and legal opinions pertaining to whether the so-called MOF letter was intended to create legal obligations or not, the arbitral Tribunal found that: firstly, the said letter “created a duty for the Republic of Indonesia to ensure that PLN honored and performed its obligations under the ESC and under any arbitral award rendered pursuant to it; and secondly the Republic of Indonesia has breached that duty.” Accordingly, the arbitral Tribunal arrived in paras. 197-199 of the final award to conclude that:
  - It is “indisputable” that “The Republic of Indonesia has failed to live up to its undertaking, to cause PLN to respect its obligations under the ESC […]; PLN’s breach of the ESC has been determined by an arbitral award which, as the ESC stipulated, is binding and definitive.”
  - “The MOF letter unequivocally required the Government of Indonesia to cause PLN to honor and perform its obligations. In the PLN award it was held that the ESC is terminated for PLN’s breach. The Republic of Indonesia has not shown – and indeed cannot show, given the PLN award as a res judicata – that it caused PLN to act in such a manner that it would not commit, or would cure, the breach.”
  - “The record shows that the Republic of Indonesia obstructed both: a) performance of the ESC, by regulatory measures fully described in the PLN award; and b) satisfaction of the PLN award, by failing to use its statutory power over PLN and Pertamina to cause them to desist from court actions seeking to set aside the PLN award and to paralyze this arbitration.”

The arbitral Tribunal consequently ruled that “in the absence of any claim for the damages, the outstanding debt represented by the PLN award constitutes the measure of the claimant’s damages flowing from the Republic of Indonesia’s breach of the MOF letter.”

Within the same context of global relationship comprising: a tripartite ESC concluded between PLN, Pertamina with a foreign entity in change of exploiting natural geothermal gas resources to guarantee and supply electricity on long-term basis over 30 years; JOC with Pertamina covering the development and exploitation of the geothermal fields; and the formal written approval of both the ESC and the JOC by the Minister of Mines and Energy on behalf of the Republic of Indonesia, a single arbitration request was brought by another foreign investor called Karaha Bodas Company, referred to as “KBC”. This was against all three Indonesian entities: Pertamina, PLN and the Government of the Republic of Indonesia (GOI), under UNCITRAL rules as provided for under section 8 of the ESC, as well as under art. 13 of the JOC.

Since the three Indonesian Respondents refrained from appointing the second arbitrator, and upon recourse by the Claimant to the appointing authority agreed upon what happened to be ICSID’s Secretary General, the author of this report was appointed as second co-arbitrator. After consultation with the claimant’s appointed arbitrator professor Bernardini, the two co-arbitrators chose Maître Yves Derains as chairman of the arbitral Tribunal.

The respondents raised certain challenges concerning the jurisdiction of the arbitral Tribunal over the GOI, the non-exhaustion of amicable settlement procedure, about the regularity of consolidating KBC’s claims into a single arbitration, as well as the constitution of the arbitral Tribunal.

In a preliminary award addressing the said issues and rendered on 30 September 1999, the arbitral Tribunal came to the following ruling:

- The arbitral Tribunal decided that it had no jurisdiction over the Government of Indonesia, invoking inter alia that: “approval by the Government of contracts of national interest […] is a straightforward feature of contracts concluded by state-owned enterprises throughout the world”. According to the text of both contracts “they could not become effective without the approval of the minister which was the starting point for calculating the term of the contract. Thus, the very purpose of the minister’s approval is clearly defined: it is a condition precedent to the entering into force of the JOC and the ESC. This is a clear indication that the parties did not consider that the GOI was also a party to the contracts”. In other words, according to the Tribunal, it was “within the framework of its duty to control state-owned

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26 The full texts of the awards were revealed and made available with the consent of all parties concerned in the other case studied hereinafter, concerning the Karaha Bodas Project, and were made public within the judicial proceedings engaged by the Indonesian parties against the said awards.
companies and agreements involving the energetical resources of the country” that “the Minister of Mines and Energy of the Republic of Indonesia was authorizing the implementation of the contracts agreed upon by the parties. It was not expressing the will to become a party to them.”

- The arbitral Tribunal’s scrutiny of the relevant facts and legal provisions led to the rejection of the respondents’ objection to its jurisdiction for lack of respect of the amicable settlement procedures contemplated by the arbitration clauses. It also led to the acceptance of KBC’s position according to which a party may act against several parties bound by a different but similar arbitration clauses. This was considered fully justified in the case under consideration, not only on the basis of the connexity between the JOC and the EFC, but due to the fact that “in reality the two contracts are integrated”, and the “parties did not contemplate the performance of two independent contracts, but the performance of a single project consisting of two closely related parts”. The arbitral Tribunal clearly indicated that: “due to the integration of the two contracts and the fact that the Presidential Decrees, the consequences of which are at the origin of the dispute, affected both of them, the initiation of two separate arbitrations would be artificial and would generate the risk of contradictory decisions.”

- With regard to the respondents’ complaint about an alleged “structural inequality created when the ICSID Secretary General appointed one person on behalf of them”, the arbitral Tribunal decided to be primarily guided by the spirit of the contracts, and the “underlying intent of the parties”, as a basic principle of interpretation reflected by art. 1343 of the Indonesian Civil Code, as well as in compliance with the UNCITRAL arbitration rules. Taking into account the relevant texts, the Tribunal expressed its satisfaction that when the secretary general of ICSID appointed an arbitrator, “failing an appointment by the Respondents, he was respecting the intention of the parties”.

- The adjudication of the merits between KBC, as claimant, Pertamina and PLN, as the two remaining respondents after excluding the GOI for lack of jurisdiction, permitted the parties to fully plead their respective positions with the assistance of the witnesses introduced on both sides, either on facts, auditing and economic analysis, or on the applicable legal rules – including the submission of “the Himpurna/Patuha awards given the same value as any other supporting academic materials”.

- The first question addressed by the arbitral Tribunal in its final award of 14 February 2001 relates to whether the two respondents were in breach of their obligations under the ESC and/or the JOC. In response to this basic question, the arbitral Tribunal focused on the effects of the Presidential Decrees which ordered the postponement of the Karaha Geothermal project, constituting a “Government-related event” as defined in both the JOC and the ESC; thus a force majeure event for KBC, but not for Pertamina and PLN. Therefore, in light of the allocation of risk provisions of both the ESC and the JOC, the Tribunal concluded, that: “since a governmental event is not a force majeure event for them, their non performance has no legitimate excuse and is a breach of contract”.

- Consequently, with regard to the remedy to be ordered, the arbitral Tribunal stressed that 6 years elapsed after the execution of the contracts and 3 years after the Presidential suspension Decrees without any serious effort to render performance possible in a foreseeable future. This was a situation which led the Tribunal to declare that both the JOC and the ESC were terminated. In this respect, the Tribunal stated: “it would be unreasonable and contrary to all the parties’ interest, the spirit of the contracts and the legitimate intent of the parties, which the arbitral Tribunal must respect pursuant to Art. 13.2 of the JOC and s. 8.2(h) of the ESC, to maintain them indefinitely bound by contractual links”.

- The arbitral Tribunal proceeded thereafter with the task of awarding compensation to KBC on the basis of the rules established with regard to that category of what it characterized as “Long Term International Development Agreements”. According to the Tribunal, in a case such as the one under consideration: “the foreign investor is entitled to seek recoupment of its entire investment as an essential element of compensation, in the sense that due to the frustration of his legitimate expectations in reliance on the contracts previously concluded it has to be reimbursed for what he incurred as proved expenditures”.

- However, in order to comply with “the spirit and the legitimate expectations of the parties as understood from the global textual structure of the contractual documents”, the arbitral Tribunal found itself bound to go beyond the recovery of the capital invested in US dollars, the currency in which the said investments were originally paid. After deciding that the damnum emergens due to the claimant to compensate its lost investments amounted initially to a total of US $ 93.1 million at the relevant time when performance in reliance on the contracts came to an end, the
arbitral Tribunal considered it necessary “to establish the present value of these lost investments”, and in order to achieve this task, the Tribunal ruled on the basis of the evidence submitted to it about a “risk-free rate” conservative measure of 5.8% per annum, “indicating what would be the least non-speculative yield that a prudent person could have earned by placing the amount in question at a secured type of investment”.

- After establishing – as stated above – the actualized present value of the lost investments to be recovered under the heading of *damnum emergens*, the arbitral Tribunal turned to the assessment of whatever *lucrum cessans* may be allocated due to the loss of geothermal development opportunities.

In this respect, the arbitral Tribunal began by ascertaining that the claimant “is entitled to obtain the benefit of its bargain”, emphasizing that “the loss of a business opportunity (*perte de chance*) is a widely recognized basis for the lost profits damages component”.

However, in undertaking this assignment, the Tribunal indicated the need: “to assess with a reasonable degree of confidence the level of profits which the claimant might have legitimately expected to earn out of a project which had not yet reached the stage of full development and which would have been subject to the vagaries of a number of risks typical of this kind of projects in a country such as Indonesia”.

The analysis of the relevant factors affecting the determination of the magnitude of the risks involved, against which no protection was afforded by the JOC and the ESC, as well as the determination of an appropriate discount rate applicable for the calculation of the future cash flow projections, led the arbitral Tribunal to fix an amount to be allocated to the claimant. This went under the heading of lost profits deemed reasonable which was considerably below what was claimed by KBC and its experts.27 It is left to future arbitral cases to demonstrate the degree of adequacy of the solutions adopted in this case and in the previous ones, which inaugurated a new era in arbitrations related to modern oil and gas cooperation agreements concluded between foreign investors and the host countries which are structured as BOTs, BOOTs, or otherwise.

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27 The Karaha Bodas final award became equally in the public domain due to the various judicial recourses for annulment submitted in front of Courts in Switzerland were the seat of arbitration was located as well as in front of Jakarta Courts. Equally, many judicial procedures were engaged in front of Singapore and USA Courts resisting enforcement of the award. The latest in date was adjudicated by the U.S. Court of Appeals, for the Fifth Circuit, decision of 23 March 2004 in *Karaha Bodas v. Pertamina*.