International Arbitration Of Petroleum Disputes: *The Development of a Lex Petrolea*©

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I. Introduction

Over the past 25 years, an increasing number of international arbitral awards relating to the petroleum industry have been published. These public awards provide the source material from which customary law may be drawn.

The Government of Kuwait argued, in one case, that a sub-species of these disputes has "generated a customary rule valid for the oil industry - a *lex petrolea* that was in some sort a particular branch of a general universal *lex mercatoria*."[1] In the context of that very narrow claim, the contention was rejected, but it is the thesis of this paper that in a larger context, these published awards have created the beginnings of a real *lex petrolea* that is instructive for the international petroleum industry.

This paper will discuss this incipient "*lex petrolea*" and the rules, or at least the range of rules, established by surveying virtually all reported international arbitration awards relating to the petroleum industry. The paper is arranged by identifying and categorizing the issues decided in these published awards, with each issue discussed on a case-by-case basis in order to provide the fullest exposition of the issue along with the factual context in which it was raised and decided. It is hoped that this paper will provide a comprehensive road map of the major substantive issues raised, and the disposition of those issues, in modern international arbitrations involving the petroleum industry.

II. International Arbitral Procedural Law

The most comprehensive procedural law governing an arbitration will be set out in the arbitration rules of the institution selected to administer the arbitral proceeding. For example, the arbitral Tribunal may apply the International Rules of the American Arbitration Association (AAA), the Arbitration Rules of the International Chamber of Commerce (ICC), International Court of Arbitration, or the Arbitration Rules of the London Court of International Arbitration (LCIA). In lieu of the rules of an institution, the Tribunal may apply the UNCITRAL Arbitration Rules, which are a set of procedural rules for conducting an international arbitration that were prepared by a United Nations' commission and are not connected to any particular institution,

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1 Government of the State of Kuwait v. American Independent Oil Co. (AMINOIL), Award of 24 May 1982, 21 International Legal Materials 976, 1036 (1982), 9 Yearbook Commercial Arbitration 71, 87 (1984).

although institutions such as AAA and LCIA will apply them if the parties agree to their use. In addition, the Inter-American Commercial Arbitration Commission (IACAC) has adopted the UNCITRAL Arbitration Rules, with certain modifications, as its own. The UNCITRAL rules may also be adopted by the parties for use in an ad hoc arbitration. If the parties decide on an ad hoc arbitration but do not adopt such ready-made rules, then they must frame their own rules sufficient for conducting the proceeding or fall back on the law of the country where the arbitral proceeding will be held. Typically, this law will provide procedures for certain, limited types of problems such as selecting the arbitrators, but the host law often does not provide sufficient rules for conducting the proceeding itself. In that event, the parties or the arbitrators will have to determine the procedures to be used.

Certain often-faced procedural problems of international arbitration have been addressed by reported decisions of arbitral tribunals. These decisions, and the procedural law adopted by them, will be described below.

A. Competence - Competence of Arbitrators

The title of this subsection refers to the competence of arbitrators to determine their own competence. It may also be described as the jurisdiction of arbitrators to determine their own jurisdiction. While it may be assumed that arbitrators will have a psychological—and even financial—motive to find in favor of their own competence to hear and determine the dispute, it must be kept in mind that exceeding its jurisdiction (as set out in the parties' agreement) is one of the few grounds for vacating the arbitral award of a Tribunal. New York Convention art. V (1)(c). Because of this practical restriction, and the integrity of the arbitrators, international tribunals are generally careful not to exceed their jurisdiction.

The UNCITRAL Model Law, which has been adopted in Texas but not in New York or by federal law in the United States, specifically addresses this issue. It expressly provides that the arbitrators have jurisdiction to determine their own jurisdiction. UNCITRAL Model Law art. 16(1). This provision amounts to a restatement of the law that has developed in arbitral decisions.

In the early case of <u>Saudi Arabia v. Arabian American Oil Co. (ARAMCO)</u>,[2] which was an ad hoc arbitration proceeding, the Government of Saudi Arabia both challenged the jurisdiction of the ad hoc arbitral Tribunal and sought to expand it. The Government took the position that it could withdraw from arbitration any act done by it in the exercise of its sovereign power. In that case, the Government signed an agreement with A.S. Onassis for the transportation of oil, but Aramco claimed that agreement violated its own contract with Saudi Arabia, which gave it the right to produce and transport the oil. At the same time as it challenged the Tribunal's competence, the Government argued that the Panel was invested with wider powers and could take into account future events so as to harmonize the Government's two contracts.

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[2] Decision of 23 August 1958, 27 International Legal Reports 117 (1963).

The Tribunal rejected both positions. It held that it was authorized to be the judge of its own competence, as expressed in Article 11 of the Draft Convention on Arbitral Procedure adopted by the International Law Commission (United Nations, New York 1955). It then held that Saudi Arabia's withdrawal of sovereignty issues from the arbitration was effective as a principle of internal and external independence so that the Tribunal could not impose upon the Government any obligations not assumed by treaty or by contract. But the Tribunal found its jurisdiction was not dependent on the State's sovereignty and that it was competent to determine whether the Onassis contract infringed Aramco's rights under its agreement.

As to the second issue, the Panel determined that it could only decide disputes, such as the five questions submitted by the parties, and could find that the two contracts were compatible or in conflict. The Panel was not authorized as an *amiable compositeur*, however, affirmatively to promulgate a method to reconcile or harmonize the two agreements. Consequently, the Tribunal rejected the suggestion that it had wider powers than those bestowed upon it by the parties' agreement.

In another well-known ad hoc arbitral decision - Texaco Overseas Petroleum Co. (TOPCO) & California Asiatic Oil Co. v. Government of the Libyan Arab Republic,[3] - the Libyan Government did not participate in the arbitration so the sole arbitrator addressed the issue of whether he had the competence to determine his own jurisdiction. The arbitrator inferred from language in clause 28 of the Deeds of Concession—". . . the sole arbitrator, shall determine the applicability of this clause and the procedure to be followed in the arbitration"—that the parties intended for the arbitrator to decide on the scope of his own jurisdiction. The arbitrator also held that his competence was based upon a customary rule of international law that vests arbitrators with the authority to rule upon their own jurisdiction, citing inter alia to the International Court of Justice's decision in the Nottebohm case,[4] the Statute of the International Court of Justice, art. 36, ¶ 4; ICSID Convention art. 41, ¶ 1; and ICC Arbitration Rules art. 8, ¶ 3 (1975).

The National Iranian Oil Company attacked the jurisdiction of a sole arbitrator in an ad hoc case because the Special Committee established by Iran's Single Article Act of 1980 ruled that the 1966 contract was null and void *ab initio*.[5] Rejecting this claim, the arbitrator noted that Article 41 of the Exploration and Production Contract provided that in the absence of agreement by the parties, the arbitrator determines the procedure for the arbitration. The same article also provided that the arbitrator was to decide any disputes based on equity and generally recognized principles of law. Relying in part on this, the arbitrator held that "[i]t is a fundamental principle in international arbitration . . . that an arbitrator has 'competence over the competence.'" Based on equity and principles of international law, the arbitrator decided, in this ad hoc proceeding, that he was competent to decide on his own jurisdiction.

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3 Award of 19 January 1977, 17 I.L.M. 3 (1978), 4 Y.B. Com. Arb. 177 (1979).

4 1953 I.C.J. 111, 119.

5 Elf Aquitaine Iran v. National Iranian Oil Co. (NIOC), Preliminary Award of 14 January 1982, 11 Y.B. Com. Arb. 97 (1986).

In an ICC case held in Switzerland, the arbitral Tribunal relied upon Article 8 of the Swiss Intercantonal Arbitration Convention, which expressly provided that an arbitral tribunal shall determine its own jurisdiction when the validity of an arbitration agreement is disputed.[6] Based on this law and the fact that the validity of the arbitration clause itself was not challenged (although the validity of the contract was attacked), the Tribunal found that it was competent to determine its own jurisdiction.

The Tribunal in Wintershall, A.G. v. Government of Qatar,[7] noted that article 21(1) of the UNCITRAL Arbitration Rules gives it the power to rule on its own jurisdiction.[8] In this regard, it was noted that "the tendency has been not only to a non-restrictive but even to an expansive view of international arbitrations."[9] The Panel specifically held that "a non-restrictive interpretation of the Tribunal's jurisdiction is appropriate..."[10]

The common ground of these decisions lies in the approach and findings of the arbitrators. In each case, the Tribunal looked first to the contract to determine the parties' intent on the jurisdictional issue, and then supported a decision based on general contract language by finding that customary international law provides for an arbitral tribunal to determine its own jurisdiction.

B. Separability of Arbitration Clauses

In many arbitration proceedings, one party - often a governmental entity - claims that the contract containing the arbitration clause has terminated by its own terms, has been terminated, or was void *ab initio*. The logical claim then is that the arbitration agreement contained in the contract has also terminated or is void, and since binding arbitration is consensual, the parties are not bound to arbitrate their dispute. This problem has arisen many times and is now determined by the doctrine of the separability of arbitration clauses from the remainder of the agreement. Like the question of the competence of the arbitrators to determine their own jurisdiction, the doctrine of the separability of arbitration clauses is included in the UNCITRAL Model Law.[11]

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6 Deutsche Schachtbau-und Tiefbohrgesellschaft mbH v. Government of the State of R'as Al Khaimah (UAE) & the R'as Al Khaimah Oil Co. (RAKOIL), Final Award in ICC Case No. 3572 of 1982, 14 Y.B. Com. Arb. 111 (1989).

7 Partial Award of 5 February 1988 and Final Award of 31 May 1988, 28 I.L.M. 795 (1989).

8 Id. at 811.

9 Id.

10 Id.

11 UNCITRAL Model Law art. 16(1).

In TOPCO v. Libya,[12] the arbitrator addressed the issue of whether, if the nationalization had voided the Deeds of Concession, this would affect the arbitral clause. The arbitrator held that the arbitration clause would not be affected even if the Deeds were void because of the principle of the autonomy or independence of the arbitration clause from the contract in which it is contained. In support of this decision, the arbitrator referenced the Permanent Court of International Justice decisions in the cases of Lena-Goldfields[13] and Losinger.[14]

Similarly, the Tribunal in Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic,[15] held that "[i]t is widely accepted in international law and practice that an arbitration clause survives the unilateral termination by the state of the contract in which it is inserted and continues in force even after the termination." The arbitrator rationalized this decision by finding it was the intention of the parties and is a basic condition for creating a favorable climate for foreign investment. The Tribunal cited in support of this proposition to ICSID Convention art. 25, Resolution No. 1803 (XVII) of the U.N. General Assembly § 1, ¶¶ 1 & 4 (Dec. 21, 1952), and the arbitrations of the Prophet Mohammed, as indicating that arbitration is consistent with Islamic law and practice. The LIAMCO case was also an ad hoc arbitration.

NIOC claimed in the Elf Aquitaine matter,[16] that the Exploration and Production Contract was rendered void *ab initio* by declaration in 1980 of a Special Committee of the Iranian Government, and therefore, the Government was not bound to the arbitration clause. The arbitrator rejected this claim and said, "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 Tribunal noted that an arbitral clause may not always be operative if there never existed a valid contract between the parties, but the arbitrator did not find that to be the case here. The arbitrator summed up by stating, "The autonomy of an arbitration clause is a principle of international law that has been consistently applied in decisions rendered in international arbitrations, in the writings of most qualified publicists on international arbitration, in arbitration regulations adopted by international organizations and in treaties."

The same question arose in a different context in All-Union Foreign Trade Association "Sojuznefteexport" v. Joc Oil, Ltd.,[17] which was an arbitration before the Foreign Trade

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12 17 I.L.M. 3 (1978), 4 Y.B. Com. Arb. 177 (1979).

13 5 Annual Digest of International Law Cases, Nos. 1 & 258, at 38 & 426 (1929).

14 1936 Permanent Court of International Justice, Ser. C, No. 78 at 105.

15 Award of 12 April 1977, 6 Y.B. Com. Arb. 89 (1981).

16 11 Y.B. Com. Arb. 97 (1986).

17 Award in Case No. 109/1980 of 9 July 1984, 18 Y.B. Com. Arb. 92 (1993).

Arbitration Commission (FTAC) of the USSR Chamber of Commerce and Industry. There, the Association filed an arbitration claim with the FTAC, but Joc Oil claimed the contract (including the arbitration clause) was invalid because it was not signed by two persons with a power of attorney from the Chairman of the Association, and therefore, did not comply with the requirements of Soviet law for foreign trade transactions. Joc Oil also claimed that the theory of the autonomy of an arbitration agreement was not applicable in the USSR. On these bases, Joc Oil contended that the FTAC did not have jurisdiction to proceed with the arbitration. The Tribunal found the contract to be invalid on the ground asserted by Joc Oil, but rejected the company's argument on the autonomy of the arbitration clause. The Tribunal noted that the overwhelming majority of Soviet authors recognized the autonomy of arbitration clauses, cited to UNCITRAL Arbitration Rules art. 21(2), and stated that a 1974 FTAC decision treated an arbitration agreement as a procedural contract and not as an element (condition) of a material-legal contract. An arbitration agreement is invalidated only for "defects in will, mistake, fraud and so on," none of which were found to exist in this case. The FTAC concluded, therefore, that the arbitration clause is a procedural contract, independent of the contract in which it is contained, and is valid.

C. Effect of National Law Barring Arbitration

Some governmental entities, most notably those of Iran, have argued in certain petroleum cases that arbitration agreements were invalid or ineffective because of a national law that purportedly barred arbitration by the State entity. In those cases, the national law that allegedly barred arbitration was promulgated many years after the contract containing the arbitration clause was executed. The tougher issue, which is not directly answered by reported international petroleum arbitration decisions, is whether a *pre-existing* national law may prevent a foreign governmental entity from arbitrating. Article 47 of the Vienna Convention on the Law of Treaties and the Amoco and Phillips cases, which are discussed below, may be instructive on this question.

NIOC contended in the Elf Aquitaine proceeding[18] that the Single Article Act of 1980, which was enacted long after the contract containing the arbitration clause was signed, and the later decision of the Special Committee declaring the agreement null and void *ab initio,* gave exclusive jurisdiction to the Committee and had the effect of barring arbitration by NIOC. The arbitrator held that a State is bound by an arbitration clause that it or its company signs, and it cannot unilaterally set aside the arbitration clause and deprive the clause of its operability.

NIOC argued to the same effect before the Iran-U.S. Claims Tribunal in two cases - Amoco Iran Oil Co. v. Islamic Republic of Iran,[19] and Phillips Petroleum Co. Iran v. Islamic Republic of Iran.[20] Unlike Elf Aquitaine, these cases involved treaty obligations of Iran. The

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18 11 Y.B. Com. Arb. 97 (1986).

19 Award No. ITL 12-55-2 (30 December 1982), 1 Iran-U.S. Cl. Trib. Rep. 493.

20 Award No. ITL 11-39-2 (30 December 1982), 1 Iran-U.S. Cl. Trib. Rep. 487.

Tribunal noted that Article 47 of the Vienna Convention on the Law of Treaties of 1969 requires that notice of any restriction on a country representative's authority to bind his country must be given to the other negotiating State before expressing his nation's consent to the treaty. Iran's representative did not notify the United States of any restriction on his authority, based on the Single Article Act of 1980, in agreeing to the Claims Settlement Declaration (CSD), which established the Iran-U.S. Claims Tribunal. The Tribunal also noted that Iran did not argue, pursuant to Vienna Convention article 46, that the Single Article Act constituted a rule of Iran's internal law of such fundamental importance that a manifest violation would be grounds for invalidating Iran's consent to the Algiers Accords. Consequently, the Tribunal decided that the Single Article Act did not bar arbitration by NIOC of the claims in dispute.

D. Exhaustion of Local Remedies

"The International Court of Justice has declared that 'the rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.'"[21] NIOC has argued in at least two cases that this principle of exhaustion of local remedies applies to international arbitration.

In the Elf Aquitaine case, NIOC claimed that, despite the arbitration clause in the contract, Elf Aquitaine must present its claims to the Special Committee set up by the Iranian Government to review oil agreements before it could arbitrate. The sole arbitrator held that the rule of local redress only governs complaints made by a State in exercising its right of diplomatic protection of its nationals; it does not apply to a request for arbitration pursuant to an arbitration agreement. As the arbitrator said, "the parties have by choosing arbitration established a procedure for settlement of disputes which excludes the national legal remedies provided for in national legislations." Therefore, the arbitrator held that Elf Aquitaine was not required to submit to local redress before seeking arbitration.

NIOC made the same claim before the Iran-U.S. Claims Tribunal in Amoco International Finance Corp. v. Government of the Islamic Republic of Iran.[22] Specifically, NIOC argued that Amoco had failed to exhaust its local remedies by not seeking compensation before the Iran Government's Special Commission. The Iran-U.S. Claims Tribunal held that its jurisdiction was determined exclusively by the terms of the CSD, and the CSD did not condition the Tribunal's jurisdiction on the exhaustion of local remedies.

E. Application of Arbitration Clauses to Non-Signatories

It is a fundamental principle that arbitration is consensual, and there must be an agreement to arbitrate before a party can be forced to participate in binding arbitration. But the question has

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21 Elf Aquitaine v. NIOC, 11 Y.B. Com. Arb. 97 (1986), citing the International Court of Justice decision in the Interhandel case (Switzerland v. United States), 1959 I.C.J. Reports at 27.

22 Award No. 310-56-3 (14 July 1987), 15 Iran-U.S. C.T.R. 189.

arisen in some cases as to the proper parties to an arbitration agreement. For example, is a parent or subsidiary company bound to an arbitration agreement of its affiliate? This issue may arise not only in the context of corporate affiliates, but also with respect to claims of third-party beneficiaries, agents, and alter ego relationships. The importance of this issue is emphasized by the fact that the absence of an arbitration agreement, or a Tribunal's action in exceeding the scope of the agreement, are among the few grounds for vacating an arbitral award under the New York Convention.[23]

It was asserted in an ICC arbitration that the parent company of a corporation that signed a contract containing an arbitration clause should also be bound to the arbitration agreement, although it was not a signatory.[24] In that case, F.C. (a Bahamian company) and F.D. (a French company) signed an Operating Agreement for the exploration and exploitation of certain oilfields in a Central American country. The Operating Agreement required ICC arbitration in Geneva with three arbitrators. F.C. and its parent company, S.C. (a Luxembourg company), brought an arbitration claim under the Operating Agreement against F.D. and its parent company, S.D. (also a French company). Although S.C. was not a signatory to the Operating Agreement, no objection was made to its participation in the arbitration as a claimant. S.D., however, contested the jurisdiction of the arbitral tribunal over it on the ground that it never signed or consented to the arbitration agreement.

Swiss law required a written arbitration clause, but S.D. never signed the Operating Agreement with the arbitration clause. The Claimants argued that the behavior of S.D., the Operating Agreement, and other contractual relationships and documents created an implicit agreement by S.D. to arbitrate. Specifically, the Claimants pointed to Article VII of the "Protocol d'Accords No. 1", which dealt with the main issues to be encompassed by the Operating Agreement. That Protocol left it to S.D., however, to decide on the structure for its operations in Central America. S.D. set up its subsidiary, F.D., specifically to run those operations.

The arbitral Tribunal noted that it is the Claimants' burden to prove that S.D. is a party to an arbitration agreement. The Tribunal held that the various contractual relationships between the Claimants and S.D. are not sufficient because they do not include an arbitration clause. Claimants knew, even when the Protocol was signed, that F.D. would be the company carrying out the operations in Central America. Because Claimants could have requested that S.D. sign the Operating Agreement with the arbitration clause, but did not do so, the Tribunal held that it lacked jurisdiction over S.D.

Although the published opinion does not make it clear, the award implies that only the Qatar General Petroleum Corporation (QGPC), a company wholly-owned by the Government of Qatar, signed the Exploration and Production Sharing Agreement (EPSA) with the Claimants in

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23 New York Convention, Arts. II(1) & (2), V(1)(a) & (c).

24 F.C. & S.C. v. F.D. & S.D, Partial Award of 17 March 1983 in ICC Case No. 4402, 9 Y.B. Com. Arb. 138 (1984).

Wintershall, A.G. v. Qatar.[25] Among other reasons for upholding its own jurisdiction, the Panel ruled that the QGPC was acting as an agent of the Government of Qatar, and the QGPC's actions were attributed to the Government.[26] In support of this holding, the Tribunal emphasized that the Emir appointed the QGPC's Board of Directors, the majority of whom were officials of Qatar's Department of Petroleum Affairs, and the Emir could remove them at will. Moreover, the Chairman of the Board of the QGPC was the Government's Minister of Finance and Petroleum. It was held that under Qatari law, the QGPC operated as an agent of the Government of Qatar.[27] On this basis, the Tribunal held it had jurisdiction over the Government.

F. Assignment of Arbitration Rights

Whether a party may assign its rights under an arbitration agreement was raised as an issue in the Sojuznefteexport v. Joc Oil case.[28] In that case, the Association assigned its claim against Joc Oil to H. K. Lehne. Joc Oil contended that this assignment was improper. The Tribunal noted that the Claimant assigned only its claim for payment of the debt, and decided that an arbitration agreement "cannot at all be the subject of cession."[29] Because the arbitration agreement is an autonomous procedural contract, the assignee must independently consent to the arbitration agreement. Therefore, the Tribunal held that the Association remained the proper owner of the claim against Joc Oil, and was the proper plaintiff on the main claim and the proper defendant on the counterclaim.

G. New Claims

The question of a party's ability to assert new claims that arose after the commencement of an arbitration proceeding arose in the context of the ICC Arbitration Rules in National Oil Corp. (NOC) v. Libyan Sun Oil Co. (Sun Oil).[30] There, Sun Oil argued that certain claims of NOC were new claims and were outside the scope of the arbitration.[31] Sun Oil contended that NOC's original claim was that Sun Oil had wrongfully withdrawn from the Exploration and Production Sharing Agreement (EPSA) and did not mention claims made later under articles 8.2 and 25.2 of the EPSA. According to Sun Oil, those later claims were based upon facts that occurred more than 3½ years after the arbitration commenced and had no "nexus" to NOC's original claim that Sun Oil withdrew from the contract.

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[25] 28 I.L.M. 795 (1989).

[26] Id. at 811.

[27] Id. at 812.

[28] 18 Y.B. Com. Arb. 92 (1993).

[29] Id. at 100.

[30] Final Award of 23 February 1987, 29 I.L.M. 601 (1990), 16 Y.B. Com. Arb. 54 (1991).

[31] Id. at 611.

The Tribunal rejected Sun Oil's claim, even though NOC's "new claims" were arguably based on different legal grounds than its original claim, because the facts that gave rise to the original claim were the same as those on which the more recent claims were based. Thus, there existed a "tight link" between the original claim and the more recent ones that could justify the applicability of article 16 of the ICC Arbitration Rules. More importantly, however, the Tribunal held that NOC's new claims could not exceed the Terms of Reference laid down under the ICC Rules. Since NOC's claims in the Terms of Reference were broadly framed, the last claims made were held not to exceed the Terms of Reference. The Tribunal concluded that "the last claims made by N.O.C. although related to circumstances which arose after the Request for Arbitration, and even after the first award of the Arbitral Tribunal, did not constitute 'new' claims and..., as such, they fall within the Terms of Reference." Therefore, the Panel refused to dismiss NOC's claims.

H. Applicable Procedural Law

In the absence of an explicit agreement by the parties as to the procedural law to govern their arbitration proceeding, arbitral tribunals have reached differing decisions on the procedural law to be applied. This issue should not be confused with the arbitration rules to be applied - usually the UNCITRAL Rules or the rules of particular institutions such as the ICC, AAA or the LCIA. This issue deals with the law of the state, canton or country that provides the legal framework, procedurally, for the conduct of the proceedings. This law will fill any gaps in the arbitration rules used or, occasionally, specify a mandatory provision that may override a specific arbitration rule. Typically, the procedural law will be that specified in the parties' agreement, that specified by international law, or that of the state, canton or country which is the seat of the arbitration proceeding.

In Saudi Arabia v. ARAMCO,[32] the arbitration clause provided that Saudi Arabian law was to be applied to the extent of matters within the jurisdiction of Saudi Arabia, and otherwise, the law to be applied was that deemed applicable by the arbitral Tribunal. The agreement provided for the seat of the Tribunal to be at Lucerne, Switzerland, but the parties agreed when the Tribunal was constituted to meet in Geneva. Because the parties clearly agreed to withdraw their disputes from the local courts of Saudi Arabia, the Tribunal held that the procedural law to be applied was not intended to be that of Saudi Arabia. Moreover, the Tribunal held that a sovereign State such as Saudi Arabia cannot be subjected to the law of another State to govern the arbitral proceeding. Therefore, the law of either Switzerland or the Canton of Geneva, as the seat of the arbitration, could not be applied. "It follows that the arbitration, as such, can only be governed by international law..." The Tribunal applied the law of nations to the procedural issues of the arbitration.

[32] 27 International Legal Reports 117 (1963).

The next significant case to discuss this issue in detail was that of British Petroleum Co. (Libya) Ltd. (BP) v. Government of the Libyan Arab Republic.[33] The arbitrator discussed the holding of the Aramco case, but ultimately rejected it, finding that the sovereignty of a State party would not be infringed by subjecting it to municipal procedural law in an international arbitration. The arbitrator decided that, by agreeing to arbitration, the parties must have intended an effective remedy, and an award founded on the procedural law of a specific legal system is more likely to be effective than one lacking nationality, such as an arbitration procedurally governed by international law. Since the Tribunal had fixed the seat of the arbitration in Copenhagen, it decided that Danish procedural law would govern the arbitration. In support of its holding, the Tribunal cited the case of Sapphire International Petroleums Ltd. v. National Iranian Oil Co. (NIOC).[34]

The sole arbitrator in TOPCO v. Libya,[35] another case (like BP) arising from the Libyan oil nationalizations of 1973, discussed both the Sapphire municipal law approach, which was adopted in the BP case, and the international law approach of the Aramco case. The arbitrator in Topco adopted the Aramco approach, holding that he could not subject a State party to the law of another country. Because the arbitration was to take place outside the country of the State party, the parties intended a neutral judge. Based on this reasoning, the Tribunal adopted international law to govern the procedural aspects of the arbitral proceeding.

An ICC arbitration involving an Algerian State enterprise as claimant and seller against an African State enterprise as defendant and buyer ignored this debate and applied as its procedural law the ICC Arbitration Rules, pursuant to the parties' agreement, and the compulsory rules of the Swiss Arbitration Concordat.[36] This ruling was based on the fact that Switzerland, specifically Geneva, was the seat of the arbitration proceeding.

In one arbitration, the sole arbitrator decided to hold the arbitration in Copenhagen and to apply Danish procedural law, although he noted that law was significant only for the arbitral pleadings.[37] The arbitration clause itself provided that the arbitral tribunal was not to be restricted by any specific rule of law, but was permitted to base its decision on considerations of equity and generally recognized principles of law. The parties had the power to choose the *lex contractus*, and the State party is not free to change that law by subsequent legislation. The arbitrator also noted the need to place international contracts on the footing of an autonomous legal system founded on international law and independent of the parties' national laws. Therefore, the

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33 Award of 10 October 1973, 53 International Law Reports 297 (1979), 5 Y.B. Com. Arb. 143 (1980).

34 35 International Legal Reports 136 (1957), 13 Int'l & Comp. L.Q. 1011 (1964).

35 17 I.L.M. 3 (1978), 4 Y.B. Com. Arb. 177 (1979).

36 Algerian State Enterprise v. African State Enterprise, Award of 30 May 1979 in ICC Case No. 3099 & 3100, 7 Y.B. Com. Arb. 87 (1982).

37 Elf Aquitaine v. NIOC, 11 Y.B. Com. Arb. 97 (1986).

Tribunal decided to apply principles of international law to issues such as the competence-competence of the arbitrator.

In Kuwait v. AMINOIL,[38] the arbitral seat was Paris and the substantive law was agreed, in Article III, to be that determined by the Tribunal, having regard to the international character of the relationship and the principles of law and practice prevailing in the world. With respect to the procedural law, however, the Tribunal held that the parties had clearly chosen the French legal system, pursuant to Article IV (1) of the arbitration agreement, for any mandatory provisions of its procedural law.

Finally, the parties agreed that their arbitration would be conducted according to the UNCITRAL Arbitration Rules, which the arbitral Panel recognized in Wintershall, A.G. v. Qatar.[39] Since the Tribunal decided to hold the arbitration at The Hague, in The Netherlands, the Tribunal held that the UNCITRAL Rules would apply but were subject to any mandatory provisions of the Netherlands Arbitration Law, which would prevail in the event of any conflict.[40]

I. Applicable Substantive Law

Another procedural issue upon which considerable attention has been focused by international arbitral panels is that of determining the applicable substantive law. The early debate on this issue focused upon whether a contract to which a sovereign State was a party could be subjected to the municipal law of another country. Although recognizing that the parties may select the governing law in their agreement, modern practice generally prefers an approach that denationalizes the applicable substantive law and applies general principles of law.

This latter approach was first taken in a published international arbitral opinion in the case of Petroleum Development, Ltd. v. Sheikh of Abu Dhabi,[41] an ad hoc arbitration. In that case, the Tribunal noted that the contract was made in Abu Dhabi and was to be wholly performed in that country, so if any municipal law were applicable, it would be that of Abu Dhabi. Apparently, the agreement did not provide for the governing law, and article 17 of the Agreement merely stated that the agreement was intended to be applied in a spirit of goodwill and integrity and to be interpreted in a reasonable manner. The Tribunal held that this clause repelled the notion that any municipal legal system should be applicable to the contract. The Tribunal also observed that the Sheikh of Abu Dhabi administers a purely discretionary justice with the assistance of the Koran, and there is no settled body of legal principles applicable to the construction of modern commercial instruments. With this background, the Tribunal held that article 17 invited, or even prescribed, "the application of principles rooted in the good sense and common practice of the

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38 21 I.L.M. 976 (1982), 9 Y.B. Com. Arb. 71 (1984).

39 28 I.L.M. 795, 801 (1989).

40 Id.

41 1951 International Law Reports 144.

generality of civilized nations - a sort of 'modern law of nature'."[42] Although refusing to apply English municipal law, the Tribunal accepted certain principles of English law as forming part of the modern law of nature for application to the parties' dispute.

A lengthy, although confused, discussion of this issue was published by the arbitral Tribunal in Saudi Arabia v. ARAMCO.[43] There, the arbitration agreement provided that the Tribunal would apply Saudi Arabian law insofar as "matters within the jurisdiction of Saudi Arabia are concerned", and according to the law deemed applicable by the Tribunal as to any other matters. Saudi Arabian law was designated as the Muslim law taught in a particular school and applied in Saudi Arabia. The Tribunal held that the substantive law to be applied should be determined by resorting to the conflicts of laws rules of the *lex fori*, but there was no *lex fori* in that case to determine what conflicts rule should be used, and the Tribunal found that general public international law does not contain such rules. Therefore, it decided to look to the "indications given by the parties" and, if that failed, by taking into account all circumstances of the case. The Tribunal determined that the concession had the category of a kind of constitution, and as such, it must be strictly observed by the parties. The Panel noted that the concessionaire was "the holder of subjective rights of a public law character, which cannot be taken away from him as long as he fulfills his obligations..."[44] Since the contract did not have a *lex fori*, and it was concerned with immovable property situated in Saudi Arabia, the Tribunal said it would consider as decisive the *lex situs* for the purpose of determining the character of an oil concession. The agreement was not between two sovereign States, so it was held not to be governed by public international law. The Tribunal stated that resort must be had to the principles of private international law known as the autonomy of the will, according to which the law expressly chosen by the parties should first be applied and, failing that, the law presumably intended by the parties should be applied. Because the Tribunal was unable to determine what law was tacitly chosen by the parties (there being no express choice), the Tribunal determined to reconstruct, in an abstract manner, the choice of law that reasonable persons would have intended. Having an international character, the agreement was interpreted, and the parties' rights and obligations supplemented, by resort to general principles of law.

In summary, the Tribunal held that the law of Saudi Arabia would be applied, which includes the concession agreement in the nature of a constitution as to the relationship between the parties, and that to the extent of gaps in the law of Saudi Arabia, principles emanating from the world-wide custom and practice in the oil business would be applied. As to the international effects of the concession, such as the sale and transport of oil products, the Tribunal held that "these effects are governed by the custom and practice prevailing in maritime law and in the international oil business."[45] Finally, the Tribunal held that "public international law should be

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42 Id. at 149.

43 27 International Legal Reports 117 (1963).

44 Id. at 159.

45 Id. at 171.

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 laws in the State, as is the case in all matters relating to transport by sea, to the sovereignty of the State on its territorial waters and to the responsibility of States for the violation of its international obligations."[46]

Perhaps, the first clear statement of the modern position is found in Sapphire International Petroleums v. NIOC.[47] The Tribunal in that case rejected the *lex fori*, which was Switzerland, finding that an arbitrator is not bound by the conflict rules enforced by the arbitral forum because the choice of conflict rules is governed by the common intention of the parties. Since the contract was both concluded in Iran and due to be performed there, the Tribunal noted that the *lex loci contractus* and the *lex loci executionis* both point to the application of Iranian law. But the Tribunal found evidence in article 38, paragraph 1, of the Concession Agreement to exclude the application of Iranian law, and the Tribunal noted that the character of a concession as partly public and partly private tends towards the exclusion of Iranian law. Sapphire would not be protected against legislative changes in its contract if it were governed by Iranian law. Article 38 provided that the contract was to be performed according to the principles of good faith and goodwill. The Tribunal found in this a negative intention to reject the exclusive application of Iranian law. By reference to the rules of good faith, the Tribunal decided that the parties intended not to apply the strict rules of a particular legal system, but to rely upon the rules of law common to civilized nations. Therefore, the Tribunal held, "It is in the interest of both parties to such agreements that any disputes between them should be settled according to the general principles universally recognized and should not be subject to the particular rules of national laws..."

An ICSID arbitral Tribunal was called upon to determine the applicable law in a dispute relating to the nationalization of AGIP's 50% interest in a Congolese company.[48] A Protocol of Agreement, by which AGIP sold a 50% interest in the company to the Congolese Government in 1974, provided that Congolese law applies, supplemented by principles of international law. The Tribunal held that this provision binds the parties, has the force of law for the Tribunal, and must be applied. Congolese law provided that French civil and commercial legislation in force on the date the country gained its independence in 1960 was to be applied in the Congo. The Tribunal took note of the Congo's Constitution, which guaranteed private property and provided that expropriation must take place only pursuant to law. Congo's Constitution and French law in effect in 1960 were held to be the substantive law applicable to the parties' dispute.

An ICC Tribunal made a similar determination in Algerian State Enterprise v. African State Enterprise.[49] There, the parties' agreement provided that Algerian law was applicable. Until

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46 Id. at 172.

47 35 International Legal Reports 136 (1957), 13 Int'l & Comp. L. Q. 1011 (1964).

48 AGIP Co. SpA v. Government of the Popular Republic of the Congo, Award of 30 November 1979, 8 Y.B. Com. Arb. 133 (1983).

49 7 Y.B. Com. Arb. 87 (1982).

1975, when the Algerian Civil Code became effective, Algerian law applied French law, except when contrary to Algerian sovereignty. Because the contract was entered into while French law was in effect, the Tribunal held that French law should apply because the rights and obligations under the contract remained subject to the legal rules in effect when the contract was concluded.

All three of the Libyan nationalization cases also addressed this issue. In the BP case, the concession provided that it would be governed by principles of the law of Libya common to the principles of international law, and in the absence of such principles, then by general principles of law, including those principles applied by international tribunals. The arbitrator noted that this excludes any single municipal legal system. The Tribunal rejected both of BP's arguments that a legal principle could be applied only if supported both by Libyan law and international law or that public international law applied. The Panel fell back on the precise wording of the concession, holding it did not say that public international law applied and even if there were no principles common to Libyan and international law, then general principles of law would still apply.

In the TOPCO case, the arbitrator had before it precisely the same choice-of-law clause. This case stands as one of the best articulations of the principle of internationalization of the law applicable to contracts between public and private entities. In a clear analysis, the arbitrator first took up the question of whether parties have a right to select the governing law. The Tribunal determined they do. The arbitrator, next, referred to the contract language as a "two-tier system" by which principles of Libyan law are applicable to the extent they are common to international law principles, and alternatively, in the absence of such commonality, then general principles of law are to be applied. The arbitrator noted that the clause refers to "principles", not "rules", of Libyan law, and applying principles of Libyan law does not rule out the application of international law principles. The Tribunal then stated that under a new concept of international law, contracts between States and private persons can be "internationalized" in the sense of being subjected to public international law. Such internationalization results from the reference in the contract to international law and general principles of law, the contractual clause adopting international arbitration as the method for resolving disputes, and from the nature of the dispute between a State and a private person. The arbitrator adopted this concept of internationalizing the contract, but held this only means that the private party has an international capacity. Applying Libyan and international law (*pacta sunt servanda*), and finding them to be in conformity, the Tribunal held the Deeds of Concession to have binding force.

The arbitrator in the LIAMCO proceeding, faced with the same governing law clause, held first that "it is an accepted universal principle of both domestic and international laws that the parties to a mixed public and private contract are free to select in their contract the law to govern their contractual relationship." The arbitrator noted that in the first instance, Libyan domestic law is applicable, and subsidiarily, general principles of law apply. Any part of Libyan domestic law that is inconsistent with principles of international law must be excluded. The Tribunal looked to article 38 of the Statute of the International Court of Justice to determine the meaning of the phrase, "principles of international law." For the meaning of the term, "principles of the law of

Libya," the Tribunal referred to legislative enactments of Libya, including all petroleum concession laws, complemented by Islamic law and principles of natural law and equity. The Tribunal found that Libyan law and international law both apply custom and equity and that certain general principles of law are found in Libyan legislation and Islamic law, including the principle of the sanctity of property and contracts, respect for acquired vested rights, a prohibition of unjust enrichment, the obligation to pay compensation for expropriations, and others.

There was no choice of law clause in the operating agreement, assignment agreement or concession agreement in Deutsche Schachtbau-und Tiefbohrgesellschaft mbH v. RAKOIL.[50] The Tribunal took note of article 13(3) of the ICC Rules of Conciliation and Arbitration, which provides that in the absence of an agreement by the parties, the arbitrator shall determine the applicable law according to the conflicts rule he deems appropriate. The agreements were between a number of companies organized under various laws and a State and a State agency. The Panel held that it would be inappropriate to apply the law under which any of the companies were organized or the law of the State that is a party to the agreements. It then referred "to what has become common practice in international arbitrations particularly in the field of oil drilling concessions and especially to arbitrations located in Switzerland", and held the applicable law to be "internationally accepted principles of law governing contractual relations".

Another Tribunal quoted the governing law clause in an arbitration agreement signed in 1979, which called upon the Panel to determine the law "having regard to the quality of the parties, the transnational character of their relationships and the principles of law and practice prevailing in the modern world."[51] A governing law clause in a 1973 agreement between the parties provided that the parties would base their relations on principles of goodwill and good faith, and that the agreements would be interpreted based on principles common to the laws of Kuwait and the State of New York, and in the absence of such principles, then in conformity with principles of law normally recognized by civilized states, including those applied by international tribunals. The arbitral Panel pointed out that the law of Kuwait applies to many matters and emphasized that it is a highly evolved law that embodies public international law. By referring to the transnational character of the parties' relations, and to general principles of law, the arbitration agreement calls upon the Tribunal to apply a "wealth and fertility" of legal rules and provides it with sufficient latitude to review different sources of law. The Panel held that these different sources do not contradict one another but blend together in this case.

The issue of the applicable law was a simple matter for the FTAC in Sojuznefteexport v. Joc Oil.[52] There, the parties' oil supply agreement called for the application of Soviet law. The Panel noted that the question of whether the Association properly executed the contract, and

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50 14 Y.B. Com. Arb. 111 (1989).

51 Kuwait v. AMINOIL, 21 I.L.M. 976 (1982), 9 Y.B. Com. Arb. 71 (1984).

52 18 Y.B. Com. Arb. 92 (1993).

whether the contract was valid, would be governed, independently of the parties' agreement, by the Soviet law that concerns the form of foreign trade transactions for Soviet organizations and the procedure for their signature.

In an ad hoc arbitration involving an Exploration and Production Sharing Agreement (EPSA) in Qatar, a retreat was sounded from the trend toward denationalization of international oil contracts.[53] The Panel held that in the absence of a governing law clause, the substantive law to be applied would be that of Qatar because of the close links of the EPSA to that country. The Tribunal went on to say that public international law may be applied if the Panel determined it to be relevant, but it decided that international law was not relevant and applied only the substantive law of Qatar.

The Iran - U.S. Claims Tribunal addressed the governing law issue in Mobil Oil Iran, Inc. v. Government of the Islamic Republic of Iran.[54] Article V of the CSD provided for the Tribunal to apply such choice-of-law rules and principles of commercial and international law as it deemed applicable, taking into account relevant usages of trade, contract provisions and changed circumstances. The Tribunal concluded that the legality of an expropriation (including contractual rights) must be determined by international law. The validity under international law of the Single Article Act, and its application to the Sale and Purchase Agreement (SPA), was not dependent upon the law chosen by the parties to govern their agreement. To determine an issue of breach or repudiation of contract, however, the law provided by the contract must be relied upon. The Panel found article 29 of the SPA to be ambiguous and to be only secondarily concerned with a choice of law, but although the first sentence of the SPA said it "shall be interpreted in accordance with the laws of Iran," the Tribunal noted that this reference to Iranian law was made "solely for interpretation of the Agreement."[55] For all matters other than the interpretation of the contract, the Tribunal decided that, taking into account its international character, it is not appropriate that it be governed by the law of one party. Therefore, the Tribunal held that Iranian law would be applicable to interpretative issues for the contract, and that general principles of commercial and international law would be applied to all other issues.

In Amoco International Finance v. Iran,[56] the Iran-U.S. Claims Tribunal determined that the legality of an expropriation must be determined by international law. The Tribunal specifically decided that the 1955 Treaty of Amity between the U.S. and Iran would be applied and that rules of customary international law could be applied for the limited purpose of filling in *lacunae* in the Treaty, ascertaining the meaning of undefined terms, or to aid in the interpretation of provisions.

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[53] Wintershall, A.G. v. Qatar, 28 I.L.M. 795 (1989).

[54] Award No. 311-74/76/81/150-3 (14 July 1987), 16 Iran - U.S. C.T.R. 3, 24.

[55] Id. at 26.

[56] 15 Iran-U.S. C.T.R. 189, 214.

III. The International Energy Industry Today

The first half of the twentieth century saw the creation and rapid growth of the international energy industry. Many governments granted generous concessions in the early years to international petroleum companies in which title to the oil in place was conveyed to the companies, the concession covered vast tracts of land, the term of the concession was 60 years or more, and the government received merely a one-eighth royalty. In 1938, the Mexican Government began a half century of expropriations of petroleum concessions by confiscating all foreign oil companies' concession rights within the country. The next shock occurred when Venezuela negotiated an agreement in 1943 by which it shared in the revenues of oil production on a virtually 50-50 basis. That 50-50 principle became a world-wide standard until Enrico Mattei of ENI in Italy struck a deal with Iran in 1957 that provided the Government with 75% of the revenues. Since the 1970's, numerous concessions have been expropriated or renegotiated to provide the governments with a much higher percentage of the revenues and greater control over production.

Modern international energy projects involve a host of agreements and issues. Typically, international petroleum companies will enter into production sharing agreements with governments in Asia or Africa, licenses with governments in Europe, or service agreements (or risk service agreements) with governments in South America. Various elements of each of these types of agreements may be combined in a hybrid contract. A production sharing agreement often requires the participation in drilling and production activities of a local, government-owned company, often with a carried interest for any exploratory wells. Through the government-owned company's participation in the project and royalties, bonuses and taxes, governments may effectively take up to 90% of the total revenues of a project.

An international petroleum company entering into an agreement with a government may act on behalf of a consortium of companies, which enter into an operating agreement to define, among themselves, their rights and obligations in the venture. The operating agreement will typically attach an accounting procedure to spell out the method of calculating the costs to be shared. The evaluation, bidding, negotiation and acquisition phases of a project may be governed among the consortium members by a participation agreement or a study and bidding agreement and a confidentiality agreement. If the drilling is successful and production is economic, offtake agreements will be entered into by the members of the consortium to set out the method and procedure by which they will nominate and lift their share of the production for shipping and export. Transportation agreements of various types will also be used for shipment either by sea or by pipeline. Finally, crude oil sales or exchange agreements - often made by telephone or telex - will be negotiated by the companies to dispose of their product. Each of these agreements, and each step of this chain, involves numerous issues that may create a dispute and a need for international arbitration.

Until recently, wells drilled for oil that discovered only natural gas were often plugged because of the expense of transporting the gas and the lack of a natural gas infrastructure in many countries. Some Liquefied Natural Gas (LNG) projects were undertaken, but the cost of LNG facilities and transport is extreme. In the past few years, companies have become more willing to produce non-associated natural gas and to bear the expense of facilities to transport (by pipelines or LNG) or consume (power plants) the gas. Many contracts with host governments, however, include only a short provision stating that if non-associated natural gas is discovered in commercial quantities, then the parties will negotiate a new agreement for the exploitation of the gas. This agreement to negotiate raises new issues for the international petroleum industry.

Future issues that the industry will face include questions of who (the companies or the governments) will bear the enormous expense of abandoning wells at the conclusion of a drilling and production project. Most modern production sharing agreements provide that all facilities will belong to the government at the conclusion of a project, even though the initial expense was borne by the companies. Including the abandonment costs in a company's expenses may make a project uneconomical. Another major problem relates to environmental issues. Many countries do not have well developed environmental laws, but the risk is increasing that such laws may be developed and applied retroactively to drilling projects begun decades earlier.

IV. *Lex Petrolea*

A. EXPROPRIATIONS

1. Concessions

Two preliminary issues relating to the nature of concessions have arisen from time to time in expropriation cases. The first is whether a concession is a contract that can be breached. The second is whether contractual rights represent property which is capable of being expropriated and for which compensation is due in the event of expropriation. Affirmative answers have evolved to both of these questions.

In BP v. Libya,[57] British Petroleum argued that its concession was a contractual instrument, which was concluded pursuant to legislation that contemplated a contractual relationship. According to BP, the concession created a direct link between BP and Libya. BP's expert witness opined that under Libyan law, concessions are administrative contracts. The arbitrator accepted BP's arguments and held that the concession was in the nature of a contract and created a direct contractual link between BP and Libya. Apparently, the Libyan Government did not argue in this early case that the administrative nature of the contract allowed it unilaterally to modify or terminate the agreement.

In another arbitration[58] the sole arbitrator expressly held that Deeds of Concession granted by a former government of Libya were of a contractual nature because they expressed an agreement of the wills of both the concessionaires and Libya. This holding was based on general principles of law and the teachings of comparative law. The arbitrator went on to find that these were international contracts because of their connections to different States.

The Iran-U.S. Claims Tribunal, Chamber Three, was faced with the question of whether contract rights constitute property for purposes of compensation for an expropriation in Amoco International Finance v. Iran.[59] Iran claimed that Amoco's 50% interest in the shares of Kharg Chemical Co., Ltd., was not property within the meaning of the 1955 Treaty of Amity between the U.S. and Iran. Chamber Three noted Iran's concession that for nationalizations there is "no basis for any distinction between real property and contract rights" because both are subject to a State's right of eminent domain. The Panel decided that an expropriation "may extend to any right which can be the object of a commercial transaction, *i.e.*, freely sold and bought, and thus has a monetary value." It held that Amoco's interests constituted "property" or "interests in property" as those terms are used in the Treaty, and thus, are subject to compensation in the event of an expropriation under the terms of the Treaty.

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57 53 International Law Reports 297, 324, 327 (1979), 5 Y.B. Com. Arb. 143, 149 (1980).

58 Texas Overseas Petroleum Co. (TOPCO) & California Asiatic Oil Co. v. Government of the Libyan Arab Republic, Award of 19 January 1977, 17 I.L.M. 3, 10-11 (1978), 4 Y.B. Com. Arb. 177, 181 (1979).

59 15 Iran-U.S. Cl. Trib. Rep. 189, 219-21.

Chamber Two of the Iran-U.S. Claims Tribunal has also held that contract rights are "interests in property" as that term was used in the Treaty of Amity.[60] The negotiating history of the Treaty indicated that this phrase was included at the insistence of the U.S. for the purpose of ensuring that contract rights would be protected. In the following passage, the Tribunal noted the necessity of compensating a taking of contractual rights:

> As the Tribunal has held in a number of cases, expropriation by or attributable to a State of the property of an alien gives rise under international law to liability for compensation, and this is so whether the expropriation is formal or *de facto* and whether the property is tangible, such as real estate or a factory, or intangible, such as the contract rights in the present Case.

It now seems settled that contract rights in a concession, a production sharing agreement, a sales agreement, or other contract, constitute interests that can be expropriated and for which compensation is required. Under international law, the nationalization of such interests clearly require compensation.

2. Nationalization of Contractual Rights

a. Lawfulness of Expropriations

The lawfulness of nationalizations has been the subject of considerable confusion over the years in arbitral decisions. There is no question under international law today that States have the right to nationalize their own natural resources, but that right comes with a corresponding obligation to compensate the party whose property is confiscated. [61] The moderm issue is the amount of compensation payable for a nationalization. In that context, the lawfulness or unlawfulness of a nationalization may affect the standard for compensating, as well as the amount of compensation payable.

One international arbitral case addressed the legality of a nationalization in the context of a claim of tort (*delictual*) liability.[62] The Tribunal found no fraudulent or purely discriminatory intent involved, and therefore, rejected any tort liability. It also refused to find unjust enrichment and *abus des droits* (abuse of rights) because these causes of action are only resorted to subsidiarily when no other grounds are available.

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60 Phillips Petroleum Co. Iran v. Islamic Republic of Iran, Award No. 425-39-2 (29 June 1989), 21 Iran-U.S. C.T.R. 79, 118-19.

61 See, e.g., AGIP v. Congo, 8 Y.B. Com. Arb. 133, 139 (1983).

62 LIAMCO v. Libya, 6 Y.B. Com. Arb. 89, 104 (1981).

Other cases have held that nationalizations constitute breaches of contract. One tribunal found that, by a nationalization, Libya breached its obligations under the Deeds of Concession.[63] In BP v. Libya,[64] the sole arbitrator found that the nationalization of BP's property, rights and interests constituted a fundamental breach of the Concession, was a total repudiation of the agreement and the Government's obligations, was arbitrary and discriminatory and violated public international law because it was made for purely extraneous political reasons, and was confiscatory because no offer of compensation was made in the two years since the nationalization.

Still other cases have found no breach of contract, but nevertheless have determined that an obligation exists to compensate, or to pay damages for failure to compensate, within a reasonable time. In LIAMCO v. Libya, the Tribunal found that the nationalization was not unlawful provided that due compensation was paid, but since it had not been paid, LIAMCO was entitled to indemnity as a substitute award for the failure to compensate in a timely fashion.[65]

The arbitral Tribunal in AGIP v. Congo[66] held a nationalization to be a violation both of Congolese law and of international law because it breached the stabilization clauses of the contract. The Panel rejected AGIP's argument, however, that the nationalization was irregular under the Congolese Constitution because it was not required by the national interest. AGIP sought to distinguish between the government acting in the general interest of the populace and acting in a private interest as a shareholder of a company. The Panel decided that a State is still acting in the general interest of the national community when it nationalizes a company of which it is a shareholder.

One recent case holds that the lawful/unlawful distinction is relevant only because, for an unlawful taking, two additional remedies may be possible over and above those that may be awarded for a lawful expropriation: (1) restitution of the property, and (2) any increase in the value of the property between the date of the taking and the date of the award.[67] In that case, neither restitution nor any increase in value was sought, so the distinction was irrelevant. The Tribunal did say, however, that no compensation less than the value of the property on the date of the taking is due if the nationalization is lawful.

Perhaps the most comprehensive discussion of the unlawfulness of a nationalization is found in Amoco International Finance v. Iran.[68] The Tribunal held that a clear distinction must be

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63 TOPCO v. Libya, 17 I.L.M. 3, 37 (1978), 4 Y.B. Com. Arb. 177, 186 (1979).

64 53 International Law Reports 297, 329 (1979), 5 Y.B. Com. Arb. 143, 150 (1980).

65 6 Y.B. Com. Arb. 89, 104-07, 117 (1981).

66 8 Y.B. Com. Arb. 133, 138-40 (1983).

67 Phillips Petroleum v. Iran, 21 Iran-U.S. C.T.R. 79, 122.

68 15 Iran-U.S. C.T.R. 189, 224-34.

made between lawful and unlawful expropriations, since the rules applicable to the compensation to be paid by the expropriating State differ according to the legal characterization of the taking. Amoco claimed that the nationalization was unlawful because (1) it violated Iranian internal law; (2) no compensation was offered or paid; (3) it was discriminatory; (4) the decision to expropriate was not motivated by a public purpose but was intended to avoid contractual obligations; and (5) it breached the Khemco contract (including its alleged stabilization clauses). The Tribunal considered each claim in turn and found: (1) it is doubtful that conformity with domestic law is a requisite for the legality of a nationalization under international law, but nevertheless, the process culminated in a legislative act, which was legal under Iranian law; (2) the Single Article Act of 1980 provided an administrative procedure to determine compensation by the Iranian Government's Special Commission, but Amoco never took advantage of it, and arbitration was possible in the event negotiations failed; (3) discrimination is prohibited by customary international law, but the mere fact that one other concern — the Iran-Japan Petrochemical Company — was not expropriated does not prove discrimination since a policy of nationalization of an industry can be implemented gradually in successive stages; (4) an expropriation only to avoid contractual obligations or solely done for financial purposes is not lawful, but the Single Article Act was promulgated to complete the nationalization of the oil industry, which is a public purpose, and the fact that financial considerations are involved does not prove that there is no public purpose; and (5) the contract contained no stabilization clauses, and the Iranian Government was not a party to the contract, so there was no breach of contract. Based on these findings, the Iran-U.S. Claims Tribunal held that Iran did not act unlawfully in nationalizing AMOCO's interests.

These cases stand for the proposition that an expropriation is unlawful if it is discriminatory, it is not motivated by the public interest of the expropriating country, it breaches stablization clauses of the parties' contract, or if no compensation is paid, offered or other provision for it made. The modern effect of such illegality, however, is merely to permit an award of additional compensation.

b. Effect of Stabilization Clauses

A stabilization clause has been defined as "contract language which freezes the provisions of a national system of law chosen as the law of the contract as of the date of the contract, in order to prevent the application to the contract of any future alterations of this system."[69] The history of stabilization clauses has been traced to the period between World War I and World War II when U.S. companies began to include them in concessionary contracts because of Latin American nationalizations.[70] The purpose of these clauses was to ensure that the concessions would be operative for the full term provided in the contract. The modern consequence of the classic stabilization clause aimed at prohibiting an expropriation is not to invalidate a

69 Amoco International Finance v. Iran, 15 Iran-U.S. C.T.R. 189, 239.

70 Kuwait v. AMINOIL, 21 I.L.M. 976, 1052 n.7 (1982), 9 Y.B. Com. Arb. 71, 95 (1984) (Separate Opinion of Sir G. Fitzmaurice).

nationalization, but to make it unlawful, which in turn affects the amount of compensation that may be awarded.

The sole arbitrator in TOPCO v. Libya noted the presence of a stabilization clause (article 16) in the concession, which provided that the Libyan Government "shall take all the steps that are necessary to ensure that the Company enjoys all the rights conferred upon it by this concession, and the contractual rights expressly provided for in this concession shall not be infringed except by agreement of both parties."[71] The clause went on to provide that the concession would be interpreted according to the laws and regulations in effect at the time it was granted, and no amendments would apply without the Company's consent. The Tribunal decided that the Government could not exercise its sovereignty to nationalize in violation of its specific contractual commitments in the stabilization clauses, and the nationalization in the face of these stabilization clauses amounted to a breach of the Deeds of Concession.

A different, and somewhat confusing, approach to stabilization clauses was taken by the Tribunal in the case of Kuwait v. AMINOIL.[72] There, article 17 of the 1948 Concession provided that the Concession could not be annulled or altered by legislation or regulations unless jointly agreed. Article 7(g) of the Supplemental Agreement of 1961 also provided that the agreement could not be terminated before the end of the term except by surrender or default. The Tribunal rejected the Government's arguments that these clauses did nothing more than embody general principles of contract law, that they were void because they were imposed on Kuwait during colonial times, and that they were annulled by the subsequent Kuwaiti Constitution of 1962 or by the public international law rule of *jus cogens*. The Tribunal took the view that the purpose of the stabilization clauses was only to prohibit any measures of a confiscatory nature. With respect to damages, however, these clauses were held to create legitimate expectations that must be taken into account.

In a separate opinion, one of the arbitrators, Sir G. Fitzmaurice, voiced another perspective. The question, as he saw it, was the right of the Government to nationalize in the face of a contractual undertaking not to do so. The purpose of these clauses was to prohibit any measure terminating the contract before the end of the term; they were not limited to confiscatory measures. Sir Fitzmaurice rejected the notion that the test can ever be whether a nationalization is confiscatory because, by its inherent nature, it always is. Thus, it was his view that the nationalization was rendered unlawful because it was irreconcilable with the stabilization clauses.

In AGIP v. Congo,[73] the Government of the Congo agreed in the Protocol Agreement to guarantee the stability of AGIP's local subsidiary's legal status, and in articles 4 and 11 of the Agreement not to apply any laws or decrees that would alter the Company's legal status. An ICSID Tribunal found that the nationalization of AGIP's Congolese subsidiary was clearly

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71 17 I.L.M. 3, 24 (1978), 4 Y.B. Com. Arb. 177, 178, 183 (1979).

72 21 I.L.M. 976, 1020 (1982), 9 Y.B. Com. Arb. 71, 80-82 (1984).

73 8 Y.B. Com. Arb. 133, 139-40 (1983).

inconsistent with the stabilization clauses, was irregular under international law, and gave rise to an obligation by the Government to compensate AGIP fully. The Panel specifically decided that stabilization clauses "have the limited effect that changes in the legislative and regulatory arrangements stipulated in the Agreement cannot be invoked against the other contracting party."

The contract in the Amoco International Finance case before the Iran-U.S. Claims Tribunal included two provisions that were claimed to be stabilization clauses.[74] One was set out in article 30, paragraph 2, which applied to current laws and regulations existing when the contract was signed. The Tribunal found this provided no guarantee for the future and was not a stabilization clause. The other provision was embodied in article 21, paragraph 2, and provided that no measures could be taken to annul, amend or modify the agreement except by mutual consent. The Tribunal decided this created a principle of interpretation and implementation of the contract in a cooperative manner, it did not bind the Government of Iran because the Government was not a signatory of the contract, and it was not a stabilization clause. The Panel found that any contractual limitation on a nation's right to nationalize must be expressly stipulated, must be within the State's regulations, and must cover only a relatively limited period of time. In the absence of a stabilization clause, a contract does not bar nationalization, and any such nationalization is not unlawful.

More recent stabilization clauses provide that if any government action adversely affects the economics of the project to the companies, then the terms of the agreement will be readjusted to keep the companies in the same financial position as provided by the contract on the date it was signed. No published international arbitration awards have dealt with this type of stabilization clause.

c. Creeping Expropriation

A nationalization can be *de jure* or *de facto*. Creeping expropriation is a variation of a *de facto* nationalization in which the expropriation occurs over a period of time by a series of gradual actions and measures rather than by a single act taken at a definite time. For example, new taxes affecting the economic returns of a project or increasing regulations undermining the control of a venture may ripen into an effective expropriation over time.

As a variant of a *de facto* nationalization, a creeping expropriation can give rise to a claim for compensation even if no executive decree or legislative act can be found confirming the taking. Of great significance is that a creeping expropriation may lead to a finding that a nationalization has occurred at a time earlier than the date when a formal decree is issued. This may affect the amount of compensation payable since later acts - actions taken by a government before the issuance of any formal decree of expropriation - may reduce the value of the concession or contractual rights seized, and thus reduce the amount of compensation to be paid.

A U.S. drilling contractor, Sedco, claimed a creeping expropriation of its shares of the Iranian company, Sediran Drilling Company, in the case of Sedco, Inc. v. National Iranian Oil Co.

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[74] 15 Iran-U.S. C.T.R. 189, 239-41.

(NIOC).[75] Clause C of the Law for the Protection and Development of Iranian Industries, which was promulgated in August 1980, provided that factories and institutions that received substantial loans from the government, and whose total debt exceeded net assets, "will be nationalized." Iran argued that this clause was applied to Sediran in order to transfer Sedco's shares to Iran. The Iran-U.S. Claims Tribunal observed that Clause C of that law "is not *per se* a formal decree of nationalization..." On the other hand, Clause A was held to present "a classic formal decree of nationalization," although the Tribunal did not rest its finding of expropriation on that decree.

The Panel ruled that the Treaty of Amity did not expand Iran's responsibility for a taking beyond the areas already recognized by international law; the Treaty merely incorporates the rules of customary international law as to the question of what constitutes a taking. The Tribunal also noted, "It is an established principle of international law that an act of expropriation does not require a formal decree of nationalization." Mere regulation, within a State's accepted police power, however, does not give rise to liability for economic injury, but a taking must be presumed when an outright transfer of title occurs, as it did here under Clause C.

Sedco argued that a taking occurred many months before Clause C was promulgated. The Tribunal found that in the summer or early fall of 1979, Sedco was denied access to Sediran's funds and was deprived of its ability to participate in the management and control of Sediran. But the event focused on by the Tribunal as defining the moment of taking was 22 November 1979, when Iran appointed three provisional or temporary directors of Sediran. The Tribunal held that "the appointment by Iran of temporary managers is *prima facie* evidence that the entity involved is an Iranian controlled entity..." and the appointment of such managers is "an important factor in finding a taking." The rationale is that such an appointment represents a "denial of the owner's right to manage the enterprise." In conclusion, the Tribunal said:

> When, as in the instant case, the seizure of control by appointment of "temporary" managers clearly ripens into an outright taking of title, the date of appointment presumptively should be regarded as the date of taking. The choice of the date of taking is not without significance because the value of the shareholders' expropriated interest may change dramatically during the surrounding time. Selection of the earlier date of the appointment of government managers as the time of taking is equitably most appropriate given that the Government of Iran and not Sedco became the chief architect of Sediran's fortunes at that point... It is legally the most appropriate date because valuation must discount the effect of expropriatory acts....
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> When, as in the instant case, it also is found that on the date of the government appointment of "temporary" managers there is no reasonable prospect of return of control, a taking should conclusively be found to have occurred as of that date...

[75] Award No. ITL 55-129-3 (28 October 1985), 9 Iran-U.S. C.T.R. 248, 276-79.

A different view was taken by another chamber of the Iran-U.S. Claims Tribunal in the Amoco International Finance case.[76] Amoco claimed a series of actions resulted in an expropriation by 1 August 1979. Specifically, Amoco claimed that it was notified in May 1979 that its expatriate employees would not be allowed to return to Iran, and in June and July 1979 Amoco was informed that the sale of products would be managed by the National Petrochemical Company of Iran (NPC) and NIOC. The Tribunal believed, however, that Amoco had already concluded it had no future in the petrochemical industry in Iran, and both parties had substantially agreed to terminate Amoco's involvement. As a result, for purposes of determining whether the expropriation violated Iranian law, the Tribunal concluded that the expropriation was a lengthy process that was ambiguous for a long period, had not occurred as of August 1979, and was not complete until 24 December 1980, when Amoco was notified that the Special Committee set up under the Single Article Act had decided that the Khemco agreement was null and void. Thus, the expropriation did not violate domestic law. For purposes of determining compensation, however, the Tribunal held Amoco's expropriated interest in Khemco would be valued as of 31 July 1979 because Iran caused NPC and NIOC to act in July 1979 in a manner contrary to the position taken by Khemco's Board of Directors, thereby depriving AMOCO of its rights in the management of Khemco.

Perhaps the leading case on creeping expropriation in the energy industry is that of Phillips Petroleum v. Iran.[77] In that case, NIOC sent a letter to the Consortium of which Phillips was a party on 10 March 1979, repudiating the Consortium agreement. The Tribunal held that a State may act through organs or entities not part of its formal structure, and NIOC is one of the instruments by which the Government carried out its national oil policy. Following the letter, NIOC unilaterally set production rates substantially below those of pre-Revolution levels. An internal memorandum of 11 July 1979 referred to the Government's policy that all hydrocarbon sales must be made by NIOC. A notice of 13 September 1979 in the Official Gazette stated that all oil contracts shall be signed by NIOC on behalf of the Government. A law adopted on 5 July 1979 stated that the petroleum industry had already been nationalized. Negotiations also began in the spring of 1979 for a sale/purchase agreement, which was linked by NIOC to the termination of the Joint Structure Agreement (JSA). One of the Consortium parties was informed on 29 September 1979 that the JSA was terminated. In January 1980, the Single Article Act was promulgated by the Iranian Government, and a written notification of the nullification of the JSA was sent in August 1980.

On this set of facts, the Tribunal held that it need not determine the intent of the Government; the Government's liability does not depend on proof that the expropriation was intentional. It is the effect of the measures on the owner that determines if an expropriation has occurred. Here, however, the Tribunal found both that the effects of these actions were consistent with a policy to nationalize the oil industry and that the Iranian Government intended to terminate the JSA. The Tribunal stated, "The conclusion that the Claimant was deprived of its property by conduct attributable to the Government of Iran, including NIOC, rests on a series of

[76] 15 Iran-U.S. C.T.R. 189, 226-29, 244, 289.

[77] 21 Iran-U.S. C.T.R. 79, 112-19.

concrete actions rather than any particular formal decree, as the formal acts merely ratified and legitimized the existing state of affairs."

The date of the "creeping expropriation" next concerned the Tribunal. It determined that the taking occurs "when the interference has deprived the Claimant of fundamental rights of ownership and such deprivation is 'not merely ephemeral', or when it becomes an 'irreversible deprivation'." The Tribunal found that the taking occurred here not in August 1980, when notice was given to the Consortium of the formal nullification of the JSA, but as of 29 September 1979 when the parties were informally told in a meeting that the JSA was terminated.

d. Duress

A claim often raised by parties who have suffered expropriations - particularly creeping expropriations - is that earlier actions of the government, to which the parties agreed, were coerced by economic pressure. Such agreements are typically claimed to be invalid based on the legal doctrine of duress. In the absence of a written record of reservations of rights, protests or a lack of consent, this claim is seldom given much credence.

Revision of a concession from the Government of Kuwait to AMINOIL was embodied in an agreement of July 16, 1973, and a letter of December 22, 1973.[78] When Kuwait terminated the agreement in September 1977 and confiscated AMINOIL's assets, AMINOIL claimed that the July 1973 agreement and December 1973 letter were obtained by duress because it was threatened with a prohibition of all exports if it did not consent. The Tribunal observed that strong economic pressure "can result in depriving such consents of certain supplementary or side effects." The Panel noted that such effects should not be enlarged by extensive interpretations. While AMINOIL failed to protest Kuwait's unilateral setting of prices in 1973, which was contrary to the terms of the concession, it did not forfeit the right to refuse consent on other occasions, even under analogous conditions. A legally valid consent, which is given under economic constraint, cannot serve as a precedent for establishing a customary rule of general validity. To constitute duress, the Panel held there must be an "absence of any other possible course" or the object or means used to obtain it must be illegal. The Tribunal found that AMINOIL had not proved "the illicit character of the threats" against it, neither did AMINOIL enter any reservations of its position nor protest Kuwait's actions. Therefore, the Tribunal refused to find duress. The company simply made a disagreeable choice because it was still possible to live with it, but the Government's pressure did not inhibit the company's freedom of choice.

e. Failure to Perform Releases the Other Party

The arbitrator found that NIOC deliberately refused to carry out its obligations under a concession agreement, which was a breach of contract, in Sapphire International Petroleums v. NIOC.[79] NIOC's attitude in hiding behind reasons it knew were invalid, adopting a wholly

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[78] Kuwait v. AMINOIL, 21 I.L.M. 976, 1007 (1982), 9 Y.B. Com. Arb. 71, 74-76 (1984).

[79] 35 International Law Reports 136, 181-85 (1957), 13 Int'l & Comp. L.Q. 1011, 1015-18 (1964).

negative attitude, and failing to perform duties that were clearly defined in the agreement breached the contract provisions that required the parties to carry out their agreement according to the rules of good faith and in a spirit of good will. The Tribunal observed that it is a fundamental principle of law that contractual undertakings must be respected; the rule *pacta sunt servanda* is the basis of every contractual relationship. Respect for acquired rights is also a general principle of law recognized by international tribunals. A third general principle of law is that the failure by one party to a synallagmatic contract to perform its obligations in breach of contract releases the other party from its obligations. This principle is founded on the interdependence of obligations, the reciprocal effect of obligations, the equal value of obligations, or an implied condition. The party released from performance by the breach of the other party is entitled to recover damages.

The arbitrator concluded that the deliberate failure of NIOC to carry out its obligations in breach of contract justified Sapphire in not performing the contract by stopping its prospection work. Although some legal systems require immediate notice by a party in Sapphire's position that it intended to repudiate the contract, and perhaps even a grace period given, the arbitrator ruled that NIOC's continued refusal to perform made any notice superfluous. The failure to give formal notice could not have caused any damage to NIOC, and the invocation of such a rule requiring notice would be incompatible with the principle of good faith.

3. Defenses Claimed by Expropriating States

a. Implied Termination or Waiver

An agreed termination of a Sale and Purchase Agreement (SPA), as a defense to an expropriation claim, was argued by the Government of Iran in Mobil Oil v. Iran. [80] In 1973, Mobil Oil and other Consortium members entered into the SPA with Iran and NIOC, which replaced and terminated the Consortium Agreement of 1954. Mobil and the other Consortium members claimed before the Iran-U.S. Claims Tribunal that NIOC and Iran repudiated the SPA and expropriated the Consortium members' contract rights by a letter of 10 March 1979. In that letter, the Chairman of the Board and Managing Director of NIOC wrote, inter alia, that the Consortium's "future relationship" with NIOC "has to be based on the following principles." Those principles included: (1) NIOC would treat the Consortium members as its prime customers, (2) there was no place for Oil Services Company of Iran (OSCO) nor its expatriate employees, (3) OSCO's Iranian employees "shall be transferred to NIOC," (4) NIOC would take over OSCO's contracts with contractors and consultants, and (5) Iranian Oil Services Ltd. (IROS) may continue, provided that the Consortium members transfer their shares and interests in IROS to NIOC.

By letter of 23 March 1979, the Consortium replied, saying the members would like to meet with NIOC "to reach an agreement in respect of the termination of the 1973 Sale and Purchase Agreement" and that they were "pleased that NIOC shall be prepared to treat the

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[80] 16 Iran-U.S. C.T.R. 3, 40-43.

Consortium Member Companies as its prime customers." The Consortium's letter noted that any termination must "deal with repayment of Members' investment and advances and settlement of any claims of either party," that the Consortium members would reserve all their rights, and that they could not accept NIOC's statements that the SPA had proved to be inoperative soon after its effective date because of the Consortium's alleged failure to comply with essential provisions.

The Tribunal noted that the parties did not comply with many provisions of the SPA, beginning soon after it was signed, such as the fact that posted prices were unilaterally determined by Iran, and that by the end of 1975, the SPA no longer governed essential aspects of the parties' relationship. Although it refused to find that the SPA was frustrated or terminated, it did find that many important provisions of the SPA were replaced by the end of 1978 with ad hoc or *de facto* agreements. The Tribunal next noted that the Consortium did not treat the 10 March 1979 letter as a repudiation, and it held that NIOC did not repudiate the SPA. Instead, it held that the Consortium's 23 March 1979 letter constituted an agreement to terminate the SPA, with the legal and financial terms of the termination to be determined by negotiation. As of that time, the SPA was temporarily suspended by *force majeure*.

In a concurring opinion, Judge Charles Brower noted the erroneous premise of the Award in "mistaking Claimants' practical acceptance of the political realities in Iran . . . for a conditional surrender of their legal rights . . ." Making the point in eloquent fashion, Judge Brower stated, "An unwanted but inevitable fate is no less unilaterally imposed by virtue of its being gracefully accepted than if it had been less decorously confronted. Style never has been a matter of legal consequence."

While the Tribunal seems to hold that there was a mutual agreement reached in March 1979 to terminate the SPA, in light of the position of the Consortium that the NIOC letter unilaterally repudiated the contract and expropriated the Consortium's rights, the case is better analyzed as a finding of an implied termination or an implied waiver of rights. Nevertheless, one of the lessons of this case is that, in order to preserve a party's legal rights, written protests should be made whenever the other party takes action inconsistent with the terms of the contract.

b. Doctrines of Changed Circumstances and Unforeseen Events

One international arbitral tribunal has defined the doctrine of changed circumstances or *rebus sic stantibus* in these terms:

> Under international law, the principle of the binding force of treaties is sometimes restricted by the proposition of "*Rebus sic stantibus.*" This means that the binding force is subject to the continuance of circumstances under which a treaty was concluded. If such circumstances change substantially, then its modification or cancellation may be claimed and resorted to.
>
> This limitation is akin to the "doctrine of unforeseen events" (*theorie de l' imprevision*), which is known in civil and administrative laws in some countries.

The Libyan Civil Code, as well as other Arab civil codes, referred to such restrictive phenomena, and provided in paragraph 2 of said Article 147 as follows:

> 2. However, if exceptional general circumstances arise which were not capable of being foreseen and for which the performance of the contract, although did not become impossible, but has become so onerous to the debtor that it threatens him with heavy loss, (then) the Judge, according to the circumstances and after weighing the reciprocal interests of the parties, may reduce the onerous obligation down to a reasonable limit. Any agreement to the contrary shall be void.[81]

An interesting variation of these doctrines arose in the Kuwait v. AMINOIL[82] case. Article 9 of the Supplemental Agreement of 1961 provided that if, as a result of changes in existing concessions or terms agreed in new concessions, Middle Eastern governments should receive an increase in benefits, then AMINOIL would consult with the Government of Kuwait concerning whether alterations in the parties' agreements would be equitable. It was argued that this provision is analogous to the doctrines of changed circumstances or unforeseen events, but the Panel refused to consider those doctrines, instead sticking to the text of Article 9's requirements.

Before the Iran-U.S. Claims Tribunal, NIOC and the Government of Iran claimed the right to terminate the Joint Structure Agreement (JSA) because of changed circumstances.[83] NIOC and Iran pointed to article V of the CSD and claimed it allowed the Tribunal to take into account changed circumstances. The Tribunal noted, however, that this provision only allows the Tribunal to consider changed circumstances for the purpose of determining the law to be applied. Iran claimed that this doctrine applied to terminate the JSA both because of the social changes brought about by the Iranian Revolution and because of the change in oil policy of the new regime. The Tribunal distinguished the case of Questech, Inc. v. Ministry of National Defense of the Islamic Republic of Iran,[84] in which the changed circumstances doctrine was applied to excuse contractual obligations, because of "the obvious differences between the cancellation of military intelligence projects of unique political sensitivity and the taking of contract rights involving offshore petroleum fields." The Tribunal rejected the doctrine of changed circumstances in this case because "a revolutionary regime may not simply excuse itself from legal obligations by changing governmental policies . . . ."

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81 LIAMCO v. Libya, 6 Y.B. Com. Arb. 89, 103-04 (1981).

82 21 I.L.M. 976, 1001-03, 1024 (1982), 9 Y.B. Com. Arb. 71 (1984).

83 Phillips Petroleum Co. Iran v. Iran, 21 Iran-U.S. C.T.R. 79, 111.

84 Award No. 191-59-1 (25 September 1985), 9 Iran-U.S. C.T.R. 107.

c. *Force Majeure*/Frustration/Impossibility

Two chambers of the Iran-U.S. Claims Tribunal have held that *force majeure* is a general principle of law that may be applied even if the contract is silent on the point. In Mobil Oil v. Iran,[85] Chamber Three specifically stated, "It also is admitted generally that *force majeure*, as a cause of full or partial suspension or termination of a contract, is a general principle of law which applies even when the contract is silent." In that case, the contract provided in article 27 a *force majeure* clause that could temporarily suspend the contract, but the Tribunal said that although the contract was silent on the point, under general principles of law *force majeure* could also "terminate" the contract under the proper conditions. Similarly in Phillips Petroleum v. Iran,[86] article 36 of the JSA provided a *force majeure* clause that could be invoked by the operator, but it did not provide that NIOC could invoke *force majeure*. Nevertheless, the Tribunal noted that under general principles of *force majeure*, NIOC could also invoke the doctrine.

In the Mobil Oil case, Iran and NIOC argued that *force majeure* conditions persisted over a long time period, which frustrated the agreement by changed circumstances, thereby resulting in the full termination of the contract. The Tribunal held that *force majeure* events were created by the revolutionary events of late 1978 up to March of 1979, when Iran resumed oil exports. The Tribunal noted that "*force majeure* conditions will have the effect of terminating a contract only if they make performance definitively impossible or impossible for a long period of time."[87] The Tribunal found that as of NIOC's letter of 10 March 1979, which did not mention *force majeure*, the contract could not be considered as frustrated or terminated by *force majeure*. A new government had been installed by that date and oil exports had resumed. Thus, the Tribunal rejected Iran's claim that the contract was frustrated or terminated by events of *force majeure*.

NIOC and Iran claimed in the Phillips Petroleum case that the JSA was totally frustrated by conditions of *force majeure*, which made it impossible for the parties to perform their obligations.[88] Again, the Tribunal held that *force majeure* conditions prevailed in late 1978 and early 1979 due to strikes and work stoppages in the oil industry. *Force majeure* conditions were held to have ended, however, when the new government ordered a resumption of oil production. Iran claimed, however, that the oil workers adamantly opposed any resumption of the JSA, and their attitudes created continuing *force majeure* conditions that prevented NIOC from performing its obligations. The Tribunal rejected this claim, holding that the oil workers' attitudes were congruous with the Revolutionary Government's stated policies and "did not constitute an independent and effective force which can be said to have made performance of the JSA impossible for that same Government." The oil workers acted in accordance with the policies of

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85 16 Iran-U.S. C.T.R. 3, 39.

86 21 Iran-U.S. C.T.R. 79, 108.

87 16 Iran-U.S. C.T.R. 3, 38-39.

88 21 Iran-U.S. C.T.R. 79, 107.

the new Government. Therefore, the Tribunal held that Iran and NIOC failed to prove that *force majeure* conditions prevented performance of the JSA or that its performance was frustrated.

d. Administrative Contracts

Some governments have claimed that petroleum concessions were administrative contracts, which allow the governments unilaterally to amend or terminate the agreements. These claims have been uniformly rejected by international arbitral tribunals, except for the BP v. Libya case, in which the Government did not argue that an administrative contract allows it unilaterally to modify or terminate the agreement.

Application of administrative law to a petroleum concession was first argued in Saudi Arabia v. ARAMCO.[89] The Government of Saudi Arabia relied on French administrative law to claim it could modify an oil concession by administrative regulations. The Tribunal rejected this claim because there was no reason to apply French law to a dispute between a U.S. company and Saudi Arabia, a petroleum concession is not a public service concession since the public is not a customer of the concessionaire and the concession does not involve any users or any dues paid by the public, and there is no *Conseil d'Etat* to review and annul any illegal administrative act.

The same argument was raised in the case of TOPCO v. Libya.[90] There, the arbitrator refused to apply the concept of administrative contracts to a concession. The arbitrator reasoned that the concession did not meet the requirements of Libyan law for an administrative contract because of the stabilization clause, which negated the power of the public authority unilaterally to amend or abrogate the agreement. It was also decided that administrative contracts are not sufficiently widely and firmly recognized in the leading legal systems of the world to constitute them as a general principle of law, and therefore, they did not come within the concession's governing law clause applying principles common to Libyan law and international law.

The Tribunal in the AMINOIL case noted that administrative contracts were originally developed in France and subsequently adopted in other countries such as Egypt and Kuwait.[91] Administrative contracts are governed by two special rules: (1) a public authority can vary the private party's liabilities, but not so as to modify the financial clauses of the contract or to disturb the general equilibrium of the parties' rights and obligations (i.e., the "financial equation"); and (2) the public authority may terminate the contract when essential necessities concerning the functioning of the State require such action. The Panel observed that the termination of administrative contracts is practicable only because this act is subject to the control of judicial organs enjoying the confidence of both parties. The arbitrators concluded that the theory of administrative contracts could not justify a nationalization. First, the theory is unknown in international law, and therefore, it is not a principle of law common to Libyan and international

[89] 27 International Law Reports 117, 214-15, 218 (1963).

[90] 17 I.L.M. 3, 19-21 (1978), 4 Y.B. Com. Arb. 177, 182 (1979).

[91] Kuwait v. AMINOIL, 21 I.L.M. 976, 1022 (1982), 9 Y.B. Com. Arb. 71, 82-83 (1984).

law and does not come within the governing law clause of the contract. Second, in French administrative law, the power of the government to take measures to change a contract is provided for, at least tacitly, by the contracting parties, while nationalization is not a power provided for by the contract. Finally, the stabilization clauses expressly negate the power of the government to nationalize.

e. United Nations Resolutions

The Government of Libya contended in the TOPCO and LIAMCO cases that certain resolutions of the United Nations established a rule of international law that left the issue of compensation for an expropriation exclusively to the municipal law and courts of the expropriating State. The arbitral Tribunals in the Libyan nationalization cases reached differing conclusions on this issue.

The first relevant United Nations resolution was No. 626 (VII) of 21 December 1952, which suggested that "the right of peoples freely to use and exploit their natural wealth and resources is inherent in their sovereignty, " and suggested both that States refrain from impeding the exercise by another State of its sovereignty over its natural resources and that States have due regard, in exercising its rights over its resources, for maintaining the flow of capital. The next relevant resolution was No. 1803 (XVII) of 14 December 1962. Resolution No. 1803 provides that a nationalization or expropriation "shall be based on grounds or reasons of public utility, security or the national interest," and the owner shall be paid "appropriate compensation" in accordance both with the rules in force in the expropriating State and with international law.

Libya relied most prominently upon more recent U.N. resolutions adopted in 1974. U.N. Resolution No. 3201 (S-VI) of 1 May 1974, entitled "Declaration on the Establishment of a New International Economic Order" said, in Article 4(e), that a State had a right to nationalize its resources and could not be subjected to economic, political or other coercion to prevent the exercise of that right. Most importantly, U.N. Resolution No. 3281 (XXIX) of 26 July 1974, Article 2, provided that each State has a right to nationalize or expropriate foreign property in which case appropriate compensation should be paid, taking into account the expropriating State's relevant laws and regulations and all circumstances which that State considers pertinent. In the event of any controversy, it shall be settled under the domestic law of the nationalizing State and by its courts, unless it is freely agreed that other peaceful means be used.

The arbitrator in TOPCO[92] found substantial differences between Resolution No. 1803, which calls for compensation to be set in accordance with the rules of the expropriating State and in accordance with international law, and the subsequent resolutions, especially Resolution No. 3281, which do not provide a role for international law in setting compensation for an expropriation. In analyzing the United Nations voting patterns for the various resolutions, the arbitrator found that a majority voted for Resolution No. 1803, including many developed countries with market economics, and the inclusion of the reference to international law was an essential factor in the support of several Western countries. With respect to subsequent

[92] 17 I.L.M. 3, 27 (1978), 4 Y.B. Com. Arb. 177, 184 (1979).

resolutions, however, while they were supported by a majority of States in the United Nations, they were not supported by industrialized nations with market economics. The Tribunal held that only Resolution No. 1803 reflected the state of customary law. In support of this holding, the arbitrator noted that 65 countries had ratified the ICSID Convention as of 31 October 1974.

The Tribunal also decided that the entire text of Resolution No. 3281 negated the arguments of Libya because another provision of the Resolution referred to good faith, and the arbitrator concluded that it would be a violation of the most elementary principle of good faith if there was a fundamental imbalance in which a contract bound only the private party but not the State.

In the LIAMCO case,[93] by contrast, the arbitrator ruled that the more recent resolutions of 1974, "if not a unanimous source of law, are evidence of the recent dominant trend of international opinion concerning the sovereign right of States over their natural resources..." The Tribunal went on to note that this right "is always subject to the respect for contractual agreements and to the obligation of compensation..."

4. Remedies for Expropriations

a. *Restitutio in integrum*/specific performance

Some petroleum companies have asserted as their principal remedy in nationalization cases the right to restitution in kind (*restitutio in integrum*) or specific performance. These assertions touched off a debate over whether restitution in kind or specific performance is recognized in international law as a remedy for a nationalization. In modern practice, restitution in kind does not appear to be generally recognized as a remedy for an expropriation, although it might be applied if the expropriation is unlawful or the Government is incapable of discharging its obligations.

British Petroleum sought *restitutio in integrum* or specific performance as its principal remedy for the nationalization of its interests by Libya in 1971.[94] The Tribunal noted the practice of States at that time in exercising diplomatic protection of their nationals by requesting restitution in kind or, alternatively, monetary compensation. The Tribunal also surveyed the international case law, noting that the German Government did not claim *resitutio in integrum* in the Chorzow Factory case, so the discussion of that remedy by the International Court of Justice was merely *obiter dictum*. The Tribunal found no explicit support in public international law for applying remedies of specific performance or *restitutio in integrum* for wrongful breach of contract. The arbitrator concluded that there is no uniform general principle of law by which "specific performance is a remedy available at the option of an innocent party, especially not a private party acting under a contract with a Government." The principal remedy under public international law is damages. As an afterthought, the arbitrator observed that it has been argued

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93 6 Y.B. Com. Arb. 89, 101 (1981).

94 BP v. Libya, 53 International Law Reports 297, 346 (1979), 5 Y.B. Com. Arb. 143, 141-45 (1980).

that *restitutio in integrum* should be available as a remedy when a State is insolvent or incapable of discharging its obligations, and thus, damages is not an adequate remedy, but noted that BP made no such claim in this case.

A different result was reached by the arbitrator in TOPCO v. Libya.[95] There, the Tribunal found that *restitutio in integrum* is an appropriate remedy under the Libyan Civil Code and Muslim law, and cited the Chorzow Factory case as applying the rule of *restitutio in integrum*. The arbitrator also held that the overwhelming majority of authors recognize *restitutio in integrum* as the proper remedy to repair injuries caused by an unlawful act, although in practice it is applied only in exceptional cases. The arbitrator noted his disagreement with the notion of applying this remedy only in exceptional cases. The Tribunal concluded that under both Libyan law and principles of international law, the normal sanction for non-performance is *restitutio in integrum*, and it is inapplicable only to the extent restoration of the *status quo ante* is impossible. The parties' contract provided, in clause 28, paragraph 5, that the arbitrator was to specify an adequate time period for the party to comply with the decision, and if the party did so, then it would not be deemed in default. The arbitrator determined that this provision implied that performance was the principal remedy intended by the parties and damages was only a subsidiary remedy. The Tribunal found Libya's nationalization to be a breach of contract and gave Libya five months to comply with the award by performing the contract or other measures would be taken.

The final installment of the great trilogy of Libyan nationalization cases also addressed this remedy.[96] The arbitrator there found that article 206, paragraph 1, of the Libyan Civil Code and Islamic jurisprudence recognize specific performance as an appropriate remedy, when it is possible. The Tribunal also decided that the principle of *restitutio in integrum* is common to international law, but is conditioned by the possibility of performance. "Such impossibility is in fact most usual in the international field." According to the arbitrator, "restitution presupposes the cancellation of the nationalization measures at issue, and such cancellation violates also the sovereignty of the nationalizing State." Moreover, the arbitrator decided there was insufficient authority that nationalization in breach of a concession is an internationally unlawful act permitting restitution as a remedy. The Tribunal, therefore, rejected the remedy of *restitutio in integrum*.

Although not directly claimed as a remedy by AMINOIL, the Tribunal noted that the company's damage calculation included an element *of restitutio in integrum* in Kuwait v. AMINOIL.[97] The Panel held that AMINOIL's estimate of damages was founded on the assumption that the concession would have lasted its entire term without modification, which is consistent with restitution. The Panel rejected this assumption in setting damages.

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95 17 I.L.M. 3, 32-36 (1978), 4 Y.B. Com. Arb. 177, 185 (1979).

96 LIAMCO v. Libya, 6 Y.B. Com. Arb. 89, 105-06 (1981).

97 21 I.L.M. 976, 1031, 1035 (1982), 9 Y.B. Com. Arb. 71, 86 (1984).

Finally in Phillips Petroleum v. Iran,[98] Chamber Two of the Iran-U.S. Claims Tribunal indicated that the remedy of restitution of property may be available if the expropriation were unlawful. The Panel decided it need not determine the availability of that remedy because restitution was not sought by Phillips.

b. Damages

(1) Loss Suffered *(Damnum Emergens)*

Dammum emergens, which refers to out-of-pocket costs and losses, is the least controversial element of damages awardable for an expropriation. It is universally held that if any compensation is due, at a minimum, the *damnum emergens* must be paid by the expropriating State.

In Sapphire International Petroleums v. NIOC,[99] the sole arbitrator in a relatively early nationalization case held that the compensation for breach of a concession "includes the loss suffered (*damnum emergens*), for example the expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have obtained." The expenses for which NIOC was held liable in the Sapphire case included $350,000, which constituted the amount of a letter of credit wrongfully cashed by NIOC, and expenses incurred in performing the contract such as the cost of prospection work, the claimant's share in the capital of IRCAN, and the registration fees of certain companies in Iran. The arbitrator held, however, that these expenses could be claimed only through the end of June 1960, which was the date by which the claimant had stopped performing its obligations. The total expenses awarded amounted to $650,874.

The arbitrator in LIAMCO v. Libya,[100] concluded that the compensation to be awarded for the nationalization of LIAMCO's property by Libya should include the value of all tangible property seized. Specifically, the arbitrator said "there is no difficulty also that the indemnity should include as a minimum the *damnum emergens*, e.g. the value of the nationalized corporeal property, including all assets, installations, and various expenses incurred." For these assets and expenses, the Tribunal awarded LIAMCO the full amount of its claim for its 25.5% interest in the physical plant and equipment -- $13,882,677.

As part of the damages, the Tribunal in the AMINOIL case awarded the Claimant the depreciated replacement value of the fixed assets seized by Kuwait.[101] The Panel did not limit the damages awarded to the value of AMINOIL's assets, but also included a going concern value.

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98 21 Iran-U.S. C.T.R. 79, 122.

99 35 International Law Reports 136, 186 (1957), 13 Int'l & Comp. L.Q. 1011, 1018-19 (1964).

100 6 Y.B. Com. Arb. 89, 107 (1981).

101 21 I.L.M. 976, 1038, 1042 (1982), 9 Y.B. Com. Arb. 71, 90 (1984).

In the AGIP case,[102] the Tribunal awarded F 968,071.86 against the Congolese government for non-recovery of commercial debts, F 16,688,388 for payments made by AGIP as guarantor, and F 2,800,000 for 50% of the shares of the joint company nationalized by the Congo. The Panel also held that the Government must be substituted in place of AGIP for all subsequent obligations contracted by the company. The Panel categorized these losses as *damnum emergens*.

For the appropriation of Sisa's drilling rigs, as part of its damage claim, Sedco sought the lost revenue from the loss of use of the rigs for the period of time from their appropriation by Iran until they could be replaced.[103] Sedco denominated this claim as one for lost profits, but the Iran-U.S. Claims Tribunal "determined that the claim is in fact 'a direct loss resulting from the unavailability of the rigs to Claimant for use elsewhere and as such is *damnum emergens*'." The Panel accepted Sedco's estimate that it would take nine months to replace the rigs, but deducted two months during which the rigs would be moved, and thus, would be without any revenue. The Tribunal awarded such lost revenue for seven months per rig in the total amount of $4,817,064. The Panel also held that, because of the award of loss of use damages until replacement, it would not be appropriate to award interest on the value of the appropriated property until the theoretical replacement date. With respect to the loss of use of Sediran's rigs, the Tribunal denied this claim because Sedco claimed damages for the expropriation of its shareholder interest in Sediran, and since Sediran's rigs were not taken by Iran, there was no loss of revenue to Sediran. Therefore, Sedco was amply compensated otherwise.

(2) Loss of Profits *(Lucrum Cessans)*

Considerable controversy surrounds the question of whether lost profits may be awarded for an expropriation, although it is likely that lost profits may be included in the compensation if the expropriation is unlawful under international law. Because of this dispute, some arbitral tribunals have noted that parties have resorted to creative ways to claim lost profits, without calling them such.

The arbitral Tribunal in Sapphire International Petroleums v. NIOC[104] considered whether lost profits may be awarded for breach of a concession in an area not yet prospected. The Tribunal observed that the existence of both commerciable quantities and damages were uncertain, and it framed the issue as whether the plaintiff had a right to compensation for loss of a "chance" to discover oil. The plaintiff established a sufficient probability of success, which gives the concession a market value, based on the expert testimony of a geologist. The geologist testified that the minimum loss Sapphire would suffer was its investment of $8 million and the

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102 8 Y.B. Com. Arb. 133, 141, 143 (1983).

103 Sedco, Inc. v. National Iranian Oil Co. (NIOC), Award No. 309-129-3 (2 July 1987), 15 Iran-U.S. C.T.R. 23, 53, 111-12.

104 35 International Law Reports 136, 187-90 (1957), 13 Int'l & Comp. L.Q. 1011, 1019-21 (1964).

most would be lost profits of $46 million. The Tribunal decided this analysis did not fully account for all risks involved such as prospecting in a desolate region and the possibility of wars and price recessions. With these factors in mind, the Tribunal decided that lost profits could be awarded and gave Sapphire $2 million for such profits.

A full analysis of the recoverability of loss of profits can be found in the sole arbitrator's award in LIAMCO v. Libya.[105] There, the arbitrator found that most municipal law systems permit lost profits as part of the damages for breach of contract, that both Libyan law and Islamic law also allow the recovery of lost profits, and that classical international law allows the recovery of lost profits for both wrongful taking of property and lawful nationalizations. The Tribunal determined, however, that the recent evolution of international law indicated that there was no constant and uniform rule for the compensation of lost profits for nationalizations, at least not *all* future profits. While awarding full damages claimed for the physical plant and equipment seized and $66 million as "equitable compensation" for the nationalization of Concession No. 20, the Tribunal specifically rejected lost profits for Concession No. 17 because such profits were not "certain and direct", were doubtful and were not probably realizable. Therefore, lost profits were rejected for that concession. Lost profits were not rejected outright for Concession No. 20, but were considered as part of equitable compensation.

The Panel in Kuwait v. AMINOIL,[106] considered profits to a certain extent. There, the Tribunal took into account a reasonable rate of return for AMINOIL, noting that it "had come to accept the principle of a moderate estimate of profits, and ... this ... constituted its legitimate expectation." The Panel seemed to adopt as its method the value of "the undertaking itself, as a source of profit," as well as the value of the assets seized. AMINOIL received an award of $179,750,764 in that case.

In AGIP v. Congo,[107] the arbitral Tribunal opined that the principle of full compensation for losses is limited in certain circumstances, but held that those circumstances were not present because the Government had not invoked any contributory negligence or other fault by AGIP and the nature of the damages was not unforeseeable. The Tribunal held that the Congo had breached the contracts independent of the nationalization itself. AGIP limited its claim for loss of profits to a symbolic sum of F1 for each of its three claims: (1) failure to pay dividends, (2) loss of profits under the Assistance Agreement and Trade Marks Agreement, and (3) loss of profits for breach of Article 14 of the Protocol Agreement. On the basis of these claims, the Panel awarded AGIP F3 for *lucrum cessans*.

A brief discussion of Mobil's, and the other Consortium members', claims for lost profits was included in Mobil Oil v. Iran.[108] Having decided that the parties mutually agreed to terminate

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105 6 Y.B. Com. Arb. 89, 107 (1981).

106 21 I.L.M. 976, 1038 (1982), 9 Y.B. Com. Arb 71, 89-90 (1984).

107 8 Y.B. Com. Arb. 133, 141-43 (1983).

108 16 Iran-U.S. C.T.R. 3, 55.

the SPA and negotiate the question of compensation, which negotiations were interrupted and never completed because of the Revolution, the Tribunal concluded it had to determine what the parties could have legitimately expected from good faith negotiations. In this context, the Panel noted that the Consortium members did not lift the total crude oil to which they were entitled in the last years of performance, and NIOC ceased to give priority to the companies' requirements. Therefore, the Tribunal held that the claimed loss "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." Lost profits, therefore, were rejected by Chamber Three of the Iran-U.S. Claims Tribunal.

A lengthy discussion of lost profits as an element of compensation was undertaken by the Iran-U.S. Claims Tribunal in Amoco International Finance v. Iran.[109] There, Chamber Three decided that for a lawful expropriation, the going concern value at the time of dispossession is the measure and limit of compensation, while for an unlawful expropriation, lost profits might be added. This indicates that lost profits are not included in the going concern value at the date of the taking, although future prospects are considered. The Discounted Cash Flow (DCF) method suggested by Amoco was rejected by the Tribunal because, inter alia, it neglects the *dammum emergens* and makes *lucrum cessans* the sole element of compensation, which "opens a large field of speculation". In issuing its opinion, the Tribunal awarded Amoco 50% of the going concern value of Kharg Chemical Co., "without addition of future lost profits beyond such value."

(3) Net Book Value

Beginning with the Libyan oil nationalizations in 1971, governments have contended that, at least for a lawful expropriation, they owe only the net book value of the tangible assets seized. Libya's Prime Minister explained net book value in these terms:

> ... we will just assume that this particular company since the signing of the concession agreement, although it had spent 100 million dinars, had recovered until 1962 something like 60 million dinars. The book value at the time of nationalization or participation is 40 million dinars...[110]

The arbitrator in that case considered Libya's position that only net book value was owed to be an "extreme" position, and rejected it. The arbitrator, similarly, rejected LIAMCO's argument for *restitutio in integrum* or lost profits for all concession reserves as an equally "extreme" position. In lieu of these two "extremes," the arbitrator adopted the principle of ***equitable compensation***.

The Government of Kuwait argued very strongly for net book value as the standard for compensating AMINOIL for a 1977 nationalization in Kuwait v. AMINOIL.[111] In that case, the

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109 15 Iran-U.S. C.T.R. 189, 249-51, 258-59.

110 LIAMCO v. Libya, 6 Y.B. Com. Arb. 89, 112 (1981).

111 21 I.L.M. 976, 1035-36 (1982), 9 Y.B. Com. Arb. 71, 87, 90 (1984).

Government suggested that a number of negotiations and settlements during the period of 1971-1977 "had generated a customary rule valid for the oil industry - a *lex petrolea* that was in some sort a particular branch of a general universal *lex mercatoria*." The Government contended that the compensation in these cases had reference only to the net book value of the redeemable assets. The Tribunal rejected Kuwait's claim because the negotiations included many complex factors other than merely the parties' legal rights, were held under strong economic and political pressures, and the companies and the importing States had a strong need to continue a steady supply of petroleum products. The arbitral Panel did note that the net book value standard might be appropriate if the matter involved a recent investment so that the original cost and present replacement cost are close in amount. Otherwise, however, the Panel held that other methods of determining compensation should be used.

A rather careful analysis of the net book value compensation standard is found in Amoco International Finance v. Iran.[112] Iran claimed that net book value is "the normal standard of compensation in case of lawful expropriation, especially in the oil industry..." The Third Chamber of the Iran-U.S. Claims Tribunal observed that this standard had "the advantage of being easily and objectively assessed," but the Tribunal refused to credit Iran's argument, saying:

> ... the theory that net book value is the appropriate standard of compensation in all cases of lawful expropriation overlooks the fact that a nationalized asset is not only a collection of discrete tangible goods (equipment, stocks and, possibly, grounds and buildings). It can include intangible items as well, such as contractual rights and other valuable assets, such as patents, know-how, goodwill and commercial prospects. To the extent that these various components exist and have an economic value, they normally must be compensated, just as tangible goods, even if they are not listed in the books.

In the Amoco case, the Tribunal stated that the traditional approach under international law is to compensate the net value of the transferred assets, both physical and intangible, including the profitability of an ongoing enterprise, and went on to adopt the going concern value of Amoco's interest in the Kharg Chemical Company, Ltd.

(4) Equitable Compensation

The arbitrator in LIAMCO v. Libya,[113] found no common principles between the domestic law of Libya and international law as to the compensation due for a nationalization and rejected the traditional damage formulas of "prompt, adequate and effective" compensation and "full and prior" compensation. The sole arbitrator labeled as "extreme" both compensation views of net book value and recovery of full profits of the concession reserves. Instead, the Tribunal held that "it would be reasonable and just to adopt the formula of *'equitable compensation'* as a

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112 15 Iran-U.S. C.T.R. 189, 265.

113 6 Y.B. Com. Arb. 89, 113 (1981).

measure for the estimation of damages . . ." Relying on this compensation formula, the Tribunal awarded LIAMCO $13,882,677 for its 25.5% interest in the physical plant and equipment and $66 million (out of LIAMCO's $186,270,000 claim) for its rights in Concession No. 20.

(5) Discounted Cash Flow (DCF) Method

The Iran-U.S. Claims Tribunal explained the DCF method as calculating "the claimant's prospective net earnings over the term of the JSA and discount[ing] them to give their value at the date of taking, using a discount rate that takes into account the perceived risks."[114]

In the case of Kuwait v. AMINOIL, AMINOIL presented two methods for determining the value of its nationalized interests: (1) the sum of anticipated profits for the full term of the concession, discounted to present value, without considering the value of the assets, or (2) the total anticipated profits over a limited number of years, discounted over that limited period to present value, but taking account of the value of the assets.[115] The first of these theories of recovery is equivalent to the DCF method. The ad hoc Tribunal agreed in principle that both of these methods were acceptable, but preferred to consider a variety of methods. It focused on a method based on "the reasonable rate of return," which it ruled the parties used in their relations and negotiations, and seemed to adopt a going concern value taking account of the undertaking, as a source of profits, and the value of the assets. AMINOIL was awarded on this basis $179,750,764.

The DCF method was specifically discussed by the Iran - U.S. Claims Tribunal in Amoco International Finance v. Iran.[116] The Third Chamber rejected this method because it held the expropriation to be lawful, and "the DCF method *prima facie* seems not fitted to the present issue." The Panel determined that the DCF method fails to consider the *damnum emergens*, but instead, "*lucrum cessans* becomes the sole element of compensation." Because this method allows a projection of damages over a long time period, the Tribunal noted it opened "a large field of speculation due to the uncertainty inherent in any such projection...," and said it amounted to "a capitalization of hypothetical future earnings for all other elements of valuation." Although it said it was not rejecting the DCF method altogether, the Panel appeared to do just that. In lieu of the DCF method, the Tribunal adopted the going concern approach for valuing Amoco's interest.

Chamber Two of the Iran - U.S Claims Tribunal gave a more sympathetic hearing to the DCF method in Phillips Petroleum v. Iran.[117] The Panel understood the DCF method not as a request for future lost profits, but rather as a relevant factor in determining fair market value. The Tribunal considered the DCF method to be "a relevant contribution," but determined it would not

114 Phillips Petroleum v. Iran, 21 Iran-U.S. C.T.R. 79, 123.

115 21 I.L.M. 976, 1034-35, 1037-38, 1041 (1982), 9 Y.B. Com. Arb. 71, 86-87 (1984).

116 15 Iran-U.S. C.T.R. 189, 258.

117 21 Iran-U.S. C.T.R. 79, 123.

use it as the exclusive method of analysis. The Panel also noted its disagreement with Phillips Petroleum's DCF calculations, holding that they did not take into account all of the relevant risks.

(6) Underlying Asset Valuation Approach

The AMINOIL Tribunal considered a method of valuing AMINOIL's expropriated interests, as an alternative to AMINOIL's DCF method, by which total anticipated profits are calculated for a limited term of years and discounted (over that same period) to present value, but also taking account of the depreciated replacement value of AMINOIL's nationalized assets.[118] The Tribunal held that this method was acceptable in principle, but applied instead a combination of methods based mainly on going concern value. This method, claimed by AMINOIL, is akin to the underlying asset valuation approach.

The Iran - U.S. Claims Tribunal, Chamber Two, specifically decided to consider the underlying asset valuation approach as one method for valuing the claimant's nationalized interest in Phillips Petroleum v. Iran.[119] This approach was defined by the Panel as valuing both Phillips' tangible investments and its intangible assets, including the profitability of its share of the going concern, and deducting the claimant's share of liabilities. This method is specifically applied by calculating the tangible assets at their depreciated replacement value, thereby adjusting the book value, and then quantifying "the intangible assets including profitability of the property interests taken" by determining an appropriate income figure based on historic earnings and applying a multiple, which takes into account legitimate expectations in an oil venture. The Tribunal used this method to confirm its compensation award of $55 million, determining a depreciated replacement value of Phillips' tangible investment of $22-23 million and an intangible asset value of approximately $38 million based on $3 million of annual income and a reasonable rate of return of 5%.

(7) Going Concern Value

The arbitral Tribunal in Kuwait v. AMINOIL[120] adopted a standard for valuing AMINOIL's nationalized interest based on the value of the going concern. In that case, the Tribunal ruled that it would take account of "all the elements of an undertaking," including separate appraisals of the value "of the undertaking itself, as a source of profit," as well as the depreciated replacement value of the fixed assets. Putting it slightly differently, the Tribunal held that the amounts owed to AMINOIL included "the value of the various components of the undertaking separately considered, and of the undertaking itself considered as an organic totality - or going concern - therefore as a unified whole, the value of which is greater than that of its component parts, and which must also take account of the legitimate expectations of the owners." The Panel ordered that AMINOIL receive $179,750,764.

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118 21 I.L.M. 976, 1034-35, 1038, 1042 (1982), 9 Y.B. Com. Arb. 71, 86 (1984).

119 21 Iran-U.S. C.T.R. 79, 124.

120 21 I.L.M. 976, 1038, 1041 (1982), 9 Y.B. Com. Arb. 71, 90 (1984).

Chamber Three of the Iran-U.S. Claims Tribunal decided that "the measure of such compensation [for a nationalization] shall be the full value of the asset taken," pursuant to the 1955 Treaty of Amity between the U.S. and Iran.[121] The full value was held to be the value of Amoco's 50% of the shares of the Kharg Chemical Company, Ltd. Since the company was a going concern at the time of the expropriation, the Tribunal held that "[g]oing concern value, accordingly, is the measure of compensation in this case." This value was explained by the Tribunal in the following words:

> Going concern value encompasses not only the physical and financial assets of the undertaking, but also the intangible valuables which contribute to its earning power, such as contractual rights (supply and delivery contracts, patent licenses and so on), as well as goodwill and commercial prospects. Although those assets are closely linked to the profitability of the concern, they cannot and must not be confused with the financial capitalization of the revenues which might be generated by such a concern after the transfer of property resulting from the expropriation (*lucrum cessans*).
>
> The value of a going concern ... is "made up of the values of the various components of the undertaking separately considered, and of the undertaking itself considered as an organic totality - or going concern - therefore as a unified whole, the value of which is greater than that of its component parts."

The Panel also noted that the liabilities of the company on the valuation date must be deducted from the total value. The Panel left it for another occasion to determine the actual value of the going concern.

In Phillips Petroleum v. Iran,[122] Chamber Two of the Iran-U.S. Claims Tribunal made a similar holding. That Panel began with the 1955 Treaty of Amity, which provided both for "the prompt payment of just compensation," and that "[s]uch compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken..." According to the Tribunal, when the property taken is a going concern, this standard is met by "compensation that makes the Claimant whole for the 'fair market value' of the property at the date of taking." The Claimant's contract rights in the JSA were held to be only part of a going concern because it only had a right to *participate* in the management of the joint operating company and a right to take and export only its percentage share of the petroleum produced. Because NIOC and Iran took complete control over the going concern to the exclusion of the Claimant's interest, the Claimant was held to be entitled to the fair market value of its interest in the JSA on the date of the taking. The Tribunal decided it must take into account all relevant circumstances, including equitable considerations. In determining a value, the Panel took into account the DCF method, as argued

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121 Amoco International Finance v. Iran, 15 Iran-U.S. C.T.R. 189, 269.

122 21 Iran-U.S. C.T.R. 79, 119.

by the Claimant, but also considered the "underlying asset valuation" approach. On this basis, Phillips was awarded $55 million for its expropriated interest in the JSA.

(8) Liquidation Value

Sedco sought compensation for Iran's expropriation of its 50% shareholder interest in Sediran, an Iranian company, as of 22 November 1979.[123] Instead of seeking compensation on the basis of Sediran's going concern value, Sedco asserted recovery for the liquidation value of the company as of the date of the expropriation. Sedco asked the Tribunal to assume the winding up of Sediran's affairs and the disposition of its assets on the open market at the appropriate date. The Panel agreed that the liquidation value was a "fair measure of value" for the case. "Thus, in compensation for the expropriation of its shares in SEDIRAN, Claimant is entitled to one-half of the full value of all of SEDIRAN'S assets, including property, cash, securities, and accounts receivable, reduced by the liabilities of the company outstanding at the date of taking." On this basis, taking into account comparable sales, appraisals, the amount of insurance coverage, replacement value, and current net book value, the Panel awarded Sedco the sum of $30,783,090 for its 50% share of the liquidation value of Sediran on the date of the taking.

(9) Inflation

The question of including inflation in the calculation of damages was discussed by the Tribunal in Kuwait v. AMINOIL,[124] The Panel took note of the high rate of inflation in effect in the late 1970's and early 1980's and said it would be unfair to determine a replacement value based on the original purchase price when it bore no relation to the present replacement value because of inflation. The Tribunal also talked of profits not being true income but representing a capital value because of the need to reinvest them to replace depleted oil. The Panel buttressed its findings by reference to the "gold clause" in the 1948 Concession, OPEC's use of a "basket of currencies", and the parties' discussion of inflation in their negotiations. In conclusion, the Tribunal held, "In the compensation to be paid to AMINOIL, it would be natural to take account of the progress of inflation generally, and in particular by reference to the price of refined petroleum products on the American market." An annual inflation rate of 10% was fixed by the Tribunal.

(10) Interest

LIAMCO requested a 12% interest rate on amounts it claimed for Libya's nationalization of its interests, although recognizing that setting the rate lay in the arbitrator's discretion.[125] The Libyan Civil Code provided for interest of 4% in civil cases and 5% in commercial cases. The Tribunal concluded that it was "just and equitable to consider the interest claimed not as usury

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123 Sedco, Inc. v. NIOC, 15 Iran-U.S. C.T.R. 23, 101.

124 21 I.L.M. 976, 1039-40, 1042 (1982), 9 Y.B. Com. Arb. 71, 90-92 (1984).

125 LIAMCO v. Libya, 6 Y.B. Com. Arb. 89, 115-16 (1981).

(*ribâ*), but as a compensatory equivalent consideration of the said discount rate...." The Tribunal reduced the interest to the 5% rate allowed by Libyan law and granted interest only from the date of final assessment of damages because interest cannot be awarded on unliquidated damages before they are ascertained.

In the AGIP case,[126] interest was awarded against the Congolese Government calculated from the dates on which the different amounts were due to AGIP, or were paid by it, up to the date of actual payment at the lowest rates in effect during the relevant periods on the markets concerned.

B. PRODUCTION SHARING CONTRACTS

1. *Force Majeure* Clause

The applicability of a *force majeure* clause to excuse an operator's failure to complete an exploration program arose as an issue in National Oil Corp. (NOC) v. Libyan Sun Oil Co,[127] Libyan Sun Oil Co. (Sun Oil), a Delaware company, entered into an Exploration and Production Sharing Agreement (EPSA) with NOC, a state-owned Libyan corporation, in late 1980. The contract provided that it was to be governed and interpreted in accordance with the laws and regulations of Libya, including the Petroleum Law. Sun Oil was to be the operator and had a minimum exploration program obligation estimated at $100 million. In late 1981, political tensions between the U.S. and Libya worsened, and in December 1981, the U.S. Government prohibited persons using U.S. passports from traveling to Libya. Sun Oil repatriated its U.S. personnel. In March 1982, the U.S. Government issued regulations prohibiting the export of certain technology without a license. Sun Oil sought such a license, but its application was denied. Sun Oil invoked the *force majeure* clause, based on the U.S. Government passport and export regulations, to justify its failure to carry out its exploration obligations. NOC challenged the applicability of the *force majeure* clause and initiated this ICC arbitration in Paris.

Libyan Civil Code art. 360 provides three conditions for the invocation of *force majeure*: (1) the event must be beyond the control of the parties, (2) the event must be unforseeable at the time the contract was executed, and (3) the event must render performance of the obligation absolutely impossible. 29 I.L.M. at 584. The Supreme Court of Libya emphasized in a 1971 decision in the LATSIS case that performance must be *absolutely* impossible by the means intended by the parties in order to constitute *force majeure* under the statute. The parties agreed that article 360 was not a public order provision and the parties were free in their contract to exclude *force majeure* or make it more flexible. 29 I.L.M. at 584. Article 22, the *force majeure* provision of the EPSA, provided that any failure to perform was excused "to the extent attributable to force majeure." The next sentence said: "Force majeure shall include, without limitation: Acts of God; insurrection; riots; war; and any unforeseen circumstances and acts

126 8 Y.B. Com. Arb. 133, 143 (1983).

127 First Award of 31 May 1985, 29 I.L.M. 565, 584 (1990), 16 Y.B. Com. Arb. 54, 57 (1991).

beyond the control of such Party." The succeeding paragraph allowed the parties to terminate the EPSA if performance "is affected by force majeure" for a continuous period of one or two years.

The Tribunal addressed the question of whether the parties intended by their *force majeure* clause to exclude the conditions of Libyan Civil Code art. 360. The Panel held that the EPSA did not define *force majeure*; the portion quoted above merely specified certain events that were deemed to fall within *force majeure* without defining *per se* the meaning of that term. The Panel focused on the "impossibility" condition of article 360 and noted that the word "attributable" indicates a direct causal link between the event and the non-performance, while the term "affected" does not provide any indication as to the applicability of the "impossibility" test. While an increasing number of international contracts have included, within the circumference of the term *force majeure,* events that make performance "very difficult," "more expensive than anticipated," or events "which cannot be overcome by the use of reasonable means at reasonable costs," the Tribunal said that "such exceptions to the common law of *force majeure* [the impossibility condition] must be expressly provided for; they should not be presumed or implied."

The Panel held that the EPSA provision indicated an intent not to strictly apply the enforceability requirement, but it did not exclude the fundamental requirement of impossibility. The Tribunal went on to hold that the first two requirements of article 360 -- beyond the parties' control and the unforeseen circumstance requirement--were met by the U.S. Government regulations.

As for the impossibility condition, the Panel accepted Sun Oil's argument that the parties assumed that Sun Oil would perform the contract with its own U.S. personnel and technology, but the Tribunal found nothing in the contract that made it an "essential condition" that Sun Oil would use its own technology or U.S. management personnel. The contract did not exclude Sun Oil from using non-U.S. personnel or other companies' technology to perform. In fact, the agreement allowed Sun Oil to use contractors to perform the exploration operations and provided that Sun Oil would cause its parent and affiliates to aid in the performance of the agreement. The Panel decided that Sun Oil could perform by having its Canadian, U.K. or other foreign affiliates send management personnel and technology to Libya to perform, without violating U.S. regulations. Perhaps, the most convincing evidence to the Tribunal was the fact that two U.S. companies -- Occidental and Coastal -- had similar obligations in Libya that they had been able to perform despite the U.S. passport and export regulations. Therefore, the ICC Tribunal held that these regulations did not make it impossible for Sun Oil to perform, so it could not properly invoke the *force majeure* clause. Although deciding that Sun Oil had mistakenly invoked this provision, the Panel held it did not do so in bad faith.

2. <u>Withdrawal and Repudiation</u>

The NOC claimed that Sun Oil's actions in invoking *force majeure* and refusing to perform constituted a withdrawal from the EPSA, under article 3.4.[128] That provision gave Sun Oil the right to withdraw, but required it to pay the costs of the uncompleted exploration program if it

[128] <u>NOC v. Libyan Sun Oil</u>, 29 I.L.M. 601, 605, 608 (1990), 16 Y.B. Com. Arb. 54, 68 (1991).

did withdraw. The Tribunal rejected NOC's claim in this respect, holding that the mere invocation of the *force majeure* clause did not constitute a withdrawal. The NOC also claimed that Sun Oil's refusal to resume operations following the Tribunal's decision that the *force majeure* clause was not properly invoked by Sun constituted a withdrawal. Likewise, the Panel refused to credit this argument because a "withdrawal cannot result from a merely presumable, hypothetical or inferred intention;" it can only result under the EPSA from an intent that is expressly notified to the other party. Sun Oil never invoked article 3.4 and never notified NOC that it intended to withdraw. Therefore, Sun Oil was held not to be liable to NOC on this ground; however, it was held liable for breach of contract by ceasing its exploration operations in December 1981 for a reason ruled legally invalid by the Panel.

Sun Oil, for its part, claimed that NOC repudiated the EPSA by its failure to attempt an amicable settlement, by its "hasty" commencement of the arbitration proceeding, and by its telex of 8 April 1982 in which it stated that Sun Oil's actions amounted to a withdrawal from the EPSA and that it was awaiting a response "in order to finalize all outstanding matters between" the parties. The arbitral Tribunal dismissed Sun Oil's claims, finding that NOC did not express an intention to repudiate the contract, and in fact, in later telexes, it expressly said it did not intend to terminate the EPSA. The Panel also found a deadlock on whether an event of *force majeure* had occurred, and therefore, NOC properly resorted to arbitration. The Tribunal found no bad faith on the part of NOC, and it ruled that NOC did not repudiate the agreement.

3. Termination by Fundamental Error, Mutual Misunderstanding or Mutual Conduct

Sun Oil claimed that the EPSA was void because of fundamental error or mutual misunderstanding or was terminated because the mutual conduct of the parties treated it as such.[129] Under Libyan law and other legal systems, a contract may be terminated by differing intentions of the parties, known as fundamental error or mutual misunderstanding. The error, however, must relate to an essential condition of the agreement. The Tribunal found no factual basis for this claim, rejecting Sun Oil's contention that the use of its U.S. personnel and technology were essential conditions of the EPSA.

The Panel agreed with Sun that a contract may be terminated by mutual conduct of the parties, just as it may by explicit statements. Similarly, if the parties treat a contract as terminated, it is terminated as a matter of law. But "each party must reveal by its conduct ... an implicit agreement that the contract has been terminated." In this case, however, each party requested performance of the contract while accusing the other of a disguised intent to terminate it. In these circumstances, there was no mutual conduct evidencing an implicit agreement to terminate the contract.

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[129] NOC v. Libyan Sun Oil, 29 I.L.M. at 613.

4. Damages/Liquidated Damages/Mitigation

NOC sought an order requiring Sun Oil to pay the costs of the uncompleted portion of the exploration program pursuant to articles 8.2 and 25.2 of the EPSA.[130] Sun Oil had undertaken a minimum exploration obligation estimated to cost $100 million. Article 8.2 of the EPSA provided that if any part of the exploration program for any area were not properly completed by the end of the exploration period for that area, then Sun Oil "shall immediately pay ... the costs of such uncompleted part..." Article 25.2 said that in the event of a termination of the EPSA by NOC, all amounts owed by Sun Oil "shall become immediately due and payable."

Based on the specific language of article 8.2, the Tribunal rejected Sun Oil's argument that this provision only comes into play when oil has been produced under the EPSA. Likewise, Sun Oil's claim that NOC suffered no loss because whatever oil ever existed remains in the ground and under NOC's control was also rejected. The Panel accepted the view that if NOC suffered no loss, article 8.2 would be inapplicable. This view was grounded in article 227(1) of the Libyan Civil Code. The Tribunal found, however, that "N.O.C. 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.". The Panel held that article 8.2 provided the legal basis for NOC's claim, noting that the EPSA is a risk contract under which "Sun Oil undertook an unconditional and absolute duty" to timely complete the exploration operations or pay the costs of the uncompleted part.

NOC was held entitled to terminate the contract because "Sun Oil's cessation of performance in January 1982 [as a result of the U.S. Government passport and export regulations] and its failure to resume performance in July 1985 [after the Tribunal's holding that the regulations did not constitute *force majeure*] were not legally justified and constituted a material breach of its contractual obligations." Next, the Panel decided that NOC could only claim damages based on its "actually suffered loss," according to general contract law, because the amount payable under article 8.2 as liquidated damages would be "grossly exaggerated" - which is the standard set in Libyan Civil Code art. 227(2) for disregarding a liquidated damage provision. This holding was based on three factors. First, the Tribunal considered the full circumstances of the case, including the serious and unforseeable difficulty for Sun Oil in replacing its U.S. personnel, which was created by the U.S. regulations. Second, the liquidated damages, estimated by NOC at $200 million, were held to be very excessive and out of proportion to NOC's actual loss, which "consists of the damages flowing from the fact that N.O.C. did not receive, within the exploration period, the geophysical information and data needed to assess the petroleum resources". In support of this point, the Panel observed that there was, at the time it wrote, a surplus of oil on the world market, and crude oil prices were correspondingly low.

The third point was based on NOC's failure to mitigate its loss. This was explained in the following terms:

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130 Id. at 617.

> ...from July 1982 to the end of 1985, N.O.C. made no effort to mitigate the loss caused by the cessation of exploration operations. In particular, N.O.C. did not propose, or unequivocally declare its willingness to discuss, alternative plans that would have permitted the continuation of the exploration operations, perhaps on a more modest level through the use of outside contractors or another operator...

In particular, NOC did not respond to a 1983 telex from Sun Oil in which Sun said it would not interfere with efforts by NOC to find alternative means to go forward with the exploration program. Instead, "NOC persisted in its uncompromising attitude" demanding immediate payment by Sun Oil "on the unjustified ground" that Sun's conduct constituted a withdrawal from the EPSA.

Article 227(2) of the Civil Code of Libya permits a judge to reduce the liquidated damages if they are grossly exaggerated, and the Panel held this gave it broad discretion to determine the damages. The Tribunal noted NOC's refusal, despite repeated requests, to produce any evidence of its "actual proven losses". Therefore, the Tribunal held it "fair and equitable" to award damages of $20 million for breach of contract, with the expenses of the arbitration to be borne 60% by Sun Oil and 40% by NOC.

5. Breach of Contract/Non-Associated Natural Gas

Many international oil contracts have been negotiated with only a short provision stating that if non-associated natural gas is discovered, the parties will negotiate a future contract for the exploitation of the gas. With the companies' increasing desire to exploit gas discoveries, rather than plugging such wells (as in the past), has come a need to find a way to enforce these gas provisions when negotiations over exploitation projects fail. These contracts present the question of whether a party can breach a contract by failing to negotiate in good faith. This issue was squarely faced in the case of Wintershall, A.G. v. Qatar.[131]

Wintershall entered into an Exploration and Production Sharing Agreement (EPSA) in 1976 with Qatar in substitution for a Concession Agreement of 1973. Wintershall obtained a 30-year exclusive right to explore, drill and produce petroleum in a defined area; Wintershall was required to relinquish 50% of the Contract Area after five years, and another 20% after eight years. If neither crude oil in commercial quantities nor economically-utilizable, non-associated natural gas were found within eight years, Qatar was entitled to terminate the EPSA. If non-associated natural gas were discovered, Wintershall was permitted to produce it either pursuant (1) to further contractual arrangements to be mutually agreed, or (2) to the "go it alone" principles set out in EPSA art. XV (3), ¶ 3.

Wintershall never discovered crude oil in commercial quantities, although because of a boundary dispute with Bahrain, the Emir instructed it not to drill in the Structure A area, which was regarded as the area most likely to contain crude oil. In 1980, Wintershall notified Qatar of its discovery within the Contract Area of non-associated natural gas in substantial quantities,

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131 28 I.L.M. 795, 813 (1989).

which it believed to be economical. Qatar and Wintershall considered several projects for the use of the natural gas from the Contract Area as well as natural gas from an adjacent area in which the Qatar General Petroleum Corporation (QGPC), a wholly-owned corporation of the Government of Qatar, held the petroleum rights. No agreement was ever reached on these projects. Wintershall, and other Claimants with an interest in the EPSA, invoked the arbitration clause and claimed that Qatar breached the EPSA (or expropriated the Claimants' contractual rights) both (1) by denying permission to explore the Structure A area, and (2) by failing to agree on further contractual arrangements for the use of the non-associated natural gas.

The arbitral Tribunal rejected each of these claims and found no breach or expropriation by Qatar of the EPSA. First, as to the Structure A area, the Government was expressly authorized by the EPSA to limit Wintershall's operations, so the Panel held there was no breach by Qatar's refusal to allow exploration of this area. Second, with respect to the natural gas project proposed for the adjacent area, the Tribunal found that Wintershall's rights under the EPSA did not extend outside the Contract Area, Wintershall's proposals were no more than mere offers, their acceptance by Qatar was not required by EPSA's duty of good faith negotiation, the Government did not agree to any plan or project for the joint development of the adjacent area, and Qatar had no legal duty to unitize the area or to accept the proposals for joint development. Third, the Panel found no breach by the Government's refusal to agree to a utilization plan or other contractual arrangements for the non-associated natural gas discovered within the Contract Area. The Tribunal found there was no violation by Qatar of any duty to negotiate in good faith, such a duty does not obligate the Government to agree to Wintershall's proposals, no agreement was reached as to those proposals, and the Government's refusal to accept them was made in good faith and was justified by normal commercial practice. The Panel also found that Qatar never agreed that utilization of the Contract Area gas was economical and that the Government's failure to notify Wintershall within four years that it did not consider utilization of the gas to be economical did not constitute acceptance by silence. Thus, no breach of contract or expropriation by Qatar was found.

6. Specific Performance/Equitable Extension of Contract/Waiver

Although it found no breach of contract or expropriation by the Government of Qatar, the arbitral Tribunal did find that Wintershall was entitled to an extension of the relinquishment periods provided by the EPSA.[132] In particular, although it rejected the claim that the Government misrepresented its boundary dispute with Bahrain as to the Structure A area, the Panel did find that Qatar failed to disclose the details of that dispute prior to the signing of the EPSA. The Tribunal ruled that a statement by the Emir effectively indicated an intent not to apply the relinquishment provisions of the EPSA harshly, and it therefore found an intent not to apply, and that it would be inequitable to apply, those relinquishment provisions to the Structure A area until Wintershall is permitted to develop that area under the EPSA. The Panel referred to this extension of the relinquishment terms of the EPSA as specific performance of the contract. Two members of the Tribunal based this remedy on the fact that no oil had yet been found in the Structure A area, so any order of payment would be an unjust enrichment of Wintershall. In a

[132] Wintershall v. Qatar, 28 I.L.M. 795, 814, 817 (1989).

separate opinion, one of the arbitrators - Ian Brownlie - expressed the view that specific performance would be oppressive to Qatar, that an extension of the relinquishment terms can be justified only on the basis of a waiver theory based on the Government's conduct in not seeking to apply those provisions to Structure A (and not on the basis of the terms of the EPSA itself), and that the payment of equitable compensation would be the more appropriate remedy.

As to the non-associated gas in the Contract Area, although it determined that the Government had no duty to agree to further contractual arrangements for the utilization of that gas, the Tribunal did find that the failure of Qatar to notify Wintershall within four years that it did not consider the gas to be economically utilizable resulted in the loss of the Government's right to participate in the development of those resources, other than if the Claimants exercised the "go it alone" option of article XV (3). The Government's refusal to agree to terms for a joint project to use the Contract Area gas could not prevent Claimants from exercising the "go it alone" provision, which the Panel considered not to really be a "go it alone" option, but rather a joint venture on the terms stipulated in the EPSA.

On these bases, the Tribunal held that Wintershall's relinquishment period would be extended eight years from the date of the award for exercising the "go it alone" rights to develop the natural gas in the Contract Area and that the relinquishment term for the Structure A area would not begin to run until Claimants were permitted to develop that area.

7. Petroleum Costs/Off-Take of Natural Gas

In the Wintershall case, the Tribunal interpreted the EPSA to allow the Claimants to recover the "Petroleum Costs" of the non-associated natural gas "to the extent and out of 40% of Net Production in each calendar year."[133] The Panel held that the term "Petroleum Costs", defined as all expenditures made and all costs incurred in carrying out Petroleum Operations related to the EPSA, includes the costs of re-injecting any constituent elements of natural gas, and therefore, such costs are recoverable by Claimants at a maximum annual rate of 40% of the Net Production. The Claimants may not recover as Petroleum Costs their "share of any excess of the annual value of Cost Recovery Natural Gas over Petroleum Costs actually recoverable not used or to be used to satisfy Claimants obligation under a Natural Gas project--up to 10%, or any of the Government's share of this excess (not so used or to be used) -- up to 90% -- purchased by the Claimants pursuant to their preferential right..." If so the Government decides to re-inject natural gas, the costs of doing so are for its own account.

The Tribunal also held that the obligation to off-take natural gas applies to all the constituent elements of natural gas and not just to those that can be readily marketed. Therefore, there is an obligation to off-take residual dry natural gas as well as the liquid elements.

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133 Id. at 838.

8. Unjust Enrichment

The Wintershall Tribunal rejected the Claimants' unjust enrichment claim, which was based both on the alleged deprivation of the Claimants' economic interest in the natural gas discovered and on the appropriation of the well test and information about the field that resulted from the drilling and other costs incurred by the Claimants.[134] Article 81 of the Qatari Code refers to an enrichment "without lawful cause" at the expense of another party. Because Wintershall had an implied duty under the EPSA to report information it obtained about natural resources, the Government did not obtain the data "without lawful cause". Moreover, title to the gas in the ground belonged to Qatar, not the Claimants. Finally, since the Panel ordered that the EPSA continued in force, it ruled that the contractual rights of the Claimants were not taken, and there was no unjust enrichment by the Government.

9. Rental Payments

The Tribunal in Wintershall[135] ruled that if the Claimants exercised the option provided in the Panel's award to extend the EPSA, it would be inequitable for the Claimants to be required to make rental payments for the period before the date of the Final Award because of their previous inability to exercise their "go it alone" option. Therefore, rental payments were not required until Wintershall has the ability to use the "go it alone" option as ordered in the Final Award.

10. Interest

If Wintershall elected the valuation option provided in the Panel's award, and allowed the EPSA to terminate, then the Tribunal ordered the Government of Qatar to pay interest from the date of the Final Award "at the generally prevailing LIBOR rate on the date of the award."[136]

C. OPERATING AGREEMENTS

The failure of a party to pay its contractual share of the costs of a sole risk operation arose in Deutsche Schachtbau v. RAKOIL.[137] In 1973, the Government of R'as al Khaimah entered into a concession agreement with an exploration company to explore for oil and gas in the territorial waters of R'as al Khaimah. The parties subsequently entered into an Operating Agreement on 24 February 1974, which named the exploration company as operator. The Operator assigned some of its contractual rights to a Consortium of companies. The Consortium was required to carry out seismic work and the drilling of two exploratory wells. The Government was not required to

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134 Id. at 820.

135 Id. at 807.

136 Id. at 809.

137 14 Y.B. Com. Arb. 111, 119 (1989).

participate in the cost of these operations until and unless commercial quantities of oil or gas were discovered. The first exploratory well was proven dry. Thereafter, the parties signed an Assignment Agreement, which annexed a 1976 Operating Agreement, by which RAKOIL (a Government-owned oil company) acquired a 48.78% participating interest.

The Government, through RAKOIL, exercised its right under the Assignment Agreement to drill two additional exploratory wells as "sole risk" operations. Deutsche Schachtbau-und Tiefbohrgesellsacht mbH (DST) succeeded to the exploration company as operator on 1 January 1979, and it elected to participate in the sole risk operations. The Government entered into an agreement with Sea and Land Drilling Contractors to perform certain services. In 1978, the Government stopped paying its share of the exploration costs. This arbitration ensued before the International Chamber of Commerce Court of Arbitration, and the Government and RAKOIL filed suit against DST in a court of the R'as al Khaimah requesting that the agreements be set aside and that DST be restrained from continuing the arbitration. The court granted an order to that effect.

1. Misrepresentations or Mistake

The Government and RAKOIL claimed they entered into the Assignment Agreement and the Operating Agreement as a result of misrepresentations by the Consortium that substantial quantities of oil had been discovered. DST rebutted the Government's claim by pointing to the fact that the Government received both daily reports and an analysis of test results showing that while hydrocarbons were present, it was impossible to say in what quantities, and stating that test results were not promising. The arbitral Tribunal found no representations that commercial quantities had been discovered in either the Assignment Agreement or the 1976 Operating Agreement, and it found no representations otherwise. It, therefore, rejected the Government's argument that it was induced to enter into the agreements as a result of misrepresentations by the Consortium, and it also found no facts to indicate that the agreements should be held invalid on the basis of mistake.

2. Audits

The Government and RAKOIL sought an audit of the Operator's records as allowed by the Accounting Procedure, but the Tribunal found that the Government and RAKOIL took no steps to arrange such an audit and omitted to challenge the accounts presented by the Operator. DST produced witness statements and audited financial statements and reports proving the amounts claimed as exploration costs. The Tribunal found DST's amount to be proven to its satisfaction.

3. Sole Risk Operations

DST argued that the contract with Sea and Land was entered into by the Government and was exclusively its debt. The Tribunal found, however, that this contract was entered into as part of the sole risk operations in which DST elected to participate as operator, and accordingly, the

Operator was entitled to claim from the Government its share of the expenses of this operation, but it was not solely the Government's debt.

4. Costs

The Panel noted Article 20 of the ICC Rules of Conciliation and Arbitration and paragraph XVIII(1) of the Operating Agreement, which provided for the "payment by the party in default of all costs paid or incurred by non-defaulting parties". The Tribunal relied upon these provisions as a basis for awarding all costs and expenses to DST and against the Government. On this basis, DST was awarded $395,837 for its collection costs, legal costs and arbitration costs.

5. Interest

The arbitration Tribunal rejected DST's argument that the absence of the word "simple" in paragraph XVIII(1) of the Operating Agreement implied that the parties intended to allow compound interest to be awarded. The Tribunal held DST was entitled to simple interest on the sums awarded. The Panel awarded DST interest up to the date of the award and for the period after the date of the award until paid at the rate of 3% per annum above the prime rate of Commerzbank, up to a maximum of 14% per annum. In total, DST was awarded $4,635,664 against the Government and RAKOIL, which included accrued interest, and arbitration and legal costs.

D. OIL SUPPLY CONTRACTS

An oil supply agreement formed the basis for an unusual arbitration in Sojuznefteexport v. Joc Oil.[138] The case involved issues of the validity of contracts of a state agency, the risk of loss due to an agency's lack of authority in contracting, and principles of restitution and valuation.

1 Validity of State Agency Contract

Joc Oil, Ltd., a Bermuda company, entered into a contract in 1976 with the All Union Foreign Trade Association Sojuznefteexport, a Soviet organization, by which Joc Oil was to purchase 3.85 million metric tons of oil and oil products. The contract was signed only by the Chairman of the Association. Joc Oil challenged the validity of the contract because Soviet law requires that contracts of Soviet organizations be signed by two persons who have received a Power of Attorney signed by the chairman of the organization. Article 14 of the Fundamental Principles of Civil Legislation of the USSR and article 45 of the RSFSR Civil Code provided that any contract not signed as prescribed by law is invalid.

Even though both parties treated the contract as valid and performed it over a long period of time, the Foreign Trade Arbitration Commission of the USSR Chamber of Commerce and Industry (FTAC) held it invalid because of "the imperative rule" of articles 14 and 45. The

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138 18 Y.B. Com. Arb. 92, 99 (1993).

Tribunal also rejected the Association's assertion that the contract at issue was purportedly approved by some other agreements.

2. Risk of a Party's Lack of Authority

JOC Oil alleged, as a counterclaim in the arbitration, a breach of contract by the Association by its failure to deliver oil as agreed.[139] The FTAC rejected Joc Oil's counterclaim, saying:

> On signing a contract each of the parties must satisfy itself as to the authority of the person (or persons) who has signed the contract as a party. And if it does not do this, by that very fact, it takes upon itself the possible unfavourable consequences of the signing of the contract by the person not having the authority to do so or not possessing sufficient authority and correspondingly the consequences of recognition of the contract as invalid as a result of non-observance of the procedures established for its signing. From this there follows its lack of any right to present to its partner a claim for the causing of harm connected with this.

Holding that the risk of the lack of authority of the Association's chairman to sign the contract fell upon Joc Oil - at least as to its counterclaims - the Tribunal ruled that the Association could not be liable to Joc Oil for breach of contract because the contract was not valid, and therefore, the Association had no legal obligation to deliver the oil.

Similarly, Joc Oil's claims for reimbursement of expenses for demurrage and cancellation of contracts for freight tonnage for transporting oil never delivered by the Association were rejected. Since the contract was invalid *ab initio*, "the risk of bearing expenses connected with the payment of demurrage and dissolution of contracts for the carrying of tonnage must fall upon the firm 'Joc Oil'."

3. Unilateral Restitution/Mutual Restitution

In the Joc Oil case, the FTAC took note of article 14 of the Fundamental Principles of Civil Legislation of the USSR (article 48 of the RSFSR Civil Code), which provides that the parties to an invalid transaction must return to the other party everything received under the transaction or, if that is impossible, reimburse its value in money. The Tribunal termed this as bilateral or mutual restitution. The Panel rejected Joc Oil's position that an invalid transaction gives rise to no legal consequences; it does not give rise to the consequences intended by the parties, but it does give rise to other consequences.

The FTAC held that it was impossible to effect full mutual restitution by the return of the oil and oil products delivered because the oil has been resold and long since consumed. Therefore, the mutual restitution rule of article 48 is insufficient to remedy the dispute. Because

139 Sojuznefteexport v. Joc Oil, 18 Y.B. Com. Arb. 92, 108 (1993).

Joc Oil had not paid for all of the oil it received, the Panel held it necessary to effect unilateral restitution by ordering Joc Oil to pay for the oil received but for which it never paid. The legal basis for this was found in article 473 of the RSFSR Civil Code, which required a person, who without legal basis acquires property at the cost of another, to return the unjustly-acquired property.

4. Statute of Limitations

Joc Oil claimed that the Association's demands must be considered as new claims first presented in 1984, but the basis for which arose in 1977. Therefore, the company contended that the claims were made outside the three-year period of limitations provided by Soviet law. The Arbitration Commission rejected Joc Oil's assertion because it found that the right to restitution only arose when it recognized the contract as invalid. Therefore, the Association's claims changed their character from breach of contract to restitution within the period of limitations.

Joc Oil's claim for lost profits, on the other hand, was dismissed by the FTAC as having expired in 1980, and therefore, falling outside the three-year period of limitations. The Panel held that a claim arises when a person knew or should have known about the breach of his right, and Soviet law does not permit the presentation of a claim, for which the period of limitations has expired, even as a defense to another presented claim.

5. Valuation of Property

The FTAC, next, took up the question of how to value the oil received by Joc Oil but not paid for.[140] The Tribunal held, under article 473 of the RSFSR Civil Code, that the oil and oil products must be valued at the moment they were acquired by Joc Oil. Joc Oil argued they should be valued at that time according to the prices at which the Association purchased the oil and oil products, but this was rejected. Instead, the Panel held that reimbursement should occur at the prices that the Association "should have received" from Joc Oil for the goods, and therefore, the oil must be valued at world prices for corresponding goods predominant at the time Joc Oil acquired them. Since Joc Oil did not prove that the prices for the oil set out in the invoices to it from the Association exceeded world prices, the Tribunal considered it justified in using the invoice prices as the value of the oil.

6. Lost Profits/Interest

The Association also presented a claim against Joc Oil for $96,922,873.42 pursuant to article 473, paragraph 5, of the RSFSR Civil Code.[141] On this claim, the FTAC held that "a person who has unjustly acquired property is obligated also to return or reimburse all profits which he received or should have received from the property from the time when he knew or should have known about the unjustified receipt of the property." Therefore, the Panel ruled that

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[140] Id. at 104.

[141] Id. at 107.

Joc Oil was obligated to pay interest for the use of the monetary sum from the time when payment for the goods should have been made upon accounts presented by the Association and not disputed by Joc Oil.

Joc Oil objected to this claim because it was never late in paying its monetary obligations and because interest cannot exceed 3% pursuant to article 226 of the RSFSR Civil Code. The Tribunal refused to credit Joc Oil's argument, finding that the claim arose under article 473, not article 226.

The Arbitration Commission also held that the Association had the right to claim reimbursement for profits up to the time that Joc Oil makes payment for the goods. The amount of profits was determined by the Tribunal on the basis of an average percentage for credit granted, as mutually used in the oil trade.

7. Waiver of Claims

Joc Oil also argued that the Association and it reached an agreement in August 1977 by which the Association waived its right to present a claim against Joc Oil.[142] The Association denied any such agreement, and the FTAC held that such an agreement could have legal significance only if it was in proper written form. Since it was not, the Panel rejected Joc Oil's claim.

8. Costs

Finally, the FTAC held that Joc Oil must reimburse the Association part of its expenses in paying the arbitration costs in a sum proportional to the amount of the claims satisfied - $991,402.43.[143] On the basis of the restitution claim, the FTAC ordered Joc Oil to pay the Association in total the sum of U.S. $199,255,719.55

E. DRILLING CONTRACTS

A drilling contract was the subject of an ad hoc international arbitration in Western Company of North America v. Oil & Natural Gas Commission of India (ONGC).[144] The parties entered into a drilling contract in 1982 for a jack-up rig at a dayrate of $41,600 per day for 24 months. The two-year term ended on July 17, 1984, but the contract provided that it "shall be extended to complete or abandon the well then in progress."

In the spring of 1984, the parties began negotiations to extend the contract beyond 24 months at a reduced dayrate of $18,500 per day. On May 20, 1984, Western began drilling well

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142 Id. at 109.

143 Id.

144 Interim Award of 17 October 1985, 13 Y.B. Com. Arb. 5, 14 (1988).

KI-1, which continued beyond the 24-month contract term and was not completed until December 2, 1984. Negotiations for an extension of the dayrate contract continued until October 1984, but proved unsuccessful.

1. Equitable and Promissory Estoppel and Quantum Meruit

The ONGC claimed that Western was estopped, under Indian law principles of equitable and promissory estoppel (the contract provided that Indian law would govern) to claim the original contract dayrate of $41,600 per day because of the negotiations for a lower dayrate. The ONGC claimed that statements made during the negotiations by Western constituted a representation that was relied on by the ONGC. The ONGC also claimed that Western should be compensated for the period from July 17, 1984, to December 2, 1984, only on the basis of quantum meruit at the rate of $18,500 per day.

Western instituted arbitration and sought approximately $6 million, based on the original dayrate. The arbitrator held in favor of Western. He reasoned that, although Western negotiated for a reduced dayrate, its consistent position was that any extension at a reduced rate must be for a period of at least one year. The ONGC wanted a shorter period. In each of its letters to the ONGC (except one), Western said expressly that if an agreement could not be reached, then the terms of the original contract would control for any drilling beyond the 24-month term. Not surprisingly, the ONGC pointed to the one letter in which Western did not include this statement as a representation, on which the ONGC relied, that the lower dayrate would apply to any drilling done beyond July 17, 1984.

2. Reservation of Rights and Reliance

The arbitrator held that because of the reservation of rights by Western, there was no representation that could be relied upon by the ONGC. The arbitrator also pointed to an August 1984 letter from the ONGC to the Ministry of Energy in which the ONGC admitted that the original contract rate would continue if no agreement for an extension were reached. On the basis of that letter, the arbitrator held that the ONGC did not rely upon any representation by Western. Since there was no representation by Western and no reliance by the ONGC, there could be no estoppel. The arbitrator ruled that the contract was clear and the original dayrate of $41,600 per day applied to the period from July 17, 1984, to December 2, 1984.

This arbitral award is instructive about the importance of properly documenting a party's position, and reserving its rights, during negotiations to amend a contract.

F. TRANSPORTATION CONTRACTS

The first significant published international arbitration award of the modern era dealing with the petroleum industry involved the case of Saudi Arabia v. ARAMCO.[145] While this is the

[145] 27 International Law Reports 117, 172 (1963).

earliest arbitration of the modern era and involves a unique set of facts, it is included here because of its application of principles of contract interpretation to a concession agreement.

The Government of Saudi Arabia granted an exclusive oil exploration concession over eastern Saudi Arabia to Standard Oil Company of California (SOCAL) in 1933. Socal formed the California-Arabian Standard Oil Company (CASOC) and assigned its right in the concession to it. In 1944, CASOC became ARAMCO. Article 1 of the 1933 Concession granted the Company "the exclusive right, for a period of sixty years..., to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum ... and the derivatives...." On January 20, 1954, Saudi Arabia concluded a contract with Aristotle Onassis, giving Onassis' Saudi company, Saudi Arabian Maritime Tankers Co., Ltd., a right of priority for the transport of Saudi oil for 30 years. ARAMCO objected to the Onassis agreement on the ground that ARAMCO had the exclusive right to transport Saudi oil and the Onassis agreement conflicted with its contract. Arbitration ensued to settle these issues.

The first question that arose was whether ARAMCO had the exclusive right to transport oil. The arbitral Tribunal noted that its task was to determine the common intention of the parties at the time the contract was signed by examining the contract terms used and the parties' conduct in performing their contract. The Government admitted that Moslem principles of contract interpretation are the same as those recognized in international law. The Panel found that one of the fundamental principles of Moslem law is that "generic terms must be interpreted extensively" and "they must be given the general purport implied in their generality, unless they are restricted by a special qualification limiting their scope and calling for a restrictive interpretation." A principle found by the Panel to be generally followed in interpreting concessions is that "any restriction on the rights granted by a general clause must be expressed in a clear and unequivocal manner if it is to be invoked against the concessionaire." The Panel also applied the principle of good faith.

One of the complicating factors of interpreting the contract was the fact that it was written in two languages - English and Arabic - neither of which was provided to be authoritative over the other. The Panel solved this problem by looking to the text of both languages and reconciling the meaning.

The term "exclusive right" in the 1933 Concession was held to mean an absolute right, which belongs only to the holder and excludes competition. The term was also ruled to include a negative obligation by the Saudi Arabian Government to refrain from doing anything that would interfere with ARAMCO's right to export oil and oil products. ARAMCO's right was noted to be in the character of a limited monopoly.

The Tribunal focused on the words "transport, deal with, carry away and export" in Article 1 of the Concession and held them to be unambiguous. These words were given their plain, ordinary and usual meaning. These exclusive rights were held to necessarily imply the right of the concessionaire to conclude all contractual arrangements needed for the export of oil.

The Government argued for application of the principle of restrictive interpretation. This principle requires that government contracts be interpreted restrictively in the rights given to private parties and in favor of the government unless the private right is expressly spelled out. ARAMCO claimed this principle was obsolete. The Panel found this principle not to be obsolete, but also found it did not apply here. The principle of restrictive interpretation was held to apply only when the meaning of a contract is impossible to determine. The arbitrators ruled that this principle is only justified "when the sovereign rights invoked by the State concern interests of a general nature which cannot be defended otherwise than by disregarding the doubtful clauses of a contract." For purposes of this principle, public service concessions governed by municipal administrative law were distinguished from concessions for the development of natural resources. The principle of restrictive interpretation was not considered to be a cardinal rule of legal interpretation; before resort to it, the Government must not merely contend - but must establish - specific ambiguities or gaps in the written text. Instead of applying this principle, the Tribunal evaluated the parties' rights in a spirit of complete equality.

The Government also argued for application of the rule *verba chartarum fortius accipiuntur contra proferentum* - interpreting the contract against the party who drafted it, which was alleged to be ARAMCO. The Tribunal found no proof that the Concession Agreement was concluded on ARAMCO's initiative. Nevertheless, the Panel also decided that this rule only has full effect in adhesion contracts and is applied in national and international decisions only when all other means of interpretation have proved ineffective.

The Tribunal rejected Saudi Arabia's arguments that the order of the verbs in Article 1 ascribe a territorial limitation to the word "transport" that restricts its meaning to domestic transport in Saudi Arabia, that ARAMCO never (before this dispute) claimed an exclusive right to transport by sea and never owned or chartered any tankers, and that Article 1 does not expressly mention the right to ship. The various terms in Article 1 - "transport, deal with, carry away and export" - were held to partly cover the same ideas, but also to complement each other so as to give the "greatest possible width" to the language and make it clear that transport by sea is included in the Company's exclusive rights. The Panel bolstered its conclusion by reference to the Offshore Agreement of 10 October 1948, which broadened the concession to include all waters of the Persian Gulf over which the Saudi Government had dominion, thereby indicating that transport by sea was included in the Company's rights.

Resort was also had to the principle of practical interpretation, which provides for construing an agreement in accordance with the conduct of the parties in performing the contract. As proof that the parties recognized that the concession granted ARAMCO the exclusive right to transport oil by sea, the Panel pointed to the facts that the Company handled all details of transporting and exporting the oil for years without any protest from the Government, that ARAMCO arranged for the transport and export of the oil through f.o.b. (free on board) sales that allowed the buyer to choose the vessel, that the Company used Offtake Agreements for the sale and transport of oil, and that the Government had notice of ARAMCO's sales arrangements for 17 years and tacitly approved.

The next question concerned whether the Onassis concession conflicted with the ARAMCO concession. The 1933 concession provided that ARAMCO may not assign its rights without Government approval, so Saudi Arabia argued ARAMCO had breached the agreement by entering into Offtake Agreements and f.o.b. sales in which the buyer chooses the vessel for transporting the oil. Therefore, the Government concluded, ARAMCO had improperly assigned its right in breach of the concession agreement. The Tribunal held that ARAMCO did not assign its right under the agreement to transport and export the oil; it had the right to contract with independent contractors and specialized organizations to perform some of the technical operations of the oil enterprise, which is the proper characterization of the f.o.b. sales. Moreover, the Onassis agreement would conflict with the principle of the freedom of the seas, which includes the right of access to the ports of Saudi Arabia for loading oil. Finally, ARAMCO's rights have the character of acquired or vested rights, which cannot be taken away by a second concession. Respect for acquired rights is a fundamental principle both of public international law and of the municipal law of most civilized States. The Tribunal held the two agreements were in conflict because a priority right of Onassis to transport ARAMCO's oil would necessarily encroach upon ARAMCO's exclusive rights to transport and export oil. The Onassis contract could not derogate from ARAMCO's acquired rights and could have no affect on its offtakers and buyers. Since the Onassis contract had never been implemented, the Panel went no further in its award.

G. EXTENSION OF CONCESSIONS TO THE CONTINENTAL SHELF

The issue of whether a concession was sufficiently broad to cover the Continental Shelf arose in two cases in 1950 and 1951. Although important developments in the law of the continental shelf have occurred since 1951, and have substantially modified the law stated here, these cases are included for the purpose of completeness in this review of published international arbitral awards involving the petroleum industry.

In Petroleum Development (Qatar) Ltd. v. Ruler of Qatar,[146] an ad hoc arbitration Panel was faced with a Concession granted by the Ruler of Qatar to the Anglo-Persian Oil Company, Limited, in 1935. The Concession provided that the Company had "the sole right throughout the Principality of Qatar to explore, to prospect, to drill for and to extract and to ship and to export, and the right to refine and sell petroleum and natural gases ... and everything which is extracted therefrom." The Concession also gave the Company the right to "operate in any part of the State of Qatar as defined below..." The State of Qatar was defined as "the whole area over which the Shaikh rules and which is marked on the north of the line drawn on the map attached to this Agreement." The Anglo-Persian Oil Company assigned its rights and obligations under the Concession to Petroleum Development (Qatar) Limited. In 1949, a dispute arose as to the extent of the area subject to the Concession.

The Shaikh's arbitrator conceded that the Concession included islands over which the Shaikh rules and which are shown on the map attached to the Concession, to the extent the islands lie to the north of the line drawn on the map. The arbitrator also did not dispute that the

[146] Award of April 1950, 51 International Law Reports 161.

Concession includes lakes and rivers of Qatar, to the extent they lie north of the line on the map, whether such lakes and rivers are shown on the map or not.

Without indicating its reasoning, the arbitral Tribunal held that the Concession:

(1) includes islands over which the Shaikh ruled on the date of the Concession, whether or not shown on the map attached to the Concession;

(2) includes the bed and subsoil of all the inland or national waters both of the islands referenced above and of the mainland of the State of Qatar to the extent it lies north of the line drawn on the map; and

(3) includes the sea-bed and subsoil beneath the territorial waters both of the islands referenced above and of the mainland of Qatar to the extent it lies north of the line on the map.

The Panel also decided, however, that the Concession does not include the sea-bed or subsoil beneath the high seas of the Persian Gulf contiguous to the territorial waters.

A later case - Petroleum Development Ltd. v. Sheikh of Abu Dhabi[147] - faced the same issue, with the arbitrator reaching a similar result (and including his reasoning). The Sheikh of Abu Dhabi entered into a written contract in 1939 to transfer to Petroleum Development (Trucial Coast) Limited the exclusive right to drill for mineral oil in a certain area of Abu Dhabi. The contract defined the area in Article 2 as "the whole territory subject to the dependencies, and all its islands and territorial waters" or as "the whole of the lands which belong to the rule of the Ruler of Abu Dhabi and its dependencies and all the islands and the sea waters which belong to that area." The arbitrator decided that the difference in translations was not important and accepted the translation of the Government, since it was not opposed by the Claimant.

The arbitrator found that the words in Article 2, "and all the islands and sea waters which belong to that area", makes it clear that the Concession covers the subsoil of the territorial belt. The Sheikh's arguments that "sea waters" was merely included as a means of access to dry land and that there was no word for "territorial waters" in the archaic Arabic language used in Abu Dhabi in 1939 were rejected.

The question was whether the quoted language was limited to the territorial belt or also included the Continental Shelf. The arbitrator found that the doctrine of the Continental Shelf was unknown to the parties in 1939, its classic enunciation is found in the Truman proclamation of 1945, and in 1949 the Trucial States issued similar proclamations. The arbitrator decided that the doctrine of the Continental Shelf had not acquired the status of an established rule of international law, and certainly did not constitute such a rule in 1939 when the contract was concluded. The language of the contract was construed to exclude the Continental Shelf, and the negotiations were held not to modify this construction.

[147] Award of September 1951, 51 International Law Reports 144.

On this basis, the arbitrator concluded that the contract included the subsoil of the territorial waters, including the territorial waters of the islands of Abu Dhabi, but it did not include the subsoil of the Continental Shelf (i.e., the submarine area contiguous with Abu Dhabi outside the territorial zone).

V. Conclusion

While the published international arbitral awards involving petroleum issues are not so numerous yet and do not indicate such a unity of opinion in the international community on the proper resolution of all issues as to create anything like blackletter law rules, nevertheless, immense progress has been made in the past 25 years. The publication of awards has allowed later arbitrators to learn from the opinions of earlier tribunals and to build upon the foundations already constructed, rejecting unfounded reasoning and showing a growing sophistication and clarity. The result of this progress is that on some petroleum issues, clear legal rules have evolved, while on others at least the proper range of rules has been identified. This has not yet created a mature set of legal regulations, but it has developed the beginnings of a *lex petrolea* that serves to instruct, and in a certain sense even regulate - within broadly-defined boundaries - the international petroleum industry. As international arbitration continues to grow (provided that the publication of awards also continues), this *lex petrolea* may yet mature into a fully-developed subset of international law.