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MATERIALS ON

INTERNATIONAL PETROLEUM TRANSACTIONS

By

Ernest E. Smith
Rex G. Baker Centennial Chair in Natural Resources Law
The University of Texas School of Law

John S. Dzienkowski
Professor and Roy and Grace Whittenburg Faculty Fellow
The University of Texas School of Law

Owen L. Anderson
Eugene Kuntz Professor in Oil, Gas and Natural Resources Law
The University of Oklahoma

Gary B. Conine
Associate Professor of Law
University of Houston Law Center

John S. Lowe
George W. Hutchison Professor of Energy Law
Southern Methodist University School of Law

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PREFACE

The plans for this book were initiated several years ago by Professors Ernest E. Smith and John S. Dzienkowski of The University of Texas School of Law. Aware of the increasingly global scope of both the economy and legal arrangements, they set out to design a book that could be used to teach how law and legal arrangements function in the context of international business transactions and to do this by examining a single subject of international trade: energy resources—primarily petroleum. This focus reflects their shared belief that the interrelationship between the structure of commerical transactions and the development of public and private law is nowhere more pronounced than in the transactions involving the extraction, transportation, and sale of petroleum. Historically, oil has been the subject of the most important international agreements and disputes. Many of the legal doctrines applicable to transnational private arrangments have been developed in response to the arrangements by which oil has been extracted and sold. Moreover, different issues are raised along each link in the chain of transactions that begins with obtaining rights of exploration and ends with a sale in the world market place. These issues are not solely matters of private law. Along this chain the rights and interests of different governments come into play, including national policies aimed at vindication of sovereign rights, energy self-sufficiency, taxation, and environmental protection. International agreements and international organizations also must be considered. Documents as diverse as the Convention on the International Sale of Goods, the United Nations Resolution on Permanent Sovereignty over Natural Resources, the General Agreement on Tarrifs and Trade, and the Geneva Convention on the Continental Shelf are all highly relevant. Few other subjects of international trade provide an opportunity to examine such matters at various points in its stream of commerce. Moreover, no other commodity, either historically or currently, can match the importance of petroleum to the world's political and economic order.

As the scope of the book expanded and the movement of world events accelerated, the need for contributions by additional co-authors with special expertise in new or changing areas became clear. The dissolution of the Soviet Union, attempts at privatizing the petroleum industry in the Russian Federation, growing concern over the environmental impact of mineral development, and the desirability of including comparative studies dealing with solid minerals and expanded materials on joint development agreements immediately suggested the addition of Professor Gary B. Conine of the University of Houston Law

Professor Lowe thanks C. Paul Rogers III, Dean of the Southern Methodist University Law School, William L. Hutchison, Esq., and the Hutchison Endowment, for their support of his work on this project. He appreciates also the assistance provided by Thomas D. Cuadle, Lanty Winford Dean, Tiffany Haertling, Richard Howard, and Paul Seve, while they were law students at SMU, as well as his secretary, Dolores McKnight.

This book would not have been possible without the patience, computer skills, and common sense of Debbie Steed, who typed, re-typed, and formatted the book. Her persistence and co-ordination of the contributions of the various authors have added immeasurably to the quality of the book. We are also grateful to Pauline M. Simmons, whose special talents as an editor greatly enhanced the form, style, and consistency of the final product.

Finally, we thank the Rocky Mountain Mineral Law Foundation, which provided significant financial and moral support for this project.

We have used several conventions in this book. We have frequently omitted both footnotes and citations from cases and other materials without inserting ellipses or otherwise signaling the deletions. All footnotes, including those in cases and excerpts from books and articles, have been numbered consecutively from the beginning of each chapter. In a few instances materials in cases has been slightly re-arranged to enhance clarity.

Staying current with the rush of world events has been a principal difficulty in preparing this book. Segments on the new "openness" in the Soviet Union had to be replaced after the Soviet Union dissolved. The United States Congress approved NAFTA as the book went to press. Other events may make portions of the book obsolete within months after it is published. While already planning for a second edition, we believe that the basic structure and contents of the book as written will provide valuable tools for instruction in international transactions as conducted during the decade of the 1990s.

Ernest E. Smith
John S. Dzienkowski
Owen L. Anderson
Gary B. Conine
John S. Lowe

November 1993

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PART II. EXPLORATION, DEVELOPMENT, AND PRODUCTION

TABLE OF CASES

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the application to it of certain provisions thereof. See Article 19 of the Vienna Convention. Such unilateral declarations that a state does not accept a certain part of a treaty are usually referred to as "reservations." Thus several states ratified the 1958 United Nations Convention on the Continental Shelf, but entered reservations as to Article 6, which laid down rules for delimiting the boundaries of a continental shelf claimed by two or more countries.

3. Since accession to a treaty normally requires specific, affirmative action, there is usually little dispute over whether a state has agreed to be bound. Customary law, on the other hand, exists because states believe they are already obligated to comply with certain practices. In the *North Sea Continental Shelf* cases, 1969 I.C.J. Reps. 4; 8 I.L.M. 340 (1969), the International Court of Justice at paragraph 77 of its opinion made the following comments on whether state practice constituted customary international law:

> Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it * * * . The states concerned must therefore feel that they are conforming to what amounts to legal obligations. The frequency or even habitual character of the act is not in itself enough.

Does the doctrine that treaties are legally binding depend upon customary law? Would it ever be possible for customary law to supersede or invalidate a treaty?

4. In addition to its other sources, international law has also been based upon "general principles of law recognized by civilized nations," natural law, and *jus cogens*, or "compelling law." Determining "general principles" requires a comparative law approach. If treaties and customary international law fail to provide a rule for a specific situation, the "gap" can be filled by looking to domestic laws to determine if they provide a common principle or doctrine. Although the general principles concept was originally limited to the laws of Western countries, it now requires a search of legal systems worldwide. See generally Gerrit W. Gong, The Standard of "Civilization" in International Society (1984).

The other two traditional sources of international law are likely to be somewhat foreign to many American students. Most of the early theorists of international law, including Hugo Grotius, Emmerich de Vattel, and Charles de Montesquieu, relied heavily upon natural law. For example, de Vattel based the doctrine of the equality of nations upon principles of natural law. There are many conflicting theories of natural

law, but the underlying concept is that some principles are so fundamental that they are found within all communities, including the community of states.

Jus cogens is related to the concept of natural law. It includes principles that are so fundamental that they override or void conflicting provisions of treaties or rules of customary law. The concept of *jus cogens* is incorporated into Article 53 of the Vienna Convention on the Law of Treaties. It provides

> A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm [*jus cogens*] of international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.

U.N. Doc. A/CONF. 39/27 (1969), *reprinted in* 63 Am. J. Int'l L. 875 (1969).

What norms are so fundamental that they should be deemed *jus cogens*? Would the principle, *pacta sunt servanda*, fall within this category?

A concise description of general principles, natural law and *jus cogens* and their role in international law is contained in Mark W. Janis, An Introduction to International Law 46-54 (1988).

2. COMMON LAW AND CIVIL LAW SYSTEMS

Any international business transaction will involve issues related not only to international law but also to domestic law of two or more countries. This is particularly true of petroleum operations, because a major portion of the project is usually performed within the host country by a multinational corporation of a different citizenship. This situation means that the participants must be conscious of basic differences in the legal systems of the affected countries. Lawyers from common law countries must be prepared to understand the distinctions between their own legal regime and civil law systems. Attorneys representing developing countries, likewise, may need to be cognizant of different approaches in common law jurisdictions. The principal source of the law and the structure of legal rules within those sources is one of the first differences noted. This distinction is evident in the nature of the source material used in this text from time to time.

The common law and civil law traditions have their respective origins in different political, social, and intellectual settings. The civil law had its origin in Continental Europe where the predominance of decentralized governments with their own customized laws, a scholarly focus on universal principles contained in the codifications of Roman Law, and the doctrine of strict separation of legislative and judicial functions combined to create legal systems in which lawmaking was the province of the legislature. The task of the courts was limited to finding, interpreting, and applying the correct legislative principle. To enable the courts to accomplish this function effectively, it was necessary for the statutory codes to be complete, coherent and clear.

By contrast the common law tradition originated in England where a unified government could impose a central judicial system that assured laws developed from local custom were made uniform throughout the land. Additionally many laws could be effectively formulated by the judiciary as the need for them developed. Under such a system there was little or no need for comprehensive legislative codes and the legislative role was generally restricted to specialized laws. Thus, the common law is often looked upon as one that is created cautiously from case by case experience rather than one created in the abstract from universal premises.

This difference in the scope of the judiciary's role is the basis for the primary distinction between the common and civil law traditions: the binding force of precedent. Under the common law, a court is bound by the principles of a previous decision by that court or a higher court, provided that the basic reasoning of the prior case is applicable to the facts of the present case. In the civil law tradition, the trial judge is only to apply statutes and regulations. In theory, binding judicial decisions would be antithetical to the civil law. The judge is free to ignore previous decisions by other courts. Lower courts are not bound by the decisions of other courts. In practice, however, it is not uncommon to find even civil law courts giving sufficient deference to prior decisions to blur this distinction. The laws promulgated by the legislature are rarely comprehensive, coherent and clear enough to reduce the judicial function to a mechanical application of a statute. At a minimum, the courts must still interpret the law, fill gaps in the law, and reconcile conflicting laws. In reality, some degree of adherence to precedent can be found in the civil law as well as the common law.

In theory, these different approaches to the judicial function and the acceptable sources of the law mean that the logic of the common law is inductive and that of the civil law is deductive. The common law judge will employ the principles and policies evident in prior decisions to identify legal rules that appear to be applicable to the case presented for decision. The decision will often be reduced to a written opinion that reviews the facts in detail, develops the rule, and applies that rule to the facts. The detail of the written opinion may be later used by other courts as a guide to both the rule and its application. In the civil law court, the judge will ideally find the applicable rules stated in a statutory text and apply those rules directly to the facts in the case at hand. The decision, when reduced to writing, will omit the factual detail and emphasize instead the principles applied, much the same as in the statement of a statutory rule.

The use of statutory prescriptions is also different in each system. The cautious approach of the common law tradition found legislation necessary only to address specific social or economic problems. Solutions for all contingencies were unnecessary as long as the court could construct a rule from the principles of prior cases. Any statute that deviated from the common law applied by the courts was narrowly construed and applied only where clearly intended. Statutes within the common law tradition must be detailed to prevent the courts from escaping their intended effects. Thus, the common law system has become an unsystematic collection of statutes, court decisions, and customary practices with no clear hierarchical arrangement. Under the civil law, the statutes are the point of origin and must necessarily be broad and general to create rules for all issues that may arise. If a statute is not directly applicable, the court will search for an underlying principle in the statutes that will resolve the matter by analogy, thereby avoiding the obscurities and gaps in the law that might preclude application of the statute in the common law approach. But as a rule, the statutes of a civil law system will be more organized and consistent than the mix of legislative and judicial laws that comprise the common law. Just as the civil law has yielded in part to the practical need for some adherence to precedent, common law systems have attempted to systematize some of their laws through modern codes that unify, clarify, and simplify the collection of principles that have developed over the years. As a result, civil and common law systems are gradually moving closer together in their legal methods and techniques and the line between them slowly blurring in the practical demands of the modern world.

For a thorough analysis of the differences between the common and civil law systems, see John Henry Merryman, The Civil Law Tradition: An Introduction to the Legal Systems of Western Europe and Latin America (1985); and Konrad Zweigert & Hein Kötz, An Introduction to Comparative Law (1977).

3. TRANSNATIONAL REACH OF DOMESTIC LAWS

Because international transactions affect more than one country, one commonly encountered issue is which country's domestic law should apply. In personal injury suits, this determination is usually made through a traditional conflicts analysis. See, e.g., Fogleman v. ARAMCO (Arabian American Oil Co.), 920 F.2d 278 (5th Cir. 1991), involving an injured American worker hired by the California subsidiary of a Delaware corporation to work for its Saudi Arabian affiliate that was constructing an offshore oil platform in the Persian Gulf for ARAMCO. If there is no difference in the laws of the countries connected with the injured party, choice of forum may assume paramount importance. This is especially true if a successful plaintiff is likely to receive a much higher recovery in one forum than he will in alternative forums. In situations such as the Piper-Alpha disaster, where dozens of workers aboard a North Sea oil platform were killed, this possibility has given rise to a "mid-Atlantic settlement formula." Plaintiffs have been offered settlements based upon the size of a personal injury award obtainable in a U.S. court, discounted by factors of time, legal uncertainties of recovery, and litigation expenses. See Hans Baade, "Foreign Oil Disaster Litigation Prospects in the United States and the *'Mid-Atlantic Settlement Formula'*," 7 *J. Energy & Nat. Resources L.* 125 (1989). In most other types of disputes, the parties have attempted to resolve the issues of choice of law and choice of forum in advance of controversy by including specific provisions in their agreement. See, e.g., The Breman v. Zapata Off-Shore Co., Chapter 2, infra.

A second issue arises from the attempted extraterritorial application of domestic law. In other words, how should the law of one nation with an interest in either the goods produced from a transaction or the citizenship of the actors apply to a transaction that occurs outside the border of the domestic nation? It is most commonly encountered in connection with taxation, for many countries routinely seek to tax their residents' foreign income. A controversial example of the extraterritorial reach of United States law is the Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-1 and 78dd-2. In the wake of several highly publicized scandals involving bribery of foreign officials in the airplane manufacturing industry, Congress amended the securities law to provide criminal and civil penalties for the bribery of foreign officials. The act makes it unlawful for issuers of securities registered under the securities laws to make payments or offer anything of value to any foreign official for the purposes of "influencing any act or decision of a foreign official in his official capacity * * * or inducing such foreign official to use his influence with such foreign government or instrumentality * * * in order

to assist such issuer in obtaining or retaining business * * * ." 15 U.S.C. § 78dd-1(a). American companies have complained that the legislation puts them at a competitive disadvantage in that they are required to refrain from practices that are viewed by their competitors as part of the ordinary cost of doing business in many countries. Interestingly, few countries have adopted similar legislation and efforts in the United Nations to discuss corrupt practices have not resulted in a consensus.

The United States antitrust laws may provide the most striking example of attempted extraterritorial reach. The Sherman Antitrust Act applies to conduct outside the United States and may even reach acts of foreign corporations outside the United States if they were intended to affect interstate commerce and actually had some affect. See e.g., United States v. Aluminum Company of America, 148 F.2d 416 (2d Cir. 1945); In re Uranium Antitrust Litigation, 1980-1 Trade Cas. (CCH) at 63 (7th Cir. 1980). Since many countries actively encourage their industries to form cartels and to engage in oligopolistic conduct, the extraterritorial application of American antitrust laws often conflicts with opposing economic policies of other nations. Even countries that favor a highly competitive marketplace may view such laws as infringing upon their national sovereignty.

4. OVERVIEW OF INTERNATIONAL TAXATION IN UNITED STATES

Although a study of international taxation is beyond the scope of this book,[3] it is important to realize that participants to an international transaction spend much time examining the tax effect of their proposed transaction. The law of international taxation will significantly influence the structure of the transaction as well as the methods of compensation and payment for the parties involved. Because a study of international taxation would need to review the laws of all nations as they relate to international transactions, this brief section will only examine the broad principles of U.S. international tax rules.

The United States tax system imposes a tax upon net taxable income. Individual persons are taxed at graduated rates up to 39.6 percent and corporations are taxed at graduated rates up to 35 percent. Certain entities such as partnerships and S corporations, are not taxed at the entity level. Their net income is attributed to the individual owners and taxed only once, whereas corporations are taxed once at the entity level and a second time when they distribute dividends at the shareholder level. This double taxation often makes the corporate entity form undesirable.

3 For an excellent and comprehensive examination of international taxation, see Joel D. Kuntz & Robert J. Peroni, United States International Taxation (1992).

> We conclude that the political act complained of here was clearly within the act of state doctrine and that since the disputed pleadings inevitably call for a judgment on the sovereign acts of Libya the claim is non-justiciable. 550 F.2d at 73.

* * *

[The court's discussion of the Hickenlooper amendment has been omitted.]

For the reasons set forth above, the Court declines to recognize or enforce the arbitral award. * * *

Notes

1. In 1988, the Congress amended the Federal Arbitration Act to change the law in the above excerpted case. Courts now should not invoke the act of state doctrine to deny enforcement, confirmations of arbitration agreements and execution of judgments based upon such awards. See 9 U.S.C. § 15 (1988).
2. Should the Foreign Sovereign Immunities Act effectively eliminate the act of state doctrine, or should both doctrines co-exist together? See International Ass'n of Machinists v. OPEC, 649 F.2d 1354, 1359-60 (9th Cir. 1981), cert. denied 454 U.S. 1163 (1982). If they co-exist, why and how?
3. The act of state doctrine only applies to public acts of a sovereign. Would the doctrine apply to shield a public official of a foreign sovereign who accepted bribes in exchange for awarding an oil concession? See Clayco Petroleum Corp. v. Occidential Petroleum Corp., 712 F.2d 404 (9th Cir. 1983). For a discussion of the public act requirement, see Comment, "Defining the 'Public Act' Requirement in the Act of State Doctrine," 58 U. Chi. L. Rev. 1151 (1991).
4. In International Ass'n of Machinists v. OPEC, 649 F.2d 1354 (9th Cir. 1981), cert. denied, 454 U.S. 1163 (1982), the court held that the act of state doctrine barred a labor union's suit against OPEC and its member nations under the antitrust laws:

> When the state qua state acts in the public interest, its sovereignty is asserted. The courts must proceed cautiously to avoid an affront to that sovereignty. * * *
>
> The remedy IAM seeks is an injunction against the OPEC nations. The possibility of insult to the OPEC states and of interference with the efforts of the political branches to seek favorable relations with them is apparent from the very nature of this action and the remedy sought. While the case is formulated as an anti-trust action, the granting of any relief would in effect amount to an order from a domestic court instructing a foreign sovereign to alter its chosen means of allocating and profiting from its own natural resource.

Id. at 1360-61.

5. In Hunt v. Mobil Oil Corp., 550 F.2d 68 (2d Cir.), cert. denied, 434 U.S. 984 (1977), Hunt brought suit against the major oil companies for conspiring to prevent Hunt from reaching an agreement with the Libyan government and thus causing expropriation of Hunt property. The court denied the right to bring the suit under the act of state doctrine, because the action required a judgment on the sovereign acts of Libya.

C. RECOGNITION AND ENFORCEMENT OF JUDGMENTS AND ARBITRAL AWARDS

Central to the decisions regarding the choice of decisionmaker and forum is the question whether the judgment can be enforced against the party to obtain satisfaction. The following excerpts address the enforcement of judgments and arbitral awards.

ROBERT B. VON MEHREN, TRANSNATIONAL LITIGATION IN AMERICAN COURTS: AN OVERVIEW OF PROBLEMS AND ISSUES

Private Investors Abroad—Problems and Solutions in International Business in 1984 at 22-30 (1984)[45]

A plaintiff who has secured a judgment from an American court against a foreign defendant has good reason to be pleased but may face further problems in attempting to have the judgment satisfied. If the defendant is unwilling to comply with the judgment and has insufficient assets in the United States against which the judgment can be enforced, it will be necessary for the plaintiff to initiate proceedings abroad for the recognition and enforcement of the American judgment. Indeed, there may even be obstacles to enforcement of an American judgment within the United States.

United States Is Not A Party To Bilateral Or Multilateral Conventions

There is no settled, customary rule of international law regarding the transnational recognition and enforcement of judgments. The courts of each nation traditionally have applied that nation's own rules in determining whether to honor a judgment rendered in another nation. There are essential similarities in the standards applied in different nations—for example, as among the United States and other common-law nations; however, real certainty in the area has been achieved only with the conclusion of bilateral or multilateral conventions. Such international agreements currently govern recognition and enforcement between or among many nations of Europe and the British Commonwealth. Unfortunately, the United States is not at present a party to any such agreement.

* * *

[The other alternative to a convention is a treaty between two countries which addresses the recognition of judgments.]

General Principles of Comity

In the absence of treaties, the reciprocal recognition practice of the United States and other nations is governed by general principles of international comity, embodied in national or local statutory and case law. While the requirement of reciprocity or mutuality as an element of comity in their area has since lost favor in the American law, the Uniform Foreign Money-Judgments Recognition Act does not make reciprocity a precondition for recognition and enforcement of foreign-country judgments, and the Restatement (Second) of Conflicts of Law, § 98, Comment (1971), questions whether considerations of reciprocity are material. It typically remains a centerpiece of law in civil-law nations.

Thus, the courts of many European and Latin American nations will not as a matter of course give conclusive effect to an American money judgment, even if satisfied that the rendering American court had jurisdiction and that fundamental fairness attended the proceedings. Under their national laws, in the absence of a treaty, these foreign courts must additionally be satisfied that the rendering American court would grant reciprocal recognition to their countries' judgments. Moreover, while the actual practice with respect to foreign-country judgments in the United States under the common law generally has not placed any greater—and probably has placed fewer—obstacles before European judgments than the European courts have placed before American judgments, because of the absence of statutory law and the dearth of case authority in many American jurisdictions, it has often been difficult for the proponent of the American judgment to establish the elements of reciprocity.

For example, in the Federal Republic of Germany, judgments of countries with which there is not treaty relationship, including the United States, may be recognized and enforced as long as none of the grounds set forth in Section 328 1 of the Code of Civil Procedure for refusal of recognition is present. These grounds have to do with the propriety of jurisdiction of the foreign court, the adequacy of service of process, the consistency of the judgment with "good morals or the purpose of a German Law," and, finally, the existence of reciprocity.

The German courts have traditionally interpreted the reciprocity requirement quite strictly. * * *

Recent decisions of the German Supreme Court have been considerably more liberal in interpreting the reciprocity provision. Currently the existence of reciprocity will be assumed by German courts where recognition and enforcement of German judgments abroad encounter difficulties essentially no greater than the obstacles that would conversely be imposed by Germany. Partial reciprocity, i.e., reciprocity for the particular class of judgment at issue, is held to be sufficient. It is also now settled that the foreign rules need not be identical with the German provisions but that the rules as whole must be essentially equivalent.

In the absence of a uniform American law regarding the treatment of foreign judgments, no determination can be made as to whether reciprocity exists between Germany—or any other nation—and the United States as a whole. In this connection, one commentator has analyzed the Uniform Foreign Money-Judgments Recognition Act (the Uniform Recognition Act) against the German provisions governing recognition and enforcement of foreign judgments. His conclusion is that the laws are almost completely equivalent and thus that, for money judgments, reciprocity exists with those American states that have adopted the Uniform Recognition Act.

It would actually appear that American states that follow the pure common-law requirements for according conclusive effect to foreign judgments—jurisdiction, proper notice, opportunity to be heard, absence of fraud, finality, and consistency of public policy of the forum—should also now be held in Germany to have a relationship of reciprocal recognition and enforcement, since these are similar to the conditions set forth in the German Code of Civil Procedure. There can be no assurance of this. However, the courts of France, while not requiring reciprocity, do require conditions similar to the common-law requirements noted above to be met before granting conclusive effect to a foreign judgment.

ROBERT H. FOLSOM, MICHAEL WALLACE GORDON & JOHN A. SPANOGLE, JR., INTERNATIONAL BUSINESS TRANSACTIONS IN A NUTSHELL
519-22 (4th ed. 1992)[46]

Enforcement Of Arbitral Awards: The 1958 Convention

In over eighty countries, the enforcement of arbitral awards is facilitated by the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21 U.S.T. 2518, T.I.A.S. No. 6997, 330 U.N.T.S. 38, implemented in the United States by 9 U.S.C. §§ 201-208. "[T]he principal purpose underlying American * * * implementation * * * was to encourage the recognition and enforcement of commercial arbitration agreements in international contracts and to unify the standards by which agreements to arbitrate are observed and arbitral awards are enforced in the signatory countries." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 520 n. 15 (1974). In an abbreviated procedure under 9 U.S.C. §§ 203, 208, federal district courts entertain motions to confirm or to challenge a foreign award.

The Treaty commits the courts in each Contracting State to recognize and enforce arbitration clauses and separate arbitration agreements for the resolution of international commercial disputes. Where the court finds an arbitral clause or agreement, it "*shall* * * * refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative, or incapable of being performed" (emphasis added). The Treaty also commits the courts in each Contracting State to recognize and enforce the awards of arbitral tribunals under such clauses or agreements, and also sets forth the limited grounds under which recognition and enforcement may be refused. Under the Treaty, grounds for refusal to enforce include: (1) incapacity or invalidity of the agreement containing the arbitration clause "under the law applicable to" a party to the agreement, (2) lack of proper notice of the arbitration proceedings or the appointments of the arbitrator, (3) failure of the arbitral award to restrict itself to the terms of the submission to arbitration, or decision of matters not within the scope of that subdivision, (4) composition of the arbitral tribunal not according to the arbitration agreement or applicable law, and (5) non-finality of the arbitral award under applicable law.

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In addition to the above grounds for refusal, recognition or enforcement may also be refused if it would be contrary to the public policy of the country in which enforcement is sought; or if the subject matter of the dispute cannot be settled by arbitration under the law of that country. Courts in the United States have taken the position that the "public policy limitation on the Convention is to be construed narrowly [and] to be applied only where enforcement would violate the forum state's most basic notions of morality and justice." *Fotochrome, Inc. v. Copal Co., Ltd.*, 517 F.2d 512 (2d Cir. 1975). Recourse to other limitations of the Convention, in order to defeat its applicability, has been greeted with judicial caution. *Parsons & Whittemore Overseas Co., Inc. v. Societe Generale De L'Industrie Du Papier (Rakta)*, 508 F.2d 969 (2d Cir. 1974).

* * *

Cases in the United States have pointed out that parties cannot refer a dispute to a court while an arbitration is in progress (*Siderius, Inc. v. Compania De Acero Del Pacifico, S.A.*, 453 F.Supp. 22 (S.D.N.Y. 1978)) or block enforcement in the United States in reliance upon the fact that the award, although binding in the country where rendered, is under appeal there. *Fertilizer Corp. of India v. IDI Management, Inc.*, 517 F.Supp. 948 (S.D. Ohio 1981). After the arbitration is concluded, a party may not be able to block enforcement of the arbitral award in reliance upon the United States Foreign Sovereign Immunities Act (see *Ipitrade International, S.A. v. Federal Republic of Nigeria*, 465 F.Supp. 824 (D.D.C. 1978), but may be able to block enforcement in reliance upon the Act of State Doctrine. *Libyan American Oil Co. v. Socialist People's, etc.*, 482 F.Supp. 1175 (D.D.C. 1980). One court has granted enforcement, under the Convention, of a New York award rendered in favor of a non-citizen claimant against a non-citizen defendant. *Bergesen v. Joseph Muller Corp.*, 548 F.Supp. 650 (S.D.N.Y. 1982).

Note

In 1990, Congress amended the Foreign Sovereign Immunities Act as follows:

> *Section 1605. General exceptions to the jurisdictional immunity of a foreign state*
>
> (a) A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case-

> (6) in which the action is brought, either to enforce an agreement made by the foreign state with or for the benefit of a private party to submit to arbitration all or any differences which have arisen or which may arise between the parties with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration under the laws of the United States, or to confirm an award made pursuant to such an agreement to arbitrate, if (A) the arbitration takes place or is intended to take place in the United States, (B) the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards, (C) the underlying claim, save for the agreement to arbitrate, could have been brought in a United States court under this section or section 1607, or (D) paragraph (1) of this subsection is otherwise applicable.

28 U.S.C. § 1605(a)(6).

Chapter 3

THE POLITICS OF NATIONAL SOVEREIGNTY OVER NATURAL RESOURCES

Table of Sections

An inherent risk in any investment in a foreign nation is the possibility that the investment will be expropriated or nationalized by the foreign government. In the last century, private multinational corporations have lost their investments in producing oil properties through direct expropriation by the governments of Iran, Kuwait, Libya, Mexico, and Venezuela. Further, it is inaccurate to simply list the direct nationalizations. Other, less drastic, forms of expropriation have occurred in most of the Middle Eastern countries through renegotiations. These examples probably account for a vast productive capacity of the world's petroleum reserves. There are countless other instances of less intrusive forms of expropriation, such as legislation that affects the arrangement between the multinational and the country.

The form of expropriation chosen by a country often depends upon the political circumstances leading to the action and the anticipated need for foreign involvement in the future marketing of the asset. For example, Mexico's expropriation resulted from a political climate that favored ousting foreign ownership of national resources. In 1951, Iran nationalized the Anglo-Iranian Oil Company but in 1954 lured oil companies back into new concessions because of its inability to market its petroleum. In 1970, Libya selectively nationalized foreign concessions to increase its share of involvement in some fields while retaining foreign involvement in other concessions. Other nations in the 1970s chose the route of renegotiation.

One author explains the reasons why Saudi Arabia did not favor outright nationalization:

Nationalization, however, was not a viable option for Saudi Arabia for several reasons. Ideologically, it was not consistent with the Saudi private-enterprise-based economic system. Politically, Saudi Arabia had close ties with the United States, founded on its being politically more moderate and anti-Communist Middle Eastern governments. Most important, nationalization would have interfered with the Saudi program of maximum development of virtually endless oil reserves. Unlike Kuwait and Libya, Saudi Arabia had not been willing to defer extraction of some of its oil either in the context of a national conservation, or in the context of integration of the oil industry with the rest of the economy, or as a political weapon in dealing with the West. * * * Unlike Algeria, Iran and Iraq, which were also seeking production expansion, Saudi Arabia had made little progress in building up the skills and manpower to plan and manage exploration and production on the scale its large operations would require. Without the assistance of the vertically integrated oil companies, Saudi Arabia might have had to resort to destructive price competition to find markets for all the oil it planned to produce during the rest of this century. * * *

Finally, nationalization would have endangered Saudi Arabia's plans for its investment of its soaring oil revenues. Saudi Arabia hoped to secure access to investment opportunities which would provide a rate of return sufficient to prevent losses through inflation and devaluations in the real value of its mounting currency reserves. To accomplish this goal, Saudi Arabia had to maintain favorable relations with industrialized consuming states and Western oil companies. The former were the source of capital goods and technology necessary for industrialization at home, and they provided the primary potential markets for developing export trade abroad. The approval of industrialized states would also be necessary for extensive investment in their economies. Furthermore, the cooperation of the majors, with their extensive experience in and control over downstream operations, would be useful when and if Saudi Arabia decided to commence downstream activities.

Note, "From Concession To Participation: Restructuring the Middle East Oil Industry," 48 N.Y.U. L. Rev. 774, 788-89 (1973).

Historically, periods of nationalization—whether characterized by expropriation, by increased legislative and regulatory control, by confiscatory taxes or by a combination of these things—have often been followed by periods in which governments have favored private ownership and private decisionmaking. During such periods government regulation of extractive industries is relaxed in favor of free-market forces, and ownership of natural resources and the national companies that control them may be transferred into private hands. The initial impetus for such a change in direction is often economic, as inefficiencies and lack of capital make operations difficult and less profitable. Politics also plays

a role in the perception that the state-owned industry is stagnant or corrupt. This results in a mistrust of government control and ownership.

In this chapter we first examine the rights of a nation over its **natural resources and the limitations on** a nation's right to nationalize a foreign participant's assets. Next, we examine the issue of compensation. Third, we present several efforts to obtain compensation for nationalized assets. Finally, we discuss the trend toward privatizing state-owned companies and the resources they control.

A. SOVEREIGNTY OVER NATURAL RESOURCES: LIMITATIONS ON THE RIGHT TO EXPROPRIATE

The sovereignty of a nation extends to its natural resources. In most countries such resources are owned by the public and administered by the government. Public ownership necessarily implies that such resources will be developed in the public interest and for the benefit of the citizens of the nation. The fact that natural resources are exhaustible differentiates them from other resources that may not necessitate public control. The special view that natural resources are part of national sovereignty may also arise from a nation's history and the fact that a government's surrender of control over resources has severe consequences.

Over the years, the United Nations has expressed a voice on the issue of expropriation through its General Assembly resolutions. In 1963, shortly following the Cuban nationalization of U.S. property, the United Nations passed a Resolution on Permanent Sovereignty Over Natural Resources recognizing a state's strong interest in controlling its mineral wealth but also reflecting a Western perspective toward takings of property. This document was excerpted in Chapter 1. In 1974, a greatly expanded United Nations issued two documents relating to sovereignty and nationalization. The Declaration on the Establishment of a New Economic Order took a more domestic view towards the topic, and several Western nations (France, Japan, United Kingdom, United States, and West Germany) had reservations about this resolution. The Charter of Economic Rights and Duties of States also passed but with sixteen nations voting against this resolution. The latter two resolutions are excerpted below. Identify the substantive differences among the three United Nations documents. Are they significant from a country or multinational's perspective?

UNITED NATIONS DECLARATION ON THE ESTABLISHMENT OF A NEW INTERNATIONAL ECONOMIC ORDER

U.N.G.A. Res. 3201 (1974), *reprinted in* 13 I.L.M. 715 (1974)

We, the Members of the United Nations,

Having convened a special session of the General assembly to study for the first time the problems of raw materials and development, devoted to the consideration of the most important economic problems facing the world community,

Bearing in mind the spirit, purposes and principles of the Charter of the United Nations to promote the economic advancement and social progress of all peoples,

Solemnly proclaim our united determination to work urgently for the establishment of a new international economic order based on equity, sovereign equality, interdependence, common interests and co-operation among all States, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and the developing countries and ensure steadily accelerating economic and social development and peace and justice for present and future generations, and, to that end, declare:

* * *

4. The new international economic order should be founded on full respect for the following principles:

(a) Sovereign equality of states, self-determination of all peoples, inadmissibility of the acquisition of territories by force, territorial integrity and non-interference in the internal affairs of other States;

* * *

(d) The right of every country to adopt the economic and social system that it deems the most appropriate for its own development and not to be subjected to discrimination of any kind as a result;

(e) Full permanent sovereignty of every state over its natural resources and all economic activities. In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation, including the right to nationalization or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State. No State may be subjected to economic, political or any other type of coercion to prevent the free and full exercise of this inalienable right;

* * *

inalienable

(f) The right of all States, territories and peoples under foreign occupation, alien and colonial domination or apartheid to restitution and full compensation for the exploitation and depletion of, and damages to, the natural resources and all other resources of those States, territories and peoples;

* * *

UNITED NATIONS CHARTER OF ECONOMIC RIGHTS AND DUTIES OF STATES

U.N.G.A. Res. 3281 (1975), *reprinted in* 14 I.L.M. 251 (1975)

THE GENERAL ASSEMBLY,

Solemnly adopts the present Charter of Economic Rights and Duties of States.

Chapter I. Fundamentals of International Economic Relations

Economic as well as political and other relations among States shall be governed, *inter alia*, by the following principles:

(a) Sovereignty, territorial integrity and political independence of States;

(b) Sovereign equality of all States;

* * *

inalienable

Chapter II. Economic Rights and Duties of States

Article 1. Every State has the sovereign and inalienable right to choose its economic system as well as its political, social and cultural systems in accordance with the will of its people, without the outside interference, coercion or threat in any form whatsoever.

Article 2. (1) Every State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities.

(2) Each State has the right:

(a) To regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment;

(b) To regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational corporations shall not intervene in the internal affairs of a host State. Every State should, with full regard for its sovereign rights, co-operate with other States in the exercise of the right set forth in this subparagraph;

(c) To nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. In any case where the question of compensation gives rise to a controversy, it shall be settled under the domestic law of the nationalizing State and by its tribunals, unless it is freely and mutually agreed by all States concerned that another peaceful means be sought on the basis of the sovereign equality of States and in accordance with the principle of free choice of means.

The United Nations resolutions excerpted above address the right of sovereigns to exercise control over their natural resources as well as the resolution of disputes arising from such exercises of national sovereignty. These statements must be examined in light of the general limitations on the rights of nations to expropriate foreign-owned property. These limitations are briefly summarized by the American Law Institute below; however, it is important to note that the most important limitation from a practical perspective is the requirement of compensation and how the proper amount is to be determined.

AMERICAN LAW INSTITUTE, RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES
(1987)

Section 712. Economic Injury to Nationals of Other States

A state is responsible under international law for injury resulting from:

(1) A taking by the state of the property of a national of another state that is (a) not for a public purpose, or (b) discriminatory, or (c) not accompanied by provision for just compensation; for compensation to be just under this Subsection, it must, in the absence of exceptional circumstances, be in an amount equivalent to the value of the property taken, be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national;

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(2) a repudiation or breach by the state of a contract with a national of another state

(a) where the repudiation or breach is (i) discriminatory; or (ii) motivated by other non-commercial considerations and compensatory damages are not paid; or

(b) where the foreign national is not given an adequate forum to determine his claim of breach or is not compensated for any breach determined to have occurred;

(3) other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests of a national of another state.

Notes

1. Most commentators have noted that the taking must be for a public purpose. See Martin Domke, "Foreign Nationalizations: Some Aspects of Contemporary International Law," 55 Am. J. Int'l L. 585 (1961) ("This concept of 'public utility' or 'public use' or 'dominant public purpose' is embodied in the Constitutions of many countries as a justification for taking private property.") Are there any nationalizations that are "not in the public interest?" How could you prove this proposition?

2. Professors Folsom, Gordon and Spanogle address one other dimension of this problem that is a requirement of customary international law. See Ralph H.. Folsom, Michael Wallace Gordon & John A. Spanogle, Jr., International Business Transactions: A Problem-Oriented Coursebook 902-907 (2d ed. 1991). In most cases, both customary international law and domestic law require that the private party exhaust local remedies before pursuing an international forum for obtaining compensation. Although the United States generally does not require a party to attempt to exhaust local remedies, one can make a persuasive argument that a country exercising its national sovereignty should have the chance to establish a system of compensation for complying with international law before other sovereigns intervene in the matter. In the context of this requirement, the authors raise the interesting issue of whether a nation can insert a clause in an international agreement that prohibits a private party from seeking the help of its own government in any disputes arising out of the agreement and, if this clause is violated, the private party will forfeit all of its rights under the agreement. See id. at 903, 905-907. Such a clause is referred to as a "Calvo" clause. Not surprisingly, most Western nations dispute the validity of such a clause

and argue that all nationals should have a right to seek the diplomatic efforts of their own governments.

3. As a practical matter, the major issue in most expropriations is not whether the taking is illegal but how much the private parties will receive from the government that has expropriated the property. Professor Hans Baade has observed that "[e]ven where an expropriation is illegal, in the absence of specific treaty obligations to the contrary the only remedy available to the government of the aliens affected is a claim for pecuniary compensation, not for restitution." Hans W. Baade, "Indonesian Nationalization Measures Before Foreign Courts—A Reply," 54 Am. J. Int'l L. 801, 830 (1960). In one arbitration, a panel awarded specific performance in favor of the multinational oil companies and against Libya; however, the parties settled the dispute for $76 million in petroleum. See Texaco Overseas Petroleum Co. v. Libyan Arab Republic, 53 I.L.M. 389 (1979); Andrew B. Derman, "Nationalization and the Protective Arbitration Clause," J. Int'l Arb. 131, 134 (Dec. 1988).

Texaco — Spec Perf.

B. DETERMINING THE PROPER COMPENSATION IN AN EXPROPRIATION

The above material has briefly touched the two questions regarding compensation: (1) whether compensation is just and fair or appropriate or prompt, adequate, and effective; and (2) which law will determine the content of the definition of compensation—the domestic law of the expropriating country, the law of the country of the private party, or international law. Although these issues are important, a third question bears further examination: how should the parties calculate the measure of compensation?

Many different ways exist to calculate the compensation that a private party should receive when a government expropriates the party's property. Commentators have used at least four different standards to value the nationalized assets: (1) Market value, (2) Book Value, (3) Discounted Cash Flow Value, and (4) Replacement Value. Market value is generally defined as the fair market value of the investment as determined by what a willing buyer will pay a willing seller on the day before the expropriation in a freely negotiated transaction. The obvious problem with this approach is that in the vast majority of expropriations of energy assets there are few or no comparable transactions to serve as a benchmark for the fair market value. There is also no readily ascertainable marketplace (such as a stock market or exchange) to serve as a surrogate for determining a market price between a buyer and a seller. Thus, although companies with expropriation claims would like to rely

Market Value

upon this manner of determining the basis for compensation, the amounts are too speculative to be convincing. The book value of an expropriated investment is defined as the actual amount invested in the project less the amounts deducted as current expenses and depreciation and amortization of the assets. Book value often refers to the net amount listed in the multinational's accounting books on the day of the expropriation. Companies often argue that book value does not take into account the value of the assets discovered, and this needs to be taken into account in determining the amount of the compensation because of the significant risk in making the investment. Sovereigns often seek to use net book value as the maximum amount of the compensation; they may also argue that this amount should be reduced by amounts spent for resources that have not been discovered, by amounts considering the possible environmental or other damage that the multinational may have imposed upon the country, or by an amount reflecting acts of negligence or intentional wrong that the multinational may have done during the term of the arrangement.

The problems with fair market value and book value from the multinationals' perspective have led them to rely upon discounted cash flow and replacement value as methods of calculating the compensation for expropriated assets. Discounted cash flow is calculated by projecting the cash flow from the project during its remaining life and discounting this projection by an interest rate to reflect the present values of these amounts. Of course, both the computation of the projected net cash flow earnings and the identification of a discount rate are speculative tasks. In the context of expropriations, commentators often refer to the "Cinderella effect" in which the multinational finds the expropriated property far more valuable after the taking than before the taking. Both the expected future production levels and the future price of the resource are very difficult to ascertain. And, thus, discounted cash flow often becomes a dispute among experts hired by both sides in the compensation procedure. Replacement cost or value is defined as the price that the private company will need to pay to replace the assets that have been expropriated. Although this may seem as a determination of fair market value, companies can often better prove the cost of replacing the lost assets. For example, most oil companies have an internal cost of discovering a barrel of oil in different regions of the world. If the underlying assets are traded on a futures market, the parties can also look to the established prices to determine the replacement cost of the expropriated reserves.

In most cases, the sovereign will adopt the view that compensation should be limited to discounted cash flow and that from this amount the decisionmaker should deduct amounts owed to the nation under the agreement. The multinational will argue for fair market value, discounted cash flow, or replacement value. Of course, one can hypothesize cases in which the book value will be higher than the current fair market value because the foreigner has spent more in exploration and development than the value of the discovered resource. In such a situation, the parties will adopt the measures more favorable to their position of either obtaining maximum compensation or reducing the amount of the payment.

In the typical expropriation, the private parties' figure for compensation differs significantly from the government's offer of compensation often by a factor of five or ten. An economist and frequent expert witness in expropriation proceedings has written a paper that attempts to show how net book value and discount cash flow value should not differ significantly in the majority of cases. See Randolph Stauffer, "Political Risk and Overseas Oil Investment," Soc. Petroleum Engineers SPE 18514 (1988). Although Professor Stauffer raises many different potential adjustments to each figure, he primarily argues that each party's figure must be adjusted up and down to reflect a search for true fair market value of the expropriated investment.

With respect to the sovereign's argument for net book value, he argues that this figure needs to be adjusted for (1) depreciation method used—if the company has used an accelerated basis for depreciation, some of the asset values must be increased to reflect current asset life, (2) inflation and currency fluctuations—net book value should be adjusted up to reflect the investment in current dollars, (3) unused assets—the value should be reduced for assets that are not used or useful, and (4) research and development costs—net book value should include some upward adjustment for unamortized research outlays that have contributed to the asset value. Id. at 3-4.

With respect to the multinational's argument for discounted cash flow value, Professor Stauffer challenges the various assumptions made by the company. The first assumption that he examines is the company's choice of a discount rate. He points out that it is in the company's interest to claim a low profit rate and low discount rate to keep the discounted cash flow value high. Thus, one must examine the company's true rate of return on its investment so the cash flow can be properly discounted. Second, he argues that the company's assumptions on the future cash flow must be examined to determine whether they are based upon actual production levels or potential production levels anticipated throughout the project. Future output from existing facilities may be more certain than production from future exploration or secondary recovery. Many of these claims are too speculative to be included in the discounted cash flow calculation. Third, Professor Stauffer argues that a key, but difficult to

ascertain, assumption in this calculation is the future price of oil. Of course, changes in this assumption directly affect the discounted cash flow value. Finally, he argues that the entire projection of future cash flow must be examined from the perspective of the economic environment. Factors such as future tax and environmental liability affect cash flow and should be examined in detail for consistency. Id. at 4-6.

Professor Stauffer argues that the only case in which a significant difference will exist between the adjusted net book value and the adjusted discounted cash flow is when a monopoly or windfall profit exists. A windfall profit as used by him in this case is defined as a situation in which a very small investment finds a significant reservoir or resource. In such a case, the sovereign will undoubtedly argue that no foreign multinational is entitled to be compensated for a windfall related to the significant value of the country's resources. The sovereign will argue that the company is entitled only to recover its investment as indicated by net book value. Id. at 6.

Notes

1. Examine the different methods of calculating the value of an expropriated investment. Which method is fairer to the parties involved? How should a court or tribunal determine which method should be used in a particular case?

2. Do you agree with Professor Stauffer's analysis that discounted cash flow should not significantly differ from net book value? What assumptions is he making about oil and gas investments? Can you identify situations in which his formula does not work?

3. Should a country be able to use claims of negligence and violations of the agreement to reduce the amount of compensation that it should pay for an expropriation?

4. Some multinational corporations obtain insurance against expropriation and other risks of investing in a foreign country.

Private Insur.

> Private insurance for risks of foreign investment tends to be short term, such as 3-5 years. It may be obtained for expropriation (including creeping expropriation), or for arbitrary recall of credit, repudiation of contracts (such as the cancellation of a license), currency blockages, some commercial losses, embargoes and revocation of export/import permits and political diversions of investment assets (e.g., caused by hijacking). Lloyds of London plays a major role in issuing insurance against investment risks by private insurers. Lloyds is joined by a few United States private insurers in offering investment risk insurance. * * *

> The 1982 Export Trading Company Act (Title II) allows some banks to offer foreign investment insurance. * * * Some other nations have their own insurance schemes, designed to assist their own foreign investors and traders. Finally, on a global basis, the World Bank established the Multilateral Investment Guarantee Agency (MIGA) to offer foreign investment risk insurance not greatly dissimilar to that offered by the United States Overseas Private Investment Corporation (OPIC).

MIGA

OPIC

* * *

> Government insurers cover a variety of risks, such as short term, import and export risks, or long term risks involving direct investment. The United States Export-Import Bank (Eximbank) and the Overseas Private Investment Corporation (OPIC) provide these respective forms of coverage. OPIC has been the preeminent insurer of foreign investment risks. But its existence has often been somewhat tenuous. Many members of Congress believe its role should be assumed by the private sector; however, this fails to realize the political policy role played by OPIC, which sets premiums partly by normal insurance risk analysis and partly by foreign policy goals. Private insurance companies would avoid assuming much of what OPIC insures. Consequently, OPIC survives by successive legislative consent, if not approval. The 1988 amendments include provisions to enhance private political risk insurance programs, affirming the encouragement of bringing the private sector into the area by cooperative risk sharing programs and an advisory group. 22 U.S.C. § 2194b.

ExImBank

Ralph H. Folsom, Michael Wallace Gordon & John A. Spanogle, Jr., International Business Transactions in a Nutshell 436-38 (4th ed. 1992).

5. A draft treaty document used by the State Department makes the following observations:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known; include interest at a commercially reasonable rate from the date of expropriation; be paid with~~out de~~lay; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.

BITS —

valuat.

Treaty Between the United States of America and _______ Concerning the Reciprocal Encouragement and Protection of Investment art. III (Revised—Feb. 24, 1984)

C. EFFORTS TO OBTAIN COMPENSATION

As covered in the discussion in Chapter 2 on special issues encountered in dealing with foreign governments, a private party is often limited in its access to many courts by the doctrines of act of state, sovereign immunity, and political question. These doctrines, and especially the act of state doctrine, are frequently asserted as defenses to actions alleging unlawful expropriation. The Supreme Court in Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964), addressed the question of whether the act of state doctrine applied to deny recovery for a confiscation of property by the Cuban government in connection with the exporting of sugar from Cuba. The United States Department of State urged the court to allow the action in this case; however, the Supreme Court applied the act of state doctrine and dismissed the case:

> The text of the Constitution does not require the act of state doctrine; it does not irrevocably remove from the judiciary the capacity to review the validity of foreign acts of state.
>
> The act of state doctrine does, however, have "constitutional" underpinnings. It arises out of the basic relationships between branches of government in a system of separation of powers. It concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations. The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere. * * *

Id. at 423.

In response to the *Sabbatino* decision, Congress passed the Hickenlooper amendment, 22 U.S.C. § 2370(e)(2), to the Foreign Assistance Act.

> (2) Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or a party claiming through such state) based upon (or traced through) a confiscation or other taking after January 1, 1959, by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection: Provided, That this subparagraph shall not be applicable (1) in any case in which an act of a foreign state is not contrary to international law or with respect to a claim of title or other

right to property acquired pursuant to an irrevocable letter of credit of not more than 180 days duration issued in good faith prior to the time of the confiscation or other taking, or (2) in any case with respect to which the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court.

In this section, we first present a private party's innovative efforts to obtain compensation from Libya for an outright expropriation. We then excerpt an article that discusses many of the international tribunal and arbitration decisions involving expropriations.

HUNT v. COASTAL STATES GAS PRODUCING CO.

583 S.W.2d 322 (Tex. 1979)

Barrow, Justice

This suit was instituted by Nelson Bunker Hunt, Herbert Hunt and Lamar Hunt (Hunt) seeking damages against Coastal States Gas Producing Company and Coastal States Marketing, Inc. (Coastal States) for the alleged conversion of oil to which Hunt was entitled by virtue of a concession agreement with Libya. Coastal States counterclaimed for damages for Hunt's allegedly tortious interference with the contract and business opportunities of Coastal States. Both parties moved for summary judgment on the issue of liability after extensive development of the case. The trial court denied relief on all claims and the court of civil appeals affirmed. 570 S.W.2d 503. We affirm the judgment of the court of civil appeals.

Hot Oil

In 1957 the Government of Libya granted Hunt a concession which gave him the right, for fifty years, to explore, drill and extract oil in an area now identified as the Sarir field. Hunt assigned a one-half undivided interest in this concession to British Petroleum Exploration Company, Ltd. (British Petroleum) in 1960. Oil was discovered in the concession area in 1961 and, by 1967, it was produced in marketable quantities. In September 1969, Colonel Mu'ammar al-Qadhafi assumed power in Libya under a new government, the Revolutionary Command Council, and commenced making changes in the existing contractual relations with the various oil producers holding concession agreements with Libya. In 1971, the Libyan Government nationalized the operations and interest of British Petroleum in the Sarir field and transferred its rights to the Arabian Gulf Exploration Company (AGECO). AGECO is a corporation whose entire capital stock is owned by the Libyan Government.

On June 20, 1973, by Libyan Law No. 42 of 1973, the Libyan Government nationalized all the rights and assets of Hunt in the concession agreement and assigned these rights to AGECO. Although Libya agreed to pay compensation, the amount was to be determined by a committee designated by the State. In response to this action, Hunt published notices in newspapers throughout the world claiming that the Libyan nationalization violated international law and threatened suit against anyone who came into possession of Sarir oil. In May 1973, Coastal States entered into a contract with AGECO to purchase oil from the Sarir field and it continued to purchase oil under this contract despite Hunt's claims against Libya and threatened suits. This oil was transported by Coastal States to a refinery in Italy where it was processed and sold to third parties. It was stipulated that a portion of the products derived from this oil was subsequently taken to the United States, although it was not stipulated that Coastal States transported or caused any of such products to be brought here. Nevertheless, Coastal States is domiciled in the United States and, at least, the net proceeds derived from the Sarir oil were brought here and are the basis of Hunt's suit for conversion.

British Petroleum was a party to the controversy with Coastal States at one time, but it subsequently entered into a full settlement with the Libyan Government after arbitration of its claim and it does not now assert any claim against Coastal States.[1] In May 1975 Hunt entered into a settlement agreement with the Libyan government whereby, for the sum of approximately $19,000,000, it released any and all claims against the Libyan Government arising out of the nationalization of the Sarir field. Coastal States was not a party to this agreement and Hunt now seeks to recover the proceeds realized by Coastal States from oil allegedly purchased from AGECO prior to the May 1975 settlement.

Act of State

Both the trial court and the court of civil appeals concluded that the trial court was foreclosed from inquiring into the validity of the Libyan nationalization of Hunt's interest in the Sarir field by the ~~Act of State Doc~~trine. These courts further concluded that as a matter of law, Hunt's actions in giving notice of his claim to oil from the Sarir field did not violate either state or federal law and would not support Coastal States' claim for damages for tortious interference. Hunt and Coastal States both filed applications for writ of error and complain of the take-nothing judgment entered on the claim of each.

APPEAL BY HUNT

Hunt's claim against Coastal States is necessarily based upon the assertion that Libya's expropriation was invalid so that Coastal States

1 The arbitrator held that Hunt did not acquire title to the oil in the strata.

acquired no title from AGECO. The critical question involved in Hunt's appeal is the applicability of the Act of State Doctrine and more precisely, whether Hunt's suit comes within the exception to the doctrine created by the *Hickenlooper Amendment*, 22 U.S.C. § 2370(e)(2). The lower courts have held that the doctrine bars inquiry by a Texas court into the validity of acts done by a foreign sovereign.

The Act of State Doctrine is a judicially created doctrine of restraint. The landmark case of Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964) reaffirmed the doctrine as originally articulated in Underhill v. Hernandez, 168 U.S. 250 (1897) in the following language: Sabbatino

> "Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves."

In Sabbatino it was stated that the doctrine "arises out of the basic relationships between branches of government in a system of separation" and the courts (sic) prior recognition of the doctrine "expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere."

In Hunt v. Mobil Oil Corp., 550 F.2d 68 (2d Cir. 1977), cert. denied, 434 U.S. 984, the Act of State Doctrine was held to bar Hunt's inquiry into the validity of Libya's nationalization of Hunt's concession. In holding that the trial court properly dismissed Hunt's claim against seven major oil producers in the Persian Gulf area for damages under the anti-trust statute, the circuit court said:

> "We conclude that the political act complained of here was clearly within the act of state doctrine and that since the disputed pleadings inevitably call for a judgment on the sovereign acts of Libya the claim is non-justiciable."

This final judgment against Hunt in that case controls his present suit for conversion unless it comes within the exception to the Act of State Doctrine created by the Hickenlooper Amendment. Benson v. Wanda Petroleum Company, 468 S.W.2d 361 (Tex. 1971).

The Hickenlooper Amendment was enacted by Congress in 1964 shortly after the Sabbatino holding and in obvious reaction to it. It provides in part:

> "[No] court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a CLAIM OF TITLE OR OTHER RIGHT TO PROPERTY is asserted by any party including a foreign state * * * based upon (or traced through) a confiscation or other taking * * * by an act of that state in violation of the principles of international law. * * *" (Emphasis Added)

22 U.S.C. § 2370(e)(2). It must be recognized at the outset that this exception which was adopted over the objections of the Executive Department of the United States has been narrowly construed by our courts.

The statute enumerates three requirements which must exist in order to avoid the Act of State Doctrine under the Hickenlooper Amendment. 1. Expropriated property must come within the territorial jurisdiction of the United States. 2. The act of the expropriating nation must be in violation of international law. 3. The asserted claim must be a claim of title or other right to property. 22 U.S.C. § 2370(e)(2). The court of civil appeals concluded, without consideration of the first two requirements, that the Hickenlooper Amendment is not applicable to this case because Hunt acquired only a contract right by the agreement with Libya. We agree with this conclusion and therefore limit our consideration to the third requirement stated above.

Since Libya is both the place of the contract's execution and performance as well as the location of the subject matter, Libyan substantive law governs the interpretation and construction of the rights conferred to Hunt by the Concession Agreement. Cantu v. Bennett, 39 Tex. 304 (1873).

The Concession Agreement expressly provides that the applicable law is the Libyan Petroleum Law No. 25 of 1955 and this law provides in part:

> "(1) All petroleum in Libya in its natural state in strata is the property of the Libyan State.
> "(2) No person shall explore or prospect for, mine or produce petroleum in any part of Libya, unless authorized by a permit or concession issued under this Law."

The expressed intent of the Concession Agreement was to grant Hunt the right to search for and to extract oil within the defined area for the stated term.[2] It did not grant Hunt title to the oil in the strata. Under Libyan law, *title to the oil passed at the wellhead*. In 1966 Hunt and Libya voluntarily amended the 1957 Concession Agreement. Clause 16 of the amended agreement states:

> "(1) The Government of Libya will take all the steps necessary to ensure that the Company enjoys all the rights conferred by the Concession. The CONTRACTUAL RIGHTS expressly created by this concession shall not be altered except by mutual consent of the parties.
>
> "(2) This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of the execution of the agreement of amendment by which this paragraph (2) was incorporated into this concession agreement. Any amendment to or repeal of such Regulations shall not affect the CONTRACTUAL RIGHTS of the Company without its consent." (Emphasis added)

This language is significant in that it not only refers to Hunt's rights as "contractual," but it also recognizes Libya's ownership of the oil. We conclude that Hunt obtained only a contractual right under the Concession Agreement.

The Hickenlooper Amendment by its express terms applies only to a claim of title or other right to property. This construction was made abundantly clear in 1965 when Congress added the words "to property" following the phrase "claim of title or other right." Thus this exception to the Act of State Doctrine has no application here where only a contractual right was expropriated from Hunt. We have been cited to no case, and have discovered no case, holding to the contrary.

The trial court and the court of civil appeals did not err in concluding that the Act of State Doctrine bars judicial inquiry into the validity of Libya's actions.

APPEAL BY COASTAL STATES

We agree with the holding of the court of civil appeals that Hunt's motion for summary judgment was properly granted on Coastal States' claim of tortious interference with business contracts and business relations. Hunt's contractual rights in the Sarir field were expropriated by Libya and Hunt was fully justified in apprising the international community of his intent to file suit if they dealt with oil from this field.

The judgment of the court of civil appeals is affirmed.

[2] The Concession Agreement provides that the designated area may be reduced at stated intervals during the fifty year term.

Dissenting Opinion by Justice Steakley, joined by Chief Justice Greenhill and Justice Spears.

DISSENT: Sam D. Johnson, Justice

I respectfully dissent.

* * *

In May, 1975, Hunt settled his claims against the Libyan government for the nationalization of the Sarir field. Hunt and Coastal States stipulated that Libya's payment of approximately $19,000,000 for that agreement represented only the net book value of Hunt's physical assets located on Concession 65 and "that no portion of such sum was for oil previously sold by AGECO or for oil in place." Hunt's present suit seeks an adjudication with respect to a one-half share of the oil purchased by Coastal States from the date of the expropriation in May, 1973, to the date of Hunt's settlement with Libya in May, 1975.

In Hunt's suit against Coastal States, he alleged that the expropriation by Libya was an illegal confiscation and therefore did not affect his rights to recover against subsequent converters of the oil from the Sarir field. Hunt claimed that Coastal States acquired the oil with full knowledge of Hunt's contrary possessory rights, title and interest. A pre-trial hearing was held with each party calling experts in international and foreign law who expressed their opinions regarding the application of Libyan and international law to the facts of this case. The parties thereafter submitted the motions for summary judgment discussed above.

I. THE ACT OF STATE DOCTRINE

I would hold that the Hickenlooper Amendment, 22 U.S.C. § 2370(e)(2), a statutory exception to the act of state doctrine, is applicable to Hunt's claim and directs a judicial determination on its merits.

The act of state doctrine was articulated in Underhill v. Hernandez, 168 U.S. 250, 252 (1897): "Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory." This doctrine was reaffirmed in the landmark case Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964). * * *

* * *

* * * Courts of the United States have long recognized a duty to determine controversies on their merits, according to the applicable law

which includes international law.[3] Our courts have never been required to pay unlimited deference to foreign acts of state. The courts of other nations do not follow such an inflexible rule in the protection of their Executive Branch. Furthermore, the adoption of such an inflexible rule is likely to cause as much embarrassment to the Executive Branch as an adjudication on the merits.

* * *

II. *THE HICKENLOOPER AMENDMENT*

In the wake of reaction against Sabbatino, Congress passed the Hickenlooper Amendment. It became law on October 7, 1964, and was reenacted as permanent law in 1965. It reads as follows:

> Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right to property is asserted by any party including a foreign state (or a party claiming through such state) based upon (or traced through) a confiscation or other taking after January 1, 1959, by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection: Provided , That this subparagraph shall not be applicable (1) in any case in which an act of a foreign state is not contrary to international law or with respect to a claim of title or other right to property acquired pursuant to an irrevocable letter of credit of not more than 180 days duration issued in good faith prior to the time of the confiscation or other taking, or (2) in any case with respect to which the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court.

3 U.S. CONSTI. art III, § 2, extends the judicial power "to Controversies * * * between a State, or the Citizens thereof, and foreign States, Citizens or Subjects." Hilton v. Guyot, 159 U.S. 113, 163 (1895) declared that:

> International law, in its widest and most comprehensive sense—including not only questions of right between nations, governed by what has been appropriately called the law of nations; but also questions arising under what is usually called private international law, or the conflict of laws, and concerning the rights of persons within the territory and dominion of one nation, by reason of acts, private or public, done within the dominions of another nation—is part of our law, and must be ascertained and administered by the courts of justice , as often as such questions are presented in litigation between man and man, duly submitted to their determination.
>
> The most certain guide, no doubt, for the decision of such questions is a treaty or a statute of this country. But when, as is the case here, there is no written law upon the *subject, the duty still rests upon the judicial tribunals of ascertaining and declaring* what the law is , whenever it becomes necessary to do so, in order to determine the rights of parties to suits regularly brought before them. In doing this, the courts must obtain such aid as they can from judicial decisions, from the works of jurists and commentators, and from the acts and usages of civilized nations. (Emphasis added).

22 U.S.C. § 2370(e)(2).

* * *

Under the Hickenlooper Amendment, any court in the United States must determine the merits of controversies if (1) any party makes a claim of title or other right to property based upon or traced through a confiscation or taking, (2) the President has not filed with the court a suggestion that the application of the act of state doctrine is required by the foreign policy interests of the United States,[4] and (3) that taking was by a foreign state in violation of the principles of international law. The amendment further directs that the determination be made "giving effect to the principles of international law." Despite the majority's assertion to the contrary, the statute does not require that the expropriated property itself be brought within the territorial jurisdiction of the United States. The amendment does apply to the proceeds of such property.[5] * * * I would hold that the case at bar is in that class of cases encompassed by the amendment and that our courts are under a duty to make a determination on the merits of this controversy.

A. *Claim of title or other right to property.*

The majority has concluded that, under Libyan law, Hunt does not have title to oil in strata, but only has a contract right to that oil, and that therefore he has no claim to property as required by the Hickenlooper Amendment. I disagree. The Hickenlooper Amendment does not require proof of title to property; it requires adjudication of controversies when "a claim of title or other right to property is asserted ." (Emphasis added). The amendment also requires that the determination be made giving effect to the principles of international law, not according to the law of the country that has just accomplished the confiscation.

Significance has been attached to Congress' addition of the words "to property" after the phrase "a claim of title or other right" when it reenacted the amendment and made it permanent in 1965. A close

4 The Proviso clause of the amendment also exempts its application "in any case * * * with respect to a claim of title or other right to property acquired pursuant to an irrevocable letter of credit of not more than 180 days duration issued in good faith prior to the time of the confiscation or other taking."

5 Although the amendment does not refer specifically to proceeds, it is clear that it was intended to apply to the property as long as it is traceable. The Sabbatino case itself involved the proceeds of the expropriated property. The shipment of sugar never came within the territorial jurisdiction of the United States.

reading of the legislative history surrounding the adoption of this amendment makes it clear that these words were added to assure the availability of the act of state doctrine as a defense in certain cases where American banks, insurance companies, and other financial institutions that have had reserves expropriated abroad might otherwise be susceptible to multiple liability.[6] This does not preclude the applicability of the amendment to cases where a contract has granted a party a claim of title or other right to certain tangible property that has been the subject of expropriation by a foreign sovereign. Furthermore, it has long been recognized that contract rights are a form of property protected by the Fifth Amendment. See United States Trust Co. v. New Jersey, 431 U.S. 1, 19, n. 16 (1977).

* * *

The majority cites four cases presumably as support for the holding that the Hickenlooper Amendment is inapplicable because Hunt only acquired a contract right in the Concession Agreement. None of these cases, however, is directly on point, nor does any preclude a holding that a claim to property, granted by contract, is encompassed by the Hickenlooper Amendment. Of the four cases cited, only one actually involved a claim to tangible property that was expropriated and later brought into the United States.

* * *

The only case cited that involved property allegedly expropriated and later brought into the United States was Occidental of Umm Al Qaywayn, Inc. v. Cities Service Oil Co., 396 F.Supp. 461 (W.D. La. 1975), dismissed in part, reversed in part, 577 F.2d 1196 (1978). Occidental sued Cities Service for the conversion of oil in three tankers, claiming that the oil had been produced from an area of the Persian Gulf in which Occidental held valid concession rights. Cities Service contended

6 In 1964, the Hickenlooper Amendment was adopted as a temporary law with the ~~understanding that it would be further~~ considered the following year. In 1965, after additional hearings, the Amendment became permanent law as part of the Foreign Assistance Act of 1965. Two significant changes were made. First, as noted, it was made permanent law. Second, the words "to property" were added as described above. The purpose of that addition was explained in the Senate Report:

> **The words "to property" have been inserted to make it clear that the law does not prevent banks, insurance companies, and other financial institutions from using the act** of state doctrine as a defense to multiple liability upon any contract or deposit or insurance policy in any case where such liability has been taken over or expropriated by a foreign state. In such cases, it is not intended to affect any defense previously available to such institutions. (Emphasis added). S. Rep. No. 170 on S. 1837, 89th Cong., 1st Sess. 19 (1965).

that it held the only valid concession rights to the area in dispute. Each company held a concession granted by one of the States bordering the Persian Gulf. The area covered by each concession was defined by the territorial waters of the State granting those rights. The boundary lines were in dispute between these governments, however, with each government claiming the area where this oil was produced. It was never clearly established that Occidental had valid concession rights in the area in dispute. The boundary dispute was the crucial factor that led the Fifth Circuit Court of Appeals to hold that the controversy between Occidental and Cities Service involved a political question and was therefore non-justiciable. 577 F.2d 1196. In light of that holding on appeal, I consider the portion of the district court's opinion stating that the Hickenlooper Amendment does not apply to contract claims to be of no significant precedential value.

Occidental is further distinguishable from our case at bar because of the applicability of the second proviso of the Hickenlooper Amendment. That proviso precludes application of the amendment when the President "determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court." A letter from the State Department was included in the Government's amicus curiae brief in Occidental wherein the opinion was expressed that "it would be contrary to the foreign relations interests of the United States if our domestic courts were to adjudicate boundary controversies between third countries and in particular that controversy involved here." 577 F.2d at 1204, n. 13. Conversely, Hunt has produced expressions from the State Department supporting his pursuit of legal remedies in regard to the oil from the Sarir field, as will be discussed below.

I do not find any of the cases above to be controlling in light of the clear Congressional intent, as discussed previously, to include contractual rights to property within the exception provided by the Hickenlooper Amendment. Indeed, I have been cited to no case, and have discovered no case, holding squarely that a claim to property, granted by contract, is not encompassed by the Hickenlooper Amendment.

Finally, the amendment's application is not restricted to cases where the plaintiff has asserted a claim of title or other right to expropriated property. Rather, the amendment requires a determination on the merits "in a case in which a claim of title or other right to property is asserted by any party * * * based upon (or traced through) a confiscation or other taking. * * *" Therefore, by its language, the Hickenlooper Amendment applies if either the plaintiff, or the defendant, claims title or right to property based upon a taking by a foreign country. Clearly, Coastal States, the defendant here, is a party claiming the right to oil from the Sarir field based entirely upon Libya's taking of Hunt's concession rights. In this case, therefore, both the plaintiff, Hunt, and the defendant, Coastal States, are asserting claims of right to property that was expropriated by Libya.

B. Department of State's Support of Hunt.

The second proviso of the Hickenlooper Amendment exempts its application "in any case with respect to which the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court." This provision avoids the situation that concerned the United States Supreme Court in Sabbatino: that judicial determinations of parties' rights might interfere with, or embarrass, the Executive Branch of the government.[7] There has been no such request filed with any court in this case. In fact, the Department of State has indicated its belief that the Hickenlooper Amendment was passed precisely to permit American courts to entertain suits such as this, brought in pursuit of "hot" oil; that the nationalization of Hunt's interest in the Sarir field by Libya violated international law; and that wherever possible Hunt should be supported in his pursuit of legal remedies.[8] It is apparent, therefore, that the Department of State has

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7 The Department of State originally opposed the passage of the Hickenlooper Amendment. However, after the Hickenlooper Amendment was passed, the Department of State took the position that the amendment was valid and constitutional. Banco Nacional de Cuba v. Farr, 383 F.2d 166, 181, n. 16 (1967).

The State Department's acceptance of the Hickenlooper Amendment *post-Sabbatino* is further shown in a letter from its Legal Advisor to the Solicitor General, and appended to the majority opinion in *Alfred Dunhill of London, Inc. v. Cuba*, 425 U.S. 682, 706-11 (1976):

> In general this Department's experience provides little support for a presumption that adjudication of acts of foreign states in accordance with relevant principles of international law would embarrass the conduct of foreign policy. Thus, it is our view that if the Court should decide to overrule the holding in Sabbatino so that acts of state would thereafter be subject to adjudication in American courts under international law, we would not anticipate embarrassment to the conduct of the foreign policy of the United States.

Id. at 710-11.

The letter also refers to several recent decisions where courts of other nations have reviewed state acts under international law and noted that

> "As far as can be determined, this exercise of the judicial function in foreign jurisdictions has not caused serious foreign relations consequences for the countries concerned."

Id. at 710.

8 Statement by the Department of State on policy on "hot" Libyan Oil:

> Question has been raised in testimony before the Subcommittee on Multinational Corporations of the Senate Committee on Foreign Relations about the policy of the Department of State in respect of "hot" Libyan oil. The statement that follows describes that policy.
>
> * * *
>
> * * * *The purpose of the Sabbatino Amendment*, which is the law today, *is precisely to permit American courts to entertain suits such as those that have been brought in pursuit of "hot" oil.* * * *
>
> * * *
>
> Following Bunker Hunt's nationalization, representatives of the Company requested the Department to support its litigation in respect of oil believed to originate in the expropriated concession. * * * It was the conclusion of the Department of State, in light of the illegal nature of the nationalization of Hunt and the implications which that action had for the interests of other U.S. nationals in Libya, and elsewhere, that the U.S. Government could and should take certain steps to support the Hunt Company's position. Hunt, and its concession partner, BP, should, it was thought, pursue their legal remedies wherever possible since a failure to do so would encourage the Libyan Government to continue its policy of expropriating foreign oil companies in violation of international law. Having determined that the nationalization on June 11 was invalid under international law, it was believed that it was important for the U.S. Government to assert that position on behalf of the Hunt Company, a U.S. national, in an attempt to make it as difficult as possible for the Libyan Government to profit by its unlawful acts.
>
> * * *
>
> As noted, the State Department is of the view that the Libyan nationalization decrees * * * are violative of international law. The June decree was discriminatory, arbitrary and not for a public purpose; the September decree made an offer of inadequate compensation and also failed to respect the obligation to arbitrate disputes with concession holders. In these circumstances, and having regard to the foreign policies pursued by the Libyan Government and the state of relations between the Libyan and United States Governments, it was and remains highly unlikely that the Executive Branch would find it appropriate to request courts in the United States to refrain from passing upon acts of the Libyan Government on grounds of "act of State." (Emphasis added).

UNITED STATES OF AMERICA'S NOTE VERBALE No. 59, Presented to Ministry of Foreign Affairs of the Libyan Arab Republic, dated July 5, 1973:

> * * * It is clear from those pronouncements [the speech by Chairman Qadhafi, see p. 24 infra, and the official commentary accompanying the law expropriating Hunt's Interest] that the reasons for the action of the Libyan Arab Republic Government against the rights and property of the Nelson Bunker Hunt Oil Company were political reprisal against the United States Government and coercion against the economic interests of certain other U.S. Nationals in Libya. Under established principles of international law, measures taken against the rights and property of foreign nationals which are arbitrary, discriminatory, or based on considerations of political reprisal and economic coercion are invalid and not entitled to recognition by other states.

LETTER, From William J. Casey, Under Secretary of State, to G. Henry M. Schuler of Nelson Bunker Hunt, dated August 3, 1973:

> I am writing in response to your letter of August 2, 1973 regarding the nationalization on June 11, 1973 of Nelson Bunker Hunt's rights and property in Libya. In your letter, you requested me to approve the release of the text of a diplomatic note transmitted by the U.S. Government to the Government of the Libyan Arab Republic on July 8, 1973, which contained our position with respect to the June 11 nationalization. * * * I am

determined that adjudication of Hunt's claim by the judicial branch of our government will cause no serious harm or embarrassment to the conduct of foreign policy by the Executive Branch of our government.

C. Violation of International Law

The amendment also requires that the taking by the foreign state be "in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection." The majority does not reach this question since it found the Hickenlooper Amendment inapplicable to the instant case on other grounds.

Hunt contends that Libya's expropriation violated international law because it did not provide for prompt, adequate compensation and because it arbitrarily discriminated against him for a political purpose unrelated to any legitimate public interest. In my view, the Hickenlooper Amendment itself requires speedy compensation, equivalent to the full value of the expropriated property.

The amendment refers to the "principles of compensation and the other standards set out in this subsection" as quidelines for the determination of the adequacy of compensation. That subsection, 22 U.S.C. 2370(e)(1), requires the President to suspend assistance to any country expropriating property owned more than 50% by United States' citizens if that government does not, within a reasonable time after the expropriation, take steps to discharge its obligations toward those citizens, "including speedy compensation for such property in convertible foreign exchange, equivalent to the full value thereof, as required by international law. * * *" The statute, therefore, anticipates that United States' citizens will receive the full value of their expropriated property and that such compensation will be forthcoming shortly after the expropriation takes place. Other authority indicates further that the United States expects compensation to its citizens for expropriated property to be reasonably prompt and to be for the full market value.[9]

It is uncontested that Hunt received no compensation from Libya until approximately two years after the expropriation and that the compensation received at that time was limited to the net book value of

enclosing the text of the substance of the note and will provide you with certified copies * * * as soon as they are available. We have no objection to your using this note in connection with any pending or proposed litigation or in any other way appropriate to the assertion of your legal rights to the nationalized property. * * *

9 § 188. Adequacy of Compensation:

(1) Compensation, to be adequate in amount within the meaning of § 187, must be in an amount that is reasonable under the circumstances. * * * Under ordinary conditions, * * * the amount must be equivalent to the full value of the property taken, together with interest to the date of payment. (Emphasis added).

Restatement of the Law (Second), Foreign Relations Law of the United States, § 188 (1965).

the physical assets on the concession at the time of the nationalization. The nationalization decree purported to provide some measure of compensation to Hunt. However, the amount of compensation was to be determined by a committee appointed by Libya's oil minister, with no provision for Hunt to produce evidence as to the value of his interest in the Sarir field. Further, the decree explicitly precluded any appeal from the committee's decision. The Restatement of the Law (Second), Foreign Relations Law of the United States, § 185 (1965) states that the taking of property by a state is wrongful under international law if, among other things, "there is not reasonable provision for the determination and payment of just compensation." Comment (e) elaborates on this requirement and explicitly refers to two elements of fairness which were denied Hunt: that an impartial tribunal or administrative authority determine his rights, and that he have a reasonable opportunity to obtain and present witnesses and evidence in his own behalf. I conclude that the compensation provisions of the nationalization decree were illusory and did not meet the requirements for adequate compensation.

Coastal States points out that several countries, notably Latin American and Communist countries, do not acknowledge any duty to provide compensation to aliens for expropriated property. There is also disagreement among international law experts as to whether something less than full market value may constitute adequate compensation. However, in the case at bar, we have the additional consideration that the property was seized as a means of political and economic retaliation against the United States.

The retaliatory nature of Libya's expropriation of Hunt's interest in the Sarir field is clearly shown in the text of a speech given by Libyan Chairman Mu'ammar al-Qadhafi at a celebration marking the third anniversary of the closing of the United States Air Force Base at Wheelus:

> The United States, which has suffered defeats everywhere, has not yet been taught the final lesson, especially when we see it being quarrelsome in the Arab world and completely siding with Israel * * * we say with a loud voice that this United States needs to be given a big hard blow on its cold insolent face in the Arab area.
>
> U.S. policy, brothers, is going to lead to a catastrophe for U.S. interests in the Arab area in particular. The time has come for the Arab peoples to confront the United States. The time has come for the U.S. interests to be threatened earnestly and seriously in the Arab area, regardless the cost. * * *
>
> The United States is still scorning the Arab nation and its rights. It is continuously giving Israel the most modern arms to enable it to humiliate the Arab nation or to conquer at its will or to remain

unjustly in the occupied territory. Also, U.S. (arrogance) is now *manifested in the attitude of the oil companies*. * * *

However, the time may come, if it has not already come, for the serious and dangerous confrontation to take place—a confrontation the cost of which we must bear with the oil companies and with the entire U.S. imperialism. On this occasion, the RCC of the Libyan Arab Republic has decided to nationalize the American oil company Bunker Hunt. (Emphasis added.)

There is generally a consensus among authorities that an uncompensated expropriation, when done as an act of retaliation, is contrary to international law. The Second Circuit Court of Appeals reviewed such authorities and concluded:

Unlike the situation presented by a failure to pay adequate compensation for expropriated property when the expropriation is part of a scheme of general social improvement, confiscation without compensation when the expropriation is an act of reprisal does not have significant support among disinterested international commentators from any country. And despite our best efforts to deal fairly with political and social doctrines vastly different from our own, we also cannot find any reasonable justification for such procedure. Peacetime seizure of the property of nationals of a particular country, *as an act of reprisal against that country, appears to this court to be* contrary to generally accepted principles of morality throughout the world.

Banco Nacional de Cuba v. Sabbatino, 307 F.2d 845, 866 (1962), reaffirmed in Banco Nacional de Cuba v. Farr, 383 F.2d 166, 183, cert. denied, 390 U.S. 956 (1968). I agree with the reasoning of the Second Circuit Court of Appeals and would hold that the expropriation of Hunt's interest in the Sarir field by Libya was without prompt, adequate compensation; that the expropriation was in retaliation against the United States; and that for these reasons the expropriation violated international law.

I would reverse the summary judgment against Hunt and remand his suit against Coastal States for a determination on the merits. Chief Justice Greenhill and Justice Franklin Spears join.

Notes

1. The *Hunt* decision reflects a general feeling of American courts that expropriations involve such sovereign and international matters that they do not belong in the United States courts. How can one justify

this belief in light of the Hickenlooper amendment? Does the majority in the Texas case take an unduly narrow reading of the amendment?

2. The Texaco-California Asiatic Oil Company arbitration with Libya provides an interesting example of the role of the United Nations resolutions in the determination of compensation in private arbitration. Libya refused to participate in this proceeding, and its interests were represented in a memorandum to the court. In that memorandum, Libya took the position that "Nationalization is an act related to the sovereignty of the State. * * * Nationalization, being related to the sovereignty of the state, is not subject to foreign jurisdiction. Provisions of international law do not permit a dispute with a state to be referred to any Jurisdiction other than its National Jurisdiction." Dispute Between Texaco Overseas Petroleum Corporation/California Asiatic Oil Co. and the Government of the Libyan Arab Republic, 17 I.L.M. at 27-37 (1978).[10] The arbitrator, a French law professor, found that substantial differences existed between Resolution 1803—the Resolution on Permanent Sovereignty Over Natural Resources—and the subsequent resolutions. He then examined the support among the nations in the world for the different resolutions as determined by the various votes and made the following ruling:

86. Taking into account the various circumstances of the votes with respect to these Resolutions, *this Tribunal must specify the legal* scope of the provisions of each of these Resolutions for the instant case.

* * *

As this Tribunal has already indicated, the legal value of the resolutions which are relevant to the present case can be determined on the basis of circumstances under which they were adopted and by analysis of the principles which they state:

—With respect to the first point, the absence of any binding force of the resolutions of the General Assembly of the United Nations implies that such resolutions must be accepted by the members of the United Nations in order to be legally binding. In this respect, the Tribunal notes that only Resolution 1803 (XVII) of 14 December 1962 was supported by a majority of Member States representing all of the various groups. By contrast, the other Resolutions mentioned above, and in particular those referred to in the Libyan Memorandum, were supported by a majority of States but not by any of the developed countries with market economies which carry on the largest part of international trade.

10 Reproduced with permission from 17 I.L.M. 1 (1978), © American Society of International Law.

87. (2) With respect to the second point, to wit the appraisal of this legal value on the basis of the principles stated, it appears essential to this Tribunal to distinguish between those provisions stating the existence of a right on which the generality of the States has expressed agreement and those provisions introducing new principles which were rejected by certain representative groups of States and having nothing more than a *de lege ferenda* value only in the eyes of the States which have adopted them; as far as the others are concerned, the rejection of these same principles implies that they consider them as being *contra legem*. With respect to the former, which proclaim rules recognized by the community of nations, they do not create a custom but confirm one by formulating it and specifying its scope, thereby making it possible to determine whether or not one is confronted with a legal rule. * * *

On the basis of the circumstances of adoption mentioned above and by expressing an opinion *juris communis*, Resolution 1803 (XVII) seems to this Tribunal to reflect the state of customary law existing in this field. * * * The consensus by a majority of States belonging to the various representative groups indicates without the slightest doubt universal recognition of the rules therein incorporated, i.e., with respect to nationalization and compensation the use of the rules in force in the nationalizing State, but all this in conformity with international law.

* * *

90. The argument of the Libyan Government, based on the relevant resolutions enacted by the General Assembly of the United Nations, that any dispute relating to nationalization or its consequences should be decided in conformity with the provisions of the municipal law of the nationalizing State and only in its courts, is also negated by a complete analysis of the whole text of the Charter of Economic Rights and Duties of States.

From this point of view, even though Article 2 of the Charter does not explicitly refer to international law, this Tribunal concludes that the provisions referred to in this Article do not escape all norms of international law. * * * Now, among the fundamental elements of international economic relations quoted in the Charter, principle (j) is headed as follows: "Fulfillment in good faith of international obligations".

* * *

91. Therefore, one should note that the principle of good faith which had already been mentioned in Resolution 1803 (XVII), has an important place even in Resolution 3281 (XXIX) called "The Charter of Economic Rights and Duties of States". One should conclude that a sovereign State which nationalizes cannot disregard the commitments undertaken by the contracting State: to decide otherwise would in fact recognize that all contractual commitments undertaken by a State have been undertaken under a purely permissive

Stabiliz's clause

condition on its part and are therefore lacking of any legal force and any binding effect. From the point of view of its advisability, such a solution would gravely harm the credibility of States since it would mean that contracts signed by them did not bind them; it would introduce in such contracts a fundamental imbalance because in these contracts only one party—the party contracting with the State—would be bound. In law, such an outcome would go directly against the most elementary principle of good faith and for this reason it cannot be accepted.

* * *

17 I.L.M. 29-31. Does this arbitral result mean that private arrangements may be affected by the manner in which a few western states vote upon a particular resolution? Will international energy agreements change over time as the United Nations adopts other resolutions (for example, resolutions on the environment)?

3. The Iran-U.S Claims Tribunal and Iran's continuing funding of the claims awarded by this body is largely the result of the freeze that the United States imposed on Iranian assets in the United States. In order to lift this freeze, Iran had to consent to the establishment of the tribunal. During the period of this tribunal's existence, United States oil companies brought ten cases against Iran and the National Iranian Oil Company. The last case involved claims by ARCO and Sun and each company received $130.45 million in settlement of the expropriation. See Andrew Kelly, "Iran Settles Last Big U.S. Oil Expropriation Case," Reuter Bus. Rep. (Aug. 19, 1992). In 1990, Iran paid $600 million to AMOCO for a similar claim. See L.A. Times, Dec. 25, 1990, at D).

4. In several private energy agreements with sovereigns, the country and the multinational have included a stabilization clause that states that the country agrees not to change any term of the agreement and not to expropriate the assets of the multinational for a specific period. Are such clauses enforceable in an arbitration? If so, does the existence of the stabilization clause give the multinational any additional remedies against an expropriation? The Kuwait-Aminoil arbitration involved a stabilization clause. See Fernando R. Teson, "State Contracts and Oil Expropriations: The Aminoil-Kuwait Arbitration," 24 Va. J. Int'l L. 323 (1984). Not surprisingly, Aminoil argued that the stabilization clause gave them protection as a concessionaire and Kuwait argued that the clause was colonial in character and thus invalid. The tribunal refused to interpret the stabilization clause as to prohibit a country from nationalizing private assets; instead, it found that such a clause meant that the expropriation could not be confiscatory in character. Full compensation was required.

PATRICK M. NORTON, "A LAW OF THE FUTURE OR A LAW OF THE PAST? MODERN TRIBUNALS AND THE INTERNATIONAL LAW OF EXPROPRIATION"

85 Am. J. Int'l L. 474, 475-85 (1991)[11]

I. THE INTERNATIONAL LAW OF EXPROPRIATION IN 1974

The "Premodern" Case Law

Although the issue is not undisputed, there is general agreement that in the earlier part of this century the international law of expropriation was well settled. Under the "Hull formula," state expropriation of foreign-owned property required the payment of "prompt, adequate, and effective" compensation. This standard was recently reformulated in the *Restatement (Third),* which states that an expropriation requires the payment of "just compensation," meaning, "in the absence of exceptional circumstances, * * * an amount equivalent to the value of the property taken * * * paid at the time of taking * * * and in a form economically usable by the foreign national." Contrary to the terminology of both the Restatement and the Hull formula, I shall refer to this general concept of compensation as "full compensation," recognizing that this phrase is imprecise but believing that it conveys the underlying idea more clearly and concisely than any alternative.

The beginning point for virtually every analysis of the "premodern" law is the holding of the Permanent Court of International Justice in the *Chorzow Factory* case.[12] Germany argued there that Poland's expropriation of German-owned industrial property in Upper Silesia violated the Convention concerning Upper Silesia of May 15, 1922. The Court agreed and held the expropriation to be unlawful. In an oft-quoted passage, the Court distinguished not only such internationally illegal acts of expropriation from legal acts, but also the remedy appropriate for each:

> The essential principle contained in the actual notion of an illegal act—a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals—is that reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear [must be made]. * * *

[11] Reprinted with permission, 85 AJIL 474 (1991), © The American Society of International Law.

[12] Factory at Chorzów (Ger. v. Pol.) (Indemnity), 1928 PCIJ (ser. A) No. 17 (Judgment of Sept. 13).

In contrast, lawful expropriation did not require restitution but only payment of "the just price of what was expropriated," measured as "the value of the undertaking at the moment of dispossession, plus interest to the day of payment."

Chorzow Factory is important to the present inquiry because its continued vitality is the starting point for many of the recent decisions. It is also of interest because, like many of the more recent tribunals, the Court rested its holding on judicial precedent, on a "principle * * * established * * * in particular by the decisions of arbitral tribunals." Consistent with its general practice, the Court did not further specify the precedents it had in mind, but these are not difficult to identify. Some sixty international claims tribunals sat between the early nineteenth century and the Second World War, many dealing with claims arising out of takings of alien property. Although their reasoning is sometimes obscure, none held that the appropriate measure of compensation was less than the full value of the property taken, and many specifically affirmed the need for full compensation.

Postwar Cases

Between the beginning of the Second World War and the early 1970s, only a handful of arbitrations addressed the international law of expropriation. The *ARAMCO,*[13] *Sapphire,*[14] *Abu Dhabi*[15] and *Qatar*[16] arbitrations were the first of a series arising out of efforts by the states of the Middle East to terminate or renegotiate long-term petroleum concessions.

For present purposes, several common features of these decisions are relevant and uncontroversial. First, none of the concession agreements had a clear choice-of-law clause. As a consequence, each tribunal applied, in one manner or another, "general principles of law."[17] Second, in ascertaining the content of that law, the arbitrators frequently cited as

[13] Saudi Arabia v. Arabian American Oil Co., 27 ILR 117 (Sauser-Hall, Badawi/Hassan, Habachy, arbs., 1958) [hereinafter ARAMCO].

[14] Sapphire Int'l Petroleums Ltd. v. National Iranian Oil Co., 35 ILR 136 (1963) (Cavin, sole arb.).

[15] Petroleum Dev. Ltd. v. Sheikh of Abu Dhabi, 18 ILR 144 (1951).

[16] Ruler of Qatar v. International Marine Oil Co., 20 ILR 534 (1953)

[17] *ARAMCO,* 27 ILR at 167-69; *Sapphire,* 35 ILR at 170-75; *Qatar,* 20 ILR at 545 ("principles of justice, equity, and good conscience"); *Abu Dhabi,* 18 ILR at 149 ("principles rooted in the good sense and common practice of the generality of civilized nations—a sort of 'modern law of nature'").

precedents the decisions of earlier international arbitral tribunals that had applied similar general principles or public international law. And third, in every instance the tribunal held the concessionary state to the terms of its concession, or to damages for its breach, largely on the basis of this body of international precedent.[18] These decisions thus continued a precedent-based jurisprudence of expropriation and can reasonably be argued to support a continued requirement under international law as of the mid-1960s for the payment of full compensation for expropriated property.

The Great Ideological Debate

In the late 1950s and early 1960s, dozens of new states gained their independence and challenged customary international law. Many of these states refused to consider themselves bound by a law in whose formation they had not participated and which, they maintained, did not reflect their own cultural and legal traditions. The law of expropriation attracted their special animus since it purported to place strict limitations on how they could deal with foreign investors in control, at the time of independence, of many of the new states' natural resources.

The debate was waged largely in the General Assembly and other international forums. The last consensus on the issue was embodied in the 1962 General Assembly Resolution 1803 (XVII), Permanent Sovereignty over Natural Resources, adopted by a vote of 87 to 2, with 12 abstentions:

1803

> Nationalization, expropriation or requisitioning shall be based on grounds or reasons of public utility, security or the national interest which are recognized as overriding purely individual or private interests, both domestic and foreign. In such cases the owner shall be paid appropriate compensation, in accordance with the rules in force in the State taking such measures in the exercise of its sovereignty and in accordance with international law.

Non discrim.?

Resolution 1803 thus affirmed the applicability of international law to the expropriation of alien property and a duty under that law to pay compensation for property expropriated. But the forthcoming debate was foreshadowed in the stipulation that compensation need only be

18 *ARAMCO*, 27 ILR at 191-98, 205, 216-17; *Sapphire*, 35 ILR at 182-90. The *Qatar* and *Abu Dhabi* arbitrations enforced the concessions at issue but turned primarily on whether the continental shelf came within the terms of those concessions, not on the law of expropriation or the enforceability of concession agreements generally. See *Abu Dhabi*, 18 ILR at 150-57; Qatar, 20 ILR at 162-64.

"appropriate"—an ambiguous term subject to interpretation by each state as it saw fit.[19]

The consensus, even on these terms of ambiguity, eroded over the next few years. In Resolution 3201 (S-VI), the Declaration on the Establishment of a New International Economic Order (the NIEO), a large majority of the General Assembly proclaimed the right of each state to exercise control over and exploit its natural resources, "including the right to nationalization or transfer of ownership to its nationals." Shortly thereafter, by a vote of 118 to 6 with 10 abstentions, all of the major capital-exporting states opposing or abstaining, the General Assembly adopted the Charter of Economic Rights and Duties of States (the Charter). Again, "appropriate compensation" was asserted as the standard, but disputed questions of "appropriateness" were referred to the nationalizing state's law and tribunals; international law was not mentioned.

Throughout this period, approximately from 1963 to 1974, no international tribunal ruled on an expropriation dispute. Following the relative paucity of decisions from 1939 to 1963, many observers questioned the continued relevance of judicial and arbitral decisions to this area of international law.

II. THE NEW JURISPRUDENCE

The Libyan Oil Cases

Between 1971 and early 1974, the Libyan Government nationalized the interests and properties of foreign oil companies in Libya. Three separate arbitral tribunals adjudicated the lawfulness of these nationalizations and the remedies of the companies.

The BP Arbitration.[20] British Petroleum's interests were expropriated, and went to arbitration, first. Swedish Judge Gunnar Lagergren, as sole arbitrator, found that Libya's taking of BP's property, rights, and interests "violate[d] public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character. * * * [T]he fact that no offer of compensation has been made indicates that the taking was also confiscatory." The largest part of

19 It has been argued that "appropriate" was understood at the time of the debate as being equivalent to both "adequate" and "full." See Schwebel, "The Story of the U.N.'s Declaration on Permanent Sovereignty over Natural Resources," 49 A.B.A.J. 463, 465-66 (1963). Had that been the case, one obviously wonders why the resolutions did not use those terms. In fact, the debate and a series of votes on alternative drafts were quite confused, and it must be assumed that the resulting formulation was the normal product of a political impasse. * * *

20 British Petroleum Exploration Co. v. Libyan Arab Republic, 53 ILR 297 (Lagergren, sole arb., 1973).

Lagergren's opinion was devoted to the appropriate remedy for this violation.

In attempting to identify principles of international law common to Libyan law, as required by the choice-of-law clause in the concession agreement,[21] Lagergren placed primary reliance on "the case law of international tribunals." After an extensive examination of that case law reaching back to the nineteenth century, and after an attempt to distinguish *Chorzow Factory* as dictum,[22] he concluded that *restitutio in integrum* was available as a remedy under public international law for a state in breach of a concession agreement but only "as a vehicle for establishing damages." Lagergren was not required to calculate damages, but his reference to reparation "as a vehicle for establishing damages" seemingly endorsed damages in full, at least in cases of unlawful expropriation.

The BP decision was rendered in the midst of what I have called the "Great Ideological Debate" in the General Assembly challenging the customary international law of expropriation and did not have to address the effect of the Assembly's resolutions. The other two Libyan oil arbitrations were several years later and confronted the issue directly.

TOPCO/CALASIATIC. The claims of the Texas Overseas Petroleum Company (TOPCO) and the California Asiatic Oil Company (CALASIATIC) were heard jointly by Professor René-Jean Dupuy, then Secretary-General of the Hague Academy of International Law, as sole arbitrator. Dupuy determined that the arbitration was "directly governed by international law." Like Lagergren, Dupuy relied heavily on the case law of international tribunals, but he differed in his conclusions.

Dupuy determined that the *Chorzow* holding that, in principle, *restitutio in integrum* is the preferred remedy in international law for a wrongful expropriation was still valid law, and he ordered Libya to resume performance under the concession agreement. One can reasonably infer that, had he thought damages the appropriate remedy, Dupuy would

21 The concession contracts at issue in the Libyan oil cases had identical choice-of-law clauses:

> This Concession shall be governed by and interpreted in accordance with the principles of law of Libya common to the principles of international law and in the absence of such common principles then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals.

Quoted in von Mehren & Kourides, supra note 31, at 481-82.

22 Lagergren argued in this regard that Germany had abandoned its claim for return of the factory before bringing the PCIJ case and asked for and was granted only damages. Id. at 337-40. Technically, therefore, he is correct that the Court's categorical statement that *restitutio in integrum* is the preferred remedy is only dictum. Nevertheless, most authorities have considered the statement an authoritative exposition of the law. See note 43 infra.

have required damages in the amount of the full value of the expropriated interests.

Dupuy also rested his holding on the views of numerous publicists and policy rationales underlying the *Chorzow Factory* decision. Dupuy emphasized the existence of a negotiated, written investment agreement between the parties. He held that failure to enforce such an agreement "would go directly against the most elementary principle of good faith" and would be fundamentally unfair to the foreign investor, which had relied on that agreement in making expensive investments and undertaking commercial risks.

1803

In the course of his holding, Dupuy determined that General Assembly Resolution 1803, by virtue of its nearly unanimous adoption, was declaratory of existing customary international law at the time. The subsequent NIEO and Charter resolutions, in contrast, had "nothing more than a *de lege ferenda value* * * * in the eyes of the States which have adopted them; as far as the others are concerned, the rejection of these same principles implies that they consider them as being *contra legem.*" Lump sum settlements were likewise of no evidentiary value for determining international law because they were "inspired basically by considerations of expediency and not of legality."

LIAMCO.[23] The *Libyan American Oil Co.*, or LIAMCO, arbitration was heard by Dr. Sohbi Mahmassani of Lebanon. Mahmassani held that Libyan law required good faith observation of the concession agreement and entitled LIAMCO to both *damnum emergens* and *lucrum cessans*. He determined, however, that *international law* was less clear because international arbitral precedents were too dated to be relied upon; the General Assembly's NIEO resolutions, although not binding and admittedly imprecise, represented "the recent dominant trend of international opinion"; postwar lump sum settlements also contradicted a full compensation standard; and *restitutio in integrum*, as opposed to damages, would infringe on the authority of a sovereign within its own territory. For these reasons, Mahmassani held that, although "the classical formula of '[prompt], adequate and effective compensation' remain[s] as a maximum and a practical guide for * * * assessment," it was not the only compensation standard applicable under international law.

restitution — sov ty.

Mahmassani concluded, in particular, that international law was not firmly established on the availability of *lucrum cessans* and, in the absence of congruence between international and Libyan law, that he was not authorized to award *lucrum cessans*. He therefore turned to the

this is misguided — mistaken

23 Libyan American Oil Co. v. Libyan Arab Republic, 20 ILM 1 (1981) (Mahmassani, sole arb., 1977) [hereinafter LIAMCO].

alternative clause of the choice-of-law provision in the concession contract and found that, under "general principles of law," he was authorized to award "equitable compensation." Seemingly in ~~contradiction to~~ his holding that *lucrum cessans* ~~was unavailable~~, Mahmassani then based the largest part of the award of "equitable compensation" on a calculation of the claimant's lost profits.

AMINOIL

Like the Libyan cases, the AMINOIL arbitration[24] grew out of an Arab nationalization in the 1970s of a long-term petroleum concession, in this instance by Kuwait. The opinion turned largely on an extensive exegesis of the terms of AMINOIL's 1948 concession agreement and the extent to which that agreement had been amended during negotiations with the Government of Kuwait during and after the 1973 oil crisis.

The tribunal found AMINOIL's 1948, preindependence concession, including its "stabilization clause," valid and binding because the Government of Kuwait had ratified it after independence. A majority of the tribunal, however, decided that the concession and the stabilization clause had been amended in subsequent negotiations; that Kuwait's 1977 decree terminating the concession and nationalizing AMINOIL's assets therefore did not violate the stabilization clause of the original agreement; and that AMINOIL was entitled only to "appropriate compensation" for a lawful taking of its property interests. The tribunal then unanimously held that the determination of "appropriate compensation" required an "inquiry into all the circumstances relevant to the particular case"; that compensation "must be calculated on a basis such as to warrant the upkeep of a flow of investment in the future"; and that, for such an important, long-term contract, "there must necessarily be economic calculations, and the weighing-up of rights and obligations, of chances and risks, constituting the contractual equilibrium." Although accepting in principle AMINOIL's proffered "discounted cash flow" method of valuing the expropriated interests, including the speculative elements of that method, the tribunal held that the parties had agreed that AMINOIL would only receive a "reasonable rate of return" from its investment. On the basis of that return, adjusted for inflation, the tribunal calculated the value of AMINOIL's investment as a "going concern."

Stabiliz'n clause

The AMINOIL tribunal applied public international law both directly and as an integral part of Kuwaiti law. But its examination of the relevant international law was limited. It cited no arbitral precedents, relying, rather, on the "appropriate compensation" standard of Resolution

1803

24 Kuwait and American Independent Oil Co., 66 ILR 519, 21 ILM 976 (1982) (Reuter, Sultan & Fitzmaurice, arbs., 1982) [hereinafter AMINOIL].

1803 as the "codification" of customary international law at the last time of consensus; the tribunal rejected subsequent General Assembly actions because of the lack of such a consensus.

The Iran-U.S. Claims Tribunal

The "Algiers Accords" that released the U.S. diplomatic hostages in Iran created the Iran-U.S. Claims Tribunal and vested that Tribunal with jurisdiction over expropriation claims of U.S. nationals against Iran. To date, at least fourteen separate opinions in seven cases have examined the relevant law in detail. Other Tribunal decisions deal with the same issues implicitly.

The Tribunal's rulings on this issue were shaped by Article IV, paragraph 2 of the U.S.-Iran Treaty of Amity, Economic Relations, and Consular Rights, which provides:

> Property of nationals and companies of either High Contracting Party, including interests in property, shall receive the most constant protection and security within the territories of the other High Contracting Party, in no case less than that required by international law. *Such property shall not be taken except for a public purpose, nor shall it be taken without the prompt payment of just compensation. Such compensation shall be in an effectively realizable form and shall represent the full equivalent of the property taken*; and adequate provision shall have been made at or prior to the time of taking for the determination and payment thereof.

The Tribunal's opinions should, and generally do, turn on the requirements of this paragraph. Because, however, the continued applicability of the Treaty after the rupture in U.S.-Iran relations was both a legal and a political issue, many opinions also consider the otherwise applicable international law. Although technically dicta, these holdings are of greatest interest here.

The majority opinions. All of the Tribunal's significant expropriation decisions have been rendered by a majority composed of a "neutral" and an American arbitrator, with an Iranian arbitrator dissenting. Each of the Tribunal's three Chambers, with seven different majorities involving eleven arbitrators, has examined the applicable legal standard for compensating an expropriation. As dispositive decisions, these majority opinions have the most legal significance.

All of the majority opinions have required the payment of full compensation. In the AIG case, Arbitrators Mangard and Mosk held that "it is a general principle of public international law that even in a case of lawful nationalization the former owner of the nationalized property is normally entitled to compensation for the value of the property taken," and that "the appropriate method is to value the company as a going concern."[25] In TAMS, Arbitrators Riphagen and Aldrich, citing *Chorzow Factory* and *Norwegian Shipowners*, held the claimant "entitled under international law and general principles of law to compensation for the full value of the property of which it was deprived."[26] In *Sola Tiles*, Arbitrators Bockstiegel and Holtzmann held that the "full compensation" standard of the Treaty was the same standard as required by international law.[27] Acknowledging the widespread use of an "appropriate" compensation standard in international law, they found that recent arbitral and judicial tribunals, citing TOPCO and AMINOIL, had generally equated that standard with full compensation. Böckstiegel and Holtzmann considered it "appropriate" in this sense to award the claimant the fair market value of its business as a going concern, "including compensation not only for physical assets * * * but also for goodwill and lost future profits." In SEDCO, Arbitrators Mangård and Brower held that customary international law required the payment of full value, though, on the facts of the case, their holding was limited to "discrete expropriations of alien property" *vice* large-scale nationalizations. And in a Partial Award in the AIFC case, Arbitrators Virally and Brower held that the international law of expropriation authorizes *restitutio in integrum* in cases of unlawful expropriation and payment of "the just price of what was expropriated" in cases of lawful expropriation; and, in the latter case, that "just compensation" is "compensation equal to the full value of the expropriated assets," measured as "going concern value." Virally and Brower disagreed as to whether "full value" in cases of lawful expropriation includes lost profits.[28] Arbitrators Briner and Aldrich

25 American Internat'l Group and Islamic Republic of Iran, AWD 93-2-3, slip op. at 14-15, 21 (Mangard, Mosk & Ansari Moin, arbs., Dec. 19, 1983), 4 IRAN-U.S. C.T.R. 96 (1983 III) [hereinafter AIG].

26 Tippetts, Abbett, McCarthy, Stratton and TAMS-AFFA, AWD 141-7-2, slip op. at 9 (Riphagen, Aldrich & Shafeiei, arbs., June 22, 1984), 6 IRAN-U.S. C.T.R. 219 (1984 II) [hereinafter TAMS]. The claimant in TAMS, however, only requested, and was awarded, the dissolution value of its business. Id., slip op. at 15.

27 Sola Tiles, Inc. v. Iran, AWD 298-317-1, slip op. at 15-16 (Böckstiegel, Holtzmann & Mostafavi, arbs., Apr. 22, 1987), 14 IRAN-U.S. C.T.R. 223 (1987 I).

28 The majority opinion was written by Virally and concurred in by Brower, with a dissent as to how going concern value should be calculated in cases of lawful expropriation. Id., Concurring Opinion of Judge Brower [hereinafter Brower]. Virally argued that the difference in the standard of compensation in cases of lawful versus cases of unlawful expropriation is that "if the taking is lawful the value of the undertaking at the time of the dispossession is the measure and the limit of the compensation, while if it is unlawful, this value is, or may be, only a part of the reparation to be paid." AIFC, supra note 82, slip op. at 84. On the basis of an analysis of questions put by the *Chorzow Factory* Court to an expert inquiry, he concluded that the "something extra" in cases of unlawful expropriation is *lucrum cessans*. Id. at 86. Although Virally acknowledged that cases of lawful expropriation required valuation of the expropriated enterprise as a "going concern" and that this included the concern's "future prospects," he maintained that these "future prospects" were not the same as "future profits" or *lucrum cessans*. Id. Virally offered no explanation, however, of what "future prospects" mean if they do not include "future profits."

Brower construed *Chorzow Factory* as presenting a "simple scheme":

> If an expropriation is lawful, the deprived party is to be awarded damages equal to "the value of the undertaking" which it has lost, including any potential future profits, as of the date of taking; in the case of an unlawful taking, however, either the injured party is to be actually restored to enjoyment of his property, or, should this be impossible or impractical, he is to be awarded damages equal to the greater of (i) the value of the undertaking at the date of loss (again including lost profits), judged on the basis of information available as of that date, and (ii) its value (likewise including lost profits) as shown by its probable performance subsequent to the date of loss and prior to the date of the award, based on actual post-taking experience, plus (in either alternative) any consequential damages.

Brower, supra, at 17-19. For a fuller analysis of the AIFC opinions generally endorsing Brower's view, see Lieblich, supra note 51, at 57-67.

subsequently resolved this issue in Brower's favor in *Phillips Petroleum*, rejecting any distinction for these purposes between lawful and unlawful expropriations, and endorsing the relevance of lost profits to assessments of full compensation in all cases. The majority opinions in Payne and *Phelps Dodge* also contain language supportive of a full compensation standard under international law, but the *ratio decidendi* of each appears to rest on the applicability of the Treaty. * * *

Notes

1. Although every nation has sovereign powers over its natural resources, and such powers include the right to expropriate, the legal and practical consequences of such an action are severe. Apart from the requirement of compensation, a country must examine the short-term and long-term consequences of such an action. In the short term, the country may be foreclosed from markets for its oil. In the long term, such actions may discourage multinational ventures with the country. In Chapter 6, we examine in more detail Mexico's expropriation of oil company assets. For an examination of the consequences of Mexico's expropriation in subsequent years on the Mexican petroleum industry, see Ernest E. Smith & John S. Dzienkowski, "A Fifty-Year Perspective on World Petroleum Arrangements," 24 Tex. Int'l L. J. 13 (1989).

2. The United Nations has taken an aggressive role in establishing a claims process for persons, corporations, and governments that have been injured as a result of Iraq's invasion of Kuwait. See Markham Ball, "Claims Against Iraq; U.N. Claims Process: Steps Taken to Date, Issues to Resolve," 15 Middle East Executive Rep. 9 (1992).

3. The outright and creeping expropriations of the last century were often accompanied by the creation of a state-owned enterprise. These enterprises were established as part of the general exercise over a nation's sovereignty. Recently this trend has reversed itself, and now there is a trend towards the privatization of state-owned industries. The next section briefly examines this new trend. In specific countries this trend has led to the renewal of claims of compensation when the state-controlled assets are finally opened to private ownership. In 1992, Shell Espana, SA asserted a claim against the Spanish government for assets that were expropriated in 1927. See Brian McGarry, "Shell's Memory May Haunt Spain," Int'l Herald Trib., Jan. 11, 1993. Shell is arguing that it at no time accepted the expropriation and the recent move to privatize the assets removes the government's claim that the assets are being used for a public purpose. Some of the assets have been given to Shell's competitors in the new private petroleum marketplace.

D. TREND TOWARD PRIVATIZATION OF STATE-OWNED ENTERPRISES

The 1970s witnessed an expansion in the number of producing countries with state-owned oil companies. In most cases, these state enterprises were the only companies that could be granted petroleum development rights by the government. Although some companies conducted operations through production sharing and risk-service contracts with private firms, others were expected by law to conduct all phases of petroleum activity without private participation.

While the value of crude oil was climbing, the inherent weaknesses of these companies discussed in Chapter 1 were not always apparent. But as supplies grew and then exceeded demand, prices, revenues, and profits fell, exposing the inefficiencies of state operations. Governments with budgets dependent on the revenues of these companies found it difficult to provide the investment capital needed to continue the risky development of new reserves. Private lenders became reluctant to extend credit to inefficient management. To attract petroleum investment, some of these governments found it necessary to privatize their industries.

The essential goal of privatization is to make the economic decisionmakers of an industry accountable to the private sector. This goal may be achieved by sale of the entire company or its assets to private investors, or it may be achieved through other actions that make the company more efficient by introducing it to market forces.

There have been several impediments to the denationalization that comes from the full sale of a company or its assets. Where political sentiments have long opposed foreign ownership of natural resources, public resistance to the surrender of state ownership is common. Due to inadequate domestic capital and the difficulty of attracting foreign investment, the sale of large enterprises may be impractical. Management and employees may object, because they view the sale of the company as a threat to vested interests. In such cases, it has been easier to pursue a policy of liberalization that permits the government to retain ownership but subjects the company to the incentives that would come from private ownership in a competitive environment. Thomas Wälde, "Restructuring and Privatization," Utilities Pol'y (Oct. 1991).

Both denationalization and liberalization can be accomplished in a number of ways. The route selected depends on factors unique to the country, the government, and the economy involved and must be tailored for the industry affected by the change. For a thorough discussion of the problems that must be considered in the Latin American context, see Carlos E. Martinez, "Early Lessons of Latin American Privatizations," 15 Suffolk Transnat'l L.J. 468 (1992). The following are some of the more common methods employed:

(a) *The Sale of Company Stock* is usually accomplished as a primary stock issue, although technically it is a secondary distribution of government held shares created by the incorporation of the company in preparation for privatization. It can entail a public tender, which assures a wider distribution of the shares, a private offering that permits screening of potential owners, or a management/employee buyout that rewards those who have contributed to the development of the company. Such sales are best utilized where the company has reasonable earning potential that can be verified through financial data. The sale can involve all or only part of the government's interest. Where the state retains a majority interest, the company is not fully privatized but its new dependence on the private sector as a source of investment may be enough to subject it to the discipline of the capital market.

(b) *The Sale of Company Assets* can be accomplished by dissolving the business and liquidating all its assets or by selling only portions of its assets to simplify the company's operations or to eliminate unprofitable operations. If the state company continues to operate, the asset sales can be used to create competition from purchasers who become new entrants in the industry. Sales can be accomplished through public auctions or private transactions.

(c) *Company Reorganization* is often a prelude to the sale of stock or assets. By creating subsidiary companies, the government can

> consultations to work out reasonable solutions for the exploitation, regulation and other matters relating to the natural resources in their contiguous parts of the continental shelves.

This view is again similar to some provisions of the Geneva Convention and the Draft Convention, which call on states to settle their boundary problems by negotiations, but differs significantly from the Geneva Convention in that the Chinese view does not provide for the application of the equidistance rule absent agreement between the parties or special circumstances. It can safely be inferred from the Chinese Government's attitude concerning the continental shelf that the natural-prolongation-of-land-territory principle of the *North Sea Continental Shelf* cases will be China's primary consideration in any agreement limiting the continental shelf. The Chinese so favor this theory that Chinese legal scholars suggest inclusion of the following clause in any future convention on the continental shelf concerning shelf delimitation: "The delimitation of the continental shelf between states with opposite or adjacent coasts should be effected through agreement under the guiding principle of natural prolongation and in accordance with equitable principles, taking into account all relevant circumstances." The same scholars suggest the inclusion of an additional clause for compromise: "A joint management or development regime might be established in the disputed area of the continental shelf between the parties concerned as a modus vivendi pending agreement on delimitation, or as a substitute for the delimitation of the said area." Thus, it is evident that the Chinese are attempting to make the natural-prolongation-of-land-territory theory, which essentially rests upon a geomorphological and geological basis, a rule of international law that is binding on all states.

* * *

China has not officially proposed a legal definition of the continental shelf, nor has it ever expressed acceptance of the definition contained in the 1958 Convention on the Continental Shelf. China attempted to define the continental shelf in earlier drafts of its offshore petroleum law, but later considered it unwise to do so because the definition might result in repercussions from the coastal states in the region, thus making the situation intractable.

Article 2, paragraph 1 of the newly promulgated offshore petroleum law provides the following definition concerning the ownership of China's offshore petroleum resources: "All petroleum resources in the internal waters, territorial waters, and continental shelf of the PRC as well as other sea areas falling under the marine resource jurisdiction of the PRC are owned by the PRC." Paragraph 2 of the same article provides

that "[a]ll buildings and structures installed, and vessels serving, in the above-mentioned sea areas for the purpose of exploiting petroleum resources, as well as the corresponding onshore and offshore oil and/or gas terminates and bases are under the jurisdiction of the PRC."

It is easily seen from the definition above that China has tactfully avoided defining the legal shelf by simply claiming ownership of the petroleum resources in the continental shelf. Yet, the same question remains: What is the exact limit on claims of sovereignty over the continental shelf? In all of the Chinese Working Papers and declarations surveyed in this Article, there is not a single document in which such a limit was mentioned, nor is any method of delimitation suggested. This deliberate omission baffles many foreign lawyers and scholars. Two reasons may be given for this lack of specificity. First, it leaves more room for consultation, especially in matters involving international relations. Second, as evidenced by China's repeated objections of the specific claims of Japan, South Korea, Vietnam and the Philippines, China might feel that it is in her best political and strategic interests to remain unspecific on this point for as long as possible.

Resolving disputes through consultation and mediation has always been an important aspect of the Chinese legal system. According to recent official statistics, up to ninety percent of recent domestic civil cases have been solved by this method. The Mediation Committee, composed of people chosen from the masses, has been given legal status in the new Chinese civil Procedural Law. This preference for resolving disputes through consultation is deeply rooted in traditional Chinese society, in which the law was weak and unpopular. * * *

Notes

1. How does the Chinese view of the principles applicable to determining continental shelf boundaries differ from that of the Geneva Convention? From that of the International Court of Justice? Is it consistent with the UNCLOS? Is the Chinese position on the continental shelf more consistent with the geological concept than with any of the legal definitions?

2. Additional discussions of maritime territorial disputes between China and her neighbors can be found in Choon-Ho Park, "The South China Sea Disputes: Who Owns the Islands and the Natural Resources," 5 Ocean Development & Int'l L. J. 27 (1978); Tao Cheng, "The Dispute Over the South China Sea Islands," 10 Tex. Int'l L.J. 265 (1975); and Tao Cheng, "The Sino-Japanese Dispute Over the Tiao-yu-tai

(Senkaku) Islands and the Law of Territorial Acquisition," 14 Va. J. Int'l L. 221 (1974).

C. RIGHTS OF MINERAL DEVELOPMENT WITHIN A STATE

Even though a state's boundaries are established and receive international recognition, the issue of mineral ownership and the right to authorize development may not be at an end. Claims of rights by private persons, governmental entities within the state, and even occupying military forces may have to be addressed.

1. PRIVATE RIGHTS IN MINERALS AND MINERAL DEVELOPMENT

(a) Private vs. Sovereign Ownership

A few countries, most notably the United States and Canada, still give effect to the old Latin maxim, *cujus est solum ejus est usque ad coelum ad infernos*, and recognize private ownership of underlying minerals. In these countries, determination of mineral ownership depends upon rules of property that must be left to other courses. See, e.g., Eugene O. Kuntz, John S. Lowe, Owen L. Anderson & Ernest E. Smith, Cases and Materials on the Law of Oil and Gas (2d ed. 1993). In virtually all other countries valuable minerals, such as gold, silver, oil, natural gas, coal, and uranium, belong to the sovereign. However, many states moved to a regime of sovereign ownership of minerals after a period in which private ownership was recognized. In some instances, the statutory or constitutional provision abolishing private ownership of subsurface minerals was unclear in scope or intentionally left pockets of ownership unchanged. For example, in Britain the Petroleum (Production) Act of 1934 (excerpted in Chapter 1), gave the Crown exclusive rights in "petroleum existing in its natural condition in strata in Great Britain," but specifically exempted petroleum subject to oil production licenses that had already been executed. More significantly, Northern Ireland and all maritime areas were excluded from the Act's coverage, for the term "Great Britain" is usually deemed to include only England, Scotland, Wales, and their off-shore islands. The act's limited coverage gave rise to the litigation in *Earl of Lonsdale*.

EARL OF LONSDALE v. ATTORNEY GENERAL

[1982] 3 All E.R. 579

15 January Slade J. read the following judgment: In this action, the Right Honourable James Hugh William, seventh Earl of Lonsdale, as plaintiff, seeks a declaration that the ownership of any oil or natural gas in or under certain tracts of land which form part of the bed of the sea adjacent to the Cumbrian coast and are referred to in the pleadings as the Lonsdale off-shore areas down to the bottom of the coal measures in and under such areas, is vested in him as tenant for life under a settlement dated 5 October 1936. * * * The contest is now one between Lord Lonsdale and the Crown.

The action raises questions on the construction and legal effect of a lease of 1860, articles of agreement of 1880, a conveyance of 1880 and a deed of exchange of 1935. Most particularly, it concerns the proper interpretation to be given to a provision contained in the conveyance of 1880 whereby the Crown granted to predecessors in title of Lord Lonsdale its interest in all of certain specified minerals (if any) down to the bottom of the coal measures in and under the same tracts of land. The interpretation of the words just quoted is the first principal issue in the action. If, contrary to the Crown's contention, the effect of one or more of the four instruments was to vest any oil or natural gas in Lord Lonsdale's predecessors in title, the further question arises whether all or any part of the oil or natural gas claimed by him has in the event vested again in the Crown by virtue of subsequent legislation, that is to say the Petroleum (Production) Act 1934 and the Continental Shelf Act 1964 or one of them. This is the other principal issue in the action.

* * *

THE ISSUES:

The plaintiff contends that on their true constructions, the words "mines and minerals", as used in the phrase "all other mines and minerals (if any) down to the bottom of the coal measures", which appeared in the parcels clauses of the 1880 conveyance and the 1935 deed of exchange, include oil and natural gas and that this is what entitles him to the declaration which he seeks. * * * [T]he three principal issues that now fall to be decided (though the second is subsidiary to the first) are these.

(1) Does the phrase "mines and minerals" as used in the 1880 conveyance and the 1935 deed of exchange on its true construction include oil and natural gas or either of them?

other work involving disturbance with the surface of the land. It was only intended to include substances which could be won by means of underground works, beginning on the adjacent lands of the grantee.

(2) So far as the evidence shows, oil and natural gas are not and never have been capable of being extracted from the earth on a commercial basis by means of underground mining, whether by tunnels or excavation. The available methods of extraction are either by means of drilling or (in the case of oil) by means of a shaft dug from the surface. As at 1880 the latter, more primitive, method was the one more commonly used in Europe. However, in the case of oil situated beneath the bed of the sea, as opposed to dry land, extraction by means of a dug shaft would not have been practical. Mr. Maclachlan in cross-examination said that, so far as he was aware, no shafts were dug down to the bed of the sea in the 1880's. If, therefore, it had been contemplated that the grantee was to have the right to extract oil and natural gas (if any), it must also have been contemplated that he should have the right to drill holes in the bed of the sea for the purpose of such extraction. However, as I have already pointed out, any such last-mentioned right would have been quite inconsistent with the express provisions of the 1880 articles and conveyance. These provisions show clearly that the grantee was not intended to have the right to interfere with the surface of the sea bed for the purpose of extracting any minerals. They clearly contemplated that the coal, culm, ironstone and fireclay would be won by means of underground works beginning on the adjacent lands of the grantee, followed by tunnelling or other excavation. * * *

(3) The third point is closely bound up with the second. In the parcels clause to the 1880 conveyance, the words "other mines and minerals (if any)" closely follow a reference to "coal, culm, ironstone and fireclay", all of which have the common characteristics that they are solid substances, which are capable of being won by means of underground workings beginning on the adjacent land of the grantee followed by digging. * * *

* * *

(5) On the authority of Barnard v. Farquharson [1912] App. Cas. 864 at 869, [1911-13] All E.R.R. 190 at 193 per Lord Atkinson, I think I am entitled to take into account the state of knowledge of petroleum and natural gas in 1880 and the way in which they were then regarded and treated. * * *

Applying a similar objective test in the present case, on the evidence before me, I infer that the parties to the two deeds of 1880 never intended that rights to extract oil and natural gas (if any) should pass to the grantee. As at that date, I infer from the evidence that neither category of rights would have been regarded as having any use or commercial value by persons dealing with the sale of minerals in the relevant area of Cumberland and indeed that the existence of gas (if any) would have been regarded as a dangerous nuisance.

These five points in my judgment make it reasonably plain that, in the context of the 1880 articles and 1880 conveyance, the phrase "mines and minerals (if any)" was not intended to include anything except solid substances, capable of being dug out of the earth by means of a mine, and in particular was not intended to include oil and natural gas.

* * *

Summary of conclusions

Counsel on both sides have referred in argument to the theoretical possibility that different conclusions could apply in respect of oil and of natural gas. I have throughout this judgment borne in mind this possibility. Neither side, however, has invited me to draw any distinction between the two substances or has directed my attention to any points which in my judgment make it necessary to draw any such distinction.

To summarise my conclusions, they are as follows.

(1) The 1880 conveyance and the 1935 deed of exchange did not operate to pass any rights to oil or natural gas to the plaintiff's predecessors in title, principally because (a) the phrase "mines and minerals" is an indefinite term which may bear many different meanings in different contexts and there is no rule of construction which requires that it should be construed as including oil or natural gas in the absence of a sufficient indication to the contrary, (b) there is no clear evidence that, in the vernacular of the mining world, landowners or commercial men as at 1880 or 1935, the phrase included oil or natural gas, (c) there are a number of indications to be derived from the 1880 conveyance itself which suggest that the phrase was not intended to include anything except solid substances dug out of the earth by means of a mine or mines opened on the adjacent land of the grantee, (d) the phrase is at least an ambiguous one and, since these were grants by the Crown, it was incumbent on the grantees to require the inclusion of explicit words including oil and natural gas, if it was their intention that these substances should be included in the grant.

(2) The phrase "down to the bottom of the coal measures" in the relevant grants refers to the bottom of the lowest identifiable seam of coal that is or might be worth mining.

(3) If it had become necessary to decide the points, I would have held (a) that the rights in any oil and natural gas situated in the Lonsdale

off-shore areas outside territorial waters which may have been granted to the plaintiff's predecessors became revested in the Crown by virtue of the Continental Shelf Act 1964, but (b) the rights in any oil and natural gas situated in the Lonsdale off-shore areas inside territorial waters which may have been granted to the plaintiff's predecessors did not become revested in the Crown by virtue of the Petroleum (Production) Act 1934 or any other legislation.

However, in view of my decision on the first issue, these second and third issues do not arise.

As things are, I must dismiss this action.

Action dismissed.

Notes

1. The decision in *Earl of Lonsdale* was based primarily on the court's construction of the instruments before it and left open the possibility that other Crown grants of mining rights extending beneath the territorial sea might be construed to include oil and gas. Parliament acted immediately to eliminate this possibility. Section 18 of the Oil and Gas (Enterprise) Act 1982 amended the 1934 Petroleum Act by including a provision that the 1934 statute, which vested ownership rights in the Crown, "applies at any time to petroleum which at that time exists in its natural condition in strata in Great Britain or beneath the territorial waters of the United Kingdom adjacent to Great Britain."

2. Although ownership rights in petroleum and natural gas in the ground now appear to be definitely settled in the United Kingdom, the principal case is important in illustrating the arguments advanced in American courts, where the meaning of "other minerals" and the ownership of specific substances is still being litigated. The issue has arisen in two contexts. The first is where the federal government or a state has granted or patented land, but has reserved specified substances, such as coal or oil and gas, along with "other minerals." In this context the meaning of "minerals" has turned on the legislative intent in authorizing the reservation. American courts almost invariably interpret this intent quite broadly to include all substances that may have value if extracted. For example, the U.S. government's reservations of "coal and other minerals" in patents issued pursuant to the Stock-Raising Homestead Act of 1916, 43 U.S.C. §§ 291 et seq. (repealed Oct. 21, 1976) have been construed to include gravel, Watt v. Western Nuclear Co., Inc., 462 U.S. 36, 103 S. Ct. 2218, 76 L.Ed.2d 400 (1983), and even rights in geothermal energy, United States v. Union Oil Co., 549 F.2d 1271 (9th Cir. 1977). State courts have usually taken an equally generous approach in

interpreting a state government's reservation of "minerals." See, e.g., Schwarz v. Texas, 703 S.W.2d 187 (Tex. 1986). But see Oklahoma ex rel. Commissioners of Land Office v. Butler, 753 P.2d 1334 (Okl. 1987).

The second context in which the issue has arisen is a severance of surface and mineral rights in a transaction between private parties. In this situation, disputes over the meaning of "minerals" typically arise with respect to a grant or reservation of "oil, gas and other minerals." In Moser v. United States Steel Corp., 676 S.W.2d 99 (Tex. 1984), the Texas Supreme Court used language similar to that urged by the plaintiff in *Earl of Lonsdale* in concluding that the word "minerals," when used in a deed or similar instrument "includes all substances within the ordinary and natural meaning of that word, whether their presence or value is known at the time of severance." Conversely, the Nevada Supreme Court adopted a test reminiscent of that advanced by the Crown when it held that a reservation of "other minerals of every kind and nature whatsoever existing upon beneath the surface of, or within said lands," was ambiguous and concluded that the case should be remanded for the admission of extrinsic evidence regarding the parties' intent. See Christensen v. Chromalloy American Corp., 99 Nev. 34, 656 P.2d 844 (1983).

There is an extensive literature on the meaning of "minerals" in a grant or reservation between private persons. A representative sample of different approaches to deed construction includes Robert E. Beck, "'And Other Minerals' as Interpreted by the North Dakota Supreme Court," 52 N.D. L. Rev. 633 (1976); Edwin P. Horner, "Lignite—Surface or Mineral?", 31 Ark. L. Rev. 75 (1977); Bruce M. Kramer, "Conflicts Between the Exploitation of Lignite and Oil and Gas: The Case for Reciprocal Accommodation," 21 Hous. L. Rev. 49 (1984); Eugene O. Kuntz, "The Law Relating to Oil and Gas in Wyoming," 3 Wyo. L. J. 107 (1949); John S. Lowe, "What Substances are Minerals?", 30 Rocky Mtn. Min. L. Inst. 2-1 (1984); and Richard C. Maxwell, "The Meaning of 'Minerals'—The Relationship of Interpretation and Surface Burden," 8 Tex. Tech. L. Rev. 255 (1976).

3. Even though sovereign ownership of subsurface minerals is undisputed, a prospective developer who has received a license from the state may be required to reach an accommodation with the owner of the soil, who is likely to be a private person. If an agreement cannot be reached, the licensee has recourse either to an administrative or to a judicial remedy. For example, under the Mexican mining law and accompanying regulations, the holder of a mining concession can apply to the Ministry of Energy, Mines and Governmental Industry for the appointment of an expert to verify the need for the requested rights of

surface use. If the expert renders a decision favorable to the concessionaire, the Ministry must approve the request, and the owner of the soil is indemnified on the basis of an official governmental appraisal.[6] See Ley Reglamentaria del Artículo 27 Constitucionál en Materia Minera, Diario Oficial (June 26, 1992, effective Sept. 25, 1992) and Reglamento de la Ley Minera, Capítulo II, Diario Oficial (Mar. 29, 1993, effective Mar. 30, 1993) in Mining Law and Regulations of Mexico (Fausto C. Miranda trans., 1993).

In some countries the prospective developer's remedy is not always automatic. In Great Britain the Mines (Working Facilities and Support) Act of 1966 (as amended in 1974) authorizes the High Court or Court of Sessions to confer rights of surface use in specified situations, including those where the grant of surface rights is expedient in the national interest, and the landowner has unreasonably refused to agree or has demanded terms that are unreasonable under the circumstances. The licensee, who must seek judicial intervention, has the burden of establishing that "it is not reasonably practicable to obtain the right by private arrangement." Should a landowner who refuses to negotiate unless the licensee agrees in principle to make some level of production related payments (i.e., royalties), be deemed to have demanded unreasonable terms? See BP Petroleum Development Ltd. v. Ryder, *summarized in* 2 Estates Gazette L. Rep. 233 (1987) and Case Digest & Nat'l News [1987/88] 2 OGLTR 49.

Under the British statute, a court granting rights of surface use also determines the amount and nature of compensation to be paid the landowner. Compensation is based on what would be fair and reasonable as between a willing grantor and a willing grantee. In negotiations for rights of surface use, does the possibility of recourse to the courts as authorized by the British statute work to the advantage of the licensee or the landowner?

(b) Rule of Capture

Declarations that the sovereign owns all oil and gas in the ground leave one potentially troublesome question unanswered: Is an oil company liable for damages if a well drilled on one tract drains oil from beneath an adjacent tract licensed to a different company? The American courts have answered the question in the negative. See, e.g., People's Gas Co. v. Tyner, 131 Ind. 277, 31 N.E. 59 (1892); Barnard v. Monongahela

6 There are some differences in the procedure, depending upon whether the concessionaire is seeking permanent rights in the surface, temporary occupancy, or an easement. See Reglamento de la Ley Minera, Capítulo II, regs. 43 & 44.

Natural Gas Co., 216 Pa. 362, 65 A. 801 (1907). They applied the rule of capture, which only requires that the producer's well be bottomed on the producer's own land and denies recourse to a landowner whose property is being drained. One explanation for the universal adoption of the rule of capture by American courts during the early years of the oil industry is that awarding an injunction or damages to an owner whose land was being drained might have halted oil development altogether. Another explanation is simple judicial convenience. At a time when almost nothing was known about petroleum geology, courts would have found it virtually impossible to determine which tracts in the vicinity of an oil well were being drained and how much of the oil produced originally underlay which land.

The factors that influenced American courts to deny liability for oil drainage would also have been present in other countries, but there is an almost total dearth of authority on the issue. Moreover, a British case dealing with an analogous situation within the commonwealth suggests a contrary result. The Trinidad Asphalt Co. v. Ambard [1899] A.C. 594 (PC) involved the mining of "pitch" or tar, which underlay the surface at a depth varying from four to seven feet. The defendants had excavated their land to a depth of twelve feet and all the way to the boundary line of the plaintiffs' land. During the day, pitch from the portion of the stratum underlying plaintiffs' land was heated by the tropical sun and oozed into the defendants' excavation. The defendants appropriated and sold between 200 and 300 tons of the pitch that had come in this fashion from the plaintiffs' property. Although the court focused on the defendants' duty to provide lateral support for the plaintiffs' adjacent land, which was subsiding because of the mining activities, the court also rejected the defendants' argument based upon a theory of nonownership similar to that accepted by several American courts in early decisions establishing the rule of capture. The court refused to analogize pitch to water, which is unowned until produced.

There are several reasons why the rule of capture is rarely an issue under modern development arrangements. First, governmental agencies in some countries use information obtained from initial geological surveys to avoid splitting geological structures between different licensed areas. Second, unlike onshore oil and gas leases in the United States, licenses, concessions and production-sharing agreements typically cover very large areas, such as the 50,000 hectares (123,500 acres) authorized by the Turkish petroleum code. Even though most countries require their licensees to relinquish as much as 50 percent of the area after the initial term of the license, the company has substantial discretion in deciding which part to retain and can frequently keep exclusive control over a single reservoir. Third, if a reservoir underlies areas licensed to different companies, the licensees may be required to enter into a plan of co-ordinated development. If a reservoir crosses national boundaries, such plans, which are referred to as unitization agreements in the United States, may also be mandated by treaty.

2. FEDERATIONS

Many of the world's countries, including Australia, Canada, India, Mexico, Russia, Switzerland, and the United States are federations. They are composed of separate units that have some degree of internal self-governance and may even have limited treaty-making powers, although as a matter of domestic law the constitutions of most federations prohibit component states from entering into international treaties or alliances. See, e.g., U.S. Const. art. I, § 10. See generally Luigi DiMarzo, Component Units of Federal States and International Agreements (1980). In "Socialist Federation—A Legal Means to the Solution of the Nationality Problem: A Comparative Study," 82 Mich. L.Rev. 1213 (1984), Viktor Knapp characterizes federations as either "synthetic" or "analytic" in origin. Older federations, such as Switzerland and the United States, were synthesized from existing relatively weak states or territorial units that united to form a stronger entity. Most other federations, including countries as diverse as Germany, India, Nigeria, and Mexico, were based on "analytic" principles. These countries divided their territories into component units based upon historic, geographic, ethnic, administrative, or even entirely artificial boundaries. He suggests that the ethnic element played a relatively minor role in the delineation of most internal federation boundaries except for those of the former socialist federations (the U.S.S.R., Czechoslovakia, and Yugoslavia) where a federal system was adopted as the basic legal mechanism for resolving the problems posed by diverse ethnic groups.

Is the distinction between federations that are "synthetic" and "analytic" in origin helpful in analyzing the legal relations among the component units and between the units and the central government? Is it historically accurate? Can the former Soviet Union be accurately characterized as either entirely analytic or synthetic in origin? What about the United States? At a time when several federations have dissolved and others are threatened with dissolution, what factor or combination of factors seems most important to the long-term stability of a federation?

The existence of a federal system raises several fundamental issues relating to mineral development, such as whether the sovereign rights of mineral ownership reside in the national government or the component states and how control over mineral exploration, development and sale is allocated among the governmental units. As the following material suggests, there is a wide variety of approaches to the treatment of mineral rights within a federation. In reading the material, consider whether the origin of a federation as "synthetic" or "analytic" should have any bearing on the way the issues are resolved.

CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS

Article 27. The nation has direct ownership [Corresponde a la nación el dominio directo] * * * of all minerals or substances that constitute deposits whose character is distinct from the components of the soil; * * * beds of precious stones; combustible solid minerals; petroleum and all solid, liquid and gaseous hydrocarbons * * * .

Notes

1. The Mexican states play little or no role in Mexico's mineral law regime. Article 27 of the Mexican Constitution unequivocally vests ownership of all hydrocarbons in the nation rather than the individual states. The central government has implemented its sovereign rights by entrusting control over all activities connected with the exploration, exploitation, transportation, refining, and sale of oil and natural gas to a national monopoly, Petroleos Mexicanos (PEMEX). The structure and powers of PEMEX are described in Section B of Chapter. 1.

2. In sharp contrast with the Mexican states, the Canadian provinces exercise a degree of control over oil and natural gas that, in some instances, is paramount to that of the central government. Part of their control derives from outright ownership. Although there is considerable private and federal ownership of onshore oil and gas, most of the productive reserves are owned by the four western provinces (Alberta, British Columbia, Manitoba, and Saskatchewan), which receive substantial income from royalties. In several instances this pattern of ownership has led to conflicts between the provinces and the federal government. During the 1970s Alberta raised its royalty rates in order to capture the windfall benefit from increased oil prices. The province's action adversely affected federal revenue from taxes on producers' income. For a discussion of the central government's response (producers must include royalties paid Alberta in their taxable income) and Alberta's

bonus bidding for a small number of blocks that were offered in a round where the majority of blocks were granted by the discretionary method.

The discretionary allocation system is not without its critics. The large amounts raised through bonus bidding in 1971 led to arguments that more blocks should be offered on this basis. The following critical analysis of the discretionary system as contrasted with the auction system is from Kenneth W. Dam, Oil Resources: Who Gets What How? 33-34 (1976):

> A discretionary system encourages some applicants to apply for licenses with the hope not of carrying on the physical exploitation themselves but rather of assigning the license at a profit to an operating company. Hence a discretionary systems leads * * * to controls on assignments of licenses. Where an auction system is not used, the exclusive license may have a value that reflects the fact that the return to capital is above the competitive level. From the moment the license in granted, the licensee's right is an item of value, which, barring legal restraints on assignment, can usually be converted to cash by sale to an operating company. This would normally be true even before it was known whether or not oil or gas were present: the uncertainty is merely an element of risk which tends to reduce but does not eliminate the cash value of the license.
>
> The auction system tends, provided the bidding is not collusive, to retain the financial benefit of this value for the licensing agency rather than granting it to the licensee. Competition will induce the applicants to increase their respective bids to the point where any element of an above-competitive return will be eliminated. The only profit remaining will be the normal profit on the producing operation itself. The prospect of turning a quick profit on sale of the license is thereby reduced, if not eliminated. The auction system therefore tends to eliminate applicants who seek merely to sell their license rather than to exploit the licensed resources.
>
> To the extent that one is concerned with applicants who intend to carry on exploitation themselves in the mistaken supposition that they have the technical and financial capacity to do so, the licensing authority would have two alternatives consistent with the use of an auction system. The first is, as suggested above, to eliminate bidders without the requisite technical and financial qualifications through the reservation of certain residual discretion in the licensing authority or through detailed eligibility criteria. Alternatively, the licensing authority may trust to the self-interest of the applicant, who, when he discovers his inability to exploit the resources, will find that he will earn more, or lose less, by selling the license to a competent producing company than by continuing alone.
>
> In summary, the auction system, in contrast to the British discretionary system, has two attractive qualities. It allocates licenses to the most efficient applicant, and it eliminates the above-competitive return attaching to scarce resources. Both are important.

Notes

1. How would you modify the British system? Is Mr. Dam correct in his observations? Is there any manner to weigh properly the financial and nonfinancial aspects of a particular applicant?

2. It appears that in a discretionary bidding system, the more discretion that is afforded to the decisionmaker, the more sophisticated that decisionmaking body must be with respect to evaluating the bids. Thus, it appears that a state oil company may be the appropriate body to at least review and compare the bids for a decisionmaker if it cannot make the decision itself.

B. CONCESSIONS AND LICENSES

There are four basic arrangements to develop petroleum between host countries and the multinational oil companies: (1) the concession, (2) the production sharing agreement, (3) the participation agreement, and (4) the service agreement. Although each of these arrangements can be used to accomplish the same purpose, they are conceptually different from each other. Each provides for different levels of control granted to the multinational, for different compensation arrangements, and for different levels of state oil company involvement. However, it is important to note that precise categorization of a particular country's arrangements is not always possible.

The early arrangements to develop mineral reserves all adopted the form of granting the multinational corporation a concession to the mineral reserves. Although it is difficult to find a classic concession in use today, many countries, including the United Kingdom and the United States, continue to use a concession-based system of granting developmental rights that differs significantly from the provisions of the original agreements.

1. CLASSIC CONCESSIONS: THE MIDDLE EAST EXPERIENCE

Historically, early grants of mineral rights were made through the use of the classic concession. The characteristics of this agreement were: (1) a grant of rights to mineral development over a vast area of acreage; (2) for a relatively long period; (3) providing to the multinational corporation extensive control over the schedule and manner in which the mineral reserves were developed, and (4) reserving few rights to the sovereign, except the right to receive a payment based upon production.

The archetypal Middle Eastern concession was obtained by William D'Arcy from the Shah of Persia in 1901. For a $100,000 "bonus," another $100,000 in stock in his oil company, and a 16 percent royalty, D'Arcy received exclusive oil rights to 500,000 square miles of Persia for the next 60 years. Other concessions in the region generally followed this format; they were granted for long terms and covered immense areas. The 1933 concession which the King of Saudi Arabia granted to Standard Oil of California for 50,000 pounds of gold was for a 66-year term and ultimately covered as much territory as the D'Arcy grant. Six years later, the Ruler of Abu Dhabi granted a 75-year concession covering the entire country to a consortium composed of five major oil companies. The Kuwaiti concession was for a similarly long 75-year term that covered the entire country. See Robert O. Anderson, Fundamentals of the Petroleum Industry 40 (1984); Atef Suleiman, "The Oil Experience of the Middle East Emirates and Its Legal Framework," 6 J. Energy & Nat. Res. L. 1, 3 (1988).

These concessions did not specifically obligate the companies to drill on any of the lands granted or to release territory if exploration and drilling were not undertaken. Moreover, the host countries had no right to participate in managerial decisions; the sole financial benefit received by the countries or their rulers was the right to royalty. Many early concessions also freed the companies from all tax obligations other than those specifically provided for in the agreement. See Raymond P. Mikesell, Petroleum Company Operations and Agreements in the Developing Countries 20-21 (1984).

The royalty provisions in the Middle Eastern concessions granted in the 1930s were generally less favorable to the rulers than those in the original grant to D'Arcy. These later concessions typically provided for a royalty calculated as a flat rate per ton rather than as a percentage of the value of the sale price of production. Thus, both the Ruler of Abu Dhabi and the Sultan of Muscat and Oman received three rupees per ton of oil produced from their respective concessions; the Arabian concession set the royalty at 21 gold shillings per ton. See Atef Suleiman, "The Oil Experience of the United Arab Emirates and Its Legal Framework," 6 J. Energy & Nat. Resources 2 (1988). Three rupees was approximately eight cents per barrel.

The following excerpt represents an early concession signed in 1937 between a private British company and the country of Oman. The selected provisions of the agreement illustrate the characteristics of the classic concession.

AGREEMENT BETWEEN PETROLEUM CONCESSIONS, LTD AND SULTAN OF MUSCAT AND OMAN[1]

(1937)

ARTICLE 2

The period of this agreement shall be 75 (Gregorian) Calendar years from the date of signature.

ARTICLE 3

The Sultan hereby grants to the company for a period of five years from the date of signature of this agreement (hereby referred to as "the option period") the exclusive right to explore, search for, drill for, produce and win natural gas, asphalt, ozokerite, crude petroleum and their products and cognate substances * * * within the leased area.

ARTICLE 6

The Company may also at any time during the Option period declare in writing its intention to take up the concession over the lease area.

* * *

ARTICLE 9

The Company shall conduct its operations in a workmanlike manner and by appropriate scientific methods and shall take all reasonable measures to prevent the ingress of water to any petroleum bearing strata and shall duly close any unproductive holes drilled by it and subsequently abandoned. The Company shall keep the Sultan informed generally as to the progress and result of its drilling operations but such information shall be treated as confidential.

* * *

ARTICLE 19

(a) The Company shall have the right at any time after the expiry of three years from the date of signature * * * to give the Sultan notice in writing of its intention to terminate this Agreement and this Agreement shall absolutely determine on the date fixed for such termination in such notice.

(b) If such notice be given not later than thirty years after the date of such signature the Company shall be entitled * * * to remove free of all taxes and duties all plant building, stored material and property provided that for a period of three months from the

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receipt of such notice the Sultan may purchase—should he so desire—the same a price equal to the replacement value of that date less depreciation. * * *

(c) If such notice be given later than thirty years after the date of such signature all the property aforesaid shall become the property of the Sultan free of all cost.

* * *

ARTICLE 24

Failure on the part of the Company to fulfill any of the conditions of this Agreement shall not give the Sultan any claim against the Company or be deemed a breach of this Agreement insofar as such failure results from force majeure * * * . Force majeure as used in this Agreement includes the Act of God, war insurrection, riot, civil commotion, tide, storm, tidal wave, flood, lightening, explosion, fire, earthquakes and any other happening which the Company could not reasonably prevent or control.

ARTICLE 25

The Sultan shall not by general or special legislation or by administrative measures or by any act whatever annul this Agreement ***. No alterations shall be made in the terms of this Agreement * * * except in the event of the Sultan and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations * * * .

The primary benefit to the Sultan of Oman and Muscat was a royalty on production. What other benefits could a country expect from a concession and what rights could it extract from the multinational. In a document produced by the government of Saudi Arabia, the government listed the following terms that were in its favor in the concession granted in 1937 to Standard Oil:

- Employment of Saudi labor.
- The Company had to submit detailed reports on its operations.
- The Saudi Government had a right to appoint a special commission at the Company's expense, which had the power to inspect the Company's operations and accounts.
- The Company had to supply the Saudi Government with limited amounts of gasoline gas and asphalt at no cost.

Government of Saudi Arabia, Development of Resources Document (1972).

Notes

1. The Middle Eastern concessions were strikingly similar to the oil and gas leases granted in the United States in the first three decades of this century. See Ernest E. Smith & John S. Dzienkowski, "A Fifty-Year Perspective on World Petroleum Arrangements," 24 Texas Int'l L. J. 13 (1989). Although U.S. oil and gas leases rarely, if ever, covered tracts as immense as those in the Middle East, this difference was attributable to the size of the farms and ranches owned by American lessors, rather than to a greater skill in bargaining. Like the Ruler of Abu Dhabi, Texas and Oklahoma landowners typically entered into a single oil and gas lease covering all property they owned, whether it was a 40-acre farm or an 85,000-acre ranch. Moreover, many fixed term leases, some for as long as 99 years, were still in effect. Other leases, as written, might in theory last forever, even though production was never obtained. "No term" leases, as they were called, permitted the lessee to maintain the lease in effect indefinitely by the payment of an annual rental. If oil production was obtained, however, royalty clauses in U.S. leases generally entitled the landowner to a fraction of the oil produced rather than to a fixed amount per ton, although the percentages varied considerably from lease to lease. In the case of gas, some leases did not base the payment on volume of production but merely provided for an annual payment of a set amount per gas well.

By the 1930s, however, a standard American oil and gas lease had emerged that differed significantly from its Middle Eastern counterparts that were being executed at the same time. Leases covering all property owned by the lessor were still the rule, but fixed term and no-term leases had disappeared. The lease term had assumed its modern form, which provided that the lessee's interest would last for a set number of years—usually 5 or 10—and so long thereafter as oil or gas might be produced. Unless drilling and production occurred by the end of the primary term, the lease terminated. The royalty clause for both oil and gas had also become standardized at 1/8 of production for oil and 1/8 of the sale price or market value for gas. Rather curiously, the midwestern farmer who leased his land to an oil company was now in a better contractual position than the Middle Eastern sheik. Under the typical concession, the oil company did not risk losing its concession if it failed to drill. The opposite was true under the oil and gas lease. The American lease format, although not guaranteeing drilling, at least assured the U.S. landowner that his land would not be tied up indefinitely by the payment of a small annual rental. If oil was discovered, neither the Middle Eastern concession nor the U.S. lease imposed upon the oil company any express contractual duty to produce from the well. Under the concession, the well could safely be shut in if the company wanted to do so. Under the U.S. lease, the lessee risked losing the lease for lack of production at the end of the primary term—at least if the shut-in well was the initial discovery well. (The only exception was for a gas well, since form leases almost invariably permitted them to be shut in pending a search for a pipeline connection.) Finally, if production was obtained, the U.S. lessor was not limited to a flat sum per ton, but received either 1/8 of the production or its sale price.

Of even greater importance than the lease format, the American lessor had the benefit of American courts. The most widely used printed oil and gas leases had been drafted for use by oil companies and contained relatively few provisions favorable to the lessor. The courts, however, had long shown their willingness to redress egregious imbalances in contractual rights between the oil companies and their lessors. The judicial hostility to the patent unfairness of the no term lease had been the principal factor leading to its discontinuance. Its enforceability had been brought into question by judicial suggestions that it lacked consideration, and its demise had become assured with the emergence of the implied covenants doctrine. It was, indeed, the doctrine that the lessee impliedly covenants to perform as a reasonable prudent operator and to undertake the various obligations imposed by such a standard that provided the American lessor with the greatest protection. By the turn of the century, U.S. courts had come to the view that an oil and gas lessee impliedly covenants to explore, develop, and produce from the leased premises for the mutual benefit of both itself and the landowner.

2. One authoritative source offers the following perspective on the concession system:

> The early concession system [was the product of the prevailing general circumstances]. * * * It must be recalled that in those days, concessions were granted by Sovereigns with sometimes little authority, often under foreign political dominance. Also, the countries concerned were backward, sometimes nomadic, and in no case possessed a legal framework liable to govern such things as petroleum operations. Therefore, in order to fill that void, concessions were not only tilted in favor of [multinational corporations] but also written in such a way that they constituted self-sufficient charters for those areas of the world where existed no infrastructure of any kind, nor any government control or capabilities of any sort. Hence, it is hardly surprising that the word "concession became associated with "underdevelopment" and "political dominance"; this explains from a psychological standpoint, the hostility shown toward this type of agreement.

Keith W. Blinn, Claude Duval, Honore Le Leuch, Andre Pertuzio, International Petroleum Exploration and Exploitation Agreements: Legal Economic and Policy Aspects 60-61 (1986) (citing Ahmed Sadek El-Kosheri, "Le regime jurdique cree par les accords de participation petroliere dans le domain petrolier," Recueil des Cours ded L'Academie de La Haye, Vol. IV (1975)).

3. In the Middle East, the European oil companies began obtaining concessions almost 25 years before the American companies showed an interest in this region of the world. See Middle East Oil (Exxon Background Series, ed. 1980). This is attributable in part to the fact that European nations had a presence in the Middle Eastern countries, while the United States relied upon its own production to meet its domestic consumption.

4. One characteristic of the early concessions is the fact that when one multinational corporation obtained a concession, it would often spread the risk among several other multinationals. In some cases, agreements would be formed among multinationals to protect against large swings in price or disruptions in supply. And, in other cases, multinationals would enter into an arrangement to develop the concession jointly. For instance, the original Saudi concession was granted to Standard Oil of California in exchange for a payment of 50,000 gold pounds with another 50,000 gold pounds due upon the discovery of production. After Standard Oil received the concession, it transferred the rights under the agreement to the California Arabian Standard Oil Company which, in turn, brought in three other oil companies to participate in the venture. The name of the company was changed to the Arabian American Oil Company (ARAMCO) with ownership in the following percentages: (1) Standard Oil of California—30%; (2) Standard Oil of New Jersey—30%; (3) Texaco—30%; (4) Mobil—10%.

5. The historical development of agreements in solid mineral ventures appears to parallel the history of petroleum agreements. Early solid mineral agreements were similar to the oil concessions in the Middle East. Several nations with onerous concessions in solid mineral developments attempted to renegotiate their agreements in line with what OPEC had done with the oil concessions. In fact, in the 1970s, Zaire, Zambia, Peru, and Chile nationalized their foreign copper ventures.

2. OPEC: FROM CONCESSION TO PARTICIPATION

Soon after the Middle Eastern concessions were signed and after vast reserves of oil were discovered, the sovereigns realized that they had signed one-sided agreements with the multinationals. At that time, they perceived three very different options. First, they could follow Mexico's example in 1938 of nationalizing the entire oil industry and placing all of the mineral properties in a state oil company. However, they would also need to deal with the multinational's response, which in Mexico's case was an international boycott of Mexican oil. Although a few countries ultimately followed Mexico's lead in using expropriation to regain control over their domestic reserves, such actions generally did not take place until thirty or more years later. See Guillermo F. Margadant, La Expropriacion Petrolera Mexicana en el Marco de la Politica Petrolera Latino-Americana En General 14-18 (1988) (discussing the wave of nationalizations that took place in Latin America from 1968 to 1976).

Second, the countries could choose to do nothing and honor their contracts. However, this option seemed intolerable in light of the long durations of the agreements and the vast acreages covered by the arrangements.

Finally, the sovereigns could turn to renegotiation as a means of equalizing the arrangements. Most countries chose this latter approach. In much of the Middle East, the original concessions were renegotiated, which ultimately resulted in entirely new and significantly different arrangements.

Although several countries managed to renegotiate their concessions in the 1950s and the 1960s, the major restructuring of the original arrangements occurred in the 1970s. The pre-OPEC renegotiations depended largely upon the bargaining power of the sovereign and the profitability of the particular concession. From 1950 to 1960 (when OPEC was formed), some countries, such as Saudi Arabia, made significant changes to their agreements, while other countries made minor changes. The Saudi example is instructive of the types of changes that were eventually sought by all sovereigns that had entered into the classic concession. In 1950, Saudi Arabia sought to renegotiate its "take" from the concession that it had granted to ARAMCO. The existing royalty arrangement gave the sovereign only 21 cents per barrel of oil produced even though the barrel sold for over $2. The Saudi government sought and received additional "take" through a sharing of the profits made on each barrel produced and sold as well as a royalty on each barrel.

The concession was modified to include a 50-50 profit sharing plan.[2] A similar change was made in concessions granted by Iran and Iraq.

In 1950, Saudi Arabia also sought to impose its own system of taxation on ARAMCO's profits. Although ARAMCO and companies in other concessions resisted, they eventually agreed to pay the local sovereign tax. The tax, initially 20 percent, was later raised to 50 percent on ARAMCO's share of the profits from Saudi operations. In 1953, Saudi Arabia discovered that ARAMCO was discounting the price obtained for sales to the parent corporations. After objections, ARAMCO agreed to discontinue the practice. The ARAMCO agreement was also amended to allow Saudi Arabia to appoint two members to the board of directors of the company. More substantial changes to the agreements, however, needed to await the formation of OPEC.

OPEC was formed in 1960 when five oil producing nations met to address the question of falling oil prices. See Note, "OPEC as a Legal Entity," 3 Fordham Int'l L.F. 91, 92-93 (1979-1980). Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela met in Baghdad to examine the control of petroleum by seven oil companies—Exxon (Esso), British Petroleum, Shell, Standard Oil of California, Mobil, Gulf, and Texaco. OPEC concluded that these seven multinationals were able to exercise tremendous control over production and prices of petroleum. The influence of OPEC on the sovereign's ability to renegotiate the old concessions cannot be overstated. The countries shared invaluable information about the types of arrangements that were being offered in the 1960s by the major oil companies as well as information about company abuses of the concession system. Further, OPEC as a cartel with the theoretical ability to act in unison posed a significant threat to a major center of profit for the oil companies. This equalization of the bargaining power made the renegotiation process a serious vehicle for a major restructuring of the traditional concession system.

OPEC's major objective was to provide a collective approach to improving the revenues from their mineral reserves. OPEC first turned its attention to the low crude oil prices that had begun in the late 1950s and continued throughout the 1960s. During the first half of the twentieth century, the major oil companies had begun a policy of issuing a posted price for crude oil—a "published price at which producers were prepared to sell to all comers in tanker-cargo lots." Note, "From Concession to Participation: Restructuring the Middle East Oil Industry," 48 N.Y.U. L. Rev. 774, 778 n. 13 (1973). These posted prices were used to compute

2 In 1951, Saudi Arabia insisted that the profits had to be calculated before the payment of U.S. taxes.

taxes owed to the governments. When the major oil companies reduced their posted prices in response to worldwide competition, OPEC objected. OPEC was victorious, receiving a price floor on which their royalties and profit sharing would be calculated regardless of world market price. OPEC also studied and proposed changes in the accounting methods for royalty to increase their' revenue.

This pressure upon the major oil companies also provided individual countries with increased bargaining power:

> While OPEC was assisting in the collective negotiation of improvements in the financial terms of the major concessions, individual countries were negotiating various piecemeal changes in the structure of the arrangements. These modifications included: a few instances of relinquishment of undeveloped territory; some cases of country acceptance of a minimum output schedule; the agreement of some concessionaires to sell, or offer as royalty payments, limited amounts of crude to emerging state-owned oil companies for refining and marketing abroad, usually in barter deals, restricted to noncompetitive markets; increased, though far from controlling, representation of host governments on concessionaire boards; and some commitments to employ more nationals at technical and managerial levels, as well as to contribute to economic and social development around offtake sites.

Id. at 780-81. Specific examples of such changes include: (1) an agreement by Saudi Arabia and ARAMCO in 1963 to extend its 50-50 profit sharing arrangement to the Trans-Arabian pipeline that had been built across Saudi Arabia, Jordan, Syria, and Lebanon; and (2) the reduction of marketing expenses charged to ARAMCO, which resulted in greater profits for the company and, thus, the Saudi government.

The major contribution of OPEC, however, was its efforts to modify fundamentally the basic concession agreements that continued to govern the arrangement between the country and the multinationals. The initial step to the major restructuring began in 1971 with a meeting at Tehran between the leaders of the Gulf states and twenty-three multinational corporations. These negotiations resulted in the following agreement:

- The Agreement guaranteed continued shipment of oil and stability in financial arrangements for the five years 1971-1975.
- It gave the Gulf countries concerned an additional yearly income of over US 1,200 million for the year 1971, rising to nearly $3,000 million in 1975.

- The companies were given guarantees against any change in major financial terms for a period of 5 years, as well as guarantees against any further OPEC demands during the term of the Agreement.
- The tax rate on the oil exports of the Gulf states was set at 55% in addition to a regular increment of 35 cents per barrel on the posted prices at Gulf terminals. This increment included 2 cents in settlement of price differentials.
- As of the Agreement's going into effect, the posted price of Gulf crude was to be determined according to a new gravity differential system, and companies had to effect as of June 1, 1971 and on the first day of each subsequent year for the period 1973-1975, a new increase of 2.5% in postings to compensate for world-wide inflation.
- The producing countries agreed not to ask for further price increments or for any additional financial obligation during the five years.

Government of Saudi Arabia, Development of Resources Document (1972).

The idea of participation had been raised by the sovereigns and by OPEC at several times in the past, but the multinationals had firmly resisted any local ownership in their concessions. Saudi Arabia had raised the idea of a partnership when it sought relinquishment of territories in 1963, and several OPEC countries had sought adoption of this idea as a demand. Soon after the Tehran agreement, the countries, primarily through the initiative of Saudi Arabia, again sought to renegotiate the concession arrangements. In 1972, the multinationals agreed in principle to the concept of participation, and by the end of that year an agreement was signed transforming several concession agreements into participation arrangements. The Saudi-ARAMCO agreement gave the government a 25 percent stock interest in ARAMCO; from 1978 this interest would increase by 5 percent each year (with a final increase of 6 percent) bringing the sovereign ownership to 51 percent.

Several reasons may explain the willingness of the oil companies to renegotiate the original Middle Eastern concessions. First, many companies may have feared that other countries would nationalize private assets with little hope of compensation. To the extent that one viewed this as a choice between contractual modification or complete loss of the concession, the prospect of renegotiation became more palatable. Second, these concessions were immensely profitable, and the oil companies viewed any arrangement whereby they could continue to reap the rewards of the vast Middle Eastern oil reserves as acceptable. Third, the oil companies with the Middle Eastern concessions were vertically integrated; in other words, they had sister and subsidiary organizations involved in all facets of the transporting, refining, and retailing areas of the petroleum industry. With this type of organization, access to the vast reserves for the foreseeable future is perhaps more valuable than the ability to reap significant profits from production of the reserves. Finally, in many instances, the multinationals had developed a significant presence in the foreign country; there was considerable empathy with the sovereign's claims that the early concessions were unreasonable.

Notes

1. Current arrangements for mining solid minerals often pose the same problems for the host country as the early petroleum concessions. The only available suppliers of equipment, material, and services are affiliates of the mining company, and the only market for the product is also with an affiliate. The following provisions have been used to protect the host country from the abuses that can arise from the latter situation. Consider whether they are sufficient to protect the host country.

> In any event sales commitments with Affiliates shall be made only at prices based on or equivalent to arm's length sales and in accordance with such terms and conditions at which such agreements would be made if the parties had not been affiliated, with due allowance for normal selling discounts or commissions. Such discounts or commissions allowed the Affiliates must be no greater than the prevailing rate so that such discounts or commissions will not reduce the net proceeds of sales to the Company below those which it would have received if the parties had not been affiliated. No selling discounts or commissions shall be allowed an Affiliate in respect of sale for consumption by it. The Company shall submit to the Government evidence of the correctness of the figures used in computing the above prices, discounts and commissions, and a copy of the sales contract.

> "Affiliated Company" or "Affiliate" means any person that directly or indirectly through one or more intermediaries, controls or is controlled by or is under common control with, the person specified. "Control" (including the terms "controlled by" and "under common control with" and "controls") means the possession, directly or indirectly, of the ability to influence management decisions. Without limiting the generality of the above, such influence is presumed to exist if one person holds, directly or indirectly, 25% or more of the outstanding voting shares of another person.

2. The OPEC nations frequently used the doctrine of changed circumstances to argue that the old concessions were no longer operable. Under this doctrine, one must look to the new agreements now being offered as well as surrounding circumstances to determine whether the old terms are workable. One can obtain a better appreciation of this view from the perspective of a Saudi Arabian report on the renegotiation of the ARAMCO concession:

> The Arab petroleum industry is located in developing countries compelled by their socio-economic and political circumstances to struggle very hard to achieve development in its most perfect form in the shortest possible time. Furthermore, the economic prosperity and scientific advancement of the petroleum industry in general are progressing daily. Since petroleum concessions are long-term contracts, successive change in circumstances, partly attributable to the special circumstances of the host country and party to economic and scientific developments in the oil industry, are inevitable in implementing the contract.
>
> This being the case, the interests of the parties to the petroleum contract could very well conflict, and it becomes necessary for them to resort to amicable negotiations in an effort to insure the continuation of their mutual well being and good will in fulfilling their obligations. The principle of change of circumstances, like any other legal principle, may be abused, but the idea itself is a good idea, and ought not to be discredited.
>
> There is no doubt that in countries which follow Roman legislation the adoption of the theory of contingency is based on their belief that changing circumstances could affect the binding power of the contract without prejudice to the spirit of the contract's binding power in its essence.
>
> In Islamic law, however, self sufficiency in the necessities of life is a duty imposed as an Islamic principle to make sure that the Moslem community is free to attain all that it needs for itself, without having to stretch its hand out for alms from other nations.
>
> As a matter of fact, the theory of change of circumstances is not confined to the law of individual states. It actually received international acceptance when it was incorporated in the wording or article 19 of the League of Nations Charter, which gave the League the right to reconsider international treaties and positions, whenever they become inapplicable, or when their continuation would constitute a threat to world peace. Hence, we see that the idea of changing circumstances is accepted almost unanimously as a principle in the context of various legal systems.

Government of Saudi Arabia, Development of Resources Document (1972).

3. OPEC is structured as a governing body with full members and associate members and a conference, a board of governors, and a secretariate to fulfill the goals of the institution. See Lawrence Stoehr, Note, "OPEC as a Legal Entity," 3 Fordham Int'l L. F. 91 (1979-1980).

4. In 1978, a labor union filed a complaint against OPEC and its member nations on the grounds that it violated the antitrust laws. See International Ass'n of Machinists & Aerospace Workers v. OPEC, 649 F.2d 1354 (9th Cir. 1981). The claim was brought on behalf of all consumers of oil and sought injunctive relief and damages against OPEC for its price-setting policies. The appellate court affirmed a dismissal of the case as barred by the act of state doctrine. The court stated that "[t]he courts should not enter at the will of litigants into a delicate area of foreign policy which the executive and legislative branches have chosen to approach with restraint. The issue of whether the FSIA [Foreign Sovereign Immunities Act] allows jurisdiction in this case need not be decided, since a judicial remedy is inappropriate regardless of whether jurisdiction exists." Id. at 1361-62.

5. Several commentators have written scholarly defenses of OPEC's policies as necessary to counteract the power of the multinationals and as an assertion of sovereign independence by countries with significant oil reserves. See Jehanqir Amuzegar, "OPEC in the Context of a Global Power Equation," 4 Denver J. Int'l L & Pol'y 221 (1974); Ibrahim F. Shihata, "Arab Oil Policies and the New International Economic Order," 16 Va. J. Int'l L. 261 (1976). However, some economists point to OPEC as the perfect example of how cartels cannot effectively join to agree on price fixing for any significant period.

6. In 1974, in response to the oil embargo imposed by OPEC nations against several western nations, the Organization for Economic Cooperation and Development formed the International Energy Agency (IEA). Its sixteen founding members included: Austria, Belgium, Canada, Denmark, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. See Alfred C. Aman, Jr., Energy and Natural Resources Law: The Regulatory Dialogue 10-3 n.b (1983). The IEA established an International Energy Program with four major components: "(1) an emergency oil allocation program; (2) an international oil\market industry information exchange and consultation program; (3) a long-term energy cooperation program; and (4) a program to promote cooperation between the IEA, OPEC, and other non-IEA, oil consuming countries (primarily Third World nations)." Id. at 10-10. See also Donald E. Claudy, "The International Energy Agency," 14 Nat. Res. Law. 457 (1982). Can an agency such as the IEA give consuming nations leverage against OPEC? Should an agency seek to undermine OPEC and dismantle it or should it focus on reducing the consuming nations' reliance on OPEC oil?

3. MODERN CONCESSIONS AND LICENSES

Today, although some countries, both in the Middle East and elsewhere, still use the concession format, the provisions are much different from those of the original agreements. This subsection first examines the modern concession as an administrative contract and then examines representative clauses in the modern concession and the provisions of the concession used in the United Kingdom.

(a) Modern Concessions as Administrative Contracts

A study of modern concessions requires an understanding of the French concept of an administrative contract. The following excerpt and notes address the issues that are raised when this concept is introduced in a business arrangement.

HENRY CATTAN, THE LAW OF OIL CONCESSIONS IN THE MIDDLE EAST AND NORTH AFRICA
1-2, 73-76, 3-4 (1967)[3]

The number of State contracts with private parties has increased considerably in recent times. This increase is due to several reasons, among which are the large number of countries which have emerged to independence, the growth of international trade and communications and the expansion in the commercial and industrial activities of States. The monopoly by the State in socialist countries of internal and foreign trade and the assumption by the State in many nonsocialist countries of various industrial and economic activities have multiplied the State's commercial dealings. The State today, more than at any time in the past, not only runs its political and administrative machine but also acts as merchant, banker, carrier by air, land or sea, oil producer, steel manufacturer, insurer and engages in all kinds and forms of economic, commercial and industrial activities. Such activities involve the state in a wide variety of contracts and transactions with its nationals or with alien individuals or corporations.

3 Reprinted with permission of Oceana Publications, Dobbs Ferry, New York. The material in this excerpt has been rearranged.

In this study we are principally concerned with one type only of State contracts, namely, oil concessions. By reason of the State's ownership of mineral resources * * * , oil concessions in these regions constitute State contracts. However, before attempting to discuss specifically the law governing oil concessions, it will be useful first to review the legal background of State contracts generally * * * . State contracts are subject to special considerations which distinguish them from other contracts. * * *

In essence, the contractual nexus in State contracts is almost the same as, if not identical to, that in other contracts. It is because of the similarity in the intrinsic contractual elements of these two classes of contracts that a controversy at one time arose among French jurists as to whether any difference in fact existed between a civil contract and an "administrative contract." It is now recognized, however, in countries which apply the *droit administratif* that the contractual link is somewhat looser in administrative contracts than in other contracts by reason of the power which is reserved in the contract in favour of the State to alter unilaterally what are described as the "regulatory conditions" of the administrative contract.

* * *

The *droit administratif* was not the creation of statute but of the French courts. Why did the French courts find it necessary to deviate from the rules of the civil law and develop special rules with regard to administrative contracts? Much of the answer will be found in an example. It was found early in the century that the ordinary rules of contract were not always suitable for certain public contracts, in particular those which concerned concessions of public services or utilities. * * * The principle was, therefore, developed that the administration can, in the public interest and in order to modernize a public service, "aggravate" the contractual obligations of the concessionaire, subject to his indemnification for damage caused to him.

* * *

* * * One of the concepts which are peculiar to the *droit administratif* under French law is that the contractual relationship under a *contrat administratif* is subject to the regulatory power of the State or the public authority concerned. Such regulatory power implies the recognition in favour of the administration of a latitude to include in the contract stipulations which reserve for it certain special powers to modify the nature of the work or the manner of performance of the public service or even to terminate unilaterally the contract in case of breach without recourse to any judicial process. Such contractual stipulations are

recognized to be "in derogation of the common law" of contracts and could be held to be void or illegal in a contract made between private parties. If an oil concession were to be considered as being subject to administrative law, this could entail the application to it of legal principles which are peculiar to administrative contracts.

* * *

It is not enough, however, for an oil concession to attract the application of administrative law that the country granting the concession should possess a system of *droit administratif*; it is also necessary that the oil concession agreement should possess the characteristics of the *contract administratif* which is subject to administrative law. State contracts may be either administrative contracts subject to administrative law or they may be contracts of private law subject to civil law. * * *

* * *

The differences which exist between State contracts and other contracts concern principally one or more of the following aspects:

(1) The conditions required for the formation of the contract.

The restrictions on the freedom of contract are not the same in the case of State contracts as in private contracts. The making of certain State contracts may be prohibited while others cannot come into existence without prior legislative or administrative approval. Again, some State contracts can be concluded only subject to the observance of a prescribed procedure. * * *

(2) The subject matter of the contract.

In some cases, the subject matter of a State contract possesses a public character and relates either to public property or to the performance of a public service.

(3) The law which governs the contract.

Some State contracts are governed by the same legal rules and principles as private contracts. Other State contracts are subject to different legal rules and principles. * * *

(4) The application of special legal concepts.

Certain classes of State contracts entail the application of legal concepts which are unknown or inapplicable in the civil law. Thus, the concept of the "regulatory power" of the State, the principle of the "financial equation" of the contract and the doctrine of ***imprévision*** or unforeseeable circumstances are peculiar to administrative contracts. * * *

(5) The grant to the party contracting with the State of special powers and privileges * * * such as the right to invoke the benefit of public expropriation, or of a privilege, such as a tax exemption or tax reduction.

(6) The sovereignty and public personality of the State as a contracting party.

* * *

Notes

1. In 1992, one proposed draft of the new Russian Oil and Gas Law contained the following provision:

> Oil and gas substrata shall be allotted for use by legal or physical persons on special permissions (licenses). The license shall be the basic legal instrument regulating the relations between the State and the User of oil and gas substrata. It shall certify the User's right to undertake one or more forms of use of the oil and gas substrata provided that the User fulfills certain obligations. * * * In some exceptional circumstances the [licensing authority] has the right to revise the terms of a license on the order of the government. * * * In such a case the user is compensated for the damage caused by the revision of the license terms.

How would you classify concessions under this law if enacted? What would have been the effect? What would the Russian Federation gain from this provision?

2. Given the factors that determine the existence of a state contract, what is the legal nature of a modern concession? Mr. Cattan analyzes the question in part as follows:

> An oil concession possesses certain common features with the concession of a public service. Both types of concessions are granted by the State—this being the case with respect to oil concessions in the Middle East and North Africa where mineral resources come under State ownership. Both types of concessions are endowed with certain attributes and privileges, such as tax exemptions, and often entail the grant to the concessionaire of exceptional powers usually associated with the exercise of public authority, such as the expropriation of land or the use of State domain. As a result there exists a deceptive similarity between them. It is not surprising, therefore, that some confusion sometimes arises with respect to their legal affiliation.

> Notwithstanding certain common traits, the public service concession and the oil concession differ fundamentally in their purpose, nature and legal effects. The basic differences between them can be summarized as follows:
>
> (1) * * * In the case of a public concession, the concessionaire assumes the duty to perform on behalf of the State or of a public authority a service for the public. Such service may, for example, be the supply of gas, water, electricity or transportation. The concessionaire is granted the right to charge rates or fees, usually at a prescribed tariff, to users of the service. In the case of an oil concession, the concessionaire does not undertake the performance or management of a public service for which he collects revenue from the public; instead he conducts a commercial enterprise under an agreement with the State or a national oil company whereby he acquires the right to produce, export and sell a mineral resource in return for a financial consideration which he pays to the State or the national company.
>
> * * *
>
> The public service concession was distinguished from the oil concession in the arbitration between Aramco and the Government of Saudi Arabia as follows:
>
> > "Aramco's Concession could not be viewed as a public service concession, because it does not involve any users, nor any dues to be paid by the public, which does not have recourse to the concessionaire's service. To turn a concession into a public service, it is not enough that the exploitation of some national resource is of extreme importance to the economy of the conceding State, or even that the State's financial stability is dependent on such exploitation. The Company has no duty to manage a continuous and permanent service to the benefit of third parties (users). Its prosperity and its solvency depend on economic and political circumstances. This situation explains why no *cahier des charges*, containing the law of the service, has been annexed to the Concession contract. The status governing the Company does not involve, therefore, any 'act-condition' in the sense of French law; the State cannot intervene in order to modify the clauses of the concession."
>
> * * *
>
> > "In conclusion, it may be said that a mining concession in French law is an act *sui generis*, which cannot be completely assigned to any other category. It is an act which partakes of the nature of a unilateral act in that it depends on the authorization of the State and of that of a contract in that it

requires an agreement of the respective wills of the State and of the concessionaire."

Henry Cattan, The Law of Oil Concessions in the Middle East and North Africa 76-78 (1967).

Are there other arguments against classifying the concession as an administrative contract?

3. A common law contract requires a "meeting of the minds" to be valid. Should the legal nature of a concession be affected by whether its terms were fixed by legislation or regulation? Does the absence of full negotiation deprive it of being a valid private contract? Or would unilateral drafting make it a contract of adhesion? Can that concept be used against the state or the private contracting party?

4. Unlike contracts for the sale of oil, which typically last no longer than a few months, concessions and production sharing agreements are intended to cover operations that may continue 20 years or more. For that reason, they give rise to special legal problems.

> There exists one other circumstance which appears to have some influence on the legal rules applicable to State contracts. This is the duration of the agreement. On the basis of their duration, one can distinguish between long term contracts and contracts of short duration or of immediate performance, such as those which involve a cash-and-carry type of transaction. State loans and oil concessions are usually made for long terms. These contracts are exposed to the vicissitudes of time and become subject to considerations which are inexistent in contracts of short duration or immediate performance. For instance, a State's purchase of goods and its grant of a mineral concession for a period of fifty years are both State contracts, yet the legal problems to which they can give rise during their performance are quite different in each case. The contrast between them is obvious: the former concerns a passing transaction while the latter creates and regulates a durable contractual relationship. State loans have often given rise to problems resulting from currency devaluation. Public service concessions have given rise to problems resulting from the disturbance of their economic equilibrium. Oil concessions have given rise to problems relating to the adjustment of their financial and other conditions to new circumstances. Experience shows that long term State contracts differ from other State contracts which do not involve any appreciable time in performance, but the legal implications which flow from such difference are probably still in need of definition and clarification. Prof. Jennings has remarked that there exists a strong body of authority in favour of the view that certain classes of State contracts, such as long term economic development agreements, differ by their very nature from other State contracts and are therefore subject in some respects to different rules; and that a contract can be invested as it were with a specifically international character and so be placed upon a different footing from other State contracts.

Id. at 10.

5. There can be advantages to the concessionaire under administrative law. The doctrine of *imprévision* imposes an obligation on the state to indemnify the concessionaire of a public service for onerous burdens resulting from unforeseen circumstances. If both parties can insist on adjustments on this ground, should the investor be satisfied with having a state, rather than a private, contract?

6. Some commentators suggest that the concession is *sui generis*. Others more specifically assert it to be in an intermediate position between public service commissions and private contracts. Does this clarify the matter?

(b) Representative Clauses in Modern Concessions

The characteristics of a concession that were most criticized by the sovereigns were the (1) vast areas of acreage committed for long periods to one company; (2) little or no control by the sovereign over the multinational corporation's operations, and (3) financial drawbacks of participating on a royalty basis. Modern concessions contain clauses that minimize or eliminate many of these objections.

The modern concession, exemplified by the concession agreement developed by Abu Dhabi, grants "the exclusive rights to explore, search, and drill for, produce, store, transport, and sell petroleum" within the designated concession acreage for a specified number of years. See Keith W. Blinn, Claude Duval, Honore Le Leuch & Andre Pertuzio, International Petroleum Exploration and Exploitation Agreements: Legal, Economic, and Policy Aspects 63-64 (1986). This period is generally far shorter than the period of the early concessions. For example, Article 3 of the Abu Dhabi Concession provides for a 35-year term. However, in some instances where countries have wished to encourage development of areas requiring expensive technology or of areas presenting difficult engineering, meteorological, or geographical problems, terms approaching 50 years have been granted. Licenses granted by the United Kingdom in 1988 for the "deep-water areas" north and west of Scotland provided for an 8 year initial term followed by a 16 year second term and an overall term of 48 years. See Terence C. Daintith & Geoffrey D.M. Willoughby, United Kingdom Oil and Gas Law 5-345 (2d ed. 1992).

The modern concession also contains relinquishment clauses and express obligations to enter into a work program. The effect of a produced and saved in the Concession Area each year, excluding Crude Oil used by the Company * * * . If the production of Crude during a calendar year shall reach an average rate of [100,000 barrels per day, the company shall pay 16%; 200,000 barrels per day - 20%]

Other provisions address additional compensation, such as the requirement that the multinational pay the government a bonus, annual rentals, or additional forms of compensation. The Abu Dhabi bonus and annual rental clauses read as follows:

ARTICLE 10. BONUS PAYMENTS.

The Company agrees to pay the Government the following amounts at the time in the manner stated:

(a) U.S. 4.0 million * * * within thirty (30) days after the Effective Date.

(b) U.S. 5.0 million * * * within thirty (30) days after the discovery of Crude Oil in commercial quantities;

(c) U.S. 4.0 million * * * after regular exports of Crude Oil have reached and maintained an average rate of 50,000 barrels per day for thirty (30) consecutive days;

(d) U.S. 6.0 million * * * after regular exports of Crude Oil have reached and maintained an average rate of 100,000 barrels per day for thirty (30) consecutive days;

(e) U.S. 6.0 million * * * after regular exports of Crude Oil have reached and maintained an average rate of 200,000 barrels per day for thirty (30) consecutive days;

ARTICLE 11. ANNUAL RENTALS

The Company agrees to pay to the Government the following amounts of annual rentals at a time in the manner stated:

(a) U.S. 100,000 * * * within thirty (30) days after the effective date.

(b) U.S. 100,000 * * * within thirty (30) days after each anniversary of the effective date.

(c) U.S. 100,000 * * * within thirty (30) days after the discovery of Crude Oil in Commercial quantities and each anniversary thereof up to and including the anniversary preceding the export commencement date.

Other clauses in the modern concession clarify issues that were not addressed in the earlier oil concessions. These issues became a point of contention in the renegotiations in the Middle East. The Abu Dhabi concession includes the following clauses:

ARTICLE 17. TAXATION.

The Company shall, with respect to its net income from operations under this Agreement, pay basic income tax at 55%. [If production reaches an average of 100,000 barrels per day, the tax goes

up to 65%; and upon reaching 200,000 barrels per day, the tax goes up to 85%].

ARTICLE 1. DEFINITIONS.

(D) "Posted Price" means the f.o.b. price published from time to time for each grade, gravity, and quality of Crude oil offered for sale to buyers generally for export at the relevant point of export ruling on any day which price shall be a price of comparable grade, gravity, quality in the Arabian Gulf and having regard to geographic location.
* * *

Notes

1. In the Abu Dhabi concession, the government reserves the right to search for any other substances within the concession area.

2. One commentator has noted that concession agreements pose three questions: (1) How much control is given to the foreign company? (2) How is the share of revenue defined? and (3) Except for development of petroleum reserves, how should the foreign company become involved in the country? See Detlev Vagts, International Business Problems (1988). What are the advantages to the modern concession agreement? Why did many of the Middle Eastern countries enter into concession agreements in the first 50 years of this century? What caused the shift to other forms of agreements?

(c) United Kingdom Licensing System[5]

The provisions of U.K. licenses are based upon model clauses that have been set out in government regulations. These clauses vary, depending upon the type of license sought. The government grants both exploratory and production licenses and has separate licenses for onshore and offshore areas. An exploration license, for example, contains the following provisions:

2. In consideration of the payments hereinafter provided and the performance and observance by the Licensee of all the terms and conditions hereof, the Minister, in exercise of the powers conferred upon him by the Act of 1934 and the Act of 1964, hereby grants to the Licensee LICENCE AND LIBERTY in common with all other persons to whom the like right may have been granted or may hereafter be granted during the continuance of this licence and

5 Many of the clauses set out in this subsection can be found in Terence Daintith & Geoffrey Willoughby, United Kingdom Oil and Gas Law, Part 5 (2d ed. 1992).

agreements provide for the recovery of exploration costs out of the production; other agreements provide no such provisions for recovery.

Notes

1. In theory, one could view a participation agreement as a partnership or corporation between the country and the multinational company. Historically, however, the participation arrangements have developed from the original concession agreements in the Middle East; thus, their structure was developed through compromise rather than through an initial decision to create such an arrangement. Since few of the participation agreements began with undeveloped and unproducing properties, it is difficult to determine how such agreements would handle the risks and uncertainties of exploration.

2. In the Saudi participation agreements, the sovereign insisted on sharing in the profits from all phases of the operation including refining, transporting, and marketing. Hossain, 124-126.

4. OPTIONS TO CONVERT A CONCESSION OR PRODUCTION SHARING ARRANGEMENT INTO A PARTICIPATION ARRANGEMENT

In light of the significant risks that a sovereign or its representative may incur upon entering into a participation arrangement with a multinational corporation, many sovereigns prefer to use a concession or production sharing arrangement, with an option to convert the arrangement to one of participation. As illustrated above, in the participation arrangement, the sovereign can decide to contribute only its land to the joint arrangement and thus avoid the financial risk that may result from the failure to discover petroleum reserves. However, in light of the historical background in the Middle East of concession to participation, countries may be more comfortable with the option to convert certain fields or projects.

The option to participate clause may be broad and give the sovereign a right to opt at any time to become a participant, or the clause may be narrow and limited. The following clause illustrates an example of a broadly worded clause.

ABU DHABI CONCESSION AGREEMENT

Article 44. Government's Option

(A) At any time after the date of discovery of Crude Oil in Commercial Quantities, the Government may by notice in writing to the Company elect either by itself or by an entity it nominates to

acquire a non-assignable undivided participating interest of sixty (60) percent (or such lesser portion as the Government shall then determine) in all rights and obligations under this Agreement and in the Concession Area.

(B) The Government shall pay for such participating interest a sum equal to sixty (60) percent or such lesser proportion as the Government shall have elected to acquire of the total accumulated costs and expenses recorded in the book of the company * * * as of the date of discovery of ~~the Crude Oil * * *~~ (excluding the bonus and rental paid by the Company before the date of discovery of Crude Oil. * * * Payment of such sums shall be made by the Government in ten equal annual installments together with interest * * * .

An example of a narrowly worded option to participate clause can be found in the Model Indonesian production sharing arrangement. As you examine this clause, identify the situations in which the sovereign would want to exercise its participation rights.

MODEL PRODUCTION SHARING CONTRACT BETWEEN PERTAMINA AND PRIVATE COMPANIES[11]

1. PERTAMINA shall have the right to demand from CONTRACTOR that an X% undivided interest in the total rights and obligations under this contract be offered to either a limited liability company to be designated by PERTAMINA the shareholders of which shall be Indonesian nationals or to an Indonesian entity to be designated by PERTAMINA (the Indonesian participant).

2. The [participation] rights * * * shall lapse unless exercised by PERTAMINA not later than three months after CONTRACTOR'S notification * * * of its first discovery in the Contract Area, which * * * can be produced commercially * * * . PERTAMINA shall make its demand known to CONTRACTOR by registered letter.

3. CONTRACTOR shall make its offer to the Indonesian participant within one month after the receipt of PERTAMINA's letters * * * .

4. The offer by CONTRACTOR to the Indonesian participant shall be effective for a period of six months * * * .

5. In the event acceptance by the Indonesian participant of the CONTRACTOR's offer, the Indonesian participant shall be deemed to have acquired the undivided interest on the date of CONTRACTOR's notification to PERTAMINA.

11 VI A Collection of International Concessions and Related Instruments ___ (Peter Fischer ed. 1985).

6.1 For the acquisition of a X% undivided interest * * * the Indonesian Participant shall reimburse CONTRACTOR an amount equal to X% of the sum of operating costs which CONTRACTOR has incurred up to the date of the notification * * *.

6.2 At the option of the Indonesian Participant, the said amount shall be reimbursed: (i) either by a transfer of the said amounts within three months * * * or (ii) by the way of payment out of production of 50% of the Indonesian Participant's production entitlements under this contract * * * equal in total to 150% of the said amount * * *.

6.3 [The method of reimbursement shall be stated at the time of acceptance of the offer.]

Notes

1. What are the consequences to the corporation when a sovereign exercises the right of participation?
2. Under each of the option arrangements that appear above, when might a sovereign decide not to exercise the option to convert the arrangement into a participation agreement?

E. COMMON CLAUSES FOUND IN INTERNATIONAL PETROLEUM AGREEMENTS

The prior sections have sought to differentiate among the three basic types of international petroleum agreements: the concession, the production sharing arrangement, and the participation agreement. As stated before, although one can attempt to offer conceptual and theoretical differences among the three, in reality it may be difficult to classify petroleum agreements precisely into one category. This difficulty may result from a harmonization of the agreements whereby the parties are borrowing the best of each type of agreement to fit a particular situation. It may also result from the fact that these alternative agreements evolved over time and not in a vacuum at the same time.

The actual content and organization of particular agreements differs significantly. Some agreements are organized around the concepts of responsibilities of each of the parties. Other agreements simply scatter topics within different articles. Despite the variation in organization, all modern petroleum agreements contain common clauses. This section will offer some examples of these clauses under the subdivision of clauses benefiting the host country and clauses benefiting the multinational corporation.

1. CLAUSES BENEFITING THE HOST COUNTRY

Even in the early concessions, a prime consideration in entering into the arrangement was the investment of capital in the local economy. This investment served the dual function of providing jobs in the short term and training local citizens to operate the venture in the long term. The Abu Dhabi agreement contained the following local labor provision:

ARTICLE 20. CONTRACTORS.

(B) In selecting of contractors, the Company shall wherever possible select contractors who are subjects of the Government provided that the Company is reasonably satisfied with their ability to perform the work entrusted to them and provided that their terms and conditions are competitive with those of other contracts for such work.

The burden of the local labor provision depends upon the cost of training and employing local labor. Many multinationals may indeed prefer local labor because of the lower salary costs and the absence of unions or strong labor laws.

A second dimension of local investment involves the requirement that the multinational purchase materials from local suppliers. The early agreements included a provision that the multinational prefer local suppliers if the quality was equal to foreign suppliers. An example of such a clause is contained in the Abu Dhabi agreement.

ARTICLE 24. EMPLOYMENT OF PERSONS.

Subject to the applicable laws and regulations in Abu Dhabi, the Government and the Company agree that in the selection of nationalities the efficiency of operations must be given consideration. In selecting its employees in Abu Dhabi, the Company agrees that it shall, as far as consistent with the efficient management of the Company and its undertakings, give first priority to citizens of the United Arab Emirates, second priority to Arab subjects, and third priority to nationalities which the Government has advised the Company are acceptable.

More assertive host countries may require that a certain percentage of purchases must be from local manufacturers. There may be a constant percentage or an increasing percentage. To the extent that the local supply issue involves equivalent goods, price becomes the predominant issue for the multinational. However, in some instances, price may be a secondary factor—quality may be the more predominant issue. In the China case study in Chapter 7, we have included a provision requiring the multinational to favor materials from local suppliers. Compliance proved difficult for certain materials that required a high degree of technical sophistication. For example, Chinese suppliers could produce pipe for domestic production, but their product was less suitable for the rigors of the offshore drilling projects than other available pipe.

Host countries also commonly require that a multinational invest a certain portion of its profits in a related industry in the host country. An example of such a provision is the following clause in the Abu Dhabi concession agreement.

> ARTICLE 45. INVESTMENT.
>
> (A) When the production of Crude Oil from the Concession Area shall have reached and maintained an average daily rate of one hundred thousand barrels per day for ninety consecutive days, the company shall make or cause to be made studies as to the feasibility of carrying on one or more of the following hydrocarbon activities:
>
> (1) Production and export of Methanol.
> (2) Recovery and Export of Liquid Petroleum Gas.
> (3) Nitrogen fertilizer.
> (4) Crude Oil Desulpherization.
> (5) Export of Liquefied Natural Gas.
>
> (D) The Company undertakes to invest at least ten percent of its profits in one or more of the above mentioned projects whose economic viability has been established.

In some instances, such an investment provides another profit-making opportunity and, in other cases, it is part of the cost of entering into the petroleum agreement.

Notes

1. In the modern concession section earlier in this chapter, we mentioned the use of the relinquishment clause in reducing the acreage committed to a multinational in a modern concession. In both production sharing arrangements and in participation agreements, host countries use the relinquishment clause to recover acreage that can be the subject of a new arrangement. The clause also provides an incentive to the multinational to develop the reserves early so that it can make a more informed decision on the acreage that will be retained and the acreage that will be released.

2. Early concessions sought to hold the multinational to a certain standard of conduct by tying the contract performance to "good oil field practices" or "industry standards." At first, such clauses were designed to allow a host country to complain when a multinational was not fulfilling the expectation of the agreement. These clauses were asserted when a multinational was performing its role in a substandard manner or when the company's negligence led to an accident injuring persons or property. These clauses were also used to create a minimum environmental standard for cleanups and closing down the facilities. Examples of such clauses are included in Chapter 9.

2. CLAUSES BENEFITING THE MULTINATIONAL

Apart from the clauses that set forth the obligations of the multinational under the agreement, there are two types of provisions that are important to the multinational: clauses that will allow the multinational to realize its profit and clauses that protect its investment. In international petroleum arrangements, the nature of the commodity simplifies the multinational's realization of the profit. In the majority of early concession agreements, the multinational sought payment through the export of petroleum into the world market. The world valuation of oil and the ability to sell a cargo of oil in many different markets for a hard currency significantly simplified the manner in which multinationals realized their profits. Even in cases in which the primary purpose of the arrangement was to produce oil for domestic consumption, the host country could pay the multinational in oil. Whenever oil was used for payment, a price mechanism provision had to be included in the contract. As we stated earlier in this chapter, the major multinationals controlled the posted price of oil in the first part of this century. Today, many spot and commodities markets exist for the product and a price mechanism can be established relatively easily.

The multinational will also seek to include clauses in the agreement that help to protect its investment. In Chapter 2, we examined the desirability of including an alternative dispute resolution clause and a choice of law clause in an international petroleum arrangement. These clauses are particularly important when one of the parties is a sovereign. In Chapter 3, we examined the risk of expropriation in an international energy transaction. As included in this discussion, multinationals have sought to use the stabilization or equilibrium clauses in an attempt to curb slow or dramatic changes in the agreement. That clause seeks to freeze the legal and regulatory climate within the host country at the time of the agreement. It seeks to prevent a country from enacting new legislation that partially or completely changes the terms of the international agreement.

There are many types of stabilization or economic equilibrium provisions. The most basic type states that the host country agrees not to enact any legislation or make any regulatory changes that will affect the agreement for its duration or for a set period. This type of provision was used several times during the period of renegotiation of the early concessions between OPEC and the major oil companies. The Liamco-Libyan agreement included the following language:

> This concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of the execution of the Agreement * * * . Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent.

62 I.L.M. 140, 170 (1980).

The more recent clauses do not attempt to reject the application of the new law or regulation upon the arrangement. They state that if the economic benefits of the agreement are adversely affected by the new law or regulation, the parties shall adjust the economic benefits of the contract to give the multinational the same benefits that would have been received in the absence of the new legislation. Some provisions provide that the host country must make an adjustment to the satisfaction of the multinational. Other provisions state that the changed regulation shall require that the parties enter into negotiations for a certain period. If the negotiations do not lead to an agreement, the parties will enter into binding arbitration.

In Chapter 3, we examined the consequences of a stabilization clause as against an outright expropriation. Although a stabilization clause will not offer a multinational corporation the right to specific performance of the clause, it often will affect the measure of damages that the company can receive in an arbitration. A recent article discussing the ways in which risk should be reduced in an international agreement offers the following advice in drafting stabilization clauses: "The first [lesson] is that a stabilization clause should be very explicit in what it is meant to prohibit. The clause should provide that the State expressly waives its rights to nationalize. The second lesson is that a stabilization clause should provide that its terms are binding regardless of subsequent compromise, negotiation, or amendment of the contract unless both parties provide expressly, in writing, to change the meaning or binding effect of the stabilization clause." Paul E. Comeaux & N. Stephan Kinsella, "Reducing the Political Risk of Investing in Russia and Other C.I.S. Republics: International Arbitration and Stabilization Clauses," Russian Oil & Gas Guide 21, 24 (Apr. 1993).

Notes

1. The purpose for many international petroleum agreements is to give the host country access to technology and expertise that would be very expensive to purchase outright. In some instances, this information is a trade secret of the particular multinational; in other instances, it may be protected by a patent owned by the multinational or another entity. In any event, the multinational may have an incentive or a legal requirement to safeguard closely the expertise or information. In such circumstances, multinationals frequently include provisions that address the protection and sharing of such technological information. Examples of such agreements are included in the next chapter.

2. In countries with a highly bureaucratized government, multinationals will often seek to obtain blanket or relaxed permission on a series of items that might be otherwise time consuming and expensive to obtain. Such basic items include visas for key personnel, rights to transportation facilities at set rates, custom import and export permission for materials without delays and tariffs, and rights to power and water needed to conduct operations. In some cases, the state oil company is paid to arrange such services for the multinational and, in other cases, the language is directed at government subdivisions that may be in charge of the permit process.

3. In addition to the economic stabilization clause, international petroleum agreements also typically contain a force majeure provision. Certain force majeure clauses are relatively vague as to the types of conditions that will allow one or both parties to terminate the agreement. Other provisions are more specific and in some cases use a period (such as a year) for which the circumstances must exist before the multinational can claim a force majeure defense. One agreement in the former Soviet Union used language that required the circumstances to last for an uninterrupted period of one year and to make the agreement unprofitable from the multinational party's perspective; then the contract could be terminated upon thirty day's notice.