CHAPTER 2

THE DEVELOPMENT OF PETROLEUM ARBITRATION

2.1 Historical Survey Petroleum Arbitration (1859 to 1950)

Petroleum has changed many features of the world and will continue to do so for many years. The question of who shall control this ‘newborn’ and who shall decide and determine all aspects of this liquid has been considered and is one of the most controversial issues in this recent history. The conflict in some instances and the cooperation in many others between the great powers in the world to gain exclusive control or possession of petroleum is the distinctive feature of this period. As Engdahl has written, “No other element has shaped the history of the past one hundred years so much as the fight to secure and control the world's reserves of petroleum.”

Indeed, petroleum is not purely an economic matter, it is undoubtedly also a political matter. As Mohr stated, “World-wide fight for oil has gone on with a vigourous ruthlessness, and a fury which can be understood only by bearing in mind the importance attached it by the various governments concerned”.

The interest of western countries in the domination of petroleum resources was clear. Mohr quoted a letter which was written by the French senator, Henri Berenger, to Clemenceau in 1919. Berenger writes:

“He who owns the oil will own the world, for he will rule the sea by means of the heavy oils, [... ] by reason of the fantastic wealth he will derive from oil the wonderful substance which is more sought after and more precious today than gold itself.”

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2 Anton Mohr, The Oil War, 29 (London: Martin Hopkinson & Co. Ltd. 1926).
3 Id., at 29.
4 Id., at 30.
Mohr himself argued that It is doubtful, indeed, whether any other chapter in contemporary history can show so many biased statements and wilfully falsified documents of a more or less `official' character as the story of the oil war.

He added that this is due, of course, primarily to the character of the war and the secrecy with which it is being waged. It is all going on behind drawn blinds, as it were. The government of the various countries very seldom appear openly in the field; not infrequently they act under cover of private companies, whose capital and management are more or less controlled by them.\(^5\)

### 2.1.1 The Early Period -19th Century

Petroleum was known by some old nations. Egyptians, for instance, used petroleum in the process of mummification; the Romans also used petroleum to light the temple of Jupiter. Petroleum was a divine substance for Native American, and was a nuisance for the white settlers. China was the first nation to know the secret of the extraction of petroleum from the sub-earth.\(^6\)

However, the first evidence of the modern importance of petroleum can be traced back to the 19th century, when the first petroleum producing well was drilled in Pennsylvania in the United States of America in 1859 by Edwin I. Drake.\(^7\) Some years later, John D. Rockefeller, with his business associates, entered the petroleum refining business when he formed in 1870 Standard Oil (Cleveland, OH) to produce kerosene for lighting purposes.\(^8\) Demand for petroleum in the United States of America during the nineteenth century grew considerably as the car industry grew.\(^9\)

Efforts to discover new sources of petroleum moved outside the United States of America. In 1873 Alfred Nobel's family drilled in Baku in Russia (today's Azerbaijan)\(^10\) and in this year Russia became a petroleum producer. A few years later, in 1898 petroleum was discovered in Romania.\(^11\) “Between 1900 and the number of 1914 petroleum producers increased and new

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\(^5\) Id., at 31.


\(^7\) Id., at 1.


\(^9\) Supra note 6 at 2.


sources of petroleum were detected in Mexico, Peru, Egypt, Galicia (now part of Poland and Ukraine) and Persia (modern Iran).\textsuperscript{12}

The practice of controlling petroleum resources from outside the land in which they were located was initiated by the United Kingdom at the end of the 19\textsuperscript{th} century. Ruling the world seas was the primary objective of the British Navy. Admiral Lord Fisher, who held the office of First Sea Lord Admiralty, was a powerful advocate for the use of petroleum in the navy.\textsuperscript{13}

\subsection*{2.1.2 Early 20\textsuperscript{th} Century}

Controlling the petroleum resources in different parts of the world became increasingly important to western countries, especially the United Kingdom, at the beginning of the 20\textsuperscript{th} century. To achieve this goal, Winston Churchill continued what Lord Fisher had started. Churchill, on 17 July 1913 put forward a policy before the House of Commons which later became the basis of Britain's petroleum strategy. This policy was based on government control of British petroleum companies by purchasing the majority of shares in these companies\textsuperscript{\emph{i}}.\textsuperscript{14}

The Arab countries and Persia were the focus of Churchill's policy, since Britain had preceding interests in this area. British presence in this area for petroleum purposes started in 1900 when William Knox D'ArCY discovered petroleum in the desert of southern Persia.\textsuperscript{15} D'ArCY was granted a concession agreement by the Shah of Persia, which "still reads like musical comedy"\textsuperscript{16} By this concession agreement, D'ArCY was given the exclusive right for sixty years to drill for, produce, pipe and carry away petroleum and petroleum products throughout 500,000 square miles of the Persian Empire.\textsuperscript{17}

\begin{flushleft}
\textsuperscript{12} \textit{Ibid.}
\textsuperscript{13} For more details see for instance: Anton Mohr, \textit{The Oil War, supra} note 120; H. E. Davenport/Russell Sidney Cooke, \textit{The Oil Trust & Anglo-American Relations}, (London: Macmillan and Co.Limited 1923); F. William Engdahl, \textit{A Century of War: Anglo-American Oil Politics and the New World Order, Supra} note 1; E. D. Shaffer, \textit{The United States and the Control of World Oil},(London/ Canberra; Croom Helm 1983); and Ted Wheelwright, \textit{Oil & World Politics: from Rockefeller to the Gulf War,} (Sydney: LEFT Book Club Co-operative Ltd. 1991).
\textsuperscript{14} \textit{Supra} note 1.
\textsuperscript{15} H. E. Davenport/ Russell Sidney Cooke, \textit{The Oil Trust & Anglo-American Relations, Supra} note 13 at 11.
\textsuperscript{16} \textit{Id.}, at 11.
\textsuperscript{17} \textit{Ibid.}
\end{flushleft}
The Anglo-Persian Oil Company was formed in 1909 (the name changed in 1935 to the Anglo-Iranian Oil Company, then later to the British Petroleum Company). Two of its directors were represented in the Admiralty, and they had the last word in all strategic issues. The speech of Churchill in the House of Commons on 17 July 1913 clearly disclosed the policy of the British government in relation to petroleum resources. He said that:

“Our ultimate policy is that the Admiralty should become the independent owner and producer of its own supplies of liquid fuel. [...] We must become the owners, or at any rate the controllers at the source [...] to draw oil supply, so far as possible, from sources under British control or British influence, and along those sea or ocean routes which the Navy can most easily and most surely protect.”

To achieve such an objective, considerable tactics were employed; Britain collaborated with France and the Netherlands to subvert the international reputation of the American government and American companies. In addition, the British Foreign Office was ordered to strengthen its diplomatic ties in the Arab region and elsewhere in terms of gaining concession agreements, and at the same time, British companies were encouraged to become more aggressive in seeking and obtaining petroleum concessions in foreign countries.

2.1.3 The American Factor and the Post-World War One Distribution

Prior to 1920 the United States of America and its petroleum companies were excluded from the Arab region and Persia, and the region was dominated by Europe. However, after the First World War, the American attitude towards overseas business changed, the United States began to break the European monopoly.

From that time on, obtaining control of oil became one of the cornerstones of US foreign policy. It became the essential ingredient in the expansion and consolidation of the American Empire.

18 Id., at 16.
19 Id., at 18-20.
20 Abdulaziz Al-Sowayegh, Arab Petro-Politics, 16(London/Canberra: Croom Helm 1984).
21 Supra note 13 at 37, E. D. Shaffer, The United States and the Control of World Oil.
The United States State Department was a considerable supporter of American petroleum companies.

The State Department has often taken its policies right out of the executive suites of the oil companies. When Big Oil can't get what it wants in foreign countries, the State Department tries to get it for them. In many countries, the American Embassies function virtually as branch offices for the oil combine [sic].

The above statement illustrates the intimacy of the relationship between politics and business in relation to petroleum, in the 20th century and some would argue the 21st as century as well. As a US State Department bulletin suggests

A review of diplomatic history of the past 35 years will show that petroleum has historically played a large part in the external relations of the US than any other commodity.

American history in the Arab region started in the late 1920s. In 1927 the petroleum war was resolved in favour of the `Major' petroleum companies or `Seven Sisters'. Five of these companies were American, i.e. Standard Oil of New Jersey (Exxon), Gulf Oil Corporation (Gulf), Texas Oil Company (Texaco), Standard Oil Company of California (Socal or Chevron) and Mobil Oil Company (Mobil). One of these companies was British; i.e. British Petroleum Company (BP). One of them was Anglo-Dutch, Royal Dutch-Shell Group (Shell). There is another petroleum company normally named the `eighth' which is Compagnie Francaise des Petroles (CFP)(France).

The aim which was formalised on that day between American British, Dutch and French petroleum companies was to divide the booty `plunder' between the `victors' and to control the

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24 “The peace agreement was formalised in 1927, at the Achnacarry, Scottish castle of Shell's Sir Henri Deterding. John Cadman, representing the British Government's Anglo-Persian Oil Co. (British Petroleum), and Walter Teagles as president of Rockefeller's Standard Oil of New Jersey (Exxon), gathered under the pretence of a grouse shoot, to conclude the most powerful economic cartel in modern history. The Seven Sisters were effectively one institution.” F. William Engdahl, A Century of War, supra note 1, at 87.
petroleum resources in the Arab region. In fact, this agreement was between the United States of America and the United Kingdom in order to determine the influence of each in this region.

The terms of this agreement, which is formally called "As Is Agreement of 1928" or the "Achnacarry Agreement" were kept secret. Moreover, in order to perform this agreement the perspective countries only ratified this private pact in the same year, in what became known as the "Red Line Agreement." Since this time, "with minor interruption the Anglo-American grip over the world's oil reserves has been hegemonic." 27

This American accomplishment was a consequence of the power of American petroleum companies, supported by American public opinion and Congress, to persuade Washington to intervene on their behalf against European discrimination; “America insisted on a share in the fruit of victory.” 29 The following words of the State Department illustrate the intentions of western countries in the Arab region and elsewhere:

“This government has contributed to the common victory, and has a right, therefore, to insist that American nationals shall not be excluded from a reasonable share in developing the resources of territories under mandate.” 30

After American attendance in 1927 which was a result of British and French agreement, this region became oligopolised by these three countries. By virtue of the ‘As Is Agreement’ or ‘Achnacarry Agreement’, the region in question was divided between these three countries as follows; Iraqi concession agreements for 75 years went to the control of British Petroleum, the Royal Dutch Shell group and the French Compagnie Francaise des Petroles, along with the Rockefeller group. Control of Kuwait's resources was given to British Petroleum and the American

25 Id., at 87.
26 Ibid.
27 Ibid.
28 Supra note 20 at 17.
29 Id., at 16.
30 United States Foreign Policy, State Department Paper, (10 February 1944) quoted in Id., at 17.
31 “A red line from the Dardenelles down through Palestine, to Yemen, up through the Persian Gulf, Encompassing Turkey, Syria, Lebanon, Saudi Arabia, Jordan, Iraq, and Kuwait was drawn. Inside the line, the oil interests of the three countries worked out iron-clad divisions of territory, which have largely held to this day,” F. William Engdahl, A Century of War, supra note 1 at 88.
Gulf Oil Company.\textsuperscript{32} American companies monopolised control over both Saudi Arabia and Bahrain petroleum resources.\textsuperscript{33}

After the cartel of these ‘Major’ companies or ‘Seven Sisters’ had been organised, they initiated tactics to deal with other companies which were not members (‘outsiders’) in relation to all the aspects of petroleum in the region.\textsuperscript{34}

Thus, the Anglo-American conflict relating to petroleum resources was resolved by the ‘Special Relationship' which had been formed to control this area by both of them. It is worth recalling the argument of the American ambassador to the Netherlands when he stressed the importance of petroleum to his country’s economy. He said that:

“Ample supplies of petroleum have become indispensable to the life and prosperity of my country as a whole, because of the fact that the United States is an industrial nation in which distance renders transportation difficult and agriculture depends largely on labor-saving devices using petroleum products. The reserve of oil, wherever and in whatever country they existed, had to be controlled by US companies”.\textsuperscript{35}

\textbf{2.1.4 World War Two Period}

World War II reinforced the significance of petroleum, and the battle over the control of petroleum resources started again. For instance, during the war, Germany attempted to cut off the petroleum supply from Iran to the Allies.\textsuperscript{36} The United States of America became increasingly concerned about the depletion of American petroleum reserves. Consequently, the United States of America doubled its efforts to guarantee the future supplies.\textsuperscript{37}

To conclude, the ‘Major’ petroleum companies, supported by their home countries, were gluttonously exploiting the petroleum resources in the Arab region and Persia, and they continued their efforts to obtain new concession agreements in order to tighten their grip upon the petroleum resources.

\textsuperscript{32} \textit{Ibid.}


\textsuperscript{34} \textit{Id.}, at 88.

\textsuperscript{35} E. D. Shaffer, \textit{The United States and the Control of World Oil}, supra note 13 at 55.

\textsuperscript{36} Ted Wheelwright, \textit{Oil & World Politics: from Rockefeller to the Gulf War}, supra note 13 at 8.

\textsuperscript{37} E. D. Shaffer, \textit{The United States and the Control of World Oil}, supra note 13 at 75.
sector across this region. The sole aim of these companies was to gain as much profit as possible while the petroleum producing countries themselves received only crumbs. Iran, for instance, calculated that the Anglo-Iranian Oil Company (British Petroleum) made a profit of $320,000,000 in 1948 on its production of 23 million tons of Iranian petroleum, while paying Iran a royalty of $36,000,000.\textsuperscript{38}

2.2    (1951 - to present)

2.2.1    Post World War Two Period

Petroleum history after the Second World War shows a marked change in favour of the producing countries. Two particular events related to this period deserve special attention.

Following the end of World War II most developing countries began their efforts to disentangle themselves from colonialism. They focused first on the economy. Control of the petroleum sector, as the most significant factor in their economy, became the first priority.

Before discussing the efforts of developing countries to gain control of their economy, it is worth mentioning that the Second World War altered the positions of western countries in the petroleum game. As discussed above, Britain, prior to the eve of World War II, was the first and strongest ruler of this region's petroleum resources, and the position was maintained up to the end of the war. 44\% of the Arab/ Iranian petroleum industry was owned by Britain, where the United States of America owned only 40\% and France and the Netherlands 8\% each.\textsuperscript{39} However, a few years later, the scales tipped up in favour of the United States of America, as it became the dominant world power. By 1959 the United States owned 50\% of the petroleum industry compared to Britain's 18\%.\textsuperscript{40}

Several factors contributed to this change among them that after World War II the United State of America increased its efforts to control foreign petroleum resources. William C. Bullitt, Under Secretary of the Navy, in his speech to President Roosevelt, illustrated that petroleum was

\textsuperscript{38} Supra note 1 at 108.
\textsuperscript{39} Supra note 13 at 10.
\textsuperscript{40} Ibid.
the most vital element in the American economy: “To acquire petroleum reserves outside our boundaries has become, therefore, a vital interest of the United States.”

In 1943 the United States of America gained `an unprecedented Lend-Lease Agreement' from the Saudi King Abdulaziz whereby Saudi Arabia ensured that it would favour American petroleum interests after the war. Consequently, five of the ‘Major’ American petroleum companies were exploiting the Saudi petroleum sector after World War II.

2.2.2 The Early Nationalization

In order to achieve their goal of independence developing countries attempted to gain control of their natural resources, especially the petroleum sector. These countries began to nationalise the ridiculous petroleum concession agreements. Iran provides the best example in this regard. Iran's attempt started a few months after Mohammed Mossadegh became the Iranian Prime Minister, when he submitted a recommendation to the Iranian Parliament, ‘the Majlis’, that Iran should nationalize the Anglo-Iranian Petroleum Company (British Petroleum Company). The Iranian Parliament voted to accept Mossadegh's recommendation, with fair compensation to the company.

The consequences of this event illustrate the reaction of western countries towards any attempt by developing countries to control their natural resources. Iran, prior to voting for nationalisation had asked for an equal share in petroleum profits, whereby it would receive 50% of the Anglo-Iranian Petroleum Company's profits, and Iranian participation in the management of the company. The Anglo-Iranian Petroleum Company rejected the Iranian claims and the British Foreign Office refused to intervene in this matter claming that ‘governments are not interested in private matters’. This is despite the fact that the British government owned 53% of the Anglo-Iranian Petroleum Company.

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41 US Senate, A Documentary History of the Petroleum Reserves Corporation, at 3 quoted by E. D. Shaffer, The United States and the Control of World Oil, supra note 13 at 84.
42 Supra note 1 at 102.
43 Id., at 109.
However, once Iran nationalised the company, the British government suddenly became more interested in what it had previously considered a ‘private matter’.

Iran, on one hand, has the right to control its natural resources. On the other hand, it also offered just compensation to the British government. Iran not only agreed to pay just compensation, it also guaranteed a similar level of petroleum supply to Britain compared to that supplied before nationalisation, and agreed to employ British nationals in the Anglo-Iranian Company.\(^{45}\) However, the British government, as Engdahl has argued, not only intervened in the negotiation but went further. The British government dispatched units from the Royal Navy to Iranian waters and threatened the occupation of Abadan, because Iran had committed the unforgivable sin of putting British interests at risk.\(^{46}\) Furthermore, in 1951 Britain declared full economic sanctions against Iran.\(^{47}\)

The consequences of the British action had a great impact upon the Iranian economy and even upon Iranian sovereignty. Iranian petroleum income declined sharply from $400 million in 1950 to less than $2 million in July 1951 and Mohammed Mossadegh fell in August 1953.\(^{48}\) This was the first example of the harmful consequences developing countries faced when attempting to regain control of their natural resources.

### 2.2.3 The Establishment of OPEC

The formation of the Organization of the Petroleum Exporting Countries (OPEC) provides a second example of the developing countries struggling to regain control of their natural resources. The formation of (hereafter OPEC) is considered as a significant development in the relationships between petroleum countries and petroleum companies as well as their home states. The creation of this organisation, as discussed above was an attempt of petroleum countries to control their vital resources (petroleum) for development. Since the petroleum sector is the sole

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\(^{47}\) “By September 1951 Britain had declared full economic sanctions against Iran, including an embargo Against oil shipments, as well as a freeze on all Iranian assets in British banks abroad. British warships were stationed just outside Iranian coastal waters; land and fair forces were dispatched in Basrah in British-controlled Iraq, close to the Abadan refinery complex. The British embargo was joined by all major Anglo-American oil companies”, *ibid*, at 110.

\(^{48}\) *Ibid*, at 110.
natural resource for most of these countries, it constitutes the main source of wealth for their development. As the secretary general of OPEC stated,

“The fact that many of our Member Countries earn more than 90 per cent of their foreign exchange from hydrocarbon [petroleum] sales thus makes them highly vulnerable.” 49

OPEC was created in Baghdad (Iraq), on 14 September 1960 by five petroleum countries (Iran, Iraq, Kuwait, Saudi Arabia and Venezuela). At present OPEC consists of eleven petroleum-producing and exporting countries, the other six are Algeria, Indonesia, Libya, Nigeria, Qatar and the United Arab Emirates.

The principal aim of OPEC as stated in its Statute is the coordination and unification of the petroleum policies of Member Countries and determination of the best means of safeguarding their interests individually and collectively.

2.2.4 Bilateral Investment Treaties

Bilateral investment treaties (BITs) provide the framework for the promotion and protection of foreign investment. They were proposed by developed countries after the Second World War (in the period of decolonisation) in order to ensure protection for their investment in developing countries. 50 The treaty which was negotiated in 1959 between the Federal Republic of Germany and Pakistan is considered as the first new BITs which concluded between developed and developing countries. 51

It was stated that most BITs typically include disciplines in the following area:

National and most-favoured-nation treatment;

Fair and equitable treatment;


Guarantees in respect of expropriation and compensation for war and civil disturbances;

Guarantees of free transfer funds and repatriation of capital and profits;

Subrogation of insurance claims; and dispute settlement provisions, both state-to-state and investor-to-state.\(^{52}\)

2.2.5 The Energy Charter Treaty

The Energy Charter Treaty (ECT) is a multilateral treaty, limited in its scope in respect of the energy sector.\(^{53}\) The ECT signed in Lisbon on 17 December 1994 after three years of negotiations started in 1991 by the Conference on the European Energy Charter, and entered into force in April 1998.\(^{54}\) The Treaty was born as a reaction to the collapse of the Soviet Union and the end of the Cold War which offered an unprecedented opportunity to overcome the previous economic divisions on the European continent.\(^{55}\)

Establishing a close economic collaboration between Western Europe, mainly the European Union and the states emerging in Eastern Europe and Central Asia from the former Soviet Union was the focal aim of this Treaty.\(^{56}\) Wälde has stated that the ECT connects two significant strands of international economic policy and law: First it is an attempt to commit the

\(^{52}\) Luke Peterson, “Changing investment Litigation, Bit by BIT”, available at: www.iisd.org/pdf/2001/trade_investment.pdf (visited on 12 December, 2014); also, it was stated that “BITs have a number of provisions that afford security to foreign investment. In general, these provisions establish both substantive and procedural rules that protect foreign investment”, for more details see Kenneth J. Vandevelde, “Investment Liberalisation and Economic Development: The Role of Bilateral Investment Treaties”, 36 (3) Columbia Journal of Transnational Law 501-527,506 (1998).


\(^{55}\) Available at: www. Encharter.ore, (Visited on 8 December, 2014).

states of the former USSR to “a model of liberal international economic policy, with respect to investment, trade and transit.” Second, it is “one link in a long chain of efforts to create an international investment and trade regime.”

According to the recent report of the Secretariat of the Treaty, its provisions focus on five broad areas.

The protection and promotion of foreign energy investments, based on the extension of national treatment, or most-favoured nation treatment (whichever is more favourable); free trade in energy materials, products and energy-related equipment, based on WTO rules; freedom of energy transit through pipelines and grids; reducing the negative environmental impact of the energy cycle through improving energy efficiency; and mechanisms for the resolution of state-to-state or investor-to-state disputes.

The ECT consists of two principal bodies: First, the Conference, -an intergovernmental organisation- which is the governing and decision-making body for the ECT, therefore, all states who have signed or acceded to the Treaty are members of the Conference. Second, the Secretariat, which is based in Brussels, staffed by energy sector experts from different countries of the Conference's constituency, and it is headed by a Secretary General.

2.3 The Development of Petroleum Arbitration

In terms of petroleum arbitration, especially between developing petroleum producing countries and foreign petroleum companies, many questions are raised. It is necessary to consider where petroleum arbitration derives its force from; whether or not from the contractual obligation of both parties, specifically at the first stage of petroleum concession agreements at the beginning of the last century. We must also ask whether the parties to the agreement were at that time in the

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59 Art. 34 of the Treaty; for more details about the function of the Conference see Art. 34 (3); also, for the Latest members of the Energy Charter Conference see, available at: www.Encharter.org, (Visited on 8 December, 2014).
60 For the Secretariat functions, see Art. 35 of the Treaty, available at: www.encharter.org, (Visited on 8 December, 2014).
same position and of equal bargaining power; whether the host states exercised free will and free choice which would enable them to effectively negotiate the agreement terms. Yet we know that all these countries were colonised and controlled by petroleum companies’ home states, and where the free will of one contractual party is not available we normally declare the contract prima facie ‘null and void’. It is well established that the will and consent of the parties is the cornerstone of arbitration. We must therefore examine the (none) consensual character of these past agreements.61

2.3.1 Notion of Petroleum Arbitration

Petroleum arbitration is a method of settling disputes which normally arise out of petroleum matters, particularly, exploration and exploitation transactions, invariably between a petroleum producing country and a petroleum company outside the specific national jurisdiction.62

The idea of international arbitration in disputes between states and foreign companies arose from the theory of ‘delocalisation’ of the procedural and substantive law issues, in order to avoid submission to national jurisdiction and also to protect the contract from any unilateral change that may be brought about by the contractual state. In fact, international arbitration proved to be simply a defender of foreign companies. It has been said that investment contracts are long-term, therefore international arbitration between states and companies is considered to be a safeguard for these companies if a dispute arises.63 As Cahier states

62 It was stated that “there are two basic arrangements for exploration and exploitation of petroleum around the world: concessions and contracts. Contracts can be divided into three types: production sharing, risk service, and pure (non-risk) service contracts. The basic difference between concessions and all types of contracts lies in the division of oil and gas production. [...] The concession was the original system used in the world petroleum arrangements. It is still the most widely used system”, for more details see Gordon H. Barrows, Worldwide Concession Contracts and Petroleum Legislation, 14(Tulsa/ Oklahoma: Penn Well Books 1983).
63 See, Philippe Cahier, “The Strengths and Weakness of International Arbitration Involving a State as a Party”, in: Julian D. M. Lew (ed.) Contemporary Problems in International Arbitration, 241-249-241(1987 Netherlands: Martinus Nijhoff Publishers); Delaume also argues that, “it is thus understandable that investors seek to escape this danger by various means. One of these is to resort to ‘stabilisation’ clauses that are intended to protect the investor against further changes in the content of the host state's law. Another device is more radical in approach in the sense that it seeks to remove the relationship from the reach of the host state law by placing it under the aegis of international norms.” Georges R. Delaume, Transnational Contracts Applicable Law and Settlement of Disputes: Law and Practice, A Study in Conflict Avoidance, 15 (Dobbs Ferry / New York: Oceana Publications. INC. booklet 1 1988).

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If a dispute arises, one of two courses can be followed. One is to file suit in the local courts. The result is uncertain because the local courts will enforce local law, which may have changed since the contract was made. The state immunity to suit may also make the court proceeding stillborn. The second course is to claim the diplomatic protection of the state under whose laws the company is incorporated. This is no more satisfactory than the first alternative, since it may leave the company unprotected in certain cases.64

Böckstiegel notes, “In investment contracts arbitration is often chosen because foreign investments are specifically open to the risk of interference by public authorities of the host state and legal procedure of protection may either not, or sufficiently, be available in that host state or may at least not be satisfactory for the confidence of the prospective investor”.65

This assumption has been articulated by the majority of western scholars, as we have seen in the first chapter, from the early days of investment history in developing countries up to the present day.66

2.3.2 “Early” Disputes

The type of arbitration involving a state and a private entity (as a typical petroleum arbitration is) started at the beginning of the 20th century. One of the first recorded instances of international arbitration was between the USSR and an American investor called Harriman.67

This arbitration resulted from the failure of a concession agreement between the USSR and Harriman. In 1925 the USSR granted Harriman a concession agreement concerning a vast manganese deposit in Chitauri. This concession agreement contained an arbitration clause in Russian and English.

64 Philippe Cahier, supra note 62 at 241.
66 See, for instance, the latest lecture in this subject, The Freshfields Bruckhaus Deringer Arbitration Lecture, which was given by Elihu Lauterpacht, on 27 November 2001.
67 “The Harriman arbitration was one of the first international arbitrations to which the USSR was a party, and it was certainly the first arbitration between the USSR and any American firm,” V. V. Veeder, “Lloyd George, Lenin and Cannibals: The Harriman Arbitration”, 16 Arbitration International 115-139,117 (2000).
However, a few years later Harriman faced several obstacles in exploiting this concession, such as international competition and the decision of the USSR to violate Harriman's monopoly by opening new manganese mines in the Ukraine. Consequently, Harriman, in order to avoid financial crisis, opted for recourse to the concession agreement's clause.68

In the field of petroleum, the conflict between the Iranian government and the Anglo-Iranian Oil Company in 1932 was the first discord between a state and a petroleum company. Iran, on 27 November 1932 notified the company that its concession agreement which was signed at the beginning of the 20th century was annulled.69

Then there are the famous petroleum arbitrations, such as the arbitration between the Sheikh of Abu Dhabi and Petroleum Development Ltd,70 the arbitration between the Ruler of Qatar and International Marine Oil Company71, and the arbitration between Saudi Arabia and the Arabian American Oil Company (Aramco).72 All these arbitrations, and other arbitrations such as the Libyan arbitrations,73 and the Aminoil- Kuwait arbitration,74 were ad hoc arbitrations.

2.3.3 From *ad hoc* to Institutional Arbitration – ICSID

Administration of petroleum arbitrations by institutions commenced in the second half of the 20th century. The International Centre for Settlement of Investment Disputes (ICSID) for instance, registered the first request for arbitration in a petroleum dispute on 4 November 1977 between AGIP SpA and the Government of the People's Republic of the Congo. The Centre was

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68 Id., at 130-138, “the Harriman arbitration clause was considered as a long clause providing detailed rules on the composition of the arbitration tribunal.”


70 See, Petroleum Development Ltd. v. The Sheikh of Abu Dhabi (1951) 18 ILRI 44.


formed under the ‘Washington Convention’ or the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 18 March 1965.\textsuperscript{75}

2.3.4 Main Characteristics of Petroleum Arbitration

It was argued that petroleum arbitration is based upon two principles: ‘separability of the arbitration clause’ or what is sometimes called ‘the autonomy of the arbitration agreement’, and the ‘stabilisation clause’. The first principle, ‘separability' simply means that the arbitration agreement is completely different from the main contract in which it is found, because it functions autonomously. Consequently, if there is an allegation that the contract is invalid or null and void, the arbitration agreement shall remain immune from such allegation.\textsuperscript{76}

The case law of petroleum arbitration served this argument. The arbitral tribunal in Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic for instance, stated that

It is widely accepted in international law and practice that an arbitration clause survives the unilateral termination by the State of the contract in which it is inserted and continues in force even after that termination.


Then the tribunal added that: This is a logical consequence of the interpretation of the intention of the contracting parties, and appears to be one of the basic conditions for creating favourable climate for foreign investment.\footnote{Liamco v. Libya, (1981) 6 YBCA 89-118, 96.}

The tribunal in this case justified its conclusion by referring to two points; the ‘intention of the contracting parties' and by expressing that the separability of the arbitration clause is `one of the basic conditions for creating a favourable climate for foreign investment'. However, the tribunal’s justification appeared slightly contradictory, because there is potential tension between these two points. It haven seen that the tribunal was only concerning about the second point irrespective of the intention of the contracting parties.

The same approach was articulated in the arbitration between \textit{Elf Aquitaine Iran (France) and National Iranian Oil Company (Iran) (NIOC)}.\footnote{Elf Aquitaine Iran (France) v. National Iranian Oil Company (Iran) (NIOC) (1986) 11 YBCA97.} The Iranian claim was that the agreement between the parties was null and void \textit{ab initio} and that the Iranian government was not bound to this agreement since it was signed by a Special Committee rather than government. The sole arbitrator argued that:

“It is a generally recognised principle of the law of international arbitration that arbitration clauses continue to be operative, even though an objection is raised by one of the parties that the contract containing the arbitration clause is null and void [...]”\footnote{Id., at 102.}

The second principle as it has been argued in petroleum arbitration is the `stabilisation clause,' which means: Contract language which freezes the provisions of a national system of law chosen as the law of the contract as of the date of contract, in order to prevent the application to the contract of any future alteration of this system.\footnote{Amoco International Finance v. Iran, Iran- US CTR 189 at 239.}

The aim of this clause or clauses, as Bishop argues, was to ensure that the concessions would be effective for the full periods which had been agreed in the contract. However, the modern consequence of the classic stabilisation clause, as Bishop States, “is not to invalidate
nationalisation, but to make it unlawful, which in turn affects the amount of compensation that may be awarded."\textsuperscript{81}

The stabilisation clause was found in the first generation of the concession agreements of exploitation of natural resources, especially those of petroleum contracts.\textsuperscript{82} The general aim of these clauses is in fact to create a special regime applicable to the foreign company by derogating from the host state's law.

However, it could be argued that petroleum arbitration differs from other arbitration in which the principle of confidentiality which is considered as an eminent feature in international commercial arbitration should not prevail in petroleum arbitration. In other words, the host state's citizens should have knowledge concerning any petroleum arbitration proceedings. This argument derives its authority from two points. First, petroleum is domain of the host state's citizens and therefore arbitration proceedings which concern this resource should be conducted under the knowledge of citizens. Second, the state in petroleum agreements and accordingly in petroleum arbitrations only acts on behalf of its citizens and therefore it is a significant matter to be aware of their rights and obligations.

\textbf{2.3.5 Are Petroleum Disputes Investment Disputes?}

We must ask ourselves whether petroleum agreements are distinct from other types of investment contracts, consequently, petroleum arbitration differs from normal international commercial arbitration. On one level the answer would be no, it functions procedurally in the same way as other commercial or investment arbitrations. The pattern is the same: request for arbitration, appointment of arbitral tribunal, preliminary proceedings, hearing, and award.\textsuperscript{83} Indeed, the peculiarities or the differences of petroleum arbitration are derived from the nature of the

\textsuperscript{82} For more details see Id., at 1158.
\textsuperscript{83} W. R. Bentham, “Special Features in Oil and Gas Arbitration, “a paper was submitted to the Symposium on Oil and Gas Disputes, London: Court of International Arbitration (LCIA), 23 November 2001; the fundamental aspects of petroleum arrangements as Barrows argues are: risk and financing, economic return (profit), and management, Gordon H. Barrows, Worldwide Concession Contracts and Petroleum Legislation, supra note 61 at 2-3.
petroleum industry itself, which can pose special problems, and the nature of petroleum agreements, rather than from the arbitral process.\textsuperscript{84}

Undoubtedly the petroleum industry is an international, global industry by nature, and political issues have more influence on this industry than any other.\textsuperscript{85} Furthermore, petroleum affects the daily life of all nations, whether the petroleum producing countries who are concerned about the availability of petroleum, as well as the industrialised countries concerned about supply. In addition, although the petroleum industry is a high risk one, it also very profitable one.

However, on a second level it could be argued that petroleum agreements do have their own particular characteristics. Generally, normal investment agreements are: time definitive, namely they exist or are in effect for a specific agreed time only; their scope is specified; and these agreements are based on feasibility studies which enable the investors to calculate their profits and also their losses. Moreover, these kinds of investment are normally organised and controlled according to the local law of the receiver country.\textsuperscript{86} That said, the risk lies with the investor.

The petroleum agreements are different in several respects. First, the period of time of these agreements is lengthy extending to several decades. For example an agreement was signed on 24

\footnotesize
\begin{itemize}
\item[84] Ibid.
\item[85] Ibid.
\item[86] Most Arab countries enacted codes in order to regulate foreign investments, see for instance Oman Foreign Capital Investment law, issued on (16 October 1994).
\end{itemize}

\textbf{Art. 1} “without prejudice to the provisions of the Royal Decree No. 57/93, non-Omani – whether natural of (sic) juridical persons - shall not conduct any commercial, industrial or tourism businesses or otherwise participate in an Omani company except with a licence from the Minister of Commerce & Industry to be issued in accordance with the Provisions of this law. Art. 2 “[T]he licence referred to in the preceding Article shall be granted after the following conditions have been met:

\begin{itemize}
\item[a)] The business shall be conducted by an Omani company with capital of not less than R0150,000 [\$388.600 approximately] and the foreign share therein shall not exceed 49% of the total capital. However, the above percentage may be increased up to [up to] 65% of the company's capital by a decision from the Minister of Commerce & Industry following a recommendation from the Foreign Capital Investment Committee.
\item[b)] The percentage referred to in above paragraph may be further increased up to 100% of the company's capital for the projects which contribute to the development of national economy upon the approval of the Development Council following a recommendation from the Minister of Commerce & Industry, provided that the project's capital shall not be less than R0 500.000[\$1,295,336] b) [...] Art. 3 “Exemptions from the conditions specified in the above Article for obtaining the licence shall be granted to the following:
\item[1)] Companies which conduct business in the Sultanate of Oman by virtue of special contracts or agreements with the Government of the Sultanate or which are established by virtue of a Royal Decree. (Reference will be given in part three on foreign investment laws in some Arab countries).\end{itemize}
June 1937 between the Sultan of Oman and Basil Henry Lermitte on behalf of Petroleum Concession Limited for the exploration and exploitation of petroleum in the Sultanate of Oman. This agreement started on 24 June 1937 and is in effect until 24 June 2012.  

More recent petroleum agreements are not much shorter. The agreement which was signed on 15 March 1987 for the exploration, development and production of petroleum between the Government of the Syrian Arab Republic, and Syrian Petroleum Company, Tricentrol Exploration Overseas Limited, and Norsk Hydro A. S. provides in Article 3 (F) that

The development period of any development contract shall be twenty (20) years from the date of Commercial Discovery which relates to such development contract. Subject to the approval of company this period may be renewed for an additional period of ten (10) years at the option of contractor upon six (6) months prior written notice to company.

A similar article can also be found in the Qatar Model Offshore Exploration and Production Sharing Agreement of 1986. “Article (4) Term” provides that the “term of this Agreement shall be a period of twenty five (25) years from the Effective Date.” In addition, the current Omani Exploration and Production Sharing Agreement is for a period of over thirty years.

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87 A concession agreement between Sultanate of Oman and Petroleum Development (Oman) Limited. Some amendments only occurred to the agreement. The first amendment was on 20 October 1937 when Petroleum Concession Limited transferred its obligations and benefits under the said agreement to Petroleum Development (Oman and Dhofar) Limited, which changed its name on 27 March 1951 to Petroleum Development (Oman) Limited. The second amendment was on 7 March 1967 when the Sultan of Oman (Sultan Said bin Taimur) resigned the same agreement “[I]n the exercise of his powers as Sultan of Muscat and Oman on his own behalf and in the name and on behalf of his successors” with the same company (Petroleum Development 'Oman' Limited). It was provided that “[T]his agreement shall as from the date of signature replace the Existing Convention (which shall hereafter be no effect) and shall subsist until 24th June, 2012 or such later date as the Sultan and the Company may agree, unless terminated in accordance with Articles 17,18, or 23 of this agreement” (Art. 1).


89 Ibid, Supplement no. XCII (92).

90 Art. 2(1) provides that, “The Government hereby grants to the Company, subject to the terms of this Agreement, the exclusive right to explore for, develop and produce Petroleum within the Contract Area, and sell or dispose of its share of Petroleum hereunder. The initial term of this Agreement shall be for a period of three (3) years from the Effective Date hereof, extendable at the Company's option pursuant to the conditions set forth in Article 3.2 below for two (2) consecutive additional periods of two (2) years each following the initial term. However, in the event of a Commercial Discovery hereunder, the term of this Agreement shall be extended for a period of thirty (30) years from such Discovery Date, (unpublished).
The second particular feature of petroleum agreements is the negotiation power of the petroleum companies, which is reflected in the agreement, especially in terms of the scope of the agreements or the size of the concession area. As with the above agreements, it appears that the petroleum companies have a wide range of rights which may be not provided for in any other kind of investment agreement. For instance, in the Omani Agreement with the Petroleum Development (Oman) Limited, Article 3 (1) provides that

The Company shall have during the currency of the Agreement:

1. The exclusive right to explore, search and drill for, produce and win Petroleum within the Leased Area;

2. The exclusive ownership of all Petroleum produced and won within the Leased Area;

3. the right by such means as the Company selects, to refine and transport and sell for use within the Sultanate or for export and to export freely, or otherwise to deal with or dispose of any and all such Petroleum and the products thereof;

4. The right subject as is hereinafter provided to do all things necessary or desirable for the purpose of the above operations.

The same could be said of the size of the concession area; some of these concession agreements cover the entire state's lands, mainland and sea. One such agreement is the Omani Agreement.\textsuperscript{91}

The third distinguishing character of the petroleum business and petroleum agreements is what is called “the Costs Recovery,” which simply means that all petroleum companies have the right to cover all their exploration costs once petroleum has been discovered.\textsuperscript{92}

\textsuperscript{91} Art. 2 (1) provides that, “[T]he area to which this Agreement applies (hereinafter referred to as “the Sultanate”) is the mainland of Muscat and Oman, all islands appertaining thereto, and such parts of the territorial waters as are situated within 3 nautical miles of the said mainland and of the said islands”, \textit{ibid.}

\textsuperscript{92} \textit{See}, for instance the Omani Exploration and Production Sharing Agreement, Art. 10; Qatar Model Offshore Exploration and Production Sharing Agreement of 1986, Art. 12 “subject to the auditing provisions under this Agreement, contractor shall recover petroleum costs”, \textit{see supra} note 88.
Hence, considering all these aspects, it is possible to conclude that petroleum arbitration has its own particular features which make it different from any other kind of arbitrations in other fields of investments, such as debt, or between private parties. Indeed, it could be said that petroleum disputes require specific forms and substance because of two main reasons; peculiarity of petroleum agreements; and role and impact of the petroleum industry in the economy of many countries especially developing countries.93

2.4 Concluding Remarks

By examining the history of petroleum on the one hand and the development of petroleum arbitration on the other, it becomes evident that western countries have shaped this history in their favour, and the petroleum companies were their instruments. Hence, it is no surprise if some scholars argue that the origins of arbitration in the petroleum field particularly and in other investment fields in general is tainted.94

Therefore, we need to examine the possibility for arbitration to divorce itself from its reputation as a method of protecting western interests in developing countries, and return it back to a system of resolving disputes in a neutral manner, namely acquire a new reputation as securing justice and neutrality rather than power. We need also to examine how western scholars can contribute in finding principles that consider the interest of both parties of petroleum agreement. This is imperative given that:

Justice is the refuge of the weaker states whereas power is the weapon of the stronger states as well as stronger entities in the process of globalisation that is currently afoot.95

It may be possible that the arbitration mechanism becomes the favoured system for the settlement of disputes in the petroleum sphere, but only if this system ceases to be a method of protecting foreign investment and becomes more justice.

If arbitration achieves this, developing countries will freely accept it, and their acceptance will not be based, as has been the case in the past, or their need for foreign investment, or to become

93 Ibid.
95 Id., at 106.
members of a convention or part of a club and the global economy.\textsuperscript{96} Or as Walde accurately argues, if you want the benefits, you have to accept the disciplines [sic]. If you don't, you are an "out" state, a pariah; your reputation suffers, and everybody will do less business with you and then only with much higher security margins.

\textsuperscript{96} Thomas Wälde, “Current Issues in Investment Disputes `comments’”, a paper was submitted to the London Court of International Arbitration (LCIA) seminar, (London on 23 November 2001).