Petroleum Arbitration: Applicable Law and Appropriate Arbitral Forum (A Study of Petroleum Disputes in Arab Countries)

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Applicable Law and Appropriate Arbitral Forum

(A Study of Petroleum Disputes in Arab Countries)

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A Thesis Submitted in Fulfilment of the Requirement for the Award of Doctor of Philosophy at Queen Mary, University of London

February 2004

Abstract

Petroleum maintains a primary role in the world energy market as well as in the daily life and livelihood of Arab petroleum countries, since these countries are highly dependent upon revenues from the exploitation and export of this resource. Therefore, the petroleum industry is fraught with conflicts of interests, primarily between developing petroleum exporting countries and petroleum companies sustained by their home states, most of which are developed countries. The majority of disputes have been settled by arbitration, most of which have been controversial.

The question of the applicable law to the merits of a dispute is intimately related to the controversies surrounding arbitral tribunals. The prevailing perspective of western scholars during the 20th century, and still to an extent today, was that host state law was inadequate, and host state courts were partial. Therefore, these scholars held any dispute arising between a host state and a petroleum company should be dealt with as an international dispute and should be settled far away from the host state's court and governed by laws or rules other than that of the host state.

This thesis examines the past and present of petroleum arbitration, the perceptions and the practice, and aims to suggest a modified method of determining the applicable law to petroleum disputes. It argues that contrary to the previous allegations, the legal infrastructure of host states has developed over the years and today offers an adequate law to govern the merits of petroleum disputes. It further suggests a semi-localisation approach. The thesis focuses only on arbitration as a method of resolving such disputes, and limits itself to Arab petroleum countries.

The thesis argues that petroleum contracts have their own characteristics and therefore should not automatically be subject to the ICSID Convention or to other principles of investment arbitration. The time is ripe for the establishment of a specialised institution to undertake the settlement of disputes arising out of petroleum transactions.

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This thesis is dedicated to the memory of my father, who left us so suddenly.

Acknowledgment

I am grateful to Dr. Loukas A Mistelis and Professor Julian D M Lew for supervising the thesis and for considerable assistance and guidance.

I am also grateful to my mother for her constant pray in order to seize the moment, and to my wife and my daughter for patiently tolerating my absence and waiting endlessly for my return.

Table of abbreviations

AAA	American Arbitration Association
AC	Law Reports, House of Lords (Appeal Cases)
AJIL	American Journal of International Law
Arbitration	Arbitration, Journal of the Chartered Institute of Arbitrators
ASA Bulletin	Swiss Arbitration Association Bulletin
ASIL Proceedings	American Society of International Law. Proceedings
BYIL	British Yearbook of International Law
ICJ	International Court of Justice
FSIA	Foreign Sovereign Immunity Act (USA)
GAFTA	Grain and Feed Trade Association
ICC	International Chamber of Commerce
ICC Bulletin	International Chamber of Commerce International Court of Arbitration Bulletin
ICCA	International Council for Commercial Arbitration
ICLQ	International and Comparative Law Quarterly
ICSID	International Centre for Settlement of Investment Disputes
ICSID Rep	International Centre for Settlement of Investment Disputes Reports
ILA	International Law Association
ILM	International Legal Materials
ILR	International Law Reports
Iran-US CTR	Iran-US Claims Tribunal Reports
J Int'l Arb	Journal of International Arbitration

LCIA	London Court of International Arbitration
Lloyd's Rep	Lloyd's Law Reports
MAI	Multilateral Agreement on Investment
Model Law	UNCITRAL Model Law on International Commercial Arbitration adopted 21 June 1985
OPEC	Organisation of the Petroleum Exporting Countries
OPIC	Overseas Private Investment Corporation
OECD	Organisation for Economic Co-operation and Development
PCIJ	Permanent Court of International Justice
SIA	State Immunity Act (UK)
UNCITRAL Arbitration Rules	Arbitration Rules of the United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
USC	United States Code
WLR	Weekly Law Reports
WIPO	World Intellectual Property Organisation
YBCA	Yearbook of Commercial Arbitration

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General Introduction – The Issue Stated

It is an undisputed fact that petroleum has a considerable influence upon the welfare of people and economies in both developed, and to an even greater extent developing countries. It is not an exaggeration to state that for petroleum developing countries, petroleum constitutes their most significant economic resource.

Most developing countries, especially Arab countries, have traditionally relied on agriculture and fishing as a source of income before they became petroleum-exporting countries. Since the petroleum era, perceived by many as the golden era, everything in these countries has changed. The income derived from petroleum exportation is so high that the accompanying modernisation has affected all aspects of the community.

Hence, it comes as no surprise that developing nations will do whatever is necessary to protect this vital resource; these countries regard petroleum as the natural resource which enables them to achieve a high standard of life for their citizens.

At the same time, industrial plants and factories in the western world require petroleum, most of which is imported from developing countries. In fact, petroleum is fundamental for the industrialised world and competes with the farming industry for most important "traditional" industry relating to natural resources. For instance, petroleum provides about 40% of the energy Americans consume, 97% of transportation fuels and in the United States alone petroleum industry employs nearly 1.4 million people.

These facts clearly illustrate the reasons for the conflict over petroleum between developing and developed countries. This conflict intensified after World War II, when most developing countries struggled to liberate themselves from colonialism. Control over their natural resources was among the first struggles of developing countries, in view of the fact that petroleum companies, which were all established in western countries, were controlling and exploiting this natural resource on their terms and in their favour leaving only crumbs for host states.

The struggle of developing countries to gain control over their own natural resources led in many cases to petroleum disputes between host states and petroleum companies. Arbitral tribunals, which consisted of exclusively western arbitrators,

resolved all these conflicts by applying western rules of law, since these arbitrators considered the host state law to be incapable of dealing with such sophisticated contracts. Moreover, the decisions of these tribunals invariably tended to fall in favour of the petroleum companies. The scepticism of western countries towards the host state law continues even nowadays due to historical allegation that the local law is insufficient and that unilateral change of the contract and the relevant law by the host states are always possible.

This, in return, made developing countries suspicious of international arbitration, as they considered it as only an umbrella for protecting the interests of developed countries and the petroleum companies. Consequently, developing countries voiced objections against petroleum arbitrations and insisted on resolving any petroleum disputes in national courts.

Although the issue of state contracts, in general, and petroleum contracts, in particular, has received extensive and thorough analysis by distinguished scholars and experts from different countries all over the world, there remain some points in petroleum contracts and disputes that require further discussion and analysis, especially the issue of applicable law in the light of the experience gathered in the last fifty years and procedural and substantive law reforms in the region in question.

Hence, the overriding aim of this thesis is to challenge, discuss and analyse one of the most controversial issue in petroleum disputes, i.e. applicable law. The thesis aims to suggest *a method of determining which law is most appropriate* for such disputes. To achieve this goal the study is divided into three main parts, each of which is subdivided into chapters, and a conclusion.

The *first* part is an introduction to this study. Chapter one discusses the themes, the working hypothesis and the methodology of the thesis. The second chapter examines the evolution of petroleum arbitration, and offers a more general history of petroleum.

Part *two* analyses the determination of the law applicable to the merits of petroleum disputes, in two chapters. Chapter one offers a detailed analysis of the case law in petroleum arbitration, in particular the *Abu Dhabi*, *Qatar*, and *Aramco* cases. The second chapter of this part discusses theories of determination of applicable law by parties as well as determination of the applicable law by the arbitrators, when there is no determination by the parties. Reference is also made to public

international law, and general principles of law, both national and anational, such as the UNIDROIT Principles of International Commercial Contracts.

The *third* part of the thesis analyses new trends concerning petroleum arbitration. This part is divided into three chapters. The first chapter deals with doctrinal background, in particular state sovereign immunity and public policy. Chapter two discusses the role of the International Centre for Settlement of Investment Disputes (ICSID). Chapter three discusses the development of host states laws at national and international level.

A couple of points should be highlighted. First, this thesis undertakes a thorough examination of one of the most controversial issues in petroleum arbitration: applicable law. It will be argued that the law of petroleum exporting countries has developed over the years and offers an adequate law to govern the merits of petroleum disputes, should the parties so agree.

The thesis focuses only on arbitration as a method of resolving disputes in the petroleum arena, as arbitration has become one of the most common methods of dispute resolution. This is because arbitration is considered to be faster compared to national court procedures; it is a neutral and private method of resolving disputes where the contracting parties can choose their arbitrators, law, and the place of arbitration; it also provides a final and binding decision. It will also be argued that petroleum contracts are *sui generis* investment contracts and that they should not automatically be subject to the ICSID Convention or to other principles of investment arbitration.

There is no discussion of the system of the Bilateral Investment Treaties (BITs) or the Energy Charter Treaty (ECT). There are several reasons: first, there are hardly any treaties in the petroleum industry particularly, between Arab petroleum exporting countries and the home states of major petroleum companies (USA for instance); second, territorial scope of the ECT is limited to the Europe and Central Asia. Where useful conclusions can be drawn from BIT or ECT practice and are relevant to this thesis will be discussed. Finally, this thesis is limited to the study of petroleum disputes related to Arab countries.

This thesis aims to achieve a resolution of the tension between developing and developed countries by finding a consensus in the settlement of disputes relating to exploiting this vital natural resource for the benefit of both. Moreover, it is hoped

that this solution would not only be restricted to the petroleum disputes in the Arab world, but would also be used in resolving petroleum and other natural resources disputes in different parts of the world. It will also be suggested that the time may have come for the establishment of an arbitration institution for the resolution of petroleum disputes.

PART ONE

INTRODUCTION

Chapter One: Themes, Hypothesis and Methodology

One of the most important trends in international economic and commercial relations in the late 20th century was the rapid and unprecedented growth of arbitration,[1] which can be simply defined as a consensual agreement between parties to refer their dispute to a third neutral party, arbitrator(s), who is authorised to render a binding decision after a hearing at which both parties have an opportunity to be heard.[2] In other words, arbitration is a private justice system which operates, at least with the tolerance, or preferably with the support and assistance of national and international legislation and national courts. In many countries arbitration has become the favoured method of settling disputes between parties in commercial matters with or without an international element.[3] The increase in disputes which have been resolved by arbitral tribunals, whether by *ad hoc* or institutional arbitration, highlights the fact that arbitration plays an indispensable role in the effective resolution of commercial disputes.[4]

However, the success of arbitration has been mainly in the field of commercial disputes where the parties to the disputes arguably have an equal bargaining position, being in the same line of business and having similar levels of experience. Where the arbitral tribunal finds an initial consent between parties to refer their dispute to arbitration, then as a matter of course the parties should avoid resort to any national courts and should be compelled to arbitration; the parties are bound by the decisions of the tribunal, the arbitral award. Yet, in the field of

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1 Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, (Cambridge: Grotius Publications Limited 1990), at 1.

2 *Black's Law Dictionary*, (6th ed., St. Paul / Minn: West 1990), at 105.

3 Christian Hausmaninger, "Civil Liability of Arbitrators: Comparative Analysis and Proposals for Reform", 7 (4) J Int'l Arb 7-48, 16 (1990); Martin Domke, "Arbitration", 28 *New York University Law Review* 835-851, 835 (1953).

4 For example, the case load of the International Chamber of Commerce (ICC) increased from 250 in 1980 to 466 in 1998; a similar trend can be observed with the London Court of International Arbitration (LCIA), where there were 70 new cases in 1998, see Julian D. M. Lew, "Achieving the Potential of Effective Arbitration" 65 *Arbitration* 283-290 (1999); it was reported that there are well over 2000 arbitrations a year under the auspices of the better known arbitration institution, Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M. Kröll, *Comparative International Commercial Arbitration*, (The Hague: Kluwer Law International 2003), at 33.

petroleum, the situation is entirely different to both the pure commercial arena, and arbitration between states.[5]

Where petroleum is concerned, the situation is frequently complex because the parties to the contract are invariably a state or a state entity on the one side and a private company on the other side. Hence, the relationship between the host states and the petroleum companies differs from the traditional commercial ones mentioned above. This relationship would have generally started during the period of colonialism when developing countries were dominated and controlled by western countries.

This type of international arbitration involving disputes between sovereign states and foreign private companies is a relatively recent phenomenon.[6] The international arbitration of disputes between states and foreign companies started at the beginning of the 20th century, first in relation to concession agreements between private entities and the succession state of Tsarist Russia.[7] It then exploded in the second half of the twentieth century when colonialism was retreating and the use of gun boat diplomacy to settle investment disputes was unwise in the context of the nationalist movements sweeping Asia and Africa.[8] At that time western countries supported international arbitration as the preferred method to provide a new form of protection for international investment contracts.[9]

The consequence of this protection was to tie up the natural resources sector of the economies of developing countries in chains of "unequal contracts."[10] Under

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5 F. A. Mann, "State Contracts and International Arbitration", 42 BYIL 1-37, 6 (1967).

6 A. H. Hermann, "Disputes between States and Foreign Companies" in: Julian D. M. Lew (ed.), *Contemporary Problems in International Arbitration*, (1987 the Netherlands: Martinus Nijhoff Publishers), 250-263, 250, he later added that, "the need for it springs from the increasing role played in the world economy by the multinational corporations, on the one hand, and by state traders, the new merchant princes, on the other"; see also Virtus Chitoo Igbokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said" 14 (1) J Int'l Arb 99-124, 100 (1997); for a historical survey, see J. Gillis Wetter, *The International Arbitral Process*: *Public and Private*, vol. 1 (Dobbs Ferry/ New York: Oceana Publications 1979), at 407.

7 See V. V. Veeder, "LIoyd Gerorge, Lenin and Cannibals: The Harriman Arbitration", 16 *Arbitration International* 115-139 (2000).

8 M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, (Singapore: Longman Publishers (Pte) Ltd. 1990) at 9.

9 Ibid., at 9.

10 Virtus C. Igbokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said", supra note 6, at 100; these contracts were described as following: "The classical contractual framework in the extractive sector (petroleum, hard minerals, timber, etc) was the concession [...] It excluded the host government from participating in the ownership, control, and operation of the undertaking. The transnational

such agreements, petroleum companies received the exclusive rights to explore, produce, market and transport petroleum. Moreover, these agreements were extended for a long period of time, typically between 40 and 75 years,[11] and the royalties due to the host state were commonly so ridiculously low that they did not exceed 3 Indian Rupees (75 cents) per ton or about 10 cents per barrel.[12] For instance, such a clause found in the Agreement of 1937 between the Sultan of Oman and a petroleum company, provides that

> In consideration of the payments described in Article (***) the Sultan hereby grants to the company for the remainder of the period of this Agreement the exclusive right to explore, search for, drill for, produce, win, refine, transport, sell, export, and otherwise deal with or dispose of the substances and to do all things necessary for all or any of the above purposes within the Leased Area.[13]

Petroleum contracts have fundamental effects on the economic and social life of developing countries, in particular, in view of the fact that the petroleum sector is considered a vital resource to these countries and most of them rely upon it as a sole resource as will be explained below.

Unequivocally, the contractual relationships between host states and transnational corporations were badly negotiated, and the two parties were arguably of unequal bargaining power.[14] As a consequence, this apparent inequality and the scepticism of western investor states towards the courts of the host state impacted upon the attitude of developing countries towards international arbitration in investment contract disputes, especially in petroleum disputes. Arbitration was

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corporation was given exclusive, extensive, and plenary rights to exploit the particular natural resource and was in effect assured ownership of that resource at the point of extraction." Samuel K. B. Asante, "Restructuring Transnational Mineral Agreements", 73 AJIL 335-371, 338 (1979).

[11] Yinka Omorogbe, *The Oil and Gas Industry*: *Exploration and Production Contracts*, (Lagos/ Benin/ Ibadan/ Jos/ Oxford: Malthouse Press Ltd.1997), at 58.

[12] Mana Saeed Al-Otaiba, *The Petroleum Concession Agreements of the United Arab Emirates*, (London & Canberra: Croom Helm 1982), at 3; or as Asante argued that "in many cases the companies paid a nominal rent of, say, £150 for a whole concession, plus one or two bottles of rum," Samuel K. B. Asante, "Restructuring Transnational Mineral Agreement", supra note 10, at 339.

[13] Blin Duval Le Leuch and Pertuzzio, (1986), at 56 quoted by Yinka Omorogbe, *The Oil and Gas Industry*: *Exploration and Production Contracts*, supra note 11, at 59, (this agreement is still in effect until 24 June 2012).

[14] See the next chapter.

unwelcome by developing countries,[15] since these countries perceived international arbitration to be biased in favour of western countries or investor companies.[16] The refusal of Latin American countries to settle disputes by tribunals other than domestic courts is the best example of developing country scepticism and suspicion towards international arbitration.[17]

The success of arbitration in other fields, such as the sale of goods as Sornarajah argues,[18] cannot be transferred to petroleum disputes. Nor can the trade, investment or commercial relationships between private parties from different countries be transferred to the area of petroleum where the disputing parties are in different positions. Indeed, it may be argued that petroleum contracts and petroleum disputes have their own features which distinguish them from the familiar investment agreements and consequently from normal international arbitration. These features are elaborately discussed at the end of the second chapter of this part.

The lack of success in state contract arbitration, notably in petroleum disputes, is ascribed by some scholars[19] to the bias of the early arbitration cases, such as the *Abu Dhabi* case[20] and the *Aramco* case[21], towards the private investor. Thus, an advocate of arbitration concedes that, "it may be true that in the beginning of this century, and until the 1950s, arbitrations conducted by various 'international' tribunals or commissions evidenced bias against developing countries."[22]

In this thesis it is argued that petroleum arbitration is a method of settling disputes which normally arise out of petroleum matters. In particular, under the scope of petroleum disputes we understand exploration and exploitation transactions, invariably between a petroleum producing country and a petroleum company outside

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15 M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, supra note 8, at 5.

16 Ibid., at 5.

17 Jose Luis Siqueiros, "Arbitral Autonomy and National Sovereign Authority in Latin America", in: Thomas E. Carbonneau (ed.), *Lex Mercatoria and Arbitration*: *A Discussion of the New Law Merchant*, (1998 Dobbs Ferry/ New York: Transnational Juris Publishing), at 219.

18 M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, supra note 8, at 5.

19 See for example M. Sornarajah, ibid.; Virtus C. Igokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said", supra note 6; Ahmed A. El-Kosheri/ Tarik Riad, "The Law Governing a New Generation of Petroleum Agreement: Changing in the Arbitration Process", 1 *ICSID Review*: *Foreign Investment Law Journal* 257-288, 258 (1986).

20 See *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR 144.

21 See *Saudi Arabia v. Arabian American Oil Co.* (*ARAMCO*) (1963) 27 ILR 117; see also *the Ruler of Qatar v. International Marine Oil Co. Ltd.* (1953) 20 ILR 534.

22 See Jan Paulsson, "Third World Participation in International Investment Arbitration" 2 *ICSID Review*: *Foreign Investment Law Journal* 19-65, 21 (1987).

the specific national jurisdiction. This thesis does not aim at classifying or discussing the whole range of petroleum disputes, such as those relating to finance, construction, joint venture, sale and marketing, etc.

1.1 Themes

It is an understatement to say that international arbitration in petroleum disputes was unwelcome in the 20th century as far as developing countries were concerned. However, in the 21st century, with all the legal and economic developments that have occurred, especially in developing countries, has the attitude of these countries towards international arbitration remained the same? Is the fear and uncertainty which prevailed throughout the 20th century in petroleum arbitration still present and if so, why? More precisely, what was the main conflict factor in previous petroleum arbitrations? Moreover, has the discussion in the context of petroleum arbitration been completed?

At the same time, other questions must be raised from another point of view, such as whether western countries are still suspicious of the legal infrastructure and the legal systems in developing countries, and whether petroleum companies still fear unilateral amendments in the petroleum contracts by legislative reforms in the host state. Are such fears justified? It is necessary to examine the relationships between developing petroleum countries and petroleum companies in the present day and in the light of economic and legal reforms world-wide. Undoubtedly better, more equitable relations than the past regime are required.

Some western lawyers and arbitrators suggest that such contracts between states and a foreign company for exploitation of mineral resources must be governed by laws other than those of the host state.[23] The consequence would be that the terms of the contract cannot be changed unilaterally by the legislation of the host state.[24] The same lawyers and arbitrators have further argued that the violation of these contracts would be considered a violation of (public) international law, since these contracts may be characterised as international treaties.[25] Therefore, a "stabilisation

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[23] See for instance, Richard B. Lillich, "The Current Status of the Law of State Responsibility for Injuries to Aliens", [1979] *Proceedings* ASIL 244; F. A. Mann, "The Consequences of an International Wrong in International and National Law", 48 BYIL 1-65 (1976-77).

[24] M. Sornarajah, "The Myth of International Contract Law", 15 *Journal of World Trade Law* 187-217, 187 (1981).

[25] Ibid., at 187.

clause" is considered to be implied in state contracts, especially in petroleum contracts, in order to provide a guarantee that such contracts will not be subject to any unilateral change.[26]

The significance of the above in legal terms must be assessed; scholars of western countries were expressing the view that concession agreements were to be treated as an international treaty, rather than a mere commercial agreement or contract.[27] The power of petroleum companies and their home states to make this assumption a reality, in terms of imposing their conditions on the petroleum industry, is clear. Yves Dezalay and Bryant Garth argue that, "these huge companies became so much the bastions of the establishment that they considered themselves in one sense above the state and in another quasi-statelike."[28]

In addition those lawyers and arbitrators think that the host state governments while applying their municipal law may not at any time act impartially toward foreign investors, so that foreign companies felt that relying on host state's law exposed foreign companies investment to a variety of risks.[29]

Because of this sidelining of the host state's law as well as the creation of a very strong aegis to protect state contracts, which ultimately protects foreign companies, a form of "delocalisation" or "internationalisation" of investment contracts has emerged.

The justification for such delocalisation is based on the assumption that a number of smaller countries lack a comprehensive legal system which is appropriate for the settlement of disputes between foreign investors and governments, as well as

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[26] Ibid., at 187.

[27] *Cf.* M. Sornarajah, "Power and Justice in Foreign Investment Arbitration" 14 (3) J Int'l Arb 103-140, 108 (1997).

[28] Yves Dezalay/ Garth G. Bryan, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order,* (Chicago/ London: The University of Chicago Press 1996), at 77; it was reported that "the annual budget of a transnational oil company is likely to exceed the entire gross national product of its Third World host nation", the Central Intelligence Agency (CIA), *The World Fact Book 1999*, quoted by Amr A. Shalakany, "Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism", 41 *Harvard International Law Journal* 419-468, 467 (2000); the Royal Dutch/ Shell Group (Shell) for instance, operates in 145 countries and employs more than 115,000 people, see *the Shell Report 2002* <www.shell.com> last visited 6 October 2003.

[29] Jeswald W. Salacuse, "Bit by Bit: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries", 24 *International Lawyer* 655-675, 659 (1990); Professor Brigitte Stern for instance, stated at her lecture "International Law as Applicable Law under ICSID" which was introduced at a conference on 'Public International Law in Commercial Disputes' held at the British Institute of International and Comparative Law, London on 7-8 June 2002 that the application of public international law is only to protect the foreign companies in contracts between states and private parties even with sufficient of the home state's law. This statement was an answer to a question raised by a participant at the conference.

on the widespread fear of foreign investors of local allegedly biased, court and administrative procedures.[30] Foreign investors argued that host states would fail to perform their obligations under the contract by invoking their own legislative or executive law to justify non-performance.[31] These assumptions were articulated in the famous petroleum arbitrations namely the *Abu Dhabi* case,[32] the *Qatar* case[33] and the *Aramco* case.[34] In these three tribunals, arbitrators agreed unanimously that these developing countries do no have any legal principles which can be employed to deal with complex contracts.

For instance, in the *Abu Dhabi* case, Lord Asquith of Bishopstone after asking "what is the 'proper law' applicable in constructing this contract", he stated that

> This is a contract made in Abu Dhabi and wholly to be performed in that country. If any municipal system of law were applicable, it would *prima facie* be that of Abu Dhabi. But no such law can reasonably be said to exist. The Sheikh administers a purely discretionary justice with the assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.[35]

The same assumption can be found in the *Qatar* case; Sir Alfred Bucknill stated in the pertinent part

> There is nothing in the Principal or Supplemental Agreements which throws a clear light upon the intention of the parties on this point. If one considers the subject matter of the contract, it is oil to be taken out of the ground within the jurisdiction of the Ruler. That fact, together with the fact that the Ruler is a party to the contract and had, in effect, the right to nominate Qatar as the place where any arbitration arising out of the contract should sit, and the fact that the agreement was in Arabic as well as English, points to Islamic law,

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30 Joy Cherian, *Investment Contracts and Arbitration*: *The World Bank Convention on the Settlement of Investment Disputes,* (Leyden: A. W. Sijthoff 1975), at 13.
31 F. A. Mann, "State Contract and State Responsibility" 54 AJIL 572-591 (1960).
32 *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR 144.
33 *The Ruler of Qatar v. International Marine Co. Ltd.* (1953) 20 ILR 534.
34 *Saudi Arabia v. Arabian American Oil Co.* (*ARAMCO*) (1963) 27 ILR 117.
35 *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR 144, 149.

that being the law administered at Qatar, as the appropriate law.
On the other hand, there are at least two weighty considerations against that view. One is that in my opinion, after hearing the evidence of the two experts in Islamic law, Mr. Anderson and Professor Milliot, there is no settled body of legal principles in Qatar applicable to the construction of modern commercial instruments.[36]

He later added that,

> I have no reason to suppose that Islamic law is not administered there strictly, but I am satisfied that the law does not contain any principles which would be sufficient to interpret this particular contract.[37]

Consequently, arbitrators applied other laws and principles, such as general principles of law and public international law.[38] This premise, as Sornarajah argues, is based on a false assumption which implies some sort of racial superiority.[39]

If we examine petroleum contracts between European or American states or state entities and petroleum companies, the law of the host state is normally applied. As Sornarajah points out

> This reasoning concedes that in foreign investment disputes which arise in western states, the law of the host state is the only relevant law but that the situation is different in the case of developing countries. The justification for this is said to be found in the policy reason that flow of foreign investment into developing countries will not take place unless such investment is given a better standard of protection than is to be found in uncertain local law.[40]

That simply means "Take it or leave it."[41] Delaume explained "if one of the parties is in a strong bargaining position, the temptation is great to solve the problem

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36 *The Ruler of Qatar v. International Marine Co. Ltd.* (1953) 20 ILR 534, 544.
37 Ibid., at 545.
38 M. Sornarajah, "Power and Justice in Foreign Investment Arbitration", supra note 27, at 107.
39 Ibid., at 108.
40 Ibid., at 110.
41 Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, (Dobbs Ferry/ New York: Oceana Publications 1978), at 78.

in its favour. One judge, one law, preferably my own."[42]

Any validity in this line of reasoning must be based on the asserted inadequacies of local law. However, this law has developed and can offer nowadays an adequate framework to govern the merits of petroleum disputes. It will also be argued in part two of this thesis that Islamic law, even at that time, was not lacking principles which may be sufficiently sophisticated to deal with the complex contracts involving the petroleum industry.

In any event, the conviction of western arbitrators and scholars of the incapacity or incompetence of the host state's law to deal with petroleum contracts, and the 'need' for other norms to deal with this matter, provided the origins of what is today called internationalisation of foreign investment contracts.

Such internationalisation raises many legal issues. The first is the important doctrine in international commercial arbitration of 'party autonomy', i.e. whether the parties to the contract can freely choose the law which they believe is most appropriate to govern their contract and any dispute that may arise in the future. The second is the doctrine of the state sovereign immunity, and whether this is relevant in the context of petroleum contracts. These questions will be analysed fully in part two and part three of this thesis.

1.2. Hypothesis

Although there has been considerable debate relating to state contracts in general and petroleum contracts in particular, especially from an applicable law perspective, since the mid-20th century, it appears that the final word has not yet been said. On one hand, scholars from developing countries argue that the municipal law of the host state should govern these contracts.[43] This is based on the fact that the legal validity of the investment contract made by a foreign entity is assessed by the law of the host state, since the foreign entity, as Sornarajah stated, accepted to come into the host state to engage in the transaction and like any alien, is subject to the host state's law.[44] In other words, municipal law is the law of the place where the

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[42] Georges R. Delaume, *Transnational Contracts Applicable Law and Settlement of Disputes: Law and Practice, A Study in Conflict Avoidance*, (Dobbs Ferry/ New York: Oceana Publications. Booklet 1 1988), at 6.

[43] Virtus C. Igbokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said", supra note 6, at 109.

[44] M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, supra note 8, at 11; concerning a provision in the Mexican Constitution which provides that "foreigners must

contract was made and the law of the place where it is to be performed, and foreign companies do not have any personality in this sense in international law.[45] Consequently, the law applicable to the contract has to be a domestic system, i.e. host state law.[46] On the other hand, some scholars from western countries argue that the host state's law is inadequate to deal with such sophisticated contracts.[47]

The application of host state law to petroleum disputes is widely supported by developing countries because of two fundamental considerations.[48] First, the performance of the contract occurs in the host state and the contract itself physically exists in that state so it is reasonable to apply the municipal law of that state, rather than applying another law.[49] Second, once the foreign investor has entered into an investment contract in another state it is presumed to have consented to the law of that state.[50]

The case law in this regard defends this perspective; for instance, the Permanent Court of International Justice, in the *Serbian loans* case stated that, "any contract which is not a contract between states in their capacity as subjects of international law is based on the municipal law of some country."[51] The International Court of Justice advocated the same perspective in the *Anglo-Iranian Co* case.[52] Moreover, in the case of *Alsing v. Greece*, the law of Greece was applied.[53]

It is well established in many jurisdictions that the law of the country of the

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agree before the Mexican government to consider themselves as Mexicans regarding their property, and to bind themselves not to invoke the protection of their governments with respect to such property", Professor Enriquez argues that "the rationale, in my view of this provision, is that any foreigner wishing to invest in another country must accept the legal standards of such other country", Raymundo E. Enriquez, "Expropriation under Mexican Law and its Insertion into a Global Context under NAFTA", 23 *Hastings International and Comparative Law Review* 385-392, 388 (2000).

45 Ibid., at 11.

46 Ibid., at 11.

47 Lord Asquith of Bishopstone in the *Abu Dhabi* case for instance, stated that "It would be fanciful to suggest that in this very primitive region there are any settled legal principles applicable to the construction of modern commercial instruments." *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR 144, 149.

48 Virtus C. Igbokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said", supra note 6, at 109.

49 Ibid., at 109.

50 Ibid., at 109; see also supra note 76.

51 *Serbian loans Case* [1929] PCIJ series. A. no. 20, at 41.

52 *Anglo-Iranian Co.* case, supra note 61, at 115.

53 The *International Law Reports* states however that, "this case does not raise issues of international law in the accepted sense, and it has been included in this volume because of two reasons. The first was as it is concerned with the interpretation of agreements concluded between governments and foreign nationals and companies, and as a consequence "[T]his applies in particular, to the question of the nature and interpretation of so-called administrative contracts concluded by a government" 23 ILR 623-682,658 (1956).

party with the closest connection to the contract should be applied, since most of the contractual performances would be in this country. For example, in Article 4(1), the Rome (EC) Convention on the Applicable Law to Contractual Obligations, which opened for signature in Rome on 19 June 1980 asserts that the applicable law is the law of the country with which the contract is most closely connected, in case of non-determination of law by choice of the parties. The same rule has been reiterated in the Inter-American Convention on the Law Applicable to International Contracts, in Article 9.

It is therefore surprising to find that investors are advised by their home states to divorce as far as is possible the provisions of the contract from the law of the host state.[54] Therefore it is easy to see the ignorance of the host state's laws. An example of this ignorance in a slighting way was found in Libyan cases.[55] The choice of law clause was the same in different concession agreements.[56] However, if this was the intention, it was not fulfilled, because not one of those arbitrators who dealt with these cases gave sufficient importance to the law of Libya, which, according to the clause, should be the first choice of legal system.[57] On a plain reading of this clause, as Redfern and Hunter argue

> It seems clear that the intention was that the concession agreement should be governed by the principles of the law of Libya, to the extent that these were in accordance with the principles of international law, and that the role of Libyan law should be ignored or overridden, to the extent that it failed to comply with those established principles.[58]

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[54] Paul E. Comeaux/ Thompson & Knight & N. Stephan Kinsella, Duane, Morris & Heckscher, "Treaty Provisions Regarding the Protection of Investment", in: Charles E. Stewart, Rogers & Wells (eds.), *Transnational Contracts,* (New York: Oceana Publications INC. 2001), Binder 1, at p. Com. 1.1-31

[55] Libyan cases: *Texaco Overseas Petroleum Company (U.S.) and California Asiatic Oil Company (U.S.) v. The Government of the Libyan Arab Republic,* (1978) 17 ILM 3-37, reprinted in (1979) 4 YBCA 177-187; *Libyan American Oil Company (LIAMCO) (USA) v. The Government of the Libyan Arab Republic,* (1981) 6 YBCA 89-117; and *The British Petroleum Company (Libya) Ltd. v. The Government of the Libyan Arab Republic,* (1979) 53 ILR 297-388, reprinted in (1980) 5 YBCA 143-167.

[56] This clause, which was a part of clause 28, reads as follow: "This concession shall be governed by and interpreted in accordance with the principles of the law of Libya common to the principles of international law and in the absence of such common 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", ibid., at 181.

[57] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, (3rd ed., London: Sweet & Maxwell 1999), at 106.

[58] Ibid., at 106.

Hence, some scholars consider the Libyan petroleum arbitrations as the most flagrant proof of bias in the arena of international commercial arbitration,[59] and as important landmarks in the theory of internationalisation of foreign investment agreements.[60]

Clearly, there are two conflicting opinions upon the applicability of the municipal law as the proper law in petroleum contracts. Or is it a case of a difference between theory and practice?

It is necessary to ask whether it is the case that developing countries cannot fully perform their rights and duties relating to their mineral resources. There is no doubt that petroleum companies, sustained by their home states, have used developing countries' need for technology and know-how to coerce these countries into accepting_their terms and conditions. The propaganda which prevailed in the 1950s and 1960s provides an insight into how these companies perceive petroleum states, perceptions which still exist today.

> What we did for Saudi Arabia is a story that's never been told. We brought them into the world. We buried them. Oil was almost just a sideline. I've never seen anything so paternal[61]

Hence, should this propaganda prevail nowadays with all change which occurred in Arab petroleum exporting countries? Moreover, should those decisions in the old petroleum arbitrations still be considered as a dogma in the sphere of natural resources arbitration particularly in petroleum arbitration or not? Furthermore, to what extent arbitration is considered as a favourable method in the settlement of petroleum disputes?

It could be argued that it is no more accepted that decisions were rendered during the era of colonialism be considered as a guidance or a dogma to arbitration practice in the 21st century when almost all nations have achieved an advanced legal

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[59] Amr A. Shalakany, "Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism", supra note 28 at 425.

[60] M. Sornarajah, "The Climate of International Commercial Arbitration" 8 (2) J Int'l Arb 47-86, 61 (1991); see also in general M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, supra note 8.

[61] Quoted by Yves Dezalay/ Bryant G. Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order*, supra note 28, at 77 from Robinson Jeffrey, *Yamani: The inside Story*, (London: Fontana 1988), at 86 (when I checked the latter reference I did not find the above quotation).

system, and Arab petroleum exporting countries are among these nations. So, the allegation that these countries lack an advanced legal system appropriate for the settlement of disputes arising out of complicated contracts such as petroleum contracts is no longer tenable. In addition, despite the fact that, arbitration was not welcomed by developing countries during the 20th century, arbitration may be considered an appropriate method to settle disputes which invariably arise out of petroleum transactions if this mechanism (arbitration) remains just and neutral.

It may also be stated that petroleum contracts are *sui generis* investment contracts and that they should not fall directly under the jurisdiction of the ICSID Convention or to other principles of investment arbitration. Therefore, the petroleum industry needs a specialised forum or an arbitration institution to undertake the settlement of disputes which arise out of its transactions.

1.3. "Institutional" approach (reflection)

The United Nations Assembly gave developing countries absolute sovereign rights over their natural resources. Moreover, the early arbitrations in petroleum disputes state that the host state's laws should apply to the petroleum investment contracts if such laws are available. It was stated that the arbitrators themselves, in the *Abu Dhabi, Qatar* and *Aramco* cases, "acknowledged that if there were sufficient laws applicable to the petroleum contracts in the host state, such laws would have to be applied by the arbitrator."[62] So, their resort in practice to laws other than the host

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[62] M. Sornarajah, "Power and Justice in Foreign Investment Arbitration", supra note 27, at 109; in the Aramco case, Sauser-Hall, the Referee for instance stated that "[T]he arbitration tribunal is thus called upon to reconstruct, not the choice of law which the parties might have had in mind or intended, but, in an abstract manner, the choice of law which reasonable persons would have made and intended. In other words, the tribunal must resort to objective criteria in order to connect certain matters regulated by the contract with a specified place and a specified legal system. [T]he Aramco Concession Agreement signed by the Government of Saudi Arabia and an American corporation has, because of its parties and of its ramifications, an international character. The law expressly by chosen by the parties must be taken into consideration, therefore, provided this choice is reasonable, that is to say, provided the parties have selected a legal system connected with their transaction. This is undoubtedly so here, for many reasons. The Contract was signed at Jeddah, Saudi Arabia; the *lex loci contractus*, then is the law of that state [...] lastly, the contract is, for the most part, to be performed in this state. its performance entails the exploitation, in a direct manner, of the hidden wealth of the subsoil of Saudi Arabia and the creation of proprietary rights in immovables [immovable] situated in the territory of that state. [T]he law in force in Saudi Arabia should also be applied to the content of the concession because this state is party to the Agreement, as granter, and because it is generally admitted, in private international law, that a sovereign state is presumed, unless the contrary is proved, to have subjected its undertakings to its own legal system. This principle was mentioned by the Permanent Court of International Justice in its Judgment of July 12th, 1929 concerning the *Serbian* and *Brazilian Loans* (Judgment no. 14, PCIJ,

state's laws should only be because these laws lacked sufficient principles to cope with the problems that arose from large and complex contracts.[63]

After World War II, in the 1960s new countries emerged and started their fight to liberate themselves from the constraints and patrimony of colonialism, by asserting their economic independence and struggling for control over their natural resources. These countries generally sustained that the western countries had exploited their natural resources without any consideration during the colonial period, and it was time to start controlling their resources for the benefit of their own citizens. Moreover, they argued that western countries had, without any participation in or consent of these new countries, developed these unequal principles, especially the principle of state responsibility. Therefore, these principles were considered unjust, inequitable and essentially colonial in character.[64] In addition

> The era of colonialism did not provide any such basis of reciprocity between the colonial power on one hand and their victims on the other. The relationships between them were being [sic] principally those between the exploiter and the exploited.[65]

Therefore, large scale and widespread movements of expropriation/ nationalisation took place after the Second World War in developing countries, concerned with asserting their right to self-determination and their sovereignty over natural resources.[66]

The doctrine of sovereignty over natural resources was one of the principal issues in international relations in the 20th century since developing countries considered themselves to have absolute rights to restructure their political and economic system in order to ensure their economic independence.[67]

The United Nations supported these attempts of developing countries to protect and control their natural resources. The United Nations, in an attempt to reach an agreement which could satisfy all nations, adopted several resolutions. The most

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Series A, no. 20, at 41 and Judgment no. 15, PCIJ, Series A. no. 21, at 121)." *Saudi Arabia v. Arabian American Oil Company* (*ARAMCO*), (1963) 27 ILR 117, 166-167.

63 Ibid., at 108.

64 Samuel K. B. Asante, "International Law and Foreign Investment: A Reappraisal" 37 ICLQ 593 (1988).

65 Ibid, at 594.

66 Ibid, at 594.

67 Ibid., at 594.

relevant resolutions were:

- **General Assembly Resolution 523 (VI) 1952 "Integrated Economic Development and Commercial Agreements"**

This resolution was the first instrument to consider the rights of developing countries to control their natural resources. Poland, on 26 November 1951, introduced a draft resolution on integrated economic development and long-term trade agreements. This draft was under the auspices of "Economic Development of Under-Developed Countries."[68] Poland pointed out that such agreements 'must not contain any economic or political conditions violating the sovereign rights of the economically under-developed countries or conditions which are contrary to the aims of the plans for economic development of these countries.[69]

This draft asserted that these countries have the right to control freely their natural resources in accordance with the right to development.[70] The relevance of this resolution, as Schrijver stated, lies in the fact that,

1. For the first time the (sovereign) *right*, of 'under-developed countries' to determine freely the use of their natural resources;
2. for the first time the *obligation* to utilise such resources in order to be in a better position to further the realisation of their plans of economic development in accordance with their own national interests; and
3. for the first (and last!) time the obligation to utilise such resources not only in their own national interests, but also in order to further the expansion of the world economy.[71]

- **General Assembly Resolution 626 (VII), 1952**

This resolution was adopted after a draft proposed by Uruguay on 5 November 1952 under the heading 'Economic Development of Under-Developed

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[68] Nico Schrijver, *Sovereignty over Natural Resources*: *Balancing Rights and Duties,* (Cambridge: Cambridge University Press 1997), at 39.
[69] Ibid., at 39; see also UN. Doc. A/C. 2/L.81, 21 November 1951; and A/C.2/L.81/Corr.1.
[70] Nico Schrijver, *Sovereignty over Natural Resources*: *Balancing Rights and Duties*, supra note 68, at 40.
[71] Ibid., at 41.

Countries'.[72] Uruguay's argument in this draft was logical and legitimate, that,

> Foreign financing in the form of aid, loans or private investments was certainly a valuable and indeed an essential factor in the development of under-developed countries but it was not the ideal situation. The ideal for an under-developed country was to attain economic independence, to dispose freely of its own resources, and to obtain foreign exchange by selling its products to buyers of its own choice.[73]

This proposal expressed the desire of developing countries to protect their weak economies, and utilise and exploit their own natural resources. This was the first time developing countries had expressed such views in the United Nations; this was after the first decisive step taken by the Iranian Government on 1 May 1951. On this day, Dr. Mossadegh, the Prime Minister of Iran, announced the official decision to nationalise the Anglo-Iranian Oil Company.[74] This step has been called the first major economic "North-South clash" in the post-war period.[75]

With this announcement, Iran annulled the 1933 petroleum concession agreement which granted the Anglo-Iranian Oil Company the exclusive rights to extract and process petroleum in a specified area in Iran up to 1993.[76] A very important issue has been raised from this case relating to the competence of the International Court of Justice over petroleum contracts. On 22 July 1952 the ICJ concluded that it had no jurisdiction over this case,[77] since concession contracts did not fall within the meaning of the term 'international conventions' of Article 38(1) of the ICJ Statute.[78]

The said proposal, which was suggested by Uruguay, was adopted after a

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[72] Ibid., at 42; see also UN Doc. A/C.2/L.165, 5 November 1962.

[73] Nico Schrijver, *Sovereignty over Natural Resources*: *Balancing Rights and Duties*, supra note 68, at 43; see also UN Doc. A/C.2/SR.231, 6 December 1952, at 253.

[74] Nico Schrijver, *Sovereignty over Natural Resources*: *Balancing Rights and Duties*, supra note 68, at 41.

[75] Ibid., at 41.

[76] Ibid., at 41; see also the *Anglo-Iranian Oil Co.* case (*UK v. Iran*) (1952) (jurisdiction) Judgment of 22 July 1952 ICJ Rep at 93.

[77] Ibid., at 42, and the Anglo-Iranian Judgment, ibid., at 115, the court's decision was by nine votes to five.

[78] Alan W. Ford, *The Anglo-Iranian Oil Dispute of 1951-1952*: *A Study of the Role of Law in the Relations of States*, (Berkeley/ Los Angeles: University of California Press 1954), at 179.

major debate between United Nations members,[79] in which many members supported the right of developing countries to freely manage their wealth and natural resources.

- **General Assembly Resolution 1314 (XIII), 1958**

This resolution established the Commission on Permanent Sovereignty over Natural Resources and instructed it to conduct a full survey of the status of permanent sovereignty over natural resources as a basic constituent of the right to self-determination.[80] The main outcome of this Commission was General Assembly Resolution 1803 (XVII).[81]

- **General Assembly Resolution 1803 (XVII), 1962**

In this resolution two important facts were restated. First, people and nations have the full right of permanent sovereignty over their wealth and resources. Article 1 asserts that these rights must be exercised in the interest of national development and the well-being of the people of the state concerned. Second, the resolution provides the grounds or reasons for nationalisation or expropriation of domestic or foreign investments: public utility and national interest. Article 4 stipulates that appropriate compensation shall be paid to the owner.[82] Article 7 of the resolution asserts that

> Violation of the rights of peoples and nations to sovereignty over their natural wealth and resources is contrary to the spirit and principles of the Charter of the United Nation and hinders the development of international co-operation and the maintenance of peace.[83]

Moreover, this resolution obliged foreign investment agreements to respect the sovereignty of people and nations over their natural resources (Art. 8).[84]

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[79] For more details see Nico Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties*, supra note 68; and the UN Docs.

[80] See Ian Brownlie (ed.), *Basic Documents in International Law*, (4th ed., Oxford: Oxford University Press 1995), at 236.

[81] Nico Schrijver, *Sovereignty over Natural Resources: Balancing Rights and Duties*, supra note 68, at 59.

[82] Ian Brownlie (ed.), *Basic Documents in International Law*, supra note 80, at 238.

[83] UN Doc. A/5217 (1963), reprinted in 2 ILM 223-226 (1963).

[84] Ibid.

- **Charter of Economic Rights and Duties of States, 1974**

On 12 December 1974 by a vote of 120 in favour, 6 against (Belgium, Denmark, German Federal Republic, Luxembourg, United Kingdom, United States), and 10 abstentions, the General Assembly of the United Nations adopted a new resolution on the rights of states to manage and freely control their economic resources.[85]

The initiative for this resolution occurred during the United Nations Conference on Trade and Development III (UNCTAD), when President Echeverra of Mexico proposed the drafting of this Charter.[86] Chapter One of this Charter concerns the fundamentals of international economic relations, and focuses on sovereignty.[87] However, the most relevant issues were raised in Articles 1 and 2 in Chapter Two. These Articles assert each country's permanent sovereignty over their natural resources. They confirm that every state has the sovereign right to choose its economic, social and political system in accordance with the will of its people, without any outside intervention (Art.1).[88] Article 2 asserts every state's right to exercise full permanent sovereignty over all its wealth, natural resources and economic activities, including possession, use and disposal.[89] It also asserts that the state has the following rights:

> - 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;
> - 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...
> - To nationalise, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid

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85 Ian Brownlie (ed.), *Basic Documents in International Law*, supra note 80, at 244.
86 Nico Schrijver, *Sovereignty over Natural Resources*: *Balancing Rights and Duties*, supra note 68, at 100.
87 Ian Brownlie (ed.), *Basic Documents in International Law*, supra note 80, at 244.
88 Ibid., at 244.
89 Ibid., at 244.

by the state adopting such measures...[90]

Prior to this Charter, the Organisation of the Petroleum Exporting Countries (OPEC), at its Sixteenth Conference which was held in Vienna on 24-25 June 1968 endorsed a resolution entitled "Declaratory Statement of Petroleum Policy in Member Countries."[91] These countries stipulated in the preamble of that declaration that hydrocarbon resources constitute the main basis for their economic development and they have full rights to exercise permanent sovereignty over their natural resources in the interest of their national development.[92] The declaration also determines the method of settling petroleum disputes. It provides that

> Except as otherwise provided for in the legal system of a Member Country, all disputes arising between the Government and operators shall fall exclusively within the jurisdiction of the competent national courts or the specialised regional courts, as and when established.[93]

It follows that the integration of natural resources, especially the petroleum sector, into the national economy has become accepted as an important principle[94], and is a key demand of developing countries.

1.4. Methodology

The claim which was dominant in the 20th century that developing countries lack a well developed legal system to deal with petroleum contracts needs to be reviewed. While western countries view the political and legal systems in developing countries with suspicion, at the same time developing countries are wary of international arbitration, since these countries perceive international arbitration, especially in petroleum investments, to be a legal method of protecting a foreign (western) investor. As a consequence, some scholars from these countries argue that the success which has been recorded in the context of commercial arbitration cannot

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90 Ibid., at 245.

91 "Resolution of the Sixteenth OPEC Conference 'XVI.90': Vienna, 24-25 June 1968", *OPEC Official Resolutions and Press Releases 1960-1983*, (Oxford: Pergamon Press 1984), at 61.

92 Ibid., at 61.

93 Ibid., at 63; for more details see part three, chapter three of this thesis.

94 Ahmed S. El-Kosheri/ Tarek F. Riad, "The Law Governing a New Generation of Petroleum Agreement: Changing in the Arbitration Process", supra note 19, at 258.

and should not be applied to petroleum disputes.[95]

However, the most controversial issue in petroleum contracts and disputes is the determination of applicable law.

Hence, the overriding goal of this thesis is to examine the determination of applicable law in petroleum arbitration. This will be explored not only from the perspective of developing countries - most of them insist upon applying their domestic laws and argue that the allegation of insufficiency of the host state's law no longer exists today, since these countries have in place appropriate legal systems which can govern all contracts and disputes - but also from as neutral a viewpoint as possible. This thesis aims to provide a comprehensive discussion based on analytical and critical research, and to explore the hypothesis of the competency of domestic or host law as an applicable law in petroleum arbitration. This will be examined alongside other theories which have been applied in previous petroleum arbitrations, such as *lex mercatoria*, or public international law.

To achieve this, we must examine arbitral practice, i.e. awards from institutional bodies and *ad hoc* arbitration, especially all relevant major cases of the 20th century, such as the *Abu Dhabi* case, the *Qatar* case, the *Aramco* case, the *Libyan* cases and the *Aminoil* case, which constitute the main case studies of this thesis, along with a comparative study of the legal systems in some Arab countries.

This should help us answer the controversial question of the most appropriate applicable law in petroleum arbitration. This should also shed light on applicable law in other state contract disputes.

However, first we must turn to the history of petroleum in order to provide the context for our study.

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[95] M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, supra note 8, at 5.

Chapter Two: The Development of Petroleum Arbitration

This chapter aims at providing a factual basis for the assessment of the impact of the petroleum exploration companies upon the Arab petroleum countries, and the influence of these companies upon petroleum arbitration. This brief historical survey is divided into two periods: 1859-1950, 1950-to the present.

1. 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 one of the most controversial issues in this recent history. The conflict in some instances and the co-operation 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."[1]

Indeed, petroleum is not purely an economic matter, it is undoubtedly also a political matter.[2] 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 to it by the various governments concerned.[3]

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

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1 F. William Engdahl, *A Century of War*: *Anglo-American Oil Politics and the New World Order*, (Germany: Dinges & Frick 1992), at 8.

2 Anton Mohr, *The Oil War*, (London: Martin Hopkinson & Co. Ltd. 1926), at 29.

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.[4]

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]

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

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3 Ibid., at 29.
4 Quoted in ibid., at 30.
5 Ibid., at 31.
6 E. B. Brossard, *Petroleum Politics and Power*, (Tulsa/ Oklahoma: Penn Well Books Publishing Company 1983), at 1.
7 Ibid., at 1.
8 <www.encyclopedia.com/html/R/Rockefj.asp> last visited 20 March 2002.

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 sources of petroleum were detected in Mexico, Peru, Egypt, Galicia (now part of Poland and Ukraine) and Persia (modern Iran).[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 19th 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.[13]

1.2. Early 20th 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 20th 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.[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

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9 E. B. Brossard, *Petroleum Politics and Power*, supra note 6, at 2.

10 <www.encyclopedia.com/html/R/Rockefj.asp> last visited 20 March 2002.

11 Derek Fee, *Petroleum Exploitation Strategy*, (London / New York: Belhaven Press 1988), at 7.

12 Ibid., at 7.

13 For more details see for instance: Anton Mohr, *The Oil War*, supra note 2; H. E. Davenport/ Russell Sidney Cooke, *The Oil Trust & Anglo-American Relations*, (London: Macmillan and Co. Limited 1923); F. William Engdahl, *A Century of War: Anglo-American Oil Politics and the New World Order*, supra note 1; E. D. Shaffer, *The United States and the Control of World Oil*, (London/ Canberra: Croom Helm 1983); and Ted Wheelwright, *Oil & World Politics: from Rockefeller to the Gulf War*, (Sydney: LEFT Book Club Co-operative Ltd. 1991).

14 See in general F. William Engdahl, *A Century of War: Anglo-American Oil Politics and the New World Order*, supra note 1.

desert of southern Persia.[15] D'Arcy was granted a concession agreement by the Shah of Persia, which "still reads like musical comedy".[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.[17]

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.[18] 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.[19]

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.[20]

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.

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15 H. E. Davenport/ Russell Sidney Cooke, *The Oil Trust & Anglo-American Relations*, supra note 13, at 11.
16 Ibid., at 11.
17 Ibid., at 11.
18 Ibid., at 16.
19 Quoted in ibid., at 18-20.

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.[21]

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].[22]

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.[23]

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'.[24] Five of these companies were American, i.e. Standard Oil of New Jersey (Exxon), Gulf Oil Corporation (Gulf), Texas Oil Company (Texaco), Standard Oil

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[20] Abdulaziz Al-Sowayegh, *Arab Petro-Politics*, (London/ Canberra: Croom Helm 1984), at 16.
[21] E. D. Shaffer, *The United States and the Control of World Oil*, supra note 13, at 37.
[22] Jack Anderson, "Washington Exposed", *Public Affairs Press*, Washington, [1967] at 202 quoted by Ted Wheelwright, *Oil & World Politics: from Rockefeller to the Gulf War*, supra note 13, at 6.
[23] John Loftus, "US Department, in 'Petroleum in International Relations", XIII *US Department of State Bulletin* 173-175 [5 August 1945], cited in Engler, quoted by, Ted Wheelwright, ibid., at 7.
[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

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 Française 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 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.[25] 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."[26] 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:[28] "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

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cartel in modern history. The Seven Sisters were effectively one institution." F. William Engdahl, *A Century of War*, supra note 1, at 87.

25 Ibid., at 87.

26 Ibid., at 87.

27 Ibid., at 87.

28 Abdulaziz Al-Sowayegh, *Arab Petro-Politics*, supra note 20, at 17.

29 Ibid., at 16.

30 United States Foreign Policy, State Department Paper, [10 February 1944] quoted in ibid., at 17.

agreement, this region became oligopolised by these three countries.[31] 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 Française des Petroles, along with the Rockefeller group. Control of Kuwait's resources was given to British Petroleum and the American Gulf Oil Company.[32] American companies monopolised control over both Saudi Arabia and Bahrain petroleum resources.[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.[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 [35]

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

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[31] "A red line from the Dardenelles down through Palestine, to Yemen, up through the Persian [Arabian] 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

[32] Ibid., at 88.

[33] Burton I. Kaufman, *The Oil Cartel Case: A Documentary Study of Antitrust Activity in the Cold War Era*, (London: Greenwood Press 1978), at 20.

[34] Ibid., at 88.

[35] E. D. Shaffer, *The United States and the Control of World Oil*, supra note 13, at 55.

attempted to cut off the petroleum supply from Iran to the Allies.[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.[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 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.[38]

In fact, Arab petroleum countries during this period played a very small role, limited only to competing with each other to sell concession agreements to petroleum companies which controlled all aspects of petroleum in the Arab region.[39] However, in the following decades the situation was to change at least to an extent as is detailed below.

2. 1951 – to present

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

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[36] Ted Wheelwright, *Oil & World Politics: from Rockefeller to the Gulf War,* supra note 13, at 8.
[37] E. D. Shaffer, *The United States and the Control of World Oil*, supra note 13, at 75.
[38] F. William Engdahl, *A Century of War*, supra note 1, at 108.

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.[40] 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%.[41]

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 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."[42]

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.[43] Consequently, five of the 'Major' American petroleum companies were exploiting the Saudi petroleum sector after World War II.

2.2. The Early Nationalisation

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 nationalise the Anglo-Iranian Petroleum Company (British Petroleum Company). The Iranian

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39 See in general: Jacques Cremer/ Saleh Djavad-Isfahani, *Model of the Oil Market*, (London: Harwood Academic Publishers 1991); see also Morris A. Adelman, *The World Petroleum Market*, (Baltimore/ London: The Johns Hopkins University Press 1972).

40 Ted Wheelwright, *Oil & World Politics: from Rockefeller to the Gulf War*, supra note 13, at 10.

41 Ibid., at 10.

42 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.

Parliament voted to accept Mossadegh's recommendation, with fair compensation to the company.[44]

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.[45]

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.[46] 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.[47] Furthermore, in 1951 Britain declared full economic sanctions against Iran.[48]

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

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[43] F. William Engdahl, *A Century of War*, supra note 1, at 102.
[44] Ibid., at 109.
[45] Ibid., at 109.
[46] Ibid., at 109-110.
[47] Ibid., at 109.
[48] "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.

Mohammed Mossadegh fell in August 1953.[49] This was the first example of the harmful consequences developing countries faced when attempting to regain control of their natural resources.

2.3. The establishment of OPEC

The formation of the Organisation 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 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 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.[50]

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.[51]

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

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[49] Ibid., at 110.

[50] Rilwanu Lukman, Secretary General of OPEC, "OPEC: Past, Present and Future Perspectives", the Seminar for the Media on the II Summit of OPEC Heads of State, Caracas, Venezuela: 20 July 2000 <www.opec.org/NewsInfo/Speech/sp2000/spluCaracasJuly00.htm> last visited 16 November 2001.

after the Second World War (in the period of decolonisation) in order to ensure protection for their investment in developing countries.[52] 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.[53]

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.[54]

However, although the number of these treaties increased dramatically during the twentieth century,[55] the involvement of Arab petroleum exporting countries in these treaties particularly between these countries and the home states of major petroleum companies, United States for example, is relatively limited.[56] The following chart proves this fact.

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[51] Art. 2 (A) of OPEC Statute, (Vienna, Austria: published by the secretary of OPEC; for more details about OPEC and its aims see part three, chapter three of this thesis.

[52] See *Bilateral Investment Treaties in the Mid-1990s*, United Nations Publication 1998, at 1-8.

[53] Ibid., at 8; Rudolf Dolzer/ Margrete Stevens, *Bilateral Investment Treaties*, (The Hague: Martinus Nijhoff Publishers 1995), at 1; see also <www.worldbank.org/icsid/treaties/intro.htm> last visited 9 December 2003.

[54] Luke Peterson, "Changing investment Litigation, Bit by BIT", <www.iisd.org/pdf/2001/trade_inv_litigation.pdf> last visited 12 December 2003; 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] It was stated that "in the last ten years alone, the number of BITs quintupled – going from 385 to 1857", Luke Peterson, "Changing investment Litigation, Bit by BIT", ibid.

[56] See for example U. S. Bilateral Investment Treaty Programme <www.ustr.gov/pdf/bit.pdf> last visited 12 December 2003.

	USA	UK	France	Germany	Italy	Japan	China
Algeria	X	X	X	Signature	Into force	X	X
Libya	X	X	X	X	X	X	X
Iraq	X	X	X	X	X	X	X
Kuwait	X	X	Into force	Signature	Into force	X	Into force
Oman	X	Signature	Signature	Into force	Signature	X	Signature
Qatar	X	X	X	Signature	X	X	X
Saudi Arabia	X	X	X	Signature	X	X	X
United Arab Emirates	X	Into force	Signature	X	Signature	X	Into force

- Source: ICSID[57]
- X: no agreement.

The very fact that no such agreement exists has the consequence that there is hardly any arbitration practice based on BITs. As it will be shown later in the thesis most arbitrations relating to petroleum disputes were ad hoc and were based on contract rather than treaty.

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.[58] 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.[59] The Treaty was born as a

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[57] For more details see <www.worldbank.org/icsid/treaties> last visited 9 December 2003.

[58] Craig S. Bamberger, "An Overview of the Energy Charter Treaty", in: Thomas W. Wälde (ed.), *The Energy Charter Treaty: An East-West Gateway for Investment & Trade*, (1996 London: Kluwer Law International), 1-33, 1.

[59] Thomas W. Wälde, "Editor's Preface", in: Thomas W. Wälde (ed.), *The Energy Charter Treaty: An East West Gateway for Investment & Trade*, ibid, at xix; Mirian Kene Omala, *NAFTA and the Energy*

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.[60]

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.[61] Wälde has stated that the ECT connects two significant strands of international economic policy and law: First it is an attempt to commit the 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."[62]

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."[63]

The ECT consists of two principal bodies: First, the Conference, -an inter-governmental 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

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Charter Treaty: *Compliance with, Implementation and Effectiveness of International Investment Agreements*, (The Hague: Kluwer Law International 1999), at 51-55; see also <www.encharter.org> last visited 8 December 2003.

[60] See <www.encharter.org> last visited 8 December 2003.

[61] Thomas W. Wälde, "European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects: Introductory Notes", 33 ILM 360 (1995); it was reported that "[T]he fundamental aim of the Energy Charter Treaty is to strengthen the Rule of Law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thus minimising the risks associated with energy-related investments and trade", Energy Charter Secretariat, "Introduction to the Energy Charter" <www.encharter.org> last visited 8 December 2003.

[62] Thomas W. Wälde, "Editor's Preface", in: Thomas W. Wälde (ed.), *The Energy Charter Treaty*: *An East-West Gateway for Investment & Trade*, supra note 59, at xix.

the Conference.[64] 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.[65]

It is worth mentioning that the participation of Arab petroleum countries to the ECT is considerably limited, since these countries are just observers at the ECT's Conference.

Petroleum arbitration cannot be discussed separated from petroleum history in the Arab region, and both must be considered together. Therefore, the next part of this chapter will be devoted to examining the development of petroleum arbitration. Which normally consists of two different parties petroleum country or countries as an international law body and foreign petroleum company or companies as a private body.

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 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 (non) consensual character of these past agreements.

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[63] Energy Charter Secretariat, "Introduction to the Energy Charter", <www.encharter.org> last visited 8 December 2003.

[64] 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 <www.encharter.org> last visited 8 December 2003.

[65] For the Secretariat functions, see Art. 35 of the Treaty, <www.encharter.org> last visited 8 December 2003.

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.[66]

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.[67] As Cahier states

> 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.[68]

Or as Böckstiegel notes

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[66] 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*, (Tulsa/ Oklahoma: Penn Well Books 1983), at 1, 4.

[67] 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*, (1987 Netherlands: Martinus Nijhoff Publishers), 241-249, 241; 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, *Trasnational Contracts Applicable Law and Settlement of Disputes: Law and Practice, A Study in Conflict Avoidance*, (Dobbs Ferry / New York: Oceana Publications. INC. booklet 1 1988), at 15.

[68] Philippe Cahier, ibid., at 241.

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.[69]

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.[70]

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.[71]

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 Chiatura. This concession agreement contained an arbitration clause in Russian and English.

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.[72]

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

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[69] Karl-Heinz Böckstiegel, "The Legal Rules Applicable in International Commercial Arbitration Involving States or State-Controlled Enterprises" in: *60 Years of ICC Arbitration A Look at the Future*, (1984) at 124.

[70] 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.

[71] "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, "LIoyd George, Lenin and Cannibals: The Harriman Arbitration", 16 *Arbitration International* 115-139, 117 (2000).

[72] Ibid., at 130-138, "the Harriman arbitration clause was considered as a long clause providing detailed rules on the composition of the arbitration tribunal."

concession agreement which was signed at the beginning of the 20th century was annulled.[73]

Then there are the famous petroleum arbitrations, such as the arbitration between the Sheikh of Abu Dhabi and Petroleum Development Ltd.[74], the arbitration between the Ruler of Qatar and International Marine Oil Company[75], and the arbitration between Saudi Arabia and the Arabian American Oil Company (Aramco).[76] All these arbitrations, and other arbitrations such as the Libyan arbitrations,[77] and the Aminoil- Kuwait arbitration,[78] were *ad hoc* arbitrations. These cases are discussed in part two, chapter two of this thesis.

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 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.[79] A detailed analysis of the

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[73] Alan W. Ford, *The Anglo-Iranian Oil Dispute of 1951-1952: A Study of the Role of Law in the Relations of States*, (Berkeley / Los Angeles: University of California Press 1954), at 17.

[74] See *Petroleum Development Ltd. v. The Sheikh of Abu Dhabi* (1951) 18 ILR1 44.

[75] See *The Ruler of Qatar v. International Marine Oil Co. Ltd.* (1953) 20 ILR 534.

[76] See *Saudi Arabia v. Arabian American Oil Co* (*ARAMCO*) (1963) 27 ILR 117.

[77] Libyan cases: *Texaco Overseas Petroleum Company (U.S.) and California Asiatic Oil Company (U.S.) v. The Government of the Libyan Arab Republic,* (1978) 17 ILM 3-37, reprinted in (1979) 4 YBCA 177-187; *Libyan American Oil Company (LIAMCO) (USA) v. The Government of the Libyan Arab Republic,* (1981) 6 YBCA 89-117; *The British Petroleum Company (Libya) Ltd. v. The Government of the Libyan Arab Republic,* (1979) 53 ILR 297-388, reprinted in (1980) 5 YBCA 143-167.

[78] *Government of the State of Kuwait v. American Independent Oil Co.* (*AMINOIL*) (1984) 9 YBCA 71, (1982) 21 ILM 976-1053.

[79] From the establishment of ICSID to the present, only ten petroleum disputes have been registered at ICSID. Six cases were concluded i.e. *AGIP S. P. A. v. People's Republic of the Congo*, registered on 4 November 1977, *Scimitar Exploration Limited v. Republic of Bangladesh and Bangladesh Oil, Gas and Mineral Corporation*, registered on 3 November 1992, *Tesoro Petroleum Corporation v. Trinidad and Tobago* (conciliation), registered on 26 August 1983, *Occidental of Pakistan, Inc. v. Islamic Republic of Pakistan*, registered on 7 October 1987, *Societe Kufpec* (*Congo*) *Limited v. Republic of Congo*, registered on 27 January 1997 and *Mobile Argentina S. A. v. Argentine Republic*, registered on 9 April 1999, see <www.worldbank.org/icsid/cases/cases.htm> last visited 13 January 2004. The other four pending cases are: *Repsol YPF Ecuador S. A. v. Empresa Estatal Petroleos del Ecuador* (*Petroecuador*), registered on 5 October 2001, *F-W Oil, Inc. v. Republic of Trinidad and Tobago*, registered on 29 November 2001, *Plama Consortium Limited v. Republic of Bulgaria*, registered on 19 August 2003 and *TG World Petroleum Limited v. Republic of Niger* (conciliation), registered on 9 December 2003, see <www.worldbank.org/icsid/cases/pending.htm> last visited 13 January 2004.

ICSID arbitration is given in part three of this thesis.

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.[80]

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.[81]

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 would seen that the tribunal was only concerning about the second point irrespective of the intention of the contracting parties.

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[80] See in general R. Doak Bishop, "International Arbitration of Petroleum Disputes: The Development of a *Lex Petrolia*" 23 YBCA1131-1210 (1998); about the autonomy of the arbitration agreement in general see for instance, Emmanuel Gaillard/ John Savage (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, (London: Kluwer Law International 1999), at 198-240.

[81] *LIAMCO v. Libya*, (1981) 6 YBCA 89-118, 96.

The same approach was articulated in the arbitration between *Elf Aquitaine Iran (France) and National Iranian Oil Company (Iran) (NIOC).*[82] The Iranian claim was that the agreement between the parties was null and void *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 [...].[83]

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.[84]

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."[85]

The stabilisation clause was found in the first generation of the concession agreements of exploitation of natural resources, especially those of petroleum contracts.[86] 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

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82 *Elf Aquitaine Iran (France) v. National Iranian Oil Company (Iran) (NIOC)* (1986) 11 YBCA97.
83 Ibid., at 102.
84 *Amoco International Finance v. Iran*, Iran- US CTR 189 at 239.
85 R. Doak Bishop, "International Arbitration of Petroleum Disputes: The Development of a *Lex Petrolia*" 23 YBCA1131-1210 (1998).
86 For more details see ibid., at 1158.

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.

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.[87] Indeed, the peculiarities or the differences of petroleum arbitration are derived from the nature of the petroleum industry itself, which can pose special problems, and the nature of petroleum agreements, rather than from the arbitral process.[88]

Undoubtedly the petroleum industry is an international, global industry by nature, and political issues have more influence on this industry than any other.[89] 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

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[87] 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 66, at 2-3.

[88] Ibid.

[89] Ibid.

of the receiver country.[90] 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 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.[91]

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

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[90] Most Arab countries enacted codes in order to regulate foreign investments, see for instance Oman Foreign Capital Investment law, issued on 16 October 1994.
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:
a) The business shall be conducted by an Omani company with capital of not less than R O 150,000 [$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.
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 R O 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:
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).

[91] 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), (unpublished).

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.[92]

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."[93] In addition, the current Omani Exploration and Production Sharing Agreement is for a period of over thirty years.[94]

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,[95] 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;

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92 *MIDDLE EAST: Basic Oil Laws and Concession Contracts*, (New York: Barrows) Supplement no. XCVII (97).

93 Ibid., Supplement no. XCII (92).

94 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).

95 See supra note 91.

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.[96]

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.[97]

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.

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.[98]

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,

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[96] 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" , ibid.

[97] 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", see supra note 93.

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.[99]

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.[100]

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 members of a convention or part of a club and the global economy.[101] Or as Wälde 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.[102]

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[98] See for example M. Sornarajah, "Power and Justice in Foreign Investment Arbitration", 14 (3) J Int'l Arb 103-140,103 (1997).

[99] Ibid., at 106.

[100] Ibid., at 140 "such a change can only take place if arbitration moves away from the view that it exists to create principles which protect foreign investment and into a position in which it evolves as a system that evinces neutrality, which indicates that principles favourable to the interests of the host states also receive a balanced acceptance", ibid., at 105.

[101] 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.

[102] Ibid.

PART TWO

THE APPLICABLE LAW TO THE MERITS OF PETROLEUM DISPUTES

Part Two: The Applicable Law to the Merits of Petroleum Disputes

Introductory remarks

It is undisputed that the determination of the precise applicable law to the merits of a dispute is one of the most complicated tasks facing an arbitrator and a national judge. However, the dilemma of the national judge is less complex compared to that of an arbitrator at an international tribunal. In the former situation, the judge at the national court has no choice other than applying the forum's conflict of laws rules. The complexity occurs in the case of the international arbitrator, who does not have any *lex fori*[1], since the arbitrator does not derive his authority from a nation but from the agreement between the parties[2]. This principle has been firmly accepted even in countries that are considered to be relatively unfamiliar with arbitration. The Cassation Court in Kuwait for instance, asserted this principle, in its judgement on 30 November 1993, "the arbitrator derives its power from the contract".[3] Consequently, in this case the arbitrator examined several methods related to the issue to reach a decision.[4] However, numerous questions arise in this regard, such as what are these methods? Which conflict of rules should the arbitrator apply? Which conflict of laws system should an arbitrator choose and why? Is it necessary to choose a specific law or conflict of laws system? And if he does not choose any specific conflict of laws or rules could he apply a non- national system?

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[1] See for example Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, (Dobbs Ferry, New York: Oceana Publications 1978), at 67.

[2] Carlo Croff, "The Applicable Law in an International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" 16 *International Lawyer* 613-645 (1982).

[3] See an extract of this case in the Directory of Lawyers & Jurists in the GCC States, first version (2000-2001), at 158 (the Arabic Section).

[4] A. F. M. Maniruzzaman, "State Contracts and Arbitral Choice-of-Law Process and Techniques: A Critical Appraisal", 15 (3) J Int'l Arb 65-92, 65 (1998); Mistelis for instance, argues that "there are two sources of determination and two main systems. The law may be determined as a matter of party autonomy or as a default or express power by the tribunal", Loukas A Mistelis, "Arbitration Involving States Applicable Law: Can the Arbitral Tribunal Apply the Law of another Country to a State? A paper was submitted to the School of International Arbitration/ ICC Institute of World Business Law 17th Annual Symposium of Arbitrators on 17 March 2003.

Where state contracts in general, and petroleum contracts in particular, are concerned the matter may be more controversial, because petroleum contracts often involve fundamental public interests for the contracting state. The most disputed issue in state contracts is the doctrine of state sovereign immunity. Does the involvement of a state in a contractual relationship result in a waiver of its immunity or not? Another important question is raised here, does state immunity from jurisdiction should be treated the same as immunity from execution? In a dispute between *Creighton Limited v. Government of the State of Qatar*, brought before the United States Court of Appeals for the District of Columbia Circuit[5], the claimant insisted that "Qatar, by agreeing to arbitrate in France, implicitly waived its sovereign immunity." A full analysis of sovereign immunity will be given in part three of this thesis.

The classical approach in state contracts is to give priority to national law, i.e. "substantive law determined through national conflict of laws rules."[6] This perspective has already been upheld by case law. The highly distinguished judgment of the Permanent Court of International Justice in the *Serbian* loans case in 1929 is a significant example. This court decided that "all contracts not concluded between states as subjects of public international law are governed by a national law." [7]

However, this approach has been questioned. First, it has been argued that some national law is incapable of governing disputes such as those arising out of state contracts, especially petroleum disputes or other disputes involving natural resources. In other words, these national laws lack the quality and sophistication required to deal with international petroleum contracts.[8] An alternative argument is that it is unacceptable to rely only upon municipal law in a state contract, because the rights of the private party would be at the mercy of the contracting state, since the state can amend its law unilaterally. Therefore, according to the perspective of most western jurists and practitioners, state contracts must be extracted from the jurisdiction of the contracting

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[5] *Creighton Limited v. Government of the State of Qatar*, 337 U. S. App. D. C. 7; 181 F. 3d 118 1999 U. S. App. LEXIS 14856, reprinted in (2000) 39 ILM151.

[6] Horacio A. Grigera Naón, *Choice–of–Law Problems in International Commercial Arbitration*, (Tubingen: J. C. B. Mohr (Paul Siebeck) 1992), at 114.

[7] *Serbian Loans Case*, [1929] PCIJ Series A, no. 20, at 41.

[8] See for example: *Petroleum Development Ltd v. Sheikh of Abu Dhabi*, (1951) 18 ILR 144; *Saudi Arabia v. Arabian American Oil Company* (*ARAMCO*), (1963) 27 ILR 177.

state, and be governed by other laws or rules. In this situation, is party autonomy, which is considered as a cornerstone in international arbitration, affected? Many other questions arise here, such as why a state which is considered as an international legal subject cannot exercise its rights and apply its rules in its contractual relationships with private parties? Are the powers and privileges of a private party greater than that of a contracting state? In order to answer these questions concerning applicable law, this part will be divided into two chapters. The first chapter examines a practical approach, whereas the second chapter provides a theoretical discussion.

Chapter One: The Practice Examined-The Case Law

Introductory remarks

This chapter examines some famous arbitral decisions in the sphere of petroleum disputes in Arab Countries, in order to determine whether these decisions can be considered as a dogma in petroleum arbitration, especially in the method of determining the applicable law to the substance of a dispute because of the following reasons. First, most of these decisions were rendered during the era of colonialism. Second, most of the arbitrators who determined these disputes were appointed by petroleum companies or by virtue of their requests.

Thus, it may be argued that the petroleum companies' interests, were well protected, since it is believed by some that the arbitrator should first consider his appointee's interests while he is performing his task.[9] However, it is worth mentioning that the reason which stands behind the choice of these specific cases, was the impact and the influence of arbitrators' decisions which were rendered in these disputes especially which concerns the method of determining the applicable law to the substance of a dispute in state contracts in general and in petroleum contracts in particular, although it may be argued that there were other petroleum cases in Arab Countries. Delocalisation theory of a contract between a state and a foreign company may be one of outputs of these decisions.[10]

Hence, this chapter will summarise the facts and the nature of the dispute of these significant cases, then analyse the issue of the applicable law.

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[9] See for instance, Alan Redfern, "Dissenting Opinions in International Commercial Arbitration: The Good, the Bad and the Ugly", the Freshfields Bruckhaus Deringer Arbitration Lecture, which was given on 4 November 2003. On the duties of arbitrators see for instance Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, (3rd ed., London: Sweet & Maxwell 1999), at 251-260; see also Michael J. Mustill/ Stewart C. Boyd, *Commercial Arbitration* (2nd ed., London: Butterworths 1989), at 220.

[10] See the next chapter.

2.1. Petroleum Development Ltd. *v.* Sheikh of Abu Dhabi

(a) The facts

On 11 January 1939 Sheikh Shakhbut bin Sultan, the ruler of Abu Dhabi, signed an agreement with Steven Hemsley Longringg, the general manager of Petroleum Development (Trucial Coast) Ltd, a British company registered in London.[11] Under Article 3 of this Agreement, the Sheikh granted the Company the exclusive right to drill for and produce petroleum within a specified area in Abu Dhabi.[12] Article 2 determined the concession's area, which included the whole territory under the rule of the ruler of Abu Dhabi, its islands and territorial waters.[13] In exchange for the aforesaid rights, the Company would pay to the Rule the following royalties:[14]

Sum of Rs. [Indian Rupees] 300,000 within thirty days of the date of signature of this Agreement;

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[11] Mana Saeed Al-Otaiba, *The Petroleum Concession Agreements of the United Arab Emirates 1939-1971 (Abu Dhabi)*, (vol. 1, London & Canberra: Croom Helm 1982), at 11. It is worth mentioning that the Agreement was written in Arabic, several efforts to find the original copy of the Agreement have not been successful, and therefore the following Agreement's Articles will be cited from the above reference.

[12] Article 3 provided that "the Ruler by this Agreement grants to the Company the sole right, for a period of seventy-five years from the date of signature, to search for, discover, drill for and produce mineral oils and their derivatives and allied substances within the area, and sole right to the ownership of all the substances produced, and free disposal thereof both inside and outside the territory: provided that the export of oil shall be from the territory of the Concession direct without passing across any adjacent territory.

And it is understood that this agreement is a grant of rights over oil and cannot be considered an Occupation in any manner whatsoever", ibid., at 12.

[13] Article 2 reads "a) the area included in this Agreement is the whole territory subject to the rule of the Ruler of Abu Dhabi and its dependencies, and all its islands and territorial waters. And if in the future there should be carried out a delimitation of the territory belonging to Abu Dhabi, by arrangement with other governments, then the area (of this Agreement) shall coincide with the boundaries provided in such delimitation.

b) If in the future a Natural Zone should be shared be formed adjacent to the territories of Abu Dhabi and the rights of ruler over such Neutral Zone be shared between the Ruler of Abu Dhabi and another Ruler, then the Ruler of Abu Dhabi undertakes that this Agreement shall include all the mineral oil rights which belong to him in such a zone.

c). The Company shall not undertake any works in areas used and set apart of places of worship or sacred buildings or burial grounds", ibid., at 11.

[14] Art. 4, ibid., at 12.

Sum of Rs. 100,000 at the end of each year until discovery of petroleum in commercial quantities, at which time the royalty may be increased in accordance with Article 5 (d).[15] In addition the Company would pay to the ruler a lump sum of Rs. 200,000 upon the discovery of petroleum in commercial quantities.

After the discovery of commercial quantities of petroleum the ruler would be paid a royalty of three Rupees per ton of petroleum instead of an annual sum.

According to Article 12 (a) the ruler has the right to grant to a third party a concession for any substances other than those which have been given by virtue of this Agreement to the Company. It is worth noting that Article 11 and Article 14 of the Agreement constitute a considerable example of non-equivalence in bargaining power between the contracting parties. Article 11 conferred upon the Company the full right to terminate this Agreement after three years with only six months written notice (Paragraph (a)). In addition, the Company had the right to transfer its movable and immovable property without any payment of any charges or tax to the Ruler within thirty years of the singing of the Agreement (Paragraph (b)).[16] At the same time, Article 14 contained a stabilisation clause which prevented the ruler from making any amendments or terminating the Agreement during its course.[17]

However, Article 5 (b) required the Company to present to the ruler an annual clear and intelligible statement regarding petroleum production, and the ruler had the right to examine that statement as well as to inspect the Company's petroleum production.[18] The question here is whether the ruler can invoke this Article and observe or control the Company's operations. The Agreement also contained an arbitration clause in which it was stated

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[15] Art. 5 (d) provided that "if the Company does not succeed in discovering a drilling location within four years from the date of signature, then it must either surrender all its rights as provided in this Agreement or must increase by twenty-five per cent the annual amounts payable under para. (b) of Art. 4. And thereafter at the end of each period of three years these amounts shall be increased by a further twenty-five per cent until the commencement of drilling or until the Company shall surrender its rights", ibid. at 13.

[16] Ibid., at 14.

[17] Art. 14 (a): "The Ruler shall not by any special or general legislation or by any administrative measures or by any other means cancel this Agreement otherwise than as provided in Para. (b) of this Article. No alteration in the conditions of this Agreement shall be made either by the Ruler or by the Company except after agreement between the two parties that such alteration is in the interests of both", ibid., at 15.

[18] Art. 5 (b), ibid., at 12.

a) If any time during the currency of this Agreement there should be any difference or dispute between the two parties as to the interpretation or execution of any provision thereof, or anything herein contained or in connection herewith, such dispute shall be referred to two arbitrators, one selected by each of the two parties, and a referee to be chosen by the arbitrators before proceeding to arbitration.

b) Each party shall nominate its arbitrator within sixty days after the delivery of a request so to do by the other party, failing which its arbitrator may, at the request of the other party, be designated by the British Political Resident in the Persian Gulf [Arabian Gulf]. In the event of the arbitrators failing to agree upon the referee within sixty days of being chosen or designated, the British Political Resident in the Persian Gulf [Arabian Gulf] may appoint a referee at the request of the arbitrators or of either of them.

c) The decision of the arbitrators, or in case of a difference of opinion between them, the decision of the referee, shall be final and binding on both parties.

d) In giving a decision the arbitrators or the referee shall specify an adequate period of delay during which the party against whom the decision is given shall conform thereto, and that party shall be in default only if he has failed to conform to the decision prior to the expiry of that period, and not otherwise.

e) The place of arbitration shall be such as may be agreed by the parties, and in default of agreement shall be London or Baghdad.[19]

Article 17 declared that both parties intended to execute the Agreement in a spirit of good intentions and integrity, and to interpret the Agreement in a reasonable manner.[20]

(b) The nature of the dispute

The dispute between the parties arose in 1949 when the ruler sought to grant a concession to another company, an American Company (Superior Corporation), for the

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[19] Art. 15, ibid., at 15.
[20] Ibid., at 16.

exploitation of petroleum of the subsoil of the continental shelf, after the American President Truman had initiated the doctrine of the continental shelf in 1945.[21] The Petroleum Development Company claimed that the ruler could not do so, since this right had already been granted to it under the 1939 Agreement[22]. Therefore, the conflict between the parties concerned the area of the Concession, whether it included the sea-bed and subsoil of Abu Dhabi's territory.

The parties failed to solve their dispute amicably so they referred it to arbitration. Lord Asquith of Bishopstone (the Umpire), who rendered an award in the dispute reported that "certain disputes [...] have arisen under this agreement and were in fact referred to arbitration; the said arbitrators did differ, and appointed me as Umpire."[23] He specified the nature of the dispute as follows

> The nature of the dispute referred to arbitration and the subject matter of this award are formulated in a letter from the claimants [the Company] to the respondent [the Ruler] dated the 18th July 1949. The letter runs as follow:
> The arbitration is to determine what are the rights of the Company with respect to all underwater areas over which the Ruler has or may have sovereignty, jurisdiction, control or mineral oil rights. The Company claims that the area covered by the Agreement of the 11th January 1939 (notably Article 2 and 3 thereof), includes in addition to the mainland and islands:
> (1) All the sea-bed and subsoil under the Ruler's Territorial Waters (including the Territorial Waters of his islands), and
> (2) All the sea-bed and subsoil contiguous thereto over which either the Ruler's sovereignty jurisdiction or control extends or may hereafter extend, or which now or hereafter may form part of the area over which he has or may have mineral oil rights.[24]

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[21] See *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, (1951) 18 ILR 144-161, 147, 153, reprinted in (1952) 1 ICLQ 247-261; Juha Kussi, *The Host State and the Transnational Corporation: An Analysis of Legal Relationships*, (England: Saxon House Teakfield Limited 1979), at 71; see also Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note 9, at 114.

[22] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, 18 ILR 144-161, 146 (1951).

[23] Ibid., at 145.

[24] Ibid., at 145.

The Umpire, after examining the doctrine of the continental shelf, rendered the following Award:

> I am of the opinion that the *prima facie* construction of the Agreement, which in my view excludes from the Concession the shelf, is not modified so as to include it by the negotiation incident to the Agreement any more than by the (in my view incompletely established) doctrine of the shelf itself.[25]

However, the most important matter here is how the Umpire determined the applicable law.

(c) Applicable law

In the process of determining the applicable law to the substance of the dispute, Lord Asquith of Bishopstone began by asking "what is the 'proper law' applicable in construing this contract?"[26] He answered

> This is a contract made in Abu Dhabi and wholly to be performed in that country. If any municipal system of law were applicable, it would *prima facie* be that of Abu Dhabi. But no such law can reasonably be said to exist. The Sheikh administers a purely discretionary justice with assistance of the Koran; and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.[27]

He further added that Article 17 of the Agreement rejected the application of municipal law, it in fact invited "the application of principles rooted in the good sense and common practice of the generality of civilised nations."[28] Moreover, he concluded that both parties had intended to reject the application of any municipal law: "I do not

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[25] Ibid., at 160. The proceedings of the arbitration were held at 5 Rue le Tass, Paris, France, from Tuesday, 21 August 1951 to Tuesday, 28 August 1951, 1 ICLQ 261 (1952).
[26] Ibid., at 149.
[27] Ibid., at 149.

think that on this point there is any conflict between the parties."[29] As a consequence of this conclusion he set aside the law of Abu Dhabi and applied what is called the general principles of law. On the ground that Abu Dhabi did not have any legal system that may be considered applicable to govern this type of commercial contracts. In fact he precisely said, "but no such law can reasonably be said to exist."[30]

(d) Concluding remarks

This Agreement was concluded at a time when Abu Dhabi and all of the Arabian Gulf was under the colonial rule of Britain, so any basis for party autonomy is doubtful, because the host state was the weak bargaining party and this weakness was clearly apparent in the terms of the Agreement, especially Articles 11 and 14. Regarding the applicable law, Lord Asquith not only declared that Abu Dhabi was a very primitive region so it was difficult to find any settled body of legal principles, he also added that the Arabic language in the Gulf (which was the language of the Agreement) was "an archaic variety of the language".[31] These two points seem to contradict each other: the conclusion that there was a clear agreement between the contracting parties to exclude any municipal law, and the allegation that the language of the Agreement was an archaic language.

As mentioned above, Lord Asquith rejected the application of the municipal law of Abu Dhabi because he considered that it was difficult to find any body of legal principles in this region because it was ruled by the *Qura'an*, and then he relied upon Article 17 of the Agreement which he said contained "principles rooted in the good sense and common practice of the generality of civilised nations".[32] In fact, Article 17 provided that both parties intended to perform the Agreement "in a spirit of good

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[28] Ibid., at 149.

[29] Ibid., at 149.

[30] Ibid., at 149; see also Juha Kussi, *The Host State and the Transnational Corporation*: *An Analysis of Legal Relationships*, supra note 21, at 72; Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note, 9, at 114; Virtus Chitoo Igbokwe, "Developing Countries and the Law Applicable to International Arbitration of Oil Investment Disputes: Has the Last Word been Said?", 14 (1) J Int'l Arb 99-124, 111 (1997); Lawrence Atsegbua, "International Arbitration of Oil Investment Disputes: the Severability Doctrine and Applicable Law Issues Revisited", 5 *African Journal of International and Comparative Law* 634-660, 650 (1993); M. Somarajah, "The Climate of international Arbitration", 8 (2) J Int'l Arb 47-86, 63 (1991).

[31] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, 18 ILR 144-, 149 (1951).

[32] Ibid., at 149.

intentions and integrity, and to interpret it in a reasonable manner".[33] It cannot be inferred from this Article that the parties had intended to exclude the application of municipal law. Hence, it could be concluded that the rejection of the application of Abu Dhabi law was due to a lack of knowledge of that law and its language, or it was simply a technique to circumvent that law to apply principles other than the host state's law.[34]

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[33] Mana Saeed Al-Otaiba, *The Petroleum Concession Agreements of the United Arab Emirates 1939-1971 (Abu Dhabi)*, supra note 11, at 16.

[34] See M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, (Singapore: Longman Singapore Publishers 1990), at 18.

2.2. Ruler of Qatar *v.* International Marine Oil Company Ltd.

(a) The facts

On 5 August 1949, the Sheikh of Qatar, hereafter called the Ruler, signed an agreement called 'the Principal'[35] with Sir Hugh Weightman on behalf of the Central Mining and Investment Corporation, and Robert Morton Allan Jr. on behalf of the Superior Oil Company. Under this agreement both companies gained exclusive rights for a period of 65 years from the date of signature to explore for, drill for, develop, produce, transport and dispose of petroleum within a specific area of Qatar's territory.[36] This area was specified by Article 3 of the Agreement which stated

> The area covered by the exclusive rights described in Article 2 shall include all of the sea-bed and subsoil underlying the waters of the Persian [Arabian] Gulf which fall within the jurisdiction and control of the Ruler of Qatar and which lie beyond the territorial waters, contiguous to the mainland and islands of Qatar.[37]

The Ruler assigned his rights to his son, Sheikh Ali Bin Abdullah Al-Thani; Weightman and Allan assigned their rights and obligations to the "the International Marine Oil Company" (for whom they were dealing as agents).[38]

According to the Agreement, the Ruler would receive the following rights: the sum of Rupees 500,000 on the date of signature of the agreement, non returnable under any circumstances;[39] an annual payment of the sum of Rupees 1,000,000, to start one year after the date of signature of the agreement.[40]

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[35] *Ruler of Qatar v. International Marine Oil Co.*, (1953) 20 ILR 534, the Agreement was written in Arabic and English, Art. 30 stated that "this Agreement has been written in the Arabic and English languages, each of which has equal validity, but it is understood that the Ruler will refer to the Arabic text", ibid., at 536.

[36] Art. 2, ibid., at 535.

[37] Ibid., at 535.

[38] Ibid., at 534.

[39] Art. 4 of Principal agreement.

[40] Art. 5 provided that "the Company shall pay to the Ruler annually the sum of Rupees 1,000,000, the first payment to be made one year after the date of signature of this Agreement. Upon discovery of oil in commercial quantities this annual rental shall cease, but the amount payable thereafter to the Ruler as Royalty under the terms of Article 8 hereof shall in no circumstances be less than the sum of Rupees

The Principal Agreement contained an arbitration clause, in line with other petroleum agreements. The clause provided that any doubt or dispute arising between the parties concerning the rights or liabilities of either party under the Agreement should be referred to two arbitrators, and to a referee who should be chosen by the arbitrators.[41] The Agreement produced a definition of the term 'discovery of petroleum in commercial quantities', in which the term means 'the time when a well or wells are drilled, tested and found capable of producing no less than 15,000 barrels of petroleum of satisfactory quality per day, for thirty consecutive days, according to good petroleum field practice'.[42] The Agreement also gave the Company the right to terminate the Agreement at any time at which point both parties would be free from any further obligations, except that the Company would have to pay all amounts due to the Ruler up to the actual date of termination.[43]

(b) The nature of the dispute

The dispute between the parties arose in 1952 as the Company had not discovered petroleum in commercial quantities. On 3 May 1952 the Company sent a notice to the Ruler stating that it would terminate the Agreement after three months of the date of the notice, on 3 August 1952.[44] A meeting took place in Doha, the capital of Qatar, on 4 May 1952 to discuss the issue. The representative of the Ruler insisted that the Company was liable to pay the sum of Rupees 1,000,000, which was due on 5 August 1952, but the representative of the Company rejected this allegation. The parties decided to resort to arbitration to solve the dispute. The parties appointed their arbitrators then the latter appointed Sir Alfred Bucknill as the referee.[45] The fundamental issue before the arbitral tribunal was

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1,000,000, annually. For this purpose calculations shall be made on the expiry of each period of twelve months from the date of signature of this agreement. When oil is discovered in commercial quantities in the concession area the Company shall, if the Ruler so desires, make a loan to him of Rupees 1,000,000. The Company shall have the right to recover such a loan by deduction from up to one half of the royalties accruing thereafter to the Ruler, provided that the amount paid to the Ruler in any one year shall not in consequence be reduced below the sum of Rupees 1,000,000 as provided above", ibid., at 535.

[41] Ibid., at 534.

[42] Ibid., at 535.

[43] Ibid., at 543.

[44] Ibid., at 539-540.

[45] Ibid., at 534.

Whether the parties intended that the first payment of Rupees 1,000,000 to be made one year after 5th August 1949 was to be a payment in respect of the year 5th August 1949 to 5th August 1950, or a payment in respect of the year 5th August 1950 to 5th August 1951.[46]

Hence, the difference between the parties regarded the annual payment: whether the sum of Rupees 1,000,000 which was payable on each 5th August was the rent for the past twelve months as the claimant (the Ruler) argued, or it was a payment for the future twelve months as the respondent (the Company) argued.[47]

(c) Applicable law

The tribunal asked "whether the proper law to be applied in the construction of the Principal agreement is Islamic law or the principles of natural justice and equity." The referee referred to the case of *Bearman* v. *Dux Oil Co.* which concerned a petroleum concession agreement which was decided in 1917 by Mr. Justice Hardy, a Member of the Supreme Court of Oklahoma [as it was cited by the referee]. Mr. Hardy stated in his judgment that

> On the construction of contracts, it is the duty of the court to place itself as far as possible in the situation of the parties at the time their minds met upon the terms of the agreement, and from a consideration of the writing itself ascertain their intention, and if this cannot be done by the instrument itself, the circumstances under which it was made and the subject matter to which it relates may be considered, and with these aids, it is the duty of the court so to interpret the contract as to give effect to the mental intention of the parties as it existed at the time of contracting, so far as that intention is ascertainable and lawful.[48]

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[46] Ibid., at 536.
[47] Ibid., at 536.
[48] Ibid., at 544; see also *Bearman* v. *Dux Oil & Gas Co. et. al.*, 64 okla, 147; 166p. 199; 1917 okla. LEXIS 602.

In his mission to determine the applicable law in the Principal Agreement, Sir Alfred asserted that the contracting parties had never submitted any indication upon this point. Thus, he considered the law of Qatar to be the applicable law. He stated

> If one considers the subject matter of the contract, it is oil to be taken out of the ground within the jurisdiction of the Ruler. That fact, together with the fact that the Ruler is a party to the contract and had, in effect, the right to nominate Qatar as the place where any arbitration arising out of the contract should sit, and the fact that the agreement was written in Arabic as well as English, points to Islamic law, that being the law administered in Qatar, as the appropriate law.[49]

So, Sir Alfred first considered the law of Qatar was the applicable law according to a number of facts: the subject matter of the contract; the Ruler himself was a party to the contract and Islamic law was the law which administrated in Qatar. However, he later ignored these facts, stating that "there are two weighty considerations against that view."[50] After he had listened to two experts in Islamic law, he reported that "there is no settled body of legal principles in Qatar applicable to the construction of modern commercial instruments."[51] He added

> I have no reason to suppose that Islamic law is not administered there [Qatar] strictly, but I am satisfied that the law does not contain any principles which would be sufficient to interpret this particular contract.[52]

Furthermore, Sir Alfred stated that "both experts agreed that certain parts of the contract, if Islamic law was applicable, would be open to the grave criticism of being invalid".[53]

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[49] Ibid., at 544.
[50] Ibid., at 544.
[51] Ibid., at 544.
[52] Ibid., at 545.

(d) Concluding remarks

Sir Alfred considered Islamic law insufficient to govern petroleum contracts, so he excluded it and applied instead the principles of 'justice, equity and good conscience.' He arrived at this conclusion by asking experts in Islamic law. However, Islamic law is dominated by the idea of equity as Professor Milliot, one of the two experts, pointed out: "equity is the basis of Muslim law".[54] The referee did not give any explanation for his decision, except in stating that this law is not capable of governing petroleum contracts.

However, the disputed matter in this case was only about the principle of apportionment, and it was stated during the arbitral process that Islamic law includes this principle. Sir Alfred reported that

> These sums were apportionable in respect of time according to the principles of justice, equity and good conscience. I may here point out that the two expert witnesses called before me both agreed that Islamic law, although mediaeval in origin and development, laid down the principles of apportionment.[55]

Therefore, it may be argued that the exclusion by Sir Alfred of Qatar law, was in order to avoid resorting to any municipal legal system, not because that law did not contain any principles may suitable to govern the dispute.

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[53] Ibid., at 545.
[54] Ibid., at 546.
[55] Ibid., at 546.

2.3. Saudi Arabia *v.* Arabian American Oil Company (ARAMCO)

(a) The facts

On 29 May 1933 the Saudi Arabia Government granted a petroleum concession agreement to Standard Oil Company of California, which later changed its name to the Arabian American Oil Company.[56] According to Article 1 of the Agreement, Saudi Arabia granted the company exclusive rights to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum and its derivatives for a period of 60 years. Article 1 reads as follow

> The Government hereby grants to the Company on the terms and conditions hereinafter mentioned, and with respect to the area defined below, the exclusive right, for a period of sixty years from the effective date hereof, to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum, asphalt, naphtha, natural greases, ozokerite, and other hydrocarbons, and the derivatives of all such products. It is understood, however, that such right does not include the exclusive right to sell crude or refined products within the area described below or within Saudi Arabia.[57]

In exchange for these rights, the Saudi Government would acquire royalties from the Company, determined according to Articles 5, 6, 7, 11, 12, 14, 15, 17 and 18, at the same time the Company would be exempt from all direct or indirect taxes, charges, fees and duties including import and export duties.[58] Article 28 gave to the Company the right to terminate the Agreement at any time by giving the Government thirty days' advance notice in writing. In such circumstances the Company's immovable property became the property of the Government free of charge, and the movable properties

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[56] *Saudi Arabia v. Arabian American Oil Company* (*Aramco*), (1963) 27 ILR 117-233. The Agreement was signed by Abdullah Suliman, Minister of Finance in Saudi Arabia, on behalf of the Saudi Arabia Government and Mr L. N. Hamilton, on behalf of Standard Oil Company of California, J. D. N Anderson, *First Memorial of Arabian American Oil Company (Aramco) in Arbitration,* Annex 1, at 1.

[57] Ibid., at 1.

[58] Art. 21, ibid.

remained property of the Company unless the Government wished to buy them. Any dispute would be settled by arbitration. The Agreement comprised an arbitration clause which reads as follows

> If any doubt, difference, or dispute shall arise between the Government and the Company concerning the interpretation or execution of this contract, or anything herein contained or in connection herewith, or the rights and liabilities of the parties hereunder, it shall, failing any agreement to settle it in another way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee who shall be chosen by the arbitrators before proceeding to arbitration. Each party shall nominate its arbitrator within thirty days of being requested in writing by the other party to do so. In the event of the arbitrators failing to agree upon a referee, the Government and the Company shall, in agreement, appoint a referee, and in the event of their failing to agree they shall request the President of the Permanent Court of International Justice to appoint a referee. The decision of the arbitrators, or in the case of a difference of opinion between them, the decision of the referee, shall be final. The place of arbitration shall be such as may be agreed upon by the parties, and in default of agreement shall be The Hague, Holland.[59]

(b) The nature of the dispute

The dispute between the contracting parties (the Government and the Company) arose at the beginning of 1954, when the Government of Saudi Arabia concluded an agreement with Mr A. S. Onassis and his companies on 29 January 1954.[60] Under this agreement, the Government of Saudi Arabia granted to Mr. Onassis the right to constitute and own a company at Jeddah in Saudi Arabia called 'Saudi Arabian Maritime

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[59] Art. 31, ibid.

[60] J. D. N. Anderson, *First Memorial of Arabian American Oil Company (Aramco) in Arbitration*, supra note 48, Annex 2, at 81, it is worth mentioning that the Agreement amended on 7 April 1954, for the full text of the Agreement see ibid. at 81-103; see also the original Memorial and Exhibits of Royal Government of Saudi Arabia, at 9-13.

Tankers Company Ltd (Satco),[61] to transport Saudi petroleum[62] for a period of thirty years, renewable for a further period with the agreement of both parties.[63]

The Arabian American Oil Company (ARAMCO) disputed Satco's Agreement on the grounds that they had the exclusive right to carry on all activities, in all forms, relating to the petroleum industry with respect to the Concession area according to the 1939 Agreement.[64] Efforts were made by the parties to solve the conflict amicably, but they did not succeed.[65] The two parties agreed to refer this dispute to arbitration on 23 February 1955.[66]

The subject matter of the dispute, as cited in the Arbitration Agreement, was

> The Government has requested Aramco to implement the Onassis Agreement, and Aramco claims that Article 4 of the said Onassis Agreement as amended conflicts with the Aramco Concession Agreement, and thereby a dispute has arisen between the Government and Aramco as to the rights and responsibilities of the Government and Aramco under the Aramco Concession Agreement, and as to the true interpretation of the Aramco Concession Agreement.[67]

During negotiation, the parties were unable to agree upon the questions which should be submitted to arbitration, however, they agreed that each party has the right to

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[61] Art. 1, ibid., at 81.
[62] Art. 4, ibid., at 82.
[63] Art. (15), ibid. at 85.
[64] See the Saudi Government Memorial, at 12.
[65] See J. D. N. Anderson, *First Memorial of Arabian American Oil Company (Aramco) in Arbitration*, supra note 48, at 36, see also the Saudi Government Memorial, at 15, it was reported in the latter that "in fact, it became clear that there was no prospect of a settlement by direct negotiation between the Company and Mr. Onassis and by letter dated 26th October 1954, in answer to a request from the Minister of Finance for a definite statement of his attitude, Mr. F. A. Davies (Chairman of the Board of Aramco) wrote: 'if no solution is found, Aramco will cooperate with His Majesty's Government in the preparation of terms of reference and in the submission of the issues to a Board of Arbitration in accordance with the Concession Agreement'. No agreed solution could in fact be found, and matters therefore proceeded on the lines referred to by Mr. Davis", at 15.
[66] The Saudi Government Memorial cites that several meetings between 25th January and 10th February 1955 were held between the two parties to reach agreement about the subject matter of the dispute, and it became clear that "the arbitration was being sought by the two parties in the most friendly spirit and with the sole object of determining, for their future guidance, their respective rights and obligations under the Concession", at 16; see the Arbitration Agreement in ibid., Exhibit 1, at 1-6.
[67] J. D. N. Anderson, the Award, at i.

submit any questions they choose.[68] It was also agreed that the arbitral tribunal should consist of two arbitrators and an umpire, and that the umpire should not be of the same nationality as either party or either of the arbitrators (Art. 1).[69] Furthermore, it was agreed that the seat of arbitration should be Lucerne, Switzerland (Art. 5).[70] Accordingly, the Government submitted to the Arbitral tribunal the following questions

- Whether the Company has, by virtue of the Concession, and if so, what right in connection with the transportation by sea of oil and other products which Aramco produces and sells.
- If the Company has any such right

a) Where, and to what extent, the Company was or is entitled in the absence of consent by the Government to transfer any right in connection with transportation by sea of oil obtained under the concession to any other person, company or corporation (for example to its buyers) having regard to the provisions of Article 32 of the Concession Agreement, or otherwise.

b) Whether the Company, by virtue of its concession, has acquired any right to refuse or deny a Government requested preferential treatment to tankers flying the Saudi Arabia flag, particularly bearing in mind the letter and the spirit of Article 23 of the Concession Agreement, and, in the event of the Company not having acquired such right, whether it has, by its letters of July 31st and August 3rd 1954 or otherwise, by refusing such preference to Saudi Arab tankers, violated its obligations under the Concession Agreement.

- Whether in any event, the Concession Agreement entitles the Company to deny preference or priority to national tankers, especially when the cost of transportation of the oil it produces and sells is not

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[68] The Arbitration Agreement Art. (3).

[69] The Arbitral Tribunal consisted of Sauser-Hall, Referee; Badawi/ Hassan, Habachy, Arbitrators. Dr. Badawi died during the proceedings and was succeeded by H. E. Mahamoud Hassan, see digest of the Award, at 1.

[70] The Arbitral Tribunal commenced first sessions in Geneva on Monday, 9th July 1956, J. N.D. Anderson, Sessions of the Tribunal Verbatim Transcript Vol. 1, at 1. The seat of Arbitration was changed to Geneva rather than Lucerne, by virtue of an agreement concluded between the Parties on 13 September 1955, see the Award, the Arabic version, at 6.

going to be higher than the annual average cost of transportation of the Company in using non-national tankers.[71]

Aramco submitted the following questions: "is Article 4 of the agreement between the Government and Mr A. S. Onassis as amended April 7, 1954, in conflict with the Aramco Concession?"[72]

(c) Applicable law

Since the Concession Agreement of 1933 did not contain any reference to the applicable law, the parties agreed in the Arbitration Agreement that Saudi Arabian law would be the applicable law and also any law that the tribunal deemed to be applicable. Article 4 of the Arbitration Agreement specifically provided that

> The Arbitration Tribunal shall decide this dispute
> (a) in accordance with the Saudi Arabian law, as hereinafter defined, insofar as matters within the jurisdiction of Saudi Arabia are concerned;
> (b) in accordance with the law deemed by the arbitration tribunal to be applicable insofar as matters beyond the jurisdiction of Saudi Arabia are concerned.
> Saudi Arabian law, as used herein, is the Muslim law as taught by the school of Imam Ahmed ibn Hanbal as applied in Saudi Arabia.[73]

In its efforts to determine the applicable law, the arbitral tribunal concluded that it should take into account any indication given by the parties. However, failing adequate indication of the parties, the tribunal would take all the circumstances of the case into account, basing its decisions on the general doctrine of private international law. In order to perform this duty, the arbitral tribunal should first examine the legal

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[71] See Saudi Memorial, at 16-18; see also the Award, at 39-40.
[72] See Aramco Memorial at 5; see also J. N. D. Anderson, the Award at 40.
[73] See Saudi Memorial, Exhibit 1, at 3; see also J. N. D. Anderson, the Award, at iv.

nature of a concession in municipal law, as the law of nations did not contain any principles regarding the characterisation of this legal institution.[74]

Consequently, the tribunal began by examining the law of Saudi Arabia in order to ascertain whether the petroleum Concession Agreement which had been granted by the Government to Aramco should be characterised as a unilateral act of public law, or as a public or administrative contract, or as a contract of private law, or a lease, or as a 'profit a prendre', or as an institution '*sui generis*', partly public and partly private.[75] According to the Arbitration Agreement concluded by the parties this question should be solved according to the principles of Muslim law, as taught by the Hanli School.[76] However, Aramco contended that Saudi Law was not sufficiently developed to determine the legal nature of petroleum agreements.[77] The Government responded by stating that according to the Islamic law, Aramco's Concession Agreement has a contractual character. Furthermore, the Memorial and the oral hearing of the Government argued that this Concession must be regarded as a *sui generis* contract. Moreover, the rule '*pacta sunt servanda*' is fully recognised by Muslim law.[78]

The tribunal reasserted the principle of private international law concerning party autonomy, emphasised that in any "contract presenting an international character, the law expressly chosen by the parties should first be applied and failing such a choice, the law presumably intended by the parties is applicable.[79] The tribunal in this regard relied upon Article 4 (b) of the Arbitration Agreement which gives the tribunal the discretion to choose a system of law other than Saudi law. The tribunal decided to construe this provision in a broad way, concluding

> As the parties to the Arbitration Agreement left to the arbitrators a broad discretion in this respect, the tribunal is free to choose one or the other of these

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[74] The Award, at 59.
[75] J. N. D. Anderson, The Award. at 62.
[76] This School is the former school in Saudi Arabia, it belongs to Imam Ahmed ibn Hanbal (745-792 AH).
[77] J. N. D. Anderson, the Award, at 62.
[78] See the Government Memorial, at 20-32.
[79] J. N. D. Anderson, the Award, at 65.

multiple theories, provided its choice is objective and is justified by the circumstances of the dispute submitted to it. [80]

At the same time, the tribunal decided to resort to objective criteria in order to connect certain matters which have been already regulated by the contract with a special place and a special legal system.[81] In this regard the tribunal perceived that the Concession Agreement because of its parties and its ramifications has an international character. [82] Therefore, the law expressly chosen by the parties must be taken into consideration, since the parties have chosen a legal system connected with their transaction.[83] The contract was concluded in Saudi Arabia, the effective date was the date of its publication in Saudi Arabia and the contract was, for the most part, to be performed in Saudi Arabia, so is it the law of Saudi Arabia that should be applied.[84] The tribunal also discussed the following statement

> The law in force in Saudi Arabia should also be applied to the content of the Concession because this state is a party to the Agreement, as grantor' and because it is generally admitted, in private international law, that a sovereign state is presumed, unless the contrary is proved, to have subjected its undertakings to its own legal system. As for the law to be applied to matters which are not governed by the law expressly chosen by the parties, according to Article IV of the Arbitration Agreement, the Tribunal adopts the following solution. The Tribunal decides to apply the law which corresponds best to the nature of the legal relationship between the Parties, without looking for the tacit or presumed intention of the contracting parties. Relying on objective consideration, the Tribunal believes that the governing law should coincide with the economic milieu where the operation is to be carried out. Guided by this criterion, the Arbitration Tribunal comes to the conclusion that some of the effects of the Concession Agreement cannot be governed by the law of Saudi

[80] J. N. D. Anderson, the Award, at. 66.
[81] Ibid., at 66.
[82] Ibid., at 66.
[83] Ibid., at 66.

Arabia, both because of objective considerations and because of the subsequent conduct of the Parties.

The Concession Agreement derives therefore its juridical force from the legal system of Saudi Arabia, the *Shari'ah*, the Divine law of Islam, supplemented by Royal Decree No. 1135.

Finally, the tribunal observed that the law which was in force in Saudi Arabia did not contain any defined rule concerning the exploitation of petroleum resources, because no such exploitation existed in Saudi Arabia prior to 1933, so this lacuna in Saudi law was filled by the 1933 Concession Agreement "whose validity and legality under Saudi law are not disputed by either side."[85] Consequently, the tribunal decided that public international law should be applied to the effects of the Concession, as no municipal law can govern all matter. It concluded

> Lastly, the tribunal holds that public international law should be applied to the effects of the concession, when objective reasons lead it to conclude that certain matters cannot be governed by any rule of the municipal law of any state, as is the case in all matter relating to transport by sea, to the sovereignty of the state on its territorial waters and to the responsibility of states for the violation of its international obligations.[86]

(d) Concluding remarks

The tribunal, in its task of determining the applicable law to the merits of the dispute examined several questions, i.e. the nature of the agreement and its subject, the nature of the contracting parties (a state and a private company in this case), municipal law and the doctrine of private international law. In the end, the tribunal decided to apply public international law. However, why did the tribunal decide to apply public international law rather than the host state's law, which had been expressly chosen by

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[84] Ibid., at 66.
[85] Ibid., at 67.
[86] Ibid., at 69-70.

the parties? Was it because of the lacuna in Saudi Arabian law? Or was it because that law was deemed incompetent to govern petroleum contracts?

Undoubtedly, that in the process of determining the applicable law, an arbitral tribunal should consider different factors such as party autonomy in which whether there was any express or implied choice of law by the parties and theories of private international law. In this case, Article 4 (a) of the Arbitration Agreement was clear in the point of party autonomy: the parties had expressly chosen Saudi law. Regarding theories of private international law, the tribunal observed these theories; however, it did not consider the doctrine of most connected factors to the transaction.

What about the competency of Saudi law? Aramco's memorial details the opinions of a number of scholars on the company's rights according to the 1933 Concession Agreement:

> Under the applicable Muslim law, the Aramco Concession Agreement gives Aramco the exclusive, absolute and unrestricted right to do anything by way of sale or export that Aramco may choose with the oil Aramco produces; that this includes the right to take the oil out of Saudi Arabia and to put it into export markets by any means that Aramco may deem advisable; that it includes the right to sell the oil to buyers on any sales terms and conditions Aramco may decide, and the buyers are likewise free to take the oil out of Saudi Arabia by any means they may choose; and that the Aramco Concession Agreement gives Aramco the absolute ownership of the oil it produces, free from any limitation or restraint. Under Hanbali law, these scholars say, the exclusive and absolute right of ownership by Aramco of the oil necessarily implies the right of Aramco to dispose of the oil as it wishes, there being no limitation found in the Agreement. They say, too, that even though Aramco had not been given such an exclusive right, by the clear intendment of the Concession Agreement, it would nevertheless possess it; and that the Government is under an obligation to

observe the rights of Aramco and to place no restriction or limitation upon them.[87]

Thus, according to these opinions, Islamic law gave complete rights to the Company, and was in no way insufficiently competent to govern the dispute. Moreover, the tribunal itself argued at the beginning of its award that "the law of nations did not contain any principles regarding the characterisation of [the legal nature of the concession]."[88] It then contradicted itself by deciding that public international law should be applied to the effect of the concession. Given the adequacy of Islamic law to govern the dispute and the above contradiction, it is not clear why the tribunal avoided the application of municipal law, Saudi law. It would therefore seem that it was an attempt to avoid any recourse to any municipal law.

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[87] See the Aramco memorial, at 51, the memorial mentioned the opinions in Annex 16: Abu Zahra, at 345-368, J. N. D. Anderson, at 369-376 and Joseph Schacht, at 526-534.

[88] The Award, J. N. D. Anderson, at 59.

2.4. Libyan Cases

Introductory remarks

The three important Libyan cases: *BP v. Libya*[89], *Texaco* and *California Asiatic v. Libya*[90] and *Libyan American Oil Co.* (*LIAMCO*) *v. Libya*[91], arose out of the attempts of the Libyan Government to control its petroleum resources after Colonel Muammar Qaddafi overthrew the monarchy and established a Social People's Arab Republic. The arbitral awards that were rendered in these cases were controversial. On the one hand, it has been argued that these awards created a remarkable feature in the arena of contracts between states and foreign companies.[92] However, on the other hand, they have been considered as the most flagrant proof of bias in the era of international commercial arbitration.[93] The details of these cases will be discussed bellow.[94]

2.4.1. BP Exploration Company (Libya) Limited *v* the Government of the Libyan Arab Republic

(a) The facts

On 18 December 1957 the Government of Libya (Petroleum Commission) granted a concession to Mr. Nelson Bunker Hunt, who was a citizen of the United States of America. The Concession was, for the most part, in the form set out in the Second

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[89] *BP Exploration Company* (*Libya*) *Limited v. The Government of the Libyan Arab Republic*, (1979) 53 ILR 297; (1980) 5 YBCA 143.

[90] *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, (1979) 53 ILR 389; (1978) 17 ILM 1; (1979) 4 YBCA 177.

[91] *Libyan American Oil Company* (*LIAMCO*) (*USA*) *v. The Government of the Libyan Arab Republic*, (1982) 62 ILR 140; (1981) 20 ILM 20; (1981) 6 YBCA 89.

[92] Christopher Greenwood, "State Contracts in International Law – The Libyan Oil Arbitrations ", 53 BYIL 27-81, 27 (1982).

[93] See for example, Amr A. Shalakany, "Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism", 41 *Harvard International Law Journal* 419-468, 425 (2000).

[94] In these cases the arbitration clause contained the following provision on the applicable law:
"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" see supra note 98.

Schedule of the Libyan Petroleum law of 1955.[95] According to the Concession Agreement Clause (1), Mr. Hunt was granted the exclusive right for 50 years to search for and extract petroleum within the designated area. The Company shall also have the right to take away such petroleum whether by pipeline or otherwise from the concession area and to use, process, store, export and dispose of the same.[96] The Libyan rights in exchange were cited in Articles 6, 7, 8, and 9. Article 6 specified that

> The Company shall in accordance with Article 13 of the Law and Clause 9 (2) of this Concession pay the following rents for each 100 square kilometres: Five Libyan Pounds for each of the first eight years; Ten Libyan Pounds for each of the next seven years, or until petroleum is found in commercial quantities whichever is the earlier; 2,500 Libyan Pounds for each year thereafter.[97]

The Concession Agreement included an arbitration clause, taken from the Libyan petroleum law of 1955, Article 28, which was inserted in all subsequent concession agreements. The original text of the law was amended by a Decree Law of 3 July 1961. Paragraph (1) of Article 28 reads

> If at any time during or after the currency of this concession any difference or dispute shall arise between the Government and the company concerning the interpretation of this concession, or its annexes or the rights or obligations of either of the two contracting parties hereunder, and should such parties fail to agree as to the settlement of such difference or dispute, the same shall, failing any agreement to settle it in any other way, be referred to two arbitrators, one of whom shall be appointed by each party, and an umpire who shall be appointed by the arbitrators immediately after their appointment. In the event of the arbitrators failing to agree upon an umpire within 60 days from the date of appointment of the second arbitrator either party may request the president or, if the president is

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[95] BP Memorial, part one, at 5.
[96] Ibid., Annex 2, at 133.
[97] Ibid., Annex 2, at 103.

a national of Libya or of the country where the company was first incorporated, the vice-president of the International Court of Justice to appoint the Umpire.[98]

Paragraph (7) of the same Article which deals with applicable law, was amended several times. In the petroleum law no. 25, 1955 it read

This concession shall be governed by and interpreted in accordance with the laws of Libya and such principles and rules of international law as may be relevant, and the umpire or sole arbitrator shall base his award upon those laws, principles and rules.[99]

This paragraph was then amended by the Decree law of 3 July 1961, as follows

This concession shall be governed by and interpreted in accordance with Libyan laws and such principles and rules of international law as may be relevant to the extent that such principles and rules do not conflict with or are contrary to Libyan laws.[100]

The Decree of 20 November 1965 introduced the third amendment to Paragraph (7) of Article 28, and it is this amendment which is taken into account in the examination of this case and other Libyan cases. The alteration read

This concession shall be governed by and interpreted in accordance with the principles of law in 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.[101]

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[98] Anis Mustafa Qasem, Petroleum Legislation in Libya, Thesis 1969, at 211, published as *Principles of Petroleum Legislation, The Case of a Developing Country*, (London: Graham & Trotman 1985).
[99] Ibid., at 217.
[100] Ibid., at 218.

The above Paragraph means, as Qasem argued

If there is a principle of law in Libya, whether it be found in the civil code (governing private contracts) or in administrative law or in principles of law established by the Libyan Supreme Court (governing administrative contracts) and such a principle is applicable to the dispute, then such a principle will have the first call on the attention of the arbitrators, and it may not be disregarded unless such a principle is found to be not in common with principles of international law.[102]

(b) The nature of the dispute

The new Libyan regime which came to power in 1969 made efforts to protect and gain control over Libyan natural resources for the benefits of Libyan citizens, pursuant to the relevant United Nations Resolutions.[103] For this purpose, several petroleum agreements were amended or terminated by nationalisation laws, at the same time Libya offered compensation to these petroleum companies. Accordingly, the Libyan Government issued on 7 December 1971 a law nationalising the BP Concession.[104] Article 1 of this law provided that

> The operations of BP Exploration (Libya) Limited in Oil Concession number 65 shall be nationalised. Ownership of all funds, rights, assets and shares relating to the abovementioned operations, shall revert to the state, including specifically the facilities and installations for exploration and drilling for, and production of, crude oil and natural gas, as well as for transportation, processing, refining, storage and export and other assets and rights relating to the aforementioned operations.[105]

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[101] Ibid., at 218.
[102] Ibid., at 219.
[103] For more detail on these Resolutions see part one, chapter one of this thesis.
[104] Text of Libyan Law Nationalising British Petroleum's Interests in Concession no. 65, *Selected Documents of the International Petroleum Industry 1971*, (Vienna: OPEC 1973), at 183.
[105] Ibid., at 183.

However, the same law provided a method of paying compensation to BP. Article 5 clearly stated that

> The state shall pay compensation to the concession holder for the funds, rights and assets reverting to it by virtue of Article 1. The determination of the amount of such compensation shall be undertaken by a Committee to be formed by a decision of the minister of petroleum in the following manner:
> a) One judge of the court of appeal as president, to be nominated by the minister of justice.
> b) One representative of the national oil corporation as a member, to be nominated by the minister of petroleum.
> c) One representative of the ministry of treasury as a member, to be nominated by the minister of treasury. The Committee may seek the help of whatever employees or others, as it deems necessary in the performance of its task.[106]

BP immediately rejected the Libyan policy, sending a letter on 11 December 1971 threatening the Libyan Government. The letter stated that the interests of BP cannot be altered without its consent, and if this occurred, BP would "take such steps as it may consider necessary or desirable to assert or protect all its rights".[107] In a separate letter of the same date, BP informed the Libyan Government that they had already instituted arbitration proceedings.[108] BP began arbitration proceedings only five days after the nationalisation law was issued, though Article 5 of this law determined a period of three months for the initiation of compensation proceedings.

Since there was no response from the Libyan Government, BP addressed a letter on 15 March 1972 to the president of the International Court of Justice, asking him to invoke Article 28 of the Concession Agreement and designate a sole arbitrator to determine the dispute.[109] The president of the International Court of Justice appointed on 28 April 1972, Judge Gunnar Lagergren president of the Court of Appeal for Western

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[106] Ibid., at 184.
[107] See the complete Letter in BP Memorial, at 12 and also Annex 22.
[108] Ibid., at 13.
[109] Ibid., at 13.

Sweden, as a sole arbitrator.[110] The presence of both parties was requested on 4 July 1972, however Libya did not attend this meeting, nor any further meeting.[111] The arbitrator declared *inter alia* that the place of arbitration would be Copenhagen, Denmark; he also decided that copies of all correspondence and documents in the case would be sent to Libya.[112]

At the first stage of the arbitration proceedings BP asked the arbitrator to declare *inter alia* that the Libyan nationalisation law was a breach of the Concession Agreement, and it is entitled to be resorted to the full enjoyment of its right under the Concession. It also asked the arbitrator to declare that it is the owner of any petroleum extracted from the Concession area after, as well as before the date of nationalisation.[113]

The arbitrator held *inter alia* that the Libyan nationalisation law was a breach of the Concession, and BP is entitled to damages arising from the wrongful act of Libya.[114]

(c) Applicable law

We now turn to examine how the applicable law was determined in this case. During the first stage of the arbitration proceedings BP declared that its Concession Agreement is considered a contractual relationship, and that there is nothing to preclude a state from entering into a binding contractual relationship, whether in international law, in general principles of law or, indeed, in the law of Libya.[115] BP then later argued that this contract "is no ordinary contract" because it is between a state and a foreign corporation. Moreover, BP argued that the contract contains clauses which in fact protect it from any unilateral alteration.[116] Indeed, BP argued that the contract is

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[110] 5 YBCA 143, 145 (1980).
[111] Ibid., at 145.
[112] Ibid., at 145.
[113] 53 ILR 297, 299 (1979).
[114] 53 ILR 297, 299 (1979); see the Tribunal decisions on these issues, which was delivered at Copenhagen on 10 October 1973, 53 ILR 297, 355-357 (1979); see also the full Award (Merits) in ibid., at 300-357. It was reported that "according to a statement issued by BP on November 25, 1974, the case was settled on 20 November 1974. The settlement agreement provided that the Government of Libya would make BP an immediate cash payment of approximately UK £17.4 million. This figure was arrived at by deducing from the sum of UK £62.4 million, agreed to be due to BP, taxes, royalties and other claims by the Government of Libya amounting to UK £45 million. The payment has been received by BP (statement issued by BP on January 31, 1975). On March 24, 1975, the arbitrator ordered the discontinuance of the arbitration proceedings", 5 YBCA 143 (1980).
[115] BP Memorial (Merits), Part Two, *Para* 73, at 13.
[116] Ibid., *Para* 81, at 16.

governed by a proper law clause, which excludes the direct application of Libyan law, because the contract contains an arbitration clause, although the whole performance of the contract would take place within Libyan territory.[117] BP proposed three choices of applicable law. First, it stated that the Concession is governed by public international law; second, alternatively, that the Concession itself constitutes the sole source of law controlling the relationship between the parties; and third, that the legal position of the parties should be decided by reference to 'general principles of law'.[118]

In order to determine the applicable law to the substance the arbitrator concluded that

> While the provision generates practical difficulties in its implementation, it offers guidance in a negative sense by excluding the relevance of any single municipal legal system as such. To the extent possible, the Tribunal will apply the clause according to its clear and apparent meaning. Natural as this would be in any event, such an interpretation is the more compelling as the contractual document is of a standardised type prescribed by the Respondent. The governing law clause moreover was the final product of successive changes made in the Libyan petroleum legislation in the decade between 1955 and 1965 by which the relevance of Libyan law was progressively reduced.
>
> In Paragraph 7 of Clause 28, reference is made to the principles of law of Libya common to the principles of international law, and only if such common principles do not exist with respect to a particular matter, to the general principles of law. The Claimant argues, in the first of three alternative submissions, that international law alone is applicable.[119]

The arbitrator examined the reasoning behind BP's assertion that the Concession was governed by international law alone. The first argument of BP was that the acceptance of a principle should be upheld by both Libyan and international law if it is to govern the Concession. Hence, if the performance of a contracting party cannot be

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[117] Ibid., at 16.
[118] Ibid., *Para* 95, at 19.
[119] 53 ILR 297, 327 (1979).

justified by the principles of both Libyan law and international law, it is not justified under the Concession. Thus BP argued that an action which is a violation of the principles of international law must necessarily be considered as a violation of the Concession, even if not in violation of the principles of Libyan law.[120] However, the arbitrator considered this reasoning to be incomplete, since it entirely ignores the content of Clause 28 Paragraph (7).[121] He further added

> In the last analysis [the case] should be tested by reference to the general principles of law. It is not correct to say that "a principle must be supported by both Libyan law and international law in order to be justifiable under the Concession" and that conduct "is justifiable only if principles of both systems of law-Libyan and international- support it". The principle may still be acceptable, and the conduct justifiable, if supported by the general principles of law.
> If a particular action by a party amounts to breach of contract under one system but not under the other, the issue is one which can only be decided by reference to the general principles of law. Thus, the first part of the Claimant's argument must be rejected. It is not sufficient for the Claimant to show that the conduct of the Respondent is a breach of international law as a basis for maintaining a claim based on breach of contract. In the event that international law and Libyan law conflict on that issue, the question is to be resolved by the application of the general principles of law.[122]

The second argument submitted by BP was that since the parties have expressly excluded the direct and sole application of Libyan law, but have made reference to the general principles of law, and since "a" system must be govern, "the only system that is left is public international law".[123] Eventually, the arbitrator concluded his decision regarding the applicable law by stating

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[120] Ibid., at 328.
[121] Ibid., at 328.
[122] Ibid., at 328.
[123] Ibid., at 329.

The tribunal cannot accept the submission that public international law applies, for Paragraph 7 of Clause 28 does not so stipulate. Nor does the BP Concession itself constitute the sole source of law controlling the relationship between the Parties. The governing system of law is what that clause expressly provides, *vis* in the absence of principles common to the law of Libya and international law, the general principles of law [must be applied], including such of those principles as may have been applied by international tribunals.

2.4.2. Texaco Overseas Petroleum Company and California Asiatic Oil Company *v.* the Government of the Libyan Arab Republic

(a) The facts

Between 1955 and 1968 the Government of Libya granted two American companies, Texaco Overseas Petroleum Company (Topco) and California Asiatic Oil Company (Calasiatic) 14 petroleum Concession Agreements.[124] Most of these agreements were modified between 1963 and 1971 with the consent of the Government and the Companies.[125] The purpose of the modifications was to bring these Concessions in line with the amendments to Libya's petroleum laws.[126] These Concession Agreements contained the same provisions concerning the mechanism for solving disputes as the previous case, arbitration was a last resort, and the arbitration provisions were the same as above.[127]

(b) The nature of the dispute

The dispute between the Government and the Companies arose in 1973, as a consequence of Libya's attempts to gain control over its petroleum resources. Libya promulgated law no. 66/1973, by which it nationalised 51% of the properties, rights and

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[124] 53 ILR 389 (1979).
[125] 4 YBCA 177 (1979).
[126] See 53 ILR 389 (1979); 4 YBCA 177 (1979).
[127] See supra notes 94, 98-101.

assets of both Companies (Topco and Calasiatic).[128] In return, the same law provided for compensation to be paid by the Government to the Companies. Article 2 of the Decree established a special committee to determine the compensation. In 1974, another decree of nationalisation (law no. 11/1974) was issued by the Libyan Government which nationalised the remaining 49% of the properties, rights and assets of both Companies, relating to all 14 Deeds of Concession they were holding.[129]

The Companies rejected the Libyan action and refused to accept the offer of compensation that had been suggested by the Government. Accordingly, they commenced arbitration procedures according to Article 28 of the deed of the Concession. On 2 September 1973 the Companies informed the Libyan Government that they had already designated an arbitrator and they asked the Libyan Government to do the same. As the Libyan Government refused, the Companies requested the president of the International Court of Justice to designate an arbitrator to hear and determine both disputes (1973, 1974).[130]

The Libyan Government not only refused to designate an arbitrator, it rejected the need for arbitration, on the grounds that Article (28)[131] of the Deeds of Concession considers arbitration as a last resort in dispute settlement, yet amicable methods had not yet been exhausted. Libya's objection was sent to the president of the International Court of Justice on 26 July 1974.[132] However, the president rejected Libya's claim and appointed Professor R. J. Dupuy as a sole arbitrator. Following this episode, Libya did not participate in the arbitration proceedings. The arbitrator began by examining his jurisdiction over the dispute.[133] On 27 November 1975 the arbitrator rendered an interim award in which he declared his jurisdiction over the dispute.[134]

(c) Applicable law

The claim which was submitted by the Companies to the tribunal focused primarily on the argument that the Deeds of Concession were binding upon the parties

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[128] This law also nationalised seven other petroleum companies, 53 ILR 390 (1979).
[129] 53 ILR 390 (1979).
[130] Ibid., at 390.
[131] See Art. 28 (1) supra note 98.
[132] 53 ILR 390 (1979).
[133] Ibid., at 391.

and that therefore the Libyan Decrees of 1973 and 1974, as well as subsequent Libyan action, breached Libya's obligations. They asked that Libya be held to perform the Deeds of Concession and fulfil their terms.[135]

In determining the applicable law, the arbitrator began by examining the nature of the Deeds of Concession, asking "whether the legal acts through which plaintiffs obtained concessions from the Libyan state are contracts?"[136] The arbitrator concluded, based on the general principles of law and the teaching of comparative law, that the deeds were in fact contracts.[137] The arbitrator then turned to the question of which law should govern these contracts, and whether the contracting parties have the right to choose in accordance with the doctrine of party autonomy. Professor Dupuy argued that "it seems desirable to establish a distinction between the law which governs the contract and the legal order from which the binding nature of the contract stems."[138] He also added that the judgement of the Permanent Court of International Justice in the *Serbian Loans* case was no longer relevant,[139] because the trends of contractual practices meant increasing delocalisation of the contract between a state and a foreign company.[140] He stated

> For the time being, it will suffice to note that the evolution which has occurred in the old case law of the Permanent Court of International Justice is due to the fact that, while the old case law viewed the contract as something which could not come under international law because it could not be regarded as a treaty between states, under the new concept treaties are not the only type of agreements governed by such law. And it should be added that, although they are not to be confused with treaties, contracts between states and private persons can, under certain conditions, come within the ambit of a particular and new branch of international law: the international law of contracts.[141]

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[134] Ibid., at 418-419.
[135] Ibid., at 437.
[136] Ibid., at 438.
[137] For more detail see ibid., at 438-441.
[138] Ibid., at 443.
[139] *Serbian Loans case*, [1929] PCIJ Series A. no. 20, at. 41
[140] 53 ILR 445-447 (1979).
[141] Ibid., at 449.

Thus, Professor Dupuy concluded that

The reference which is made mainly to the principles of international law and, secondarily, to the general principles of law must have as a consequence the application of international law to the legal relations between the parties.[142]

Hence, Professor Dupuy, ignored the Libyan law which had been cited in Article 28 (7) and interpreted this clause as primarily a choice of public international law.[143]

2.4.3. Libyan American Oil Company (LIAMCO) *v.* the Government of the Libyan Arab Republic

(a) The facts

The Libyan American Oil Company (LIAMCO) was granted three concession agreements in 1955 by the Government of Libya (nos. 16, 17, and 20) after it met the requirements of the Libyan Petroleum Law of 1955.[144] LIAMCO was given the exclusive right for fifty years, renewable for an additional ten years to search for, extract and sell petroleum from specified areas of Libya.[145] Amendments of these concessions took place between 1955 and 1968.[146] In exchange, Libya would receive an annual rent,[147] royalties[148] and annual taxes.[149] All these Concessions contained an arbitration clause, Clause 28.[150]

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[142] Ibid., at 450.

[143] Christopher Greenwood, "State Contracts in International Law – The Libyan Oil Arbitrations", supra note 92, at 46.

[144] 62 ILR 141 (1982); for more details on the Libyan petroleum law see supra note 98.

[145] 62 ILR 141 (1982).

[146] For more details on the amendments see ibid., at 152-155 and 159-160. LIAMCO assigned part of its interests in the concessions to other companies, retaining only a 25.5% share by 1973, ibid. at 156.

[147] Under Clause (6) LIAMCO would pay for each 100 square kilometres of concession territory, as follows:
- Ten Libyan pounds yearly for the first eight years;
- Twenty Libyan pounds for each of the next seven years, or until petroleum is discovered in commercial quantities, whichever date shall come first;
- 2500 Libyan pounds for each year thereafter, ibid., at 158.

(b) The nature of the dispute

The dispute arose in the same process of Libyan nationalisation of foreign petroleum companies. On 1 September 1973 the Libyan Government issued law no. 66, article (1) of which nationalised 51 % of the concession rights of a number of petroleum companies, including LIAMCO.[151] As mentioned above, the Libyan Government offered compensation to all petroleum companies.[152] In the same vein, the Libyan Government nationalised the remaining 49% of the rights and assets of LIAMCO, on 11 February 1974 under law no. 10/1974.[153] This law provided identical methods of compensation to those which had been provided by law no. 66/1973 above.

Reaction to the Libyan act came not only from LIAMCO but also from the United States. On 4 September 1973 the State Department of the United States protested against the Libyan action, arguing that Libya should fulfil all its international obligations and respect all the rights of the petroleum companies operating in Libya.[154] On 20 June 1974 the State Department addressed another note to the Libyan Government, this time alleging that the Libyan action was only political retaliation. The American allegation read as follows

> Under the principles of international law, measures taken by a state against the interests of foreign nationals, which are motivated not by reason of public utility, but of political retaliation against the state of which those nationals are citizens, are invalid and are not entitled to recognition by other states...[and the Department calls on Libya to] discharge its responsibilities under international law, including the payment of prompt, adequate and effective compensation for the interests affected by the Decree of February 11, 1974.[155]

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[148] Under Clauses 7 and 9 the royalties were 12.5% of the value of field production of petroleum to be paid quarterly, ibid., at 158.

[149] See Clause 8, ibid., at 158.

[150] See supra notes 94, 98-101.

[151] 62 ILR 140, 162 (1982).

[152] See 6 YBCA 91 (1981).

[153] 62 ILR 140, 163 (1982).

[154] Ibid., at 164.

[155] Department of State File no. D74 0146-1148, *Digest of United States Practice in International Law*, 1975, at 490. It could be argued that the American allegation that Libyan nationalisation was only political retaliation was inaccurate, because Libyan nationalisation affected many petroleum

LIAMCO directly invoked the arbitration clause, but Libya rejected the need for arbitration. Hence, LIAMCO initiated arbitration proceedings and addressed a letter to the president of the International Court of Justice on 2 July 1974. Another letter dated 17 January 1975 to the president asked him to nominate a sole arbitrator to determine the dispute.[156] On 27 January 1975 the president of the International Court of Justice appointed Dr. Sobhi Mahmassani, Counsellor-at-law of Beirut, as a sole arbitrator to hear and determine the matters of the dispute.[157]

The arbitrator began his task by convoking the parties. Libya did not appear at the arbitration proceedings. However, LIAMCO requested the arbitrator to declare that the Libya's nationalisation laws constituted a fundamental breach of the concessions and they were ineffective to transfer rights under the concessions. It also requested the restoration of its rights under the concessions. Alternatively, LIAMCO claimed damages or compensation.[158]

(c) Applicable law

In order to determine the applicable law, the arbitrator first, examined the nature of petroleum concession agreements in general and Libyan petroleum agreements in particular: that their parties normally consist of a state and a foreign company; that the subject matter of petroleum agreements is a long-term exploitation of natural resources; that although these contracts are a combination of public and private legal character, they still maintain their contractual nature.[159] The arbitrator concluded that where the contracting parties are from different nationalities and their legal systems are different, it is unfair to rely on one system and ignore the other unless the parties had already agreed to do so. Therefore, he argued that the tribunal's task is to seek guidance from the general principles governing the conflict of laws in private international law.[160] The arbitrator stated that

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companies, see for instance ibid., at 161-162; see also *BP Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic*, 53 ILR 297 (1979).

[156] 62 ILR 146-147 (1982).

[157] Ibid., at 148.

[158] Ibid., at 142; see also 6 YBCA 89, 91-92 (1981).

[159] See 62 ILR 140, 169 (1982).

The proper law governing LIAMCO's Concession Agreements, as set forth in the amended version of said Clause 28, Para. 7, is in the first place the law of Libya when consistent with international law, and subsidiarily the general principles of law. Hence, the principal proper law of the contract in said Concession is Libyan domestic law. But it is specified in the Agreements that this covers only "the principles of law of Libya common to the principles of international law". Thus, it excludes any part of Libyan law which is in conflict with the principles of international law.[161]

After the arbitrator had analysed the principles of Libyan law which are in fact mostly derived from Islamic law, he pointed out that "Libyan law in general and Islamic law in particular have common rules and principles with international law, and provide for the application of custom and equity as subsidiary sources".[162] He further stated that since these principles are consistent and in harmony with the proper law that has been chosen by the parties in Clause 28 (7), the said agreements are governed primarily by principles of Libyan law "as are common to the principles of international law".[163] As noted above, Paragraph (7) provides for "the general principles of law as may have been applied by international tribunals", where Libyan law and international law conflict.[164]

The arbitrator last concluded

> These general principles are usually embodied in most recognised legal systems, and particularly in Libyan legislation, including its modern codes and Islamic law. They are applied by municipal courts and are mainly referred to in international and arbitral case law. They, thus, form a compendium of legal precepts and maxims, universally accepted in theory and practice. Instances of such precepts are, *inter alia*, the principles of the sanctity of property and

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[160] Ibid., at 171.

[161] Ibid., at 173; Clause 28 (7) reads "this concession shall be governed 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 as may have been applied by international tribunals", see supra note 86.

[162] Ibid., at 175.

[163] Ibid., at 175.

[164] Ibid., at 175.

contracts, the respect of acquired vested rights, the prohibition of unjust enrichment, the obligation of compensation in case of expropriation and wrongful damage, *etc.*[165]

It is clear that the arbitrator gave significant consideration to Libyan and Islamic law, and he concluded that Libyan law was sufficient to be the applicable law however, he did not apply Libyan law.[166]

Concluding remarks

Has our discussion of the Libyan cases *BP v. Libya*, *Texaco* and *California Asiatic v. Libya* and *Libyan American Oil Co.* (*LIAMCO*) *v. Libya*, shed any light on the dilemma of applicable law in petroleum disputes? The three Libyan cases were exactly the same in their facts and circumstances, but the conclusion of each arbitrator was completely different. Furthermore, all three Concession Agreements specified the choice of Libyan law explicitly (and where Libyan law conflicted with international law, then the general principles of law).

However, Judge Gunnar Lagergren, in the *BP v. Libya* case, noted that this provision excludes the application of any municipal legal system, so without justification he excluded Libyan law. He finally concluded that general principles of law should govern the dispute.

In the *Texaco* and *California Asiatic v. Libya* case, Professor Dupuy went a little further because after he had asked whether the contracting parties have the right to determine the applicable law, he argued that under a new concept of international law contracts between states and private aliens, contracts should be delocalised or internationalised in the sense of being subject to public international law. He also reported that Clause 28 (7) refers to "principles", not "rules" of Libyan law, and the application of principles of Libyan law does not rule out the application of international

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[165] Ibid., at 175-176.
[166] See 6 YBCA 89-118, 94 (1981).

law principles.[167] He concluded that public international law should govern the dispute, also without given any consideration to the law of Libya.

In the *Libyan American Oil Co.* (*LIAMCO*) *v. Libya* case, Dr. Mahmassani, after a considerable analysis of Libyan and Islamic law principles, and after determining the meaning of the term "principles of international law" with reference to Article 38 of the Statute of the International Court of Justice, reached the conclusion that Libyan law and international law both apply custom and equity, and that general principles are embodied in Libyan legislation and Islamic law, including the principles of the sanctity of property and contracts, respect for acquired vested rights, a prohibition of unjust enrichment and the obligation to pay compensation for expropriations. Although of all these principles which are embodied in Libyan and Islamic law, and which are sufficient to govern the dispute, the arbitrator did not apply Libyan law, but he was convinced that the provisions of the agreement could govern the dispute. In other words, the arbitrator held that the governing law of the contract was the law of Libya, where it was not in conflict with the principles of international law.

An analysis of these decisions seems to reveal a considerable degree of protection of foreign petroleum companies irrespective of any juridical principles. The clear intention of clause 28 (7) was that the concession agreements should be governed by the principles of the law of Libya,[168] but "if this was the intention, it was not fulfilled".[169] Fatouros stated in his analysis of the *Texaco/Calasiatic* award that

> [To better] to understand the *Texaco/Calasiatic* award, one must put it in historical perspective. It reflects a significant doctrinal (and to a far lesser extent practical) trend which started in the 1950s and peaked sometime in the mid-1960s, based in major part, but by no means exclusively, on the concern of

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[167] See R. Doak Bishop, "International Arbitration of Petroleum Disputes: The Development of A *Lex Petrolea*", 23 YBCA 1131-1210, 1149 (1998).

[168] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note 9, at 106.

[169] Ibid., at 106.

western ("First World") lawyers for the protection of foreign investors in developing countries.[170]

[170] A. A. Fatouros, "International Law and the Internationalised Contract", 74 *American Journal of International Law* 13-141, 140 (1980).

2.5. Government of the State of Kuwait *v.* the American Independent Oil Company (AMINOIL)[171]

(a) The facts

On 28 June 1948 the American Independent Oil Company (Aminoil), a Delaware corporation was granted a petroleum concession agreement for the exploration and exploitation of petroleum and natural gas for sixty years[172] by the Ruler of Kuwait in the Kuwaiti part of the Neutral Zone between Kuwait and Saudi Arabia. Article 2 of the Agreement specified the Company's obligation to conduct its operations in a workmanlike manner and using appropriate scientific methods.[173] In exchange, the Ruler was granted royalties. According to Article 3, the Company shall make an immediate payment to the Ruler of a sum of US $ 625, 000, followed after thirty days by a sum of US $ 7.25 million. Moreover, the ruler would receive an annual royalty of US $ 2.5 dollars for every ton of petroleum that have been won and saved by Aminoil, subject to a minimum annual royalty of US $ 625,000.[174] Article 11 authorised the Ruler to terminate the Agreement in any of three specified cases: failure by the Company to perform its obligations in accordance with aforesaid Article 2; failure by the Company to make any of the payments due under Article 3; and if the Company is in default under the arbitration provisions of Article 18.[175] However, Article 17 prevented the Ruler from annulling this Agreement except as provided for in the previous Article, nor could he

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[171] See the complete text of the Agreement in: *Selected Documents of the international Petroleum Industry*: *Iraq and Kuwait, Pre-1966* (hereinafter *Documents*), (Vienna: OPEC 1974), at 127; see also, (1982) 21 ILM 976-1053; (1984) 66 ILR 519-627; (1984) 6 YBCA 71-96; see also Pierre-Yves Tschanz, "The Contribution of the Aminoil Award to the Law of State Contracts" 18 *International Lawyer*, 245-281 (1984); Fernando R. Teson, "State Contracts and Oil Expropriations: The Aminoil-Kuwait Arbitration", 24 *Virginia Journal of International Law* 323-358 (1984).

[172] Art. (1) "the period of this Agreement shall be sixty (60) years from the date of signature", *Documents*, supra note 171, at 127; 66 ILR 547 (1984).

[173] Art. 2 (c) clearly provided that "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 Sheikh and His Foreign Representative informed generally as to the progress and result of its drilling operations but such information shall be treated as confidential", *Documents*, supra note 171, at 128; 66 ILR 547 (1984).

[174] *Documents*, supra note 171, at 128-129. This is just an example of inconsiderable amounts host states received from petroleum companies.

[175] Ibid., at 137; 66 ILR 548 (1984).

make any amendments to the Agreement's terms without the Company's consent.[176] The Agreement also contained an arbitration clause, Article (18), referred to arbitration to solve any difference or dispute between the parties concerning the interpretation or execution of the Agreement.[177]

Negotiation between the Government of Kuwait and Aminoil to revise the 1948 Agreement was immediately initiated after Kuwait became independent in 1961.The negotiation led to the signing of a Supplemental Agreement on 29 July 1961.[178] Financial clauses of the 1949 Agreement were mainly amended as well as the Company was subjected to Kuwait Income Tax Law.[179] A new article substituted Article 11 of the 1949 Agreement; paragraph (A) of the new Article 11 gave the Ruler the right to terminate the Concession in the event of a default by the Company on its payments.[180]

(b) The nature of the dispute

After Kuwait became independent it began its efforts to gain control over its economic resources especially the petroleum sector. The Supplemental Agreement outlined above was a part of this process, and the Kuwaiti Constitution which was promulgated on 11 November 1962 asserted the importance of natural resources, that natural wealth and resources are the property of the state.[181] Moreover, Article 152 of the new Constitution determines that "any concession for the exploitation of a natural resource or of a public utility shall be granted only by law and for a determinate period".

Other negotiations between the Kuwaiti Government and Aminoil led to the signing of a draft agreement on 16 July 1973. The draft agreement introduced significant modifications to the 1949 and 1961 agreements;[182] especially in terms of tax rates, and the inclusion of a choice of law clause and a new arbitration clause.[183] The draft agreement has not been ratified, although it was modified three times in 1974. In the same period, some petroleum countries begun discussing resolutions that had been

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[176] *Documents*, supra note 171, at 136
[177] Ibid., at 137.
[178] Ibid., at 243.
[179] 66 ILR 549 (1984); see Art. 1 of the Supplemental Agreement, *Documents*, supra note 171, at 244-246.
[180] Ibid., at 252, see the complete Article in *Documents*, at 252-253.
[181] Art. (21), "all of the natural wealth and resources are the property of the state."
[182] 66 ILR 554 (1984).
[183] Ibid., at 553.

issued by the Organisation of the Petroleum Exporting Countries (OPEC); the 'Abu Dhabi Formula' was one of these resolutions.[184] Kuwait informed the Company about the new policies concerning the tax rate, but the Company denied ever having received advice from the Government.[185] The new policies on tax rates were not accepted by Aminoil and negotiations between Aminoil and the Government commenced, but no agreement was reached. Therefore the Government appointed on 27 March 1977 a committee to complete all negotiations on pending matters between the parties.[186] The Company's profits and how much it should it pay to the Government were the disputed issues. In spite of efforts by both parties to reach an agreement, the new negotiations failed. Hence, on 19 September 1977 the Government of Kuwait terminated the 1948 Aminoil Concession Agreement.[187] All interests, funds, assets, facilities and operations of the Company according to Article 2 of the decree, reverted to the state, in exchange for fair compensation to be paid to the Company, for which a special committee would be set up by the Minister of Oil.[188] The Kuwait Government stated that the take-over of Aminoil was necessary for the national interest because the latter failed to agree to the Government's terms.[189]

The Company protested against the take-over and notified the Government that it would invoke Article 18 of the Concession Agreement of 1948, initiating arbitration proceedings. Eventually, agreement was reached by the parties to hold an *ad hoc* arbitration, and an arbitration agreement was concluded on 12 July 1979.[190]

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[184] At the 42nd (Vienna) meeting of OPEC (12 and 13 December 1974) the following decision was adopted: "the Conference...decided to adopt a new pricing system based on the financial effect of the decision taken on the 10 and 11 November 1974, in Abu Dhabi. In accordance with this decision the average government take from the operating oil companies will be $10.12 per barrel for the market crude", 9 YBCA 71-96, 76 (1984).

[185] 66 ILR 555 (1984).

[186] Ibid., at 555.

[187] The Kuwait Government issued on 19 September 1977 Decree Law No. 124, "[T]erminating the Agreement between the Kuwait Government and Aminoil", Article (1) of the Decree provided that "the Concession granted to the American Independent Oil Company in accordance with the aforementioned Agreement dated 28 June 1948 shall be terminated", ibid., at 558.

[188] Art. (3) provided "a committee named the Compensation Committee shall be set up by a decision of the Minister of Oil whose task it will be to assess the fair compensation due to the Company as well as the Company's outstanding obligations to the State or other parties. It shall decide what each party owes the other in accordance with this assessment. The state or the Company shall pay what the Committee decides within one month of being notified of the Committee's decision", ibid., at 558.

[189] Explanatory Memorandum accompanying Decree Law no. 124, ibid., at 558.

(c) Applicable law

The parties agreed to solve all differences and disagreements between them amicably,[191] therefore they turned to transnational arbitration and concluded an Arbitration Agreement. The Agreement provided that the tribunal should consist of three members; two of whom would be appointed by each party and the third member who would act as president would be appointed by the president of the International Court of Justice.[192] The Arbitration Agreement left designation of the substantive law to the discretion of the tribunal. Article 3 Paragraph (2) provided that

> The law governing the substantive issues between the parties shall be determined by the tribunal, having regard to the quality of the parties, the transnational character of their relations and the principles of law and practice prevailing in the modern world.[193]

Concerning determination of the applicable substantive law, the tribunal in the first instance observed that the law of Kuwait applied to many matters, "over which it is the law most directly involved."[194] Hence, the tribunal only observed the objective criteria in the dispute. In which in the absence of a choice of the applicable law, the law which has the most connected factors to the dispute should be applied. The tribunal later considered the choice of law in other Kuwait petroleum concessions.[195] However, the tribunal did not pay any attention to the Kuwait argument that international law was part of the law of Kuwait. Finally, the tribunal concluded that the contract was an international agreement and should be governed by the application of international law.[196]

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[190] Ibid., at 559.
[191] Art. I of the Arbitration Agreement, ibid., at 532.
[192] Art. II, ibid., at 532; the tribunal consisted of Sir Gerald Fitzmaurice, Prof. Hamed Sultan, and as a chairman, Prof. Paul Reuter.
[193] Ibid., at 533.
[194] Ibid., at 560.
[195] See for instance the Offshore Concession Agreement of the Arabian Oil Company; see also the Oil Concession Agreement with the Kuwait National Petroleum Company and Hispanica de Petroleos.
[196] See for instance, A. F. M. Manniruzzaman, "State Contracts and Arbitral Choice-of-Law Process and Techniques: a Critical Appraisal", 15 (3) J Int'l Arb 65-92 (1998).

Concluding remarks

The decisions of the arbitrators in these cases concerning the applicable law to the merits of the dispute were in summary:

In the *Abu Dhabi* case, the Umpire at first excluded the application of Abu Dhabi law due to two reasons. First, the apparent insufficiency of Islamic law to govern modern commercial instruments. Second, that the parties had based their contract on "good will and sincerity of belief". So the clause required as the Umpire interpreted, "principles rooted in the good sense and common practice of the generality of civilised nations". However, this conclusion seems artificial since all contracts join common principles and are in theory based upon good will and sincerity of belief.[197] Hence, Lord Asquith resorted to a non-municipal law as Maniruzzaman stated, to "deal with the matters in hand."[198]

In the *Qatar* case, the referee came to the same conclusion as Lord Asquith, that Qatar law, which is based on Islamic law, is inadequate for the new commercial contracts, especially petroleum contracts. Moreover, he thought that the (contracting) parties, at the time of contracting, had no intention of applying Islamic law.

In the *Aramco* case, the tribunal followed the same reasoning, arguing that no national law was adequate to govern petroleum contracts.

The arbitrators' decisions in the *Libyan* cases were the strangest. These three cases were exactly the same in their facts and circumstances but the decisions were completely different.[199]

In the *Aminoil* case, the tribunal in the first instance agreed that the law of Kuwait applied on the basis that, among other things, it was the law most directly involved. However, the tribunal subsequent realised the internationalisation of the contract by the application of international law.

Unfortunately, in all these cases the determination of the applicable law has had two considerable flaws. First, arbitrators abused the principles of private international law which determines that in the absence of explicit or implied choice of law by the contracting parties, arbitrators to some extent are required to apply the principles of the

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[197] Ibid., at 73.
[198] Ibid., at 73.
[199] See *Libyan* cases above.

conflict of laws rules. In other words arbitrators in all these cases chose (*voie directe*) method which should only be activated falling a choice of law by parties. Second, there was a complete disregard of the will of the parties, since the contracting parties in some cases (e.g. Libyan cases) had already chosen the applicable law. However, arbitrators deliberately ignored this choice which simply means that they ignored the doctrine of party autonomy. The rationale for these flaws was just an attempt to avoid the application of the host state's law. This may be a consequence of the lack of knowledge of that law, or just an attempt to protect the benefit of petroleum companies irrespective of legality or illegality of these decisions. However, it is also a serious blow to party autonomy.

It could be argued that it is a considerable matter that arbitrators are required to respect and apply the law which has been chosen by the parties whether national or international. Therefore, it is unjustified to ignore the national law and start looking for another law or rules when that law is capable to govern the dispute.

Thus, do these decisions illuminate any legal principles in the sphere of petroleum arbitration?[200] To some extent it may be argued that these decisions cannot and should not be considered as a dogma in petroleum arbitrations, as all these decisions as stated above were just an attempt to consider the interest of petroleum companies. Furthermore, all those concession agreements were concluded during the period of colonisation. So it is easy to argue that the will of the host state was diminished if not null and void. Kuwait, for instance, amended its contract with *Aminoil* once it became independent. In addition, it was argued by tribunals that all Arab Countries during that era lacked an advanced legal infrastructure suitable for dealing with new commercial agreements, especially petroleum agreements. Hence, if this allegation was correct, it is unfair to quote literally decisions were given in a dark time (if this description is accurate) and apply them now in an environment that has achieved advanced elements especially these which related to laws sphere. Moreover, most members of these arbitral tribunals were only trying to avoid any resort to the host state's law, though that law had already been designated as the applicable law in most of these agreements, and there

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[200] See Fernando R. Teson, "State Contracts and Oil Expropriations: The Aminoil-Kuwait Arbitration", supra note 171, at 324.

were some votes which said of applicability of the national law to govern the dispute.[201] Consequently, it may be impartiality the adherence to the speech which said "western oil companies operating in the Middle East, were driven by political and economic consideration, generally without even an attempt to fit them into international legal doctrine."[202]

[201] See for instance, the opinion of Milliot in *Qatar* case; see also opinions of Abu Zahra, Anderson and Joseph Schacht in *Aramco* case; supra note 87.

[202] Andreas F. Lowenfeld, *International Economic Law*, (Oxford: Oxford University Press 2002), at 407.

Chapter Two: The Theories Examined

Introductory remarks

This chapter discusses the problem of applicable law in international arbitration in general, and in petroleum disputes specifically, from a theoretical perspective, by giving thorough analysis of approach or mechanisms that have being used in the way of determining the applicable law to the substance of a dispute.

1.1. Determination of the Applicable Law

1.1.1. Determination of the applicable law by the parties (party autonomy)

Contracting parties are familiar with their contractual rights and obligations of at least their expectations; therefore, they are generally capable of determining all aspects that arise in their contract especially the law which will govern their relationship and any dispute that may arise during its course. If the parties have determined the applicable law they can freely exercise this right at any time even after a dispute has arisen or before the arbitral tribunal. The aforesaid freedom of the contracting parties is known as party autonomy or the will of the parties. This simply means that the parties of a contract are free to shift their contractual obligations from the supervision under a national court to an arbitral tribunal, at the time of contracting as well as at any other time and subject it to the law of their choice.

The doctrine of party autonomy has been widely accepted in most modern laws and rules, as well as in the major international conventions. The first example of party autonomy can be seen in the Geneva Protocol on Arbitration of 1923, which was prepared under the auspices of the League of Nations. This Convention gives the contracting states the right to submit their differences to arbitration.[1] Then came Geneva Convention of 1927, which aimed to extend the mission of the previous Protocol in

[1] See Art. 1 of the Protocol.

terms of enforcing the arbitral awards.[2] The Washington Convention of 1965 on the Settlement of Investment Disputes between States and Nationals of Other States, which established the International Centre for Settlement of Investment Disputes (ICSID), asserted the doctrine of party autonomy. Article 42 (1) provides that "the tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties."[3] This doctrine was also confirmed by the Institute of International Law in its resolution on arbitration between states, state enterprises or state entities, and foreign enterprises, which was adopted at the Institute Santiago de Compostela Session on 12 September 1989. Article 6 of that resolution clearly states that "the parties have full autonomy to determine the procedural and substantive rules and principles that are to apply in the arbitration."[4]

This doctrine has been asserted in numerous contemporary laws in developed as well as in developing countries. Section 46 (1) of the 1996 English Arbitration Act for instance, provides that

> The arbitral tribunal shall decide the dispute:
>
> a) in accordance with the law chosen by the parties as applicable to the substance of the dispute, or
>
> b) if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal.

The same situation is also found in some developing countries, for instance, the Omani Law of Arbitration in Civil and Commercial Matters,[5] which is based on the UNCITRAL Model Law, and provides in Article 6 (1) that "the arbitration parties have the autonomy to determine the law that arbitrators apply to the dispute's matter." Moreover, party autonomy is well established in all modern arbitration institutions. The Rules of the GCC Commercial Arbitration Centre (Bahrain) for instance, provide in

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[2] See the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927.
[3] ICSID Basic Documents, 1985, International Centre for Settlement of Investment Disputes, at 22.
[4] See the resolution and comments by Von Mehren in 16 YBCA 233-239 (1991).
[5] This Law was issued on 28 June 1997, and it was published in the Gazette no. 602 (1997).

Article 12 that "the parties shall have the liberty of deciding the law, which the arbitrators shall apply to the issue in dispute [...]."[6] The Centre seems to have followed the rules of the leading institutions, such as the rules of the International Chamber of Commerce (ICC),[7] the London Court of International Arbitration (LCIA),[8] and UNCITRAL Rules Article 33.

(a) How the parties choose the law

The contracting parties, as previously stated, can practice their freedom in terms of choosing the applicable law in two ways. First, they can make an express choice, in a written contract at the time of contracting or after, or can express their choice before the arbitral tribunal. The Rome Convention, Article 3, emphasises that the parties have the right to choose any law at any time.[9]

The second method of choice of law by the parties is in the form of an implied or a tacit choice of law, and this form may be expressed in words or actions, which illustrate that the parties have chosen a specific law as an applicable law to govern their relations.[10] Several factors play a significant role in terms of manifesting the intention and expectation of the parties' choice of a specific law. Lew argues that there are two forms of implied choice of law, which are: "implied autonomy on the basis of surrounding facts and implied autonomy on the basis of the language used."[11]

However, the implied choice of law is not always clear to the arbitrators and can cause conflict or disagreement between the parties and arbitrators. The following cases

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[6] See these rules in the Directory of Lawyers & Jurists in the GCC States, supra note 3, at 9 (the English Section).

[7] ICC Rules, Art. 17 (1) provides that, "the parties shall be free to agree upon the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute [....]."

[8] LCIA Rules, Art.22 (3) states that, "the Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute [...]"; see also the WIPO Arbitration Rules (effective from 1 October 2002), Art. 59; AAA Arbitration Rules (amended and effective on 1 July 2003), Art. 28.

[9] Convention on the Law Applicable to Contractual Obligations, opened for signature in Rome on 19 June 1980.

[10] For more details on party autonomy in general see Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, (Dobbs Ferry, New York: Oceana Publications 1978), at 71-210; see also Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, (The Hague: Kluwer Law International 2003), at 413-424.

[11] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, ibid.,, at 184 -204.

demonstrate the necessity for an express choice of law by the parties.

In an award made on 23 October 1979[12], the respondent argued that in the absence of any explicit clause in the text of the Risk Exposure Bank Guarantee, the guarantee is governed by Belgian law. In this case, fortunately, the claimant at the hearing had not expressed any opposition to the application of Belgian law, otherwise it could not have been possible to have agreement upon the applicable law.

In the interim award of Case no. 4650 of 1985, there was no express choice of law in the agreements, and an argument about the applicable law arose between the parties.[13] The claimant argued that the law of the state of Georgia, USA, should be applied, since all significant work would be provided there, but the claimant submitted the Swiss substantive law of the *lex fori*. The respondent contended that Saudi Arabian law should be applied because the obligations were to be wholly performed in Saudi Arabia.

In a contract between a buyer from Mozambique and a seller from the Netherlands, the contract contained an arbitration clause stating that,

> Both parties undertake to fulfil this contract in good faith. Any dispute arising in consequence thereof, or in connection therewith [....], must finally undertake to submit the matter according to the regulation for agreement and arbitration of the International Chamber of Commerce to one or more arbitrators as per the said laws. The arbitration will take place in Switzerland, the law applicable is that known in England.

The controversial issue before the arbitral tribunal after a dispute had arisen was the meaning and effect of the words "the law applicable is that known in England[14].

Another example illustrates necessity of an express choice of law. In a partial award in Case no.7319 of 1992[15] between two parties, a French manufacturer (the

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[12] ICC Case no. 3316 (1979) between *Mexican Construction Company v. Belgian Bank*, Collection of ICC Awards, (1974-1985) at 87, reprinted in (1980) 107 *Journal de Droit International* (*Clunet*), 970-974.

[13] ICC Case no. 4650 (1985) between *American Architect v. Saudi Arabian company*, Collection of ICC Arbitral Awards, (1986-1990), at 67.

[14] Preliminary award of ICC Case no. 5505 (1987), Collection of ICC Arbitral Awards (1986-1990), at 142.

[15] See the award in 24 YBCA 141 (1999).

claimant) and an Irish distributor (the respondent), the arbitrator referred to the agreement between them which contained an arbitration clause stating, "this Agreement shall be construded (sic) in accordance with and governed by laws and regulations applying to members of the European Economic Community." After the dispute had arisen the issue of the applicable law was among disputed issues before the arbitral tribunal.[16]

However, is it possible for the parties to choose a hypothetical law? Or to choose conflict laws or rules of a given legal system? Or should their choice always refer to a substantive law of that system? Furthermore, can the parties choose a non-national law?

It has been argued that the parties must choose a specific law and not merely a hypothetical one.[17] Moreover, according to this argument, the parties' choice of applicable law is concerned with the substantive law of a given legal system, not the conflict of laws rules of that system (exclusion of *renvoi*).[18] This understanding has been endorsed in many laws such as the 1996 English Arbitration Act,[19] and the UNCITRAL Model Law, Article 28 (1) of which provides that

> ....Any designation of the law or legal system of a given state shall be construed, unless otherwise expressed, as directly referring to the substantive law of that state and not to its conflict of laws rules.

This position has been accepted in many Arab countries which have already adopted the UNCITRAL Model Law, such as Oman.[20] Furthermore, it is generally agreed that the parties can govern their dispute with a non-national law, such as *lex mercatoria* or *UNIDROIT* Principles. The parties can also choose more than one law, i.e. they can choose different laws to govern different aspects of their contract known as

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[16] 24 YBCA 142 (1999).

[17] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 71-210; see also Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 415.

[18] Ibid., at 416.

[19] Art. 46 (2) provides that, "for this purpose the choice of the laws of a country shall be understood to refer to the substantive laws of that country and not its conflict of laws rules."

[20] The Omani Arbitration Law in Civil and Commercial Matters, supra note 5, Art. 39 (1).

"*depecage.*"[21] This also has been well accepted in international conventions [22] as well as before tribunals. [23]

Finally, are there any limitations (statutory or other) to party autonomy?

(b) Limitations to party autonomy

Generally, arbitrators should respect and consider the choice of the parties in terms of determining the applicable law. However, it is possible to find certain exceptions to the doctrine of party autonomy. A number of circumstances have been suggested where arbitrators can limit or reject the parties' choice of law.[24] Fouchard Gaillard divides these circumstances into two groups, unsatisfactory restrictions of the effectiveness of the parties' choice of governing law,[25] and legitimate restrictions of the effectiveness of the parties' choice of governing law.[26] These theories will not be discussed here, since they have already been analysed in detail by scholars such as Fouchard Gaillard [27] and Lew.[28]

However, one aspect is particularly relevant here: the theory of "incompleteness of the law chosen by the parties" raises the question of the yardstick for such judgement, i.e. what requirements must a given law satisfy to be considered as a perfect or at least comprehensive law? Certain states insist upon applying their law(s) in certain contracts

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[21] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, (The Hague: Kluwer Law International 1999), *para.*1436 at 794; Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 71-210; see also Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 418.

[22] The Rome Convention on the Law Applicable to Contractual Obligations of 1980, Art. 3 (1) states that, "....by their choice the parties can select the law applicable to the whole or a part only of the contract."

[23] This method was used in the famous petroleum arbitration (*ARAMCO*) between *Saudi Arabia v. Arabian American Oil Company* (*ARAMCO*), (1963) 27 ILR 177; also used in the Channel Tunnel contract clause 68, *Channel Tunnel Group Ltd and France Manche S.A.v. Balfour Beatty Construction Ltd. and others* [1993] AC 334; 2 Lloyd's Rep 7 (1992).

[24] See Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para.* 1511at 842.

[25] This group contains three theories: a) the theory of the incompleteness of the law chosen by the parties, ibid., *para.* 1512 at 842-844; b) the extensive interpretation of international trade usages, ibid., *para.* 1513 at 844 – 846; c) the theory of international mandatory rules "*lois de police*", ibid., *para.* 1515 at 847 – 859.

[26] This group comprises two theories, ibid., *paras.* 1529-1536 at 859-864 and these theories are: a) scope of the law chosen by the parties; b) international public policy.

[27] Ibid., *para.* 1511 at 842.

[28] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 102.

such as investment contracts.[29] Unfortunately, most laws which have been regarded as insufficient in the past were those of developing countries, especially of Arab countries. In this context, this suggests that *complete law is considered as western law*. This conclusion would seem to be supported by an examination of arbitration awards. In *Petroleum Development Ltd. v. the Sheikh of Abu Dhabi*,[30] despite the fact that the law of Abu Dhabi was the law which had been chosen by the parties, Lord Asquith regarded this law as insufficient and rejected it.[31] The same rationale can be found in the *Aramco* case.[32] Moreover, in a dispute between *Southern Pacific Properties (Middle East) Limited (Hong Kong) and Southern Pacific Properties Limited (Hong Kong) v. The Arab Republic of Egypt*, the tribunal decided after it had heard the argument concerning the applicable law that the law of Egypt is incomplete; the arbitral tribunal stated that, "the law of the ARE [Arab Republic of Egypt], like all municipal legal systems, is not complete or exhaustive."[33] However, the situation has changed slightly because of increased regulations.

In order to complete the discussion of party autonomy it is necessary to examine this doctrine in Islamic law (*Shari'ah*).

(c) Party autonomy in Islamic law (*Shari'ah*)

It may be worth mentioning that Islamic law is drawn from two principal sources, the *Qura'an*, the holy book which was sent to Prophet Mohammed by God (*Allah*), and the *Sunna*, which is the speech and practice of the Prophet Mohammed. There are other secondary sources such as *Ijma'a*, the consensus of Moslem legal scholars regarding a legal issue and *Alquias* (analogy).

(i) Party autonomy in *Shari'ah*

In fact, Islam gives complete authority to Muslims to conclude contracts unless these contracts are forbidden by Islamic rules, since the origin in Islam is the permission

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[29] Marc Blessing, "Choice of Substantive Law in International Arbitration", 14 (2) J Int'l Arb 40 (1997).
[30] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, (1951) 18 ILR 144.
[31] Ibid., at 149.
[32] *Saudi Arabia v. Arabian American Oil Co. (ARAMCO)*, (1963) 27 ILR 177.

(*ebahah*). *All the conditions agreed upon by the Muslims are upheld except a condition which allows what is prohibited or prohibits what is lawful.* At the same time, Islam obliges Muslims to fulfil their obligations, "successful indeed are the believers...who are shepherds of their pledges and their covenant."[34] Prophet Mohammed also said, "Muslims are bound by their stipulations."[35] He also reported, "*Allah* says, I will be against three persons on the Day of Resurrection [one of these is he] who makes a covenant in My Name, but he proves treacherous."[36] However, *Shari'ah* does not build a theory of contract, because the development of the contracts system in *Shari'ah* is based on jurists, who "categorised each contract into classes of nominate contracts with their own distinctive rules."[37]

Furthermore, Islamic Law and the Holy *Qura'an* both emphasise the maxim of *pacta sunt servanda* as a direct order which cannot be derogated from, "O ye who believe, fulfil all obligations."[38] However, the understanding on interpretation of this maxim is varied among Muslim scholars. On the one hand, some Muslim scholars believe that this maxim is limited to the tolerance of parties' autonomy only to conclude the contract (i.e. offer and acceptance), while others believe that it also includes the substance of the contract such as the legal rules and the legal results which are governed

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[33] Award of 20 May 1992 in case no. ARB/84/3 (ICSID), 19 YBCA (1994), at 51-104; see the opinion of Georges R. Delaume, on this award "The Pyramids Stand – The Pharaohs Can Rest in Peace," 8 *ICSID Review: Foreign Investment Law Journal*, 231-263 (1993).

[34] *Sura* XXIII, verses 1.

[35] Sahih Al-Bukhari.

[36] Sahih Al-Bukhari, vol.3, book 34, no. 325.

[37] S. E. Rayner, *The Theory of Contracts in Islamic Law*, (London: Graham & Trotman 1991), at 86; see in general Noel J Coulson, *Commercial Law in the Gulf States*: *The Islamic Legal Tradition*, (London: Graham & Trotman 1984); Abd El-Wahab A. El-Hassan, "Freedom of Contract, the Doctrine of Frustration, and Sanctity of Contracts in Sudan Law and Islamic Law", 1 (1) *Arab Law Quarterly* 51-59 (1985); Mahdi Zahraa, "Characteristic Features of Islamic Law: Perceptions and Misconception", 15 (2) *Arab Law Quarterly* 168-196 (2000); Muhammad W. Islam, "Dissolution of Contracts in Islamic Law", 13 (3) *Arab Law Quarterly* 336-368 (1998); Nabil Saleh, "Freedom of Contract: What does it mean in the Context of Arab Laws?" 16 (4) *Arab Law Quarterly* 346-357 (2001); Nabil Saleh, "Origin of the Sanctity of Contracts in Islamic Law", 13 (3) *Arab Law Quarterly* 252-264 (1998); Parviz Owsia, Sources of Law under English, French, Islamic and Iranian Law: A Comparative Review of Legal Techniques", 6 (1) *Arab Law Quarterly* 33-67 (1991).

[38] *Surra* v, verse 1; it was stated that "according to the strict sanctity of valid contracts in Muslim law, a national Islamic state has no vested right to cancel or alter a contract by unilateral action, whether such action takes the form of an administrative, judicial or even legislation act. Similarly, Muslim law does not discriminate against foreigners or non-Muslim in matters of contract, and apart from certain exceptions dictated by the state of war, the Muslim community has a duty to respect its contractual obligations towards aliens and non-Muslims", S. E. Rayner, *The Theory of Contracts in Islamic Law*,

by the legislature.[39] Thus, parties cannot modify any established rule except when such modification is explicitly or tacitly allowed by the legislature itself.[40] On the other hand, there are Muslim scholars who reject this view, believing in the flexibility of the contract.[41]

It is clear that party autonomy in Islamic law is not restricted except when it is inconsistent with Islamic rules, therefore the contracting parties have full freedom to stipulate in their contracts laws or rules, irrespective whether these laws or rules are national or foreign.[42] However, public policy under Islamic law is considered to be the most significant obstacle to party autonomy. Public policy in Islamic law is divided into two groups.

The first contains the rules which have been cited in the divine sources (*Qura'an* and *Sunnah*). These rules cannot be violated or changed at any time or under any circumstances, and must be obeyed by all Muslim societies, by individual, courts and even by governments.[43] These rules include for example those which prohibit intoxicants and gambling,[44] usury,[45] and prostitution.[46] The second group of rules are those which are developed by society. As Al-Samdan[47] stated, divine law tolerates the fact that these values and notions developed, replaced, modified following the development in thinking of people due to time or place,[48] an example of these rules are those which are related to slavery.[49]

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ibid., at 87; see also Muhammad Hamidullah, *Conduct of State*, (Revised ed., Lahore: Ashraf 1945), at 130, 145.

[39] Abu –Zahra, Ibn-Hanbal, (no date), Cairo at 385, (in Arabic), quoted by Ahmed D. Al-Samdan, Contracts' Conflict Rules in Arab Private International Law: A Comparative Study on Principles of Islamic and Civil Legal Systems, (1981), A PhD. Dissertation, School of Law, Duke University, at 63.

[40] Ibid., at 64.

[41] Ibid., at 65.

[42] Ibid., at 66; see also S. E. Rayner, *The Theory of Contracts in Islamic Law*, supra note 37, at 91.

[43] Ahmed D. Al-Samdan, Contracts' Conflict Rules in Arab Private International Law: A Comparative Study on Principles of Islamic and Civil Legal Systems, supra note 39, at 122.

[44] "Oh ye who believe, intoxicants and gambling...are an abomination, of Satan's handiwork. Eschew such abomination, that ye may prosper," *Surah* v, verse 90 (*Qura'an*).

[45] "God has permitted trade and forbidden usury," *Surah* II, verse 275, verse 278 in the same *Surah* asserts this prohibition "O ye who believe, fear God, and give up what remains of your demand for usury, if ye are indeed believers."

[46] "Nor come nigh to adultery for it is a shameful deed and an evil, opening the road to other evils," *Surah* XVII, verse 32 *(Qura'an)*.

[47] See Ahmed D. Al-Samdan, Contracts' Conflict Rules in Arab Private International Law: A Comparative Study on Principles of Islamic and Civil Legal Systems, supra note 39, at 122.

[48] Ibid., at 122.

[49] Ibid., at 123, 124.

(ii) Conflict of laws (party autonomy) in Arab codifications

A significant shift occurred in the legal system of Arab countries from the beginning of the 20th century. Egypt first and then throughout most of the Arab world imported western ideas were introduced, among them was ideas and principles of private international law.[50] As stated above most Arab countries have enacted new laws inspired by *Shari'ah* as well as western laws, which widen the freedom of contractual relationships.[51] In addition, these laws are not the same, as *Shari'ah*, although some believe that they are.[52]

The following examples are evidence enough concerning the nature of new laws in Arab countries in terms of party autonomy. Article 126 of the United Arab Emirates Federal Civil code, for instance provide that a contract may contain several incidents and in general "any other thing which is not prohibited by a provision of the law and is not contrary to public order or morals."[53]

Similarly, Article 175 (1) of Kuwait Civil Code provides that

> The contract may contain any stipulation acceptable to both contracting parties provided it is not prohibited by the law or is in contravention of the public order or good manners (morality).[54]

Article 2 of Bahrain Commercial Code also upheld the party autonomy by stating that "there shall apply to commercial matters that which the two contracting parties have agreed upon provided that such agreement does not conflict with mandatory legislative provisions."[55]

In the sphere of arbitration, most Arab countries have enacted new laws most of which were based on the Model Law and party autonomy is well respected in these

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[50] Ibid., at vi.

[51] Rayner for example argues that "recent assimilation of civil law contracts into modern Islamic codes is evidence enough that this is the common point of view throughout the Muslim world today", S. E. Rayner, *The Theory of Contracts in Islamic Law*, supra note 37, at 96.

[52] Nabil Saleh, "Freedom of Contract: What does it mean in the Context of Arab Laws?" 16 (4) *Arab Law Quarterly* 346-357, 357 (2001).

[53] United Arab Emirates Federal Law of Civil Transactions, *UAE Official Gazette*, no. 158 (Dec. 1985).

[54] Decree Law no. 67 of 1980 enactment of the Civil Code, 1 December 1980.

[55] Law no. 7 of 1987.

laws.[56]

Hence, it could be argued that there is a wide range of discretion in the new Arab laws in terms of concluding contracts, as long as they do not contradict (like in other jurisdictions) with public policy or morals.

(d) Concluding remarks

It could be argued that the doctrine of party autonomy exists in the sphere of private parties, where all the contracting parties are on an equal footing in terms of bargaining power. However, the situation of contractual relationships between states and private parties, especially in the petroleum industry may not always be one of equality. Apart from the debatable sovereign immunity of the contracting state, there may be some political and financial pressures on the contracting state which lead it to compromise its autonomy. Article 24 of the Omani Standard Petroleum Exploration and Production Sharing Agreement for instance, provides for arbitration as a mechanism for settling any dispute which may arise between the contracting parties during the course of the agreement. The clause reads

> Any dispute which may arise between the Parties in respect of any clause of this Agreement or the obligations resulting therefrom during or after the term of this Agreement will be submitted to the International Centre for Settlement of Investment Disputes (ICSID) for arbitration by three (3) arbitrators pursuant to the Convention on the settlement of Investment Disputes between States and Nationals of other States. In the event ICSID declines to take jurisdiction of the dispute, then the matter will be finally settled by arbitration in accordance with the Rules of Arbitration of the International Chamber of Commerce by three (3) arbitrators appointed in accordance with such rules. The decision of the

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[56] See for instance, Kuwait Civil and Commercial Procedure Code no 30 of 1980, Article 173 which provides that "agreement may be made on arbitration in a specific dispute and on arbitration in all disputes arising from the implementation of a certain contract"; see also Qatar Civil and Commercial Procedure Code Chapter 13 (Arbitration) Article 190 which contains the same provision. Also, Oman Arbitration Act in Civil and Commercial Matters of 1997, Article 6 provides that (1) "[A]arbitration parties have the right to choose the law which will be applied by the arbitrators to the matter of the dispute." (2) "[I]f the arbitration parties have agreed to subject their legal relationship to the provisions

arbitrators shall be final and judgment may be entered in any court having jurisdiction.[57]

An oral interview was conducted by the writer on 15 August 2001 concerning the reasons for the Omani party's consent to this article, the answer was simply because "we have to accept all the requirements of petroleum companies or we would not have any investment in the petroleum sector." In such circumstances, party autonomy is a fragile concept.

It may be that a contract in a vital national sector such as the petroleum sector bears no comparison to goods contract which is normally agreed between a seller and a buyer. Consequently, the state party might find itself compelled to accept some terms and conditions which may be unsatisfactory.

1.1.2. Determination of the applicable law by the arbitrators

(a) Introductory remarks

Contracting parties to a large extent have the authority to choose the law which they consider appropriate to govern their contractual obligations and rights. However, occasionally the parties do not utilise this right, which results in their contract lacking guidance on the matter of applicable law. There are several reasons for this. Lew suggests that this aspect of law may not be considered important by businessmen, and therefore is left to lawyers or legal advisors.[58] Lawyers themselves sometimes render the agreement void of any clause reflecting the applicable law.[59] It may also happen that the contracting parties, after a long period of negotiation and in the happiness of the moment of agreement, do not pay any attention to issues with which they are not so familiar, or indeed are not critical to the main argument such as the applicable law.

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laid down in a standard contract or international treaty or any other document, the provisions of such a document shall be applicable including the provisions relating to the arbitration.

[57] The Omani Standard Petroleum Exploration and Production Sharing Agreement, (unpublished).

[58] See Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 10, at 221.

When the contracting parties have failed to choose the law which will govern their contract for whatever reason, the task of determining the applicable law is transferred to the arbitrators. Important questions here are: What methods or mechanisms do arbitrators follow to determine the applicable law? Do arbitrators always apply the conflict of laws system, and if yes, then how do they choose which one? Moreover, can arbitrators override the conflict of laws system and directly apply any given national law, or non-national law, i.e. "*voie directe*"? If yes is the host state's law prioritised when the dispute concerns a sovereign resource such as petroleum? Is there any limitation on the arbitrators' choice? These questions will be discussed in depth below.

(b) How the arbitrators choose the applicable law (the methods)

Fouchard Gaillard argues that arbitrators can be guided by the memoranda that have been exchanged by the parties.[60] He adds that guidance may also be found in the provisions that have been chosen by the parties, for example, in the UNCITRAL Arbitration Rules Article 33 (1) is clear and direct in this regard.[61] An identical provision can also be found in the Rules of the Cairo Regional Centre for International Commercial Arbitration,[62] and also in the Rules of the GCC Commercial Arbitration Centre (Bahrain),[63] both of which cite Article 33 (1) of the UNCITRAL Arbitration Rules.

However, the situation is changing with the new rules of major institutional arbitration. There is an increasing tendency towards 'harmonisation' of arbitration rules and procedures removing arbitration from its locality. This attempted universality appears to be part of the package of globalisation process. The recourse[64] to conflict of

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[59] Carlo Croff, "The Applicable Law in an International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" 16 *International Lawyer* 613-645, 633 (1982).

[60] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1538, at 865.

[61] Art.33 (1) expressly states that "[T] he arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable.

[62] Art.33 (1).

[63] Art.28 (2) provides that "failing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable."

[64] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para.* 1538, at 865.

laws rules in order to select a law or rules is no longer required in the new Rules of ICC 1998, LCIA 1998, AAA 2003, and the Rules of the Stockholm Chamber of Commerce of 1999. Article 17 of the ICC Rules states

> The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.

This simply means that arbitrators are no longer bound to apply the conflict of laws rules in order to determine the applicable law, instead they can go directly to the rules of law that they believe are applicable.[65] Other institutions have followed the path of the ICC in rejecting the requirement of the application of the conflict of laws rules to determine the applicable law.[66] Hence, how do arbitrators determine the applicable substantive law which they consider appropriate?

There are certain processes or theories which may be followed in this regard. Although these theories have already been analysed in depth by many scholars and commentators,[67] we will briefly examine them before turning to our main issue of petroleum disputes.

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[65] See Yves Derains/ Eric A Schwartz., *A Guide to the New ICC Rules of Arbitration*, (The Hague: Kluwer Law International 1998), at 217.

[66] AAA Rules Art. 28 (1) states that "...failing such a designation by the parties, the tribunal shall apply such law (s) or rules of law as it determines to be appropriate." LCIA Rules Art. 22 (3) provides that, "...if and to the extent that the Arbitral Tribunal determines that the parties have made no such choice, the Arbitral Tribunal shall apply the law (s) or rules of law which it considers appropriate"; The Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, Art. 24 (1) states that, "...in the absence of such an agreement, the Arbitral Tribunal shall apply the law or rules of law which it considers to be most appropriate."

[67] See for instance, Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 10, at 233; Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, at 867; Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 621; Mark Blessing, "Choice of Substantive Law in International Arbitration", supra note 29, at 48; see also in general Horacio A. Grigera Naón, *Choice–of–Law Problems in International Commercial Arbitration*, (Tubingen: J. C. B. Mohr (Paul Siebeck) 1992), at 83-151; Horacio A. Grigera Naón, "Choice–of–Law Problems in International Commercial

1) The *lex fori* as a guide in the determination of the applicable law

The first traditional guidance can be found in the theory of the seat of arbitration *lex fori* or *siege d'arbitrage*. This theory was inspired by Professor Hall Sauser, who maintained that "arbitrators must resort to the private international law rules of the place where the arbitration tribunal has its seat."[68] The statement perceives arbitration and the award as similar to the national court judgement, where the arbitrator replaces the judge of a national court; consequently, the arbitrator should apply the conflict of laws system of the country where he is sitting, as a national judge usually does.[69]

Yet, when the contracting parties have not specified the seat of arbitration, how would this theory be applied? Even if the seat of arbitration is not a contention issue, what is the connection between the seat of arbitration, Geneva for instance, and a dispute between two parties one from Oman and another from England? What if the arbitration proceedings take place in more than one location? These and many other critical questions are provoked by this theory.[70]

2) Application of the conflict of laws system of the country which would have had jurisdiction in the absence of an arbitration clause

This theory was promulgated by a distinguished Italian scholar, Dionisio

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Arbitration", 289 *Recueil des Cours*: *Collected Courses of the Hague Academy of International Law* 13-395, 229-230 (2001).

[68] Quoted by Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 245; Grigera Naón may be considered one of the contemporary proponents to the theory of *lex fori* in terms of determining the applicable law. He argues that, "even today, international commercial arbitrators occasionally look at the private international law of the place of arbitration as the exclusive source of the conflict-of-laws rule they seek to apply although the legal system of the place of arbitration does not require the mandatory application of its conflict rules by arbitral tribunal sitting in the jurisdiction." Then he later concluded that "by arbitral *lex fori* it is then meant a combination of factual and legal circumstances, inherent in international commercial arbitration, moulding arbitral choice-of-law determinations along lines that are unique to this form of dispute resolution." He believes that this "conclusion is inductive." Grigera Naón also determines the characteristics of arbitral *lex fori* compared to the juridical or national *lex fori*. For more details, see Horacio A. Grigera Naón, "Choice–of–Law Problems in International Commercial Arbitration", ibid., at 229-230, 373-376.

[69] See Beda Wortmann, "Choice of Law by the Arbitrators: The Applicable Conflict of Laws System", 14 *Arbitration International* 106 (1998).

[70] For more details on the critiques of this theory, see Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 252; Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, at 867,868; see also Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 620.

Anzilotti, based upon the assumption that the conflict of laws system of the country which would have had jurisdiction over the dispute, if the parties had not chosen arbitration as a mechanism to solve their dispute should be applied.[71]

However, this theory has been criticised on two grounds.[72] First, it abandons the major advantages of international arbitration "the avoidance of uncertainty and inconvenience related to international conflicts of jurisdiction", despite the fact that the parties chose to insert an arbitration clause into their contract. Consequently, arbitrators have the difficult task of determining the national court which would have had jurisdiction if parties had not submitted their dispute to arbitration.[73] The second criticism is the difficulty of applying this theory because of its circular nature. Arbitrators have to choose a conflict of laws system to determine which country would have had jurisdiction.[74]

3) Application of the closest connection rules either to the parties or to the arbitrator(s) or to the place of enforcement

Based on this theory several suggestions have been made in terms of the method for choosing the applicable law to the merits of a dispute. One of these is the application of the conflict of laws system of the contracting parties. However, in practice this can be a difficult task. The contracting parties in international arbitration come from different countries and different jurisdictions; if this method is applied which jurisdiction would arbitrators choose and why?

A second suggestion is that of applying the conflict of laws system or rules of the arbitrators. In this case similar difficulties arise as in the previous suggestion. Where there is a sole arbitrator this method may be useful, but when the tribunal consists of more than an arbitrator, which conflict of laws system should be chosen and why?

The third suggestion is applying the conflict of laws system of the state where the arbitral award would be enforced. Although this solution is workable in that arbitrators are always expected to render an enforceable award, the main objection to

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[71] Carlo Croff, ibid., at 620.
[72] Ibid., at 620.
[73] Ibid., at 620.
[74] Ibid., at 620.

this suggestion is the difficulty of enforcing some arbitral awards. Furthermore, if the award is to be enforced in more than one country, which conflict of laws system should arbitrators apply? Another obstacle that may arise here is the application of certain doctrines such as mandatory rules or public policies in order to hinder the enforcement of that award.[75] Therefore, it could be argued that this choice-of-law mechanism may be unsatisfactory for some parties and may lead to several obstacles to arbitration.

4) Cumulative application of relevant conflict of laws rules (*Tronc commun*)

The use of more than one conflict of laws systems from more than one jurisdiction to determine the law applicable to dispute by arbitrators is known as a cumulative choice of law.[76] In this method, arbitrators search all relevant jurisdictions that may guide them to the solution of applicable law.[77]

The arbitration clause in the Channel Tunnel contract,[78] clearly reflects the above method, therefore it provides a useful example of how the *Tronc Commun* doctrine can play a real role in determining the applicable law to the substance of a dispute.[79] The clause provides that

> The construction, validity and performance of the contract shall in all respects be governed by and interpreted in accordance with the principles common to both English law and French law and in the absence of such common principles by such general principles of international trade law as have been applied by national and international tribunals. Subject in all cases, with respect to the works to be respectively performed in the French and in the English part of the site, to the respective French or English public policy (*order public*) provisions.[80]

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75 See for example Art. 5 of the New York Convention; for more details on this theory see Carlo Croff, ibid., at 622.

76 Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note21, *para.*1547 at 872.

77 Ibid., at 872.

78 *Channel Tunnel Group Ltd and France Manche S.A. v. Balfour Beatty Construction Ltd. and others* [1993] AC 334; 2 Lloyd's Rep 7 (1992).

79 Rubino-Sammartano Mauro, "The Channel Tunnel and the *Tronc Commun* Doctrine", 10 (3) J Int'l Arb 59-65 (1993).

80 Clause (68) of the *Channel* case, *Channel Tunnel Group Ltd and France Manche S.A. v. Balfour Beatty Construction Ltd. and others* [1993] AC 334; 2 Lloyd's Rep 7 (1992).

5) Application of the conflict of laws system established by the arbitrators

The nature of arbitration is, for the most part, neutral, independent, based on the will and consent of the contracting parties, and there is no national jurisdiction over the arbitrators. When the parties choose arbitration as an alternative method to solve any dispute, they distance their contract from the jurisdiction of any national court, as arbitration generally provides a more flexible approach.[81] Consequently, the parties choose arbitration because they trust the arbitrators as capable of rendering a satisfactory award by using the most appropriate conflict of laws system.[82] In other words, according to this method, when the parties fail to choose the applicable law to their contract, 'no one particular conflict of laws system must be followed' but the arbitrators should choose the closest and most appropriate system to the dispute.[83]

6) Application of general principles of private international law

The application of general principles of private international law by the arbitrators in order to determine the applicable law is widely endorsed in international conventions.[84] Therefore, arbitrators normally search for the principles of private international law in international conventions as well as in the arbitral case law.[85]

7) The direct application of a substantive national law (*voie directe*)

Arbitrators from time to time overtake any conflict of laws system and directly apply a specific substantive national law or national rule as an applicable law to the merits of a dispute. In other words, arbitrators may apply a substantive law of a country which they believe is "appropriate" without having recourse to any conflict of laws system. The freedom to choose an applicable law or rules in this way, as Goldman argues, was first included in the 1981 French decree on international arbitration (Art.

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[81] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note10, at 299.

[82] Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 623.

[83] Ibid., at 623.

[84] The 1980 Rome Convention on the Law Applicable to Contractual Obligations for instance; see also Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1549, at 874.

[85] For more details see Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 1, at 229-369.

1496 of the New Code of Civil Procedure) followed by the 1986 Netherlands Arbitration Statute (Art. 1054(2) of the Code of Civil Procedure).[86] In terms of guidance for arbitrators, Goldman argues that the determination may be based upon connections between the case and the chosen law, or may be because of the modernity of the given law. Furthermore, the arbitrators may consider the drafting of the contract in order to avoid applying a law which may lead the contract to be considered void.[87] Interestingly, this method has been practised in two different ways. First, when there is a false conflict of laws, and second, when there is a true conflict of laws.[88]

8) Application of a non-national law standard

The arbitrators, in the absence of an express choice by the parties, have the authority to select applicable law from a wide variety of sources.[89] In direct contrast to the above method, one of these sources is rules which have no connection to any national law or any conflict of laws system. Here, the arbitrators exclude the dispute from any national jurisdiction and subject it to a set of rules that have no relevance to any national law,[90] such as the *lex mercatoria* and *UNIDROIT* Principles of International Commercial Contracts. The following chapter will discuss these rules.

(c) Limitations on arbitrators' choice

It has been argued that arbitrators have much freedom in determining the applicable law to the substance of a dispute.[91] They are not confined to a given conflict of laws system, and may look to other principles such as the trade usages, or "*depecage*"

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[86] See Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1552, at 876.

[87] Ibid., at 876; see for example ICC Award no. 4145 (1984), *Establishment of Middle East country v. South Asian construction company*, (1987) 12 YBCA 97.

[88] For more details see Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note10, at 373, 378; Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 624, 625.

[89] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1554, at 878.

[90] Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 626.

[91] See for example Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 425; the ICC Rules for instance, give authority to arbitrators

doctrine.[92] The only limitations on arbitrators are such principles relating to mandatory rules.[93] However, are there more limitations where a state is one of the contracting parties?

1.1.3. Determination of the applicable law by the arbitrators in petroleum disputes

Disagreements regarding the applicable law are often observed in contracts between states and private parties, especially in natural resources agreements, no doubt in part due to a conflict of interests.[94] If we examine both old and new petroleum agreements we find constant conflict. For example, all petroleum agreements concluded in the United Arab Emirates between 1939 and 1981 contained no reference to the applicable law.[95] The same situation is also found in Iran. Since 1954, the Iranian government has concluded four petroleum agreements with foreign petroleum companies, and the question of the applicable law was much debated in all these

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to determine the appropriate rule of law without recourse to conflict of laws system, see Article 17 of the 1998 ICC Arbitration Rules.

[92] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1557, at 882.

[93] See for example ICC Award no. 6500, 1992, *Lebanese Traders Distributors & Consultants v. Reynolds Tobacco International*, 119 Clunet 1015 (1992).

[94] A. F. M. Maniruzzaman, "Conflict of Laws Issues in International Arbitration: Practice and Trends", 9 *Arbitration International* 371-403 (1993); Böckstiegel argues that "in the kind of arbitration that we are dealing with here, which is characterised by one of the parties being a state or a state controlled corporation, the determination of the applicable law plays a much greater role also in the practice of arbitration. Especially in investment disputes"; Karl-Heinz Böckstiegel, "The Legal Rules Applicable in International Commercial Arbitration Involving States or State-Controlled Enterprises", in *International Arbitration 60 Years of ICC Arbitration, A Look at the Future*, [94] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1554, at 878.

[94] Carlo Croff, "The Applicable Law in International Commercial Arbitration: Is it Still a Conflict of Laws Problem?" supra note 59, at 626.

[94] See for example Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 425.

[94] Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, *para* 1557, at 882.

[94] See for example ICC Award no. 6500, 1992, *Lebanese Traders Distributors & Consultants v. Reynolds Tobacco International*, 119 Clunet 1015 (1992).

[94] A. F. M. Maniruzzaman, "Conflict of Laws Issues in International Arbitration: Practice and Trends", 9 *Arbitration International* 371-403 (1993); Böckstiegel argues that "in the kind of arbitration that we are dealing with here, which is characterised by one of the parties being a state or a state controlled corporation, the determination of the applicable law plays a much greater role also in the practice of arbitration. Especially in investment disputes"; Karl-Heinz Böckstiegel, "The Legal Rules Applicable in International Commercial Arbitration Involving States (Paris: ICC 1984), at 149.

[95] See Mana Saeed Al-Otaiba, *The Petroleum Concession Agreements of the United Arab Emirates* vols.1&2, (London: Croom Helm 1982).

contracts.[96] Some of the new generation of petroleum contracts also contained no reference to the applicable law.[97] So the task of determination of the applicable law becomes more difficult in state contracts than in any other contracts. In this situation, can arbitrators apply the same criteria to contracts involving a state party as they do to contractual relationships between private parties, or are there specific criteria which must be considered in these contracts? The following discussion will analyse three theories explicitly related to state parties.

(a) Delocalisation theory

Delocalisation theory has been introduced by western scholars who assume that foreign companies which conclude long-term contracts with developing states need protection from the intervention of the host state. When these contracts are delocalised or internationalised, the laws which may be applicable to these contracts are not that of the host state's law. In other words "these contracts are necessarily rooted in some form of "delocalised" law which precludes unilateral alteration of the obligations by the state."[98] In the context of applicable law, Hermann argues that "if it is the domestic law of the host country, the foreign company has lost its case." Therefore, in Hermann's opinion if a company wants a chance of winning a dispute, public international law, or, the law of another state must be applied.[99] Dupuy, the sole arbitrator in the *Texaco* case,[100] followed the same rationale when he argued that state contracts, especially petroleum contracts, must be automatically delocalised in terms of substantive law, even if the parties to such contracts did not state this, because they must have intended to do

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[96] Rouhollah K. Ramazani, "Choice-of-Law Problems and International Oil Contracts: A Case Study" 11 ICLQ 503-518, 504 (1962).

[97] See for instance, the Omani Exploration and Production Sharing Agreement (unpublished).

[98] See Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, (Cambridge: Grotius Publications Limited 1990), at 53; *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, 53 ILR 389 (1979); 17 ILM 1 (1978); 4 YBCA 177 (1979); see also *Amoco International Finance Corp. v. The Government of the Islamic Republic of Iran* (1987) 15 Iran-US CTR 189 (Champer 3), where the claim was rejected.

[99] A. H. Hermann, "Disputes between States and Foreign Companies", in: Julian D. M. Lew (ed.), *Contemporary Problems in International Arbitration*, (1987 the Netherlands: Martinus Nijhoff Publishers), 250-263, 258.

[100] *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, 53 ILR 389 (1979); 17 ILM 1 (1978); 4 YBCA 177 (1979).

so.[101]

The notion of delocalisation or internationalisation, as Lipstein[102] argues, has been employed to assist arbitral tribunals in determining the contractual rights and obligations of the parties, by relying on international law or general principles of international law as the sole source or in conjunction with municipal law.[103] As far as the applicable law is concerned, a variety of suggestions have been made, such as that a contract itself can provide, in effect, its own law with which to govern the relationships between the parties, without recourse to any legal system.[104] This is the so called vacuum theory. However, the latter theory has been rejected by some scholars. Mann for instance, insists that any contract should be governed by a given law,[105] therefore he suggests public international law as an applicable law in state contracts.[106] Hence, this theory is based upon assumption that the host state's law is incapable to govern state contracts and therefore other rules of law should be applied in this regard i.e. *lex mercatoria*, general principles of law, public international law or *ex aeque et bono*.

(b) Localisation theory

Localisation theory is based upon the rationale that the contract should be governed by the law which has the closest connection to that contract, or what is normally called the 'centre of gravity' or 'the proper law of the contract',[107] and the

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[101] Ibid.

[102] K. Lipstein, "International Arbitration between Individuals and Governments and the Conflict of Laws", in: Bin Cheng/ E. D. Brown (eds.), *Contemporary Problems of International Law: Essays in honour of George Schwarzenberger on his eightieth birthday*, (1988 London: Stevens & Sons Limited), 177-195.

[103] Ibid., at 178-179.

[104] See for instance, Derek William Bowett, "State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach", LIX BYIL 49-74, 50; see also Alfred Verdross, "Quasi-International Agreements and International Economic Transactions", 18 *The Yearbook of World Affairs* 230-247, 231(1964); and also Mahmsani decision in *Libyan American Oil Company (LIAMCO) (USA) v. The Government of the Libyan Arab Republic*, 62 ILR 140 (1982); 20 ILM 20 (1981); 6 YBCA 89 (1981).

[105] He added that "every contract by whomsoever made must be subject either to a national system of law or to public international law, for these are the only legal orders known to us", F. A. Mann, "The Theoretical Approach Towards the Law Governing Contracts Between States and Private Persons", 11 *Revue Belge de Droit International* 562-594, 563 (1975).

[106] "It is possible, however, for contracts between parties only one of whom is an international person to be subject to public international law", F. A. Mann, "The Proper Law of Contracts Concluded by International Persons", 35 BYIL 34-56, 43 (1959).

[107] A. F. M. Maniruzzaman, "Conflict of Laws Issues in International Arbitration: Practice and Trends", supra note 94, at 377.

assumption that all legal disputes relate to a national law. Therefore, when determining the applicable law, the law of the place which had the 'most significant relationship' with the transaction should be concerned.[108] Where petroleum contracts are concerned it would seem that this theory is in favour of the host state's law, as the place where the contract is concluded is the host state, the place where the contract is performed is the host state and the subject matter of the contract is a vital resource for the host state.

The Institute of International Law adopted at its Athens Session in 1979 a Resolution on the Proper Law of the Contract in Agreements between a State and a Foreign Private Person. The Resolution reads, *inter alia*:

> Article 1: Contracts between a state and a foreign private person shall be subjected to the rules of law chosen by the parties, or, failing such a choice, to the rules of law with which the contract has the closest link.
> Article 5: In the absence of any choice by the parties, the proper law of the contract shall be derived from indications of the closest connection of the contract.[109]

In the same vein, the Rome Convention of 1980 gives an important role to the principle of closest connection.[110] Moreover, the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID), Article 42 (1), clearly provides that the law of the contracting state should be applied to the dispute when there is no agreement between the contracting parties upon the applicable law.[111]

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[108] Luther L. McDougal III/ Robert L. Felix/ Ralph U. Whitten, *American Conflicts Law*, (5th ed., Ardsley/ New York: Transnational Publishers 2001), at 336.

[109] Resolution adopted at the institute session in Athens, 4 – 13 September 1979.

[110] Convention on the Law Applicable to Contractual Obligations, opened for signature in Rome on 19 June 1980. Art. 4 (1) provides that "to the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a separable part of the contract which has a closer connection with another country may be way of exception be governed by the law of that other country"; see also Richard Plender/ Michael Wilderspin, *The European Contracts Convention The Rome Convention on the Choice of Law for Contracts*, (2nd ed., London: Sweet & Maxwell 2001), at 109, 264.

[111] Art. 42 (1): "the tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable." In this regard see for instance, *Wena Hotels Ltd. v. Arab Republic of Egypt*,

In the United States, according to the Second Restatement of Conflict of Laws of the United States of America, 1971, Section 188, the rights and duties of the contracting parties are determined by the local law of the state which has the most significant relationship to the transaction and the parties.[112]

The same approach can be found in the case law. Lord Simmonds in *Bonython v. Commonwealth of Australia* expressed that

> The substance of the obligation must be determined by the proper law of the contract, i.e. the system of law by reference to which the contract was made or that with which the transaction has its closest and most real connexion [connection].[113]

In the United States, the leading case in this regard is *Babcock v. Jackson*, where the court concluded that the governing law would be that of "Ontario" because it has the "most significant relationship."[114] Likewise, in Denmark, a contract was concluded between a woman resident in Denmark and a German institute. The *Qstre Landsret* held that the contract was governed by German law because all the contract's aspects were connected with Germany.[115] The same approach has been articulated in France by the Court of Appeal of Paris, in the case of *Jansen v. Ste' Heurty*, which held that "in the absence of an express choice of a governing law, a contract is governed by that of the place with which it is most closely connected."[116] In an interim award in the ICC Case no. 6560 of 1990, the tribunal came down in favour of the law of the place of performance of the majority of the contractual obligations: "I consider that respondent's

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Case no. Arb/ 98/ 4 (ICSID), where the tribunal has found that Egyptian law is applicable to the dispute, 41 ILM 896-932, 911 (2002). A complete study on the ICSID Convention will be provided in part three of this thesis.

[112] See for instance Luther L. McDougal III/ Robert L. Felix/ Ralph U. Whitten, *American Conflicts Law*, supra note 108, at 337; see in general Eugene F. Scoles/ Peter Hay/ Patrick J. Borchers/ Symeon C. Symeonides, *Conflict of Laws*, (3rd ed., ST. Paul/ Minn: West Group 2000); see also the Final Award in the ICC Case no. 6283 of 1990, 17 YBCA 178-185, 179 (1992).

[113] [1951] AC 201 at 219.

[114] 191 N.E 2d 279 (1963); see also Luther L. McDougal III/ Robert L. Felix/ Ralph U. Whitten, *American Conflicts Law*, supra note 108, at 336-337.

[115] *Henricksen v. Muchener Heilpraktiker Kollgeium*, Qstre Landsret, 30 March 1988, quoted by Richard Plender/ Michael Wilderspin, *The European Contracts Convention The Rome Convention on the Choice of Law for Contracts*, supra note 110, at 109.

approach is fundamentally correct, namely that regard must primarily be had, to the place where the contractual obligations were to be performed."[117]

It has been argued that the "most significant relationship test could be easily reframed [sic] as a policy-weighing approach to choice of law."[118] However, at the same time it may be argued that "most significant relationship lacks exact definition."[119] This may be true in the context of other agreements, however, in petroleum agreements most significant relationships is very clear, i.e. the subject matter of the contract, *loci contractus*; the place of the performance, *loci solutionis* and the place of the contracting, *loci actus,* are most connected to the law of the host state. Hence, the law of the host state is the law which has the closest connections to the contract, and which is subsequently, the proper law to that dispute. This approach has already been upheld by experts such as Ramazani,[120] who concluded in his study of a case between the National Iranian Oil Company (NIOC) and the Pan American Petroleum Corporation that Iranian law is the applicable law because all the connected factors were in favour of Iranian law.[121]

However, although this theory (localisation theory) may be more appropriate to govern petroleum disputes, it could be argued that determination of the applicable law to the merits of a petroleum dispute needs additional consideration, as it will be discussed hereinafter.

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[116] *Jansen v. Ste' Heutry*, Court d'Appeal, Paris 27 January 1995, quoted in ibid., at 110.
[117] The Interim Award in the ICC Case no. 6560 of 1990, 17 YBCA 226-229, 228 (1992).
[118] Luther L. McDougal III/ Robert L. Felix/ Ralph U. Whitten, *American Conflicts Law*, supra note 108, at 337.
[119] Ibid., at 338.
[120] Rouhollah K. Ramazani, "Choice-of-Law Problems and International Oil Contracts: A Case Study" supra note 96, at 503-518.
[121] He justified his conclusion by applying four major "objective" tests that he considered to be generally recognised by students and practitioners of conflict of laws. These tests are: 1) the sovereignty of one of the parties (Iran in this respect); 2) the nationality of the agent, since the parties have formed a joint stock company to be called Iran Pan American Oil Company (IPAC); 3) the place where the contract was concluded, *lex loci contractus*; 4) the place of performance, which was Iran. He later added that "other tests such as the nature of the subject-matter and the place where it is situated, *lex loci rei sitae*,

(c) Semi-localisation theory

As stated above, delocalisation theory has been created for a sole aim i.e. provides a considerable protection to the investor, whereas localisation theory is based upon the rationale that the contract should be governed by the closest connection to that contract. In the petroleum industry there is no doubt that these connecting factors are in favour of the host state's law. Hence, it could be concluded that reliance of foreign companies upon laws or rules other than those of the host state was only found to provide protection to their transactions from the intervention of the host state.

Nowadays, this line of reasoning is no longer tenable, since most developing countries (host states) particularly Arab petroleum countries have achieved advanced legal systems as well as they have enacted new laws particularly for the encouragement of foreign investment.

The fact that foreign companies should rely their relationships with developing countries on laws such as international law was clearly vocalised during the drafting of the ICSID Convention. The last part of Article 42 (1) is established to facilitate this desire. However, can such a view be accepted in the sphere of a contract between a state and a foreign company when such law (international law) is only the law which regulates the relationships between international bodies (states and international organisations)? Proponents of this view i.e. Broches has suggested that an investor "would have the same rights before an ICSID tribunal as if his government has espoused his case and brought an international claim."[122] In fact this argument contradicts Article 27 of the ICSID Convention itself. The latter Article obviously, prevents contracting states from giving diplomatic protection.[123] The Report of the Executive Directors clearly summarise the idea underlying the exclusion of diplomatic protection in this Article as follow

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would also indicate the same because the subject-matter is Iranian petroleum located within the Iranian domain", ibid., at 506-509.

[122] See *the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (*History*), vol. 2, at 259, 267, 400, 420; see also Christoph H. Schreuer, *The ICSID Convention: A Commentary*, (Cambridge: Cambridge University Press 2001), at 619.

[123] Art. 27 (1) clearly provides that "[N]o contracting state shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and other contracting state shall

When a host state consents to the submission of a dispute with an investor to the Centre, thereby giving the investor direct access to an international jurisdiction, the investor should not be in a position to ask his state to espouse his case and that state should not be permitted to do so. Accordingly, Article 27 expressly prohibits a contracting state from giving diplomatic protection, or bringing an international claim, in respect of a dispute which one of its nationals and another contracting state have consented to submit, or have submitted, to arbitration under the Convention, unless the state party to the dispute fails to honour the award rendered in that dispute."[124]

Therefore, the above reasoning which considers the investor as having the same rights before an ICSID tribunal as if his government has espoused his case is disputed.

However, the reasoning which may be promoted here to elevate contracts between states and foreign companies in petroleum contracts is the significance of the petroleum industry for both host states and industrial nations. This industry is an international industry and it affects the daily life of all nations. Furthermore, it is a mix of legal and political industry. Consequently, its disputes affect the interests of both national and international parties. Therefore, the applicable law which should govern its disputes needs to be determined in a particular method.

Undoubtedly, international law governs the relationships between states and therefore it governs disputes which arise between them.[125] However, in disputes between a host state and petroleum company or companies it could be argued that arbitrators in their task to determine the applicable law to the merits of a dispute should take into consideration the following facts:

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have consented to submit or shall have submitted to arbitration under the Convention [...]", see <www.worldbank.org/icsid> last visited 21 January 2004.

[124] *The Report of the Executive Directors, para* 33, 4 ILM 524 (1965).

[125] See for instance, recent statement of Kuwait's Energy Minister concerning the potential dispute between Kuwait and Iran about the Dorra gas field. He stated that Kuwait may take the dispute with Iran over this field to international mechanism which governs such disputes including the International Court of Justice if bilateral talks fail. "[T]he dispute dates back to the 1960s, when Iran and Kuwait each awarded an offshore concession, the first to the former Anglo-Iranian Petroleum Company, which became part of BP, and the latter to Royal Dutch/Shell. The two concessions overlapped in the northern part of the field." See <www.story.news.yahoo.com/news?tmpl=story&u=/afp/kuwait_iran_saudi_gas> last visited 23 November 2003.

First, they should recognise the doctrine of party autonomy, and therefore arbitrators should apply the law which has been chosen by the parties whether national or international. Second, when there was no choice of a law by the parties arbitrators should look first at the host state's law and this law should be applied to the dispute unless this law was found completely inadequate to govern the dispute. At this time, arbitrators should set aside this law and apply directly other law or rules which they consider applicable without any recourse to the conflict of laws rules i.e. (*voie directe*).[126] If the host state's law was partially inadequate to govern a part or some parts of the dispute, in this case arbitrators should complete this *lacuna* in the host state's law by applying this law (the host state's law) to the part or parts which is capable to govern and apply other laws or rules to other parts of the dispute.

This suggestion which I promote here is different from what is usually called "concurrent laws"[127] because this method suggests that the priority in petroleum disputes is to the host state's law which in fact has the most closely connected factors to the dispute. Hence, it is the law which should govern these disputes unless this law is inadequate to do so. Similarly, it differs from Article 42 (1) of the ICSID Convention since this latter applies the national law in conjunction with international law.

Having discussed different methods of determining applicable law, we will now turn to examine types of applicable law.

1.2. Applicable Substantive Law

Introductory remarks

The peculiarity of the petroleum contract manifests itself in several ways when applying substantive law to the merits of a dispute. The question emerges which law should be applied and why is more complex. Is it the national law of the host state which has the closest connection, or should the tribunal apply other laws or rules, as has

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[126] The point here is to avoid conflict of laws and to arrive to international standard.

[127] See Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, (Student Edition, London: Sweet & Maxwell 2003), at 104.

happened in many petroleum arbitrations irrespective of the party's will.[128]

1.2.1. Public international law

It has been argued that any contract between states and a private entity should be governed by public international law in order to provide protection to the foreign investor.[129] Mann was the first, to advocate the theory of internationalisation of the state contract.[130] He stated that "the real justification" for "internationalisation" of the substantive law of a state contract "is provided by the requirements of international intercourse", and he emphasised that only public international law is "practicable",[131] because these contracts are similar to international treaties between states.[132] However, Mann later admitted that a state is not usually ready to accept laws other than its laws, and at the same time a private company often refuses to submit its contract to the law of the contracting state.[133] Thus, how useful is public international law?

(a) The notion of public international law

Public international law has been defined as "a system of rules and principles that govern the international relations between sovereign states and other institutional subjects of international law such as the United Nations."[134] Or "international law prescribed rules governing the relations of nation-states (or "states", as they are called in

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[128] See for instance *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, 18 ILR 144 (1951), reprinted in 1 ICLQ 247-261 (1952); *The Ruler of Qatar v. International Marine Oil Co.*, 20 ILR 534 (1953; and *BP Exploration Company (Libya) Limited v. The Government of the Libyan Arab Republic*, 53 ILR 297 (1979); 5 YBCA 143 (1980); *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, 53 ILR 389 (1979); 17 ILM 1 (1978); 4 YBCA 177 (1979); *Libyan American Oil Company (LIAMCO) (USA) v. The Government of the Libyan Arab Republic*, 62 ILR 140 (1982); 20 ILM 20 (1981); 6 YBCA 89 (1981).

[129] See part one, chapter one of this thesis.

[130] Toope stated that, "the first authoritative advocate of international law as a potential proper law for state contracts was Dr. Mann. Although his preference has been for the application of a "system of municipal law chosen by the parties", Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at75.

[131] F. A. Mann, "The Proper Law of Contracts Concluded by International Persons", supra note 106, at 46.

[132] Ibid., at 43, he added that "according to the theory referred to, a contract could be 'internationalised' in the sense that it would be subject to public international law *stricto sensu*; that, therefore, its existence and fate would be immune from any encroachment by a system of municipal law in exactly the same manner as in the case of a treaty between two international persons."

[133] Ibid., at 46.

[134] Martin Dixon, *Textbook on International Law*, (3rd ed., Glasgow: Bell and Bain Ltd. 1996), at 2.

the vocabulary of international law)."[135] This means that public international law regulates only the relationships between sovereign states or between sovereign states and international organisations, accordingly, individuals in their contractual relationships with states are not bodies of public international law.

(b) Are petroleum agreements international treaties?

Bowett has argued that an investment contract between a state and individuals not only is not a treaty "but cannot even be regarded as analogous to a treaty".[136] Before expressing any opinion about this statement it is worth examining both treaties and petroleum contracts. First, treaties are invariably concluded between sovereign states, whether between two states (a bilateral treaty) or between more than two states (a multilateral treaty) to regulate relations of concern to the states themselves or the international community, unlike petroleum agreements which are normally concluded between a state and a private entity or entities in order to exploit a vital resource in the host state. Hence, the treaty as Lord McNair defined it is "a written agreement by which two or more states or international organisations create or intend to create a relation between themselves operating within the sphere of international law."[137] Although there are some similarities in the method of concluding treaties and petroleum contracts i.e. intention, negotiation and consent of the parties, there still remain several differences between them, especially in the manner of ratifying treaties.[138]

The second difference between treaties and petroleum agreements concerns the manner in which they enter into force. While petroleum agreements do not need any

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[135] Barry E. Cater/ Phillip R. Trimble, *International Law*, (3rd ed., New York: Aspen Law and Business 1999), at 1-2.

[136] Derek William Bowett, "State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach", supra note 104, at 54, Derek states that "there is a world of difference between an agreement under international law between two equal, sovereign states and a contract between a state and a private party governed prima facie by the state's own law. Obviously, with a treaty one state cannot use its own municipal law to vary its treaty obligations towards another state. But it is by no means obvious why, with a private law contract, the state party should not assert that right."

[137] Lord McNair, *The Law of Treaties*, (Oxford: Clarendon Press 1961), at 4.

[138] Ian Brownlie argues that "the ratification of treaties involves two distinct procedural acts: the first is the act of the appropriate organ of the state, which is the Crown in the United Kingdom, and may be called ratification in the constitutional sense; the second is the international procedure which brings a treaty into force by a formal exchange or deposit of the instruments of ratification," Ian Brownlie, *Principles of Public International Law*, (6th ed., Oxford: Clarendon Press 2003), at 582-583.

type of deposit or registration to enter into force, treaties require certain procedures in order to be effective.[139]

The third and the most important difference between treaties and petroleum contracts is the principle of 'reservation', whereby a state may not accept particular provisions in a treaty, so that they do not become binding upon it.[140] Article 2 (1) (d) of the Vienna Convention on the Law of Treaties between States and International Organisations of 1986 defines a reservation as

> A unilateral statement, however phrased or named, made by a state, when signing, ratifying, accepting, approving or acceding to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that state.

This type of exclusion of certain provisions by contracting parties is not available in petroleum contracts. Another point of difference between treaties and petroleum contracts is that treaties cannot be terminated unilaterally, i.e. by one of the parties, whereas in petroleum contracts termination of the contract by one of the parties is more likely.[141]

Hence, it could be argued that there are significant differences between treaties and state contracts in general, and petroleum contracts in particular, and therefore state contracts cannot be dealt with in the same way as treaties, so public international law is not necessarily applicable to the disputes arising out of state contracts.

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[139] "After a treaty is concluded, the written instruments, which provide formal evidence of consent to be bound by ratification, accession, and so on, and also reservations and other declarations, are placed in the custody of a depositary, who may be one or more states, or an international organisation. The depositary has functions of considerable importance relating to matters of form, including provision of information to the time at which the treaty enters into force. The United Nations Secretariat plays a significant role as depositary of multilateral treaties.
Article 102 of the Charter of the United Nations provides that:
- Every treaty and every international agreement entered into by any Member of the United Nations after the present Charter comes into force shall as soon as possible be registered with the Secretariat and published by it.
- No party to any such treaty or international agreement which has not been registered in accordance with the provisions of paragraph I of this Article may invoke that treaty or agreement before any organ of the United Nations", ibid., at 588.

[140] Malcolm N. Shaw, *International Law*, (4th ed., Cambridge: Cambridge University Press 1997), at 642.

The above conclusion was supported by the judgement of the International Court of Justice in the *Anglo-Iranian Oil Co.* case of 1952.[142] In this case the Court acknowledged the principle that petroleum contracts are merely contracts between states and foreign corporations. It clearly stated

> The Court cannot accept the view that the contract signed between the Iranian Government and the Anglo-Persian Oil Company has a double character. It is nothing more than a concessionary contract between a government and a foreign corporation.[143]

The United Kingdom attempted to draw analogy between this case[144] and the *Free Zones of Upper Savoy and the District of Gex* case,[145] and cited the Order made by the Permanent Court of International Justice on 6 December 1930 in order to show that the concessionary contract of 1933 "laid down what was to be the law between the United Kingdom and Iran."[146] However, the International Court of Justice concluded

> The Court does not see any analogy between the two cases. The subject-matter of the dispute in that part of the Free Zones case which has been relied upon by the United Kingdom related to customs matters, which were of direct concern to the two countries, while the subject-matter of the dispute between the United Kingdom and Iran in 1932 and 1933 arose out of a private concession. The conclusion of the new concessionary contract removed the cause of a complaint

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[141] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at 74.

[142] *Anglo-Iranian Oil Co* case (jurisdiction), Judgment of 22 July 1952, ICJ Reports 1952, at 93.

[143] Ibid., at 112.

[144] ICJ Pleadings, *Anglo-Iranian Oil Co.* case, at 76, 77.

[145] The decision read as follows "as this assent given by His Majesty the King of Sardinia, without any reservation, terminated an international dispute relating to the interpretation of the Treaty of Turin; as, accordingly, the effect of the Manifesto of the Royal Sardinian Court of Accounts, published in execution of the sovereign's orders, laid down, in a manner binding upon the Kingdom of Sardinia, what the law was to be between the Parties; as the agreement thus interpreted by the Manifesto confers on the creation of the zone of Saint-Gingolph the character of a treaty stipulation which France is bound to respect, as she has succeeded Sardinia in the sovereignty over that territory", quoted by Lord McNair, *The Law of Treaties*, supra note 137 at 13.

[146] *Anglo-Iranian Oil Co.* case (jurisdiction), Judgment of 22 July 1952, ICJ Reports 1952, at 113.

by the United Kingdom against Iran.[147]

(c) The approach in practice

Although the applicability of public international law to state contracts is uncertain, this law has nonetheless been widely accepted as an applicable law to the merits of disputes in many arbitrations, especially in petroleum disputes,[148] although with applicability of the host state's law. One example is the ICC Court of Arbitration's award in the arbitration between *S.P.P. (Middle East) Limited, Southern Pacific Properties v. the Arab Republic of Egypt, the Egyptian General Company for Tourism and Hotels*, on 11 March 1983.[149] In this case, there was no agreement between the parties about the applicable law. Egypt argued that "in view of the circumstances of the case the relevant domestic law is that of Egypt."[150] However, the claimants insisted that no rules or principles drawn from Egyptian law should be allowed to override the principles of international law.[151] At the same time, the defendant rejected the claimants' argument, which was an attempt to internationalise the applicable law, concluding that "the law governing the substantive issues could be nothing but the Egyptian legal system."[152]

The arbitral tribunal closely examined the question of applicable law, taking into account different theories in this regard, and also consulting the opinion of several Egyptian scholars about the adequacy of Egyptian law.[153] However, the tribunal, after expressing the opinion that Egyptian law is the governing law, since the Agreements were both made and performed in Egypt, concluded

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[147] Ibid., at 113.
[148] See the previous chapter.
[149] See 22 ILM 752-784 (1983).
[150] Ibid., at 768.
[151] Ibid., at 769.
[152] Ibid., at 769.
[153] "Claimant's argument in the affirmative are supported by the opinion of Egyptian law specialists aimed at demonstrating that principles of international law such as "*pacta sunt servanda*" and "just compensation for expropriatory measure " are not incompatible with the Egyptian legal system. These legal opinions rendered by Dr. Gamal el Oteifi and Mr. Hamed Mansour [...] together with the opinion of Professor Fouad Riad [...]. Both Dr. Oteifi and Mr. Mansour point out that these principles are deeply rooted in the Egyptian legal tradition, characterised by the general rule of "siyadat el Kanoun", i.e. supremacy of the law," ibid., at 770.

For the foregoing reasons we find that reference to Egyptian law must be construed so as to include such principles of international law as may be applicable and that the national laws of Egypt can be relied upon only in as much as they do not contravene said principles.[154]

Certain scholars argue that the gap between national law and public international law is closing, and is no longer as great as at the time of the *Serbian Loans* case[155] so public international law may be applicable to commercial contracts, particularly state contract.[156] However, many continue to believe that these rules are uncertain and unclear: "to subject the contract to international law appears presently impossible, due to the absence of precise rules to regulate the contractual relations between states and individuals."[157] Others argue that public international law simply does not contain rules that are applicable to the regulation of complex private contractual relationships.[158] Furthermore, public international law does not have any rules of contract at present,[159] nor is it mature enough to answer specific legal questions.[160] Even scholars who support the possibility of 'internationalisation' admit that "international law is ill-adapted to the hazards of commercial activity."[161]Moreover, by subjecting foreign businesses to public international law, the foreign corporation can invoke diplomatic protection of its own

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[154] Ibid., at 771.

[155] See the *Serbian Loans Case*, [1929] PCIJ Series A, no 20, at 41, in this case it was stated that "any contract which is not a contract between states acting in their capacity as subjects of international law, is based on the municipal law of some country."

[156] Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 466.

[157] Verhoeven, "Contrats entre Etats et ressortissants d'autres Etats", in *Le contrat e'conomique international*, (Brussels: Bruyland 1975), at 14o, quoted by Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 404.

[158] Stephen J. Toope, *Mixed International Arbitration*: *Studies in Arbitration between States and Private Persons*, supra note 98, at 78.

[159] Derek William Bowett, "State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach", supra note 104, at 54.

[160] Delaume argues that "...international law has not matured to the point of supplying an answer to specific legal issues which, in the process of adjudication, may require a definite and positive answer", Georges R. Delaume, *Transnational Contracts*, (Dobbs Ferry/ New York: Oceana Publications 1976), vol. 1 para 1.13; see also Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 10, at 474.

[161] D. P. O' Connell, *International Law*, (2nd ed., London: Stevens 1970), at 976.

government,[162] which is completely in conflict with the sovereign immunity of the host state. Furthermore, it has been argued that as a matter of theory, to apply international law to state contracts is to equate foreign private parties with states.[163]

Finally, it should be noted that reference to public international law in contracts does not make foreign corporations "subjects" of international law: "this is only a choice-of-law clause, adopted for convenience or other purposes."[164]

1.2.2. Transnational law (or *lex mercatoria*)

It may be argued that the terminology of transnational law constitutes more than *lex mercatoria* e.g. UNIDROIT Principles. Here we are concerned only with *lex mercatoria*; UNIDROIT Principles will be discussed later in this chapter. Opinions on *lex mercatoria* are divided into two groups. The first considers *lex mercatoria* as a set of rules suitable to govern international economic relations,[165] whereas the second group condemns *lex mercatoria* as an enigma

> The *lex mercatoria* is in fact an enigma created by a paradox that placed many investors in a dilemma. The paradox has in turn created a quandary from which the only way out was to arrive at the enigma by way of a fallacy.[166]

Given that it is used by arbitral tribunals, if exist sufficiently for us to discuss its applicability to petroleum disputes, since the question of the existence or non-existence

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[162] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", 33 BYIL 1-19, 10 (1957).

[163] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at 78.

[164] Jean-Flavien Lalive, "Contracts between a State or a State Agency and a Foreign Company, Theory and Practice: Choice of Law in a New Arbitration Case", 13 ICLQ 987-1021, 999 (1964).

[165] Berthold Goldman, "The Applicable Law: General Principles of Law – The *Lex Mercatoria*", in: Julian D. M. Lew (ed.), *Contemporary Problems in International Arbitration*, (1987 the Netherlands: Martinus Nijhoff Publishers), 113-125, 113.

[166] Keith Highet, "The Enigma of the *Lex Mercatoria*", 63 *Tulane Law Review* 613-628, 616 (1989), reprinted in: Thomas E. Carbonneau (ed.), *Lex Mercatoria and Arbitration*, (1998 Dobbs Ferry/ New York: Transnational Juris Publishing), at 133-142; Lord Mustill clearly stated that "with all deference to those who support it, we find this idea hard to accept", Michael J. Mustill/ Stewart C. Boyd, *Commercial Arbitration: The Law and Practice of Commercial Arbitration in England*, (2nd ed., London: Butterworths 1989), at 81.

of the *lex mercatoria* has been widely discussed by many scholars.[167]

(a) The notion of *lex mercatoria*

What does *lex mercatoria* mean or refer to? Gerard Malynes defined *lex mercatoria* as the "customary law of merchants."[168] Whereas Goldman described these rules as an "autonomous source of law proper to the economic relations (*commercium*) between citizens and foreigners (*peregrine*)",[169] noting that "this customary transnational law had an illustrious precursor in the Roman *ius gentium*.[170] Goldman also labelled it "the law proper to international economic relations",[171] and "a set of general principles and customary rules spontaneously referred to or elaborated in the framework of international trade, without reference to a particular national system of law."[172] Goldman suggests that the successive Hague (1954) and Vienna Convention (1980) for the International Sale of Goods "would be part of *lex mercatoria.*"[173] Redfern and Hunter have described *lex mercatoria* as "rules of law which have been developed by

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[167] See for example, Berthold Goldman, *Lex Mercatoria,* Forum International, no. 3 (Deventer: Kluwer Law and Taxation Publishers 1983); Thomas E. Carbonneau (ed.), *Lex Mercatoria and Arbitration*: *A Discussion of the New Law Merchant*, (1998 Dobbs Ferry/ New York: Transnational Juris Publishing); Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria*, (The Hague, the Netherlands: Kluwer Law International 1999); Klaus Peter Berger (ed.), *The Practice of Transnational Law*, (London: Kluwer Law International 2001); Christoph W. O. Stoecker, "The *Lex Mercatoria*: To what Extent does it Exist?" 7 (1) J Int'l Arb 101-125 (1990); Lord Justice (Michael J.) Mustill, "The New *Lex Mercatoria*: The First Twenty-five Years" 4 *Arbitration International* 86-119 (1988); Andreas F. Lowenfeid, "*Lex Mercatoria*: An Arbitrator's View", 6 *Arbitration International* 133-150 (1990); Vanessa L. D. Wilkinson, "The New *Lex Mercatoria* Reality or Academic Fantasy?" 12 (2) J Int'l Arb 103-117 (1995); Paul Freeman, "*Lex Mercatoria*: Its Emergence and Acceptance as a Legal Basis for the Resolution of International Disputes", [1997] *The Arbitration and Dispute Resolution Law Journal* 289-300; Ole Lando, "The *Lex Mercatoria* in International Commercial Arbitration" 34 ICLQ 747-768 (1985); Leon E. Trakman, "The Evolution of the Law Merchant: Our Commercial Heritage", 12 *Journal of Maritime Law and Commerce* 153-182 (1981); Georges R. Delaume, "Comparative Analysis as A Basic of Law in State Contracts: The Myth of the *Lex Mercatoria*", 63 *Tulane Law Review* 575-611 (1989); Keith Highet, "The Enigma of the *Lex Mercatoria*", 63 *Tulane Law Review* 613-628 (1989).

[168] Gerard Malynes , Consuetudo Vel *Lex Mercatoria*: or, the Ancient Law-Merchant (London: printed by J. Redmayne for T. Basset 1685), at 1.

[169] Berthold Goldman, *Lex Mercatoria*, supra note 167, at 3.

[170] Ibid., at 3.

[171] Berthold Goldman, "The Applicable Law: General Principles of Law – The *Lex Mercatoria*", supra note 165, at 113.

[172] Ibid., at 116.

[173] Ibid., at 113.

the international business community so as to regulate commercial activities within that community."[174]

Those in favour of the *lex mercatoria* have argued that it is often an ideal motional to solve any controversy between contracting parties over choice of the applicable law, especially in contracts between a state and a private entity, where "no state law is likely to be ideal."[175] It can also avoid the resort to national legal systems with which a party may be unfamiliar.[176]

However, application of *lex mercatoria* has not been widely accepted, even in the sphere of the sale of goods. During the discussion of "the 1985 Hague Convention on the Law Applicable to Sales", efforts to adopt the *lex mercatoria* to govern the contract met with fierce resistance from several delegates who spoke out violently against it; one called the *lex mercatoria* "the law of Mickey Mouse."[177]

(b) Does the l*ex* m*ercatoria* constitute a genuine legal system?

Let us now examine the capability of these rules to govern petroleum disputes.[178]

It is generally accepted that *lex mercatoria* principles for instance, include trade usages. According to this parties are obliged to comply with any usages to which they have agreed, and also by any practice they may have established between themselves.[179] As far as the petroleum industry is concerned, the history of the petroleum industry is not sufficiently long to establish usages which must be respected by the parties, and it is difficult to establish any custom in this industry since it is monopolised by a limited number of actors and these actors are not traders but concessionaries. Other provisions

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[174] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, (3rd ed., London: Sweet & Maxwell 1999) at 118.

[175] David W. Rivkin, "Enforceability of Arbitral Awards Based on *Lex Mercatoria*", 9 *Arbitration International* 67-84, 67 (1993).

[176] Ole Lando, "*The* Lex *Mercatoria* in International Commercial Arbitration" 34 ICLQ 747-768, 748 (1985).

[177] See Ole Lando, "The 1985 Hague Convention on the Law Applicable to Sale", 51 *Rabels Zeitschrift* 60-85, 66 (1987).

[178] See these rules in Central List of *lex mercatoria* principles, rules and standards, <www.jus.uio.no/lm/private.international.commercial.law/contract.principles.html> last visited 6 July 2002; <www.tldb.de/> last visited 16 December 2003; see also the same rules with some different in order in Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria*, supra note 167, at 278-311.

[179] No. I.3 – Trade usages "the parties are bound by any usages to which they have agreed and by any practice which they have established between themselves..."

such as (no damage claim in case of consent, presumption of professional competence of parties and specialised laws prevail over general laws) are general principles that may be found in any law, and are not specific to *lex mercatoria*.

Other provisions also repeat what already exists in many legal systems. Provisions concerning "rights and duties of the parties under 'FOB', 'FAS', 'CIF', AND 'C'"[180] provide a considerable proof that these rules are more suitable for trade particularly carriage of goods rather than other vital industries such as the petroleum industry. Hence, this provision underlines the 'trade and goods' nature of these rules, and their lack of relevance to the petroleum industry.

Although another provisions concerns "compensation for expropriation" appears from the first sight that it may relevant to the petroleum industry, a close look reveals its inadequacy. The provision seems hastily thought through in the way it roughly determines situations in which a state has the right to nationalise or expropriate foreign private investment, and also the type of compensation which should be paid by the state in these situations. This provision came alone in these rules and it does not have any support or background from other provisions. Therefore, it may be argued that laws or rules which should govern and determine the rights and obligations of parties in a crucial industry like the petroleum industry should be as a complete system of rules, not only a single provision in rules applicable to another industry. Use of this provision would be more logical, to determine the liability of a carrier or an exporter, but not a state, since the entire rules deal only with the rights and obligations of merchants. Generally, some scholars have doubted the applicability of the *lex mercatoria*:

> Broadly speaking, the problems associated with the new *lex mercatoria* may be divided into three categories. First, there is no clear consensus on its sources, although a number of sources have been identified with some consistency in the

[180] "If the parties have agreed on a sale "FOB", "FAS", "CIF", or "CF", the respective rights and duties of the parties under the contract are to be determined according to the latest version of the International Commercial Terms (INCOTERMS) issued by the International Chamber of Commerce (ICC) unless the parties have indicated that a different meaning is to be attributed to the term used."

literature and elsewhere. Second, it is unclear when the new *lex* will be applied. Third, the new *lex mercatoria* is simply lacking in content.[181]

(c) The approach in practice

The lack of enthusiasm for the *lex mercatoria* is not only in the literature but also in arbitral practice. In a case between claimant *sellers* from 'Korea' v. defendant *buyer* from 'Jordan'[182] the arbitral tribunal was not persuaded that the application of the *lex mercatoria* would be feasible under the circumstances of the case.[183] The facts of the case are that the claimant and defendant entered into three sales contracts to the purchase of 1,200,000 units of goods, to be delivered in instalments; the Jordanian buyer had already contracted to deliver the same goods to an Iraqi buyer. All these three contracts contained an identical arbitration clause (clause 11) reading

> Any dispute with regards to this contract will be solved cordially; otherwise by two arbitrators appointed by each side. In an eventual non-agreement it will be governed by the laws and regulations of the International Chamber of Commerce in Paris whose ruling should be final.

A delay in delivery was the disputed matter between the parties, whether the final instalments were shipped in time or not. When negotiation between the parties did not succeed, arbitration proceedings commenced before the ICC in Paris, which designated an arbitral tribunal after the refusal of the defendant to appoint an arbitrator. The question of the applicable law of the contract arose. Although the claimant agreed that the application of Korean law would be impracticable and that the arbitrator should therefore apply *lex mercatoria,*[184] "the arbitral tribunal ... came to the conclusion that it

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[181] Philip D. O'Neil Jr/ Nawaf Salam, "Is the Exceptio non Adimpleti Contractus Part of the New *Lex Mercatoria*", in: Emmanuel Gaillard (ed.), *Transnational Rules in International Commercial Arbitration*, (1993 ICC Publication no. 480/4), 147-159, 149.

[182] Interim Award in ICC Case no. 6149 of 1990, 20 YBCA 41-61 (1995).

[183] Ibid., at 56.

[184] [51] "Claimant had argued that the application of Korean law would be impracticable and that the arbitrators should therefore directly choose the law to be applied to the contract. Such choice, according to claimant, should lead to the application of the "so-called *lex mercatoria* which, in its turn, would essentially meant the application of the Vienna Convention on the International Sale of Goods

has to apply Korean substantive law to the subject-matter of this arbitration"[185], because the three sales contracts are most closely connected to the Republic of Korea (seat of seller and place of contracting).[186]

Another dispute arose between *Deutsche Schachtbau-und Tiefbohrgesellschaft m. b. H.* (*D.S.T.*) and *R'as Al Khaimah National Oil Co.* (*Rakoil*)[187] under a petroleum exploration agreement dated 1 September 1976. The Agreement contained an International Chamber of Commerce (ICC) arbitration clause (Article 21 of the contract), reading

> 1. All disputes arising in connection with the interpretation or application of this agreement shall be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with the Rules.
> 2. The arbitration shall be held in Geneva, Switzerland and shall be conducted in the English language.[188]

In March 1979, *D.S.T* referred its claims to an arbitral tribunal sitting in Geneva; *Rakoil* on the other hand, instituted proceedings in the court of R'as Al-Khaimah in April 1979. Neither party took any part in the proceedings instituted by the other. On 4 July 1980, the arbitral tribunal awarded *D.S.T* the sum of US$ 4,635,664, whereas *Rakoil* had already been granted a judgment on 3 December 1979, in which that *D.S.T* were held liable to pay *Rakoil* the sum of US$ 1,424,891.23.[189] Neither of these judgements were enforced, since neither party could find a way to do so. In June 1986, *D.S.T* discovered a business relationship between *Rakoil* and *Shell International Petroleum Co. Ltd.* (*Shell*) which is in fact an English subsidiary of the Anglo-Dutch group, therefore *D.S.T* set

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of 11 April 1980; and that, where said Convention would be silent, French law subsidiary would have to be applied as the law in effect at the seat of the arbitration", ibid., at 56.

[185] Ibid., at 53.

[186] Ibid., at 53.

[187] *Deutsche Schachtbau-und Tiefbohrgesellschaft m. b. H. v. R'as Al Khaimah National Oil Co., Same v. Same* (*Shell International Petroleum Co. Ltd.* 'Intervening'), 3 WLR 1023-1041 (1987).

[188] Ibid., at 1029.

[189] Ibid., at 1026.

about trying to satisfy its award from *Rakoil*, and on 2 July 1986 *D.S.T* submitted an application to an English Court pursuing enforcement of the Geneva arbitration award "in the same manner as a judgment."[190] The Court refused to grant *D.S.T* its application and the appeal was dismissed. The judge concluded

> The conclusion which I draw from those judgments is that it is the policy of the law in this country that, in the conduct of arbitrations, arbitrators must in general apply a fixed and recognisable system of law, which primarily and normally would be the law of England, and that they cannot be allowed to apply some different criterion such as the view of the individual arbitrator or umpire on abstract justice or equitable principles, which, of course, does not mean 'equity' in the legal sense of the word at all.[191]

Hence, it can be concluded that *lex mercatoria* is a set of rules that has evolved through custom and the usage of merchants and traders, and that these rules are not the law of any state. The relevant question here is whether these rules can be applied to the petroleum industry.

The primary obstacle in this regard appears to be that the application of non-host state law, such as *lex mercatoria* to petroleum disputes is less logical than in the field of commerce. This is because petroleum contracts normally exist between states and foreign companies, because this type of business plays a crucial role in the life of many nations and their citizens, and because the petroleum industry is so firmly connected to its host country.

Furthermore, *lex mercatoria* has been criticised as an autonomous body of law for its very native, that it is not legitimated by a legislative authority and has no appropriate methodological base. It has also been criticised for its lack of coherence and its vagueness.[192]

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[190] Ibid., at 1026.
[191] Ibid., at 1033.
[192] Gesa Baron, "Do the UNIDROIT Principles of International Commercial Contracts form a new *Lex Mecatoria*", <www.cisg.law.pace.edu/cisg/biblio/baaron.html> last visited 11 March 2001; see also the same article in 15 (2) *Arbitration International* 115-130 (1999).

Given that there is not complete acceptance of *lex mercatoria* even in the sphere of commerce, its application to petroleum disputes is even more limited and disputed. It is worth quoting Delaume's conclusion regarding the application of *lex mercatoria* to state contracts

> For the draftsman of state contracts, the foregoing survey leads to several conclusions, none of which is supportive of the existence of the *lex mercatoria* [...] the draftsman must now be conscious that there is ample evidence that the conditions which, decades ago, might have been responsible for the advocacy of the *lex mercatoria* have now disappeared. The time is no longer when it could be argued that the law of certain developing countries could not "reasonably be said to exist." Today modern statutes enacted by third-world countries are perfectly capable of providing major categories of state contracts with a sophisticated legal framework. [193]

In the sphere of *Shari'ah* the term Custom or *urf* in Arabic replace *lex mercatoria*. However, Custom is a controversial issue in *Shari'ah* and it is only considered as a subsidiary resource, as long as it is not contrary to *Shari'ah* principles.[194]

1.2.3. General principles of law recognised by civilised nations[195]

A special legal system, as McNair has argued, is required to regulate stat contracts and to settle any disputes, because these contracts have special characteristics, i.e. a 'foreign element' or 'international element.' However, the word 'international' as McNair described it is not used in the sense of 'interstate' which must be governed by 'public international law', it refers to the type of contracts in which the parties belong to two different countries. One of these parties is generally a state from the poorer southern

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[193] Georges R. Delaume, "Comparative Analysis as a Basis of Law in State Contracts: The Myth of the *Lex Mercatoria*", supra note 167, at 609-611.

[194] See for example Mohammed K. Emam, *Tareekh Al-Fekeh Al-Islami* (*The History of Islamic Jurisprudence*), (Alexandra: *Munsha'at Al-Ma'arif* 2000), 145-157; Yousif Qasim, O*ssol Al-Ahkaam Al-Shari'ah* (*The Origin of Shari'ah Law*), (3rd ed., Cairo: *Al-Nesr Al-Zahabi* 2001), 238-244; W. M. Ballantyne, "The States of the GCC: Sources of Law, the *Shari'ah* and the extent to which it Applies", 1 (1) *Arab Law Quarterly* 3-18, 6 (1985).

[195] See the Statute of the International Court of Justice, Article 38 (1) (c).

part of the world, and the other is a corporation generally from the richer western part of the world "owing its legal existence to the laws of a foreign state and deriving its capital primarily from nationals of that state."[196] Lord McNair suggests that the system which should govern these contracts is 'the general principles of law recognised by civilised nations.'[197] His conclusion is

> The answer to these questions is not that these contracts are governed by public international law *stricto sense*, for this system is an inter-State [interstate] system *jus inter gents*. It is true that a corporation operating in a foreign country can be said to be under the protection of public international law because it can invoke the diplomatic protection of its own Government if it should meet with wrongful treatment at the hands of the Government of the country in which it is operating; but that is not the same thing as saying that the contract is governed by public international law. My submission is that in contracts of this type the parties, if they specify no particular legal system, intend that their contracts should be governed by the general principles of law recognised by civilised nations.[198]

Lord McNair examined clauses from certain agreements, such as the concession agreement between the Persian Government and the Anglo-Persian Oil Company (29 April 1933) which contained an arbitration clause to solve any dispute that may arise between the parties. McNair reported that

> These contracts belong to a somewhat unfamiliar legal system; these contracts contain an arbitration clause which itself affords some, but not conclusive, evidence of the parties' belief in the inadequacy of the national law of either of them; these contracts frequently contain a provision for requesting some international authority, such as the President of the International Court of Justice at the Hague, to appoint an umpire or referee; they frequently contain provisions of a semi-political type [...] prohibit the company or its officials from interfering

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[196] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", supra note 162, at 3.
[197] Ibid., at 9.
[198] Ibid., at 10.

with the administrative, political or religious affairs of the country in which it is operating.[199]

Before examining further the conclusion of Lord McNair, let us briefly turn to the notion of the general principles of law.

(a) The notion of the general principles of law

What are these general principles of law recognised by civilised nations, which have been advocated by Lord McNair? Unfortunately, Lord McNair did not list these principles, he only mentioned the doctrine of 'respect for acquired rights' commenting that, "this is a legal doctrine which can be said to have already attained a large measure of recognition as a general principle of law."[200] However, he stated that, he would not propose a list of these principles, since they can be developed both by contracting parties and tribunals. [201]

However, Lord Asquith of Bishopstone in the *Abu Dhabi* case contemplated these principles "rooted in the good sense and common practice of the generality of civilised nations – a sort of modern law of nature."[202] Whilst Judge Cavin considered these principles as "rules of positive law, common to civilised nations, such as are formulated in their statutes or are generally recognised in practice."[203]

The general principles of law recognised by civilised nations have been encompassed in the Statute of the International Court of Justice, Article 38 (1) (c) which reads

> The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply: international conventions, whether general or particular, establishing rules expressly recognised by the contesting states; international custom, as evidence of a general practice accepted as law;

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[199] Ibid., at 9.
[200] Ibid., at 16.
[201] Ibid., at 15.
[202] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, 18 ILR 144-164, 149 (1951).
[203] *Sapphire International Petroleum Ltd. v. National Iranian Oil Company*, (1967) 35 ILR 136-192, 175, reprinted in (1970) 9 ILM 1118.

the general principles of law recognised by civilised nations; subject to the provisions of Article 59, judicial decision and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. This provision shall not prejudice the power of the Court to decide a case *ex aequo et bono*, if the parties agree thereto.

An examination of the above Article reveals that these principles are considered as a source of law, not as a system of law *stricto sensu.*[204] Also, this Article as Jennings points out is "enigmatic" and it should be the last source of law.[205] Indeed, the general principles of law have been classified as a third source of law, following treaties and customary law in order of priority.[206]

(b) Do these principles constitute an independent legal system?

Toope argues that Lord McNair and Lalive considered these principles as a system of law.[207] Lord McNair suggested that any contract between a state and a private entity should be subjected to the general principles of law recognised by civilised nations, he clearly argued

> It is submitted that the legal system appropriate to the type of contract under consideration [state contracts] is not public international law but shares with public international law a common source of recruitment and inspiration, namely, 'the general principles of law recognised by civilised nations'.[208]

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[204] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note 174, at 114.

[205] Robert Y. Jennings, "What is International Law and how do we tell it when we see it?" 37 *Annuaire Suisse de Droit International* 59-88, 71 (1981).

[206] Johan G. Lammers, "General Principles of Law Recognised by Civilised Nations", in: Frits Kalshoven/ Pieter Jan Kuyper/ Johan G. Lammers (eds.), *Essays on the Development of the International Legal Order*, (1980 Rockville/ Maryland: Sijthoff & Noordhoff), at 53.

[207] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at 69.

[208] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", supra note 162, at 6.

The same approach has also been articulated by Lalive, who concluded that contracts between states and private companies are subject to the general principles of law (a new system of law) or as he called them "transnational law."

> It is therefore likely that all these facts point to the emergence of a new system of law, somewhat half-way between international law *stricto sensu* and domestic law. This is transnational law.[209]

However, the application of the general principles of law recognised by civilised nations to state contracts is not always welcomed. Professor Bowett argues that a contract should be subjected to a detailed body of rules, and the theory of vacuum is criticised theoretically and practically.[210] In the same vein, Redfern and Hunter argue that although the general principles of law may be considered as an important source of law, both in the public and in the private domain, these principles "do not constitute a developed code of law sufficient to deal with the complexities of modern business transactions."[211] Other scholars perceive these rules as a weak system of law which must not be applied unless put to a strict test.[212] Mann has gone further by asserting that the general principles of law are "not a legal system at all".[213] Sornarajah cites the Soviet writer, Tunkin, who has warned against the desire to use these principles.[214] Tunkin

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[209] Jean-Flavien Lalive, "Contracts between a State or a State Agency and a Foreign Company, Theory and Practice: Choice of Law in a New Arbitration Case", supra note 164, at 1008.

[210] Derek William Bowett, "Claims between States and Private Entities: The Twilight Zone of International Law", 35 *Catholic University Law Review* 929-942, 930 (1986); Professor Bowett has reiterated his view in, "State Contracts with Aliens: Contemporary Developments on Compensation for Termination or Breach", supra note 104, at 50.

[211] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, (2nd ed., London: Sweet & Maxwell 1986), at 86; this point has been omitted in the (1999) edition and substituted by the follow "unfortunately, the way in which they have been used [the general principles of law] by international arbitrators has lead to much-deserved criticism." Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note 174, at 114.

[212] For example, Michael Akehurst, "Equity and General Principles of Law", 25 ICLQ 801-825, 818 (1976), here he stated "there is only one reliable way in which general principles of law can be proved, and that is by examining the laws of different states. Such an examination may reveal that a general principle of law exists; in other cases, however, it may reveal such a divergence that no general principle of law can be said to exist. The existence of a general principle of law cannot be assumed; it must be proved."

[213] F. A. Mann, "The Proper Law of Contracts Concluded by International Persons", supra note 106, at 45.

[214] M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, (Singapore: Longman Publishers (Pte) Ltd 1990), at 135; Sornarajah cited "Tunkin, warned against the desire to

states that "this kind of "principle" is not normative and does not establish rights and duties."[215]

Bearing the inadequacies of the general principles of law in mind, let us now examine Lord McNair justification for advocating such a system. He argued that

> One of the difficulties that arises in finding a system of law appropriate to the type of contract under discussion arises from the fact that many of the countries which requires skill and capital from outside for the development of their natural resources are governed by some system of law which has not been developed to deal with this particular type of transaction. It is believed that the provision, for instance, of the Islamic law respecting economic development agreements are very inadequate, if indeed there are any at all. Moreover, the content of Islamic law differs according to the particular school of law whose teachings are to be followed.[216]

There is no evidence that Lord McNair had any familiarity with the legal systems to which he was referring. A thorough examination of Islamic law reveals that it contains many principles which respect economic transactions, principles which are very similar (if not identical) to the general principles of law. In fact, the issue of economic relationships is considered highly important in Islamic law. Hence, the Holy *Qura'an* emphasises this issue by citing a direct order to the believers to observe and fulfil their engagements. It says, "oh you who believe, observe your covenants" or "be faithful to your engagements."[217] A scholar familiar with Islam would know that there is no difference in the main principles of the different Islamic schools, only in some divisions which do not affect Muslim obligations.

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use 'general principles of law' in order to proclaim the principles of the bourgeois legal system to be binding on all."

[215] G. I. Tunkin, *Theory of International Law*, Translated by William E. Butler, (London: George Allen & Unwin Ltd. 1974), at 200.

[216] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", supra note 162, at 4.

[217] *Surah*, V. verse 1; For more details, see J. N. D. Anderson/ N. J. Coulson, "The Moslem Ruler and Contractual Obligations", 33 *New York University Law Review* 917-933 (1958); see also K. V. S. K. Nathan, "Who is Afraid of Sharia? – Islamic Law and International Commercial Arbitration, 59 *Arbitration* 125-131 (1993).

Moreover, McNair relies on the nature of many petroleum contracts (such as that they frequently contain an arbitration clause, and a clause prohibiting the company from interfering in the affairs of the country in which it is operating) as evidence of the lack of faith of the parties in the adequacy of the national law of either of them, and therefore argued that non-national law is required.[218]

What could be said about these two points is, first, it is not necessarily that any contract contains an arbitration clause must be governed by the general principles of law, since many of these contracts are governed by other legal systems. Second, prohibition which is normally imposed upon any foreign company or its officials from any intervention in national affairs in which it is operating, is considered as a basic norm of a state sovereignty and it is not only imposed upon these companies but also upon any foreigner lives in that state.

Underlying his support of the general principles of (international) law is his recognition of westerners' distrust of developing countries laws, and his belief that this distrust is well-founded. Yet, this distrust, if not well founded and a consequence of prejudice is not sufficient justification of a weak system of law.

(c) The approach in practice

It is therefore argued that arbitral tribunals which have supported the application of the general principles of law (either alone or in conjunction with an international or a national law) to state contracts, must be judged as weak and unpersuasive,[219] and indeed such decisions have led to considerable criticism.[220] In fact, these principles have been applied in some significant petroleum cases, for instance *Sapphire International Petroleum Ltd. v. National Iranian Oil Company*,[221] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*[222] and *Texaco Overseas Petroleum Co. v. Libya*[223]. Since the latter

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[218] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", supra note 162 at 9.

[219] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at 70.

[220] Alan Redfern/ Martin Hunter, *Law and Practice of International Commercial Arbitration*, supra note 174, at 114.

[221] *Sapphire International Petroleum Ltd. v. National Iranian Oil Company* (*NIOC*), (1967) 35 ILR 136, reprinted in (1970) 9 ILM 1118.

[222] *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, (1951) 18 ILR 144; reprinted in (1952) 1 ICLQ 247-261.

cases will be fully discussed in chapter two, discussion here will be limited to the former case (the *Sapphire* case).

A dispute arose in the *Sapphire* case out of an agreement signed on 16 June 1958 between the National Iranian Oil Co. Ltd. (NIOC) and Sapphire Petroleum Ltd. in which both parties became partners in a joint structure relationship.[224] The aim of this agreement, as cited in the preamble, was that *Sapphire* would provide the technical competence, the financial ability and the organisation necessary to meet the NIOC desire to expand the production and exportation of Iranian petroleum resources. The parties agreed to perform their agreement in a spirit of good faith and reciprocal good will.[225] Each of the parties was bound by several obligations.[226] The agreement contained different mechanisms to settle any dispute that might arise between them. Article 39 of the agreement, for instance, provides that any dispute between the parties should be referred to a special committee in which a friendly solution should be sought. Article 40 provides that a dispute between the parties concerning technical or accountancy questions should be referred to an expert or a board of three experts. If the parties did not agree upon the said committee solution or if the committee could not reach a solution, the dispute was to be referred to arbitration according to Article 41 of the agreement.[227]

Article 41 comprises several provisions concerning the proceedings of arbitration, i.e. the appointment of the arbitrators and the umpire (Paragraph 1), who may be appointed (if the arbitrators do not agree upon any one within four months) by the president of the Swiss Federal Tribunal at his complete discretion (Paragraph 4); each party shall have the right to apply to the president of the Swiss Federal Tribunal to appoint a sole arbitrator, if one of the parties does not appoint its arbitrator (Paragraph 2), Paragraph 3 gives authority to each party to ask the president or equal judge of the highest court of Denmark, Sweden or Brazil to appoint an arbitrator. The award shall be given by a majority in the case of an arbitration board, at all times the parties shall

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[223] *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, (1979) 53 ILR 389; (1978) 17 ILM 3; (1979) 4 YBCA 177.

[224] Article 2 of the agreement, *Sapphire International Petroleum Ltd. v. National Iranian Oil Company (NIOC)*, (1967) 35 ILR 136, 137.

[225] Ibid., at 137.

[226] Ibid., at 137-139.

comply in good faith with the award of the arbitration board or the sole arbitrator (Paragraph 6). Furthermore, the place and procedure of arbitration must be determined by the parties (Paragraph 7). It is worth mentioning that the agreement was written in Persian and English, and in case of any divergence between these two texts, the English version would prevail (Article 44). However, there was no determination of the applicable law.

On 25 August 1958, *Sapphire Petroleum Ltd.* transferred all its rights and obligations under the agreement to Sapphire International Petroleum Ltd., under Article 36 of the agreement.[228] Hence, both parties contributed equal capital and formed a company named Iran-Canada (IRCAN) which was to conduct the subject-matter of the agreement. However, the relationship between the contracting parties did not work smoothly, and disputes arose.[229] On 28 September 1960, *Sapphire Petroleum Ltd.* sent a letter to *NIOC* indicating that the dispute between them could not be settled amicably (according to Article 39) and that it required immediate arbitration. It appointed the Denver lawyer, Mr. Tippit, as an arbitrator and invited *NIOC* to appoint its arbitrator in accordance with Article 41 of the agreement.[230] The disputed matter raised in *Sapphire's* letter was that on the one hand, *NIOC*, by refusing to carry out its obligations, had violated the agreement, and on the other hand, *NIOC* had refrained from releasing the bank letter guarantee for the sum of $ 350,000 in accordance with section two of the letter dated 16 June 1958.[231] *NIOC* refused to appoint its arbitrator on the grounds that *Sapphire Petroleum Ltd.* had assigned their rights to Sapphire International Petroleum Ltd.

Consequently, *Sapphire International* requested the president of the Swiss Federal Court to apply Article 41 of the agreement and appoint a sole arbitrator. He appointed Federal Judge Pierre Cavin, of Lausanne, as a sole arbitrator.[232]

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[227] Article 39 (1 & 2), ibid., at 140.
[228] Ibid., at 144.
[229] Ibid., at 140-56.
[230] Ibid., at 161.
[231] See *Iranian Court Decision (the Court of First Instance of Teheran) on Arbitral Award in Dispute between Sapphire International Petroleums Ltd. and the National Iranian Oil Company*, 1 December 1963; 9 ILM 1118- 1124, 1119 (1970); *Petroleum Ltd. v. National Iranian Oil Company (NIOC)*, (1967) 35 ILR 136, 137.
[232] Ibid., at 162.

The arbitral hearing took place on 18 October 1962; our only concern here is the determination of the applicable law to the substance. In this regard Judge Cavin examined the applicability of *lex fori*, but he disregarded this choice, as the parties had not directly agreed upon the seat of arbitration. Since the agreement contained no express choice of law, the arbitrator had complete discretion to determine the applicable law. The arbitrator then examined the law of the contracting place and performance of the agreement and he stated

> Since the contract was concluded in Teheran and was due to be performed for the most part in Iran, the *lex loci contractus* and *lex loci executions* both point to the application of Iranian law. However, though these two connecting factors, and particularly the second, are important, they are not necessarily decisive.[233]

He also concluded that the agreement was not a commercial agreement, as its aim was to grant *Sapphire* long-term exploitation of natural resources on Iranian territory, and this exploitation involves an obligation to undertake important investment and to establish permanent installations. He added that this agreement "creates rights which are not merely 'contractual' but are concessions giving *Sapphire*, for the time being, possession and, to a certain extent, control over the territory [a kind of colonialism]."[234] Moreover, he argued that these concessions characterised this agreement as an agreement lying partly in public law and partly in private law. Hence, the arbitrator concluded that the rights of *Sapphire* "could not be guaranteed to them by outright application of Iranian law,"[235] and he stated

> It is quite clear from the above that the parties intended to exclude the application of Iranian law. But they have not chosen another positive legal system, and this omission is on all the evidence deliberate. All the connecting factors cited above point to the fact that the parties therefore intended to submit the interpretation and performance of their contract to the principles of law generally recognised by

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[233] Ibid., at 171.
[234] Ibid., at 171.
[235] Ibid., at 171.

civilised nations, to which Article 37 of the agreement refers, this being the only clause which contains an express reference to an applicable law.[236]

The arbitrator justified his decision by referring to several aspects of the contract, such as that the agreement contains an arbitration clause; that the parties' intention as expressed in the agreement was that the parties should carry out their provisions in good faith and good will; that Article 37 (2) states that '*force majeure*' as used in the agreement should be defined according to the principles of international law.[237] Finally, the arbitrator awarded *Sapphire* a claim of $ 350,000 and interest at the rate of 5%; as well as $ 2,650,874 and 5% interest, as damages for failure to perform the agreement of 16 June 1958, in addition to the decision that the cost of arbitration should be paid by *NIOC*.[238]

Most relevant here is how the arbitrator came to the conclusion that the parties had already intended to exclude the application of Iranian law, and apply the general principles of law. What complicates this issue further is that the arbitrator acknowledged that if he had applied Iranian law, the rights of *Sapphire* would not have been guaranteed. He openly said, "this could not be guaranteed to them by the outright application of Iranian law." Thus, it could be argued that rather than seeking the most appropriate applicable law by just neutral standards, Cavin determined the applicable law according to who would benefit. This award was highly criticised. Toope, for instance, remarked that "the justifications for his holding were distinctly idiosyncratic, not to say untenable."[239] He added, "indeed, it is fair to say that none of these arbitral [one of them was the *Sapphire* case] authorities are strongly persuasive on the point at issue."[240] Hence, it is not surprising that this award was set aside by an Iranian court. The court stated

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[236] Ibid., at 175.
[237] Ibid., at 172-175.
[238] Ibid., at 191.
[239] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 98, at 70.
[240] Ibid., at 71.

> ...In the view of the court [the award was] incorrect. The view adopted with regard to this matter by the aforesaid was contrary to the standard of justice and the opinion of legal writers.[241]

The court added, after it citing Article 968 of the Iranian Civil Code,[242] that

> Therefore, taking account of the foregoing premises, Mr. Cavin's reasoning in denying the jurisdiction of the Law of Iran over the agreement is overruled, and the conclusion that the principles of another law operate in the interpretation and performance of the agreement is invalid and hereby rejected.[243]

1.2.4. Quasi-international agreements

As a way of excluding a state contract with a foreign company from the jurisdiction of the host state's law, it has been argued that state contracts in general and investment contracts in particular are neither governed by the municipal law of states nor international law, but that they constitute a new type of contract which may be regarded as "quasi-international agreements."[244] Verdross considers that an agreement concluded between a state and a foreign company was only analogous agreement to an international agreement,

> We cannot consider a contract concluded between a state and a foreign national in the form of an international agreement *inter pares*, as an international contract *stricto sensu*. It is only possible and necessary to treat it by analogy to such a contract.[245]

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[241] See *Iranian Court Decision (the Court of First Instance of Teheran) on Arbitral Award in Dispute between Sapphire International Petroleums Ltd. and the National Iranian Oil Company*, 1 December 1963, 9 ILM 1118- 1124, 1123 (1970).

[242] This Article provides that "obligation arising from contracts are subject to the law of the place of conclusion of the contract unless both the parties are of foreign nationality and have either expressly or impliedly made it subject to another law," ibid., at 1123.

[243] Ibid., at 1123.

[244] Alfred Verdross, "Quasi-International Agreements and International Economic Transactions", supra note 104, at 231.

[245] Ibid., at 233.

He suggested that the most important group of these contracts is development contracts.[246] However, the proponents of this method of applicable law to state contracts have based their suggestions upon a sample of agreements which bear little relation to petroleum agreements and indeed may no longer exist. One of these agreements quoted by Verdross for instance was an agreement concluded in the 19th century between European countries and African tribes.[247]

(a) The notion of quasi-international agreements

The concept of quasi-international agreement, which was developed by Verdross, is based upon the idea that the contract itself represents the legal order,[248] or the contract itself constitutes its own legal order and proper law.[249] This means that the contracting parties not only choose the legal system suitable to their contract, but also create their own legal system.[250] Verdross's argument is based upon three assumptions. First, development agreements which are normally concluded between a state and a foreign company, are not concluded under the supervision of the host state's law, but in the form of an international agreement *inter pares* and on the basis of the principle *pacta sunt servanda* and other general principles of law. Second, a quasi-international agreement creates a new positive legal order, which according to Verdross is the *lex contractus* regulating the relations between the contracting parties. Third, these agreements normally contain an arbitration clause, considered to be the only method to solve any prospective disputes between the parties.[251] Based on these assumptions, Verdross concluded

> All this makes it clear that such an agreement *inter pares* is not a contract governed by the legal order of a state, but a new legal order established by the

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[246] Ibid., at 233.
[247] Ibid., at 231.
[248] Wolfgang Peter, *Arbitration and Renegotiation of International Investment Agreements* (2nd ed., London: Kluwer Law International 1995), at 148.
[249] Okezie Chukwumerije, *Choice of Law in International Commercial Arbitration*, (London: Quorum Books 1994), at 148.
[250] F. A. Mann, "The Proper Law of Contracts Concluded by International Persons", supra note 106, at 49.
[251] Alfred Verdross, "Quasi-International Agreements and International Economic Transactions", supra note 104, at 234.

common will of the parties on the basis of the principles *pacta sunt servanda* and other general principles of law governing contracts.

However, this theory has been criticised for aiming to "place the provisions of the contract beyond the legislative and executive competence of the state party."[252] Therefore, any attempt by the state party to alter the provisions of the contract would be impossible.[253]

(b) The approach in practice

Lord McNair, who promoted 'the general principles of law recognised by civilised nations'[254] stated that no contract can exist in a vacuum, without being subject to a legal system.[255] Mann has gone further in his critique describing this theory of quasi-international agreements as "so unattractive", "so impracticable", "so subversive of public international law", "so dangerous from the point of view of legal policy" and "so unnecessary that its novelty will not cause surprise."[256] Mann also emphasised the importance of subjecting any legal relationship in general and every contract in particular to a legal system, "[It] must of necessity be governed by a system of law and is otherwise unthinkable". Chukwumerije has summarised his objections to this theory on two grounds: theoretical and practical. Theoretically, Chukwumerije has argued along similar lines to Mann, that it would be pure fallacy to accept that contracting parties could own an agreement, acting outside any given legal system.[257] Practically, he argues that "no contract, however elaborately drafted, can contain the entire complex body of rules necessary for the resolution of the range of disputes that could arise between the contracting parties."[258]

It would therefore seem that the concept of quasi-international agreements is not appropriate to govern petroleum disputes, since this concept contains theoretical and

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[252] Okezie Chukwumerije, *Choice of Law in International Commercial Arbitration*, supra note 249, at 148.
[253] Ibid., at 148.
[254] Lord McNair, "The General Principles of Law Recognised by Civilised Nations", supra note 163.
[255] Ibid., at 7.
[256] F. A. Mann, "The Proper Law of Contracts Concluded by International Persons", supra note 106, at 49.
[257] Okezie Chukwumerije, *Choice of Law in International Commercial Arbitration*, supra note 249, at 149.
[258] Ibid., at 150.

practical obstacles and the petroleum industry invariably in need to a smooth legal system in view of its significance and rapid change in its functions.

1.2.5. UNIDROIT Principles

The idea of codifying principles to govern international contracts was submitted by the Secretariat of UNDROIT in 1971, when they presented their idea for the drafting of general principles of international contract law in them report to UNCITRAL on "progressive codification of the law of international trade."[259] The aim was to find combined efforts to develop principles and rules of international contract law which could serve as a reference point for creating private contracts and international conventions without need for recourse to domestic law,[260] as well as to facilitate the global need for international trade relationships.[261] In 1994, the UNIDROIT Principles were published; now these principles are considered as a source of "the general principles of law", in that they may be applied even if a contract does not refer to them.[262] However, what are these principles and rules? Can these principles and rules govern the relationship between the contracting parties in petroleum contracts, and thereafter be applied as an applicable law to any dispute arising between them?

(a) What are UNIDROIT Principles?

The UNIDROIT Principles are a set of rules especially tailored to the needs of

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[259] Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria*, supra note 167, at 133; see also Michael Joachim Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, (2nd ed., New York: Transnational Publishers 1997), at 19-59.

[260] Klaus Peter Berger, *The Creeping Codification of the Lex Mercatoria*, supra note 167, at 133.

[261] Michael Joachim Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, supra note 259, at 5.

[262] Michael Joachim Bonell, "The UNIDROIT Principles and Transnational Law" <www.unidroit.org/english/publications/review/articles/2000-2.htm> last visited 11th March 2001; Professor Julian D. M. Lew, has argued that "they are to apply not only where expressly chosen, but also to influence and be applied where general principles of law or *lex mercatoria* are applicable and where there is no clear rule of law. They are also intended to influence the interpretation and development of national and international law," Julian D. M. Lew, "The Principles as *Lex Contractus* Chosen by the Parties and in the Absence of an Explicit Choice-of Law Clause", a paper was submitted to the UNIDROIT/ ICC Seminar "The Use of the UNIDROIT Principles of International Commercial Contracts in International Commercial Arbitration", Paris, 27 April 2001, published in *ICC International Court of Arbitration Bulletin* (Special Supplement), 2002, at 85.

international commercial transactions.[263] The aim of these principles is to establish a comprehensive set of rules that may be used throughout the world irrespective of legal, economic or political conditions.[264] The UNIDROIT Principles were published in 1994 by the International Institute for the Unification of Private Law (UNIDROIT).[265] These Principles comprise a Preamble and 120 Articles, relating to the formation, validity, interpretation and performance/non-performance of international contracts.[266] Although these principles cover contracts in general, they do not contain specific rules for each type of contract.[267] The preamble states that these principles are general rules for international commercial contracts and shall be applied when the parties have agreed to subject their contractual obligations to "general principles of law", the "*lex mercatoria*" or the like.[268]

(b) The approach in practice

In a number of international commercial cases, the tribunal has been requested by the contracting parties to base its decision on the UNIDROIT Principles alone or in conjunction with a specific domestic law.[269] In the ICC Award no. 7375[270] in which the case concerned a contract for the supply of goods between a United States seller and a buyer in a Middle Eastern country, the claimant claimed damages with interest in connection with the delayed delivery of the goods. As the contract contained no choice-of-law clause, the arbitral tribunal concluded

> The Court decided that the contract should be governed by general legal rules and the rules of law applicable to international contractual obligations, which had gained broad recognition and international consensus in the international

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263 See UNIDROIT Principles of International Commercial Contracts–Introduction, <www.unidroit.org/english/principles/intro-1.htm> last visited 23 April 2001.

264 Ibid.

265 UNIDROIT, "Principles of International Commercial Contract", Rome 1994.

266 Hans Van Houtte, "The UNIDROIT Principles of International Commercial Contracts", 11 *Arbitration International* 373-390, 374 (1995).

267 Ibid., at 374.

268 For more details see < www.unidroit.org/english/principles/> last visited 23 April 2001.

269 Michael Joachim Bonell, "The UNIDROIT Principles and Transnational Law" <www.unidroit.org/english/publications/review/articles/2000-2.htm> last visited 11 March 2001;

270 ICC Award no. 7375 of June 1996: 11 *Measley's International Arbitration Report* (1996), A-1 et seq; N. S. 2 *Revue De Droit Uniforme* (*Uniform Law Review*) (1997), at 598.

business community, including concepts regarded as belonging to the *lex mercatoria*, and to take into account the UNIDROIT Principles as far as they could be considered to reflect generally accepted principles and rules. The Court held that the UNIDROIT Principles [...] contained in essence a restatement of those *principles directeurs* which had enjoyed universal acceptance and moreover were at the heart of those most fundamental notions which had consistently been applied in arbitral practice.[271]

In a case concerning a sale contract between a Russian and an English party, the International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation rendered an award on 25 January 2001. The arbitral tribunal referred to Article 7.4.13(2) of the UNIDROIT Principles, according to which the agreed sum to be paid in case of failure to perform may be reduced if it turns out to be grossly excessive in relation to the harm resulting from the non-performance and to other circumstances.[272]

In another case, the arbitral tribunal based its decision on Chinese Law and on "international practice, including UNIDROIT Principles." This case concerned an agreement between a Chinese company and an Eastern European car manufacturer for the provision and organisation of after sales service for vehicles delivered by the former. The dispute arose after the parties accused each other of having failed to comply with their obligations under the contract. Since the agreement contained no choice-of-law clause, the parties agreed that Chinese law was the applicable law to the merits of the dispute. However, at the same time they requested the arbitral tribunal to apply the UNIDROIT Principles as well as an expression of international practice. In this case, the arbitral tribunal rejected the claimant's request for punitive damages and in so doing it pointed out that the concept of punitive damages was not known in Chinese contract law

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[271] Ibid., at 598-600.

[272] See abstract of the case in: <www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13618&x=1 (2001)> last visited 8 August 2002.

nor had it found any international trade principle authorising the award of punitive damages.[273]

(c) Can these Principles govern petroleum contracts?

However, the issue remains as to whether the UNIDROIT Principles can govern petroleum contracts and be applied to any dispute which may arise between the contracting parties. Although it may be agreed that UNIDROIT Principles "[have] gained a broad recognition and international consensus in the international business community", and that these principles are "becoming recognised and generally accepted as rules of international commercial law",[274] there remains doubt regarding applicability of these principles to govern petroleum contracts. According to the Preamble to the Principles, these rules may be applied when the parties have agreed to apply them either by a direct reference to the Principles or by agreeing that "their contract be governed by general principles of law, the *lex mercatoria* or the like." Hence, these principles are only considered as general principles of law or *lex mercatoria*, which are not applicable to petroleum contracts as previously stated. Moreover, these principles may suit certain law jurisdictions i.e. civil law jurisdiction, more than others.[275] As petroleum contracts are not limited to one jurisdiction only, the adequacy of UNIDROIT Principles to govern these contracts is doubtful.

In fact, the main point of criticism against UNIDROIT Principles in terms of governing petroleum contracts is similar to that against *lex mercatoria*, that these principles are merchant law. In other words, these principles are tailored to serve trade and commerce matters, and are therefore less suitable to govern petroleum contracts, as which are of an entirely different nature.

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[273] ICC Award No. 10114 of March 2000, in: <www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13618&x=1 (2000)> last visited 8 August 2002.

[274] Julian D. M. Lew, "The Principles as *Lex Contractus* Chosen by the Parties and in the Absence of an Explicit Choice-of Law Clause", a paper submitted to the UNIDROIT/ ICC Seminar "The Use of the UNIDROIT Principles of International Commercial Contracts in International Commercial Arbitration", Paris, 27 April 2001, published in *ICC International Court of Arbitration Bulletin* (Special Supplement), 2002, at 85.

1.2.6. National law

When we speak of national law in relation to a petroleum dispute, this can in theory include the law of the host-state, of the home state of a foreign company, or a third state. In the Iran–Pan-American Petroleum contract for instance, there was a possibility of choosing more than one applicable law to govern their contractual relationship, i.e. Iranian law, United States law and the law of a third state.[276]

(a) Which national law

However, here, by national law we mean the law of the host state, the law where the contract was concluded and performed, and the law which has the closest connections to the contract. This derives its authority from the well known doctrine in private international law of the 'closest connection' or 'centre of gravity' or 'most significant relationship'. The doctrine has been entirely upheld by the PICJ in the *Serbian Loans* case[277] and ICJ in *Anglo-Iranian Oil Co.* case.[278]

Some scholars[279] argue that there is a difficulty in applying national law to the substance of a dispute, and this difficulty arises from the uncertainty of which national law should be applied i.e. is it the law of the place where a transaction is concluded, *lex loci contractus*, the law of the place of performance, *lex loci solutionis*, the law of the place of arbitration, *lex loci arbitri*, or the law of the habitual residence of the parties. However, in petroleum disputes, especially those which are between the Arab petroleum producing countries and foreign petroleum companies, this difficulty should not arise because all the criteria above exist in the host state.

Other scholars have argued that choosing national law can be difficult in a

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[275] Detlev F. Vagts, "Arbitration and the UNIDROIT Principles" <www.cisg.law.pace.edu/cisg/biblio/vagts.html> last visited 11 March 2001.

[276] Rouhollah K. Ramazani, "Choice-of-Law Problems and International Oil Contracts: A Case Study", supra note 103, at 504.

[277] See *Serbian Loans Case*, [1929] PCIJ Series A, no. 20, at 41.

[278] See the *Anglo-Iranian Oil Co.* case (1952) (jurisdiction) Judgment of 22 July 1952 ICJ Rep at 93.

[279] Professor Julian D. M. Lew for instance, argues that "the major difficulty in applying a national legal standard to the substance of a dispute is deciding which to apply: the *lex loci contractus*, the *lex loci solutionis*, the law of the place of arbitration, the law of the place where the plaintiff or the defendant has his habitual residence or main place of business, etc." Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 10, at 373.

federal state.[280] However, the states which are the subject of this thesis are not federal states for the most part, and in the United Arab Emirates petroleum contracts are concluded between local government and petroleum companies.[281]

There are many examples of the applicability of the national law of the host state In *Aminoil* case[282], for instance, the law of Kuwait was found applicable to govern the dispute.[283] An *Ad Hoc* arbitration held in The Hague concluded that the law of Qatar is the applicable law. The dispute arose out of an 'Exploration and Production Sharing Agreement – Qatar Offshore' (EPSA) signed on 10 April 1976 between claimants: *Wintershall A. G.* (*FR Germany*), *International Ocean Resources, Inc.* (formerly *Koch Qatar, Inc.*) (*US*), *Veba Oel A. G.* (*FR Germany*); *Deutsche Schachtbau-und Tiefbohrgesellsellschaft mbH* (*FR Germany*), and *Gulfstream Resources Canada Ltd.* (*Canada*) and respondent *the Government of Qatar.*[284] The dispute arose as a consequence of the failure to find commercial quantities of petroleum in the contract area, and the Ruler of Qatar, due to a boundary dispute with Bahrain, refused to allowed the claimant to drill in the 'Structure A' area which the claimant regarded as the most likely aria to contain crude petroleum. In the Partial Award on Liability the arbitral tribunal concluded that the law of Qatar was the applicable law to the substance of the dispute. It provided that

> By ... its Order of 8 March 1987, the Tribunal provided that 'in the absence of a

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[280] See for instance, Gaillard Emmanuel/ Savage John, (eds.), *Fouchard Gaillard Goldman on International Commercial Arbitration*, supra note 21, at 791; see also Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M Kröll, *Comparative International Commercial Arbitration*, supra note 10, at 445.

[281] For more details about petroleum agreements from 1939 until 1981 in the United Arab Emirates see Mana Saeed Al-Otaiba, *The Petroleum Concession Agreements of the United Arab Emirates*, supra note 95.

[282] See *the Government of the State of Kuwait v. the American Independent Oil Company* (*AMINOIL*), (1982) 21 ILM 976-1053; (1984) 66 ILR 519-627; (1984) 6 YBCA 71-96.

[283] See the next chapter.

[284] The fact of this case as cited in the Award was that "parties entered into "Exploration and Production Sharing Agreement – Qatar Offshore" (EPSA) on 10 April 1976 whereby the Government of Qatar granted to the claimants "the exclusive right to explore for, drill for and produce petroleum in a defined area offshore of Qatar (the 'Contract Area') and the right to store, to transport and sell petroleum for use in Qatar or for export, and to export or otherwise dispose of petroleum" (Arts. I and II EPSA). Petroleum was defined in Art. I EPSA to include liquid crude oil, gas, and all other hydrocarbon substances in the Contract Area. The "Effective Date" of the EPSA was 18 June 1973 the date of the Concession Agreement which the EPSA substituted (Art. I EPSA), and it was to run for a term of 30 years (Art. 4)." See 15 YBCA 30-62,31,32 (1990); see also the Partial award of 5 February 1988 and Final award of 31 May 1988, 28 ILM 795-841 (1989).

controlling choice of substantive governing law clause and in consideration of the close links of ...the EPSA...to Qatar, the governing substantive law should be the law of Qatar and, in case the Tribunal should determine that it is relevant to an issue, public international law'. The Tribunal, after reviewing the deposited authorities on public international law, has determined that public international law is not independently relevant to the issues before the Tribunal in this Partial Award on Liability, and that the governing substantive law on those issues is the law of Qatar.[285]

In another example, the concept of the closest connection to the contract in terms of the applicable law has upheld. In ICC Case no. 6283 of 1990 the arbitral tribunal decided that Belgian law is the applicable law, since this law has the most significant relationship to the transaction and the parties.[286]

Nowadays, most Arab countries, particularly petroleum exporting countries have developed advanced legal system and enacted new laws most of which were guided by western laws mainly of civil law origin. Therefore, it should be understood that the operative legal system in these countries is a *hybrid system* and consists of the *Shari'ah* and the civil law. Egypt may be the first of Arab countries which adopted a civil code, followed by other Arab countries such as Kuwait, Bahrain, United Arab Emirates, Qatar and Oman.[287] However, the adoption of civil code in Arab countries was varied, and therefore the *Shari'ah* is still considered as a national law in that it is the source of law in some Arab petroleum countries such as Saudi Arabia and the main source of law in other countries.[288]

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[285] 15 YBCA 30-62,34 (1990).

[286] See the Award in [1997] the *Collection of ICC Arbitral Awards 1991-1995*, 100-107.

[287] See in general Maren Hanson, "The Influence of French Law on the Legal Development of Saudi Arabia", 2 (3) *Arab Law Quarterly* 272-291(1987); B. A. Roberson, "The Emergence of the Modern Judiciary in the Middle East: Negotiating the Mixed Courts of Egypt", in: Chibli Mallat (ed.), *Islam and Public Law*, (London: Graham & Trotman 1993), 107-139; Ahmed D. Al – Samdan, Contracts' Conflict Rules in Arab Private International Law: A Comparative Study on Principles of Islamic and Civil Legal System, supra note 47, at Preface; see also Butti S Al-Muhairi, "Islamisation and Modernisation within the UAE Penal Law: *Shari'ah* in the Modern Era, 11 (1) *Arab Law Quarterly* 34-68, 35 (1996).

[288] Art. 2 of Kuwait Constitution of November 1962; Art. 1 of Qatar Constitution of April 1970; the United Arab Emirates constitution of 1971, Art. 7 provides that "the Islam is the official religion of the Union and the *Shari'ah* law is the main resource of legislation", also the Omani Basic Statute of the

It may be asked which part of national law i.e. public or private law should govern petroleum contracts and any disputes which may arise out of them. The answer may be achieved by analysing the nature of petroleum contracts in which they regulate transactions with a public nature and at the same time with economic and commercial features. Accordingly, any part of national law may govern these contracts. However, public law may be more relevant than private law, since the former normally regulates the relationships between public authorities and private persons, and the primacy in this law is always to the public interest, whereas private law regulates the relationships between private persons.[289] Moreover, the time is ripe for the enactment of new petroleum laws in Arab petroleum countries to regulate all aspects concerning the petroleum industry and these laws should be considered a part of public law.

(b) *Shari'ah* as national law

The *Shari'ah* contains principles that may be applicable to international arbitration,[290] such as (a) the observation of covenants or fulfilment of engagements: "oh you who believe, observe your covenants."[291] This principle is exactly the same as *pacta sunt servanda*; (b) "except those of the polytheists with whom you have entered into a covenant, and who shall have afterwards in no way failed you, nor aided anyone against you. So perform your covenant with them, until its term is complete, for God loveth the

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State of November 1996 states in Art. 2 that "the religion of the State is the Islam and the Islamic *Shari'ah* is the basis of legislation."

[289] See for instance, Samir A. Tanaghu, *A-Nazariyat Al-Ammah Li Al-Qanoon* (*The General Theory of Law*), (Alexandria: *Munsha'at Al-Ma'arif* 1974), at 553-592; see also Amr A. Shalakany, "Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism", 41 *Harvard International Law Journal* 419-468 (2000); Dinesh D. Banani, "International Arbitration and Project Finance in Developing Countries: Blurring the Public/ Private Distinction", 41 *Columbia Journal of Transnational Law* 355-400 (2003); the above argument may uphold by new Russian Production Sharing Act Section 1.3 which provides that "those rights and obligations of the parties to a Production Sharing Agreement, that have a private law character, are regulated by the Production Sharing Act and by Russian private law." Moss has commented on this Section stating that "Section 1.3, therefore, quite clear implies that some rights and obligations under a Production Sharing Agreement have not a private law character and are not regulated by Russian private law. These rights and obligations have, consequently, a public law character, and are regulated by Russian public law", Giuditta Cordero Moss, "National Rules on Arbitrability and the Validity of an International Arbitral Award: The Example of Disputes Regarding Petroleum Investment in Russia", *Stockholm Arbitration Report* 1-24, 13 (2001).

[290] See for instance, the opinions of Abu Zahra, Anderson and Joseph Schacht on the applicability of Islamic law in the *Aramco* case, especially the memorial of *Aramco*, in the next chapter.

[291] *Sura*, V, 1. Qura'an.

righteous"[292]; (c) "give full measure and full weight, in justice. We tax not any soul beyond its power. If you give your word, do justice thereunto, even though against a kinsman; and fulfil the covenant of God"[293]; (d) "successful indeed are the believers, who are shepherds of their pledges and their covenant."[294]

Other principles have been extracted from the practice of the Prophet Mohammed: he said that Muslims are bound by their stipulations;[295] *Allah* (God) says, I will be against three persons the day of Resurrection: one who makes a covenant in my name, but he proves treacherous;[296] give the employee his salary (wages) before his sweat becomes dry.[297]

Although *Shari'ah* has not yet been codified between two covers of one book, it is in fact, not a mere religion or ethics, it is a harmonious system which includes "a just economic order, a well-balanced social organisation, and codes of civil, criminal as well as international law."[298] It is noteworthy that it is hard to speak of *Shari'ah* as a single legal system, since the application of *Shari'ah* differs from a specific Islamic country to another depending on the official Islamic school of the country.[299] However, this application nowadays is limited to a large extent in several Arab countries to the

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[292] *Sura* XV11, 34, 36 Qura'an.
[293] *Sura* VI, 151, 153, Qura'an.
[294] *Sura* XXIII, 1-8, Qura'an.
[295] Sahih Al Bukhari, III, 187.
[296] Sahih Al Bukhari, III, 34.
[297] Sonan Ibn Maja'h 2443.
[298] Qutub Mohammed, *Islam, The Misunderstood Religion*, (Lahore: Islamic Publication 1972), at Preface, quoted by Walied M. El-Malik,, *Minerals Investment under the Shari'a Law*, (London: Graham & Trotman 1993), at 3; "since the Islamic law reflects the will of ALLAH rather than the will of a human lawmaker, it covers *all* areas of life and not simply those which are of interest to state or society", Konrad Zweigert/ Heinz Kötz, *Introduction to Comparative Law*, translated from the German by Tony Weir, (3rd ed., Oxford: Clarendon Press 1998), at 304. The idea of codifying the *Shari'ah* is considerably old. It could be referred to the first era of Islamic state, particularly to the orthodox caliph Omar bin Alkahattab, then the idea enhanced with the caliph Omar bin Abd – Alaziz, who attempted to collect the opinion of the Companions of the Prophet and the opinions of jurists in *Madianh* to be followed and employed by judges in the Islamic state's territories. For more details see Mishari Al – Zaidi, "*Takneen Shar'ah*" (Codification of the *Shar'ah*), 1086 *Al- Majalla* (*The International Magazine of the Arabs*) 8-19 (2000). The significant effort in this regard was found in the *Majellah* during the Ottoman era, and it specifically focused on the Islamic principles of contracts. However, the latter as Rayner argues could not provide a precise theory governing obligations and contracts. S. E. Rayner, *The Theory of Contracts in Islamic Law*, supra note 37, at 89.
[299] See for example, Ann Elizabeth Mayer, "Laws and Religion in the Middle East", 35 *American Journal of Comparative Law*, 127-184, 154 (1987); see also Walied M. El-Malik, *Mineral Investment under the Shari'ah Law*, ibid., at 4. The latter argues that, "there are as many expressions of Islamic law as there are states in the Muslim world. Islamic law remains the core and focal point and common law of

personal status of the Muslim people and do not extend to other issues.[300]

1.2.7. Concluding remarks

The level of disagreement regarding the applicable law to the merits of a dispute appears to be higher in the context of state contracts, particularly in natural resources contracts such as petroleum contracts between a state and a foreign private company.[301] This disagreement may be a natural result of the conflict in interest between these parties, i.e. the contracting state on the one hand struggles to ensure at least an average level of income from its mineral resources (i.e. petroleum resources) to meet some of its citizens' needs, whereas on the other hand the foreign company seeks to gain as much profit as possible from its operations in a given country.

The conflict regarding the applicable law normally arises when a choice of applicable law has not been made by the contracting parties in their contract. The task is then transferred to the arbitrators. When there is an express or an implied choice by the parties of a particular law, arbitrators are bound to apply that law. This is simply a consequence of what is known in arbitration as party autonomy, which is considered a cornerstone in arbitration. However, the sanctity of party autonomy has not always been fully respected by most arbitrators, who have argued that the host state's law is incapable of governing such contracts even if host state law was chosen as applicable law,[302] or parties had intended (even if they did not say so) to exclude the application of national law in favour of supranational system.[303] These assertions and others, such as that a foreign company requires protection from any possible change in the host state's

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Muslim countries, but, in practice, Islamic law of Egypt differs from that in Pakistan, which both differ from that in Malaysia, and so on", ibid., at 4.

[300] At least from a personal experience, all the GCC Countries except Saudi Arabia have established a modern legal system and enacted new laws in different aspects and therefore *Shari'ah* is limited to the personal status of Muslim people or even no-Muslim who wishes to recourse to *Shari'ah*. I had a personal experience where I represented a non-Muslim husband to divorce his non-Muslim wife before an Omani court according to *Shari'ah* rules.

[301] A. F. M. Maniruzzaman, "Conflict of Laws Issues in International Arbitration: Practice and Trends", supra note 94, at 371.

[302] See *Petroleum Development Ltd. v. Sheikh of Abu Dhabi*, (1951) 18 ILR 144, reprinted in (1952) 1 ICLQ 247-261.

[303] *Texaco Overseas Petroleum Company* and *California Asiatic Oil Company v. The Government of the Libyan Arab Republic*, (1979) 53 ILR 389; (1978) 17 ILM 1; (1979) 4 YBCA 177.

laws,[304] shaped the new trends of arbitral practice. As a consequence, arbitral tribunals tend to apply law or rules other than that of the host state's law. In petroleum disputes the situation is the same generally, though there is a "prevailing opinion" that "the law applicable to petroleum agreements is the national law of the state, which also happens to be the law of the place of performance of these contracts."[305]

In terms of determining the applicable law to the substance of a dispute in general and petroleum in particular, we looked to the principles of private international law. There are two dominant theories

> The twin theories which underlay the proper law were therefore the subjective theory, which looked to the intentions of the parties, and the objective theory, which sought to localise the contract.[306]

Private international law principles answer the dilemma of the proper law or the applicable law in favour of the objective theory, which relies upon the doctrine of "the closest connection factors." This theory is widely accepted in common law systems especially in England, where it was reported that "the objective test of 'closest and most connection' was adopted by the Privy Council in 1950 in *Bonython v. Commonwealth of Australia*."[307] The same approach was also used in *Amin Rasheed Shipping Corporation v. Kuwait Insurance Co.*[308], where again the English Conflict of Law Rules clearly

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[304] Lillich argued that "many foreign investors, either uncertain as to the law of the state with which they are contracting or concerned about a possible *ex post facto* change in that law or some other exercise of state sovereignty that might alter or cancel the contract to their detriment," Richard B. Lillich, "The Law Governing Disputes Under Economic Development Agreements: Reexamining the Concept of 'Internationalisation', in: Richard Lillich/ Charles N. Brower (eds.), *International Arbitration in the 21st Century: Towards "Judicialisation" and Uniformity? Twelfth Sokol Colloquium*, (1994 New York: Transnational Publishers), 61-114, 63.

[305] M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, supra note 214, at 158; see also in general, Hasan S. Zakariya, "New Directions in the Search for and Development of Petroleum Resources in the Developing Countries", 9 *Vanderbilt Journal of Transnational Law* 545-577 (1976).

[306] Peter North/ J. J. Fawcett, *Cheshire and North's, Private International Law*, (13th ed., London: Butterworths 1999), at 534.

[307] Adrian Briggs/ Jonathan Hill/ J. D. McClean/ C. G. J. Morse (eds.), *Dicey & Morris On the Conflict of Laws*, vol. 2 (13th ed., London: Sweet & Maxwell 2000), at 1197; "the substance of the obligation must be determined by the proper law of the contract, i.e. the system of law by reference to which the contract was made or that with which the transaction has its closest and *most real connexion*", *Bonython v. Commonwealth of Australia*, [1951] AC 201, at 219.

[308] *Amin Rasheed Shipping Corporation v. Kuwait Insurance Co*, (1983) 3 WLR 241.

provided that a contract is governed by the law with which it is most closely connected.[309] The prevailing view on the applicable law in the United States is similar to that of England,

> The prevailing view in the United States came to be (and is) that, in the absence of a choice of law by the parties, the applicable law is the law which has the most significant relationship to the transaction and the parties.[310]

The (1980) Rome Convention on the Law Applicable to Contractual Obligations follows the same approach.[311]

In the sphere of the petroleum industry, not only are all the connected factors, i.e. place of contracting, place of performance, the subject matter of the contract, in favour of the host state's law, but also the intention of the parties, since the choice of the applicable law in most petroleum agreements which have been mentioned above was in favour of the host state's law.[312] That both theories should be taken into account is indeed frequently asserted. Ramazani, for instance, in his study on the problem of the choice of law in the contract between Iran and the Pan American Petroleum Corporation,[313] argued that not only should both theories (objective and subjective) be taken into account to determine the applicable law, but a third theory could be adopted, "the eclectic nature of this theory takes account of both the objectivist and subjectivist methods in ascertaining the applicable law to a contract."[314] Furthermore, he noted four major 'objective' tests which are generally recognised by students and practitioners of conflict of laws in order to prove the link between the contract and the host state's law. The first test was that of the sovereignty of one of the parties, which in these contracts, is

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[309] Rule 174-(1) provides that "to the extent that the applicable law has not been chosen in accordance with Rule 173, a contract is governed by the law of the country with which it is most closely connected."

[310] Restatement, s. 188; Scoles and Hay, Chap. 18; quoted in Dicey and Morris, supra note 307, at 1196.

[311] Article 4 provides that "...the contract shall be governed by the law of the country with which it is most closely."

[312] See for instance, *Libyan* cases, *AMINOIL* Case and *Sapphire* case.

[313] Rouhollah K. Ramazani, "Choice-of-Law Problems and International Oil Contracts: A Case Study" supra note 96, at 503-518.

[314] Ibid., at 505.

the host state.[315] The second test was the nationality of the agent, the third was the place where the contract was concluded, *lex loci contractus*, and the fourth test was the place of performance. He later added a fifth test, the nature of the subject matter and the place where it is situated (Iranian petroleum located within the Iranian domain).[316]

Consequently, it could be argued that the insistence of most western scholars and practitioners on applying law or rules other than host state's law may be driven for the most part by a desire to provide a considerable level of protection to foreign companies irrespective of judicial procedure. Moreover, a lack of knowledge of the host state laws may also lead the arbitrators to exclude this law.

Now that we have examined the theoretical issues regarding the applicable law to the substance of a dispute, especially those surrounding the applicability of a host state law. The next chapter will examine the practical approach in this regard by discussing a number of significant petroleum disputes in Arab countries.

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[315] Ibid., at 506.
[316] Ibid., at 508-509.

PART THREE

THE NEW TRENDS CONCERNING PETROLEUM ARBITRATION

Chapter One: Doctrinal Background: Sovereign Immunity and Public Policy

Introductory remarks

In the realm of state contracts with private corporations, especially in the petroleum industry, certain significant issues must be taken into account in the process of determining the applicable law to the merits of a dispute. The most significant issues are the doctrine of sovereign immunity and the doctrine of public policy. In the petroleum industry, state involvement has become extremely controversial, particularly the question of whether state involvement is a public act so that the state is immune from any judicial proceedings, or whether this involvement is simply a private act which is normally undertaken by private persons, and thus the state is not immune from interference by the courts of other states. Moreover, the doctrine of public policy also plays a considerable role in determining the applicable substantive law, because arbitrators are obliged to consider the "various levels" of this doctrine.[1] Hence, this chapter discusses these two doctrines in their nexus with petroleum arbitration.

1. Sovereign immunity

Undoubtedly, a state,[2] which is a subject of international law,[3] requires much freedom in order to fulfil its national and international duties. The doctrine of sovereign immunity[4] is the cornerstone of this freedom, in which a state is

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[1] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A study in Commercial Arbitration Awards*, (Dobbs Ferry/ New York: Oceana Publications 1978), at 536.

[2] Fox notes that the term 'state' has many uses. In general conversation it can be used as a synonym for 'country', 'people', or 'government'. It may be used as a compendium term to cover all the activities of modern government, such as cabinet decisions, departmental circulars, and acts of subordinate officials, Hazel Fox, *The Law of State Immunity*, (Oxford: Oxford University Press 2002), at 23; the Montevideo Convention on Rights and duties of States, 1933 Art. (1) provides that, "the state as a person of international law should possess the following qualifications: (a) a permanent population; (b) a defined territory; (c) government; and (d) capacity to enter into relations with other states."

[3] Ibid. at 23-24.

[4] For a historical background see Sompong Sucharitkul, *State Immunities and Trading Activities in International Law*, (London: Stevens & Sons Limited 1959), at 3-19; Gamal Moursi Badr, *State*

immune from the adjudication of courts other than its own.[5] Hence, when disputes arise "a state or a state agency may prevent their adjudication in another state's court by pleading state immunity."[6] The roots of this doctrine are based on two concepts: sovereign equality,[7] "*Pari parem non habet imperium,* which means that "no state could be expected to submit to the laws of another"; and the dignity of a state i.e. that a state may be offended by being forced to submit to the jurisdiction of another state.[8] Others have referred to this doctrine in terms of the need to maintain good relations with power,[9] as well as the international comity which is due from one sovereign to another.[10]

Fox considers the doctrine of sovereign immunity as "a plea relating to the adjudicative and enforcement jurisdiction of national courts which bars the municipal court of one state from adjudicating the disputes of another state",[11] and therefore it must be understood that 'the plea' is "a bar against one state from sitting in judgement on another state; it excludes one state from even addressing, let alone deciding or enforcing, a claim brought in its local courts against another state."[12] Sovereign immunity is normally understood to mean both immunity from *jurisdiction*, and immunity from *execution*,[13] although these have to be looked at separately.

Immunity: An Analytical and Prognostic View, (The Hague: Martinus Nijhoff Publishers 1984), at 9-19; L. Ali Khan, *The Extinction of Nation-State: A World without Border*s, (The Hague: Kluwer Law International 1996), at 13-42; R. P. Anand, *International Law and the Developing Countries*, (Dordrech/ Boston/ Lancaster: Martinus Nijhoff 1987), at 73-102; about the American approach on sovereign immunity, see Richard B. Lillich, "The Proper Role of Domestic Courts in the International Legal Order", 11 *Virginia Journal of International Law* 9-50 (1970).

[5] Hazel Fox, *The Law of State Immunity*, supra note 2, at 1.

[6] Ibid., at 1.

[7] Rosalyn Higgins, *Problems and Process*: *International Law and How to Use it*, (Oxford: Clarendon Press 1994), at 78.

[8] Ibid., at 79.

[9] It was stated that "the doctrine of sovereign immunity is of an ancient vintage. It was established in this country as an absolute protection of an armed vessel in the service of a friendly sovereign", *Flota Maritima de Cuba, Sociadad Anonima v. Motor Vessel Ciudad De La Habana*, (1964, CA4 Md) 335 F 2d 619.

[10] See Thomas Oehmke, *International Arbitration*, (New York: Clark Boardman Callaghan 1990), at 224.

[11] Hazel Fox, *The Law of State Immunity*, supra note 2, at 1.

[12] Ibid., at 4.

[13] Pieter Sanders, *Ouo Vadis Arbitration*? *-Sixty Years of Arbitration Practice-*, (The Hague: Kluwer Law International 1999), at 189; it was reported that "traditionally, primary consideration has been given to immunity from judicial and enforcement jurisdiction," Louis Henken/ Richard Crawford/ Oscar Schachter/ Hans Smit, *International Law*: *Cases and Materials* (3rd ed., ST. Paul/ Minn: West Publishing Co. 1993), at 1126.

The doctrine of sovereign immunity has altered over time starting with the doctrine of the absolute immunity of states.[14] This model, which prevailed until the end of the 19th century,[15] rejected any distinction between public acts and private acts.[16] However, since the beginning of the 20th century, as states have become involved in private activities, the restrictive model, which distinguishes between public acts or the sovereign capacity (*jure imperii*) of a state, and those which are more private business, or commercial in nature (*jure gestionis*) has prevailed. [17] According to this model, a state cannot plea sovereign immunity while it is conducting private activities. This approach has been welcomed by many jurisdictions,[18] such as Europe in 1972 (the European Convention on State Immunity and Additional Protocol (ECSI)), the United States in 1976 (Foreign Sovereign Immunity Act (FSIA)), and the United Kingdom in 1978 (State Immunity Act (SIA)).

However, the distinction between public and private activities is not always easy. Toope states

> The distinction between that which is commercial and that which manifests sovereignty is not always easy to draw, and whether one should look at the "purpose" of a transaction or at its "nature" remains a moot point.[19]

More specifically, is state involvement in the petroleum industry a public activity or a private activity? Moreover, at what stage can a state no longer invoke the sovereign immunity plea? Is it at the time of proceedings which is known as 'immunity from jurisdiction' or at the time of enforcing the award i.e. 'immunity from execution'? A discussion of these questions follows.

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[14] For a historical background of this model, see Gamal Moursi Badr, *State Immunity*: *An Analytical and Prognostic View*, supra note 4, at 34-40.

[15] Rosalyn Higgins, *Problems and Process*: *International Law and How to Use it*, supra note 7, at 79.

[16] Gamal Moursi Badr, *State Immunity: An Analytical and Prognostic View*, supra note 4, at 34.

[17] Thomas Oehmke, *International Arbitration*, supra note 10, at 226; Louis Henken/ Richard Crawford/ Oscar Schachter/ Hans Smit, *International Law*: *Cases and Materials*, supra note 13, at 1126-7; for a historical background of this model, see Gamal Moursi Badr, *State Immunity: An Analytical and Prognostic View*, supra note 4, at 21-34.

[18] Hazel Fox, *The Law of State Immunity*, supra note 2 at 2.

[19] Stephen J. Toope, *Mixed International Arbitration*: *Studies in Arbitration between States and Private Persons*, (Cambridge: Grotius Publications Limited 1990), at 139.

1.1. Immunity from jurisdiction

Challenging the jurisdiction of a foreign court, whether national or international, is the first step in pleading sovereign immunity.[20] This can be used by a state to challenge a suit brought by a foreign investor.[21]

The shift in sovereign immunity from the absolute to the restrictive doctrine, as states became increasingly involved in private activities, and the distinction between public and private acts became increasingly apparent over the course of the 20th century. This led courts to focus on the act itself rather than the actor.[22] In the United States in 1952, for instance, following the "Tate Letter", the legal advisor to the State Department clearly announced that "his department would not expect American courts to avoid jurisdiction over commercial disputes involving foreign states."[23] The same shift is clear in England after the judgement of the Court of Appeal in *Trendtex Trading Corporation v. Central Bank of Nigeria*[24] when Lord Denning rejected the plea of sovereign immunity by the bank because of the commercial nature of the bank transactions.

As stated before, the restrictive doctrine of immunity has achieved considerable acceptance in several jurisdictions, such as the European Convention on State Immunity and Additional Protocol of 1972,[25] which entered into force in 1976. This states in Chapter I, Articles 1-14 the cases in which immunity from jurisdiction is not granted to a contracting state.[26] The United States enacted rules concerning sovereign immunity at a similar time,[27] the Foreign Sovereign Immunities Act of 1976 (FSIA).[28] This law is a comprehensive legal regime which specifies when a foreign state is entitled to sovereign immunity.[29] The FSIA embraces the restrictive doctrine of sovereign immunity, and therefore states engaging in commercial activities are not immune from jurisdiction.

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[20] Hazel Fox, *The Law of State Immunity*, supra note 2, at 17.

[21] David Frisch/ Raj Bhala, *Global Business Law: Principles and Practice*, (North Carolina: Carolina Academic Press 1999), at 538.

[22] Hazel Fox, *The Law of State Immunity*, supra note 2, at 4.

[23] M. Sornarajah, *International Commercial Arbitration: The Problem of State Contracts*, (Singapore: Longman Singapore Publishers Ltd 1990), at 200.

[24] [1977] Q.B. 529; [1977] 2 WLR 356; [1977] 1 Lloyd's Rep 581.

[25] See the Convention and its additional Protocol in "Explanatory Reports on the European Convention on State Immunity and the Additional Protocol", Council of Europe – Strasbourg 1972, reprinted in 11 ILM 470 (1972).

[26] Ibid.

[27] Mark B. Feldman, "The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder's View", 35 ICLQ 302-319, 303 (1986).

[28] 15 ILM 1388 (1976).

Chapter 97 Section 1605 (a) (2) of the FSIA determines three cases in which a state is considered acting commercial activities.[30]

The United Kingdom followed with the State Immunity Act of 1978 (SIA).[31] This act clearly provides in Part 1 Article 3 that a state is not immune from proceedings relating to a commercial transaction.[32] Other countries such as Singapore (State Immunity Act 1979)[33] and Pakistan (State Immunity Ordinance 1981)[34] followed in the same vein.

1.2. Does submission to arbitration constitute a waiver of immunity?

In the context of arbitration, where arbitrators normally derive their authority from the arbitration agreement only, the generally accepted view is that a state may not claim immunity from jurisdiction once it has signed an arbitration agreement. Delaume argues that a state by signing an arbitration agreement has implicitly waived jurisdictional immunity.[35] He also states that

> Decisions of international and domestic tribunals, treaty and statutory provisions found in the Europe convention and modern western statutes, all concur that a state party to an arbitration agreement is precluded from asserting its immunity in order to frustrate the purpose of the agreement.[36]

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[29] [1976] *U. S. Code Congressional and Administrative News*, at 6605.

[30] Sec. 1605 provides: General exception to the jurisdictional immunity of a foreign state [...] (2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with the activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

[31] 17 ILM 1123 (1978).

[32] Article 3 provides: (1) A state is not immune as respects proceedings relating to:
(a) a commercial transaction entered into by the state; or
(b) an obligation of the state which by virtue of a contract (whether a commercial transaction or not) falls to be performed wholly or partly in the United Kingdom.

[33] Part II (5) a state is not immune as respects proceedings relating to: (a) a commercial transaction entered into by the state [...]; see the act in Gamal Moursi Badr, *State Immunity: An Analytical and Prognostic View*, supra note 4, at 203.

[34] Article 5 (1) a state is not immune as respects proceedings relating to: (a) a commercial transaction entered into by the state [...]; see the Act in ibid., at 211.

[35] Georges R. Delaume, *Transnational Contracts*: *Applicable Law and Settlement of Disputes*, re-issue (1985), vol. 2, Ch. 11, 30-1; see also by the same author, "State Contracts and Transnational Arbitration", 75 AJIL 784-819 (1981); and "Foreign Sovereign Immunity: Impact on Arbitration", 38 (2) *The Arbitration Journal* 34-47 (1983).

[36] Georges R. Delaume, "Sovereign Immunity and Transnational Arbitration", 3 *Arbitration International* 28-45, 30 (1987), reprinted in: Julian D M Lew (ed.), *Contemporary problems in International Arbitration*, (1987 the Netherlands: Martinus Nijhoff Publishers), at 313-321.

The above statement has been adhered to by most western jurisdictions. The European Convention on State Immunity and Additional Protocol of 1972 provides in Article 12 that the plea of immunity from jurisdiction cannot be raised when a contracting state agreed in writing to submit a dispute which has arisen or may arise out of a civil or commercial matter to arbitration.[37] The same principle is also found in the United Kingdom SIA Section 9 which states clearly that where a state has agreed in writing to submit a dispute which has arisen, or may arise, to arbitration, the state is not immune as respects proceedings in the courts of the United Kingdom.[38] In the United States, the FSIA took a different view. This law made no specific reference to arbitration, although Section 1605 (a) (1) provides that a state may have waived its immunity "either explicitly or by implication."[39] However, the FSIA was amended in 1988 to rectify this gap, and now a foreign state is not immune from the jurisdiction of the American courts where the action is brought either to enforce an arbitration agreement entered into by a state with a private party or to confirm an award made according to such agreement.[40] The Canadian State Immunity Act, which came into force on 15 July 1982, is silent concerning the issue of arbitration. However, it provides in Article 4 (1) that "a foreign state is not immune from the jurisdiction of a court if the state waives the immunity," and it defines in subsection (2) and (4) of the same article the cases in which a foreign state is not entitled to immunity from jurisdiction before the Canadian courts.[41] In contrast, the Australian Foreign Sovereign Immunities Act of 1985, which came into force on 1 April 1986, clearly provides that a foreign state is not immune from jurisdiction where it is a party to an arbitration agreement.[42]

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[37] Article (12) provides: 1. where a contracting state has agreed in writing to submit to arbitration a dispute which has arisen or may arise out of a civil or commercial matter, that state may not claim immunity from the jurisdiction of a court of another contracting state [....], reprinted in 11 ILM 470 (1972); see also Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M. Kröll, *Comparative International Commercial Arbitration*, (The Hague: Kluwer Law International 2003), Chapter 27, at 733-759.

[38] 17 ILM 1123 (1978).

[39] It was argued that "the legislative history mentions as an example of implicit waiver the case where a foreign state has agreed to arbitration in another country", see *House of Representative Report* no. 94-1487, 94th Con., 2nd Sess. 18, reprinted in (1976) *U.S. Code Congressional and Administrative News*, at 6604, 6617.

[40] Amendment to Foreign Sovereign Immunities Act, (28 U.S.C. Secs. 1602-1611), ICCA HB (1987)

[41] See the law in 21 ILM 798 (1982).

[42] Australia: Foreign Sovereign Immunities Act of 1985 Art. (17), 25 ILM 719 (1986).

In the literature of international conventions we see a very similar picture. In 1982, the International Law Association produced a Draft for a Convention on State Immunity. Article 3 (2) provides that a state cannot invoke the plea of immunity from jurisdiction when the state agreed in writing to submit a dispute which has arisen or may arise to arbitration.[43] In 1991 the International Law Commission adopted a Draft on State Immunity. Article 17 states that a state enters into a written agreement with a foreign natural or juridical person to submit any dispute relating to a commercial transaction to arbitration, that state cannot invoke immunity from jurisdiction before a court of another state.[44] The New York Convention of 1958 is silent regarding the doctrine of sovereign immunity. Delaume has argued that the ICSID Convention is unique in that "consent to ICSID arbitration constitutes an irrevocable waiver of immunity from jurisdiction."[45]

Arbitral case law would seem to support the lack of sovereign immunity. In the *Ipitrade v. Nigeria* case for instance, the United States Court held that an agreement of a foreign state to arbitrate constitutes an implicit waiver of sovereign immunity according to the legislative history of section 1605 (a) FSIA.[46] However, this conclusion was not widely welcomed. Toope for instance, stated that

> There is nothing in the applicable sections of the Foreign Sovereign Immunities
> Act [28 USC 1605 (a) (1)] which renders this judicial decision a *cas d'espéce*. Moreover, the *Ipitrade* decision by no means stands alone.[47]

The following case was also in the vein of the *Ipitrade v. Nigeria* case. The dispute between *M. B. L. International Contractors, INC. and Alves Contracting Company Limited* (the petitioners) *v. the Republic of Trinidad and*

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[43] Report of the ILA Conference Montreal 1982 (London 1983), 6-10.
[44] For the text see 30 ILM 1563 (1991), see also European Convention on International Commercial Arbitration of 1961, Article 2. (1).
[45] Georges R. Delaume, "Foreign Sovereign Immunity: Impact on Arbitration", supra note 35, at 36.
[46] *Ipitrade International, S. A. v. Federal Republic of Nigeria*, 465 F. Supp. 824; 1978 U.S. Dist. LEXIS 15325; reprinted in 17 ILM 1395 (1978).
[47] Stephen J. Toope, *Mixed International Arbitration: Studies in Arbitration between States and Private Persons*, supra note 19, at 146.

Tobago (the respondent), concerned a contract to repair airfield pavements at Piarco International and Crown Point Airport in Trinidad and Tobago.[48] After the dispute arose in the course of the performance of the contract, the parties agreed to solve the dispute by final and binding arbitration, and therefore they agreed on 3 September 1985 to appoint Selby Wooding as a sole arbitrator. On 17 November 1988 the arbitrator made his decision in favour of the petitioners. The respondent refused to obey the arbitral award, and consequently the petitioners filed a petition before the U.S. District Court of the District of Columbia in order to confirm the arbitration award as the first step in enforcing that award against the respondent in the United States pursuant to the New York Convention.[49] The respondent protested the petitioners' action on the ground that sovereign immunity precludes this court's exercise of subject matter and personal jurisdiction over the respondent. The petitioners contended that the respondent implicitly waived its sovereign immunity by agreeing to submit the dispute to arbitration. The respondent rejected this contention, pleading that "there was no waiver on the ground that the arbitration agreement provides that the law of Trinidad and Tobago governs the arbitration of the dispute."[50] Finally, the court denied the respondent's motion and confirmed the arbitral award.

To sum up, the prevailing opinion that, once a state has agreed to arbitrate, it is no more entitled to immunity from jurisdiction. However, the situation is different concerning immunity from execution.

1.3. Immunity from execution

Badr argues that waiver of immunity from jurisdiction does not always entail waiver of immunity from execution.[51] He supports this conclusion with two reasons

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[48] *M. B. L. International Contractors, INC. v. Republic of Trinidad and Tobago*, 725 F. Supp. 52; 1989 U. S. Dist. LEXIS 13806.

[49] Ibid., at 2.

[50] Ibid., at 2.

[51] Gamal Moursi Badr, *State Immunity: An Analytical and Prognostic View*, supra note 4, at 107; in the same vein Emmanuel and Edelstein have argued that, "the act of entering into an arbitration agreement and thereby waiving immunity from jurisdiction, will not be considered sufficient to constitute a waiver, on the part of the state party, of its immunity from execution, as least insofar as concerns the assets used to perform its sovereign activities", Emmanuel Gaillard/ Jenny Edelstttein, "Recent Developments in State Immunity from Execution in France: *Creighton v. Qatar*", 15 (10) *Mealey's International Arbitration Report* 14 (2000); Lew, Mistelis and Kröll also state that, "the fact that a state cannot claim immunity from

a) that forcible execution on the property of a foreign state would create more problems for the state of the forum and would adversely affect its relations with the foreign state more than the mere subjection of the foreign state to the jurisdiction of the forum, and
b) that the property of the state of the forum itself being immune from forcible execution, it would be more difficult to justify execution on the property of the foreign state than to justify denial to it of immunity from suit. The assimilative approach would operate here in favour of immunity from execution for the foreign state.[52]

It is understood from the above overview that a state is entitled to invoke immunity from execution. Therefore, this fact is eminent in the literature of a number of conventions as well as in the case law. Execution against a state's property is prohibited under the 1972 European Convention on State Immunity without the advance written consent of that state.[53] The same approach is articulated by the Draft Convention on State Immunity of 1991, Article 18.[54] Under the ICSID Convention, although Article 53 (1) provides that the award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention, immunity from execution still constitutes an obstacle to enforcement of ICSID awards.[55] This fact derives its rationale from Article 55 of the ICSID Convention which reads

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jurisdiction does not necessarily mean that the state is not immune from the actual execution of the award", Julian D. M. Lew/ Loukas A. Mistelis/ Stefan M. Kröll, *Comparative International Commercial Arbitration*, supra note 37, at 750.

[52] Gamal Moursi Badr, *State Immunity: An Analytical and Prognostic View*, supra note 4, at 107.

[53] Art. 23 states that "no measures of execution or preventive measures against the property of a contracting state may be taken in the territory of another contracting state except where and to the extent that the state has expressly consented in writing in any particular case", European Convention on State Immunity and the Additional Protocol of 1972, supra note 25.

[54] Art. 18 "no measure of constraint, such as attachment, arrest and execution, against property of a state may be taken in connection with a proceeding before a court of another state unless and except to the extent that: (a) the state has expressly consented to the taking of such measures.".

[55] Sornarajah for instance, argues that "despite these innovations as to enforcement which makes the ICSID award far superior to awards made against states or state entities by other tribunals, sovereign immunity continues to be a hurdle to the enforcement of ICSID awards", M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, supra note 23, at 227.

> Nothing in Article 54 shall be construed as derogating from the law in force in any contracting state relating to immunity of that state or of any foreign state from execution.[56]

The view expressed has also been recognised by a considerable number of court decisions. In the well known *LIAMCO v. Libya* case for instance, *LIAMCO*, after being granted an arbitral award[57] against *Libya*, started seeking enforcement of the award in different countries. *LIAMCO* sought enforcement of the arbitral award before the Switzerland court, and therefore it applied for attachment of all financial assets of *Libya* in banks in Zurich. On 13 February 1979, the District Court of the canton of Zurich granted the attachment, but the Swiss Federal Supreme Court vacated the attachment.[58] Similarly, the Court of First Instant of Paris (France) vacated the attachment of *Libya's* assets in France.[59] *LIAMCO* also sought recognition and enforcement of the award under the New York Convention of 1958 in the United States before the District Court of Columbia. *Libya* contended that the court was without jurisdiction, and it added that should the court find jurisdiction, it should refrain from enforcing the award under the New York Convention because of the act of state doctrine. The court accepted *Libya's* contention and rendered a decision on 18 January 1980, in which it refused the recognition and enforcement of the arbitral award.[60]

According to the doctrine of restrictive immunity, it is evident that a state cannot invoke immunity from jurisdiction, particularly, while it is conducting private or commercial activities. However, a state is still entitled to immunity from execution.

Our concern here is whether the involvement of a state in the petroleum industry is considered as a private act and therefore a state cannot invoke the doctrine of sovereign immunity. Or this act is a public act and consequently, a state can invoke the doctrine of absolute immunity when the interests of its citizens are at risk. Before answering this question it is worth discussing the

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[56] <www.worldbank.org/icsid/basicdoc/9.htm> last visited 13 February 2003.
[57] See a thorough discussion of this arbitral award in the previous chapter.
[58] See 6 YBCA 151 (1981).
[59] See the French decision in 106 *Journal du Droi International* 875-866 (1979).
[60] *Libyan American Oil Company v. Socialist People's Libyan Arab Jamahiriya*, 482 F. Supp. 1175; 1980 U.S. Dist. LEXIS 9839.

distinction between a public act and a private act as understood in certain court decisions.

1.4. Distinction between a public act and a private act

As stated above, due to the involvement of states in trade and private acts, there was a major shift regarding sovereign immunity. The doctrine of absolute immunity was gradually replaced by another doctrine which distinguishes between public and private state acts. Therefore, numerous western countries moved to limiting immunity, making it unavailable for private acts or commercial activities.[61] However, how do these jurisdictions distinguish between a public act and a private act, and what type of criteria do they follow?

The United States Foreign Sovereign Immunities Act (FSIA) Section 1603 (d) provides that "[A] 'commercial activity' means either a regular course of commercial conduct or a particular commercial transaction of act", then it expressly states that the commercial character of an activity should be determined by reference to the nature of its conduct, rather than by reference to its purpose.[62] According to the House of Representatives Committee on the Judiciary, the definition indicates that

> Goods or services to be procured through a contract are to be used for a public purpose is irrelevant; it is the essentially commercial nature of an activity or transaction that is critical. Thus, a contract by a foreign government to buy provisions or equipment for its armed forces or to construct a government building constitutes a commercial activity. The same would be true of a contract to make repairs on an embassy building. Such contracts should be considered to be commercial contracts, even if their ultimate object is to further a public function.[63]

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[61] Rosalyn Higgins, *Problems and Process: International Law and How to Use it*, supra note 7, at 81; see also *Kuwait Airways Corporation v. Iraqi Airways Company and Republic of Iraq*, [1995] 2 Lloyd's Rep. 317; *Kuwait Airways Corporation v. Iraqi Airways Co*, [2002] 2 A.C. 883.

[62] Sec. 1603 (d) provides that "[A] 'commercial activity' means either a regular course of commercial conduct or a particular commercial transaction of act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose", 28 U.S.C. (1982).

[63] See H. R. Rep. no. 94-1487, 94th Cong., 2nd Sess., reprinted in (1976) *U.S. Code Congressional and Administrative News*, at 6604-6635, 6615.

On the other hand, the Committee stated that foreign state participation in foreign assistance is a public or a governmental act in its nature. Hence, the distinguishing feature of an act here is the nature of the act not its purpose, even if the ultimate objective of an act is to further a public function.[64] Determining the nature of an act is the task of the courts, "the courts would have a great deal of latitude in determining what is a 'commercial activity' for the purposes of this bill."[65] In fact, the FSIA leaves much to the discretion of the judiciary. [66]

The English law (SIA) of 1978 gives examples of contracts in order to illustrate the meaning of a commercial act or transaction.[67] The International Commission's Draft followed the same method, listing a number of activities which are considered commercial in nature. Article 2 (1) (c) provides that "commercial transaction" means: any commercial contract or transaction for the sale of goods or supply of services; any contract for loan, other transaction of any financial nature; or any other contract or transaction of a commercial, industrial, trading or professional nature.[68] Paragraph (2) follows the American definition of a commercial activity in which the nature of the transaction should be primary. However, the Draft also gives consideration to the purpose of the contract. It states that

> In determining whether a contract or transaction is a "commercial transaction" under Paragraph 1 (c), reference should be made primarily to the nature of the contract or transaction, but its purpose should also be taken into account if, in the practice of the state which is a party to it, that

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[64] Ibid.; see also Mark B. Feldman, "The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder's View", supra note 27, at 308; see also L. Weatherly Lowe, "The International Law Commission's Draft Articles on the Jurisdictional Immunities of States and Their Property: The Commercial Contract Exception", 27 *Columbia Journal of Transnational Law* 657-678, 661 (1988-1989).

[65] H. R. Rep. no. 94-1487, 94th Cong., 2nd Sess., reprinted in (1976) *U.S. Code Congressional and Administrative News*, at 6604-6635, 6615.

[66] Georges R. Delaume, "Economic Development and Sovereign Immunity", 79 AJIL 319-346, 320 (1985).

[67] Sec. 3 (3) provides that "in this section 'commercial transaction' means:

- (a) any contract for the supply of goods or services;
- (b) any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation; and
- (c) any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a state enters or in which it engages otherwise than in the exercise of sovereign authority."

[68] See the text in 30 ILM 1563 (1991).

purpose is relevant to determining the non-commercial character of the contract or transaction.[69]

In determining the nature of an activity, the United States Court of Appeals for the Eighth Circuit in a case between *McDonnell Douglas Corporation v. the Islamic Republic of Iran*, rejected Iran's contention that "*McDonnell's* action is barred by sovereign immunity."[70] The court reported that the "FSIA recognises that sovereign immunity is the exception, rather than the rule", and this exception, as it later added "should be confined to a foreign sovereign's truly governmental acts and not extended to strictly commercial activities."[71]

Hence, it appears from the examples above that a commercial act or transaction is that which might be practiced by a private person or corporation, and therefore when a state is involved to such a transaction it is no longer entitled to sovereign immunity. These commercial transactions include the construction of a government building, or even undertaking repairs on an embassy building. The question which is raised here is whether is it logical to compare the petroleum industry with other commercial transactions. In the following section we will argue that it is not.

1.5. Is the petroleum industry a commercial activity?

To answer this question we must first recall the importance of the petroleum industry to the countries which are the subject matter of this thesis, as well as compare the importance of petroleum to previous activities which are considered commercial activities such as construction of a governmental building or even an embassy. Undoubtedly, petroleum is the life artery of these countries and it plays a crucial role in their citizens' daily life. It constitutes more than 70%

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[69] Ibid., at 1566.

[70] *McDonnell Douglas Corporation v. the Islamic Republic of Iran, the Ministry of Defence of the Islamic Republic of Iran and the Islamic Republic of Iran Air Force*, 758 F. 2d 341; 1985 U. S. App. LEXIS 29895.

[71] Ibid; the same approach has recently been maintained by the Cour de Cassation (France) in *Creighton v. Qatar*. The Court concluded that "although immunity from execution of states is the rule when such immunity has not been waived, the immunity does not cover assets intended for private economic or commercial activities", *Creighton Ltd v. Qatar*, the Cour de Cassation, 6 July 2000, 127 Cluent 1054 (2000); 15 (9) Mealy's IAR A-1 (2000).

of annual income in some countries.[72] This is the first and the most significant feature of the petroleum industry, which, will be argued here, precludes this industry from being a commercial activity. Furthermore, this industry inherently involves the state since nothing "can be carried out in its territory without its authorisation and under its strict control and supervision."[73] Moreover, petroleum contracts have a specific character which distinguishes them from other business contracts and gives them "a definite imprint that places them in a class of their own."[74] Apart from the fact that these contracts are long-term; contain a mixture of contractual and statutory or regulatory provisions (the legal nature of petroleum agreements) and that the state is always, directly or indirectly, involved in them,[75] the most significant aspect of petroleum contracts in our view is the subject matter of these contracts. Basically, these contracts regulate the relationship between the owner of the natural resources (petroleum) which is a state and a company or companies, in order to exploit this resource in favour of citizens of that state. Thus, the state here performs a public act not a private act, because this act is confined to the benefit of its citizens.

The importance of the petroleum industry to the developing petroleum countries nowadays, is comparable to the importance of vessels in previous centuries. In the 19th century for instance, when vessels played a crucial role in trade as well as in war, these vessels were granted immunity in foreign ports and territorial waters.[76] The United States Supreme Court was the first to apply the principles of state immunity to (public) ships.[77] Sucharitkul stated that

> The principles of state immunities as applied to public ships were first adopted by the United States Supreme Court at the time when America

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[72] For example, petroleum income constitutes 71% of the Omani annual budget for the year 2003, *Al-Watan* Newspaper, no. 7110, 2 January 2003.

[73] A. Z. EL Chiati, "Protection of Investment in the Context of Petroleum Agreements", 4 *Recueil des Cours: Collected Courses of the Hague Academy of International Law* 13-169, 26 (1987).

[74] Ibid., at 26; see also part one, chapter two of this thesis.

[75] Ibid., at 26; the Omani Basic Statute of the State of 1996 Art. 11 (4) provides that "all natural resources and revenues therefrom shall be the property of the state which will preserve and utilise them in the best manner taking into consideration the requirements of the state's security and the interests of the national economy [...]"; Petroleum Act of 1998 (UK) Part 1 (2) (1) provides that "Her Majesty has the exclusive right of searching and boring for and getting petroleum to which this section applies."

[76] Sompong Sucharitkul, *State Immunities and Trading Activities in International Law*, supra note 4, at 51.

[77] Ibid., at 51.

was yet a newly born state, still conscious of her sovereignty and independence.[78]

The Marshall C. J decision is a remarkable decision in this regard, because it laid down, for the first time, the principles of state immunity in general and the immunity of United States men-of-war in particular.[79] Marshall C. J. observed that

> A clear distinction is to be drawn between the rights accorded to private individuals or private trading vessels, and those accorded to public armed ships which constitute a part of the military force of the nation [...] it seems, then, to the court, to be a principle of public law, that national ships of war, entering the port of a friendly power open for their reception, are to be considered as exempted by the consent of that power from its jurisdiction.[80]

Years later, the Court of Appeals for the Fifth Circuit in the *Josefina Najarro de Sanchez v. Banco Central de Nicaragua* case found that the sale by the Nicaraguan Central Bank of foreign exchange was a sovereign act.[81] In the same vein, the Court of Appeals for the Ninth Circuit in the *Mol, Inc v. the Peoples Republic of Bangladesh*,[82] case found *Bangladesh* to be engaged in a public act. Here when *Bangladesh* terminated a contract with *Mol Inc* an Oregon corporation, to capture and export rhesus monkeys, and *Mol Inc* sued *Bangladesh*, the court concluded that

> Bangladesh was terminating an agreement that only a sovereign could have made. This was not just a contract for trade of monkeys. It concerned Bangladesh's right to regulate imports and exports, a sovereign prerogative. [...] In short, the Licensing agreement was a sovereign act,

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[78] Ibid., at 51-52.
[79] Ibid., at 52.
[80] *The Schooner Exchange v. M'Faddon and Others*, 11 U.S. 116; 3 L. Ed. 287; 1812 U.S. LEXIS 377; 7 Cranch 116; see also Sompong Sucharitkul, *State Immunities and Trading Activities in International Law*, supra note 4, at 51.
[81] *Josefina Najarro de Sanchez v. Banco Central de Nicaragua, a Foreign Banking Corporation* , U. S. Court of Appeals for the Fifth Circuit, 77 F. 2d 1385; 1985 U. S. App. LEXIS 23225.
[82] *Mol, Inc v. the Peoples Republic of Bangladesh*, 736 F. 2d 1326; 1984 U. S. App. LEXIS 20862; 14 ELR 20656.

not just a commercial transaction. Its revocation was sovereign by nature, not commercial. Bangladesh has sovereign immunity from this suit. [...] Because the act complained of was not a commercial activity and Bangladesh has sovereign immunity.[83]

In another case, *Samuel E. Friedar v. the Government of Israel*,[84] *Samuel E. Frieda*, a citizen of New York, brought an action under 28 U. S. C. Sections 1330, 1605 against *the Government of Israel* alleging that he was injured while serving in the Israeli army in 1948, and the Government refused to compensate him, despite an agreement do so. The District Court for the Southern District of New York decided that the *Israeli Government* was immune from the jurisdiction of the court under 28 U. S. C. Section 1604. The court concluded that the Government was entitled to sovereign immunity under 28 U. S. C. Sections 1604-1607[85], stating that

A determination regarding veterans' benefits in the United States is precluded from judicial review. 38 U. S. C. Section 211. It would be presumptuous for a United States court to review a foreign state's internal administrative activity, especially when identical activity by the United States government would not be subject to judicial review. I find this suit inappropriate for adjudication by United States court. I further note that the difficulty of trying this case in United States courts would justify a dismissal on forum non convenience grounds. Accordingly, the Government's motion to dismiss is granted.[86]

In a case between *International Association of Machinists and Aerospace Workers (IAM) v. the Organisation of the Petroleum Exporting Countries (OPEC)*, the United States Court of Appeal of Ninth Circuit concluded that

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[83] Ibid.
[84] *Samuel E. Friedar v. the Government of Israel, Ministry of Defence of Israel, and the Consulate General of Israel in New York*, 614 F. Supp. 395; 1985 U. S. Dist. LEXIS 17476.
[85] Ibid.
[86] Ibid.

The act of state doctrine is applicable in this case. The 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 allows jurisdiction in this case need not be decided, since a judicial remedy is inappropriate regardless of whether jurisdiction exists. [...] The decision of the district court dismissing this action is affirmed.[87]

The above decisions illustrate certain acts which have been considered as public acts, providing immunity for the state involved. How does the petroleum industry compare?

Is a petroleum transaction public in its nature or in its purpose? Compared to the above examples, it could be argued that the petroleum industry, as it exploits a national resource for the benefit of a nation, is a public activity in nature as well as in purpose, and that therefore a state is entitled to immunity when it is involved. This argument is especially significant as petroleum income is so crucial to the citizens of developing petroleum countries, and it is easy to say that it would be no any type of development in these countries without petroleum income. Hence, the allegation which says that the petroleum industry particularly in developing countries is just a commercial activity means either: lack of any type of knowledge concerning the role and impact of this industry in the developing countries compared to the same function in developed countries; or it is just a jump on the facts in order to establish a legal ground for self-benefit.

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[87] *International Association of Machinists and Aerospace Workers (IAM) v. the Organisation of the Petroleum Exporting Countries (OPEC)*, 649 F. 2d 1354; 1981 U. S. App. LEXIS 11740; 1981-1 Trade Cas. (CCH) P64, 143.

2. Public policy

Introductory remarks

The ease of enforcing an international arbitral award compared to enforcing a foreign judgment is considered a salient feature of international arbitration. However, the reality is more complex. Searching for grounds or defences in order to challenge the arbitral award is the principal concern of the losing party. The doctrine of public policy may be the most significant and the last defence in this regard. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (hereinafter the New York Convention) is the basis of this doctrine in the context of international arbitration.[88] The drafters of the Convention realised that a state was unlikely to become party to a treaty which compelled that state to recognise and give effect to a foreign arbitral award unless "there was the possibility of challenging enforcement on at least a minimum of recognised grounds."[89] Van den Berg considers public policy one of the most traditional grounds for the refusal of enforcement of a foreign arbitral award or foreign judgment, as well as for the refusal to apply a foreign law.[90]

Scholars introduced the notion of different levels of public policy to the debate, according to purpose, such as domestic and international public policies.[91] This distinction has been accepted in matters of arbitration.[92] Accordingly, it was argued that what might be considered to come under domestic public policy not necessarily fall into that of international public policy.[93]

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[88] Karl-Heinz Böckstiegel "Public Policy and Arbitrability", in: Pieter Sanders (ed.), *Comparative Arbitration Practice and Public Policy*, 1986 ICCA Congress Series no. 3, (1987 the Netherlands: Kluwer Law and Taxation Publishers), 177-204, 178.

[89] Christopher B. Kuner, "T he Public Policy Exception to the Enforcement of Foreign Arbitral Awards in the United States and West Germany under the New York Convention", 7 (4) J Int'l Arb 71-91, 71 (1990).

[90] Albert Jan van den Berg, *The New York Convention of 1958*: *Towards a Uniform Judicial Interpretation*, (Netherlands: Kluwer Law and Taxation Publishers 1981), at 360.

[91] See for instance, Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, supra note 1, at 531-532; Mauro Rubino-Sammartano, *International Arbitration*: *Law and Practice*, (2nd ed., the Netherlands: Kluwer Law International 2001), at 503- 531.

[92] Albert Jan van den Berg, *The New York Convention of 1958*: *Towards a Uniform Judicial Interpretation*, supra note 90, at 360.

[93] Ibid., at 360.

We will examine the nature of public policy and the role it can play in the sphere of international arbitration in general and in petroleum arbitration in particular.

2.1. The notion of public policy

Many have argued that public policy, is impossible to define due to the uncertainty and ambiguity of its content.[94] It was stated that "public policy still remains too vague a concept."[95] In the same vein, Sir John Donaldson asserted that public policy "can never be exhaustively defined."[96] However, Lew states that

> It is clear that public policy reflects the fundamental economic, legal, moral, political, religious and social standards of every state or extra-national community. Naturally public policy differs according to the character and structure of the state or community to which it appertains, and covers those principles and standards which are so sacrosanct as to require their maintenance at all costs and without exception. [97]

In 1853, the British House of Lords described public policy as "principles of law which hold that no subject can lawfully do that which has a tendency to be injurious to the public, or against public goods."[98] The Court of Appeal of Hamburg gave in its judgement on 26 January 1989, in a case between a seller and a buyer of soybean flour, a helpful definition of public policy. It stated that

> Apart from the violations of basic civil rights, an infringement upon public policy will result from the violation of a rule concerning the fundamental principles of political or economic life. Public policy will also be infringed

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[94] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 1, at 531-532.

[95] Oscar A. Ruiz Del Rio, "Arbitration Clauses in International Loans", 4 (3) J Int'l Arb 45-69, 65 (1987).

[96] *Deutsche Schachtbau-Und Tiefbohrgesellschaft m. b. H. v. R'as Al Khaimah National Oil Co.*, 3 WLR 1023-1041 (1987); 2 Lloyd's Rep 244, 254.

[97] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A study in Commercial Arbitration Awards*, supra note 1, at 532.

[98] *Egerton v. Brownlow* [1853] 4 HLC 1, quoted in the Report of International Law Association, the Committee on International Commercial Arbitration, London Conference (2000), at 4.

upon when the arbitral award is irreconcilable with German concepts of justice.[99]

This statement highlights the way in which diversity among states is reflected in interpretations of public policy. Therefore, what is a part of public policy in one country may not be in another with different political, economic, religious or social norms reflected in a different legal system.[100] Of great importance here is the considerable role religions principles play in determining public policy in Islamic countries.

2.2. The notion of public policy in Islamic law (*Shari'ah*)

In Islamic law (*Shari'ah*) like other legal systems it is difficult to find a definite definition to public policy. However, there are two particular features of public policy in Islamic law i.e. stability and continuity and it is comparable to public policy in other systems. This is because principles of Islamic law (especially the main principles) are derived from the sacred sources of the *Qura'an* and the *Sunnah*, and therefore the doctrine of public policy in Islamic law is fixed. Where these principles concern, for instance, the protection of the human being, property or the family, they are stable and remain the same in any place and at any time.

In fact, *Shari'ah* not only determines the areas in which daily life of Muslims should be conducted according to divine law, "but it also defines, classifies and categorise the injunctions of the lawgiver in relation to Muslims."[101] Hence, human activities are "classified on a scale of moral and ethical desirability from God's perspective."[102] This scale of religious qualifications which are known as the five qualifications (*al-ahkam al-khamsa*) are categorised as follow: obligatory duties (*wajib*), recommended (*mustahab*), permissible or discretionary (*mubah*), reprobated (*makruh*), and forbidden or prohibited (*haram*). Accordingly, the two extremes of obligatory and forbidden are binding duties and cannot be infringed or violated. Hence, contracts which contain usury (or interest) (*riba*), or

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[99] Court of Appeal of Hamburg (Germany) 26 January 1989, 17 YBCA 491, 494 (1992).
[100] Karl-Heinz Böckstiegel, "Public Policy and Arbitrability", supra note 88, at 179.
[101] Ali Rahnema, "Islamic Jurisprudence and Public Policy", in: Sohrab Behdad/ Farhad Nomani, *International Review of Comparative Public Policy*: *Islam and Public Policy*, vol. 9 (1997 London: JAI Press Ltd.), 103-122, 106.

contracts of hazard (*gharar*) are considered against the *Shari'ah* principles. The other three as Rahnema states are left to individual choice and discretion, though each one has different weight in terms of moral desirability from the viewpoint of the lawgiver.[103] He also argues that

> The five qualifications represent the width and scope of Islam's concern and preoccupation with individual and social acts. It reflects the degree to which it is a thoroughly interventions religion. [...] For Muslims, the commands and preferences of Islamic law should constitute the sole correct and acceptable code of moral conduct, assuring them of felicity in this world and salvation in the hereafter.[104]

However, this does not mean that public policy in Islamic law is inflexible.[105] In fact, the implementation of this doctrine is flexible especially in circumstances which concern the protection of private interests, whether in terms of recognition or organisation of these interests,[106] as long as there is no derogation from the major principles of Islamic law.[107] In other words, the doctrine of public policy in Islamic law is based upon respect for the general spirit of sacred sources, and also upon the principle that persons must respect their obligations, unless they authorise what is forbidden.[108] Hence, any foreign law or award must not be contrary to these principles.

The Riyadh Arab Convention on Judicial Cooperation for instance, upheld the idea of respecting principles of Islamic law in any foreign judgment by providing in Article 30 (a) that "the recognition of a judgment may be refused in the following cases: (a) if it is contrary to the provisions of the Muslim *Shari'ah* [...]". Article 37 (e) also provides that

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[102] Ibid., at 106.
[103] Ibid., at 106-107.
[104] Ibid., at 107-108.
[105] Said Ali Yehya/ Mohammed Al Sheekh Omar/ Nabeel Ibrahim Sa'ad, *Mabadi Alqanoon: Almadkhal lilkanoon wa Nazariat Al Eltizam* (*Principles of Law: An Introduction to the Law and the Theory of Obligation*), (2nd ed., Jiddah: *Dar Okaz* for printing and Publishing 1990), at 48.
[106] Ibid., at 48.
[107] See in this regard, Abd Alhadi Al Ataafi, *Masader Al Eltizam* (*sources of obligations*), at 240.
[108] See for instance, part two, chapter two of this thesis.

> The judicial authorities of this state can only refuse enforcement of the award in one of the following cases: [...] (e) if the award is contrary to the Muslim *Shari'ah*, public policy or good morals of the signatory state where enforcement is sought.[109]

A foreign arbitral award must conform with Islamic law in order to be enforced in Saudi Arabia for instance.[110] The concept of "profit" in contracts is the most controversial issue in Islamic law, since courts in some Islamic countries refuse to enforce any award which contains this concept.

However, nowadays, the concept of public policy in modern laws in Arab countries is more flexible, and concepts such as usury for instance, have found their way in most of these laws.[111]

Apart from diversity in opinions upon the notion of public policy, it is also divided into different levels and its role is not always the same in each level. Lew for instance, divided public policy into three levels: (a) national public policy, (b) community public policy and (c) international public policy.[112] Or domestic and international public policy as others argued.[113] However, before discussing the levels of public policy it is worth discussing first its role.

2.3. The role of public policy

It could be said that public policy functions as a brake on the rules of private international law,[114] i.e. it is a limit to the application of foreign law within the territory of a state: public policy "does not just operate to oust the law that

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[109] Riyadh Arab Convention on Judicial Cooperation, signed on 6 April 1983, which came into force in October 1985.

[110] See Abdul Hamid El-Ahdab, "Saudi Arabia Accedes to the New York Convention", 11 (3) J Int'l Arb 87-91, 89 (1994).

[111] See for instance, Farhad Nomani, "The Problem of Interest and Banking in Islamic Public Policy", in: Sohrab Behdad/ Farhad Nomani, *International Review of Comparative Public Policy: Islam and Public Policy*, supra note 101, at 277-310.

[112] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 1, at 533.

[113] See for instance, Albert Jan van den Berg, *The New York Convention of 1958: Towards a Uniform Judicial Interpretation*, supra note 90, at 360; by the same author, "Refusals of Enforcement under the New York Convention of 1958: The Unfortunate Few", in: *Arbitration in the Next Decade*, (1999 Special Supplement: ICC Bulletin), at 86; see also Mauro Rubino-Sammartano, *International Arbitration: Law and Practice*, supra note 91, at 505.

[114] Pierre Lalive, "Transnational (or Truly International) Public Policy and International Arbitration", in: Pieter Sanders (ed.), *Comparative Arbitration Practice and Public Policy in Arbitration*, ICCA Congress Series no. 3, supra note 88, at 261.

would normally be applicable, but to exclude the application of foreign laws in a predetermined field in any circumstances."[115] So, it is a shield with which to oppose recognition and enforcement of foreign judgments and arbitral awards.

However, this is a *negative* role of public policy,[116] whereas imposing the application of the law of the forum is the *positive* function of public policy according to Lalive.[117] In the English legal system, the private international law, Chapter 5 (2) provides that

> English courts will not enforce or recognise a right, power, capacity, disability or legal relationship arising under the law of a foreign country, if the enforcement or recognition of such right, power, capacity, disability or legal relationship would be inconsistent with the fundamental public policy of English law.[118]

A similar provision is also found in the Italian legal system which provides

> ...in no case will the laws and acts of a foreign state, the by-laws and the acts of any institutional body and private agreements have any effect on the territory of the state, when they conflict with public policy or *bonos mores*.[119]

In some countries the court can annul the arbitral award if the award is contrary to public policy. The Law of Arbitration in Civil and Commercial Matters of 1997 in Oman for instance, clearly provides that

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[115] Yves Derains, "Public Policy and the Law Applicable to the Dispute in International Arbitration", in: Pieter Sanders (ed.), ibid., at 227-256, 228.

[116] Sammartano describes this role as a *negative* role of public policy. He states that "the traditional, or *negative*, role of public policy consists in acting as a limit to the application of foreign law or to the recognition of foreign judgments", Mauro Rubino-Sammartano, *International Arbitrating*: *Law and Practice*, supra note 91, at 504; see also Pierre Lalive, "Transnational (or Truly International) Public Policy and International Arbitration", supra note 114, at 261.

[117] Pierre Lalive, "Transnational (or Truly International) Public Policy and International Arbitration", ibid., at 263.

[118] For more details see Adrian Briggs/ Jonathan Hill/ J. D. McClean/ C. G. J. Morse (eds.), *Dicey & Morris on the Conflict of Laws*, (13th ed., London: Sweet & Maxwell 2000), at 81-88.

> A court adjudicating upon an action for annulment shall of its own motion annul the arbitral award if there is anything in it contrary to public order in the Sultanate of Oman.[120]

The same law also provides in Article 58 (2) (b) that any foreign judgement or order should not contain "anything in it contrary to public order in the Sultanate of Oman." The new Civil and Commercial Procedural Law of 2002 is stricter concerning the principle of public policy. It requires that any foreign judgement or arbitral award is not contrary to any judgement or order that has already been taken by a court in Oman, nor contains anything contrary to morals.[121]

The doctrine of public policy is not only enshrined in national legislations, it is also found in several international conventions. The New York Convention of 1958 is a key convention which requires conformity with public policy in any arbitral award. Article 5 (2) (b) provides

> Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
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> ...
>
> (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

Although the Convention does not introduce an autonomous concept of public policy, it considers breach to such principles is a ground for refusal of recognition and enforcement of foreign arbitral awards.

Prior to the above Convention, the Geneva Convention of 1927 also required that recognition or enforcement of an award be compatible with public policy. It stated that an award would be enforceable unless it was contrary to the public policy or to the law of the country which it is sought to be relied upon.[122]

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[119] Section 31, General Provisions Preliminary to the Civil Code of 1942 as amended.
[120] Art. 53 (2).
[121] Chapter 4 Art. 352 (h) of the Civil and Commercial Procedural Law, issued by decree no. 29 of 2002 on 6 March 2002.
[122] Geneva Convention on the Execution of Foreign Arbitral Awards of 1927, Article 1 (e).

The UNCITRAL Model Law contains a similar provision in which public policy is a ground for setting aside an award by the courts at the seat of arbitration (Article 34) and also a ground for refusing recognition and enforcement of a foreign award (Article 36). Furthermore, the Brussels Convention on Jurisdiction and the Enforcement of Judgment in Civil and Commercial Matters of 1968 and Regulation 44/2001 considered public policy as a reason for refusal of recognition of a judgment. Article 27 (1) provides "a judgment shall not be recognised: (1) if such recognition is contrary to public policy in the state in which recognition is sought." The Amman Arab Convention on Commercial Arbitration provides in Article 35 that

> The supreme court of each contracting state must give leave to enforce the awards of the arbitral tribunal. Leave may only be refused if this award is contrary to public policy.[123]

2.4. The levels of public policy

Although functions of public policy can be understood in different ways, discussion here will focus on the notion of domestic public and international public policy, as well as substantive public policy and the way in which it overlaps with mandatory rules (or *lois de police*).

2.4.1. Domestic public policy and international public policy

When determining the applicable law to the merits of a dispute in order to render an enforceable award, arbitrators are expected to take into consideration several factors. One of these is the doctrine of public policy, since this can affect the choice of arbitrators,[124] or even the will of the parties.

Some scholars such as Böckstiegel have argued that "legal rules restricting arbitrability need not necessarily be part of public policy."[125] However such

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[123] This Convention was signed on 14 April 1987.

[124] Yves Derains, "Public Policy and the Law Applicable to the Dispute in International Arbitration", supra note 115, at 228.

[125] Karl – Heinz Böckstiegel, "Public Policy and Arbitrability", supra note 88, at 183; it was reported that "to some observes a double standard seems to be creeping into American attitude towards investment arbitration. Arbitration is good when it corrects misbehaviour by foreign host states, but not so desirable when claims are filed for alleged wrongdoing by the United

restriction is a type of domestic public policy which cannot be ignored, because any ignorance to the concept of public policy may affect enforcement of the award. Some argue that domestic public policy operates only in internal domestic relationships.[126] Others, such as Lew, divide domestic (or national) public policy into two divisions: first, internal public policy which includes both national policies recognised in customary law and legislation enacted in order to regulate certain situations and which "cannot be avoided or by-passed by the parties."[127] An example for such policy is found in several laws and legislations, Omani Labour Law of 1973 for instance, provide in Article 3 that "any condition which infringes the provisions of this law is null and void, [...] unless the condition is of greater benefit to the worker."[128] Second, external public policy which is relevant to private international law, which includes legislation of either "an imperative character" or which gives effect to fundamental policies and standards of the state."[129] Van den Berg has drawn an important distinction between domestic public policy and international public policy. Accordingly, he thinks that what is considered relevant in domestic public policy, is not necessarily relevant in international public policy.[130] Hence, it could be stated that domestic public policy means a set of rules which cannot be ignored because the intention of the legislator is over the intention of the contracting parties.[131] This latter (domestic public policy) function only in internal domestic relationships.[132]

However, international public policy as Sammartano argues represents that part of public policy which is more crucial for the legal system, and its

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States. [...] Recent trade legislation has significantly impaired the vigor [vigour] of future treaty-based arbitration of investment disputes, with the United States pursuing a course and a tone quite different from when negotiating NAFTA. Moreover, vocal opposition to investment arbitration has been expressed by important segments of the media and several non-governmental organisation", Guillermo Aguilar Alvarez/ William W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11", 28 *Yale Journal of International Law* 365 (2003).

[126] Mauro Rubino-Sammartano, *International Arbitration: Law and Practice*, supra not 91, at 506.

[127] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 1, at 533.

[128] Oman Labour Law, issued in accordance with the Sultani Decree no. 34 of 1973.

[129] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration: A Study in Commercial Arbitration Awards*, supra note 1, at 533-534.

[130] Albert Jan van den Berg, *The New York Arbitration Convention of 1958, Toward a Uniform Judicial Interpretation*, supra note 90, at 360.

[131] See Ashraf Abd Al'alim Al Rifa'ey, *Dirasah fee Khada Altahkeem* (*A Study on Arbitration*), (2nd ed., Cairo: *Dar Alnahdah Alarabiah* 1998), at 24.

[132] Mauro Rubino-Sammartano, *International Arbitrating: Law and Practice*, supra note 91, at 506.

principles which are "more jealously adhered to and which cannot be affected by the access into that legal system of a foreign provision (or decision) which conflicts with them."[133]

The Committee on International Commercial Arbitration of the International Law Association, after a six year study of public policy, introduced a recommendation at its New Delhi Conference in 2002. Recommendation 1 (d) suggests that

> The international public policy of any state includes: (i) fundamental principles, pertaining to justice or morality, that the state wishes to protect even when it is not directly concerned; (ii) rules designed to serve the essential political, social or economic interests of the state, these being known as "*lois de police*" or "public policy rules"; and (iii) the duty of the state to respect its obligations towards other states or international organisations.

The same Committee has broken down international public policy into three categories: fundamental principles; *lois de police*; and international obligations.[134] Consideration of international public policy is increasingly referred to in legislations as well as court judgments. In France, for instance, Article 1502 (5) of the New Code of Civil Procedure of 1981, specifies that "awards made outside France or in international arbitration in France must comply with international public policy."[135] Portugal also has a similar provision.[136] Reveals court decisions have upheld the notion of international public policy. For example, the Court of Appeal of Milan considered that the public policy referred to in Article 5 (2) (b) of the New York Convention is international public policy. In its decision dated 4 December 1992, the Court concluded that

> We must say that, where this consistency is to be examined, reference must be made to the so-called international public policy, being a body of

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[133] Ibid., at 506.

[134] For further details, see the Report of the International Law Association, Committee of International Commercial Arbitration, New Delhi Conference 2002.

[135] Emmanuel Gaillard/ John Savage, *Fouchard Gaillard Goldman on International Commercial Arbitration*, (The Hague, the Netherlands: Kluwer Law International 1999), at 953.

> universal principles shared by nations of similar civilisation, aiming at the protection of fundamental human rights, often embodied in international declarations or conventions.[137]

An eminent example of international public policy may be found in the award which was rendered by the French *Cour de Cassation* on 24 March 1998, in a case between *Excelsior Film TV. Srl v. UGC – PHOA*. The Court rejected the enforcement of the arbitral award on the grounds of lack of the impartiality of arbitrator, concluded that

> An arbitrator had been appointed by the same party in parallel arbitrations one taking place in France and the other in Rome, Italy. The arbitrator allegedly conveyed erroneous information to the Roman arbitral panel which influenced the tribunal's decision on jurisdiction. Excelsior Film TV, srl (Excelsior) sought to enforce the arbitral award rendered in Rome against UGC-PH. On 24 June 1994, the Court of Appeal in Paris refused enforcement on grounds of public policy for lack of impartiality of the arbitrator. Excelsior appealed to the Supreme Court, which denied the appeal and affirmed the lower court's decision. [138]

However, the distinction between domestic public policy and international public policy may not always be welcomed by courts. The Supreme Court of India, for instance, stated in its decision on 7 October 1993, in a case between *Renusagar Power Co. Ltd. v. General Electric Co.*, that

> In view of the absence of a workable definition of 'international public policy' we find it difficult to construe the expression 'public policy' in Article 5 (2) (b) of the New York Convention to mean international public policy. In our opinion the said expression must be construed to mean the doctrine of public policy as applied by the courts in which the foreign award is sought to be enforced. Consequently, the expression 'public

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[136] Article 1096 (f) of the Code of Civil Procedure (1986).
[137] See an excerpt of the decision in: 22 YBCA 725-726, 726 (1997).

policy' in Section 7 (1) (b) (ii) of the Foreign Awards Act means the doctrine of public policy as applied by the courts in India.[139]

Finally, it is worth mentioning that international public policy is understood to be narrower than domestic public policy.[140] Mayer believes that this is because international public policy generally focuses upon the most fundamental norms.[141]

2.4.2. Substantive public policy and its overlapping with mandatory rules

Before proceeding to discuss substantive public policy it is worth mentioning that there is a distinction between substantive public policy and procedural public policy. The latter is normally found in procedural law,[142] and it refers to the process by which the dispute is adjudicated.[143] Rubino-Sammartano argues that procedural public policy "plays a role in arbitral proceedings which differs depending on the applicable procedural law." He states that on the one hand, if the procedural law of the place of arbitration (*lex loci arbitri*) applies to the arbitration proceedings, the application of that law will undoubtedly consist in the application of its basic or fundamental principles. On the other hand, he argues that if the proceedings are governed by another national law, arbitrators are not only obliged to give consideration to the public policy of that procedural law, they are also obliged not to breach the rules of international public policy which normally apply in the place of arbitration.[144] A similar situation will arise "if a supranational set of arbitration rules is applicable."[145]

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[138] *Excelsior Film TV. Srl v. UGC – PHOA*, the French *Cour de Cassation* on 24 March 1998; see also *Kuwait Airways Corporation v. Iraqi Airways Corporation*, [2003] 1 Lloyd's Rep. 448.

[139] *Renusagar Power Co. Ltd. v. General Electric Co.*, the Supreme Court of India, 7 October 1993; see comments on this award by Lawrence F. Ebb, "Reflections on the Indian Enforcement of the *Ge/ Renusagar* Award", 10 *Arbitration International* 141-161 (1994).

[140] See the Report of International Law Association, the Committee on International Commercial Arbitration, New Delhi Conference, at 3.

[141] See the Report of International Law Association, the Committee on International Commercial Arbitration, London Conference (2000), at 6.

[142] Mauro Rubino-Sammartano, *International Arbitration*: *Law and Practice*, supra note 91, at 507.

[143] See the Report of International Law Association, the Committee on International Commercial Arbitration,, London Conference (2000), at 17.

[144] Mauro Rubino-Sammartano, *International Arbitration*: *Law and Practice*, supra note 91, at 511.

[145] Ibid., at 512.

(a) Substantive public policy

It has been argued that substantive public policy (*ordre public au fond*), as opposed to procedural public policy, "goes to the recognition of rights and obligations by a tribunal or enforcement court in connection with the subject matter of the award."[146] The principles of good faith and prohibition of abuse of rights; prohibition against uncompensated expropriation; *pacta sunt servanda*; and prohibition against discrimination are examples of substantive public policy.[147] Hence, it is clearly imperative that arbitrators give full consideration to substantive public policy. National prohibition of governmental bodies entering into arbitration agreements without special permission, such as in Saudi Arabia falls into the category of substantive public policy.[148]

An interesting example of a court decisions concerning substantive public policy may be found in the *National Oil Corporation v. Libyan Sun Oil Company* case.[149]On 20 November 1980, the *National Oil Corporation* (*NOC*), a Libyan state enterprise, and *Sun Oil Company* signed an Exploration and Production Sharing Agreement. The Agreement provided, *inter alia*, that *Sun Oil Company* was to carry out petroleum exploration in Libya. The Agreement contained an arbitration clause referring to the ICC. Two years later, in March 1982, the United States imposed sanctions against Libya. Consequently, no American citizens or technicians were allowed to enter Libya. Accordingly, the *Sun Oil Company* stopped its activities in Libya and in late June 1982, it notified the *NOC* that "it was claiming the export regulations as an additional event of *force majeure*." The *NOC* rejected this claim and referred the dispute to arbitration.

On 31 May 1985 the arbitral tribunal rendered a first award on the issue of *force majeure*. The tribunal held that there had been no *force majeure* within the meaning of the agreement because other American companies had continued to provide services to Libya by hiring non-American staff, and that *Sun Oil*

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[146] See the Report of International Law Association, the Committee on International Commercial Arbitration, London Conference (2000), at 17.

[147] See the Report of International Law Association, the Committee on International Commercial Arbitration, New Delhi Conference (2002), at 6-7.

[148] Kingdom of Saudi Arabia: Arbitration Rules and Codes Art. 3 provides that "government agencies may not have recourse to arbitration for settlement of their disputes with third parties except with the approval of the President of the Council of Ministers [...], Saudi Arbitration Rules and Code, issued by the Royal Decree no. M 46, on 25 April 1983.

Company had a Canadian subsidiary which was fit to take over performance. The final arbitral award was rendered on 23 February 1987, in favour of the *NOC*.[150] *NOC* sought enforcement of the award, initiating proceedings before the United State, District Court of Delaware. *Sun Oil Company* claimed that the award was contrary to public policy. However, the court rejected *Sun's* claim and awarded the *NOC* its petition.[151]

A second example examines whether recognition of a foreign award violates French public policy. In a case between *Société Grands Moulins de Strasbourg v. Cie Continentale France*,[152] the claimant argued that the award could not be enforced, on the grounds that it was contrary to a ministerial order according to which import compensations are to be paid to importers. The background of the case is that on 12 March 1982, *Grands Moulins de Strasbourg* (*GMS*) purchased durum wheat imported by *Continentale*. The contract contained an arbitration clause in London before the Grain and Feed Trade Association (GAFTA). On 3 June 1982, the parties signed an addendum to the contract. The addendum provided that any compensation or duty due in connection with the transaction would be for *Continentale*'s account, the relevant date being the day of arrival of the ship carrying the durum wheat at Le Havre.

The purchase price was paid by *GMS* on 11 June 1982. On 12 June, the French franc was devalued as part of EEC currency adjustment measures. Price adjustment measures were also announced. On 14 June, a French Ministerial Order blocked all prices on the French market as of 11 June 1982. The Order provided *inter alia*

> When compensation is granted in France in application of EEC Regulation no. 974-71 as modified, the amount of the compensation shall be deducted from the purchase price of the products benefiting from the compensation.

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[149] *National Oil Corporation v. Libyan Sun Oil Company*, United States District Court, District of Delaware, 15 March 1990 733 F Supp. 800; 1990 U. S. Dist. LEXIS 3419, reprinted in (1991) 16 YBCA 651-663.

[150] The tribunal reported that "on the question of whether *Sun Oil* could have found non-US technicians on the oil market, the tribunal relies upon the testimony of Mr. Blom. [he was in charge of Occidental's Libyan operations] he testified that Occidental Oil Corporation was able to continue its Libyan production and exploration operation", see 16 YBCA 54-78 (1991).

[151] Ibid., at 651-652.

[152] *Société Grands Moulins de Strasbourg v. Cie Continentale France*, Court of Appeal of Versailles, 2 October 1989, reprinted in (1991) 16 YBCA 129-133.

> Importers benefiting from the compensation after invoicing the goods shall-if they have not deducted the compensation from the purchase price - pay to the buyer a sum equivalent to the compensation.[153]

GMS refused to pay the compensation to *Continentale*, consequently, the latter initiated arbitration proceedings in London. On 2 December 1983, the GAFTA rendered an award according to which *GMS* should pay to *Continentale* the sum which it had received as compensation on *Continentale's* behalf. The award was affirmed in appellate proceedings. The award also granted enforcement in France by the president of the Court of First Instance of Paris and it was also affirmed by the Court of Appeal of Paris. The Supreme Court remanded the parties to the Court of Appeal of Versailles, which granted enforcement of the award on 2 October 1989. The Court reported that

> French international public policy is not violated by the enforcement of an arbitral award which attributes the compensation to *Continentale* without concretely and effectively affecting the intended aims and goals of a French regulation pertaining to public policy. Only if this were the case - leaving aside a purely formal violation of the regulation - would the intended monetary and economic balance be sufficiently affected to hold that French international public policy has been violated.[154]

(b) Mandatory rules

Mandatory rules ((*lois de police*) (imperative or prohibitive) are every legal rule which cannot be agreed oppositely to its provision nor agreed in their contracts to apply provisions other than those of its provisions.[155] Mayer has described mandatory rules as

> An imperative provision of law which must be applied to an international relationship irrespective of the law that governs that relationship. To put it another way: mandatory rules of law are a matter of public policy (ordre

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[153] Ibid., at 129-130.
[154] Ibid., at 132.

public), and moreover reflect a public policy so commanding that they must be applied even if the general body of law to which they belong is not competent by application of the relevant rule of conflict of laws.[156]

He gives examples of some mandatory rules, such as competition laws; currency controls; environmental protection laws and measures of embargo, blockade, or boycott. He asserts that "in matters of contract", the outcome of a mandatory rule of the law of a given state is to oblige arbitrators to respect this rule and to apply it irrespective of whether the contracting parties have expressly or implicitly chosen a law of another state.[157] In other words, the discretion of the arbitral tribunal is beyond the will of the parties.[158] Others have also argued that the mandatory rules of the *lex contractus* "should be applied by the arbitrators, whether or not invoked by the parties."[159] Guedj describes mandatory rules as

> Rules of substantive internal law that provide for their own application without having been selected by the normal choice-of-law rule of the forum. Their intended sphere of spatial operation is determined by reference to their object or their purposes. The reference may be express or implicit only, in which case it will be determined by judicial interpretation or construction. Such rules, at least when they emanate from the forum, must apply to all situations stated as being within the rule's scope without any importance being attached to foreign elements which might be present and which would otherwise trigger the operation of the forum's conflict rules.[160]

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[155] Khalid Abdullah Eid, *Madkhal Liderasit Alkanoon* (*An introduction to Study of Law*: *The Theory of Law*), (Morocco: *Altalib* Library 1980), at 81.

[156] Pierre Mayer, "Mandatory Rules of Law in International Arbitration", 2 *Arbitration International* 274-293, 275 (1986).

[157] Ibid., at 275.

[158] A. F. M. Maniruzzaman, "International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview", 7 (3) J Int'l Arb 53-64, 62 (1990).

[159] Serge Lazareff, "Mandatory Extraterritorial Application of National Law", 11 *Arbitration International* 137-150, 138 (1995).

[160] Thomas G. Guedj, "The Theory of the *Lois de Police*, a Functional Trend in Continental Private International Law – A Comparative Analysis with Modern American Theories", 39 *The American Journal of Comparative Law* 661-697, 665 (1991).

The existence and applicability of such rules has been found in legislations such as the American Restatement Second of Conflict of laws,[161] as well as in some conventions such as the European Convention on the Law Applicable to Contractual Obligations of 1980. The latter Convention expressly states

> When applying under this Convention the law of a country, effect may be given to mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application.[162]

Hence, it may be argued that arbitrators, although they do not have *lex fori* which means that they do not have a national forum and all the mandatory rules are foreign, they are always requested to take into consideration mandatory rules of state contracting parties. The reason for this is that a state has undisputed territorial sovereignty, as well as the fact that a state, in its contracting, is in theory representing its people's interests and welfare.[163] Therefore, the state has authority to regulate and enact laws in the public interest.[164] This fact has already been accepted by all nations and supported by several resolutions of the United Nations.[165] There is some evidence in arbitration practice of support for this understanding of mandatory rules. In the *Kuwait v. Aminoil* case for instance, the arbitral tribunal observed, in the context of the concession, the superior position of the state when it reported that "the state thus became, in fact if not in law, an associate whose interests had become predominant."[166] The tribunal also added

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[161] Restatement Second, Sec. 187 (2) (b).

[162] The European Convention on the Law Applicable to Contractual Obligation, Rome 1980, Art. 7 (1).

[163] A. F. M. Maniruzzaman, "International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview", supra note 158, at 59.

[164] Ibid., at 60.

[165] For more detail on these resolutions, see part one, chapter one of this thesis.

[166] *Government of the State of Kuwait v. The American Independent Oil Company* (*AMINOIL*) (1982) 21 ILM. 976; see also A. F. M. Maniruzzaman, "International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview", supra note 158, at 59-60.

that "the general principles of law recognise the right of the state in its capacity of supreme protector of the general interest."[167]

(c) To what extent does public policy overlap with mandatory rules?

The important question here is whether public policy and mandatory rules are two sides of the same coin. It can be argued that each has its own character, although they may have the same aim. There are certainly differences between the two: public policy, as noted above, is ambiguous and unclear, whereas mandatory rules are defined and specified, making it more difficult for contracting parties violate them. In other words, mandatory rules intervene directly, mainly at the early stage of the choice of law process, because they are the rules of the forum which must be respected and applied irrespective of the applicable foreign law. In contrast, public policy intervenes only at the ultimate stage of the choice of law process, and may be exactly after the normally applicable foreign law has been chosen and this law was contrary to the fundamental policy of the forum.[168]

Finally, mandatory rules are a tool for the operation of public policy and therefore it may be argued that the two are similar in aim but different in function.

Concluding remarks

It may be concluded that a state in its efforts to secure its public interest has a privileged attitude compared to a private party. Accordingly, a contracting state can invoke the doctrine of sovereign immunity in order to protect its citizens' interest, and therefore some state contracts particularly contracts concerning exploitation of national resources must be considered as a public act which has immunity especially from enforcement. Petroleum contracts are at the head of these contracts which deserve a special consideration due to the importance of this resource to the public interest. In return, a host state cannot threat the interests of the private contracting party by annulling a contract or amending its provisions unless in the requirements of public interest and just compensation be provided.

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[167] *Government of the State of Kuwait v. The American Independent Oil Company* (*AMINOIL*) (1982) 21 ILM 976.

[168] Nelson Enonchong, "Public Policy in the Conflict of Laws: a Chinese Wall Around Little England?" 45 ICLQ 633-661, 635 (1996).

Compensation in such circumstances may be determined according to the following criteria. An examination of petroleum agreements reveals that petroleum operations are normally divided into three stages.[169] First is the stage of "exploration and development."[170] Exploration includes geological, geophysical, aerial and other surveys as may be necessary; drilling of shot holes, core holes, stratigraphic tests; and the purchase or acquisition of necessary supplies, materials and equipment. Development includes for example all the projects that are necessary to undertake the operations such as the development of roads, camps, hospitals and schools, or activities which are related to the transportation or storage of petroleum.

Second is the stage of commercial discovery and cost recovery. This period normally begins after discovery of petroleum in one or more wells within the agreed contract area which are capable of producing an agreed quantity of petroleum (25,000 barrels per day in some petroleum agreements).[171] Petroleum agreements normally contain provisions which grant the right to the company to recover all costs incurred in operations such as exploration and development.[172]

The third stage is that of normal operation after the recovery of costs within the agreed contracting period.

Hence, if the termination of a contract was as a consequence of the company breaching its obligations, the latter should not be entitled to any compensation. If the termination was due to a state's wishes, unlinked to a company's behaviour, the state should be obliged to pay compensation to the company as follows

1) if the termination of the contract occurred during the first stage of

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[169] For a thorough study concerning different types of petroleum agreements see in general *Main Features and Trends in Petroleum and Mining Agreements: A technical paper*, United Nations Centre on Transnational Corporations, (New York: United Nations 1983); Keith W. Blinn/ Claude Duval/ Honore Le Leuch/ Andre Pertuzio, *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects*, (London: Euromoney Publications PLC 1986); Martyn R. David (ed.), *Upstream Oil and Gas Agreements: with Precedents*, (London: Sweet & Maxwell 1996).

[170] See for example Pecten Group Contract of 1985, for the Exploration, Development and Production of Petroleum between the Government of Syria and Syrian Petroleum Company, Pecten Ash Sham Company, Syria Shell Petroleum Development B. V., and Deminex Petroleum Syria GMBH (Ash Sham Area), *Middle East Basic Oil Laws and Concession Contracts*, supplement no. XCI (91), at 4.

[171] See for example Oman Exploration and Production Sharing Agreement, "definition of commercial discovery" (unpublished).

[172] See for example supra note 170 above.

"exploration and development", the host state should pay all expenses already incurred by the company, and the company would have the right to transfer all its tangible and intangible assets if the state was not interested in purchasing them.

2) If it occurred during the second stage, the host state should be obliged to pay all expenses which have not yet been recovered. In addition, the state should also be obliged to pay compensation (sum or petroleum as agreed) equal to a month of petroleum extraction earnings as a period of notice or 20% of anticipated annual profits (one year only) which is higher. Moreover, the company would have the right to transfer all its tangible and intangible assets if the state was not interested in purchasing them.
3) If the termination occurred during the last stage, the state must pay compensation to the company equal to a month petroleum production or 20% of anticipated annual profits (one year only) which is higher, after the deduction of any payment or tax for the state. The state should also pay salaries of the company's staff for a period of a month or more as a notice period, as is established in the law of the host state. In addition, the state should allow the company to transfer all its tangible and intangible assets if the state is not interested in purchasing them.

At the same time, the doctrine of public policy may be considered as a weapon for challenging a foreign law and also a foreign arbitral award and a foreign judgement. However, whereas the function of the doctrine of sovereign immunity is only restricted to states, the doctrine of public policy especially, as a challenge of a foreign arbitral award or a judgement may be used by individuals. Hence, the need for finding a midway resolution between the state public interest and the private interest is significant. This significance becomes more obvious in the petroleum industry due to the global need for this resource in the first instance, and also due to the conflict of interests between the contracting parties in the second.

Chapter Two: The Solution of the International Centre for Settlement of Investment Disputes (ICSID)

Introductory remarks

The need to find a mechanism to protect international investments was the principal motive in the establishment of the International Centre for Settlement of Investment Disputes (hereinafter ICSID or the Centre), which was established by the Washington Convention (the Convention) in 1965.[1] It is formally known as "the Convention on the Settlement of Investment Disputes between States and Nationals of other States."

The aim of ICSID according to Article 1 (2) is to provide facilities for conciliation and arbitration of investment disputes between contracting states and nationals of other contracting states.[2] It has been argued that prior to the Convention, the paths open to the private investor were limited.[3] Moreover, foreign investment disputes may create considerable tensions and their resolution may be inappropriate either before the host state's courts, or before the national courts of the foreign investor.[4] It was also argued that creation of a forum whose mission is the settlement of disputes between host states and investors would improve the investment climate by decreasing the fear of political risks which normally hinder the flow of private foreign capital.[5] The Convention, in its preamble, refers to the need for international cooperation for economic development; to the benefits of private international

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[1] Broches for example argues that "the Convention [...] offers protection to aliens against the host state", Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", 136 *Recueil des Cours*, 330-410, 355 (1972); on the need for such an institution, see Phillipe Kahn, "The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes", 44 *Indiana Law Journal* 1-32, 1-5 (1968).

[2] Washington Convention, Art. 1; for updated news on ICSID see <www.worldbank.org/icsid> last visited 15 April 2003.

[3] P. F. Sutherland, "The World Bank Convention on the Settlement of Investment Disputes", 28 ICLQ 367-400, 372 (1979).

[4] Okezie Chukwumerije, "International Law and Article 42 of the ICSID Convention", 14 (3) J Int'l Arb 79-101, 79 (1997).

[5] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 343.

investment; and to the possibility that from time to time disputes may arise in connection with such investments between contracting states and nationals of other contracting states. Furthermore, it was argued that such international methods of settling disputes may be appropriate.[6]

Between 1961 and 1965, the staff of the International Bank for Reconstruction and Development (the World Bank) – the principal sponsor of ICSID - prepared the draft of the Convention. Aron Broches, on the General Council, was described by Schreuer as the ICSID Convention's principal architect.[7] On 18 March 1965 the Executive Directors of the World Bank adopted a resolution approving the final text of the Convention.[8] This resolution instructed the president of the World Bank to submit a copy of both the text of the Convention and the Report of the Executive Directors to the Bank's members.[9] It was agreed that "the World Bank should become a signatory of the Convention to demonstrate that it consented to carry out the functions which it had been allotted under that document."[10] The Convention entered into force on 14 October 1966, 30 days after the depositing of the twentieth ratification, pursuant to Article 68 (2).[11]

This chapter will examine: (i) the composition of ICSID; (ii) the jurisdiction of ICSID; the applicable substantive law for ICSID arbitration; (iv) why ICSID is unsuitable to solve petroleum disputes.

1. Composition of ICSID

Article 3 of the Convention provides that ICSID is composed of an Administrative Council, a Secretariat, a Panel of Conciliators and a Panel of

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[6] Washington Convention, preamble.

[7] Christoph H. Schreuer, *The ICSID Convention*: *A Commentary*, (Cambridge: Cambridge University Press 2001), at 2; the drafting history is fully documented in a four volume collection: *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (hereinafter called *History*), vol. 1: *Analysis of Documents Concerning the Origin and the Formulation of the Convention*, (Washington, 1970); vol. 2 (in two parts): *Documents Concerning the Origin and the Formulation of the Convention* (in English) (Washington, 1986); vol. 3 (in French) (1968); and vol. 4 (in Spanish) (1969); see also, Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 342-350.

[8] *History*, vol. 2, at 1039; see also the *Report of the Executive Directors*, 4 ILM 524 (1965).

[9] *History*, vol. 2, at 1086.

[10] P. F. Sutherland, "The World Bank Convention on the Settlement of Investment Disputes", supra note 3, at 377.

[11] Christoph H. Schreuer, *The ICSID Convention*: *A Commentary*, supra note 7, at 4; 154 states have signed the Convention as of 26 November 2003, <www.worldbank.org/icsid>, last visited 19 January 2004.

Arbitrators. Article 2 determines that the seat of the Centre shall be in Washington at the principal office of the World Bank. However, the seat of the Centre does not necessarily determine the place of conciliation and arbitration proceedings, since the parties can agree, according to Article 63,[12] to choose another place. However, this requires consensual agreement between the parties, and must be arranged either under Article 63 (a) or with approval by the commission or the tribunal after consultation with the Secretary-General under Article 63 (b).[13]

1.1. Administrative Council

ICSID is governed by the Administrative Council, which is comprised of one representative from each contracting state.[14] The Administrative Council is chaired by the President of the World Bank, who presides in an *ex officio* capacity but does not have any vote.[15] There was an initial suggestion to limit membership of the Administrative Council to member states of the World Bank, but this suggestion was rejected.[16]

Article 6 states the principal functions of the Administrative Council. These include, for instance, the adoption of administrative and financial regulations for the Centre; rules of procedure for the institution of conciliation and arbitration proceedings. In addition, the Administrative Council adopts the annual budget of the Centre.[17] The Administrative Council reaches decisions by a majority of votes cast, except in exceptional circumstances when a majority of two-thirds is required.[18]

1.2. Secretariat

The second principal organ of ICSID is the Secretariat, which consists, according to Article 9, of a Secretary-General, one or more Deputy Secretaries-General and staff. The Secretary-General and any Deputy Secretary-General are appointed by election by the Administrative Council upon nomination by the

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[12] Article 62 provides that "conciliation and arbitration proceedings shall be held at the seat of the Centre except as hereinafter provided."
[13] See *History*, vol. 1, at 278-282; for further detail see Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 1251-1258.
[14] Convention, Art. 4 (1).
[15] Convention, Art. 5.
[16] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 18.
[17] Convention, Art. 6 (a), (b), (c), and (f).
[18] For those occasions when a two-thirds majority is required, see the Convention, Art. 2, 6 (1), 7 (4), 10 (1) and 67.

Chairman. Term of office is limited to a period of six years and re-election is permitted.[19] The Secretary-General is the legal representative and the principal officer of ICSID and is responsible for its administration, including the appointment of staff. Moreover, he performs the function of registrar, and therefore has the authority to authenticate arbitral awards rendered pursuant to the Convention.[20]

1.3. The Panels

The Panel of ICSID, according to Article 3, is divided into two: a panel of conciliators and a panel of arbitrators, and they both consist of qualified persons.[21] Appointments to each panel are made by the contracting states, which designate to each panel four people who should not be nationals of that state. The Chairman of the Administrative Council may also designate 10 people to each panel, each of whom must be of a different nationality.[22] Article 14 requires those on the panel to be of a "high moral character and recognised competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment."[23] Members of a panel may serve for a renewable period of six years,[24] and a person is eligible to serve on both panels.[25] Articles 56-58 provide for the replacement and disqualification of conciliators and arbitrators.[26]

2. Jurisdiction of ICSID

ICSID derives its jurisdiction from Article 25 (1) which reads

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a contracting state (or any constituent subdivision or agency of a contracting state designated to the Centre by that state) and a national of another contracting state, which the parties to the

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[19] Convention, Art. 10 (1).
[20] Convention, Art. 11.
[21] Convention, Art. 12.
[22] Convention, Art. 13 (1) (2).
[23] Convention, Art. 14 (1).
[24] Convention, Art. 15 (1).
[25] Convention, Art. 16 (1).
[26] See <www.worldbank.org/icsid> last visited 16 April 2003.

dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.[27]

The scope of the jurisdiction of ICSID encompasses conciliation and arbitration.[28] The jurisdiction is based upon three "postulates"[29]: the consent of the parties; the parties' identity; and the nature of the dispute.

2.1. Consent of the parties

Consent of the parties, which is stipulated by Article 25 (1), is considered by the Executive Directors' Report as "the cornerstone of the Centre."[30] Therefore, "no procedure can take place under the Centre's auspices unless both parties to the dispute have given their consent."[31] The Article specifies that the consent must be in writing. However, there is no particular form at to the consent nor is there a specific time in which it must be given, since it may be given before or after the dispute has arisen.[32] Broches states that the parties may give their consent in a single instrument,[33] it may also be found in an investment protection treaty with another state.[34] Or states may include their consent in their investment promotion laws. This

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[27] See <www.worldbank.org/icsid> last visited 16 April 2003; on terminology, scope of jurisdiction see *History*, vol. 1, at 110-118; the *Report of the Executive Directors* provides that "the term jurisdiction of the Centre is used in the Convention as a convenient expression to mean the limits within which the provisions of the Convention will apply and the facilities of the Centre will be available for conciliation and arbitration proceedings", the *Report of the Executive Directors*, supra note 8, *para* 22; see also, Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 94-101.

[28] For details on ICSID jurisdiction, see Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 82-344.

[29] Georges R. Delaume, "Convention on the Settlement of Investment Disputes Between States and Nationals of Other States", 1 *International Lawyer* 64-80, 66 (1966-67).

[30] The *Report of the Executive Directors*, supra note 8, *para* 23.

[31] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 352.

[32] Ibid., at 353.

[33] Some of the Omani Exploration Production Sharing Agreements for instance, contain an arbitration clause in which any dispute which may arise between the parties will be submitted to ICSID for arbitration.

[34] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 353. Schreuer stated that consent through BIT has become accepted practice. However, BIT, in order to provide a basis for ICSID jurisdiction, must be in force at the relevant time. Schreuer reported that in some cases, such as *Tradex v. Albania*, the tribunal found that the alleged expropriation and the request for arbitration occurred before the entry into force of the BIT between Albania and Greece. Therefore, it was not possible to establish jurisdiction on the basis of that treaty. *Tradex Hellas S. A.* (Greece) *v. Albania*, Decision on Jurisdiction, 24 December 1996, 14 *ICSID Review-Foreign Investment Law Journal* 161-196, 178-180 (1999). In *CSOB v. Slovakia*, the tribunal, while confirming the principle of consent to ICSID jurisdiction by way of a BIT, found that the BIT between the Czech and Slovak Republics had not entered into force, *CSOB v.*

practice of including consent in investment promotion laws has raised some controversial issues. One example is the *Southern Pacific Properties* (*Middle East*) *Ltd* and *Southern Pacific Properties Ltd* (*Hong Kong*) *SPP v. Arabic Republic of Egypt* case.[35] On 23 September 1974, "Heads of Agreement" were signed concerning a tourist village on the Pyramids Plateau (the Pyramid Oasis project) and a similar tourist resort at Ras-El-Hekma on the Mediterranean coast in Egypt. The parties to this agreement were *SPP*, *the Government of Egypt* - represented by its Minister of Tourism – and *EGOTH* (*Egyptian General Organization for Tourism and Hotels*), a public sector enterprise under the Minister of Tourism. The Heads of Agreement were entered into in accordance with certain Egyptian laws, including Law no. 43 of 1974 concerning the Investment of Arab and Foreign Funds and the Free Zone. However, the law did not contain an arbitration clause. The Heads of Agreement was followed on 12 December 1974 by an agreement for the development of two international tourist projects in Egypt. The latter agreement was concluded only between *SPP* and *EGOTH*, and contained an arbitration clause.[36]

On 12 April 1975, the Board of Directors of the General Organisation for Investment of Arab Capital and Tax Free Zones approved the application for the establishment of a combined tourist company by *EGOTH* and *SPP* for the development of tourist areas at the Pyramids and Ras-El-Hekma sites. Furthermore, on 22 May 1975, the President of Egypt issued Decree no. 475, permitting the use of these sites for tourism purposes. Construction work began at the Pyramids site in July 1977. However, in late 1977 opposition to the Pyramid Oasis project developed in the Egyptian People's Assembly on environmental and archaeological grounds.

By a Decree of 27 May 1978, the Minister of Culture declared the Pyramids area to be public property. On 28 May 1978, the General Organisation for Investments issued a resolution in which it decided "to drop its former issued agreement... concerning the Pyramids plateau". On 19 June 1978, Presidential

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Slovakia, Decision on Jurisdiction, 24 May 1999, 14 *ICSID Review-Foreign Investment Law Journal* 251-283 (1999); for further detail, see Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 210-212.

[35] Decision on jurisdiction, 27 November 1985, 16 YBCA 16 (1991); 3 ICSID Rep. 102 (1995). The award, 8 *ICSID Review – Foreign Investment Law Journal* 328 (1993); 32 ILM 933 (1993), with correction at 32 ILM 1470 (1993); 19 YBCA 51 (1994) (excerpts); 3 ICSID Rep 189 (1995); for more details concerning the facts of the case see (1984) 9 YBCA 111-124.

[36] 3 ICSID Rep 102 (1995).

Decree no. 267 cancelled Decree no. 475, and the area was eventually declared an "area of public interest" by the Prime Minister of Egypt on 11 July 1978.

On 7 December 1978, *SPP* initiated ICC arbitration proceedings against both the *Egyptian State* and *EGOTH*. *Egypt* rejected the jurisdiction of the arbitrators, arguing that it was not a party to the December agreement which contained the arbitration clause. By an award dated 16 February 1983, the arbitrators held that *Egypt* was a party to the December agreement and ordered *Egypt* to pay to *SPP* US$ 12,500,000 damages with interest at the rate of 5% from the date on which the request for arbitration was received by the Secretary of the ICC Court of Arbitration until payment.[37] On 28 March 1983, *Egypt* filed a petition to overturn the award. On 12 July 1984, the Court of Appeal of Paris granted Egypt's petition and annulled the award essentially on the grounds that *Egypt* was not a party to the arbitration clause.[38] In response, *SPP* sought enforcement of the award, *inter alia*, in England and the Netherlands. It failed in England where the court refused to freeze Egyptian assets,[39] while it succeeded in the Netherlands. The President of the District Court of Amsterdam granted leave for enforcement, holding that *Egypt* was a party to the arbitration clause.[40] By sheer coincidence, the enforcement decision was rendered on 12 July 1984, on exactly the same day as the French annulment decision. *SPP* desisted from further proceedings in the Netherlands.

On 6 January 1987, the French Supreme Court rejected *SPP's* recourse against the annulment decision of the Court of Appeal of Paris.[41] Almost four years earlier on 15 August 1983, *SPP* sent a letter to the Minister of Tourism stating

> Recognising that your government has taken the position that the ICC award was rendered without a jurisdictional basis, we hereby notify you that we accept and reserve the opportunity of availing ourselves of the uncontestable [incontestable] jurisdiction of the International Centre for the Settlement of Investment Disputes, under the auspices of the World Bank, which is open to

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[37] See the ICC award, 9 YBCA 124 (1984).
[38] See 10 YBCA 113-122 (1985).
[39] See 10 YBCA 504-508 (1985).
[40] See 10 YBCA 487-490 (1985).
[41] See 13 YBCA 152-155 (1988).

us as a result of law no. 43 of 1974, Article 8 of which provides that investment disputes may be settled by ICSID arbitration.[42]

Article 8 of Egypt's law no. 43 of 1974, concerning the Investment of Arab and Foreign Funds and the Free Zone, provides that

> Investment disputes in respect of the implementation of the provision of this law shall be settled in a manner to be agreed upon with the investor, or within the framework of the agreements in force between the Arabic Republic of Egypt and the investor's home country, or within the framework of the Convention for the Settlement of Investment Disputes between States and nationals of other countries [States] to which Egypt has adhered by virtue of law no. 90 of 1971, where it (i.e., the Convention) applies.[43]

On 24 August 1984, *SPP* filed a request for ICSID arbitration. *Egypt* contested ICSID's competence to hear the case, arguing that it had not consented to the jurisdiction of ICSID in its investment legislation. Specifically, *Egypt* claimed that the clause which referred to ICSID was not self-executing because it required a separate implementing agreement with the investor. Moreover, *Egypt* argued that the law offered a number of alternative methods of dispute settlement among which the parties had to choose in advance, and also that the Convention itself offers conciliation and arbitration as two possible methods of solving disputes.[44] *Egypt* also argued that law no. 43 was only to inform investors that ICSID arbitration was among the dispute settlement methods available to investors in appropriate circumstances.[45]

On 27 November 1985, the ICSID arbitrators rendered a first decision on the preliminary question of the jurisdiction of ICSID. They rejected some of Egypt's objections to their jurisdiction, and stayed the proceedings on Egypt's remaining objections, "until the proceedings in the French courts have finally resolved the question of whether the Parties agreed to submit their dispute to the jurisdiction of the ICC." ICSID arbitration was resumed on the preliminary question of jurisdiction

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[42] 3 ICSID Rep 139 (1995).
[43] 3 ICSID Rep 145 (1995).
[44] Ibid., at 122-124.

after the French Supreme Court, on 6 January 1987, affirmed the decision of the Court of Appeal of Paris, holding that the ICC award of 16 February 1983 was invalid because *Egypt* had not consented to submit the dispute to ICC arbitration. This was no longer a matter of *SPP*'s case against *Egypt*, but of the place of the Centre arbitration in Egyptian investment law. On 14 April 1988 the tribunal rejected Egypt's contention by concluding that

> On the basis of the foregoing considerations, the tribunal finds that Article 8 of law no. 43 establishes a mandatory and hierarchic sequence of dispute settlement procedures, and constitutes an express "consent in writing" to the Centre's jurisdiction within the meaning of Article 25 (1) of the Washington Convention in those cases where there is no other agreed-upon method of dispute settlement and no applicable bilateral treaty.[46]

Hence, it could be argued that consent to the jurisdiction of ICSID can take the form of: (i) a contract between a state or a state entity and a foreign national, which contains an arbitration or conciliation clause providing for ICSID jurisdiction; (ii) a bilateral or a multilateral investment treaty between states which refers any dispute between a state and a national of another state to ICSID arbitration; and (iii) a provision in domestic investment legislation providing for ICSID jurisdiction.

Article 25 (4) gives the contracting state the right to limit their consent, by defining it in abstract terms, by excluding certain types of disputes or by listing the questions they are prepared to submit to the jurisdiction of ICSID.[47] Article 25 (4) clearly provides that

> Any contracting state may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit

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[45] Ibid., at 122-124.
[46] 16 YBCA 16-40, 38 (1991).
[47] C. F. Amerasinghe, "Submissions to the Jurisdiction of the International Centre for the Settlement of Investment Disputes" 5 *Journal of Maritime Law and Commerce* 211-250, 220-222 (1973-74).

such notification to all contracting states. Such notification shall not constitute the consent required by paragraph (1).[48]

In practice, some contracting states have used the opportunity afforded by Article 25 (4). Jamaica, for instance, has excluded legal disputes "arising directly out of investment relating to minerals or other natural resources."[49] Saudi Arabia also notified the Centre on 8 May 1980 that "[T]he Kingdom reserves the right of not submitting all questions pertaining to oil and pertaining to acts of sovereignty to the [Centre] whether by way of conciliation or arbitration."[50]

In the same vein, China has also notified the Centre that

Pursuant to Article 25 (4) of the Convention, the Chinese Government would only consider submitting to the jurisdiction of the International Centre for Settlement of Investment Disputes disputes over compensation resulting from expropriation and nationalisation.[51]

Lastly, it is noted that consent to the jurisdiction of ICSID is conditional on further requirements, i.e. the identity of the parties (*ratione personae*) and the nature of the dispute (*ratione materiae*).

2.2. Identity of the parties (*ratione personae*)

According to Article 25 (1), the jurisdiction of ICSID is limited to: a contracting state or subdivision or agency designated by a contracting state and a national of another contracting state. Therefore, any dispute between any other parties such as, between two private parties or those which are wholly intergovernmental disputes (between two countries) are excluded from the jurisdiction of ICSID.[52]

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[48] See <www.worldbank.org/icsid> last visited 16 April 2003.

[49] 1 ICSID Rep 210 (1993).

[50] Ibid., at 211.

[51] Amazu. A. Asouzu, *International Commercial Arbitration and African States*, (Cambridge: Cambridge University Press 2001), at 245.

[52] Aron Broches stated that "the services of the Centre would be available only for proceedings between a government on the one hand and a foreign national on the other. These services would therefore not be available in connection with disputes between private individuals, between a government and one of its own nationals or between governments", Paper prepared by the General

Schreuer argues that contracting states are those states which have accepted membership of ICSID by depositing their instrument of ratification, acceptance or approval in accordance with Article 68.[53] Designated subdivisions of a state which also come under the jurisdiction of ICSID may include federated states, semi-autonomous dependencies, and municipalities[54] However, Article 25 (1) emphasises that the designation of a subdivision or agency should be conveyed to ICSID,[55] and therefore designation in an agreement with the investor is insufficient.[56] Furthermore, Article 25 (3) requires approval of the contracting state for the consent to ICSID jurisdiction by a constituent subdivision or agency, unless the state notifies ICSID that no such approval is required.

The jurisdiction of ICSID also covers 'a national of another contracting state', which Article 25 (2) (a) determines as any natural person who has the nationality of a contracting state other than the state party to the dispute. This jurisdiction, in accordance with Article 25 (2) (b), also covers any juridical person who has the nationality of a contracting state other than the state party to the dispute. Therefore, the jurisdiction of ICSID covers a private individual or corporation; states acting as investors have no access to ICSID in this capacity.[57] Granting direct access

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Council and transmitted to the members of the Committee of the Whole, SID/ 63-2 (18 February 1963), *History*, vol. 2, at 78; see also, Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of other States", supra note 1, at 354-361; Georges R. Delaume, "Convention on the Settlement of Investment Disputes between States and Nationals of other States", supra note 29, at 68-69; P. F. Sutherland, "The World Bank Convention on the Settlement of Investment Disputes", supra note 3, at 382-385; Amazu A. Asouzu, *International Commercial Arbitration and African States*, supra note 51, at 267-306; C. F. Amerasinghe, "Jurisdiction Ratione Personae under the Convention on the Settlement of Investment Disputes between States and Nationals of other States", 47 BYIL 227, 230-234 (1974-75); Moshe Hirsch, *The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes*, (Dordrecht: Martinus Nijhoff Publishers 1993), at 62; K. V. S. K. Nathan, *The ICSID Convention: The Law of the International Centre for the Settlement of Investment Disputes*, (Yonkers, New York: Juris Publishing 2000), at 75-97; see also in general, Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 83.

[53] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 141; Article 68 provides that: (1) this Convention shall be subject to ratification, acceptance or approval by the signatory states in accordance with their respective constitutional procedures; (2) this Convention shall enter into force 30 days after the date of deposit of the twentieth instrument of ratification, acceptance or approval. It shall enter into force for each state which subsequently deposits its instrument of ratification, acceptance or approval 30 days after the date of such deposit <www.worldbank.org/icsid> last visited 16 April 2003.

[54] C. F. Amerasinghe, "Jurisdiction Ratione Personae under the Convention on the Settlement of Investment Disputes between States and Nationals of other States", supra note 52, at 233.

[55] In the absence of such stipulation, according to Arts. 28 (3), 36 (3), the request may be rejected on the ground that there is lack of jurisdiction; see for instance, *Klockner v. Cameroon*, award, 21 October 1983, 2 ICSID Rep 9 (1994).

[56] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 153.

[57] Ibid., at 159.

to non-state parties to an international forum was one of the Convention's "avowed purposes", in order to obviate the recourse to national courts.[58]

Schreuer reported that there was significant debate during the preparation of the Convention on the question of dual or multiple nationality, particularly where nationality of a non-contracting state was involved. The preliminary draft provided that a national of a contracting state "may possess concurrently the nationality of a state not party to this convention."[59] This provision did not appear in the later draft, but no concern was expressed regarding such situations.[60] Broches asserts that "such dual nationality clearly does not affect a party's standing as a 'national of another contracting state' any more than would dual nationality of two 'other contracting state."[61]

However, the Convention was silent concerning the definition of juridical person.[62] There was only a reference in the preliminary draft to a "company", in which it was described as including "any association of natural or juridical persons, whether or not such association is recognised by the domestic law of the contracting state concerned as having juridical personality."[63] So, it appears that the requirement here is that a juridical person must only have a legal personality under an existing system.[64] Broches asserts that this criterion only needs to be met on the date of consent, and therefore any subsequent changes of nationality as he later argues are irrelevant.[65]

However, some have argued that Article 25 (2) (b) is inherently controversial.[66] In *Holiday Inns v. Morocco*,[67] for instance (the first ICSID arbitration), *Morocco* contested the jurisdiction of ICSID on the ground that it had

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[58] Ibid., at 159.
[59] Ibid., at 270; see also, *History*, vol. 1, at 122, vol. 2, at 170.
[60] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 357.
[61] Ibid., at 357-358.
[62] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note7, at 276.
[63] See *History*, vol. 1, at 122, vol. 2, at 170; see also, Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 276.
[64] Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note7, at 276.
[65] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 358.
[66] Amazu A. Asouzu, *International Commercial Arbitration and African States*, supra note 51, at 273; concerning the interpretation of Article 25 (2) (b) see C. F. Amerasinghe, "Interpretation of Article 25 (2) (b) of the ICSID Convention, in: Richard B. Lillich/ Charles N. Brower (eds.), *International Arbitration in the 21st Century: Towards "Judicialisation" and Uniformity?* (1994 Irvington, New York: Transanational Publishers), at 223-244.
[67] Pierre Lalive, "The First 'World Bank' Arbitration (HOLIDAY INNS v. Morocco) – Some Legal Problems", 51 BYIL 123-161, 125 (1980), reprinted in 1 ICSID Rep 645-681 (1993).

never consented to treat "H. I. S. A. companies" as "nationals of another state", and therefore it had never agreed to ICSID arbitration with respect to these companies.[68] The same was in the *Amco v. Indonesia* case, where Indonesia also contested the jurisdiction of ICSID,[69] and in a later case, between *AUCOVEN v. Venezuela*.[70] *Venezuela* claimed that the conditions set forth in Article 25 (2) (b) were not fulfilled. First, *AUCOVEN* was in fact controlled by ICA Holding, a company incorporated under Mexican laws, as a consequence, *AUCOVEN* could not commence ICSID arbitration proceedings, since Mexico was not a contracting state of ICSID. Second, *Venezuela* asserted that it had not consented to treat *AUCOVEN* as a national of another state.[71]

2.3. Nature of the dispute (*ratione materiae*)

Article 25 (1) provides *inter alia* that the jurisdiction of ICSID shall extend to any legal dispute arising directly out of an investment.[72]

(a) Legal dispute

The Convention asserts that the jurisdiction of ICSID extends to any "legal" dispute. Yet it does not define the term "legal dispute."[73] Broches notes, however,

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[68] Ibid., at 139.

[69] *Amco v. Indonesia*, 1 ICSID Rep 389-568 (1993).

[70] *Autopista Concesionada de Venezuela, C. A. (Aucoven) v. Bolivarian Republic of Venezuela*, Decision on Jurisdiction, 27 September 2001, 16 *ICSID Review – Foreign Investment Law Journal* 469-514, 483 (2001).

[71] Gabriela Alvarez Avila, *Autopista Concesionada de Venezuela, C. A. (Aucoven) v. Bolivarian Republic of Venezuela* (ICSID Case no. Arb/00/5) Introductory Note, ibid., at 466-467; see other cases on ICSID's jurisdiction such as: *Scimitar Exploration Limited v. Republic of Bangladesh and Bangladesh Oil, Gas Mineral Corporation*, 5 ICSID Rep 3 (2002); *Ceskoslovenska Obchodni Bank, AS v. the Slovak Republic*, 5 ICSID Rep 330 (2002); *Emilio Agustin Maffezini v. the Kingdom of Spain*, 5 ICSID Rep 387 (2002).

[72] See for example Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 361; see also Georges R. Delaume, "Convention on the Settlement of Investment Disputes between States and Nationals of other States", supra note 29, at 69-70; P. F. Sutherland, "The World Bank Convention on the Settlement of Investment Disputes", supra note 3, at 385-386; Amazu A. Asouzu, *International Commercial Arbitration and African States*, supra note 51, at 235-266; Moshe Hirsch, *The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes*, supra note 52, at 57; K. V. S. K. Nathan, *The ICSID Convention: The Law of the International Centre for the Settlement of Investment Disputes*, supra note 52, at 99-115; see also in general, Christoph H. Schreuer, *The ICSID Convention: A Commentary*, supra note 7, at 103-141.

[73] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 362; *History*, vol. 1, at 111-119.

that a distinction was made between "disputes of a legal character" and "political, economic or purely commercial disputes."[74]

The Report of the Executive Directors stated that: first, the expression "legal dispute has been used to make clear that while conflicts of rights are within the jurisdiction of the Centre, mere conflicts of interests are not."[75] The purpose of this sentence, according to Broches, was to dispel the fears of some developing countries that "investors might request a host state to consent to *conciliation* proceedings with respect to disputes in which the investor did not even claim that any of his legal rights had been impaired."[76] Second, the dispute must "concern the existence or scope of a legal right or obligation, or the nature of extent of the reparation to be made for breach of a legal obligation."[77]

(b) Investment

Clearly, the notion of investment "is central to the Convention."[78] However, the Convention does not define the term "investment." In fact, the Working Paper's draft on jurisdiction did not even make any reference to the term "investment,"[79] since it was believed that a definition would limit the scope of the Convention.[80] Furthermore, it was stated that it may be difficult to find a satisfactory definition which would not lead to "jurisdictional controversies."[81] Therefore, the Report of the Executive Directors, Paragraph (27), declares that

> No attempt was made to define the term "investment" given the essential requirement of consent by the parties, and the mechanism through which contracting states can make known in advance, if they so desire, the classes of

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[74] Ibid., at 362.
[75] The *Report of the Executive Directors,* supra note 8, *para* 26.
[76] Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 363.
[77] The *Report of the Executive Directors*, supra note 8, *para* 26.
[78] Christoph H. Schreuer, *The ICSID Convention*: *A Commentary*, supra note 7, at 121.
[79] Article 2 (1) of the Working Paper's draft read, [T]he provision of this Article shall apply to any undertaking in writing to have recourse to conciliation or arbitration pursuant to the provisions of this Convention for the resolution of any existing or future dispute between a contracting state and a national of another contracting state, *History*, vol. 2, at 22.
[80] Christoph H. Schreuer, *The ICSID Convention*: *A Commentary*, supra note 7, at 121; see also, *History*, vol. 2, at 22.
[81] Ibid., at 121-122.

disputes which they would or would not consider submitting to the Centre (Article 25 (4)).[82]

The ambiguity and uncertainty of the meaning of "juridical person" and "investment" proved to be obstacles to ICSID arbitration, providing a basis on which to contest the jurisdiction of ICSID. A recent case demonstrates this fact.

On 29 July 1999, the *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*[83] was submitted to ICSID, by *Mihaly International Corporation* (*Mihaly* USA or the claimant). The request for arbitration invoked the provisions of the 20 September 1991 Treaty between the United States of America and *Sri Lanka* concerning the Encouragement and Reciprocal Protection of Investment (the US-Sri Lanka BIT). In this case, *Sri Lanka* raised two objections to the jurisdiction of ICSID, on the basis of the identity of the parties and the nature of the dispute. For the first, *Sri Lanka* claimed that the claimant had a partnership registered under the laws of Canada which is not a party to the ICSID Convention. *Sri Lanka* also argued that the claimant had no standing before the tribunal, because of its partnership with *Mihaly* (Canada), and its capacity as an undisclosed assignee, therefore it denied any deal with the claimant.[84] The arbitral tribunal rejected this claim, but it accepted the second claim concerning the nature of the dispute. Here, the claimant argued that in the absence of any definition of the term "investment", it was appropriate to give the term "a broad interpretation to encourage a free flow of capital into developing countries."[85] Otherwise, the claimant suggested "the free flow of capital investment to developing countries would subside." *Sri Lanka* rejected the idea of a broad definition of the term "investment," claiming that developing countries would find it difficult to be members of the Convention if, by means of a broad interpretation.

The arbitral tribunal concluded that on the one hand, it was asked to "consider whether or not, the undoubted expenditure of money, [...] to obtain a contract constituted 'investment' for the purpose of the Convention." On the other hand, it was not asked and it cannot "consider in a vacuum whether or not in other

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[82] The *Report of the Executive Directors*, supra note 8, *para* 27.
[83] *Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka*, 17 (1) *ICSID Review – Foreign Investment Law Journal* 142 (2002).
[84] Ibid., at 146-147.
[85] Ibid., at 152.

circumstances expenditure of monies might constitute an 'investment'."[86] It added that undoubtedly the jurisdiction of ICSID is based upon the mutual consent of the parties to submit their dispute to ICSID. On examination of the three documents submitted by the claimant, the arbitral tribunal found that "none of these [documents] contain any binding obligation either on *Sri Lanka* or on the claimant." Therefore, it concluded that these documents cannot be understood to signify acceptance by the host state (*Sri Lanka*) that such expenditures constitute "an investment within the sense of the Convention."[87] Finally, the arbitral tribunal decided that "the tribunal is without jurisdiction to entertain the question submitted to it either in part or in whole."[88]

2.4. Jurisdiction of ICSID under BITs

ICSID leads other international instruments in this regard in which a considerable number of BITs contain a reference to ICSID.[89] In 1969 ICSID issued a set of "Model Clause Relating to the ICSID Convention for Bilateral Investment Treaties."[90]

Undoubtedly, ICSID derives its jurisdiction over BITs disputes from Article 25 (1) and the consent of the BITs parties to refer any prospective disputes to ICSID. Treaty which was signed in 1979 between Sweden and Malaysia gives a suitable example of such consent. This treaty provides that

> In the event of a dispute arising between a national or a company of one contracting party and other contracting party in connection with an

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[86] Ibid., at 155.
[87] Ibid., at 158.
[88] Ibid., at 160; see also an individual concurring opinion on the case by David Suratgar (the arbitrator appointed by the claimant), ibid., at 161.
[89] It was stated that "[I]n this connection, it should be pointed out that a number of current model treaties contain two variations of the investment dispute provision: one draft provision that provides exclusively for ICSID arbitration, and another provision that sets forth alternative forms of arbitration", Rudolf Dolzer/ Margrete Stevens, *Bilateral Investment Treaties*, (The Hague: Martinus Nijhoff Publishers 1995), at 129-130; see samples of model of these treaties in: *Bilateral Investment Treaties in the Mid-1990s*, (United Nations Publications 1998), at 219; Peterson has argued that "data available from ICSID leaves no doubt that arbitration under bilateral investment treaties is on rise. BITs cases accounted for 5 of 12 new arbitration in 2000, 12 of 14 in 2001, and a striking 15 of 19 in 2002", Luke Eric Peterson, "Emerging Bilateral Investmnet Treaty Arbitration and Sustainable Development (Current as of August 2003)" <www.iisd.org/pdf/2003/trade_bits_disputes.pdf> last visited 12 December 2003.
[90] Antonio R. Parra, "ICSID and Bilateral Investment Treaties", <www.worldbank.org/icsid/news/n-17-1-7.htm> last visited 12 December 2003.

investment in the territory of that other contracting party, it *shall upon agreement by both parties to the dispute be submitted* for arbitration to the International Centre for Settlement of Investment Disputes.[91]

Other treaties contain in addition to the ICSID jurisdiction alternative mechanisms which may include litigation before the national courts. The treaty which was signed on 10 March 1999 between the United States and El Salvador provides an example to such type of treaties. Article 9 (2) of this treaty states that

A national or company that is a party to an investment dispute may submit the dispute for resolution under one of the following alternatives:
a) to the courts or administrative tribunals of the party that is a party to the dispute; or
b)...
c) in accordance with the terms of paragraph 3.
3 (a) provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b), and that ninety days have elapsed from the date on which the dispute arose, the national or company concerned may submit the dispute for settlement by binding arbitration:
i. to the Centre, if the Centre is available, [according to Article 1the Centre, means ICSID].[92]

The relevance of Additional Facility Rules were developed in 1984 and reviewed in 2002 with view of accommodating non-ICSID cases. Many BIT disputes are administered under Additional Facility Rules.

It was stated that from the vast number of cases which have been registered at the ICSID's Secretariat since 1998, three-quarters of these cases relying upon

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[91] See Malaysia-Sweden BIT (1979), Art. 9 (1), quoted by Rudolf Dolzer/ Margrete Stevens, *Bilateral Investment Treaties*, supra note 89, at 132.

[92] Treaty between the government of the United States of America and the government of the Republic of El Salvador for the Encouragement and reciprocal Protection of Investment, signed on 10 March 1999 <www.sice.oas.org/bits/usasal_e.asp> last visited 13 December 2003.

provisions of investment treaties.[93] However, it is worth mentioning that a BIT, in order to provide a basis for ICSID jurisdiction must be in force at the relevant time.[94]

3. The applicable substantive law

Having discussed the jurisdiction of ICSID, we will now turn to the method by which ICSID tribunals resolve issues of the applicable substantive law, the most crucial issue in many arbitration proceedings. The relevant provision of the ICSID Convention in this regard is Article 42, which reads as follows

> (1) The tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the tribunal shall apply the law of the contracting state party to the dispute (including its rules on conflict of laws) and such rules of international law as may be applicable.
> (2) The tribunal may not bring in a finding of *non liquet* on the ground of silence or obscurity of the law.
> (3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the tribunal to decide a dispute *ex aequo et bono* if the parties so agree.[95]

Our concern here will be limited to the first paragraph of the article, since it is one of the most controversial issues in ICSID arbitration and the most relevant to our subject. The first sentence of the first paragraph deals with party autonomy; under this paragraph the contracting parties have freedom to subject their transaction to a legal system of their choosing. Hence, the arbitral tribunal is allowed to seek another legal system only in the absence of such choice by the parties, as is provided by the second sentence of this paragraph.[96] However, which law can the contracting parties choose?

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[93] Antonio R. Parra, "Applicable Substantive Law in ICSID Arbitrations Initiated under Investment Treaties", <www.worldbank.org/icsid/news/n-17-2-5.htm> last visited 12 December 2003.
[94] Christoph H. Schreuer, *The Convention: A Commentary*, supra note 7, at 211.
[95] See <www.worldbank.org/icsid> last visited 16 April 2003.
[96] Kahn, for instance, argues that "by giving priority to the rules of law adopted by the parties, the drafters of the Convention were faithful to their general scheme of granting a primary role in the functioning of the arbitration to the will or consent of the parties", Phillipe Kahn, "The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes", supra note 1, at 6; "[the Convention] gives primacy to the parties' choice of law", W. Michael Reisman, "The Regime for *Lacunae* in the ICSID Choice of

3.1. Which law can the contracting parties choose

Scholarly opinions differ over the question of which law the contracting parties can choose, whether the law of the host state, the law of the investor home state, the law of a third state, or international law. On the one hand, Broches, for instance, argues that the contracting parties are free to choose between a national law, international law, or a combination of both. However, when a national law is chosen, ambiguities, which are not dealt with by the Convention, may complicate the issue.[97] The first question, as Broches notes, is whether a reference to the law of a certain country should be understood as a "reference to the law as in effect at the time of the agreement or as it may have been amended at the time when the tribunal is to apply." He believes that the answer here is that "a mere reference to the law of a country" must be understood to be to that law which exists at the time of arbitration proceedings, although in his opinion Article 42 permits the parties to agree specifically on a particular law as it stands at the time of their agreement.[98] The second question, also noted by Broches, is whether the arbitral tribunal can apply international law where this law "is not in terms included in the rules of law agreed by the parties pursuant to the first sentence of Article 42 (1)."[99] Broches argues that the application of international law rules by the arbitral tribunal is at least permissible to the extent that these "rules are the 'law of the land', which is to say that they would presumably be applied by the national courts of the host state country."[100]

On the other hand, Kahn states that the contracting parties must link their relations to a legal system,[101] and therefore he thinks that there is a presumption that "a contract to which a state is a party will be governed by the law of that state."[102] Kahn divides investment into two categories: direct investment and loans. He argues that the direct investment contract should be governed by the host state's law, and therefore he claims that the application of a law "other than the host state's, even if such other law were chosen by the parties, would be most difficult." In addition,

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Law Provision and the Question of its Threshold", 15 *ICSID Review – Foreign Investment Law Journal* 362-381, 363 (2000).

[97] See Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 389.

[98] Ibid., at 389.

[99] Ibid., at 389.

[100] Ibid., at 389.

[101] Phillipe Kahn, "The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes", supra note 1, at 30.

[102] Ibid., at 12.

Kahn argues that the parties rarely choose the law of a state other than the host state. In contrast, he states that it may be common to choose a law other than the host state law in indirect investment contracts, such as a loan.[103] However, he notes that in a practical matter "rule of public international law may not be satisfactory, because [it is] developed principally to govern relations between states."[104] Furthermore, public international law "is poorly adapted to the role it is asked to play in investment; it has many *lacuna* and investment agreements were not a consideration in its evolution."[105]

Hence, although contracting parties are free to subject their contract to any legal system, the priority of the national law is so eminent in ICSID arbitration.

In practice, contracting parties have chosen a range of applicable laws. In 1982, *the Government of New Zealand* entered into an agreement with *Mobil Oil NZ Ltd*, to participate in a project for the conversion of natural gas into synthetic gasoline.[106] The Agreement provided for ICSID arbitration (Article 7 (2)), and the contracting parties chose the law of *New Zealand* to be applied by the tribunal (Article 7 (7)). In another agreement, between *AGIP* and *Congo*, the arbitration clause contained a choice of law, read "the law of the Congo, supplemented if need be by any principles of international law, will be applicable."[107]

3.2. Hierarchy of laws (national or international)

The interpretation of Article 42 (1), in terms of the discretion that has been given to the arbitral tribunal to determine the applicable law (national or international) when the contracting parties left this mission to them, is considered the most controversial issue in ICSID arbitration. The Article determines that in the absence of agreement on choice of law by the parties, the arbitral tribunal "shall apply the law of the contracting state party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable." Commentators acknowledged that the language of Article 42 (1) is ambiguous.[108]

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[103] Ibid., at 13.
[104] Ibid., at 17.
[105] Ibid., at 13.
[106] *Attorney – General v. Mobil Oil NZ Ltd.*, New Zealand, High Court, 1 July 1987, 4 ICSID Rep 117, 123 (1997).
[107] *AGIP SpA v. the Government of the People's Republic of the Congo*, 1 ICSID Rep 306, 313 (1993).
[108] Okezie Chukwumerije, "International Law and Article 42 of the ICSID Convention", supra note 4, at 96.

During the period of drafting the ICSID Convention there was considerable debate regarding this Article.[109] A number of drafts were suggested before agreement upon the final text was reached. One of these drafts assigned the choice of law to the arbitral tribunal itself

> In the absence of agreement between the parties concerning the law to be applied [...] the tribunal shall decide the dispute submitted to it in accordance with such rules of law, whether national or international, as it shall determine to be applicable.[110]

Indeed, in the final text, Broches asserts that "international law is hierarchically superior to national law under Article 42 (1)."[111] He argues that

> The tribunal will first look at the law of the host state and that law will in the first instance be applied to the merits of the dispute. Then the result will be tested against international law. That process will not involve the confirmation or denial of the validity of the host state's law, but may result in not applying it where that law, or action taken under that law, violates international law. In that sense [...] international law is hierarchically superior to national law under Article 42 (1).[112]

According to Broches, there are four situations where an ICSID arbitral tribunal can apply international law. These are:

1) where the parties have so agreed;

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[109] See in general, *History*, vol. 2; see also Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of other States: Applicable Law and Default Procedure", in: Pieter Sanders (ed.), *International Arbitration*: *Liber Amicorum for Martin Domke*, (1967 the Hague: Martinus Nijhoff), 12-19; Christoph H. Schreuer, *The ICSID Convention*: *A Commentary*, supra note 7, at 598-609; Aron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States", supra note 1, at 390; Phillipe Kahn, "The Law Applicable to Foreign Investments: The Contribution of the World Bank Convention on the Settlement of Investment Disputes", supra note 1, at 20-21; Ibrahim F. I. Shihata/ Antonio R. Parra, "Applicable Substantive Law in Disputes between States and Private Foreign Parties: The Case of Arbitration under the ICSID Convention", 9 *ICSID Review – Foreign Investment Law Journal* 183-213, 191, 192, 193 (1994).

[110] See *History*, vol.1 at 192.

[111] Ibid., at 392.

[112] Ibid., at 392.

2) where the law of the contracting state party to the dispute *calls* for the application of international law, including customary international law;
3) where the subject-matter or issue is directly regulated by international law, for instance a treaty between the state party to the dispute and the state whose national is the other party to the dispute; and finally,
4) where the law of the contracting state party to the dispute, or action taken under that law, violates international law. In this instance international law operates as a corrective to national law.[113]

Implicit in this opinion is the belief that the principal task of the arbitral tribunal is to find remedies for the foreign party, irrespective of the legality of the issue. Therefore, if the result which may be achieved by applying the host state's law is not in favour of the foreign investor, that law should be set aside in favour of another law which may better provide the desired remedies. Yet, self-evidently the objective of any legal system is to provide justice irrespective of the benefits of the parties. Reisman argues that

> If an ICSID tribunal takes the claimant's demand for a remedy as the framework of inquiry and assumes that if that remedy is not provided by the host state's law, the tribunal must then proceed to search for it in international law, the tribunal will subvert the purpose of the dispositive (sic) choice of law in Article 42 (1) and create a new regime: national law is applied insofar as it provides a particular remedy, but if it does not, international law is then searched for the remedy.[114]

Therefore, Article 42 (1), as Reisman argues, should not provide, by its own terms, "a broader dominating and displacing role of international law." Reisman believes if there is a *lacuna* in the host state's law, Article 42 (1) does not authorise the arbitral tribunal automatically to resort to international law, because the law of the contracting state may itself provide for a method for dealing with *lacuna*.[115] However, when there is a genuine *lacuna*, and the host state's law does not provide a

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[113] Ibid., at 392-393.
[114] W. Michael Reisman, "The Regime for *Lacunae* in the ICSID Choice of Law Provision and the Question of its Threshold", supra note 96, at 371.

method for dealing with this gap "the tribunal may turn to international law." He argues that "it is plain that mere inconsistence between the contracting state's law and international law cannot mean *ipso facto* that international law prevails." If that were the case, as Reisman notes "the choice of law component of Article 42 (1) would lose all of its meaning."[116] In the same vein, Chukwumerije holds that Article 42 (1) requires the application of international law in only two cases, i.e. when there are gaps in the municipal law or the municipal law violates international principles.[117]

It may be argued that, although the language of Article 42 (1) is ambiguous and a literal reading of the Article "does not yield any solution to the problem of the hierarchy of the sources"[118], the question of which law comes first may be solved by applying the principles of private international law, particularly the doctrine of the closest connection factors. This doctrine gives priority to factors such as the place of contracting and the place of enforcement in terms of choosing the appropriate law to govern the dispute. This doctrine, when applied to petroleum contracts, favours the national law of the host state. Such an approach is evident in practice. In *Benvenuti and Bonfant SRL v. the Government of the Peoples Republic of the Congo*, for instance, the arbitral tribunal applied the national law.[119] The same approach was also found in *SOABI v. State of Senegal* case.[120]

It may also be argued that the primacy of national law is encouraged by the vagueness and ambiguity which is inherent in international law. Scholars have urged lawyers to give consideration to national law. Moore, for instance argues that

> The Convention requires the tribunal to presume that the law of the state party is the applicable law in any agreement which is silent on the choice of law; therefore, a lawyer would be well advised to provide in the agreement at

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[115] Ibid., at 374.
[116] Ibid., at 375.
[117] Okezie Chukwumerije, "International Law and Article 42 of the ICSID Convention", supra note 4, at 101.
[118] Ibid., at 96.
[119] *Benvenuti and Bonfant SRL v. the Government of the Peoples Republic of the Congo*, Award, 15 August 1980, 1 ICSID Rep 330, 349 (1993).
[120] *SOABI v. State of Senegal*, Award, 25 February 1988, 2 ICSID Rep 164, 220 (1994).

the very least that the arbitral tribunal can apply only the state's law in effect at the time the agreement is signed.[121]

Finally, it is worth mentioning that "the rules of international law" referred to in Article 42 (1) refer, according to the Report of the Executive Directors, to those rules in Article 38 (1) of the Statute of the International Court of Justice.[122]

4. Why petroleum disputes should not fall directly under the jurisdiction of ICSID

The most relevant question here is whether or not petroleum disputes should fall directly under the jurisdiction of ICSID. In other words does the jurisdiction of ICSID extend to petroleum disputes under Article 25 of the ICSID Convention? Article 25 (1) provides that "[T] he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment."[123] Reluctantly, it may be accepted that petroleum contracts are investment contracts. However, these contracts are *sui generis* investment contracts and therefore they have their own particular characteristics which differentiate them from normal investment contracts.

The jurisdiction of ICSID according to Article 25 (1) extends to any legal dispute arising directly out of investment dispute. Here if we reluctantly accept that petroleum contracts are investment contracts and consequently ICSID has jurisdiction over any dispute which may arise out of these contracts, the question which arises here concern the legality of most of petroleum disputes. Although there is no doubt that most of petroleum contracts are based upon contractual relationships between host states and petroleum companies, a significant number of petroleum disputes invariably arise out of political reasons since the petroleum industry is a mix of legal and political industry.[124] Hence, petroleum disputes are not purely legal disputes and therefore the jurisdiction of ICSID according to Article 25 (1) is disputed, since this Article provides that a dispute in order to be submitted to ICSID

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[121] Michael M. Moore, "International Arbitration between States and Foreign Investors – The World Bank Convention", 18 *Stanford Law Review* 1359-1380, 1379 (1966).

[122] See the Article in *History*, vol. 2, at 962; see also the *Report of the Executive Directors*, supra note 8, *para* 40.

[123] See <www.worldbank.org/icsid> last visited 16 April 2003.

[124] See for instance, the Libyan cases in part two, chapter two of this thesis; see also *National Oil Corporation v. Libyan Sun Oil Company*, United States District Court, District of Delaware, 15 March 1990 733 F Supp. 800; 1990 U. S. Dist. LEXIS 3419; reprinted in 16 YBCA 651 (1991).

should have to be of a legal character. The Report of the Executive Directors spells out this fact by providing that the disputes which come under the jurisdiction of ICSID must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation.[125]

The second reason which opposes the direct jurisdiction of ICSID over petroleum disputes is that ICSID is part of the International Bank for Reconstruction and Development group. The principal aim of the World Bank is to lend money almost at the same base as private lending institutions (e.g. commercial banks) to facilitate investments in a number of developing countries. Hence, the desire of a number of these countries to differentiate natural resources transactions from other investment transactions as well as scepticism and suspicion of these countries towards ICSID arbitration may be the reason for these countries to exclude natural resources transactions from the jurisdiction of ICSID. In practice terms, several countries used the right provides in Article 25 (4) to exclude any dispute from the jurisdiction of ICSID.[126] Consequently, these disputes should not be subjected directly to the jurisdiction of ICSID.

In addition, the ICSID Convention was established at a time when most developing countries lacked a fully developed legal infrastructure. Nowadays, the situation has changed and these countries are encouraging foreign investments, therefore they have enacted legislation which guarantees the rights of investors.[127]

Furthermore, in practice there has been hesitation in accepting the jurisdiction of ICSID in petroleum disputes. From the establishment of ICSID to the present, only ten petroleum disputes have been registered at ICSID, only two of them continued the proceedings to the stage of rendering an award. Those cases were *AGIP S. P. A. v. People's Republic of the Congo*, which was registered on 4

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[125] See the *Report of the Executive Directors*, supra note 8, *para* 26.

[126] See for instance supra notes, 49, 50 and 51 above.

[127] See for instance, examples of such legislation in part three, chapter three of this thesis. Concerning the need for investment in some Arabic petroleum countries, Stevens argues that, "[in Saudi Arabia] the economy requires a flow of capital both from foreigners and from the estimated $ 600-700 billion held by Saudi nationals abroad. For example Saud Al Faisal, the Foreign Minister [...] claimed at a press conference in May this year [2000] that the oil, gas, electricity, desalination and petrochemical sectors alone needed $ 200 billion of investment over the next 20 years", Paul Stevens, "Saudi Arabia and the Opening of the Hydrocarbon Sector to Foreign Companies" <www.dundee.ac.uk/cepmlp/journal/html/article7-10.html> last visited 16 June 2003.

November 1977, and the award was rendered on 30 November 1979,[128] and *Scimitar Exploration Limited v. Republic of Bangladesh and Bangladesh Oil, Gas and Mineral Corporation*, which was registered on 3 November 1992, and the award was rendered on 5 April 1994.[129] In the latter case, the arbitral tribunal found that ICSID had no jurisdiction over the case, therefore the arbitral tribunal rendered the following decision

> 27. The question to be determined by the tribunal is whether the proceedings are within the jurisdiction of the Centre and the competence of the tribunal.
> 28. The tribunal has reviewed the assertions of law and statements of facts contained in the submissions and observations presented to it and in the submissions of council. The tribunal has also examined the question of corporate authorisation under the law of the British Virgin Islands, which is that proceedings initiated by a corporation without proper corporate authority or authorisation are invalid.
> 29. Based on the agreed positions of the parties and the uncontested evidence before the tribunal, the present proceedings were not initiated with proper authority or authorisation, and there is no evidence relied on by the claimant that the absence of such proper authority or authorisation has been remedied by any action subsequent to the commencement of the arbitration proceedings. In accordance with Arbitration Rule 41 (5), the tribunal therefore hereby renders an award that the dispute before the tribunal is not within the jurisdiction of the Centre and not within the competence of the tribunal.[130]

The proceedings of four of the other cases were discontinued due to amicable settlements reached by the parties or due to requests of the claimants.[131] There are

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[128] *AGIP S. P. A. v. People's Republic of the Congo* <www.worldbank.org/icsid/cases/conclude.htm> last visited 13 January 2004; see English translations of French original in, 21 ILM 726 (1982); 8 YBCA 133 (1983) (excerpts); 67 ILR 318 (1984); 1 ICSID Rep 306 (1993).

[129] *Scimitar Exploration Limited v. Republic of Bangladesh and Bangladesh Oil, Gas and Mineral Corporation* <www.worldbank.org/icsid/cases/conclude.htm> last visited 13 January 2004; 5 ICSID Rep 4 (2002).

[130] *Scimitar Exploration Limited v. Republic of Bangladesh and Bangladesh Oil, Gas and Mineral Corporation*, 5 ICSID Rep 4 (2002).

[131] These cases are: *Tesoro Petroleum Corporation v. Trinidad and Tobago* (conciliation), registered on 26 August 1983, *Occidental of Pakistan, Inc. v. Islamic Republic of Pakistan*, registered on 7

four cases still pending at ICSID, i.e. *Repsol YPF Ecuador S. A. v. Empresa Estatal Petroleos del Ecuador* (*Petroecuador*) registered on 5 October 2001, *F-W Oil, Inc. v. Republic of Trinidad and Tobago*, registered on 29 November 2001, *Plama Consortium Limited v. Republic of Bulgaria* registered on 19 August 2003 and *TG World Petroleum Limited v. Republic of Niger* (conciliation), registered on 9 December 2003.[132]

Therefore, the involvement of ICSID in petroleum disputes has been limited. Indeed, some commentators argue that the jurisdiction of ICSID should not extend to other activities such as disputes in international civil engineering contracts.[133] Nathan for instance, argued that

> The submission of disputes in international civil engineering contracts to ICSID arbitration is in breach of the ICSID Convention for the reason that such contracts do not involve any net transfer of capital resources to a developing state and are, therefore, commercial sales of goods and services and cannot be characterised as investments within the meaning of the Convention.[134]

Thus, it may be argued that it is more appropriate for petroleum disputes to not fall under the direct jurisdiction of ICSID. This may shed light upon why, in the Energy Charter Treaty of 1994, which provides several mechanisms for the settlement of disputes, the jurisdiction of ICSID was listed as the last choice available to the parties.[135]

October 1987, *Societe Kufpec* (*Congo*) *Limited v. Republic of Congo*, registered on 27 January 1997, and *Mobile Argentina S. A. v. Argentine Republic*, registered on 9 April 1999 <www.worldbank.org/icsid/cases/cases/conclude.htm> last visited 13 January 2004.

[132] See <www.worldbank.org/icsid/cases/cases/pending.htm> last visited 13 January 2004.

[133] See for example, Kathigamar V. S. K. Nathan, "Submission to the International Centre for Settlement of Investment Disputes in Breach of the Convention", 12 (1) J Int'l Arb 27-52 (1995).

[134] Ibid., at 52.

[135] These mechanisms, according to Article 26, are: 1) amicable settlement (if possible); 2) if such disputes can not be settled according to the provisions of paragraph (1) within a period of three months from the date on which either party to the dispute requested amicable settlement, the investor party to the dispute may choose to submit it for resolution:

a) to the courts or administrative tribunals of the contracting party to the dispute;
b) in accordance with any applicable, previously agreed dispute settlement procedure; or
c) in accordance with the following paragraphs of this Article. ICSID comes under this category.

Concluding remarks

As discussed above, ICSID is designed to facilitate the settlement of investment disputes between contracting states and investors of other contracting states. The jurisdiction of ICSID, according to Article 25 of the Convention, is based upon the following requirements: a legal dispute arising directly out of an investment between a contracting state and a national of another contracting state requiring written consent.

However, there have only been a limited numbers of petroleum disputes submitted to ICSID, the majority of which were settled amicably without an ICSID award. This is no doubt in part because petroleum disputes are not typical investment disputes as well as most of petroleum disputes are not purely legal disputes..

This highlights the importance of establishing a specialised institution to undertake the settlement of disputes arising out of the petroleum industry. Hence, this thesis will present a suggestion for the form of such a forum or institute. The literature of OPEC, as discussed in the following chapter, provides the basis for this suggestion.

Chapter Three: Development of Host States Laws at National and International Level

Introductory remarks

In state contracts in general and petroleum contracts in particular, the state is always presumed to be subject to its national law. This perspective was fully supported by the United Nations' Resolutions in the 20th century, a number of cases, and the practice of Latin American countries when they refused in the 20th century to settle disputes in tribunals other than domestic courts.[1] It was also endorsed by 1968 resolution of the Organisation of the Petroleum Exporting Countries (hereinafter OPEC). This resolution gives authority to the host state's courts to settle any petroleum dispute. Petroleum legislation and several petroleum agreements issued in Arab countries also applied national law to such disputes. This chapter will analyse OPEC's resolution, as well as examples of rules in some Arab petroleum countries which prioritise national law in petroleum transactions.

However, we will begin with an overview of OPEC and its aims. At present, OPEC's future is, (according to some) in question, especially after the 2003 Iraq war. Wälde for instance, asserted that "OPEC will in fact be finished."[2] Knipe wrote that "[despite the fact that] OPEC oil ministers are quick to dismiss any suggestion that the organisation's days of high influence on prices are numbered, [...] OPEC's present [is] weakness."[3] However, our concern here is limited to discussion of OPEC's 1968

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[1] For more details see part one, chapter one of this thesis.

[2] Thomas W. Wälde, "An Iraqi Scenario: Impact of Fundamental Regime Change in Iraq on Acquired and new Contractual Titles in the Iraq Oil Industry", 1 (1) *Oil, Gas & Energy Law Intelligence* 3 (2003) <www.gasandoil.com/ogel/> last visited 10 May 2003; for more information about OPEC and its Member Countries see for instance, <www.opec.org> last visited 10 May 2003; <www.eia.doe.gov/emeu/cabs/opecrev.html> last visited 12 May 2003.

[3] Michael Knipe, "The Nightmare is Over as Oil Producers Learn to Embrace a New Respectability", *The Time*, (*Focus on OPEC*) Tuesday 12 March 2002; see also A. F. Alhajji, "International Organisations in the Energy Sector, no. 2: OPEC", 1 (2) *Oil, Gas & Energy Law Intelligence* 17 (2003) <www.gasandoil.com/ogel/> last visited 10 May 2003; David G. Victor/ Nadejda M. Victor, "Axis of Oil?", (March/ April 2003) *Foreign Affairs*, at 47; Ariel Cohen/ Geralad P. O'Driscoll, "The Road to Economic Prosperity for a Post-Saddam Iraq" <www.heritage.org/Research/MiddleEast/bg1594.cfm> last visited 2 June 2003; Ekpen Omondude, "Oil Pricing in the 21st Century: Can OPEC Regain Control over Oil Prices?" <www.dundee.ac.uk/Cepmlp/Car/assets/images/Ekpea.pdf> last visited 12 May 2003;

resolution, which highlights the importance of creating a specialised institution to solve petroleum disputes.

1. The Organisation of the Petroleum Exporting Countries (OPEC)

1.1. The evolution of OPEC

Efforts to establish some type of cooperation between petroleum exporting countries began in the first half of the 20th century, as a result of the excesses of petroleum companies.[4] Venezuela, due to its experience in dealing with foreign petroleum companies, was the first to make initiatives to control petroleum income.[5] In 1947, Venezuela took the first step toward establishing cooperation between petroleum exporting countries by initiating diplomatic contact with Iran, in order to integrate their petroleum policies. Two years later, Venezuela sent an official delegation to Iran, Iraq, Kuwait, and Saudi Arabia, to encourage an exchange of opinions on petroleum policies as well as to explore avenues for cooperation.[6]

The need for cooperation between these countries became more crucial in the 1950s when petroleum companies unilaterally started reducing the posted price of petroleum, affecting Kuwait, Qatar, Iran and Venezuela.[7] Consequently, in April 1959, the Arab petroleum countries met in Cairo and decided to establish the first Arab Petroleum Congress. Iran and Venezuela attended this Congress as observers.[8] Here, the delegations agreed upon Alfonzo Perez's suggestion to establish a specialised

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Emma Ukpanah, "OPEC as a Cartel: Can U.S. Antitrust Laws be Applied Extraterritorially?" <www.dundee.ac.uk/Cepmlp/Car/assets/images/Emma.pdf> last visited 12 May 2003.

[4] Sampson states that "they [petroleum companies] had already made one cut in the posted price in February 1959, of eighteen cents a barrel-a reduction which meant that the four major producing countries in the Middle East would receive about ten percent less in taxes, or $132 million dollars a year", Anthony Sampson, *The Seven Sisters*: *The Great Oil Companies and the World they Made*, (London: Hodder and Stoughton 1975), at 157.

[5] Frank R. Wyant, *The United States, OPEC, and Multinational Oil*, (Lexington: Lexington Books D. C. Heath and Company 1977), at 66; General Information <www.opec.org > last visited 8 May 2003; see in general, Zuhayer M. Mikdashi, *The Community of Oil Exporting Countries*: *A Study in Governmental Co-operation*, (London: Allen and Unwin 1972); George Ward, *Middle East Oil: A study in Political and Economic Controversy*, (Nashville, Tenn.: University Press 1970).

[6] Frank R. Wyant, *The United States, OPEC, and Multinational Oil*, at 66.

[7] ibid., at 67 ; General Information <www.opec.org > last visited 8 May 2003.

[8] Zuhayer M. Mikdashi, *The Community of Oil Exporting Countries*: *A Study in Governmental Co-operation*, supra note 5, at 27-29; see also Frank R. Wyant, *The United States, OPEC, and Multinational Oil*, supra note 5, at 67.

consultation commission concerned with their common petroleum problems.[9] Another reduction of petroleum prices by petroleum companies occurred in August 1960, which may have increased the urgency of the need for mutual cooperation.[10]

Hence, representatives of the governments of Iran, Iraq, Kuwait, Saudi Arabia and Venezuela met in Baghdad from 10-14 September 1960, and decided to establish OPEC as a "permanent intergovernmental organisation."[11] At this conference the representatives concluded

> That the Members are implementing much needed development programmes to be financed mainly from income derived from their petroleum exports;
> That Members must rely on petroleum income to a large degree in order to balance their annual national budgets;
> That petroleum is a wasting asset and to the extent that it is depleted must be replaced by other assets;
> That all nations of the world, in order to maintain and improve their standards of living, must rely almost entirely on petroleum as a primary source of energy generation;
> That any fluctuation in the price of petroleum necessarily affects the implementation of the Members' programmes and results in a dislocation detrimental not only to their own economies, but also to those of all consuming nations.[12]

At the conference, the representatives adopted a number of resolutions. In the first resolution they announced their need for mutual cooperation, and they declared that they "can no longer remain indifferent to the attitude heretofore adopted by the oil companies in effecting price modifications." They also requested that petroleum companies maintain petroleum prices free from all unnecessary fluctuations. If "petroleum companies intended to alter petroleum prices, they should consult with the

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[9] Ibid., at 67.
[10] General Information <www.opec.org > last visited 8 May 2003.
[11] General Information <www.opec.org > last visited 8 May 2003.

member or members affected in order to fully explain the circumstances." They agreed that members should make any efforts available to them to maintain petroleum prices at the levels prevailing prior to the reductions, as well as to limit any modification in petroleum prices to serious circumstances.

In addition, members declared their intention to formulate a system by which they could ensure the stabilisation of petroleum prices, with due regard to the interests of both the producing countries and the consuming countries.

This resolution also prevented any member from accepting an offer of beneficial treatment from a petroleum company while sanctions were employed by a petroleum company against another member. It provided that

> If as a result of the application of any unanimous decision of this Conference any sanctions are employed, directly or indirectly, by any interested company against one or more of the Member Countries, no other Member shall accept any offer of beneficial treatment, whether in the form of an increase in exports or an improvement in prices, which may be made to it by any such company or companies with the intention of discouraging the application of the unanimous decision reached by the Conference.[13]

In the second resolution the members announced the establishment of OPEC. The resolution provides that

> 1. With a view to giving effect to the provisions of Resolution no. 1.1 [above] the Conference decides to form a permanent organisation called the Organisation of the Petroleum Exporting Countries for regular consultation among its Members with a view to co-ordination and unifying the policies of the Members and determining among other matters the attitude which Members should adopt whenever circumstances such as those referred to in

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[12] *OPEC Official Resolutions and Press Releases 1960-1983*, (2nd ed., Oxford: Pergamon Press 1984), at 1.

[13] See the entire text of the Resolution, ibid., at 1.

Paragraph 2 [reduction of petroleum prices] of Resolution no. 1.1 have arisen.[14]

The resolution defines the countries which attended this Conference as the Original Members of OPEC (Paragraph 2). The door was also kept open to any country with "a substantial net export of crude petroleum" to become a new member of OPEC, however, only after unanimous acceptance by the Original Members (Paragraph 3).[15]

Aside from the original members (Iran, Iraq, Kuwait, Saudi Arabia and Venezuela) and future 'full members', OPEC allowed for 'associate members' countries which do not qualify for full membership, but are nevertheless admitted under special conditions.[16]

Today, OPEC consists of eleven members. In addition to the "Founder Members", they are Qatar, which joined OPEC in 1961; Indonesia, 1962; Socialist People's Libyan Arab Jamahiriya, 1962; United Arab Emirates, 1967; Algeria, 1969; and Nigeria, 1971. Ecuador became a Full Member in 1973, then suspended its membership with effect from 31 December 1992. Gabon, which became a Full Member in 1975, terminated its membership with effect from 1 January 1995.[17]

1.2. Principal aims of OPEC

In accordance with Paragraph (4) of the second Resolution, the principal aim of OPEC is "the unification of petroleum policies for the Member Countries" as well as "the determination of the best means of safeguarding the interests of Member countries individually and collectively."[18] Also, OPEC seeks to develop ways and means to maintain the stabilisation of petroleum prices in international petroleum markets, in order to ensure the interests of the exporting countries in view of the necessity of securing a steady income for them.[19]

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[14] Ibid., at 1.
[15] See OPEC's statute <www.opec.org > last visited 8 May 2003.
[16] OPEC's statute; see also, General information <www.opec.org > last visited 8 May 2003.
[17] General information <www.opec.org > last visited 8 May 2003.
[18] Resolutions of the First OPEC Conference, Baghdad 10-14 September 1960, *OPEC Official Resolutions and Press Releases 1960-1983*, supra note 12, at 2.
[19] General information <www.opec.org > last visited 8 May 2003.

At the Conference of Sovereigns and Heads of State of OPEC Member Countries, which was held in Algiers, on 4-6 March 1975, OPEC's members stated that

> OPEC should seek, in consultation and cooperation with the other countries of the world, the establishment of a new international economic order based on justice, mutual understanding and a genuine concern for the well-being of all peoples.[20]

At the Second Summit of OPEC Heads of State and Governments which was held in Caracas, Venezuela, in 2000, members reaffirmed their commitment to the principles of OPEC. They also examined the role of petroleum in future world energy demand, they highlighted the considerable link between security of supply and the security and transparency of petroleum demand and they emphasised the need for better cooperation between petroleum countries and petroleum companies.[21]

1.3. Resolution of the 16th OPEC Conference (Resolution XVI. 90)

On 24-25 June 1968, OPEC held its 16th Conference in Vienna and rendered Resolution no. 16. In this Resolution, OPEC determined the mechanism for settling any dispute arising out of a petroleum transaction between its members and petroleum companies. The rationale for such a Resolution was the awareness of these countries of the crucial role of petroleum income in the welfare of their nations: "[petroleum resources] in Member Countries are one of the principal sources of their revenues and foreign exchange earnings and therefore constitute the main basis for their economic development."[22]

OPEC based this Resolution on principles of sovereign immunity over natural resources, principles which have been repeatedly reaffirmed by the General Assembly of

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[20] General information <www.opec.org > last visited 8 May 2003; for the entire text of the Declaration (Solemn Declaration), see *OPEC Official Resolutions and Press Releases 1960-1983*, supra note 12, at 130.

[21] General information <www.opec.org > last visited 8 May 2003.

[22] *OPEC Official Resolutions and Press Releases 1960-1983*, supra note 12, at 61.

the United Nations, especially in Resolution no 2158 of 25 November 1966.[23] Resolution 2158 provides that, "the natural resources of the developing countries constitute a basis of their economic development in general and of their industrial progress in particular." It also reaffirms the inalienable right of all countries to exercise permanent sovereignty over their natural resources. Moreover, the Resolution states that national and international organisations set up by developing countries for the development and marketing of their natural resources, "play a significant role in ensuring the exercise of the permanent sovereignty of those countries in this field and should on that account be encouraged."[24] Regarding the settlement of disputes, the 16th OPEC's Conference Resolution provides that

> Except as otherwise provided for in the legal system of a Member Country, all disputes arising between the government and operators shall fall exclusively within the jurisdiction of the competent national courts or the specialised regional courts, as and when established.[25]

In other words, any dispute between the host state and a petroleum company shall exclusively be settled before the national court of the host state. Therefore, arbitration as a method of solving disputes was excluded. Consequently, the question of the applicable law was undoubtedly resolved in favour of *lex fori*. However, the second part of the provision is open to the possibility of the establishment of a specialised forum for settling such disputes, as it states "or the specialised regional courts, as and when established."

Since 1968, the year of this Resolution, no specialised forum has been established, and therefore it may be argued that it is now time to establish such a forum to deal with petroleum disputes, particularly as the tensions inherent in the issue of petroleum resources are currently so great. A suggestion for the form of such a forum will be made in the conclusion.

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[23] General Assembly Resolutions (2158) (XXI) Permanent Sovereignty over Natural Resources, *U. N. General Assembly Resolution Adopted Session 15-22 1960- 68, 21st Session*, at 29.
[24] Ibid., at 29.
[25] *OPEC Official Resolutions and Press Releases 1960-1983*, supra note 12, at 63.

2. Rules of some Arab petroleum countries

The discussion of applicable law in certain Arab petroleum countries will examine the issue from two perspectives: theoretically, in terms of legislation, as well as practically, in terms of petroleum agreements.

2.1. Legislation

Most of the laws enacted in Arab petroleum countries, especially where commercial law is concerned, are "a direct transposition of European law."[26] In these laws, it is clear that national law is prioritised.

In the field of foreign investment law for example, the Saudi Arabia Foreign Investment Law of 2000[27] provides in Article 13 that any dispute between the government and a foreign investor should first be settled in an amicable manner, or otherwise settled in line of regulations before national courts. Moreover, the law subjects all licensed foreign investments to Saudi Arabian national taxes, as well as requiring foreign investors to adhere to the systems, statutes and instructions in the country.[28] Similarly, Kuwaiti foreign investment law provides for the application of the national law of the state. Article 17 of the investment law provides that

> In the absence of any specific provisions herein, the laws and regulations in force in the State of Kuwait, will be applied inasmuch as they are not inconsistent with the provisions hereof.[29]

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[26] Chibli Mallat, "Commercial Law in the Middle East: Between Classical Transactions and Modern Business", 48 *American Journal of Comparative Law* 81-141, 81 (2000); it was argued that "as Muslim countries gained independence from western powers in this century [20th century], they usually adopted codes paying deference to Islamic law. Even these, however, remained close in form and substance to western codes", Frank E. Vogel/ Samuel L. Hayes III, *Islamic Law and Finance: Religion, Risk, and Return*, (The Hague: Kluwer Law International 1998), at 19; see in general Jane K. Winn, "Islamic Law, Globalisation and Emerging E-Commerce Technology", in: the International Bureau of the Permanent Court of Arbitration (ed.), *Strengthening Relations with Arab and Islamic Countries through International Law: E-Commerce, the WTO Dispute Settlement Mechanism and Foreign Investment*, (2002 The Hague: Kluwer Law International), 27-42.

[27] The Kingdom of Saudi Arabia's System of Foreign Investment as formulated by Royal Decree of 11 April 2000, 16 *Arab Law Quarterly* 101-104 (2001).

[28] Ibid., Arts. 14, 15.

[29] Decree Law no. 12 of 1999 Concerning Allowing persons other than Kuwaiti Nationals to own Shares in Kuwaiti Joint Stock Companies, enacted on 1 June 1999 and promulgated in Official Gazette, issue no. 414, 6 June 1999, Nicola H. Karam, *Business Laws of Kuwait*, vol. 4, (London: Kluwer Law International 2000), at 4. 34-1

Furthermore, Article 9 provides that

> This law will apply to existing foreign capital investments to the extent that realises the objectives of this law, provided that the privileges, exemptions and securities accorded them in pursuance of its provisions, will not be less than those previously accorded to them.[30]

However, this law grants a high level of security to foreign investments. For example, Article 8 prohibits any infringement of existing rights.[31] In addition, the law also allows the foreign investor to refer its dispute to local or international arbitration.[32]

In the civil law arena, the civil law of the United Arab Emirates, which was issued in 1985,[33] states in Section 3 Article 10 that the law of the United Arab Emirates is the authoritative source in determining relationships where there is a conflict of laws. Furthermore, amending law no. 1 of 1987 provides in Article 1 that "the attached law shall apply in respect of civil transactions in the State of the United Arab Emirates."[34]

Civil Kuwaiti law also determines that when the contracting parties have failed to specify the applicable law, then the law of Kuwait should be applied when an arbitration takes place in Kuwait.[35]

In the field of company law, the national law of a state is also considered to be the applicable law. The United Arab Emirates Company Law for instance, provides that

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[30] Ibid., Art. 9.

[31] Art. 8 provides that, (1) no foreign project, which has been licensed hereunder, may devolve upon the state, except in consideration of compensation equal to the market value thereof;
(2) it is not permissible to cause injury to the rights and acquired (vested) privileges of the foreign investor, who has been licensed hereunder, except in consideration of compensation for said rights and privileges; see the other types of security granted to foreign investors in Arts. 10, 11, 12 and 16, ibid.

[32] Art. 15 provides that, (1) an agreement may be made providing for the referral to a local or international arbitration body of any dispute that may arise between the foreign investment projects and third parties;
(2) for applying the provision of this Article, a third party is meant to be the Government authorities, and the public, or private, natural or juristic persons, ibid.

[33] The Law of Civil Transactions of the State of the United Arab Emirates, issued in Abu Dhabi on 15 February 1985 and amended by law no. 1 of 1987.

[34] See *The Civil Code of the United Arab Emirates*, translated by James Whelan and Marjorie J Hall, (London: Graham & Trotman 1987), at 3. 1 – I; see also Bryan Cave, *Business Law of the Middle East: The United Arab Emirates*, vol. 1, (London: Kluwer Law International 1999), at Fed. Law no. 5 (1985) – 15.

[35] Article 1 of the Civil Code; see also Abdul Hamid El-Ahdab, *Arbitration with the Arab Countries*, (2nd ed., The Hague: Kluwer Law International 1999), at 307.

any company incorporated in the United Arab Emirates will be considered as a national company and consequently it will be subject to the law of the United Arab Emirates.[36] In the same vein, the Law of Commercial Procedure of the United Arab Emirates states in Article 1 that "the provisions of this law shall apply to traders and to all commercial activity undertaken by any person even if he is not a trader."[37]

However, despite the fact that certain Arab petroleum countries have enacted several laws as stated above, legislation governing petroleum matters is still deficient. Some major petroleum producing countries, such as Saudi Arabia, the United Arab Emirates and Qatar, have not enacted any petroleum laws covering the detailed conditions of petroleum activities.[38] In a survey concerning relevant laws in the United Arab Emirates for instance, it was stated that "we note that there is no Federal special purpose legislation governing oil and gas matters in the United Arab Emirates."[39] Although, the reason for this lack may be the nature of the relationship in petroleum transactions, in which each concession agreement contains detailed provisions concerning the rights and obligations of each party, the time is ripe to enact detailed laws regulate all petroleum activities.

Libya was among the first Arab petroleum countries which enacted laws concerning petroleum activities. All Libyan petroleum laws, whether enacted before or after the revolution, contain specific provisions concerning the applicable law and the rights and obligations of petroleum companies. [40]

In 1973, Kuwait issued law no. 19 concerning the conservation of petroleum resources.[41] The law defines the term "petroleum" as all natural hydrocarbons whether in solid, liquid or gaseous form which are or can be produced from the surface of the

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[36] Sabah M. Ali Mahmoud, *United Arab Emirates Company Law and Practice*, (3rd ed., London: Gulf Legal Services Ltd. 1997), at 113.

[37] *The Law of Commercial Procedure of the United Arab Emirates*, translated by Dawoud Sudqi El Alami, (London: Graham & Trotman 1994), at 28; see also Bryan Cave, *Business Law of the Middle East*: *The United Arab Emirates*, supra note 34, at Fed. Law no. 18 (1993) – 11.

[38] Anis Al-Qasem, *Principles of Petroleum Legislation*: *The Case of a Developing Country*, (London: Graham & Trotman Limited 1985), at 8.

[39] Bryan Cave, *Business Law of the Middle East*: *The United Arab Emirates*, supra note 34, at introduction – 23.

[40] See in general, Anis Al-Qasem, *Principles of Petroleum Legislation*: *The Case of a Developing Country*, supra note 38, at 65-221.

[41] Law no. 19 of 1973 concerning the Conservation of Petroleum Resources, *Selected Documents of the International Petroleum Industry 1973*, (Vienna: OPEC 1975), at 117.

ground or from underground and all hydrocarbons or other kinds of fuels derived there from. It also defines the term "petroleum operation" to include a range of activities such as reconnaissance and exploration for petroleum, the development of fields, the drilling of wells and the production of petroleum.[42] Furthermore, the law subjects all petroleum operations to its provisions as well as its implementing regulations.[43]

In 1986, Algeria also issued a law pertaining to the exploration, exploitation and pipeline transportation of petroleum.[44] The objective of the law, as determined by Article 1, is to define the legal system of petroleum transactions, including the rights and obligations of petroleum companies.[45] The law determines in detail the rights and obligations of petroleum companies, such as supplementary rights,[46] and the tax system.[47] Article 63 of this law determines that Algerian laws are the applicable law in any dispute arising from the application of this law. This Article provides that

> Contestation and disputes arising from the application of this law and the documents taken for its application fall within the competence of the Algerian jurisdiction pursuant to the legislation in force. However, the contestation and disputes related to the association in the field of hydrocarbons may be previously submitted before a conciliation board according to the legislation in force.[48]

Outside the Arab world, Iranian petroleum law, for instance, determines the method of settling petroleum disputes. The Petroleum Act of 1974 provides in Article 23 that

> Disputes arising between the National Iranian Oil Company and the parties to the contract, if not settled through amicable negotiations, as shall be prescribed in

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[42] Ibid., Art. 1, at 117.
[43] Ibid., Art. 2, at 117.
[44] Law 86-14 of August 19th 1986 concerning the Exploration, Exploitation and Pipeline Transportation of Hydrocarbons, *Selected Documents of the International Petroleum Industry*: *Algeria, Indonesia, Libya, Saudi Arabia 1979-1989*, (Vienna: OPEC 1993), at 1.
[45] Ibid., at 3.
[46] Arts. 30-33, ibid., at 9-10.
[47] Arts. 34-60, ibid., at 10-16.
[48] Ibid., at 16.

each contract, shall be resolved through arbitration. Provisions shall be provided in an appropriate manner in each contract. The arbitration procedure shall conform to the laws of Iran, and the site of arbitration shall be Tehran, unless the parties to the contract agree on another venue after the dispute has arisen. The validity, interpretation and implementation of the contracts shall be subject to the laws of Iran.[49]

Thus, Iranian law clearly determines the issue of the applicable law in favour of Iranian laws. This provision has been implemented, for example, in the service contract which was signed between the National Iranian Oil Company and Ultramar Company Limited, on 7 August 1974, Article 22 (11) provides that arbitrators should subject their decision to the law of Iran.[50]

2.2. Practice

In practice, before the Second World War there was no direct reference to the host state's law in petroleum agreements.[51] However, several agreements concluded since have contained a provision concerning the applicable law which refers to host state's law. The Libyan model of the exploration and production sharing agreement (EPSA III) of 1989, for instance, provides in Article 21 (governing law) that "this agreement shall be governed by and interpreted in accordance with the laws and regulations of the Socialist People's Libyan Jamahiriya, including, without limitation, the petroleum law."[52]

These agreements also determine the rights and obligations of petroleum companies. In the Participation Agreement which was concluded between the Government of the Libyan Arab Republic, the National Oil Corporation, Amerada

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[49] Iran, the Petroleum Act of 1974, *Selected Documents of the International Petroleum Industry 1974*, (Vienna: OPEC 1976), at 19, 28.

[50] Ibid., at 75.

[51] Ahmed Abdul Hamid Ashoosh, *Qanoon A n Naft* (*Petroleum Law*: *The New Trends in determining the Law Governing the International Economic Development Agreements*), (Alexandra: *Shabab Al Jamia'h* Enterprise 1989), at 43, 334.

[52] *Selected Documents of the International Petroleum Industry*: *Algeria, Indonesia, Libya, Saudi Arabia 1979-1989*, (Vienna: OPEC 1993), at 167.

Petroleum Corporation of Libya,, Continental Oil Company of Libya and Marathon Petroleum Libya, Ltd on 11 August 1973, Article 9 provides that

> The rights, privileges and immunities provided for in the Petroleum Law, the Concessions and other agreements between the Government and Second Parties heretofore enjoyed by Second Parties shall continue in full force and effect unless amended by this Agreement, and the Corporation and Second Parties hereafter shall enjoy the same in proportion to their respective participation shares.[53]

Clearly however, relationships in the petroleum industry between the host state and petroleum companies are frequently fractions, especially since some host countries enacted rules which reduce the benefits of this relationship for petroleum companies. A prime example here is a regulation issued in Saudi Arabia forbidding state agencies to resort to arbitration.[54] The Arbitration law of 1983 upholds this regulation by providing in Article 3 that

> Government agencies may not have recourse to arbitration for settlement of their disputes with third parties except with the approval of the President of the Council of Ministers. This provision may be amended by a resolution of the Council of Ministers.[55]

The origin of this regulation dated from 1963, after the settlement of the Aramco case.[56]

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[53] See the Agreement in, *Selected Documents of the International Petroleum Industry 1973*, (Vienna: OPEC 1975), at 146, 155.
[54] Decree no. 58 of 25 June 1963.
[55] Kingdom of Saudi Arabia: Arbitration Rules and Codes, issued by Royal Decree M 46, 25 April 1983.

Concluding remarks

It is clear that petroleum exporting countries were considerably concerned about the issue of the settlement of disputes arising out of petroleum transactions. National courts and national laws were the first choice of these countries in the event of a dispute.

National law is prioritised in legislation in some petroleum countries, such as Algeria, Libya and Iran. As discussed above, most developing petroleum countries have enacted advanced laws and established a new legal infrastructure which is capable of governing sophisticated contracts such as petroleum contracts. Hence, the law of the host state is no longer insufficient to govern petroleum disputes.

The establishment of a specialised institution to undertake the settlement of petroleum disputes, as suggested in OPEC's resolution, is timely and important. First, it would decrease the inherent and increasing tension between developing petroleum countries on the one hand and industrialised countries and petroleum companies on the other. Second, this is necessary because petroleum transactions are so different from those of other industries.

The idea of a specialised institution to undertake the settlement of petroleum disputes will be discussed in depth in the conclusion of this thesis.

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[56] See the case in part two, chapter one of this thesis.

Conclusion and Proposal

The purpose of this study was to examine the past and present of petroleum arbitration, and to suggest a method to determine the applicable law to the merits of petroleum a dispute. The question of the applicable law in this field is highly controversial, no doubt as a consequence of the conflict of interests between the relevant actors, i.e. developing petroleum exporting countries on the one hand and petroleum companies of developed states (often multinational corporations) on the other hand.

Developing petroleum countries presumably act from motives of enlightened national interest, pursuant to which they struggle to gain control over their own natural resources, especially petroleum, which provide crucial income to ensure a minimum standard of living for their citizens and to achieve a suitable level of development. Therefore, these countries have slowly, over the entire 20th century been in the process of disentangling themselves from colonial relationships which served the western world's interests.

Petroleum companies and their home states (predominately developed industrialised states) act to protect their interests in the petroleum industry and gain as much profit as possible from this sector, irrespective of the consequences for developing petroleum countries. To achieve this goal, petroleum companies, sustained by their home states, began at the beginning of the 20th century to tie up the natural resources sector of developing countries in chains of unequal contracts. Under such contracts, petroleum companies received the exclusive rights to explore, exploit, produce, sell and transport petroleum. These contracts were typically for a long period of time, and the royalties due to the host state were generally negligible not exceeding a few cents per barrel. At the same time, these contracts contained multiple clauses and provisions which aimed to provide a considerable level of security for the interests of petroleum companies, such as the stabilisation clause.

Against this complex background, arbitration was implemented as a mechanism for solving disputes arising out of petroleum transactions. Unfortunately, in the beginning arbitration served only to protect petroleum companies' interests,

and was not implemented as a just method of settling disputes. The petroleum arbitrations of the last century provide evidence for this. Therefore, arbitration was not welcomed by developing countries, since these countries perceived international arbitration to be biased in favour of western petroleum companies. The Libyan petroleum arbitrations are considered as the most flagrant proof of bias in the arena of international commercial arbitration. The refusal of Latin American countries to settle disputes by tribunals other than domestic courts is the best example of developing countries' scepticism and suspicion towards international arbitration. For in general, the authority of the host state was dismissed, whether in terms of its courts' jurisdiction or its laws. The mostly self-serving belief which prevailed in the last century was that the host state's law was inadequate to deal with such sophisticated contracts, and that therefore the interests of petroleum companies would be threatened under the jurisdiction of the host state's court.

Opinions on the nature of petroleum contracts and subsequently the applicable law are varied and no single one has gained overwhelming acceptance. In fact, western scholars competed in providing a description of the characteristics of petroleum contracts and subsequently the law which should govern these contracts. One opinion holds that foreign companies which conclude long-term contracts with developing states need protection from the intervention of the host state, and therefore these contracts should be delocalised in terms of substantive law. Others have argued that these contracts are international treaties which should be governed by international law and any violation of these contracts should be considered a violation of (public) international law. A third opinion states that these contracts have international elements and therefore should be governed by the general principles of law recognised by civilised nations. Others believe that these contracts are quasi-international agreements and accordingly that they themselves constitute their own legal order and proper law. Some have suggested that these contracts should be governed by transnational law such as *lex mercatoria* or UNIDROIT Principles.

However, it could be argued that most of these opinions are based on old arbitration awards rendered in the middle of the 20th century, which presumed that petroleum exporting countries (host states) lacked a sophisticated legal infrastructure. Nowadays, these countries possess advanced legal systems, and many have enacted new laws (most of which were guided by western laws mainly of civil law origin) dealing with different aspects of national or international legal issues. Consequently,

the allegation that host states lack a comprehensive legal system appropriate for the settlement of disputes arising out of complicated contracts such as petroleum contracts is no longer tenable.

Hence, it could be argued that the law of the host state may well be the applicable law to the merits of a dispute in petroleum arbitration. This opinion derives its authority from a number of facts, in addition to the point made above concerning the adequate sophistication of these countries' legal infrastructure. First, the doctrine of sovereign immunity provides that a country cannot be a subject of a law other than its national law without its consent. Second, in theory and in case law, developing countries possess authority to control their natural resources by applying their domestic laws. Third, the doctrine of private international law gives priority to the law of the closest connection or most significant relationship. In petroleum contracts there is no ambiguity regarding the most closely connected factors, since all these factors, the subject matter of the contract, the place of performance of the contract, take place within host state. Fourth, the intention of the host states, whether made clear in certain petroleum contracts, in the OPEC Resolution of 1968, or in petroleum laws issued subsequently, is in favour of host state law. Having said that and according to the suggested method (semi-localisation theory) if the host state's law is inadequate to govern the dispute, arbitrators can apply directly other law or rules which they consider applicable without any recourse to the conflict of laws rules i.e. (*voie directe*).

It is an undisputed fact that the intention of the contracting parties or the doctrine of party autonomy is the cornerstone in arbitration, since as it has been argued the answer to every dispute is to be found *prima facie* in the contract itself.[1] However, this doctrine exists in the sphere of private parties, where all the contracting parties are on an equal footing in terms of bargaining power. The contractual relationship between states and private parties, especially in the petroleum industry, may not always be one of equality because there may be some political and financial pressures on the state (particularly developing countries)

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[1] Julian D. M. Lew, *Applicable Law in International Commercial Arbitration*: *A Study in Commercial Arbitration Awards*, (Dobbs Ferry, New York: Oceana Publications 1978), at 581; see also Julian D. M. Lew/ Loukas A Mistelis/ Stefan M Kroll, *Comparative International Commercial Arbitration*, (The Hague: Kluwer Law International 2003), at 411.

which lead it to compromise its autonomy.[2] Furthermore, this doctrine has been ignored in previous petroleum arbitrations, where the law of the host state was dismissed.

Nonetheless, it is true that in certain ways host state law may be an inadequate method for dealing with disputes, and a specialised forum may be more appropriate. The Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID) has been established to create a neutral international forum which on the one hand, provides facilities for conciliation and arbitration of investment disputes between contracting states and nationals of other contracting states, and on the other hand, provides a system for the enforcement of its awards. However, petroleum disputes should not fall directly under the ICSID Convention for several reasons. First, the petroleum industry is a mix of legal and political industry and petroleum contracts are *sui generis* investment contracts; second, the ICSID Convention allows its members to exclude certain disputes from its jurisdiction, and it appears that petroleum disputes are commonly excluded; third, the enforcement of ICSID awards in practice normally faces several obstacles because a state can invoke the doctrine of sovereign immunity in order to sidestep enforcement. Hence, awards which are rendered by ICSID tribunals are no different from awards made by other tribunals.[3]

Although national courts may seem to be the obvious alternative, there are many reasons why litigation before a national court is not always the proper way to solve petroleum disputes: the difference in legal status of the contracting parties; the fact that the national court may not always be qualified to solve such disputes; arbitration has become one of the most common methods of disputes resolutions especially between parties from different countries. The increase in disputes which have been resolved by arbitral tribunals is perhaps evidence of their effectiveness.

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[2] It was argued that "such countries [developing countries] have often in the past been at a considerable disadvantage in negotiating contractual arrangements with foreign countries, because severe international asymmetries in the political and economic balance of power enabled the latter to impose restraints on a government's ability adequately to protect its own interests", Edith Penrose/ George Joffe/ Paul Stevens, "Nationalisation of Foreign-owned Property for a Public Purpose: An Economic Perspective on Appropriate Compensation", 55 *Modern Law Review* 351-367, 353 (1992).

[3] M. Sornarajah, *International Commercial Arbitration*: *The Problem of State Contracts*, (Singapore: Longman Singapore Publishers (Pte) 1990), at 230; Gaillard for instance, argues that "article 55 of the ICSID Convention reserves states' immunity from execution. By accepting an ICSID arbitration clause, a state certainly waives its immunity from jurisdiction but not from execution", Emmanuel

Despite the scepticism of developing countries, towards international arbitration the establishment of a specialised institution by petroleum exporting and importing countries may create an acceptable framework for these countries.

It has been argued that the petroleum industry has its own particular characteristics and that petroleum contracts are distinct from other types of investment contracts. Consequently, petroleum arbitration differs from normal international commercial arbitration. The petroleum industry is an international industry by nature, and political issues have more influence on this industry than any other; petroleum affects the daily life of all nations, whether the petroleum producing countries who are concerned about the availability of petroleum and their petroleum income, or the industrialised countries which are concerned about energy supply. Although the petroleum industry is high risk, it is also considerably profitable. Generally, investment agreements are time specific, namely they exist for an 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.

However, petroleum contracts typically extend over a longer period of time than other investment contracts. Petroleum companies have much power in terms of negotiation, which is reflected in the agreements, especially in the scope of the agreements such as the wide range of rights, or the size of the concession area. The third distinguishing characteristic of the petroleum industry is what is called "cost recovery", which simply means that all petroleum companies have the right to recover all their exploration costs once petroleum has been discovered. Accordingly, it could be argued that petroleum disputes require specific forms of dispute resolution because of the peculiarity of petroleum agreements, and the role and impact of the petroleum industry in the economy of many countries, especially developing countries.

However, does the petroleum industry need a specialised forum or an arbitration institution for the settlement of disputes which arise out of its transactions of the sector? If the answer is positive, where should the institution should be located and what scope should it have? Moreover, what form should the institution take? Should it be established by a regional convention between the Arab petroleum countries, or by an international convention between all petroleum producing

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Gaillard, "The Enforcement of ICSID Awards in France: the Decision of the Paris Court of Appeal

countries? What is the position of petroleum companies in this framework? Furthermore, should this institution be as an inter-governmental institution such as the International Centre for Settlement of Investment Disputes (ICSID), or private, non-governmental institution? If it takes an inter-governmental form, is there any possibility of establishing a joint venture relationship between this institution and ICSID, or the Organisation of the Petroleum Exporting Countries (OPEC)? Or is there any possible involvement of the International Chamber of Commerce (ICC) or the World Trade Organisation (WTO) or the African –Asian Legal Cooperation in its activities? In addition, does this institution need special rules namely its own, or it may adopt other rules i.e. UNCITRAL Arbitration Rules?

Having raised such questions, it could be argued that the establishment of a specialist institution to settle petroleum disputes may decrease the tensions between producing and consuming countries, by reassuring producing countries of its independence while protecting, within reason, the legitimate expectations of each party. At the same time, this institution may play a considerable role in terms of utilising petroleum for the mutual benefit of all principal actors i.e. producing countries, consuming countries and petroleum companies.

Indeed, the time is ripe for the establishment of an international arbitration institution for the settlement of disputes which arise out of petroleum -or even more- out of all energy sector transactions. The petroleum dispute settlement institution which I propose here should take the form of an international convention between all petroleum producing and all consuming countries in order to attach to the institution global appeal, and the petroleum companies should come under the umbrella of their home states, since these latter cannot be a part of international convention.

The convention should provide that, once it is ratified by a prescribed number of states (say major producing and major consuming countries) it shall come into force. In principal the convention should recognise the sovereign equality of all contracting parties.[4] Moreover, the convention should fill the gaps inherent in other

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in the SOABI Case", 5 *ICSID Review-Foreign Investment Law Journal* 69-72, 70 (1990).

[4] See for instance, Charles N. Brower, "The Lessons of the Iran-U. S. Claims Tribunal Applied to Claims Against Iraq", in: Richard B. Lillich (ed.), *The United Nations Compensation Commission*, (1995 Irvington/ New York: Transnational Publishers, INC), 15-27, 16; Daniel Barstow Magraw, "The Tribunal in Jurisprudential Perspective", in: Richard B. Lillich/ Daniel Barstow Magraw (eds.), *The Iran-United States Claims Tribunal: Its Contribution to the Law of State Responsibility*, (1998 Irvington-on Hudson/ New York: Transnational Publishers, INC), 1-46; Craig S. Bamberger, "An Overview of the Energy Charter Treaty", in: Thomas W. Wälde (ed.), *The Energy Charter*

arbitration conventions, such as the New York Convention and the ICSID Convention, particularly those gaps which concern the enforcement of awards.[5] For example, the contracting states to this convention should consider decisions (other than final awards) rendered by tribunals in the context of this institution as a final and binding award. Furthermore, this award should be enforced in the same manner as local awards, without review by national courts. This simply means that a state cannot invoke the doctrine of sovereign immunity, even at the stage of enforcement.

The convention should be guided by the following principles:

1) It should recognise the principle of separability of arbitration agreements;

2) It should also recognise the doctrine of *pacta sunt servanda*, and therefore a state cannot terminate a petroleum contract with a petroleum company, except in very limited circumstances and only for public purposes, in a non discriminatory manner, accompanied by payment of prompt, adequate and effective compensation;

3) Nonetheless, the convention should take into account the extent to which petroleum companies consider the interests of host states while they perform their contracts, or the extent to which they practice any type of discrimination against the employees of the host state, etc;

4) The performance of contracts by petroleum companies should be transparent and therefore petroleum companies should be responsible for any inaccurate information that they may provide to the host state, especially in terms of petroleum reserves. In cases of falsified information, the company should be fully responsible for paying just compensation to the host state.

The institution which will be established pursuant to this convention should have its seat/ headquarters in a neutral place such as The Hague, for instance, and it may be as a sub-chamber, for example of the Permanent Court of Arbitration, because the latter already have permanent infrastructures and considerable experience. However, the detachment of this institution from any permanent judicial or arbitral forums would be more efficient in order to gain its own reputation.

Treaty: *An East-West Gateway for Investment and Trade*, (1996 London: Kluwer Law International), 1-34.

[5] See for instance, Albert Jan van den Berg, "Recent Enforcement Problems under the New York and ICSID Conventions", 5 *Arbitration International* 2-20 (1985), reprinted in 2 *ICSID Review-Foreign Investment Law Journal* 439-456 (1987).

The institution should provide facilities for arbitration as well as conciliation to all disputes arising out of petroleum transactions whether between petroleum countries or between a state and a petroleum company or petroleum companies. Hence, the jurisdiction of the institution should extend to any disputes arising out of petroleum transactions especially those which invariably arise out of exploitation and exploration agreements between petroleum producing countries and petroleum companies, and it may also extend to any other petroleum or energy i.e. gas disputes.

The institution should have its own procedural rules for arbitration and conciliation, since the petroleum industry is considerably significant to the contracting as well as non-contracting parties and its disputes require urgent decisions, and therefore it is in need to its own rules.[6] However, prior to the establishment of such rules and in parallel to having its own rules the institution may use the UNCITRAL Arbitration Rules. At the same time, the institution should apply host state law, but the tribunal would also have the right to decide a dispute with reference to international law, or transnational rules or *ex aequo et bono* if the parties so agree.

The institution might be composed of a number of bodies, i.e. secretariat, a panel of arbitrators, a panel of conciliators and an arbitration court, which would contain people specialised in different fields, such as law, the petroleum sector (qualified petroleum engineers for example) and finance. This court would undertake a supervisory role in terms of arbitrators' tasks and decisions. Bearing in mind, the institution should have the right to review decisions to terminate a contract, or to adapt a contract and also to consider these decisions null and void, if the act of the state was not for public purposes or the compensation was inadequate.

The suggested forum or institution would begin by applying the law of the host state. After the accumulation of a body of case law, the institution would introduce its own substantive rules by way of restatement, replacing host state law.

However, it may be asked that whether as a practical matter there would be a sufficient number of disputes to justify establishing a new institution to settle petroleum disputes. Here, it could be argued that the case load of the International Chamber of Commerce (ICC) itself for instance, provides considerable evidence

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[6] It was argued that "energy [petroleum is the most significant part of the energy sector] is the very fuel of society, and societies without access to competitive energy suffer", *The Economist*, 11 February 2001.

concerning the annual increasing numbers of petroleum disputes.[7]

Furthermore, some would say that it is inevitable that such an institution would become politicised very quickly and still others would say that it would be just another bureauacracy, so not very useful or practical. The answer is opposite to these perspectives, since the petroleum industry is one of the most significant industries nowadays[8] and it invariably relies in its development upon steady relationships between its all major actors. Therefore, it could be argued that the institution would not be politicised nor become another bureauacracy, since it would provide its facilities to both governmental and private bodies in which each party would do what ever necessary to protect its interests such as maintaining a smooth movement of the institution's procedures.

The Energy Charter Treaty (ECT) may provide a successful model for regional arbitration in relation to energy.[9] However, it may be argued that the suggestion for establishment a new institution to undertake the mission of settling energy disputes in general and petroleum disputes in particular is unjustified in the existence of ECT. Here it could be stated that although this argument to some extent appears to be logical, the opposition to this opinion focuses on two reasons: First, the scope of the ECT to some extent is limited to the European territories. Second, the function of the ECT extends the mission of settling disputes to establishing a comprehensive system in all energy aspects. While the sole aim and function of the suggested institution is limited to undertake the mission of settling disputes which invariably arise out of energy (petroleum in particular) transactions disputes. Hence,

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[7] According to ICC statistics the number of cases in energy sector during the last 4 years was as follow:

1999 – 25 cases
2000 – 43 cases
2001 – 64 cases
2002 – 58 cases. Source: the ICC Secretariat. A direct contact was conducted by the writer, on 21 January 2003.

[8] It was argued that "the turnover of the global energy business approx. $1.8 trillion....global investment in energy between 1990 and 2020 will total some $30 trillion at 1992 prices", *The Economist*, 11 February 2001.

[9] Wälde has stated that "the Energy Charter Treaty, signed in Lisbon on 17 December 1994, connects two significant strands of international economic policy and law: First, it is an attempt to commit the states which were formerly part of or under the control of the Soviet Union to a model of liberal international economic policy [...]. Secondly, the Treaty is one link in a long chain of efforts to create an international investment and trade regime, [...], Thomas W. Wälde, "Editor's Preface", in: Thomas W. Wälde (ed.), *The Energy Charter Treaty*: *An East-West Gateway for Investment and Trade*, supra not 4, at xix; Art. 2 determines the purpose of the Treaty providing that "[T]his Treaty establishes a legal framework in order to promote long-term cooperation in the energy field, based

the suggestion may be well justified

Finally, the question is whether this system i.e. international treaty or convention, secretariat and options for arbitration or conciliation can be used for petroleum disputes. The answer is yes. However, finding and maintaining an adequate and practical system by which petroleum disputes in particular and energy disputes in general can be settled, is undoubtedly dependent on the will of the international community to do so especially those countries which are highly concerned about the continuity of this industry.

on complementarities and mutual benefits, in accordance with the objectives and principles of the Charter.

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