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11 Aminoil Revisited Reflections on a Story of Changing Circumstances*

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Introduction

For much of its almost 30-year existence, Aminoil's oil concession in Kuwait was a tale of hard-fought negotiation and compromise as the parties sought to accommodate within the framework of their legal relationship the dramatic changes in global political and economic conditions For Kuwait, the strategic role of the 1948 Concession changed over this period

> This Concession - in its origin a mining concession granted by a State whose institutions were still incomplete and directed to narrow patrimonial ends - became one of the essential instruments in the economic and social progress of a national community in full process of development [1]

By the late 1960's, it was apparent that a process of transition was occurring Kuwait's emerging political and economic independence, and widespread changes in the structure of oil concessions in the Arabian Gulf, led to the Concession becoming "not sustainable on its original basis ' [2] The broad question was whether the parties' rights and obligations were to be reappraised in light of changes in the very nature of the relationship, or whether the changes would be accommodated "within the framework of a *continuing* Concession" which had the effect of excluding the right of the Government to terminate it unilaterally [3] The Kuwait-Aminoil dispute is a classic example of the perennial difficulty of all long-term investments that

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[1] Para 98 *Government of Kuwait v American Independent Oil Company* Award of 24 March 1982 published in (1984) 66 ILR 518 (1982) and 21 *ILM* 976 (hereafter *Aminoil*) The Tribunal was composed of Professor Paul Reuter (president) Professor Hamed Sultan and Sir Gerald Fitzmaurice)

[2] *Aminoil* Separate Opinion of Sir Gerald Fitzmaurice 626 para 28 (hereafter *Aminoil* Separate Opinion)

[3] *Ibid*

is, reconciliation of the apparently conflicting needs for stability and evolution [4]

The Tribunal's arbitral award of 24 March 1982 in *Government of Kuwait v American Independent Oil Company*,[5] is discussed mostly for its development of the legal principles applicable to assessing the compensation due in respect of a "lawful" expropriation [6] The reasoning of the award is also notable for (1) the Tribunal's decisions on the applicable laws to govern the procedure for the arbitration and the substance of the dispute, (2) the views expressed by the majority, and by the separate opinion of former ICJ Judge Sir Gerald Fitzmaurice (concurring on the operative part), on the legal effect of so-called "stabilisation clauses' in public international law, and (3) the effect of changes in market and industry conditions on a long-term oil concessions In addition to recalling the contribution of the Aminoil award in these areas, this chapter also describes two other important issues on which the parties expended much time and effort but have been almost entirely neglected in the literature These are (1) the legal consequences of the gold clause contained in the 1948 Concession, and (2) the Government's claim in respect of Aminoil's oilfield practices

A Background

1 A Short History of Kuwait

In simple translation, Kuwait means "the Little Fort " It consists of a slender strip of land at the north-west limit of the Arabian Gulf, and on the land side it is surrounded by the far larger states of Saudi Arabia and Iraq In centuries past a natural harbour and convenient geographical location allowed Kuwait to emerge as a small port with a notable reputation for shipbuilding and sea-faring prowess, and as a base for pearl trading and fishing

[4] See H Cattan *The Evolution of Oil Concessions in the Middle East and North Africa* (Dobbs Ferry N Y Oceana 1967) xi The oil concession is a species of long term contract which has to reconcile two apparently conflicting needs stability and evolution Those two needs are in fact two interdependent conditions in an oil concession

[5] *Aminoil supra* note 1

[6] See *e g* P Kahn Contrats d Etat et Nationalisation – Les Apports de la Sentence Arbitrale du 24 Mars 1982 (1982) 109 *JDI* 844 G Burdeau Droit International et Contrats d Etat – La Sentence *Aminoil c Koweit* du 24 Mars 1982 (1982) 28 *Ann Franc Droit Intl* 454 FR Téson State Contracts and Oil Expropriations The Aminoil Kuwait Arbitration (1984) 24 *Va J Intl L* 323 (hereafter Téson) A Redfern The Arbitration between the Government of Kuwait and Aminoil (1984) 55 *BYBIL* 65 (hereafter Redfern) G Marston The Aminoil Arbitration (1984) 18 *JWTL* 177 P-Y Tschanz The Contribution of the Aminoil Award to the Law of State Contracts (1984) 18 *Intl Law* 245 (hereafter Tschanz) FA Mann The

Continues

Shaikh Mubarak took power as Emir in May 1896 under the formal protectorship of the British Government Mubarak signed treaties with Great Britain in the first decade of his reign by which he undertook not to conclude international agreements with any state other than Britain, and, unless it consented otherwise, to grant only to British interests the rights to operate post offices, exploit sponge or pearl concessions, and not to grant oil concessions except with British consent [7] From that time until the 1960s the development of Kuwait was closely connected with British interests

The first major discoveries of oil in the Middle East were made in Iran in 1908 In 1911 the Anglo-Persian Oil Company (later to become British Petroleum) expressed interest in securing an oil concession from Shaikh Mubarak, but it took years of bargaining between rival bidders before the first oil concession in Kuwait was granted to Kuwait Oil Company ("KOC") on 23 December 1934 KOC was a joint British/American venture between Anglo-Persian Oil Company and Gulf Oil Corporation KOC first struck oil-bearing sand at Burgan in 1938 but it was not until after the Second World War that commercial oil production started and began the transformation of the economy of Kuwait

On 28 June 1948 His Highness Shaikh Ahmed Al Jabir al Sabah, Ruler of Kuwait from 1921 until 1950, granted Aminoil a concession to exploit the oil reserves in the then so-called "Neutral Zone"[8] a buffer strip between Kuwait and the Kingdom of Saudi Arabia designated as a neutral area by agreement in 1922 The concession was secured upon an immediate down payment by Aminoil of US$625,000, followed 30 days later by a further payment to the Shaikh of US$7 25 million Aminoil began drilling its first exploratory wells in December 1949 and achieved crude oil production at commercial levels in 1954

Aminoil Arbitration (1983) 52 *BYBIL* 213 reprinted in FA Mann *Further Studies in International Law* (Oxford Clarendon 1990) 252 (hereafter Mann) GR Delaume The Internationalization of Law and Legal Practice Comparative Analysis as a Basis of Law in State Contracts The Myth of the Lex Mercatoria (1989) 63 *Tul L Rev* 575 (hereafter Delaume) C Gray *Judicial Remedies in International Law* (Oxford Clarendon 1990) (hereafter Gray) PM Norton A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation (1991) 85 *AJIL* 474 C Gray The Choice between Restitution and Compensation (1999) 10 *EJIL* 413

[7] Albaharna summarises UK/Kuwait political relations in HM Albaharna (ed) *The Arabian Gulf States Their Legal and Political Status and Their International Problems* (2 d ed Beirut Librairie du Liban 1975) chapters 1 5

[8] By a treaty between Kuwait and Saudi Arabia in 1965 the two countries amended the status of this strip of land which thereafter became known as the Divided Zone thus eliminating the political uncertainties involved for operators working in this area

Oil is the foundation of modern Kuwait. It is both the major driving force behind its development and also its core weakness. Kuwait has the world's third largest proven oil reserves after Saudi Arabia and the former Soviet Union, and in 1975 it accounted for over 98 per cent of total Government revenues. Yet as Kuwait is almost entirely dependent upon a finite mineral resource the Government understood the need to invest for the day when its oil reserves would be exhausted to ensure that the country would require alternative sources of income. The Government therefore controlled Kuwait's oil production in order to stretch the life of its oilfields for as long as possible.

2 A Short History of Aminoil

Important to a full appreciation of the dispute is some background information on the American Independent Oil Company ("Aminoil"). Aminoil was incorporated in Delaware in 1947 on the initiative of a former executive of Standard Oil. Three small oil companies, Phillips Petroleum Company, Signal Oil and Gas Company, and Ashland Oil and Refining Company became its major shareholders. Never more than a small producer in the international oil industry it was eventually sold to a major tobacco company.

RJ Reynolds Tobacco Company, Inc was a major US corporation engaged in a wide range of manufacturing activities including foodstuffs and tobacco, processing and transportation. It purchased Aminoil's shares in 1970 for US$40 million, with the acquisition covering the Kuwait concession – Aminoil's largest investment and main source of income – and its operations in South America. Soon after, the shares in Aminoil were transferred to the Reynolds parent corporation, RJ Reynolds Industries, Inc. One of the Government's central contentions was that, after its purchase by RJ Reynolds, Aminoil followed a policy that compromised its obligation to observe good oilfield practices because necessary capital expenditures were deferred as much as possible, as if each day in Kuwait might be its last. In 1984, two years after the arbitration was concluded, RJ Reynolds sold Aminoil for US$1.7 billion.[9]

3 The 1948 Concession, its Adaptation and its Termination

Modelled word for word on the 1934 KOC concession, Aminoil's financial obligations as set out in Articles 2, 3, 6, 7 and 8 of the 1948 Concession

[9] For an entertaining account of RJ Reynolds and its management philosophy see B Burrough and J Helyar *Barbarians at the Gate* (London: Random House 1990).

were to provide annually (1) a royalty of US$2 50 for every ton of oil recovered subject to a minimum annual royalty of US$625,000, (2) 1/8th of Aminoil's gross proceeds from the sale of natural gas, (3) 15 per cent of the shares in a subsidiary to be established to explore and exploit the Divided Zone, and (4) 15 per cent of the shares in any subsidiary to be established to operate an oil refinery

There were also operational obligations to observe good oilfield practice, but generally speaking, Aminoil had sole control over the quantities of production and the prices at which products were sold The terms of the concession, based on a fixed payment per ton granted in return for a 60-year exclusive right to exploit Kuwait's oil resources within the relevant area (until 2008, when all assets were to be transferred to the Shaikh "free of cost"),[10] exemplified the era when Kuwait was still under British protection - and when oil producing states were yet to assert their sovereign independence and to take full control over their natural resources [11]

British colonial influence in Kuwait continued until 1961 when Kuwait and the United Kingdom entered into a Treaty of Independence under which the Parties recognised and declared the sovereignty and independence of Kuwait [12] A new Constitution was promulgated on 11 November 1962 proclaiming that Kuwait was an independent and fully sovereign Arab state On 14 May 1963 it was admitted as a member of the United Nations Kuwait thus emerged from colonial power to become a fully independent state seeking a growing role in the control of its natural resources and the shaping of its destiny

In 1961 the Kuwait and Aminoil entered into a Supplemental Concession Agreement (the "1961 Agreement"), largely to reflect the emerging practice in the Arab Middle East of 50/50 profit sharing in oil concessions and 50 per cent business taxes Aminoil was also granted special financial arrangements to acknowledge the high cost/low yield nature of its operations and these were set out in a confidential side letter to the 1961 Agreement The concession area had produced only heavy crude oils of a relatively unfavourable chemical quality that required special handling and processing to create marketable products [13]

[10] 1948 Concession Article 1
[11] See also Redfern 67
[12] *Exchange of Notes* (1961) UKTS No 93 *Cmnd* 1518
[13] See *Aminoil* 549 500 paras xxvi xxxv

Further negotiations in the early 1970s led to a 1973 Draft Agreement designed to take account of changes in the global oil market The most notable developments were OPEC's successive decisions, agreed in Teheran in 1971 and Geneva in 1972 and 1973, to take control of posted oil prices and to increase their participation in oil ventures to 25 per cent [14] The *Aminoil* Tribunal held that these developments were incorporated by mutual consent or Aminoil's acquiescence into the contractual scenario and modified Aminoil's financial obligations [15] As the Tribunal noted, by 1973 "the balance of advantage in the Gulf Region had tilted in favour of governments" [16] However, Part 2 of Annex 1 confirmed that future discussions concerning the terms of the 1948 Concession would take into account that Aminoil

> Should not be denied a reasonable opportunity of earning a reasonable rate of return (having regard to the risks involved) on the total capital employed in its business attributable to Kuwait

In October 1973 OPEC established new posted prices that were 70 per cent higher than those set by oil companies Kuwait insisted that Aminoil comply or cease production immediately and, unsurprisingly, it complied

The 1973 Draft Agreement was subject to ratification by the Kuwaiti parliament, but this never occurred Nonetheless the Tribunal held that the 1973 Agreement was binding on the parties on an "interim basis" because in December 1973 Aminoil undertook by letter to act "as if the 1973 Agreement was effective", and it made payments and conducted its subsequent operations on that basis It had been open to the parties to renounce the 1973 Agreement for delay in ratification but neither party had done so [17] The Tribunal was not satisfied that Aminoil had been forced to agree these amendments under duress or threat of shut down as Aminoil alleged [18] Fitzmaurice pointed out that the 1973 Agreement was reached not so much under

> any direct government threat of a 'shut-down' (though a latent threat of it unquestionably existed) as Aminoil's

[14] See Tschanz 248 setting these arrangements out in more detail
[15] *Aminoil* 571 para 48
[16] *Ibid* para 45
[17] *Ibid* 568 para 34
[18] *Ibid* 570 para 41

> own desire – and hence long-term policy – of wanting to continue to operate in Kuwait, if it was at all possible to do so on reasonable terms [19]

In November 1974 three Gulf States met at Abu Dhabi and resolved to increase royalties to 20 per cent and income tax to 85 per cent of posted prices, effective immediately This became known as the "Abu Dhabi formula", and was adopted by OPEC in December 1974 Eager to recover from oil companies what the Gulf States considered "windfall profits" resulting from the dramatic increase in oil prices, under this formula

> revenues left to the Companies would be predetermined on a fixed (package) basis of 22 cents per barrel thereby transforming the concessions *de facto* into service contracts [20]

Aminoil requested negotiations, pleading that on these terms its operation would be loss-making for every barrel produced It proposed a number of compromises including its general willingness to agree to reduce the concession to something more like a contract of service [21] In the context of this shift in the balance of power, the Tribunal observed, it became "possible to foresee a general end to the concessionary regimes" [22] Aminoil itself seemed to understand that times had changed and that the Concession "was not sustainable on its original basis" [23] Nevertheless, negotiations between the two parties broke down in 1977

Decree Law No 124 "Terminating the Agreement between the Kuwait Government and Aminoil" was passed on 19 September 1977 [24] Article 1 provided that Aminoil's concession "shall be terminated', and by Article 2

> All the interests, funds, assets, facilities and operations of the Company, including the refinery and other installations relating to the aforementioned Concession, shall revert to the State

[19] *Aminoil* Separate Opinion 616 para 5
[20] *Aminoil* 573 para 50
[21] *Ibid* 557 para lxii
[22] *Ibid* 573 para 51
[23] *Aminoil* Separate Opinion 626 27 para 28
[24] The Decree was reprinted in *Middle East Economic Survey* Vol XX No 49 of 26 September 1977 and see the Award at 558

Article 3 established a "Compensation Committee" to assess the amount of "fair compensation" due to Aminoil, and the extent of Aminoil's "outstanding obligations to the State or other parties" However, Aminoil had already commenced arbitration proceedings and declined to participate in the Committee's deliberations

B The Award

Aminoil commenced arbitration proceedings in London, relying on Article 18 of the 1948 Concession which contained an arbitration agreement but Kuwait refused to participate in the arbitration on the ground that the 1948 Concession had effectively been superseded by the subsequent 1961 and 1973 Agreements Furthermore, the appointing authority specified in Article 18, the "British Political Resident in the Persian Gulf", had long since ceased to exist with the demise of British colonial influence in the region At the same time, Aminoil denied the legal force of the 1973 Agreement and therefore refused to invoke the arbitration agreement it contained For a time the deadlock continued After a period for negotiations *ad hoc* arbitration proceedings were commenced in Paris on the basis of a new submission to arbitration (the "Arbitration Agreement") concluded between the Parties in Kuwait on 23 July 1979 The London arbitration was discontinued

Under Article III of the Arbitration Agreement,[25] the parties called on an *ad hoc* Tribunal to rule on (1) the amount of compensation payable by the Government to Aminoil as a result of the nationalisation, (2) the amount of damages payable by the Government to Aminoil as a result of the termination of the Concession, and (3) the amount payable to the Government by Aminoil, or by the Government to Aminoil, in respect of outstanding royalties, taxes or other obligations arising out of the Parties' legal relationship

The sums at stake were significant Aminoil sought to recover over US$423 million in over-paid royalties and taxes under the contested 1973 Agreement, and compensation and damages for the allegedly unlawful termination of its Concession totalling US$2,587 million The Government's claims were far smaller but still appreciable US$32 million unpaid under the financial provisions of the 1973 Agreement, US$90 million under the Abu Dhabi formula, and US$18 million in respect of Aminoil's liabilities to third parties that the Government had met after

[25] The Arbitration Agreement is set out in the Award at 532 535

the nationalisation There were also a number of unquantified claims for damages arising out of Aminoil's alleged failure to meet its obligations to conduct its operations in accordance with good oilfield practice

1 The Law Governing the Arbitration

The Arbitration Agreement did not choose a national law to govern the proceedings but, having acknowledged that it would be "subject to any mandatory provisions of the procedural law of the place in which the arbitration is held", provided in Article IV(1) that the

> Tribunal shall prescribe the procedure applicable to the arbitration on the basis of natural justice and of such principles of transnational arbitration procedure as it may find applicable, and shall regulate all matters relating to the conduct of the arbitration not otherwise provided for herein [26]

The parties presented detailed and complex arguments about the possibilities for "delocalisation" of the arbitration from the law of its seat [27] The Tribunal found that apart from mandatory rules of French procedure,[28] the *lex arbitri* was not automatically the law of its seat Principles of transnational arbitration procedure were also relevant because "having regard to the way in which the Tribunal has been constituted its international or rather transnational character is apparent" [29] Fortunately, little of practical significance turned on this relatively obscure remark The arbitration proceeding itself drew much of its character from public international law dispute settlement

[26] *Ibid* 534

[27] See in more detail Redfern 77 87 Tschanz 254-56 In *Saudi Arabia v Arabian American Oil Company* Award of 23 August 1958 (1963) 27 ILR 117 (*Aramco*) *Texaco Overseas Petroleum Company and California Asiatic Oil Company v Government of Libya* (1979) 53 ILR 389 (*Texaco*) and *Libyan American Oil Company v Libyan Arab Republic* Award of 12 April 1977 (1982) 62 ILR 140 (*Liamco*) the tribunals chose public international law to govern the arbitration in *BP Exploration Co (Libya) Ltd v Government of the Libyan Arab Republic* Award of 10 October 1973 (1979) 53 ILR 297 (*BP Exploration*) the arbitrator chose the law of the seat of the arbitration On the debated possibilities for delocalisation of arbitration procedure in general see *e g* SJ Toope *Mixed International Arbitrations* (Cambridge Grotius 1990) 17 *et seq* On the Libyan oil arbitrations see RB von Mehren and PN Kourides „International Arbitration Between States and Foreign Private Parties The Libyan Oil Nationalization Cases (1981) 75 *AJIL* 476 C Greenwood *State Contracts in International Law – The Libyan Oil Arbitrations* (1982) 53 *BYBIL* 27

[28] *Aminoil* 532 para 4

[29] *Ibid* paras 4-5

procedures each party appointed an agent holding plenipotentiary powers, neither party was classified as claimant or respondent, and memorials were exchanged simultaneously[30]

2 The Law Applicable to the Substantive Issues

Article III(2) of the Arbitration Agreement set out the following approach to determining the applicable law to govern the dispute

> 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 [31]

This provision thus conferred considerable freedom on the Tribunal to determine the applicable law The decision it reached on applicable law differed from the decisions of the tribunal in the Libyan arbitrations where the arbitrators had looked primarily for answers to the questions raised by Libya's nationalisation in international law and general principles [32] Instead, the *Aminoil* Tribunal referred first to the law of Kuwait as the "law most directly involved" in accordance with the traditional respect due to the state party to a state contract,[33] subject to the proviso that "this conclusion does not carry any all-embracing consequences with it" because, as the Government had stressed, public international law formed a constituent part of Kuwaiti law [34] The pragmatic blend of municipal and international law thereby proposed echoed the solution found in Article 42 of the ICSID Convention [35] However, the Tribunal did not

[30] See further Tschanz 253

[31] *Aminoil* 533

[32] See *e g* *Texaco* 452-53 paras 40-45 *Liamco* 173 *BP Exploration* 327

[33] *Aminoil* 533 para 6 also *Payment of Various Serbian Loans Issued in France* (1929) PCIJ Series A No 20 41 *Brazilian Loans* case (1929) PCIJ Series A No 21 S Friedman *Expropriation in International Law (transl* IC Jackson London Stevens 1953) 156 AA Fatouros *Government Guarantees to Foreign Investors* (New York Columbia University Press 1962) 243 *cf* RY Jennings State Contracts in International Law (1961) 37 *BYBIL* 156 161 175 178

[34] *Aminoil* 533 para 6 See also Tschanz 262 63 and Teson 328 336 discussing the conflicts of law issues in more depth

[35] World Bank Convention on the Settlement of Investment Disputes Between States and Nationals of Other States signed at Washington DC 18 March 1965 (1965) 575 *UNTS* 159 reprinted (1965) 4 *ILM* 532 Article 42(1) provides (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

Continues

expand on the relationship between Kuwaiti and international law and arguably obscured the "role of international law as the ultimate controlling standard" [36] In practice, the applicable law presented the Tribunal with few difficulties because it held that these sources were not in conflict with each other so, and on most issues it could rely on the principals of customary international law [37]

3 The Stabilisation Clauses

The Concession contained provisions that were alleged, in their combined effect, to constitute a "stabilisation clause",[38] by which it was argued, Kuwait had clearly undertaken not to annul the Concession or modify its terms Article 17 of the 1948 Agreement provided

> The Shaikh shall not by general or special legislation or by administrative measures or by any other act whatever annul this Agreement except as provided in Article 11 No alteration shall be made in the terms of this Agreement by either the Shaikh or the Company except in the event of the Shaikh and the Company jointly agreeing that it is desirable in the interest of both parties to make certain alterations, deletions or additions to this Agreement

As amended in 1961, Article 11(B) provided

> Save as aforesaid this Agreement shall not be terminated before the expiration of the period specified in Article 1 thereof except by surrender as provided in Article 12 or if the Company shall be in default under the arbitration provisions of Article 18

Aminoil argued that the combined effect of these clauses was to preclude the Government from terminating or varying the Concession unilaterally Decree Law No 124, Aminoil alleged, therefore constituted a breach of

may be applicable See further CH Schreuer *The ICSID Convention A Commentary* (Cambridge Cambridge University Press 2001) 549 *et seq*

[36] Delaume 590

[37] See *e g* *Aminoil* 601 para 142

[38] For the development of the concept see FV Garcia Amador International Responsibility Fourth Report (1959) 2 *YB ILC* 1 29 UN Doc A/CN 4/119 FV Garcia Amador International Responsibility Sixth Report (1961) 2 *YB ILC* 1 47 Article 10 UN Doc A/CN 4/134/Add 1

the contract under its applicable law Citing authority including *Radio Corporation of America v China* in which the tribunal suggested that a government can "certainly sign away part of its liberty of action",[39] and *Texaco Overseas Petroleum Company and California Asiatic Oil Company v Government of Libya* ("*Texaco*") where Arbitrator Dupuy expressed the same view,[40] Aminoil argued that Kuwait's act of nationalisation was in violation of the principle *pacta sunt servanda* and therefore an unlawful expropriation

Kuwait unsuccessfully argued that the stabilisation clauses, if that is what they were, should not remain binding after Kuwait had shed its protected colonial status because these provisions had been imposed at a time when Kuwait had not been in possession of all the attributes of an independent sovereign state [41] That argument did not stand alongside the fact that Kuwait had confirmed the provisions in two separate amendments since gaining full independence, and there was nothing in the new Constitution of 1961 to prohibit the State from entering into such commitments [42]

An analogy with the French "administrative contract' concept also suggested by the Government did not find favour with the Tribunal [43] The Tribunal followed earlier awards in *Texaco* [44] and *Aramco* [45] in denying that international law or general principles of law contained a theory of administrative contracts

Kuwait was more successful with its contention that changes in the political and economic landscape had transformed the nature of the concession [46] The Government submitted that this was not a case of a supervening fundamental change of circumstances (*rebus sic stantibus*), but rather a process of change brought about by mutual agreement or acquiescence General changes in the regime applicable to the concession, paralleling the "profound and general transformation in the terms of oil concessions that occurred in the Middle-East"[47] were incorporated into

[39] *Radio Corporation of America v China* noted (1936) 30 *AJIL* 535 540
[40] *Texaco* 474 para 67 477 para 71 479 para 73
[41] *Aminoil* 587 para 90(1) This argument is supported by some commentators *e g* S Asante Stability of Contractual Relations in the Transnational Investment Process (1979) 28 *ICLQ* 401 403 and arguably underlies GA Res 3281
[42] *Aminoil* 587 para 90(1)
[43] *Ibid* paras 90 92
[44] *Texaco* 477 para 72
[45] *Saudi Arabia v Arabian American Oil Company* Award of 23 August 1958 (1963) 27 ILR 117 164
[46] See further Redfern 74 Tschanz 266
[47] *Aminoil* 590 para 97

the parties' legal relationship by virtue of Article 9 of the 1961 Agreement Article 9 was an adaptation or renegotiation clause (imprecisely described by some as a MFN clause) introduced by the 1961 Supplemental Agreement It provided

> If, as a result of changes in the terms of concessions now in existence or as a result of the terms of concessions granted hereafter, an increase in benefits to Governments in the Middle East should come generally to be received by them, the Company shall consult with the Ruler whether in the light of all relevant circumstances, including the conditions in which operations are carried out, and taking into account all payments made, any alterations in the terms of the agreements between the Ruler and the Company would be equitable to the Parties

In what has been called "a landmark discussion on the nature of oil concessions"[48] the Tribunal held that the Concession had become over time a contract governed by a changed regime in which, as "in most legal systems, the state while remaining bound to respect the contractual equilibrium, enjoys special advantages"[49] including ultimately, "the right to terminate it" [50] The balance of the Concession had changed,[51] so that "in 1977 the stabilization clauses did not prohibit a nonconfiscatory takeover" [52] The Tribunal was influenced by the work of the UN Commission on Permanent Sovereignty over Natural Resources and the UN Economic and Social Council embodied in UN General Assembly ("GA") Resolution 1803 of 14 December 1962 This declared the "inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national interests " [53] GA Resolution 1803 was considered an accurate reflection of customary international law,[54] but, as in *Texaco*, the Tribunal was not persuaded that later GA Resolutions including the Charter of Economic Rights and Duties of States of 12 December 1974 carried any legal weight [55] At the

[48] Téson 345
[49] *Aminoil* 590 para 98
[50] *Ibid* paras 100 113
[51] Redfern 103
[52] Tschanz 276
[53] GA Res 1803 (1962) 17 UN GAOR Supp (No 17) 15 reprinted (1964) 13 *ICLQ* 400
[54] *Aminoil* 587 8 para 90(2)
[55] GA Res 3281 (1974) 29 UN GAOR Supp (No 31) reprinted (1975) 14 *ILM* 251 (1975) 69 *AJIL* 484 *Texaco* 484 *et seq* paras 80-91

same time, nothing in these Resolutions proved "the existence of a rule of international law prohibiting a state from undertaking not to proceed to a nationalization *during a limited period of time*" [56]

The Tribunal accepted in principle that a stabilisation clause could be effective in public international law to fetter a state's right to nationalise property but only if the clause were expressly and specifically to that effect,[57] and only if it were for a limited time [58] Given that the Concession had already been in existence thirty years, however, the tribunal could not accept that its intended effect was to exclude nationalisation for the "especially long" full 60 years of the Concession [59] Further elucidation of this contentious issue was avoided because the Tribunal adopted a narrow reading of the particular clauses to conclude that they only applied to confiscatory measures, and nationalisation was not confiscatory where the government had provided that fair compensation should be paid [60] The consequences of the interpretation suggested by Aminoil were of such importance that the Tribunal could not presume a prohibition against nationalisation from the general language used in the Concession [61]

Although Fitzmaurice found the argument that the nature of the Concession had changed plausible, he also considered that changes should only be within the framework of the continuing concession [62] In a dissent of "considerable persuasive force"[63] Fitzmaurice concluded that it was an "illusion" that monetary compensation alone could alter the clearly confiscatory character of a forced nationalisation [64] Ultimately Fitzmaurice's disagreement was "over the principle of interpretation of the stabilization clauses",[65] Article 17 was not confined to only

[56] *Aminoil* 587 para 90(2) (emphasis original) See also GM White *Nationalisation of Foreign Property* (London Stevens 1961) 178

[57] *cf Amoco International Finance Corporation v The Islamic Republic of Iran* (1987) 15 Iran US CTR 189 para 179 *Texaco* 470 75 paras 62 68 *Re Revere Copper and Brass Inc and Overseas Private Investment Corporation* (1978) 56 ILR 258 *AGIP SpA v Government of the Popular Republic of the Congo* (1979) 67 ILR 319 concurring opinion of Arbitrator Brower in *Mobil Oil Iran Inc v Islamic Republic of Iran* (1987) 16 Iran US CTR 3 64 68

[58] *Aminoil* 587 para 90 589 para 95

[59] *Ibid* 589 para 95

[60] *Ibid* paras 93 95 See also *Liamco* 189 200-2 Mann criticised the award s reasoning on this point calling it a blatant distortion of plain language Mann 257-58

[61] *Ibid* para 94 *cf Texaco* where the state s right to nationalise was excluded by the general scope of the language used in the Libyan concession 477 79 paras 71 73

[62] *Aminoil* Separate Opinion 626 para 28

[63] Mann 252

[64] *Aminoil* Separate Opinion 625 para 26

[65] *Ibid* 621 para 19

confiscatory measures "What they are concerned with is any measure *terminating the Concession* before its time" [66] In his opinion the nationalisation was "irreconcilable with the stabilisation clauses" and therefore unlawful [67]

4 Compensation for Lawful Nationalisation

The *Aminoil* award has received much attention because it marked the start of a more rational approach to awarding compensation for nationalisation [68] The decision is to be contrasted with the Libyan arbitrations *Liamco, BP Exploration* and *Texaco* where Libya declined to appear and disputes were decided by sole arbitrators Kuwait not only participated in the Aminoil arbitration but was represented by a team of experienced international practitioners and contested the claims on the merits Moreover, the Tribunal was comprised of three highly respected international jurists, from both developed and less-developed states, with exceptional experience of contemporary trends in public international law

The Tribunal adopted a distinction between lawful and an unlawful nationalisation to guide its determination of the applicable standards of compensation Having adopted this approach, the majority held that the taking was lawful[69] on the basis that the nationalisation had been undertaken for a legitimate public purpose consistent with Kuwait's overall policy for the development of its vital petroleum industry, designed to culminate in its complete nationalisation [70] The Tribunal dismissed Aminoil's argument that the taking was discriminatory because it did not include the assets of Arabian Oil Company ("AOC"), a Japanese company operating an offshore concession in the Divided Zone Kuwait argued that the AOC concession had different features It concerned an offshore operation requiring special expertise not present in Kuwait at the time, and matters were complicated by the fact that concession was jointly held with the Government of Saudi Arabia [71] Moreover, the KOC Concession had been taken over by mutual agreement in 1975 and in 1977 only 10 per cent of the industry remained in foreign ownership The Tribunal held that it

[66] *Ibid* 625 para 24 (emphasis original)
[67] *Ibid* 621 22 paras 19-20 Fitzmaurice nonetheless agreed with the *dispositif* part of the award
[68] See *e g* Mann 214 Gray (1990)
[69] *Aminoil* 600 para 138
[70] *Ibid* 584 para 85
[71] *Aminoil* 585 para 87

> did not see why a Government that is pursuing a coherent policy of nationalisation should not have been entitled to do so progressively, in step with the development of necessary administrative and technical availabilities [72]

To be lawful in international law a nationalisation measure must be accompanied by a mechanism for assessing "fair compensation" payable to the party whose assets have been taken Decree Law no 174 of 1977 contained such a provision, referring to the Compensation Committee the task of assessing the amount the fair compensation to be paid under Decree Law no 174 Whether or not such a body, appointed by the Government, would be considered sufficiently independent is fortunately moot, because (as explained above) this mechanism was supplanted by the 1979 *ad hoc* submission to arbitration agreement

The Tribunal was thus not in any way constrained by the arbitration agreement in its approach to assessing the amount of the fair compensation to be paid One of the most interesting features of the case was that it could choose for itself the method to be used in determining the fair compensation

In their memorials, the parties argued this issue at considerable length Unsurprisingly, Aminoil contended for the "prompt, adequate and effective compensation" measure that had gained the approval of many distinguished and authoritative authors in the developed world Equally unsurprisingly, Kuwait urged the Tribunal to adopt a less encompassing standard which it argued, would be more appropriate in the case of lawful nationalisation

In the event, the Tribunal preferred to adopt the term ' appropriate compensation" as used in the UN s General Assembly Resolution 1803 [73] It explicitly rejected later General Assembly Resolutions, including the 1974 Charter of Economic Rights and Duties of States, which purported to weaken the customary international law standard of compensation for expropriation and leave the matter entirely for determination under domestic law [74]

In determining the level of appropriate compensation the Tribunal preferred "an enquiry into all the circumstances relevant to the

[72] *Ibid* para 86 This finding was later followed in *Amoco International Finance Corp v Iran* (1987) Iran US CTR 189 para 145
[73] GA Res 1803 (1962) 17 UN GAOR Supp (No 17) 15 Article 4
[74] *Aminoil* 601 2 paras 143 44 referring to GA Res 3281 (1974) 29 UN GAOR Supp (No 31) 52 Article 2

particular concrete case, than through abstract theoretical discussion" [75] The words "appropriate compensation" were used as a general standard that permitted a degree of flexibility and equitable response to the legitimate expectations of the parties, taking into account the stabilisation clause and the history and context of the investment The clear suggestion was that "appropriate compensation" could be determined differently from case to case depending upon the particular legal relationship between the parties and on the overall international context prevailing at the time [76]

The *Aminoil* case is notable for its survey of the differing methods of valuing expropriated assets [77] Kuwait argued that the appropriate measure was to look at the net book value of the assets in question, whereas Aminoil sought the monetary equivalent of *restitutio in integrum* for the replacement value of its assets and its business as a going concern - which would include an element for lost profits *Restitutio in integrum* is in theory the principal method to make full reparation for an internationally wrongful act[78] and has been ordered in the past,[79] but whether or when, as a matter of international law, an order in the nature of specific performance or *restitutio in integrum* may be made against a state in favour of a private party is an unresolved question, the principle of permanent sovereignty over natural resources, taken literally, might suggest the answer "never" [80] Occasionally tribunals have fashioned a compromise Crawford cites the *Walter Fletcher Smith* case in which the Tribunal considered that *restitutio in integrum* was the appropriate remedy in theory but found sufficient discretion in the *compromis* to award an equivalent amount in compensation in "the best interests of the parties, and of the public" [81] In the *Greek Telephone Company*

[75] *Ibid* para 144

[76] Tschanz 279

[77] *Aminoil* 608 9 paras 146-49 153

[78] See Articles 31 34 and 35 of the ILC *Articles on Responsibility of States for Internationally Wrongful Acts* adopted in *Annual Report of the International Law Commission on its Fifty-third Session* (23 April1 June and 2 July10 August 2001) A/56/10 ch IV and endorsed by the UN General Assembly by Resolution 56/83 of 12 December 2001 (*ILC Articles*) reprinted in J Crawford *The International Law Commission s Articles on State Responsibility* (Cambridge Cambridge University Press 2002) 194 211 213 and commentaries therein (hereafter Crawford)

[79] See *e g* *Spanish Zone of Morocco* case (1925) 2 RIAA 617 *Martini Case* (1930) 2 RIAA 977 *Palmagero Gold Fields* case (1931) 5 RIAA 298 *Russian Indemnity* case (1912) 11 RIAA 431 *Texaco* 407 08 paras 92 112

[80] See *BP Exploration* 347 *Liamco* 187 89 See also I Brownlie *System of the Law of Nations State Responsibility (Part One)* (Oxford Clarendon Press 1983) 210 C Gray The Choice between Restitution and Compensation (1999) 10 *EJIL* 413

[81] Crawford 214 citing *Walter Fletcher Smith* case (*USA v Cuba*) (1929) 2 RIAA 913 918

case the Tribunal allowed the respondent State the option to provide compensation instead of specific performance for "important state reasons" [82]

Article 35 of the ILC's *Articles on Responsibility of States for Internationally Wrongful Acts* allows a tribunal to make such a compromise where restitution involves a burden out of all proportion to the benefit deriving from restitution instead of compensation" [83] Article 1135(1)(b) of the NAFTA leaves the matter solely to the discretion of the respondent State, because it requires a tribunal that orders restitution of property to also provide in its award "that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution" [84] In *Aminoil* this particular controversy was avoided because the parties had recognised in the Arbitration Agreement that it was politically impracticable for Kuwait to return the nationalised property to Aminoil [85]

The Tribunal accepted the depreciated replacement value method in principle, rejecting Kuwait's proposal to apply the net book value It stated that the latter was only appropriate

> when it is a case of a recent investment, the original cost of which was not far from that of the present replacement cost [86]

Net space book value may have provided the basis for a number of compensation settlements between Gulf States and oil companies but in the absence of *opinio iuris* this practice did not influence the applicable legal principles [87]

The Tribunal adopted an interesting approach to valuing the company as a going concern recognising the "undertaking itself as a source of *profit* " [88] The value of Aminoil as a going concern was

[82] *Greek Telephone Company v Greece* cited in JG Wetter and SM Schwebel Some Little Known Cases on Concessions (1964) 40 *BYBIL* 216 221 also Crawford 214 Gray 193
[83] *ILC Articles* Article 35
[84] North American Free Trade Agreement between the United States of American Canada and the United Mexican States (NAFTA) signed 17 December 1992 in force 1 January 1994 reprinted (1993) 32 *ILM* 289 and 605 For further discussion of remedies under NAFTA Chapter 11 see T Weiler and LM Diaz in T Weiler (ed) *NAFTA Investment Law and Arbitration Past Issues Current Practice Future Prospects* (Ardsley NY Transnational 2004) 179
[85] *Aminoil* 533
[86] *Ibid* 609 para 165
[87] *Ibid* para 157
[88] *Ibid* para 164 (emphasis original)

> made up of the values of the various components of the undertaking separately considered, and of the undertaking itself considered as an organic totality – or going concern – therefore as a unified whole, the value of which is greater than that of its component parts [89]

In calculating its claim for lost profits Aminoil had focused on the period immediately before the submission of its first memorial, adjusted for interest, and also analysed future profits expected over the duration of the concession, adjusted down by an appropriate discount rate Profits were projected in both cases based on the volume of oil to be produced taking account of the remaining reserves, the capacity of the facility, the volume of sales, prices at which sales would have been made, operating and capital expenditures incurred and taxes and other payments due to Kuwait Aminoil emphasised the high degree of certainty of the figures derived from its operating history and argued that it was more reliable to project those figures forward than to apply other valuation techniques

The Tribunal did not accept this approach but it did include an allowance for the legitimate expectation of the investor to a "reasonable rate of return" as provided for in Part 2 of Annex 1 to the 1973 Agreement, rather than resorting to what Redfern describes as the more familiar "aleatory concept of 'lost profits'" [90] It was important to factor in a reasonable rate of return to acknowledge Kuwait's investor-friendly stance and in order to 'to warrant the upkeep of a flow of investment in the future" [91]

The parties' legitimate expectations also required the Tribunal account for the parties' new financial commitments entered into in 1973 as well as the Abu Dhabi formula [92] The Tribunal stressed that it was not open to it to rewrite the parties' own agreement in relation to the issues on which they had failed to agree themselves,[93] nonetheless the Tribunal deemed itself competent under the Arbitration Agreement to "liquidate the various consequences of their past conduct, and of the contractual clauses that once bound them but are now at an end" [94] Fitzmaurice agreed that

[89] *Ibid* para 178 cited with approval in *Amoco* para 265
[90] Redfern 108
[91] *Aminoil* para 147
[92] *Aminoil* 607 8 paras 160-62
[93] See further K-P Berger Renegotiation and Adaptation of International Investment Contracts The Role of Contract Drafters and Arbitrators (2003) 36 *Vand J Transnatl L* 1347
[94] *Aminoil* 581 para 75

the parties' had by implication agreed to incorporate new financial obligations into their contractual regime

> "Nevertheless in the particular circumstances of this case, I find it very hard (although some of the reasoning might not have been mine) to dissent from the conclusion reached in the Award, which is based on the view that, the principle of *something* being due on the Abu Dhabi account having been conceded the Tribunal was competent to assess what these payments ought to be "[95]

It was held that Aminoil had "come to accept the principle of a moderate estimate of profits and that it was this that constituted its legitimate expectation" [96] The Tribunal set Aminoil's reasonable rate of return at US$10 million per year, the amount due to Kuwait under the Abu Dhabi formula was the estimated amount of profits Aminoil could have earned in excess of this income,[97] although it did not specify the remaining number of years it used to calculate Aminoil's return [98]

The *Chorzow Factory* case suggests that compensation for lost profits is only required in the case of an unlawful taking The *Aminoil* Tribunal did not refer to *Chorzow*, yet it seems to have incorporated elements that effectively recognised for loss of profits to reflect the parties' "legitimate expectations", even though the nationalisation was found to be lawful [99] The Tribunal's approach arguably demonstrated a more principled and modern approach to compensation for expropriation of a going concern,[100] but the award can also be understood, as explained in *Amoco*, in the light of the Tribunal's findings on the parties' particular contractual arrangements [101] Also, because the Tribunal preferred a fact-based enquiry, and its discussion of the principles and calculations is relatively brief, it is not clear whether any long term conclusions may be extracted from the award [102]

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[95] *Aminoil* Separate Opinion 620 para 15
[96] *Aminoil* 607 para 161
[97] *Ibid* 612 para 176(2)
[98] Mann 262 interprets the award as in fact allowing nothing for loss of profit during the remaining 30 years of the Concession also Tschanz 280
[99] See Gray 183-84 *cf* Mann 262
[100] See also R Dolzer New Foundations of the Law of Expropriation of Alien Property (1981) 75 *AJIL* 553
[101] *Amoco* para 265
[102] Mann 253 Redfern 109

The Tribunal valued Aminoil's investment at just over US$206 million while its liabilities to the Government were US$123 million, leaving an award in favour of Aminoil of US$83 million The interest payable on this amount was set at 7 5 per cent and it was compounded although no detailed explanation was given as to how that figure was reached In recent awards it has been expressly acknowledged that interest "becomes an integral part of the compensation itself",[103] and it may be compounded in order to "ensure that the compensation awarded the Claimant is appropriate in the circumstances" [104] An additional allowance of 10 per cent was made to allow for inflation, which respected commentators such as Francis Mann and Alan Redfern have criticised rather convincingly on the basis that adjustments for loss of value as a result of inflation should be built into calculations of the depreciated replacement value of assets taken, whereas interest is normally designed to compensate a creditor for delay [105] As it was, these additional sums amounted to more than half of the total sum awarded [106]

It is not easy to discern principles for calculating the compensation due to a concessionaire following a lawful recovery by a State of its patrimonial resources This may well have been the Tribunal's intention, because the discussion of the calculations is relatively brief and further developments in this field of law may have been foreseen Sadly, it is too late to ask its members as none of them is still living Viewed with the advantage of hindsight approximately a quarter of a century after the award was made, and compared with the *Texaco* and *Liamco* awards, it seems clear that *Aminoil* heralds a more liberal approach to calculating the cost to the State of up-dating its contractual arrangements with proprietary licence-holders to accord with contemporary international standards

[103] *Metalclad Corporation v United Mexican States* Award of 30 August 2000 (2002) 119 ILR 615 para 128 *Asian Agricultural Products Ltd v Democratic Socialist Republic of Sri Lanka* Award of 21 June 1990 (1991) 30 *ILM* 577 4 ICSID Rep 245 para 114 R Lillich Interest in the Law of International Claims in *Essays in Honour of Voitto Saario 70 years September 13 1982 and Toivo Sainio 70 years January 7 1983* (Helsinki Finnish Branch International Law Association 1983) 55 56

[104] *Compañia del Desarrollo de Santa Elena SA v Republic of Costa Rica* (2000) 39 *ILM* 1317 para 104

[105] FA Mann *The Legal Aspect of Money With Special Reference to Comparative Private and Public International Law* (5th edn Oxford Clarendon 1992) 547 pointing out that this same error was made in *Lithgow v United Kingdom* ECHR Judgment of 8 July 1986 Series A No 102 75 ILR 439 493 Redfern 109 also noting the principles underlying the award of interest in Islamic countries

[106] *Aminoil* 613 para 178

Interestingly, the *Aminoil* Tribunal – while undoubtedly "liberal" for its time – does not seem to have taken into consideration the scale of the investments made in the host country by the concessionaire over the life of the concession, or the extent to which it had recovered its original capital investments and/or received a fair return on them in relation to the risks involved. If the Tribunal had elected to take such matters into account, modern NAFTA and BIT tribunals might today have access to useful guidance for their own tasks in assessing the compensation to be awarded in specific cases. To the present commentators it seems at least arguable that the value of the benefit injected into the host country by an expropriated (or "interfered with") investor should be accorded weight that is proportional to the investor's contractual rights.

5 Lessons for Modern Investment Arbitration Tribunals

The current approach of many tribunals appears to be that the investor was granted an exclusive licence (the term "concession" is rarely used in the 21st Century) for a long period in order to create an opportunity to recover (and make a fair return on) the initial investment, as well as to make a reasonable annual operating profit. That is undoubtedly fair. The host State gains by having its resources developed for the benefit of the nation and its citizens. The exclusive licensor gains by a receiving a fair return on its investment as well as making a normal operating profit. Neither side exploits the other if the contractual scheme has been properly crafted initially, and operated in good faith later.

However, many BITs include "contracts having a monetary value" in their lists of qualifying 'investments". Suppose, hypothetically, that a wealthy corporation from a developed country agrees to build a new railway in a less-developed country, and is granted an exclusive licence to operate the railway system in that country for 25 years for the purpose of recovering the initial investment. Suppose, further, that due to "regime change" (or some other factor) the contract is terminated before any significant investment has been made by the licensee towards the construction of the railway. Suppose, further, that there is an applicable BIT and that the "investor" starts an arbitration under the BIT claiming 25 years of lost future profits.

Based on the reasoning of some modern tribunals, an award of compensation calculated by reference to a DCF on reasonably anticipated profits over the 25 year period might be made, notwithstanding the fact that only a small fraction of the anticipated investment for the benefit of the State or its citizens had been made by the licensee An independent observer could be forgiven for wondering whether such a situation might contain an element of exploitation on the part of the investor, who will have made a substantial profit without having to make the investment that was originally contemplated

Not all international tribunals have approached calculation of the quantum of compensation in this manner For example, the *Myers* Tribunal,[107] having found in favour of the investor on liability, was confronted by a claim for anticipated lost profits initially quantified at over US$100 million In awarding compensation of US$6 5 million (excluding interest) it seems reasonable to assume that the *Myers* Tribunal took into account the fact that Myers' monetary investment in Canada had been only a little over US$1 million [108]

Returning to the purely financial aspect of the *Aminoil* arbitration, it seems that neither party could have felt aggrieved by the eventual result Kuwait acquired assets that were worth many times the total sum awarded of US$179million, even though it then had to invest substantial sums to restore both the refinery and the oilfields to accepted international standards following Aminoil's years of apparent neglect Incidentally, within a couple of weeks of receiving the award the Government despatched a cheque to Aminoil for the US$179million with a one-line covering letter in an ordinary airmail envelope - without even asking for a receipt The tobacco company, RJ Reynolds, bought Aminoil from its founders in 1970 for US$40million and sold it in 1984 for US$1 7billion, collecting about US$180million in compensation from Kuwait for loss of the concession on the way - not a bad return on investment for its seven year adventure in Kuwait!

6 The Government's Claims against Aminoil

In the many published commentaries on the *Aminoil* case, the Government's claims[109] have received little attention, no doubt because

[107] *SD Myers Inc* v *The Government of Canada* Award of 21 October 2002

[108] In the quantum phase Canada argued that a reasonable basis for assessing compensation would be the return of *Myers* investment plus interest Professor Hunter served as President of the *Myers* Tribunal

[109] As noted above neither party was willing to be categorised as the Respondent because each had claims against the other Thus the terms Claimant and Respondent were never used and memorials witness statements experts reports and so forth were all exchanged simultaneously

they raised few points of principle of the magnitude of those that have commanded the attention of academic writers since the early 1980s This is one of the reasons for writing this commentary at a somewhat late stage, some 25 years after the arbitration was concluded

The Government's claims fell into three categories, one of them succeeded in part (proportionately to a greater extent than Aminoil's claims) and the other two failed

The successful claims included the discharge of certain liabilities of Aminoil after the Government took over the enterprise, as well as unpaid instalments of royalties and taxes under the 1973 Agreement Aminoil claimed unsuccessfully that the 1973 Agreement was invalid and/or unenforceable on various grounds, including an allegation that it had been entered into under duress In the event, Aminoil s submissions under this head failed and the Tribunal awarded the total sum of US$123 million in favour of Kuwait

In fact, the failure of Aminoil's challenge to the validity of the 1973 Agreement may have been greatly to Aminoil's advantage in the long run, because the 1973 Agreement had abolished the so-called "Gold Clause" that had been included into the original 1948 Concession Agreement On the basis of one set of calculations, Aminoil would have been liable to pay some US$2,000 million if the Gold Clause had been held to be applicable The issues arising in relation to the 1973 Agreement and the Gold Clause were thus of considerable interest to those working on the case, and it may be an appropriate time to publish a brief account of that part of the story

In long term investment agreements the financial equilibrium upon which an investor, or indeed, a host state may base their initial decisions is particularly vulnerable to price fluctuations over an extended period of time Possibilities include (1) changing commodity prices, which may dramatically increase an investor's costs of operation, (2) prices for the investor's output, which may be vulnerable to the whims of the market or the host State's regulatory policies, and (3) depreciation or appreciation in the exchange rate between the currency of the capital exporting state and the capital importing state, which may impact upon the profitability of an investment for both investor and State It was the last of these variables that concerned Kuwait most at the time of the grant of the concession

The first section of this Chapter described in part how Aminoil attempted to "stabilise" the legal and financial conditions affecting its investment, Kuwait also desired stability and certainty, in respect of its financial return from the 1948 Concession

The replacement of gold and silver with paper money as a currency of exchange long-term investment contracts become vulnerable to currency fluctuations The value of money can fluctuate or be changed arbitrarily over the course of a long-term investment project so it is all the more important to link value to a stable benchmark [110] Kuwait accordingly inserted a "gold clause" in the 1948 Concession Agreement, which expressed the value of the financial obligations it created in terms independent of the fluctuations of any national currency Article 3(h) provided that

> Any obligation hereunder to pay a specified sum in United States Dollars shall be discharged by the payment of a sum in United States Dollars equal to the official United States Government purchase price in force at the date of payment for such quantity of gold, of the standard and fineness prevailing at the date of the signature hereof, as such specified sum would have been sufficient to purchase at the date of signature of this Agreement at the official United States Government price then in force
>
> The principle underlying this paragraph is that the present value of the United States Dollar shall be maintained throughout the term of this Agreement

A gold clause is simply a benchmark of value to eliminate the effects of changes in the value of the money of account, the need for which was succinctly explained by Plesch

> The use of paper money has made it necessary to devise some legal safeguards in favour of the creditor who should be protected against a subsequent depreciation of the paper currency It was obvious that the best protection available for the creditor was to bring the

[110] See further FA Mann *The Legal Aspect of Money With Special Reference to Comparative Private and Public International Law* (5th edn Oxford Clarendon 1992) 124 170

> obligation of the debtor into relation to the most stable value which was recognised throughout the world Gold [111]

Aminoil's payments to the Government were to be made in US dollars, so the Government was naturally concerned to ensure a stable stream of revenue from the investment for the life of the Concession It was therefore necessary to protect itself against any decline in the value of the dollar, and there was precedent for the use of a gold clause in these situations [112] Article 3(h) provided for future dollar payments to be based on the benchmark value of the dollar relative to an ounce of gold on the day the Agreement was signed and in this way "present value of the United States Dollar could be maintained for the term of the Agreement

When the concession was signed US $35 was "sufficient to purchase" one fine ounce of gold "at the official United States Government price then in force" but in 1971 the US suspended the convertibility of dollars to gold The dollar price of gold began to rise dramatically over the coming months By February 1972 the Ministry of Finance and Oil of the Government of Kuwait had already complained to Aminoil of short payments because calculations of royalties paid in US dollars were not adjusted by reference to the gold clause Aminoil temporised, evading the issue by reference to ongoing negotiations between the US Treasury and the IMF to fix a new dollar price for gold, but the problem remained Kuwait insisted on its right to invoke the gold clause so as to maintain the gold value of its royalties

In 1973 Aminoil asked for the gold clause to be abolished After negotiation, once Aminoil accepted the OPEC "Geneva" proposal of January 1972 to calculate oil prices based on an index that tracked changes in the exchanges rates between the dollar and a basket of nine other currencies, Kuwait agreed This *quid pro quo* was deemed a satisfactory settlement of the matter and paragraph 7 of the Part 1 of Annex 1 to the 1973 Agreement confirmed the deletion of gold clause

In the arbitration, Aminoil argued that the 1973 Agreement was invalid In reply, Kuwait stressed that, if the 1973 Agreement was invalid, so too was the abolition of the gold clause The Government insisted that Aminoil could not have it both ways The parties' legal relations would

[111] A Plesch *The Gold Clause A Collection of Cases and Opinions* (2nd edn London Stevens & Sons 1936) v *et seq*

[112] See *e g* Saudi Arabia Aramco Concession of 29 May 1933 Article 17

remain governed by the 1961 Agreement in which the gold clause had been expressly confirmed The implications for the parties' respective liabilities were immense if the gold clause remained in force Aminoil had agreed in Articles 3 and 7 of the 1948 Concession, described above, to pay to the Government various "sums and considerations" denominated in US dollars including one off payments, royalties and a share in the proceeds of sale of natural gas Some of these financial obligations had been amended in the 1961 Agreement but the gold clause remained intact, a point made clear by Article 11 which insisted that "the provisions of the Principal Agreement shall continue in full force and effect except insofar as they are inconsistent with or modified by this Agreement"

Applying the gold clause would lead to a major re-assessment of the financial relationship between the Government and Aminoil By 1978 one fine ounce of gold cost around US $226 and by 1980 the price was as much as US $600 a fine ounce in some markets Although these were no longer "official United States Government prices" the US Government did continued to buy and sell gold on the open market which, the Government argued, set a *de facto* US Government price Kuwait calculated that Aminoil's indebtedness to it could amount to approximately $1,868 million in unpaid royalties and taxes by the date the concession was revoked Any claim for lost future profits would be wiped out by the sums required to meet Aminoil's financial commitments under the 1948 Concession

Aminoil replied that the gold clause was not applicable and set out four main arguments It first submitted that the Government had not made a thorough analysis of the language and meaning of the clause itself or the payments to which it was applicable It read the phrase "a specified sum in United States Dollars" narrowly, thereby restricting the payments it would cover to only those identified sums and not derived as a percentage of production or revenue Thus, payment of 1/8 of the proceeds of sales of natural gas was not a specified sum subject to the operation of the gold clause None of Aminoil's income tax obligations arising under Kuwaiti tax laws would be subject to the gold clause either because they were not "specified sums" or due as a result of "any obligation hereunder" listed in the Agreement or its amendments

Secondly, Aminoil denied that the gold clause was ever intended to apply in the manner contemplated by the Government To do so would lead to the absurd result that Aminoil would have had to make payments to the

Government for the period 1973 to 19 September 1977 of more than twice its entire gross income as the free market price of gold increased

Thirdly, Aminoil objected to the substitution after 1971 of the London market price for gold in the absence of an official US purchase price Free market prices were something quite different from an official US purchase price Moreover, Aminoil provided evidence that a US purchase price for gold continued to be posted at a rate of around $40 an ounce (significantly lower than the London market price) until it was officially ended in 1978

Finally, Aminoil argued that the financial stability desired by Kuwait had been achieved by the turn of events Increases in payments made to the Government in the early 1970s through developments in the global oil market and changes in the parties' legal relationship had in fact far exceeded any relative increases in the price of gold OPEC members had gained control over the posted price of oil and through the cooperation of certain oil companies, linked the price to the value of a basket of currencies Then, in 1973, Kuwait unilaterally took control of prices for Kuwaiti oil These manoeuvres had assured that the value of oil did not suffer from a weak dollar and thereby indirectly had assured the value of Aminoil's royalty and tax payments as these were expressed as a percentage of the posted price

The Tribunal doubted that it could determine a "virtual" official US gold price in the absence of a real one, but in any event, the finding that Aminoil's letter had rendered the 1973 Agreement valid made any investigation into the effect of the gold clause moot because it had been cancelled by the 1973 Agreement [113] Albeit not expressly, the Tribunal seems to have acknowledged the parties' concern for financial stability in their negotiations when it noted their concern to mitigate the effects of inflation,[114] and that such stability should be applied as "two-way traffic"

A review of the parties' memorials many years after they were written conveys the impression to the reader that the Government did not advance a serious case for the application of the gold clause After all, its primary case was that the 1973 Agreement – the very agreement that abolished the gold clause – was valid and binding Rather, it seems that

[113] *Aminoil* 571 para 46
[114] *Ibid* 610 para 170

the gold clause issue presented the Government with a fine device to focus Aminoil's attention on the consequences of arguing that the 1973 Agreement was ineffective The arguments based on the gold clause do however remind the reader that in long-term investments the desire for stability may be mutual, and that stability should cut both ways

7 Oilfield Practices

Every old-style Concession, and equivalent modern exclusive licence agreement, imposes a number of logical and reasonable obligations on the concessionaire or licensee concerning effective management of the enterprise This is necessary because, by definition, in an exclusive environment no competitive forces exist to promote efficiency This element is of particular importance where the exploitation of mineral resources is concerned The mineral resources of a country, whether they are oil, gas, diamonds, gold, silver, bauxite or whatever, are often the most important source of the nation's future ability to develop the infrastructure and economic power to which every modern state aspires Inevitably, the grant of a proprietary "concession", long lease or licence creates a complex pattern of conflicts of interest between, on the one hand, the foreign investors who bring in cash investment and expertise and, on the other hand, the state itself, as the curator of the nation's wealth, and the legitimate economic interests of its citizens

In the 1948 Concession Agreement Aminoil undertook certain operational commitments in addition to its financial responsibilities [115] In particular, Article 2(C) of the 1948 Agreement required Aminoil to

> 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

Article 8(3) provided that

> the Company shall notify the Ruler as soon as practicable of any major damage of whatever nature to the oilfields or the installations and shall take all necessary measures to stop and rectify such damage

[115] 1948 Concession Agreement Articles 2 3 6 7 8

Article 8(6) of inserted by the 1961 Agreement provided

> the Company shall not start production from any field or well before testing and making sure that the well has been properly completed in accordance with good oilfield practice

Part 1 Annex 1 paragraph 5 to the 1973 Agreement modified these provisions as follows

> The Company shall at all times conduct its operations in the Concession Area in a proper and workmanlike manner and by appropriate scientific methods in accordance with good oilfield practice and shall take all reasonable measures to prevent fire and to prevent ingress of water into petroleum-bearing strata and to prevent the pollution of the sea and shall close all unproductive holes drilled by it and subsequently abandoned The Company shall keep the Appropriate Authority informed as to the progress and the results of its operations but such information shall be treated as confidential by the Appropriate Authority save insofar as it is required for the purpose of settling a dispute between the parties hereto

Good oilfield practice required Aminoil to match the practices a prudent operator would follow in order, within market constraints, to maintain production at its maximum efficient rate The Government criticised Aminoil's attitude during the years 1974 to 1977 for its failure to observe good oilfield practices in accordance with the 1948 Concession Agreement and, in particular, its unwillingness to incur the capital expenditure necessary to bring its installations into line with internationally recognised standards The price of oil had risen dramatically in these years, as had Aminoil's profits, and it was not suggested that there was any financial reason that justified Aminoil in failing to comply with reasonable conservation measures

The oil fields within Aminoil's concession area, at Wafra, South Fuwaris and Umm Gudair, are relatively deep underground To extract oil it was necessary to drill wells to a depth of around 300 metres (approximately 1000 feet) Further, before the oil strata could be reached it was necessary to drill though an underground water reservoir known as the Damman

Zone It was essential that there should be no leakage of water into the oil bearing strata and, *vice versa*, no contamination of the water reservoir through crude oil leakage This is not just a question of the quality of the oil produced (or of the water) It is a matter of maximising the ultimate recovery of oil from the fields

It may come as a surprise to the uninitiated reader that, at the relevant time, total recoveries from oil reservoirs of this type did not usually exceed about 20% of the total volume of crude oil in the reservoir [116] In order to maximise the recovery according to the standards of the era it was necessary to inject water at strategic points in order to gather pockets of crude oil into underground "pools" that could be put under pressure to rise up the wells to the surface In order to control this process it was important to control the flow of water so that it did not get into certain areas of the oil reservoir, because this would disturb the carefully designed process of maximising recovery Good management of an oil field is a process that requires investment in expert geological skills and other resources

During the relevant period (the late 1960s and early 1970s) the principal technique for preventing corrosion and cross-contamination during the drilling and production processes was to insulate the well casing from the surrounding terrain with a layer of cement The cement is not poured directly into the cavity from the top, because gravity alone would not cause the void to be filled It is pushed down the central bore of the casing and forced up from the bottom under pressure to fill the gap between the casing and the vertical hole that has been drilled This does not sound too difficult, but if the well has to be driven to a depth of 300 metres, in sections, it is not hard to imagine that this process requires specialist equipment as well as expertise and perseverance [117]

The presence of water of high salinity in the concession oilfields led to complications that required that in the development of these oil fields the best technical methods be used, but it was alleged that Aminoil did not employ such methods In particular, the Government alleged that

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[116] Recovery techniques improved significantly in the last part of the 20th Century mainly by pressurising the perimeters of the reservoirs with oil or gas to create pools of crude oil that can be extracted more easily than if the crude oil is allowed to settle in isolated pockets as extraction continues

[117] A full set of the Memorials and accompanying expert reports is deposited in the Squire Law Library at Cambridge University The aficionado with the necessary enthusiasm and a great many hours to spare can find a treasure trove of contemporary documentation there

Aminoil failed to use sufficient cement in the casings to complete its wells, contrary to the obligations in Appendix 1 of the 1961 Agreement not to start production until wells were completed in accordance with good oilfield practice The Government also alleged that Aminoil did not take necessary steps to protect the well casings from corrosion and thereby "prevent ingress of water into petroleum-bearing strata" in conformance with industry standards of good oilfield practice prevailing at the time as required under the 1973 Agreement

Aminoil of course disputed the Government's allegations suggesting that, as a matter of its own self-interest, it would never have allowed the kind of poor practices alleged Aminoil also presented experts who contested the Government's allegations and insisted that Aminoil complied with the best known practices in the then state of the art There was no express obligation in the Concession as to the level of capital expenditure required by Aminoil, these decisions were left to Aminoil's business and technical judgment It denied the suggestion that it stinted on capital expenditures, and claimed that any leaks were within the normal course of drilling operations and were dealt with by a repair work programme Any ingress of water that occurred was relatively insignificant and did not cause any loss of oil, nor was damage to the freshwater reservoirs established It was important to resolving the disputed factual allegations that Kuwait had never, orally or in writing, accused Aminoil of any deficiencies in its oil well practice or installations during its term in Kuwait although Government technical staff met an Aminoil representative on a weekly basis Article 11 of the 1948 Concession gave the Shaikh the right to terminate the concession for failure to attain acceptable standards of good oilfield practice but this right had never been alluded to, let alone invoked On the other hand the Government insisted that Aminoil's poor oilfield practices were one of the matters that led to confrontation and ultimately, Decree Law No 124, but the full extent of Aminoil's neglect and its consequences was not known to it until after the Government had taken over the oil wells in 1977

Although the Government's case concerning Aminoil's management of the oilfield was supported by significant circumstantial evidence, the expert evidence presented from each side did not lead to a clear conclusion one way or the other It was therefore hard for Kuwait to satisfy the burden of proof rightly required by the Tribunal to demonstrate that Aminoil had been in breach of its contractual obligation to make the investment that was needed to comply with the requirements of good oilfield practice It was thus not a surprise to the Government's team that the Tribunal rejected Kuwait's oilfield practice claim in a single, dismissive, paragraph [118] Nevertheless, in the aftermath of the award, there was a widely-held view within Government circles that the overall result of the arbitration must have reflected a certain feeling within the Tribunal that RJ Reynolds' adventure in Kuwait was aimed at extracting the maximum amount of money from the country without investing more than the minimum amount of capital to keep the operations running profitably The Tribunal might have been even more sympathetic to Kuwait if it had known that, a mere two years after the award was issued, RJ Reynolds would apparently be able to sell Aminoil for US$1 7 billion The extent to which this price may or may not have been influenced by a substantial pile of cash and cash-related investments accumulated overseas during its control of the oilfields in Kuwait's sector of the Divided Zone is still not in the public domain What was before the Tribunal, however, was a memorandum from an Aminoil executive dated 7 December 1971[119] that recorded

> another factor to be considered from Aminoil's viewpoint is that until we have finalised our Concession Agreement with the Kuwait Government, no significant investments which can be avoided should be made I am sure you appreciate that *in light of the touchy nature of the subject, we need to be quite careful about what ends up in writing to JO* [Joint Operations – a committee composed of Government and Aminoil representatives] *as we do not want Getty* [the concessionaire operating in the Saudi sector of the Divided Zone] *or the Kuwait Government to have correspondence indicating that we are not trying to maximise production* [120]

No reasonable independent observer would contend that this statement was a conclusive "smoking gun", because it contains an important qualification But it would not be surprising if the Tribunal entered into its quite long period of deliberations with a sense that the Government had legitimate grievances about the manner in which a part of Kuwait's sole valuable resource had been exploited by a foreign concessionaire, the more so because the concession holder was no longer owned by a consortium of dedicated oil companies It had by acquisition become the wholly-owned subsidiary of a multinational tobacco-led conglomerate

[118] *Aminoil* 600 para 136
[119] *i e* not long after RJ Reynolds purchased Aminoil from its founders
[120] Emphasis added

whose interest in Kuwait was apparently as a short-term investor rather than as a long-term partner of the State sharing the same ultimate objectives Whether or not the Kuwait Government, as then constituted, would have granted a sixty year oil concession to a tobacco company in 1948 is a matter of speculation But it seems unlikely that it would do so in the 21st Century

Conclusion

The stabilisation clauses and the gold clause were contractual techniques designed to achieve the counter-balance between stability and changed circumstances that each of the two parties sought as part of their long-term relationship The several agreed revisions to the 1948 Concession Agreement pursuant to the renegotiation/adaptation provision, and its subsequent cancellation, demonstrated the need for the relationship to evolve The Tribunal rightly applied public international law principles (which form part of Kuwait law) to these issues The Government's claim in respect of failure to observe good oilfield practice also illustrates that a concession or exclusive licence entails for investors both rights obligations and may result in claims that originate in private contract law

In one sense it is possible to view the *Aminoil* case as an "investment arbitration from yesteryear The 1948 Concession Agreement provided for down payments to the Shaikh and the payment of royalties, together with obligations relating to sound management and conservation of the country's sole resource – the petroleum based minerals that lay deep underground – all of which required a significant investment of capital into Kuwait

In another sense it was not a classic investment arbitration, as the term is commonly used in the early years of the 21st Century, because it did not take place pursuant to a treaty between states, nor did it take place under the ICSID Additional Facility It was an entirely *ad hoc* process, in which the "fountain" of the Tribunal's jurisdiction was a specially negotiated *compromis* (or *compromiso*) entered into between the Government and Aminoil after Decree Law No 124 had been brought into effect and after the dispute had arisen Thus, the arbitration itself was more a creature of private rather that public international law

The authors of this commentary (one by recollection, the other by research) have not encountered, either in its internal records or in the subsequent published materials, any description of the Aminoil arbitration as an "investment arbitration". Yet the scheme of proprietary rights conferred on the concessionaire, granted in exchange for a series of obligations to invest money to construct and maintain the facilities needed to produce, export and process crude oil, includes all the essential characteristics of modern investor/host state arbitrations. The fact that the eventual "investor protection" process was designed and implemented by means of private law arrangements, rather than through a public international law process, is of little practical significance. The Tribunal chose to apply Kuwait law to the substantive issues, but in doing so relied heavily on public international law principles as it was common ground that public international law was incorporated into Kuwait law.

What does this prove? Perhaps nothing more than that the changing jargon used by lawyers – particularly highly specialised lawyers – is a bit like putting new wine into old bottles, or at least putting new labels on the bottles. Maybe it is just another example of "changing circumstances".