SAPPHIRE INTERNATIONAL PETROLEUMS LTD. v. NATIONAL IRANIAN OIL COMPANY.

Arbitral Award. March 15, 1963. (Cavin, Sole Arbitrator.)

THE FACTS.—The following statement of the facts is taken from the arbitral award:

"1. On June 16, 1958, the National Iranian Oil Co., Ltd. (hereinafter called 'NIOC') and Sapphire Petroleums Ltd. (hereinafter called 'Sapphire'), a company registered in the province of Ontario, Canada, made an agreement in Teheran. The agreement was signed by the Chairman of the Board of Directors of NIOC, Mr. Entezam, and by the Vice-President and Attorney-in-fact of Sapphire, Mr. Spiegelmann. Before concluding this agreement, Sapphire had completed a detailed questionnaire concerning their technical and financial capabilities, their capital structure and their organization, in accordance with the Iranian Petroleum Law of July 31, 1957. Their qualifications had been considered sufficient by NIOC, as Mr. Entezam himself confirmed in his letter of February 8, 1958.

"2. The preamble to the agreement sets out that NIOC (described in the agreement as the 'first party') wish to expand the production and exportation of Iranian Oil and thus to increase the resources of Iran. For their part Sapphire (described in the agreement as the 'second party') are regarded as having the technical competence, the financial ability and the organization necessary for the accomplishment of the operations laid down in the contract. In addition, the parties agree to carry out the agreement in a spirit of good faith and reciprocal good will.

[...]

THE LAW

[...]

[...]
"C. The Merits"

"1. The validity of the contract of June 16, 1958, is not in dispute. The dispute between the parties concerns solely the Interpretation and performance of this contract.

"The arbitrator is satisfied that the plaintiff, Sapphire International, fulfilled its obligations under the contract regarding the prospecting works at least until February 1960. A preliminary field reconnaissance made by an English company, followed in January 1959 by a radio-gravimetric survey entrusted to a Canadian company, and then a general geological survey by the French Petroleum Institute took place well before the expiry of the time-limit of six months from the effective date which was laid down by Article 16 of the agreement. In January 1960, the team of technicians whom it had been decided to send at the meeting of the Board of Directors of IRCAN on the previous November 24, were on the site. Despite unfavourable climatic conditions, the gravimetric programme had been carried out on time and the plaintiffs were in the middle of organizing the seismic research and the preliminary arrangements for drilling.

"In addition, in December 1958, Sapphire International had opened an administrative office in Teheran.

"2. According to Article 10 of the agreement, during the period of prospecting Sapphire were to be responsible, through the agency of IRCAN, for 'the full exclusive and effective management and control' of operations. However, this clause is subject to Article 12, which binds Sapphire in particular:

(a) To prepare the plan of operations in consultation with NIOC;

(b) To submit to NIOC detailed reports on the progress of the work.

NIOC claimed that these clauses should be interpreted so that Sapphire were bound to obtain their consent for every operation, and that they would be free to grant or refuse their consent. Failing such consent, NIOC would be entitled to refuse to take into consideration the expenses incurred.

This allegation is clearly contrary to the letter and the spirit of the above-mentioned clauses.

"Article 10, paragraph 5, of the agreement lays down the principle that it is Sapphire, acting through IRCAN, who is responsible for the 'effective, complete and absolute' organization and control of the prospecting operations. The reference to Article 12 contained in Article 10 cannot reasonably be understood to deprive Article 10, paragraph 5, of its substance, which would have been the case if every operation had to be preceded by NIOC's consent, as the latter submitted. Furthermore, the word 'consultation' could not by itself and independent of its context authorize such a conclusion all it implied was a duty to inform and an obligation to seek the views of the partner, but not an obligation to obtain his consent.

"The defendant's interpretation is also contrary to the general character of the contract: since Sapphire were responsible for all the prospecting operations at their own expense and risk, it naturally follows that they should have exclusive control in the same way that they had complete responsibility. The reference to Article 12 cannot then have the effect of depriving Sapphire of the complete and effective management of the prospecting work, which they are recognized as having in the clearest possible way by Article 10 and which is perfectly natural as a result of the exclusive responsibility which they have undertaken.

"The only obligation falling upon Sapphire under Article 12, paragraph 1 (b), was, therefore, to inform NIOC of their activity and to see what their views were, without however being bound by them.

"3. The following recital of the facts shows that the plaintiff fulfilled this obligation.

"By the letter of November 10, 1958, they told NIOC about the start of their work. The preliminary surveys of the site entrusted to Hunting Technical Services Limited had been undertaken after consultation with NIOC and to a certain extent with their assistance. Again, in November 1958, consultation took place concerning the gravimetric research. By letter of November 22, 1958, Mr. Duxbury gave NIOC a detailed account of the state of the work and projects of the plaintiff. On December 24, 1958, Mr. Rafii, the plaintiff's field manager, again made a report on the operations in progress. He told them of the impending return to Teheran of Mr. Johnson, who would be available to go through the technical programme with NIOC. The defendant had been immediately told of the departure of the gravimetric expedition for Bandar Abbas on
January 6, 1959. On February 8 and 14, 1959, the plaintiff informed NIOC of the arrival of some geologists who were to contact the technical services of the defendant: these technicians consulted NIOC before leaving for the field. On February 14, at a meeting of the Board of Directors of IRCAN, Mr. Duxbury presented a report on all operations started or planned. On February 25, Sapphire International submitted their research programme to NIOC. On March 10, they sent the report of Hunting Technical Services Limited. On March 19, a detailed report was again sent and it was pointed out that the plaintiff would appreciate any suggestions that NIOC might make. A new report was again sent on March 31. On May 12, two reports on the expenses audited by an accountant, were sent to NIOC.

"It cannot therefore be seriously disputed that, since the beginning of operations and before the formation and setting up of IRCAN, the plaintiff had clearly fulfilled its obligation to consult NIOC, who were regularly and scrupulously kept up to date about any operations planned or already underway, and who had every opportunity for forming their views.

"But, from the end of 1958, NIOC started claiming, first impliedly in a letter of December 31 and then expressly in a letter of March 5, 1959, that their co-operation and in particular the reduction of the letter of credit depended on their prior consent to every operation. They pointed out that any work which had not had this consent would not be taken into consideration. This claim was clearly contrary to the Spirit and the letter of the agreement.

"So far as concerns the complaint of not having consulted NIOC, particularly regarding the work entrusted to Hunting Technical Services Corporation, the gravimetric exploration and the geological survey by the French Petroleum Institute, a complaint which was contained amongst others in the letter of March 5, 1959, there is no doubt that it is contrary to the facts.

"4. The letter of March 5 also reproaches Sapphire International for not having submitted their plan of operations to the Board of Directors of IRCAN. These complaints are to be taken up again and amplified by the NIOC representatives an the Board of Directors of IRCAN on May 12, 1959.

"According to Article 5 of the agreement, Sapphire acts through the agency of IRCAN. It seems from this clause that the Plans should have been drawn up by IRCAN and first of all approved by the Board of Directors of this Company, on which Sapphire International and NIOC were equally represented. Undoubtedly Article 11 of the agreement allows Sapphire to conclude contracts with sub-contractors directly, and by virtue of Article 30 of the agreement they could incur expenses for the prospecting work directly without going through IRCAN. But this is dealing with performance. According to the contract, decisions of principle, particularly those concerning plans, should be taken through the agency of IRCAN, and this meant their adoption by the Board of Directors of that company.

"However, the complaints contained in the letter of March 5, 1959, are equally without foundation. IRCAN was not formed until February 5, 1959, and there is no evidence to suggest that the delay in forming this company was due to the plaintiff. The prospecting campaign for 1958-59 had been prepared and started well before the formation of IRCAN. All the same, at the meeting of the Board of Directors of IRCAN of February 14, 1959, before the registration of the company, the members of the Board agreed on what reports to submit to the Board, if one can judge from the minutes of the meeting.

"5. These unjustified complaints, together with the excessive allegations and very premature reproaches about the management of IRCAN contained in the letter of March 5, 1959 as well as the extremely disagreeable tone of this letter and the threat to withhold recognition of the expenses, are incompatible with a spirit of 'good will', by which the parties were supposed to be actuated according to their agreement.

"While the plaintiff had all along faithfully carried out its obligations, the defendant made baseless complaints and appeared to be committed to an entirely negative attitude.

"Therefore the defendant is undeniably to blame for the crisis in the relations between the parties from that time on, a crisis which could not be averted despite the attempts made by Mr. Spiegelmann in Teheran at the beginning of April 1959. This crisis reached its culmination when an June 20, 1959, NIOC wrote refusing to reduce the amount of the letter
of guarantee. Undoubtedly one of their reasons for doing this, namely the lack of detail in the Statements of expense, was relevant. But, when they were invited by Mr. Rafii to clarify their requests on this point, NIOC never replied.

"6. It must, however, be stated that at this period neither party used the complaints formulated by each of them as a pretext for rescinding the contract. NIOC were content with a negative attitude. The plaintiff, on the other hand, continued to carry out its prospecting programme and insisted on keeping NIOC informed of its operations.

"The facts recited above are not therefore directly relevant to the question at issue. They must, however, be set out and qualified since they are significant when it comes to speaking about the effect of the following facts.

"7. After Sapphire International's appeal to the Shah and Mr. Entezam in July 1959 an effort was made to patch things up, and it seemed to succeed. At the unofficial meeting of the Board of Directors of IRCAN on November 24, 1959, an agreement was reached which provided: 1 (a) that Sapphire International should submit to the President of the Board of Directors of IRCAN all the details of the accounts already presented; (b) that within 60 days there should be another meeting of the Board of Directors of IRCAN at which Mr. Spiegelmann should submit the programme of future operations and an estimated budget of expenses; (c) that Sapphire International should immediately send technicians into the field to start an analysis of the terrain. It was stated that a report on the operations already undertaken had been submitted for the approval of the Board of Directors of IRCAN and for examination by NIOC. The radio-gravimetric report and that of the French Petroleum Institute had been forwarded to NIOC.

"By the letter of November 24, 1959, Sapphire International informed IRCAN that the detailed accounts were available for the Directors of IRCAN at the office of the company. NIOC had them examined by one of their accountants, Mr. Shahsavary.

"Mr. Rafii informed NIOC by a letter of January 27, 1960, that a team of technicians, who had arrived in Teheran on January 16, had arrived in the field on January 20, but NIOC made it known by their letter of February 4, 1960, that, since they had not been consulted on the drawing up of the programme of operations, they refused to take into consideration the expenses thus incurred, as those 'of the previous operations which have been made without consultation with the NIOC'. Although Sapphire International in a letter of the same day referred to the agreement of November 24, in particular submitting that the task of the technicians was to prepare a drilling programme which should be submitted to NIOC once it had been drawn up, the defendant continued in its attitude. In addition, they waited until the following April 16 before replying to the letter of February 4. Meanwhile, nothing had come of a personal intervention in Teheran undertaken by Mr. Spiegelmann.

"This behaviour of the defendant is in flagrant breach of the contract between the parties as well as of the agreement made on November 24, 1959. It was just as ill-considered for NIOC to maintain that they had not been consulted on the despatch of the technicians, since it was precisely because of the agreement of November 24 that Sapphire International were bound to send technicians into the prospecting area in order to collect all the information needed for continuing operations. It is in fact true, as Sapphire International maintained in their letters of December 2, 1959, and January 27, 1960, that the despatch of this team amounted to performance of the agreement, and the plaintiff informed NIOC of it. Thus, far from having not been consulted on this operation, NIOC had in fact formally agreed to it and might even be said to have required it.

"NIOC's wilful refusal to take into consideration the expenses relating to this operation is incompatible with the clear obligations which they had undertaken.

"Similarly, they were acting contrary to the letter and spirit of the contract and of the agreement of November 24, 1959, by their repeated refusal to take into consideration previous expenses, on the ground, which has already been refuted above, that they had not been consulted. The expenses undertaken by the plaintiff were quite considerable. NIOC had had ample time to check the detailed accounts. They were bound under the contract to reduce the letter of guarantee within the agreed time-limit. It would be conceivable for them to have presented their observations or to have asked for an explanation of some of the figures which had been
worked out. However, the arbitrator cannot accept their rejection of these accounts on the sole ground of an alleged absence of consultation, a ground which is so patently untrue. In the same way they were deliberately breaking their obligation, which was long over-due, to reduce the letter of guarantee, and they did so despite their undertakings and despite the repeated requests of their partner.

"The only part of the agreement of November 24, 1959, which had not then been carried out is the meeting within 60 days of the Board of Directors of IRCAN, at which the plans and the budgets relating to the prospecting and drilling should have been presented. But NIOC did not rely on this delay in any of its correspondence. Besides, it was the duty of the President of this Board, who was a representative of NIOC, to call the meeting. Finally, it seems highly likely that the plans could only be put into operation on the basis of the survey which the team of technicians were carrying out in the field.

"It is equally convenient to mention the time which NIOC took to reply to the last letter of their partner: it was not until April 16 that they answered Sapphire International's letter, which had been sent to them on the same day that the latter had received NIOC's letter of February 4. Such negligence was not called for in view of the rapid and important decisions which the plaintiff had to take.

"Thus what had already happened in the spring of 1959 was happening again: while Sapphire International faithfully carried out its obligations, the defendant deliberately broke its own, by hiding behind reasons which it must have known were without validity, and was once again taking up a wholly negative attitude and failing to perform duties which were clearly defined in the agreement of the parties. Such an attitude is a further breach of the obligations undertaken by NIOC, since the parties had expressly agreed to carry out their contract according to the rules of good faith and in a spirit of good will.

"The arbitrator therefore finds that it has been duly established that the defendant deliberately refused to carry out certain of its obligations and that this failure is a breach of contract.

"Moreover, it is a fundamental principle of law, which is constantly being proclaimed by international courts, that contractual undertakings must be respected. The rule pacta sunt servanda is the basis of every contractual relationship. Moreover, it is contained in the laws of both parties to the dispute, in Article 219 of the Iranian Civil Code as well as in Canadian law.

"8. It remains to examine whether, as is submitted by the plaintiff, this breach of certain of its obligations by NIOC resulted in the plaintiff being released from its own obligations as well as giving rise to damages, as is claimed by Sapphire International.

"There is a general rule of private law to be found in positive systems of law, which says that a failure by one party to a synallagmatic contract to perform its obligations in breach of contract releases the other party from its obligations and gives rise to a right to pecuniary compensation in the form of damages. Although the methods of applying this principle differ, particularly with regard to judicial techniques and the formalities required for the implementing of this right, this rule is a general rule, and constitutes a general principle of law recognized by civilized nations.

"It is a rule to be found in Continental law. It is contained in Article 1184 of the French Civil Code, according to which 'in every synallagmatic contract there is an implied term releasing one party from the contract in the event of the other failing to satisfy his obligations' (translation). In such a case the partner has the choice 'of compelling the other (party) to perform the agreement when this is possible, or of demanding release from the contract with damages' (translation). According to the cases, which are supported by doctrine, it is the judge's task to consider whether in all the circumstances the failure to perform is sufficiently serious for him to allow the other party to be released. A deliberate failure to perform, made with full knowledge of the facts, is sufficient justification for release even if no damage can be shown, and the debtor in default cannot submit that the breach could quite easily have been remedied. (Cf. Esmein, in Le Traité pratique de droit civil français, by Planiol and Ripert, vol. VI, Obligations, 2nd ed. (Paris, 1952), Nos. 430, 431, and the case law there cited.) This rule is the same in German law. By virtue of paragraph 326 of the German Civil Code, the failure by one party to perform its obligations allows the other party to stop performance and to demand full damages (cf. Lehmann, in Lehrbuch des Bürgerlichen Rechts, of Enneccerus, Kip and Wolff, vol. 2, 14th ed. (Tübingen, 1954), pp. 213 et seq.). It is unnecessary to go on giving examples, since nearly all Continental legislation in this field has been inspired by French or German law."
"As far as Anglo-Saxon law is concerned, it is admitted that there is a breach of contract whenever it is impossible to put forward any valid excuse for the failure to perform one or several contractual obligations. According to the Common Law, the breach of contract by one of the parties releases the other from the performance of its obligations provided the respective obligations of the parties constitute 'mutually conditional promises'. Moreover, the synallagmatic character of the contract is presumed in bilateral contracts. An anticipatory breach of contract is sufficient if the attitude of one partner gives the other sufficient reason for considering that the first will not carry out his obligations: the second party is then released from performance. A party who is released from performance as a result of the breach of contract by his partner is entitled under the common law to damages, whose effect is to put the injured party in the same position that he would have been in if the contract had been carried out in the manner provided for by the parties at the time of its conclusion (cf. Stephen's Commentaries on the Laws of England, vol. III by Cheshire, Allen & Fifoot, translated by Mitchell (Paris, 1931), pp. 208 et seq.; Williston, Contracts, revised ed., section 1288, and 3rd ed., section 699; Restatement of the Law of Contracts, published by the American Law Institute, sections 314, 315; Arminjon, Nolde and Wolff, Traité de droit comparé, vol. III (Paris, 1951), Nos. 827, 828, 830).

"These principles are no more than the expression of a logical requirement, which explains why they are generally recognized. However different the judicial techniques employed may be, however divergent may be the theoretical explanations given by doctrine, one point is certain: this principle is explained by the interdependence of the obligations contained in the same contract. It would be illogical and contrary to the most elementary notions of equity if one party could obtain satisfaction while the other suffered a loss. Whether the notion of the reciprocal effect of obligations, or of the implied condition is relied on, it is impossible to escape the essential and elementary conclusion that one of the parties must not benefit from the performance of the contract by his partner while evading his own obligations. The disregarding of the contractual law by one of the parties releases the other from its undertakings (cf. Josserand, Cours de droit civil Positif français, 2nd ed., vol. II (Paris, 1933), p. 194).

"It is necessary therefore to regard the rules set out above as rules of positive law generally recognized by civilized nations. They are the inescapable and logical consequence of the principle of good faith, to which the parties intended to submit the Performance of their agreement.

"In addition, these rules are well known both in Canadian law, which follows the Common Law, and in Iranian law. Though the Iranian Civil Code does not appear to contain this principle in a general form like French or German law, it does however expressly provide for its application to the main synallagmatic contracts, such as sale, hire, and farming tenancies (Articles 402 et seq., 492 and 534 of the Iranian Civil Code). Such a principle can therefore be regarded as common to the national laws of both parties to the contract.

"The principle set out above cannot be cast aside by reason of the fact that the present contract contains elements which have their origin in administrative law, since it concerns a territorial concession. Rules of public law, which might possibly differ from civil law, could only be taken into consideration if the Iranian State had relied upon its sovereign rights and had taken steps of a public law nature likely to endanger the performance of the contract. This is not the case. All the same, the respect for rights acquired under concessions is only one aspect of the respect for acquired rights, which is undoubtedly one of the general principles of law recognized by international tribunals (cf. McNair, loc. cit., p. 16, and the several decisions of international tribunals cited by him).

"9. The application of the above rules to the present case calls for the following considerations:

"Without doubt NIOC had carried out one of its principal obligations in allowing Sapphire International access to the concession area. But this was not NIOC's only obligation; under the contract they were bound to collaborate closely with their partner and to give Sapphire the benefit of their views, which could be useful in view of their experience and the documentary information at the disposal of this Iranian State organ concerning the exploration of oil resources in the area of the Persian Gulf; they were also bound to start verifying the statements of expense and consequently to reduce the guarantees which had been given within the agreed time-limits.

"These obligations were not without importance for Sapphire International. The material support of NIOC was likely to facilitate their work and to obviate the expense of blind experimentation. The reduction of the letter of credit allowed the
Canadian Company to extricate resources worth a considerable amount.

"In addition, and this is decisive, where a foreign company agreed to take considerable risks it was a necessary condition of their activity that they should receive the proper and close collaboration of the State organ, NIOC. At a time when they were about to undertake extremely expensive drilling operations, it would be unreasonable to require them to take an the risk of considerable investments when the attitude of their partner afforded them reasonable grounds for thinking that the latter would continue to neglect its obligations.

"The dispute between the parties in the spring of 1959 had already given the plaintiff serious and legitimate doubts about NIOC's intention to perform the contract. These doubts can be seen in the letters sent to the Shah and Mr. Entezam. Similarly, the agreement of November 24, 1959, was especially important, since it appeared to have regulated everything and to have cast aside all obstacles to the necessary co-operation of the parties. Therefore, particularly at the beginning of 1960, the Start of the drilling operations necessarily depended upon the loyal performance by NIOC of their contractual obligations and, in particular, the steps agreed upon on November 24, 1959. It is reasonable to consider that the effect which NIOC gave to the agreement of November 24, 1959, was a decisive test for Sapphire International of NIOC's real intention to carry out the agreement. However, far from carrying out the measures which had been agreed in a loyal manner and with good will, NIOC soon took up once more the attitude which in the spring of 1959 had led to the crisis which the agreement of November 24, 1959,

was intended to resolve. By their clearly unjustified grievances and refusal to reduce the guarantee they once more showed, though much more clearly this time, their intention to refuse to collaborate loyally. This behaviour was likely to convince the plaintiff that NIOC intended to avoid the contract by continuous and systematic obstruction, but without wishing to be the first to denounce it. The defendant's behaviour was thus likely to destroy any confidence their partner had in NIOC's actual Intention to carry out the contract. In these circumstances, NIOC Could not reasonably or in good faith require that Sapphire International should still be bound to proceed to prospecting or to undertake the costly operations of drilling in such precarious conditions.

"For these reasons, the arbitrator is of the opinion that the deliberate failure by the defendant to carry out its obligations in breach of contract, having particular regard to the circumstances in which this refusal to perform was made, justifies the plaintiff in not performing the contract. Since the plaintiff was entitled to consider that its partner's attitude meant that it would continue to refuse to perform, the plaintiff was released from further performance.

"10. Undoubtedly, while stopping the prospecting operations Sapphire International failed to inform NIOC expressly that they intended to repudiate the contract. Now there are certain systems of law which require such a declaration to be made immediately, or even lay down that a period of grace must first be fixed (Paragraph 326 of the German Civil Code, Articles 107 to 109 of the Swiss Federal Code of Obligations). But these rules are intended solely to prevent the creditor from putting off his decision and speculating to the detriment of the debtor. Both statute and case law limit the application of them in this sense. However, in the present case, apart from the fact that the plaintiff had several times requested NIOC to release the guarantee, requests which amounted to formal notices to perform or 'mises en demeure', and apart from the fact that the contract contained provisions for this release, NIOC's continued refusal to carry out the contract made any notice to perform superfluous. The failure by the plaintiff to make formal declaration of termination cannot have caused the defendant any damage, nor even have caused it any doubt. There is therefore no need to examine whether such rules, which are peculiar to certain systems of law only - French law ignores them, as do the Anglo-Saxon systems - should in principle be applied. For the defendant to invoke them would be incompatible with the principles of good faith and, for this reason alone, [they] could not possibly be taken into consideration.

"11. The termination of a contract as a result of breaches by the defendant means that the plaintiff has a right to damages, in accordance with the rules enunciated in Paragraph 8 above.

"According to the generally held view, the object of damages is to place the party to whom they are awarded in the same pecuniary position that they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion. They should be the natural consequence of the breach (Articles 1149 and 1150 of the French Civil Code: Esmein-Radouant-Gabolde, op cit., vol. VII, No. 855; Lehmann, loc cit. para. 14, VI, P. 59; for Anglo-Saxon law see
the references in paragraph 8 above). This rule is simply a direct deduction from the principle *pacta sunt servanda*, since its only effect is to substitute a pecuniary obligation for the obligation which was promised but not performed. It is therefore natural that the creditor should thereby be given full compensation. This compensation includes the loss suffered (*damnum emergens*), for example the expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have produced. The award of compensation for the lost profit or the loss of a possible benefit has been frequently allowed by international arbitral tribunals (cf. Hauriou, *Les dommages indirects dans les arbitrages internationaux*, in *Revue générale de droit international public*, vol. 31 (1925), pp. 203 *et seq.*, in particular pp. 211 *et seq.*, and the various precedents cited in this study).

"The claims of the plaintiff will be examined on the basis of this principle.

"12. The first claim of the plaintiff is to order NIOC to refund to Sapphire International the sum of $U.S. 350,000, the amount of the letter of credit cashed by NIOC on January 24, 1961.

"Having been released from their obligations as a result of the failure of their partner to carry out the contract in breach of it Sapphire International were also freed from the obligation imposed by Article 16 of the agreement to start drilling within two years of the effective date. Therefore NIOC cannot claim payment of the penalty laid down by Article 43, para. 2, of the contract in the event of this obligation not being carried out. They must refund this sum with interest at the usual rate of 5 per cent per annum from the date of being enriched, that is from January 24, 1961.

"13. The claim under heading 2 (a) is for the payment of compensation for 'the expenses incurred' in the conclusion of the agreement of June 16, 1958, amounting to $U.S. 165,175.

"This claim cannot be allowed by way of positive damages (*Erfüllungsinteresse*), as is claimed by the plaintiff. Their claim should put Sapphire International in the same pecuniary position as they would have been in if the contract had been performed. But the repayment of the expenses incurred in concluding the contract would tend to put them in the position they would be in if the contract had never been concluded (negative damages). As opposed to the expenses incurred in performing the contract, the expenses of concluding it do not result from the contract, which they have preceded. This is well illustrated by the fact that if at the very last moment the contract had not been concluded or had not been ratified by the Iranian political authorities, the plaintiff would not have been able to put forward any claim under this head. Undoubtedly, the plaintiff was justified in hoping to recover the expenses of making the contract out of the profit which they were expecting. But this is an element included in the compensation for loss of profit.

"Adding positive and negative damages together is a contradiction, and cannot be allowed.

"14. The items 2 (b), (c) and (d) of the claim are for payment of the following compensation:

(b) The registration fees of the Canadian Companies in Teheran amounting to $U.S. 3,500.

(c) The share in the capital of IRCAN subscribed by the plaintiff, amounting to $U.S. 5,000.

(d) The cost of the prospecting work carried out by Sapphire International, amounting to $U.S. 1,018,932.

"These are expenses incurred in performing the contract, in other words the loss sustained by the plaintiff in carrying out the contract. They are entitled to them in principle. They cannot, however, claim them beyond the end of June 1960, the date by which they had clearly given up performing their obligations.

"The arbitrator is quite satisfied from the statement of expenses verified by the Chartered Accountants Abrams, Caplan, Stekel and Zweig of Toronto, and from the certificate signed by these four experts, that up to the end of June 1960 the total amount of these expenses reached $U.S. 651,474.82, including the cost of registering the companies in Teheran. A further sum of $U.S. 5,000 should be added for the share in the capital of IRCAN, whose return to the plaintiff has not been established, whatever this amount should have been. A deduction of $U.S. 5,600 must be made from this total for the sale of installations. The total sum therefore which should be awarded to the plaintiff under this head is $U.S. 650,874.
"15. Under item 2 (e), the plaintiff claims the payment of $U.S. 5,000,000 for 'loss of profit'. Once the principle on which such an award is based is recognized in law, the determination of the amount of compensation becomes a question of fact to be evaluated by the arbitrator.

"(a) Since the question concerns the concession of an area which has not yet been prospected and where therefore the presence of oil-bearing beds in commercially workable quantities was and still is today uncertain, the existence of damage is not without doubt. No one today can affirm that the operation would have been profitable, and no one can deny it. But if the existence of damage is uncertain, it is nevertheless clear that the plaintiff had an opportunity to discover oil, an opportunity which both parties regarded as very favourable. Does the loss of this opportunity give the right to compensation?

"It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviour of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage.

"The French courts have awarded damages for 'loss of opportunity' when the victim had lost the opportunity of making a profit as a result of what someone else had done. Although in such cases the existence of damage is uncertain, case law has looked at the position at the time when the opportunity was lost and has accepted that this opportunity itself has a value whose loss gives rise to compensation. (Cf. Esmein, loc. cit., vol. VI, No. 452, 2; Savatier, Traité de la responsabilité civile en droit français, vol. II, 2nd ed. (Paris, 1951), No. 461; Mazeaud and Tunc, Traité théorique et pratique de la responsabilité civile, 5th ed. (Paris, 1957), No. 219; and the cases cited by these authors. Similarly, an English decision: Chaplin v. Hicks [1911] 2 K.B. 786.) A particularly rich source of information on this subject is the American case law, in which several decisions deal with the determination of compensation for loss of land or unprospected mining or oil concessions. In such cases, there is no need to prove the success of the search; it is sufficient to establish a reasonable probability of success. This fact alone gives the land or the concession a market value, which the courts estimate by considering the following factors: transactions relating to neighbouring territories, the appraisal of experts, and especially geologists, concerning the probability of profit, and the comparison with neighbouring areas. (Cf. Montana Railway v. Warren, U.S. Supreme Court, 1890; Philpott v. United States 243 F.2d. 1, 9th Circuit, 1957; Eagle Lake Improvement v. United States, 141 F.2d 562, 5th Circuit, 1944).

"(b) In the present case the plaintiff has put in evidence an expert report by G. Meyer, a geologist from Dallas in the state of Texas, who is a specialist in the prospecting and appraisal of oil-bearing concessions. Mr. Meyer was also heard by the arbitrator.

"It emerges from his report, which is summarized in the part of the judgment headed 'Facts', and from his verbal explanations that it is highly likely that the geological characteristics common to every oil-bearing territory are to be found in the territory granted to Sapphire under the concession, which is situated in a region very rich in oil. The geological conditions of this territory make it possible to affirm that there is a very strong chance, but not a certainty, that deposits of commercially workable oil exist in the concession area. The expert supported his evidence by reference to similar conclusions formulated by other geologists and other oil companies (in particular: Stahmer, in World Petroleum, June 23, 1952; Fohs, in Bulletin of American Association of Petroleum Geologists, 31 (1947), II, p. 137; an unpublished report of NIOC entitled 'Geology of districts', III and IV, documents which were put in evidence before the arbitrator).

Finally, the expert mentioned that the surveys which Sapphire International had started were likely to confirm these conclusions.

"Undoubtedly, as the expert Meyer has also stressed, such an appraisal is not free from uncertainty. But it is difficult to see what other proof could reasonably have been required of the plaintiff.

"Another factor to be considered is that NIOC, who certainly have an extensive documentation available and possess great experience, would not have made a concession of an area where they did not think that there was a serious chance of discovering oil. It is reasonable to suppose that they would not have required a minimum investment of $U.S. 8,000,000 from a company if they did not think that these investments had a serious possibility of being turned to a profit,
of which they and the Iranian Government would take the largest share.

"Moreover, in the arbitrator's judgement the plaintiff has satisfied the legal requirement of proof by showing a sufficient probability of the success of the prospecting undertaken, if they had been able to carry it through to a finish. The plaintiff can therefore claim compensation for 'loss of profit'.

"(c) So far as the amount of this compensation is concerned, it cannot be established exactly. It is the arbitrator's task to decide it ex aequo et bono by considering all the circumstances.

"While he refuses to give anything more than a rough estimate, which shows the simple order of magnitude, the expert Meyer considers that the maximum workable reserve would be 25,000,000 cubic metres, which means that, if everything goes as well as possible for the plaintiff, they would receive a net income of $U.S. 46,000,000. On the other hand, in case of failure, the minimum loss Sapphire would suffer would be the investment of $U.S. 8,000,000 which they had undertaken in the contract, and to this should be added certain expenses of the company in addition to the investments provided for in the contract.

"All the same, however useful they may be, the preceding appraisals do not take into account all the risks inherent in an operation in a desolate region, to which it is difficult to gain access and which has an unfavourable climate, nor the troubles-such as wars, disturbances, economic crises or slumps in prices-which could affect the operation during the several decades - 25 years at least under the contract - during which the agreement was to last. Another plausible consideration is that, now that they are released from the present contract, the plaintiff company can employ its resources, its organization and its strength in other profitable activities which it could probably not have kept an hand at the same time as the prospecting and exploration of the concession areas, which required investments and important personal obligations.

"Finally, the judge is given a wide discretion when he has to decide ex aequo et bono the compensation for damage whose extent and existence are not certain even though a sufficient probability has been established, and when his assessment rests upon conjecture.

"Therefore, in the arbitrator's judgement it is reasonable and equitable to fix the amount of compensation for loss of profit at $U.S. 2,000,000.

"16. The total amount of compensation for the expenses incurred and for the loss of profit which the plaintiff claims under heading 2 of their claims should therefore be fixed, according to the assessment of the arbitrator, at U.S. Dollars 2,650,874.

"This compensation has fallen due and immediate payment of it should be made by the defendant. It carries interest at the usual rate of 5 per cent. per annum from the date of the first step taken in arbitration procedure, that is from September 28, 1960, the date when NIOC were asked to choose their arbitrator.

[...]

¹M. Pierre Cavin, Federal Judge, Lausanne, Switzerland.
¹See The Facts at pp. 156-157 above.

Referring Principles:

IV.1.2 - Sanctity of contracts

VII.1 - Damages in case of non-performance