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ARBITRATION TRIBUNAL: AWARD IN THE MATTER OF AN ARBITRATION BETWEEN KUWAIT AND THE AMERICAN INDEPENDENT OIL COMPANY (AMINOIL)

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THE ARBITRATION TRIBUNAL

IN THE MATTER OF AN ARBITRATION between THE GOVERNMENT OF THE STATE OF KUWAIT and THE AMERICAN INDEPENDENT OIL COMPANY (AMINOIL)

Before:
Professor Paul Reuter (President)
Professor Hamed Sultan
Sir Gerald Fitzmaurice, Q.C.

FINAL AWARD

[...]

SECTION II

Statement of the Facts

(xx) Aminoil is an American Company incorporated in 1947 in the State of Delaware with the object of exploring for, producing, refining and selling petroleum, natural gas and other hydrocarbons. At that time it was controlled by a group of other American oil Companies.

(xxi) After having, on 26 June, 1948, obtained the agrément of the Government of the United Kingdom, which was then in special relations with the State of Kuwait, Aminoil was, on 28 June, granted a Concession by its Ruler for the exploration and exploitation of petroleum and natural gas in what was then called the Kuwait “Neutral Zone”. The location of the frontier between Kuwait and Saudi Arabia in this region was uncertain, and the British authorities, acting in agree-ment with those two countries, had in 1922 established this neutral zone to which both had access.

(xxii) On 7 July, 1965, Kuwait and Saudi Arabia concluded a Treaty by which they shared this zone, henceforth to 990 be
known as the “Divided Zone”. Aminoil’s Concession was situated in the Kuwait part of the Divided Zone, while Saudi Arabia had granted a Concession in its part of the Zone to the Getty Oil Company. The two Companies, in their mutual interest, concluded an agreement on 26 June, 1956, approved by the Governments of these two States, and established a common and coordinated programme of exploitation in the Zone, with a common Authority (a Joint Operations Committee) to supervise their respective field operations.

(xxiii) In 1961 the special relationship between Kuwait and the United Kingdom came to an end, and on 11 November, 1962 the Constitution of Kuwait was promulgated.

(xxiv) The principal clauses of Aminoil’s 1948 Concession relevant to the present dispute were as follows:

By Article 1 it was provided that

“The period of this Agreement shall be sixty (60) years from the date of signature”.

Article 2(C) provided that

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

Article 3 provided for the immediate payment to the Ruler of a sum of 625,000 dollars, followed after thirty days by a sum of 7.25 million dollars, and subsequently by an annual royalty of 2,50 dollars for every ton of Aminoil’s petroleum won and saved (as defined by the Concession Agreement) subject to a minimum annual royalty of 625,000 dollars. There were also other payments clauses that need not be detailed here.

Article 3(h) - the “Gold Clause” - 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”.

By Article 11 it was provided that the Ruler would have the right to put an end to the Concession before the expiry of the convenanted term of 60 years in any of three specified cases, viz. (a) failure by the Company to perform its obligations under Article 2 (vide supra) “in respect of geological or geophysical exploration or drilling”; (b) failure by the Company to make any of the payments due under Article 3; and (c) “if the Company shall be in default under the arbitration provisions of Article 18” (vide infra).

By Article 13 it was provided that, at the end of the Concession,

“... all the movable and immovable property of the Company in the State of Kuwait and said Neutral Zone shall be handed over to the Shaikh free of cost. Producing wells or borings at the time of such expiry shall be handed over in reasonably good order and repair”.

Article 17 provided that

“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”.

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Finally, Article 18 contained provisions for the reference to arbitration of “any difference or dispute . . . between the Parties . . . concerning the interpretation or execution hereof, or anything herein contained or in connection herewith, or the rights or liabilities of either Party hereunder”.

(xxv) Two other oil Companies were operating in Kuwait at about this time. Much the most important one, the Kuwait Oil Company (KOC), was jointly owned by the British Petroleum Company (BP) and the Gulf Oil Corporation (Gulf), and had had a Concession since 1934. The other, Arabian Oil Company (AOC), was Japanese owned, and in 1958 obtained a Concession relating to the Continental Shelf of the Divided Zone, outside a six-mile territorial sea belt and exclusive of certain islands.

(xxvi) From information given by the Government of Kuwait (GM p. 31), it appears that Aminoil's share of the State's total crude oil production was always proportionally slight, amounting for instance, even as late as 1972, to only some 2.5% of total Kuwait output. Its undertaking was, from the start, carried on under special difficulties of extraction and refining, due inter alia to the nature of the ground and the chemical composition of the oil taken from it. It was what is called a “high cost, low yield” enterprise - see paragraph (xxxv) below.

(xxvii) Aminoil's commercial production and exportation of petroleum products began in 1954, and in 1958 its refinery was opened at Mina Abdullah.

(xxviii) As mentioned earlier, an Agreement dated 19 June, 1961 between the Ruler of Kuwait and the Government of the United Kingdom put an end to the special relationship between the two countries and Kuwait became fully independent.

(xxix) Already during the preceding months, the Government of Kuwait and Aminoil had entered into negotiations for the revision of the 1948 Concession, which led to the signature on 29 July, 1961 of a Supplemental Agreement.

(xxx) By Article 11, this Supplemental Agreement, was to be “construed as an amendment and supplement to the Principal Agreement” [the 1948 Concession], and “all the provisions of the Principal Agreement shall continue in full force and effect except in so far as they are inconsistent with or modified by this [Supplemental] Agreement”.

(xxxi) One of the main objects of the Supplemental Agreement was to modify the financial clauses of the 1948 Concession, resulting in increased payments to the Ruler. In addition, it subjected the Company to Kuwait Income Tax law, the details being embodied in a separate “Submission to Tax Agreement”, also dated 29 July 1961. By this, Aminoil was made liable to a levy of 50% as from 1955, and of 57% as from 1961. To this was added by Article 3 of the Supplemental Agreement, a “make-up” payment equal to the excess, if any, of “the greater of . . . 50% of the Oil Profit or . . . 57% of the Oil Income” over “the aggregate of” the royalty and income-tax payments due under the Agreement.

(xxxii) Under Article 4, the Company had the obligation both to “establish and announce”, or procure the establishment and announcing, of “its posted prices”.

Article 6 (2) provided that

992 “No moneys paid by the Company to the Ruler under this Agreement shall, except in the case of an error in accounting, be returnable in any circumstance whatever”.

(xxxiii) By Article 7 (g) a new Article 11 was substituted for the existing Article 11 of the 1948 Concession - see supra - which was deleted. The new Article 11 (paragraph (A)) gave the Ruler the right to terminate the Concession in the event of a default by the Company in its payments, and then continued as follows:

“(B) Save as aforesaid this Agreement shall not be terminated before the expiration of the period specified in article 1 hereof except by surrender as provided in article 12 or if the Company shall be in default under the arbitration provisions of article 18.(C) In any of the above mentioned cases the Ruler shall be entitled to terminate this Agreement without prejudice to any antecedent rights hereunder and the Company shall at that time transfer to the Ruler all its movable and immovable property within the State of Kuwait and the Concession Area to the extent that such property is directly employed in operations hereunder together with all such rights as it may have to the use of property so employed so far as such rights are transferable to whomsoever belonging, which are at that time enjoyed by it provided that the Ruler assumes from the date of transfer all the obligations devolving upon the Company in respect of its enjoyment of the said rights”. 
(xxxiv) Finally a provision was incorporated as Article 9, reading as follows:

“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”

( xxxv) A third understanding was reached, equally dated 29 July, 1961, in the shape of a “Confidential Letter”, containing details and arrangements for taking account of the special conditions of Aminoil's undertaking. These were indeed technically complex. The crude oil was not of good quality; it was a low gravity oil, with high sulphur-hydrogen-sulphide, water and salt content, requiring expensive processing and refining, before marketing.

The great number of wells, requiring extensive gathering facilities, was also one of the factors of high cost. The marketing of such a crude oil and its product was difficult.

( xxxvi) With reference to Article 9 (supra) of the Supplemental Agreement, it was provided by paragraph 9 of the Confidential Letter, as being understood, that “the word ‘benefits’ includes arrangements not involving payments”.

( xxxvii) On 11 November, 1962, as mentioned earlier, a Constitution was promulgated by the Ruler of Kuwait. Its Article 18 provided:

“Private ownership is safeguarded. No person shall be prevented from disposing of his property save within the limits of the Law; and no person shall suffer expropriation save for the public benefit in the cases determined and in the manner prescribed by Law provided that he be equitably compensated therefor.”

By Article 21 of the Constitution:

“All of the natural wealth and resources are the property of the State.”

Finally by Article 152:

“Any concession for the exploitation of a natural resource or of a public utility shall be granted only by Law and for a determinate period.”

( xxxviii) Owing to the conditions of the petroleum market, the end of the 1960s was a difficult period for Aminoil which suffered financial losses and saw its production go down. In 1970 its shares were wholly bought by R. J. Reynolds Industries Inc..

( xxxix) In the course of the sixties, negotiations had taken place between the Government and Aminoil concerning the financial aspects of the undertaking, particularly with respect to the expensing of royalties, i.e. the charging of royalty payments as a cost against the Company's income rather than as a credit against income tax obligations (resulting in greater tax obligations for the Company). A draft agreement was prepared in 1968 but was never signed.

( xli) In February 1971, an agreement known as the Teheran Agreement was concluded between some of the Gulf States and a number of the major oil Companies. Its object was to apply various resolutions of OPEC, and in respect of the period 1971 to 1975 it provided for an increase in posted prices and an increase in the level of tax payments to 55%, the Companies receiving in exchange certain guarantees as to stabilization, particularly in the matter of governmental participation in their undertakings.

(xlii) However, in view of the weakness of the dollar, a new agreement was concluded in January 1972 (the Geneva I
Agreement). It provided for an increase of 8.49% in posted prices and made further adjustments in oil revenues based on an index for measuring changes between the exchange rate of the dollar and nine specified currencies. Another agreement of June 1973 (the Geneva II Agreement) added two more currencies to these nine.

(xlii) These Agreements led to new negotiations between the Government and Aminoil, the Government aiming at the application of the (Teheran and Geneva) Agreements, while Aminoil placed the emphasis on the special conditions of its undertaking. In a Memorandum of 24 May, 1971, the Company adumbrated a transformation in its Concession, declaring that:

“Aminoil believes . . . its basic relationship with the Government should change and that under the new relationship Aminoil should become a contractor, with the Government becoming the owner of all the Kuwait assets of the Company”. - (GCM App. VI.3)

(xliii) This idea was not accepted by the Government, and the negotiations continued, ending in 1973 in a projected revision of the concessionary Agreements of 1948 and 1961. This projected revision was embodied in a Draft Agreement dated 16 July, 1973. The Draft Agreement proposed to bring about numerous changes in the relationship between the Parties.

(xliv) As to the financial terms, the principal changes contemplated by the Agreement were:

(1) an increase in the tax rate applicable to the Company’s net income, from 57% to 80%, and
(2) an increase in the rate of computation or “make-up” payments, from 57% to 80%, both as of January 1, 1973;
(3) the expensing of royalties;
(4) acceleration of payment of income tax and “make-up” payments (thereby reducing the ‘lag’ between operations and tax payments from about twelve months to about two and a half months);
(5) application to the Company of the Teheran Agreement, as supplemented by the two Geneva Agreements (Article 2(1)).

(xlv) In a First Annex, various other amendments to the 1961 Agreement were introduced:

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<td>(a) the following paragraph was substituted for Article 2(C) of the Principal Agreement:</td>
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“(C) 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 the 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 fully 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.” |

(b) The above mentioned gold clause (Article 3(h) of 1948 - see paragraph (xxiv) supra) was deleted (Article 7, First Annex, First Part).

(c) The Government undertook to enact a new tax law in Kuwait, which the Company had requested in order to be able to claim double taxation immunity in the United States.

(d) The Draft Agreement also provided that

“Any future discussions between the Government and the Company regarding concession provisions will take into consideration that the Company 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.” 
(First Annex, Second Part, V)

(e) A choice-of-law clause was introduced (First Annex, Second Part, XIII) and a new arbitration clause was inserted (First Annex, Second Part, XIV).

(xlvi) The coming into effect of the Draft Agreement was made subject to its ratification in accordance with the laws of Kuwait (Article 4), that is by the Parliament.

(xlvii) Before the Draft Agreement was ratified, the “October War” broke out in the Middle East (1973). A consequence of it was the decision of OPEC members on October 16 to take into their hands the fixing of posted prices, hitherto decided by the Companies - see Article 4 of the 1961 Agreement, supra. Thus Aminoil, like other Companies, was instructed that posted prices would be raised a first time, as of October 16 and, a second time, as of November 1, 1973, and that further “adjustments” would be notified periodically as required by the Government. It was stated that Companies which would not agree should stop production. Aminoil, like other Companies, complied with these new conditions.

(xlviii) At the same time, the Government began to press the Company for immediate payments under the Draft Agreement of July 1973, that is to say without awaiting its formal execution and ratification by the Kuwait authorities. This, together with modifications to the Draft Agreement, was discussed at meetings between the Parties held in Kuwait between December 10 and 17, 1973 (AR Vol. V, Exh. 9). The Company eventually agreed to comply with the Government's request. Its acceptance was formalized in a crucial letter dated December 22, 1973 addressed by Mr. Ison, Vice President and General Manager for Kuwait Operations of Aminoil, to His Excellency Abdul Rahman Salem el Attiqi, Minister of Finance and Oil of Kuwait, who signed it as being agreed on December 22, 1973.

(xlix) In the first paragraph, the representative of the Company formally “accepted” the 1973 Agreement “as drafted in July of this year”, together with language changes agreed during the December meetings. In addition, the two paragraphs before the last read:

995. “The Company will make payment of obligations arising under the 1973 agreement and the Kuwait (Specified Territory) Income Tax Decree n° es 23 of 1961 with the amendments in the proposed 1974 Income Tax law in the same manner as if the 1973 agreement was effective on the date the Minister of Finance and Oil signs this letter and the proposed 1974 Income Tax law had come into force on that date and will treat all of the terms and provisions of such agreement as being effective on that date. It is our understanding that the 1973 Agreement will be signed as soon as the final documents can be prepared, and that you will then take appropriate steps to obtain due ratification thereof.” (AM Vol. VIII, Exh. 29)

(l) After the signing of this letter, the Company made a payment of approximately $13 million in respect of the retroactive effect of the financial arrangements, and it thereafter effected payments under the new terms contemplated in the July 1973 Agreement. But the proposed 1974 Income Tax Law was never passed, or even presented as a bill to the Parliament. Indeed, the 1973 Agreement was modified three times in the year 1974 at the request of the Government and in a manner that increased significantly the payments due by the Company to the Government. In February of 1974, a “final draft of the 1973 Agreement” was prepared, incorporating further changes, mainly for the application to the Company of future changes in the Teheran and Geneva Agreements, both retroactively and for the future (new Article 2(1), see AM Vol. VIII, Exh. 34). On July 16, the Government notified the Company of an increase in the royalty rate from 12 1/2% to 14 1/2% as of 1 July, 1974, (AM Vol. VIII, Exh. 35). On October 7 the Government notified the Company of an increase in the royalty rate to 16.67% as of 1 October, 1974, and an increase of the percentage of the oil profit payable to the Government to 65.75% (AM Vol. VIII, Exh. 36). All this was done by way of unilateral decision by the Government. In fact, the Government was implementing decisions taken by OPEC members (respectively on June 18 and September 13). But it may be recalled here that the official, or “posted”, price of oil was quadrupled during the year 1974, so that although the Company complied with the now more onerous terms imposed by the Government, its profits rose from $3,990 million in 1973 to $24,670 million in 1974 and later $30,637 million in 1975, and to $40,649 million in 1976.

(li) In 1974, the Government acquired a 60% share in KOC and, in conjunction with the Saudi Arabian Government, a 60% interest in the AOC Concession (GM p. 9 et seq.). The following year, the entire KOC Concession was taken over by the Government; agreement was reached as to compensation for its foreign shareholders and a long-term supply agreement was concluded. This left Aminoil as the sole totally private operator in Kuwait.

(lii) In the same period Conservation Regulations were adopted in Kuwait, pursuant to Law n° 19 of 1973 on the
Conservation of Petroleum Resources (GM App. IV.1), and came officially into force in 1976, after a trial period of six months.

(iii) In the fall of 1974, OPEC countries had begun discussing new financial terms to be imposed on the Companies in the form of taxation. In November, three Gulf States, members of OPEC, put up royalty levels to 20%, and tax levels to 85%, on posted prices; and in December 1974 a resolution was formally adopted in Vienna by the other Gulf States, Kuwait amongst them, embodying the same terms which are generally referred to as the “Abu Dhabi Formula”. These terms were enforced against major concessionaires. As between the Government and Aminoil, the question of the application of the “Abu Dhabi Formula” was informally raised in the course of 1975, but no formal request to that effect was made by the Government until October 2 of that year. After informing the Company of a new increase in posted prices, the Government stated:

“We also reconfirm our verbal advice given to you some time ago that effective 1st November 1974, royalty rate is twenty per cent of posted prices and applicable rate for oil income —— is eighty-five percent generally applied since then in Gulf area” (AM Vol. VIII, Exh. 39).

In acknowledging this the Company denied having received advice from the Government “either verbal or written” of the new terms, and indicated that application of such terms would put it at a loss on every barrel produced. The Company then requested a formal discussion of the matter (AM Vol. VIII, Exh. 40).

(iv) There followed a round of negotiations initiated by a letter from the Government to the Company dated January 25, 1976 (AM Vol. VIII, Exh. 41). The avowed purpose of the Government was (i) to devise financial terms as close as possible to those of Abu Dhabi and (ii) to have those terms applied retroactively in order to recoup what it termed “windfall profits”, i.e. profits which were attributable to the “explosion” of oil prices rather than to the concessionaire’s efforts.

(iv) Negotiations took place from February 23 through April of 1976, formal discussions being held, inter alia, on February 23 (Government's minutes of meeting in GM App. VII.2) and 24, March 19 and 29, and April 4 and 5. In the course of these negotiations - more precisely on March 19 - the Company made a written proposal (GM App. VII.1; AR Vol. V. Exh. 12) to the effect that it would accept in principle the Abu Dhabi Formula (subject to particular reference prices) and its application as from October 1, 1975 (the day preceding the Government's formal request). The reference price was to be adjusted so that the Company would have the opportunity of realizing a “reasonable level of earnings” on its Kuwait operations. The Company valued at about $18 million the profit necessary to maintain the required level of capital expenditures (the Government's take being valued at $202.5 million). Oil income rate would in that case be increased from 85% to 90%.

(iv) No agreement was reached on this proposal and there followed a long gap in the negotiations. During that time, the Parties were operating under the terms agreed to in December 1973, as amended in 1974.

(iv) On March 27, 1977, a Committee was appointed by the Government to complete all negotiations of pending matters with the Company within a period of forty-five days. The discussions which followed may be divided into two phases.

(iviii) In the first phase the Company, on 15 April, 1977, submitted a written proposal, essentially updating that of March 19 of the previous year, whereby its profits would amount to $18 to $20 million a year, corresponding to 70 ¢ a barrel (GM App. VII.1). The proposal was discussed formally, first at a meeting held on April 19 (Government's minutes GM App. VII.2; Company's memorandum AR Vol. V, Exh. 18). The Government's position as expressed during the meeting, was that a net return of $4.5 to $6 million would be fair enough to the Company, considering its investment, and that such profit would be achieved by applying a rate of income tax of 97 1/2%. During the following days, meetings took place between the Company and the Government's Technical Affairs Department (T.A.D.), on April 21 (Company's memorandum AR Vol. V, Exh. 19) and 23 (Company's memorandum AR Vol. V, Exh. 20), when the question of capital expenditure was discussed.

(ix) During a second official meeting between the Committee and the Company's representatives, held on April 24 (Government's minutes, GM App. VII.2; Company's memorandum. AR Vol. V, Exh. 22), the Company handed out a new written proposal revising that of April 15 (AR Vol. V, Exh. 21; GM App. VII.1). Under the new suggested terms, the Company would make retroactive payments as from November 1, 1974, of over $37 million, and oil income rate would be gradually raised from 85% in 1974 to 95% from 1978. The proposal was immediately discussed, but the Government's representative (although not as an official response) indicated that the Company's proposal was still not acceptable.
On May 7, the Parties met again (Government's minutes, GM App. VII.2; Company's memorandum AR Vol. V, Exh. 23). The Company had no new proposal to make and the Government offered orally that the Company be allowed a profit in the order of $7.5 million a year, insisting that this was not actually a new proposal but an ultimate effort on its part in order to reach an agreement. This figure (corresponding, although this was not officially stated, to some 25 ¢ profit per barrel) would be applicable as from January 1, 1975 and therefore would entail a retroactive payment by the Company to the Government of about $56 million. Discussions followed on the same day and at a meeting held on May 8 (Government's minutes, GM App. VII.2; Company's memorandum, AR Vol. V, Exh. 24). A group of experts also met on May 9 to work on the figures involved in the various proposals and on other technical matters (AR Vol. V, Exh. 25). At the next formal meeting, held on May 10, both Parties expressed the view that their respective positions were irreconcilable. The Company's representative accounted for the gap between the return per barrel requested by Aminoil and that achieved by other Companies, by the fact that the latter were not putting up any capital or engaging in refining and marketing; therefore their return could be regarded as a mere management fee. However, this explanation was not followed up by any suggestion as to how the difference should be taken into account. The meeting was adjourned without any date being fixed for the next one (Government's minutes, GM App. VII.2; AR Vol.V, Exh. 26).

The time set by the Government to reach an agreement expired, and on May 21, the Government set a new deadline of one month for coming to a conclusion, under threat of a shut-down of the Company's operations in Kuwait. This opened a new round of negotiations.

In this second phase, after informal discussions had taken place in late May between Mr. Ison and several high officials of the Government, the Company presented a totally new proposal in a letter dated June 22, 1977 (GM App. VII.1). The existing Concession would be terminated and replaced by a renewable ten-year service contract. The Government would take over the Company's assets free of charge, and all financial claims pending would be abandoned. The Company would manage the technical and administrative operations for a service fee based on oil income.

On June 26, the Council of Ministers of Kuwait endorsed the principle of a take-over and invited the Committee to resume negotiations for this purpose.

A formal meeting on June 27 (Government's minutes, GM App. 2; Company's memorandum, AR Vol. V, Exh. 30) and a meeting of experts on June 28 (Company's memorandum, AR Vol. V, Exh. 31) were devoted to the clarification of the Company's proposal; and at a second formal meeting on June 29, the Government indicated its position (Government's minutes, GM App. VII.2; Company's memorandum, AR Vol. V, Exh. 32). Concerning the take-over, the Government insisted that compensation should be calculated on the basis of net book value and that all past financial claims be negotiated between the Parties. Concerning the future, the Government favoured a simple marketing contract (or, alternatively, the sale of oil by the Government to the Company at a discounted price), for a period of three to five years. In the negotiations that followed, the main discussions turned around the valuation of the Company's assets in Kuwait and the sum which the Company would be prepared to pay in addition, in satisfaction of the Government's retroactive claims (meeting of July 26, Government's minutes, GM App. VII. 2. Company's memorandum, AR Vol. V, Exh. 33). By a letter of August 6, 1977 the Company informed the Government that, based on a valuation of its Kuwait assets, net of liabilities, of $44.6 million, it was prepared to make a $5 million cash payment (AR Vol. V, Exh. 34; GCM App. VI.2). No answer was received.

On September 19, 1977, the Government of Kuwait issued Decree Law n° 124, “Terminating the Agreement between the Kuwait Government and Aminoil”. Its main provisions were as follows (English translation of the Arabic, taken from the Middle East Economic Survey):

**Article 1**

The Concession granted to the American Independent Oil Company in accordance with the aforementioned Agreement dated 28 June 1948 shall be terminated.

**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.

**Article 3**
A committee named the Compensation Committee shall be set up by a decision of the Minister of Oil whose task it will be to assess the fair compensation due to the Company as well as the Company's outstanding obligations to the State or other parties. It shall decide what each party owes the other in accordance with this assessment. The State or the Company shall pay what the Committee decides within one month of being notified of the Committee's decision.

Article 4

A committee shall be set up by a decision of the Minister of Oil to make an inventory of the assets, funds and facilities which have reverted to the State in accordance with this Law. This inventory shall be turned over to the Executive Committee.” (AM Vol. VII, Exh. 3; GM App. II.8).

(lxvi) In an Explanatory Memorandum accompanying this Decree Law, it was stated that it had been rendered necessary in the national interest by Aminoil's failure to agree to the Government's terms; and at a press conference on the following day this explanation was repeated with the addition that there had “from the beginning . . . been a specific plan for the State to take over full ownership of its oil resources and put them under national management.” (AM Vol. VII, Exh. 3).

(lxvii) The take-over was formally protested by the Company in a letter dated October 20 (AM Vol. VII, Exh. 4). Meanwhile, the Government undertook the operation of the Company's concession, and the operations were later entrusted to KOC and a newly created Kuwait National Oil Company (KNOC) (GM App. II. 10).

(lxviii) On December 20, the Company notified the Ministry of Oil of its intention to initiate proceedings for arbitration, pursuant to Article 18 of the Concession Agreement of 1948.

(lxix) The Compensation Committee set up by Decree Law n° 124 was established, and it invited a high Company representative to represent the Company's point of view at one of their meetings (letter of January 7, 1978, GM App. V.1). The Company declined in view of the arbitration proceedings initiated (letter of January 8, 1978; ibid.).

(lxx) Under Article 18 of the 1948 Agreement, the place of arbitration was to be London, unless otherwise agreed. At the request of the Government, the Parties eventually agreed to hold an ad hoc arbitration in Paris. Thus the Arbitration Agreement of July 12, 1979 was concluded and the London arbitration initiated by the Company discontinued. Thenceforward the arbitral proceedings progressed as described in the immediately preceding Section I of this Award.

[...]

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70. Thus, in reviewing the history of the negotiations in the light of hindsight, it would be possible - as with all negotiations that have come to grief - to pin-point lost opportunities, and chances of agreement that were disregarded. It is not the Tribunal's function to weigh these up, but to state the law. As to that, the main points are

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as follows:

(i) A scrutiny of the negotiations fails to reveal any conduct on either side that would constitute a shortcoming in respect of Article 9 of the 1961 Supplemental Agreement, or of the general principles that ought to be observed in carrying out an obligation to negotiate, - that is to say, good faith as properly to be understood; sustained upkeep of the negotiations over a period appropriate to the circumstances; awareness of the interests of the other party; and a persevering quest for an acceptable compromise. The Tribunal here makes reference in particular to the well known dicta in the North Sea Continental Shelf and Lac de Lanoux cases.

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Firstly, the more radical one consists in affirming that these clauses do not more than embody general principles of contract law, and that in consequence the legal régime of the Concession is the same as that of any contract, and that these clauses add nothing to what would in any event be the legal position. This argument cannot be accepted, for it is a well-known principle of the interpretation of contractual undertakings (and indeed of all juridical instruments) that the interpretation to be adopted must be such as will give each clause a worth-while meaning or object. In the present case, as Aminoil has pointed out, that object resides precisely in the fact that one of the Parties, being a State, had available to it all the powers of a public Authority and, by using them, could take those steps against which it was the very object of these clauses to protect the concessionaire.

101. The Tribunal wishes however to stress here that the case is not one of a fundamental change of circumstances (rebus sic stantibus) within the meaning of Article 62 of the Vienna Convention on the Law of Treaties. It is not a case of a change involving a departure from a contract, but of a change in the nature of the contract itself, brought about by time, and the acquiescence or conduct of the Parties.

143. The most general formulation of the rules applicable for a lawful nationalisation was contained in the United Nations General Assembly Resolution n° 1803 (XVII) of 14 December, 1962, on Permanent Sovereignty over Natural Resources, Article 4 of which provides that:

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

144. The Tribunal considers that the determination of the amount of an award of “appropriate” compensation is better carried out by means of an enquiry into all the circumstances relevant to the particular concrete case, than through abstract theoretical discussion. Moreover the Charter of the Economic Rights and Duties of States, even in its most disputed clause (Article 2, paragraph 2c) - and the one that occasioned reservations on the part of the industrialized States - recommended taking account of “all circumstances” in order to determine the amount of compensation - which does not in any way exclude a substantial indemnity.

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149. For assessment of that equilibrium itself, and of the legitimate expectations to which it gives rise, it is above all the text of the contract that signifies, and it is of moment that this text should be precise and exhaustive. But it is not only a question of the original text; there are also the amendments, the interpretations, and the behaviour manifested along the course of its existence, that indicate (often fortuitously) how the legitimate expectations of the Parties are to be seen, and sometimes seen as becoming modified according to the circumstances.

[...]

4I.C.J. Reports 1969, p. 47
5Reports of International Arbitral Awards (RIAA), Vol. XII, p. 315.
8As was recently stated by the United States Court of Appeals for the Second Circuit in Banco Nacional de Cuba vs. Chase Manhattan Bank, (4 August, 1981), “It may well be the consensus of nations that full compensation need not be paid ‘in all circumstances’ . . . and that requiring an expropriating state to pay ‘appropriate compensation’ - even considering the lack of precise definition of that term, - would come closest to reflecting what international law requires. But the adoption of an ‘appropriate compensation’ requirement would not exclude the possibility that in some cases full compensation would be appropriate.”

Referring Principles:

- IV.5.1 - Intentions of the parties
- IV.5.3 - Interpretation in favor of effectiveness of contract
- IV.5.2 - Context-oriented interpretation
- IV.6.8 - (Re-) Negotiation agreement / clause (<em>pactum de negotiando</em>)
- VIII.1 - Hardship: Requirements
- XI.1 - Compensation for expropriation