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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.

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." 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.

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 *Ammoil*) The Tribunal was composed of Professor Paul Reuter (president) Professor Hamed Sultan and Sir Gerald Fitzmaurice

2 *Ammoil* Separate Opinion of Sir Gerald Fitzmaurice 626 para 28 (hereafter *Ammoil* 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.

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. 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" 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.


7 Albaharna summarises UK/Kuwait political relations in HM Alabyrinth (ed.) The Arabian Gulf States Their Legal and Political Status and Their International Problems (2 ed, Beirut Libraire 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% 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.

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.

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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 Amnoil'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, Amnoil 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.

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. 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 Amnoil 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. Amnoil 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.

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10 1948 Concession Article 1
11 See also Redfern 67
12 Exchange of Notes (1961) UKTS No. 93 Cmd 1518
13 See Amnoil 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. 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. As the Tribunal noted, by 1973 “the balance of advantage in the Gulf Region had tilted in favour of governments.” 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.

The Tribunal was not satisfied that Aminoil had been forced to agree these amendments under duress or threat of shut down as Aminoil alleged. 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...

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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.\(^\text{19}\)

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.\(^\text{20}\)

Amnoil 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.\(^\text{21}\) 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."\(^\text{22}\) Amnoil itself seemed to understand that times had changed and that the Concession "was not sustainable on its original basis."\(^\text{23}\) Nevertheless, negotiations between the two parties broke down in 1977.

Decree Law No 124 "Terminating the Agreement between the Kuwait Government and Amnoil" was passed on 19 September 1977.\(^\text{24}\) Article 1 provided that Amnoil'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.

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\(^{19}\) Amnoil Separate Opinion 616 para 5  
\(^{20}\) Amnoil 573 para 50  
\(^{21}\) Ibid 557 para lxii  
\(^{22}\) Ibid 573 para 51  
\(^{23}\) Amnoil 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, 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 "délocalisation" of the arbitration from the law of its seat\(^ {27}\). The Tribunal found that apart from mandatory rules of French procedure,\(^ {28}\) the \textit{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.

\(^{26}\) \textit{Ibid} \hspace{1em} 534


\(^{28}\) Aminoil \textit{532 para 4}

\(^{29}\) \textit{Ibid} \hspace{1em} 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.\(^{30}\)

\section*{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". 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.

3 The Stabilisation Clauses

The Concession contained provisions that were alleged, in their combined effect, to constitute a "stabilisation clause", 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...
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", and *Texaco Overseas Petroleum Company and California Asiatic Oil Company v Government of Libya* ("Texaco") where Arbitrator Dupuy expressed the same view, 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. 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.

An analogy with the French "administrative contract" concept also suggested by the Government did not find favour with the Tribunal. The Tribunal followed earlier awards in *Texaco* and *Aramco* 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. 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" were incorporated into

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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

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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 Ammoil 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 Ammoil 587 8 para 90(2)
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
58 Aminoil 587 para 90 589 para 95
59 Ibid 589 para 95
60 Ibid paras 93 95 See also Lumarco 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 *Ammoil* 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 *Lamco, 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 eg 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.  

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, Ammout 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. 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.

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

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72 Ibid para 86. This finding was later followed in Amoco International Finance Corp v Iran (1987) Iran US CTR 189 para 145.
particular concrete case, than through abstract theoretical discussion.”

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.

The Aminoil case is notable for its survey of the differing methods of valuing expropriated assets. 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 resitutio in integrum for the replacement value of its assets and its business as a going concern - which would include an element for lost profits. Resitutio in integrum is in theory the principal method to make full reparation for an internationally wrongful act and has been ordered in the past, but whether or when, as a matter of international law, an order in the nature of specific performance or resitutio 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.” Occasionally tribunals have fashioned a compromise. Crawford cites the Walter Fletcher Smith case in which the Tribunal considered that resitutio 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.”

75 Ibid para 144
76 Tschanz 279
77 Aminoil 608 9 paras 146-49 153
79 See eg Spanish Zone of Morocco case (1925) 2 RIAA 617 Martint 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
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 *Ammoil*, 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 *Ammoil*.\(^{85}\)

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 juris* 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 *Ammoil* as a going concern was

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\(^{82}\) 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


\(^{85}\) Ammoil 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 thus 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

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
Aminoil Revisited: Reflections on a Story of Changing Circumstances

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”, and it may be compounded in order to “ensure that the compensation awarded the Claimant is appropriate in the circumstances”. 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. As it was, these additional sums amounted to more than half of the total sum awarded.

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 updating its contractual arrangements with proprietary licence-holders to accord with contemporary international standards.


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 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, 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.

Returning to the purely financial aspect of the Amnoil 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$179 million, even though it then had to invest substantial sums to restore both the refinery and the oilfields to accepted international standards following Amnoil's years of apparent neglect. Incidentally, within a couple of weeks of receiving the award the Government despatched a cheque to Amnoil for the US$179 million with a one-line covering letter in an ordinary airmail envelope—without even asking for a receipt. The tobacco company, RJ Reynolds, bought Amnoil from its founders in 1970 for US$40 million and sold it in 1984 for US$1.7 billion, collecting about US$180 million 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 Amnoil

In the many published commentaries on the Amnoil case, the Government's claims have received little attention, no doubt because

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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. 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

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

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. 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

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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. Amnoil 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 Amnoil. 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 Amnoil'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 Amnoil's financial commitments under the 1948 Concession.

Amnoil 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 Amnoil'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, Amnoil 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 Amnoil 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. 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, 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

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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. 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.

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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.
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. 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.

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. 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 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.

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 Amnioil case as an “investment arbitration” from yesteryear. The 1948 Concession Agreement provided for down payments to the Shaukh 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 compromiso entered into between the Government and Amnioil 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 than 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."