Chapter 14

COMPLEXITY AND COMMERCIAL DISPUTES IN PRODUCTION SHARING CONTRACTS

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I. INTRODUCTION

The governments of hydrocarbon-producing countries have utilized a variety of different forms of contracts in their arrangements with domestic and foreign investors in the exploration and development of those resources. Featuring prominently in these arrangements for a considerable period is the Production Sharing Contract ("PSC"), in which the state retains ownership of the resources and compensates the investor with a share of the production, from which it recovers its costs and earns its profit.

The PSC was popularized as an alternative to older concession-style arrangements and, beginning around the mid-1960s, became for many years a dominant form of agreement. Since that time, many—perhaps most—hydrocarbon-producing countries have used some form of production sharing as a tool for securing investment in their upstream sectors. As a complex, valuable and long-term arrangement involving a resource that is the subject of often surpassing political and sovereign concern, the PSC has frequently been the subject of

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disputes. This chapter focuses on identifying those disputes which commonly arise from the most common forms of PSC and gives a brief overview of the main features of disputes arising from PSCs and brief case studies illustrating some of them.

Despite the ubiquity of PSCs and the broad range of potential disputes they represent, the subject matter of this chapter is, in fact, fairly narrowly circumscribed. The goal herein is simply to identify the types of commercial disputes that (i) have arisen in PSCs during the half-century (more or less) that they have been broadly used in the oil and gas industry, and (ii) have occurred with sufficient regularity that they merit inclusion on a list of "commonly encountered disputes" and then to inform the reader of what drives each type of dispute and how it might be addressed as a matter of risk management. This chapter is not an attempt to survey all PSC commercial disputes—that would require a book of its own. It does however seek to demonstrate the complexity of the subject is such that the issue of "PSC disputes" merits its own discussion.[1]

A great deal of the literature and jurisprudence that involves or touches upon PSCs is excluded by this definition. For example, cases arising under investment treaties and investment laws, particularly in the last fifteen years, have involved a number of PSCs. However, the commercial issues that are generated by the peculiar type of investment memorialized in a PSC are typically not at the forefront of the investment treaty claim being pursued. For example, the dispute at the center of *Occidental Exploration & Production Co. v. the Republic of Ecuador*, ICSID Case No. ARB/06/11, involved the cancellation (or *caducidad*) of a "Participation Contract", a form of production sharing arrangement.[2] The dispute, however, had very little to do with the

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[1] It is worth note that the Energy Arbitrators' List ("EAL"), published by the EAL Secretariat in connection with the International Centre for Dispute Resolution ("ICDR"), lists PSC dispute experience as a separate category of qualification within the more general discipline of "Energy Arbitrator." See www.energyarbitratorslist.com. Disclosure: one of the authors sits on the Review Committee for the EAL.

[2] It is worth noting that agreements involving the sharing of hydrocarbons produced from the property that is the subject of the agreement have a bewildering

commercial terms unique (or at least, common) to PSCs and a lot more to do with a state's desire to remove a disfavored contractor from its country.[3]

Thus, expropriation claims—which have occurred with somewhat distressing frequency—are not ordinarily "commercial" claims and are dealt with elsewhere in this book. Also outside the scope of this chapter are disputes that, while based on a PSC, do not concern the commercial issues that are founded in the commercial relationship represented by the PSC. For that reason, purely tax disputes, another area that is rich in literature and jurisprudence relating to PSCs are excluded.

Also unexamined is the decline in recent years of the use of PSCs in the upstream sector generally. Whole political movements have been nurtured by hostility to the very concept of the PSC, and the "booking of reserves" by PSC investors has resulted in jeremiads around the world from political opponents of foreign investment in upstream sectors of a diverse range of economies. Today, PSCs are typically (but not exclusively) either found as relatively older agreements that have been extended into the present day or are being used by states with a nascent hydrocarbon industry or for particular applications, typically involving marginal field (re-)development. It should be remembered, however, that PSCs were themselves a reaction to earlier forms of upstream investment that were determined to be unfavorable to host governments, particularly the concession.

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array of names. PSC and PSA (for "production sharing agreement") are commonly used interchangeably in the literature. Somewhat unfortunately, they are also often used as a sort of short reference to virtually any type of agreement involving production "sharing" – regardless of the form that "sharing" takes. This abbreviated taxonomy can mislead a casual reader, particularly as some forms of production sharing are deliberately labeled as something else, so as to minimize negative political consequences of "sharing" the country's resource patrimony. Some agreements are misleadingly labelled "PSC" but do not involve true production sharing, presumably for exactly the opposite reason!

[3] Although there was one way in which the case illustrates a common type of dispute: assignment and transfer limitations. This is discussed below.

Today, many hydrocarbon-producing states have eliminated any sort of production sharing or the ability to treat oil in place as "equity oil" and have transitioned to modified forms of risk sharing or pure service agreements. It remains to be seen, however, whether the PSC will make a comeback in a stable, lower oil price environment, where defraying costs risk among investors is seen as a more prudent way for cash-strapped states to develop reserves with relatively low risk to the state itself. Since the PSC persists—and may resume an important place in the suite of development modalities—this chapter aims to give a brief look at the features of the PSC which generate disputes and types of disputes that are most commonly encountered.

II. THE COMMON FEATURES OF PSCS ARE FERTILE GROUND FOR COMMERCIAL DISPUTES

There are several agreements credited with being the "first" PSC, but the first production-sharing agreement was probably that used in 1966 in Indonesia between Pertamina and the Independent Indonesian American Petroleum Association (IIAPCO).[4] Foreign oil activities in Indonesia had been based on the mining law of the Dutch colonial period, and the government of a newly independent Indonesia viewed the license concession contract as an unfavorable legacy.

The IIAPCO PSC differed from the earlier "contracts of work" found in Indonesia in two ways: (1) management control of operations was vested in the state company, and (2) the crude oil itself (and not profits) were shared between the parties.[5] This initial PSC provided that IIAPCO would finance the project and bear all pre-production risks, but could recover costs expended up to a maximum of 40 percent of oil produced annually. After cost

[4] Pertamina was founded in 1957 after Dutch assets in petroleum were nationalized in Indonesia, forming an Indonesian state-owned oil monopoly. *See* Merle Calvin Ricklefs, *A History of Modern Indonesia Since c. 1300*, at 262 (2nd ed., Stanford University Press, 1994); *see also* Shui Meng Ng, *The Oil System in Southeast Asia*, at 23-24 Institute of Southeast Asian Studies, Singapore (Field Report No. 8, Dec. 1974).

[5] *See id.*

recovery, 65 percent of crude was allocated to Pertamina and 35 percent allocated to IIAPCO.[6]

This basic structural idea behind the production-sharing agreement likely remains familiar to any reader of this book: the ownership of the unproduced hydrocarbons remains with the state, but at the same time, enterprises with industry expertise, technical know-how, financial capacity or other efficiencies are invited to manage, fund and operate the development of those natural resources in return for a share of the hydrocarbons produced.

There are today many forms of PSC and the literature has a number of excellent resource works on the key features and variations employed, but virtually all involve common features and issues in three key areas: the legal and contractual framework, the mechanics and the basic provisions, each of which is examined below.

A. Multiple Legal and Contractual Frameworks

The complexity of the legal and contractual framework applicable to the modern PSC is a key driver of disputes. A tremendous amount of effort has gone into drafting of model agreements, with the goal of identifying the expected risks and allocating responsibility for them, all with the key purpose of generating a predictable and stable contractual arrangement for what is typically a technically and financially complex endeavor conducted over decades and involving a commodity with substantial end-user price volatility. Every one of these agreements however must be negotiated, operated and enforced—and litigated—in a complex, multi-system contractual and legal framework.

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[6] *See id.* Ironically, major foreign oil corporations initially resisted this new form of contract because the companies were skeptical of investing capital into enterprises that they did not own. Thus, many of the first PSCs were entered into by independent foreign oil corporations more willing to accept terms rejected by the majors – hoping to break the dominance of the major oil companies. *See, e.g.,* Kirsten Bindemann, *Production Sharing Agreements: An Economic Analysis* at 1, Oxford Institute for Energy Studies, WPM 25, (Oct. 1999), accessible at http://www.oxfordenergy.org/wpcms/wp-content/uploads/2010/11/WPM25-ProductionSharingAgreementsAnEconomicAnalysis-KBindemann-1999.pdf (accessed 17 February 2015).

Virtually all PSCs exist within the framework of specific enabling legislation in the host state. In a number of states, the PSC is itself a statutory contract, whose terms are established by the legislature or pursuant to a legislative grant of power.

Notwithstanding this statutory foundation, the PSC (and the relationships created by this arrangement) may be embedded in (and thus subject to) multiple and overlapping legal contexts. For example, the PSC is nearly always part of a suite of related agreements, which is more or less integrated. There will often be a joint operating agreement ("JOA") by which the consortium agrees among its members how to perform the PSC. The PSC and JOA may be accompanied by other detailed contractual arrangements, each of which may be embedded in a distinct regulatory framework while subject to differing areas of domestic law as well as in the case of foreign investment, to international legal norms.

The state is often represented by a ministry of the government or one of its agencies or state enterprises, such as a national oil company. As an organ of the state, the state party's participation in the PSC may be subject in whole or in part to special administrative rules rather than to purely commercial law.

The PSC is frequently entered into by a consortium, the form of which can range from a separate juridical entity to an unincorporated joint venture, with one member designated as the operator. The entity or joint venture may be subject to the host state's law or the law of its state of formation.

The implementation of these concepts in specific provisions of the PSC is examined in greater detail in the next section. Note that PSCs are differentiated from service contracts, in which the contractor receives fees (*e.g.,* revenue, profit) from the state in exchange for work completed rather than ownership of a share of the crude.[7]

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[7] The distinction between PSCs and various forms of service contracts is complicated by the fact that some countries, such as the Philippines, refer to their contractual arrangement as either a service contract or a PSA interchangeably. *See* Daniel Johnston, INTERNATIONAL PETROLEUM FISCAL SYSTEMS AND PRODUCTION SHARING CONTRACTS, 23 (PennWell, 1994).

B. Mechanics of a PSC

The mechanics of most PSCs are quite similar, but the nature of the arrangement, while necessary to achieve the goals of the parties, is to produce near-constant friction between the parties even in periods of price stability.

To review, the PSC allocates most if not all exploration risk on the enterprise or contractor[8] – *i.e.,* if the contractor is not able to find oil, it will receive no compensation. As a result, the contractor may take on substantial risk where the quality and quantity of resource reserves may not be assured. If oil is found, the government still retains title to both the resource and the installations. The contractor generally pays a royalty on gross production to the government and, after the royalty is deducted, the contractor is entitled to an agreed-upon, pre-specified share of production for cost recovery (*e.g.,* 40 percent of production). The remainder of production (*i.e.,* profit oil) is then shared by the government and the contractor at a specified share (*e.g.,* 65 percent for the government and 35 percent for the contractor). Contractors then generally pay income taxes on their share of profit oil.

Here are some common PSC features that distinguish a PSC from other types of commercial joint ventures (and, indeed, other types of oil contracts):

- Financing, operations, technical ability, and management (and in some instances, marketing) are provided almost exclusively by the contractor and at the contractor's own risk.
- Notwithstanding this near-complete responsibility, the contractor will still have pre-determined technical and monetary obligations for the exploration and, upon discovery, development of hydrocarbon resources found in the property subject to the PSC, which we will call a "block" for these purposes.

[8] This chapter refers henceforth to the "contractor" as the contractual counterparty in the PSC.

- The contractor recovers its capital and the return on that capital, if at all, through its production share. That share typically involves some or all of the early production until certain agreed initial costs are recovered with later production split between on-going cost recovery and distributions to the state and the enterprise. The state party typically has some say on the recoverability of costs expended by the contractor. In other words, even though the contractor may be required to expend a certain amount on exploration, the state party may, typically through its role as a member of the governing body of the project, be able to stall or even prevent the contractor from recovering a cost expended towards the minimum obligation.
- The timing of the transfer of title and ownership in produced hydrocarbons is important and frequently controversial. If disputes arise, in general, the closer the contractor is to actual physical ownership, the stronger the legal position.[9] However, the closer that contractor is to ownership, the more politically sensitive the PSC will be.
- The enterprise will pay various fees and taxes on its interest, typically some form of royalty and income tax on its profits. It is not too great a generalization to say that the state will, over the lifetime of a successful block, take in excess of 80 percent of the value of hydrocarbons, after costs are recovered from the production.
- The PSC typically has an extended duration, usually expressed as a fixed period in which to perform exploration activities and an extended period of 20 or more years in which to develop the resources identified. There is often a right to extend provided the resource remains commercially viable, but that extension is often subject to a number of conditions and may be a matter for the state's reasonable discretion.

[9] *See* Johnston at 23.

- The facilities installed by the contractor typically revert to the state at the end of the PSC contract period, usually with no payment or only a nominal payment.

Nearly every one of these features is a frequent cause of disputes between the PSC parties.

C. Common Contractual Provisions

There are today a great variety of PSCs, published by a range of sources. There are also services which publish those PSCs available publically (and sometimes those which are not), particularly the exemplary service, Barrows.[10] Virtually all model PSCs and most extant PSCs (in whatever form) contain some form of most, if not all, of the following provisions:

- The scope of the property subject to the PSC—often termed the "Contract Area"—is carefully defined.
- The PSC provides for voluntary and involuntary relinquishment of portions of the Contract Area, particularly when the contractor has failed to undertake certain works or has decided not to develop them.
- Contractor obligations specify minimum amounts that must be expended in the exploration and/or development of the block, the minimum tasks (often including seismic surveying) which must be performed, and the time in which these must be accomplished.
- The PSC provides for a fixed duration, usually for each phase of the project (exploration, development, production, etc.). There will often (but not always) be a right for the contractor to extend one or more of the phases, if certain conditions are met.

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[10] *See, e.g.*, the collection of oil and gas laws and contracts accessible (for a fee) at http://beta.barrowscompany.com/ (visited on March 2, 2015).

- There are detailed, mandatory fiscal and accounting systems with robust audit and oversight rights.
- The contractor accepts a variety of taxation but often receives relief from particular taxes, such as import duties on equipment used in the performance of the PSC.
- The state may grant stabilization of certain limited parts of the applicable legal and regulatory framework. This was much more common in early PSCs, but today stabilization—if it is offered at all—is generally limited to establishing the overall tax burden on the contractor, and it is more commonly an agreement about maintaining the economic equilibrium than an agreement not to change taxation modes or rates.
- The PSC may contemplate assignability by the contractor, but this is most often quite limited and subject to some regulatory clearance process or is at the state's discretion.
- The applicable law for the PSC is today most often the law of the host country. A few PSCs have chosen a neutral state's law in circumstances where this was thought necessary to attract investment.[11]
- In contrast, it is common for the PSC to provide for a contractual method of dispute resolution, most often international commercial arbitration. In some instances, the state has adopted a public-law institution, such as the International Centre for Settlement of Investment Disputes ("ICSID").

[11] For example, the Kurdistan Region of Iraq published a model agreement which selected English law as the applicable law.

III. ONE PRODUCT OF COMPLEXITY: COMMON COMMERCIAL DISPUTES INVOLVING PSCS

The remainder of this chapter presents series of eight of the most commonly encountered commercial disputes that arise from PSC arrangements. These are certainly not an exhaustive list of commercial disputes surveyed in the literature. Moreover, many disputes that are at the top of the list of "common PSC disputes" are not discussed here because they are more appropriately discussed in chapters involving investment treaty disputes or other non-commercial categories. The task of reviewing them is complicated, however, by the twin facts that (i) most of these disputes are resolved in commercial arbitration, which is (ii) in the main, confidential and therefore, unreported. Still, while commercial disputes may lack some of the marquee appeal of the investment treaty claims, they frequently involve substantial sums.

A. Cost Recovery / Profit Oil Allocation

An operator can recover most of its costs out of a pre-specified percentage of production, called cost oil. Most contracts have a cost-oil limit, typically 50 percent of production, although contracts with unlimited cost recovery are also in existence. The level of cost recovery often varies according to the special characteristics of the field. For example, marginal deposits may need higher cost-oil ceilings in order to guarantee the expected return on a company's investment. If the cost oil is not sufficient to cover operating costs plus depreciation, depletion, amortization and, where applicable, investment credits and interest the balance will be carried forward and recovered in the following period. The more generous the cost recovery limit, the longer it takes for the government to realize its take.

The cost recovery and profit oil allocation contractual terms are critical bargaining points for each party, and each may give rise to disputes.

i. *The Government of India v. Cairn Energy India Pty Ltd & Ano*r

Cairn Energy India Pty Ltd ("Cairn") and Ravva Oil (Singapore) Pte Ltd ("Ravva") had entered into a PSC with the Government of India ("GOI"). As disputes arose between the contracting parties concerning the costs recoveries and the calculation of Post Tax Rate of Return ("PTRR") for production-sharing purposes, these disputes were referred to arbitration.

The dispute arose from a PSC between the parties to explore the Ravva Oil and Gas Field located in the offshore area in the Bay of Bengal in India. The Defendants were to carry out petroleum operations in accordance with the agreed "Ravva Development Plan". As part of this plan, the Defendants could recover actual expenditure incurred in the exploration/development of and production from the field. However, cost recovery was restricted to US188.98 million plus 5 percent in base development costs ("BDC"). The PSC envisaged that the revenue generated under the PSC was to be shared between the parties, but such recovery did not include the profit element.

The work program envisaged the drilling of 21 wells. By March 1999, the Defendants had drilled 14 of 21 wells and reached production rates of 35,000 bopd. The remaining 7 wells were reclassified as an additional work program which fell outside of the BDC cap. The Defendants claimed that they were entitled to recover the full development costs in addition to the BDC for these 7 wells. The Defendants sought full reimbursement of the expenditure incurred after 1999-2000 beyond the cost cap. The Claimant disagreed and maintained that the costs of these 7 wells were within the approved work program and the PSC.

The dispute was referred to arbitration and the tribunal allowed the Defendants' claim on the non-applicability of the BDC cap to the 7 wells and allowed the Claimant's counterclaim.

Ultimately, the Court of Appeal held that there was nothing improper in the majority arbitrators being persuaded by Cairn's construction of the relevant provisions. The Court of Appeal held that the issue which concerned an interpretation of the production

sharing agreement was a question of construction and therefore a specific question of law with which there should be no curial interference.

The *Cairn India* case illustrates many of the issues which can arise in cost recovery disputes: uncertainty on qualified costs, conflicts between minimum work obligations and cost recovery; and need to adjust work programs to meet the technical reality encountered once operations commence. They can arise, moreover, in the domestic or international context.

B. Extension

Despite the longer duration of most PSCs, either the government or the contractor may desire to extend the term of the PSC. Problems arise, however, in negotiating the extension of PSCs. Changes in standard commercial terms, the global market for oil, or the regime or ruling party may affect the ability of parties to extend existing PSCs, as is demonstrated by the ICC arbitration discussed below.

i. *Joint Venture (US) v. State W*, ICC Case No. 14108 (2011)

In a 2011 International Chamber of Commerce confidential arbitration between a U.S.-based joint venture ("JV") and a state ("State W"), the government granted the exploitation of an area to the JV through a PSC with duration of twenty (20) years, which could be extended by mutual agreement.

One year before the expiry of the 20-year term, the parties entered a Renewal and Extension Agreement (REA), signed by State W. After the parties signed the REA and received repeated assurances by State W that the extension had been granted, State W's Parliament refused to approve the REA and related agreements and the Joint Venture was evicted from the area.

The ICC arbitral tribunal held that the PSC had not been extended. However, the tribunal also held that State W's ambiguous and contradictory behavior violated its duty of good faith under the UNIDROIT Principles. State W was directed to reimburse the Joint

Venture for the costs of the exploration program it commenced because of State W's conduct.

This case illustrates one of the most common extension disputes: where a contractual right or agreement to extension faces legislative obstacles for reasons that may not be related to the operations themselves. Other manifestations of this problem include situations in which the contractor's extension is conditioned on ambiguous standards or left entirely within the discretion of the state. Earlier PSCs tended to have more objective criteria for extension – such as the continued production of oil and gas in certain quantities. In more recent agreements, however, there is often a highly discretionary aspect to extensions. This can lead to commercial disputes in cases where there are limits on that discretion, such as a general duty of good faith.

C. Termination Disputes

Like many petroleum contracts, disputes arise regarding the interpretation of the duties imposed by production-sharing agreements. One such example is described below.

i. *Wintershall A.G. (Germany), Int'l Ocean Res., Inc. (formerly Koch Qatar, Inc.) (US) and others v. Government of Qatar,* (UNCITRAL) Final Award, 5 Feb 1988

Wintershall A.G. and others (the "Claimants") entered into an Exploration and Production Sharing Agreement (EPSA) on 10 April 1976, with an effective date of 18 June 1973. The duration of the EPSA was for 30 years. The EPSA required that, eight years after the Effective Date, the Claimants were required to relinquish to the Republic of Qatar an additional 20 percent of the Contract Area, and the Republic of Qatar was entitled to terminate the EPSA if the Claimants did not (during the eight year period) discover in the Contract Area "crude oil in commercial quantities" or "economically utilizable non-associated natural gas." The EPSA required the parties to mutually agree that the utilization of non-associated natural gas is economical.

On 3 April 1980, the Claimants informed the Republic of Qatar that they had discovered non-associated natural gas in substantial quantities in the Contract Area. The parties considered several projects, but were not able to agree on the utilization projects because of the market conditions (making export of LNG from the Contract Area). The Republic of Qatar telexed Claimants on 19 June 1985 that "the term of this Agreement expired on 18 June 1985. Accordingly, this Agreement is terminated with effect from this date."

Notwithstanding this, Claimants paid the annual rental fee which Respondent accepted and neither party treated the EPSA as expired or terminated. By 1986 the parties were still not able to agree on projects. The Minister of Finance of Qatar referred the matter to UNCITRAL arbitration.

The tribunal held that there was no breach of the EPSA for Qatar's failure to accept the Claimants' proposed projects because the EPSA required that both parties *mutually agree* that the utilization of non-associated natural gas is economical. Qatar argued that it had determined that the Claimants' proposed projects were not "economically feasible," as many projects contemplated use of areas outside the Contract Area. The tribunal held that Qatar had no duty to facilitate projects/export of LNG involving areas outside the Contract Area. The tribunal held further that the Respondent did not breach any duty "of good faith negotiations" under the EPSA.[12]

D. Assignment / Transfer

i. *Saba v. Republic of Yemen*, ICC - 1 April 2013

Saba (Netherlands BVI) was a minor partner in a three-way consortium (with Yemen's Adair Int'l Oil & Gas, and a Yemeni subsidiary of Occidental Petroleum) that had entered into a PSA with

[12] In addition to the contractual claims, the Claimants alleged that respondent expropriated the Claimants' contractual rights and economic interests under the EPSA. The tribunal held that the "refusal of respondent to accept claimants' proposals [to export] outside the Contract Area in no sense constituted an expropriation of claimants' contractual rights, since the claimants had no legal rights under the EPSA to jointly develop the area outside the Contract Area."

Yemen in 2000. Adair forfeited its interest in the block, following which Occidental desired to withdraw, and Saba wanted to pursue the commercial development alone. Yemen refused the assignment of Occidental's interest to Saba. Saba filed for ICC arbitration in February 2010 seeking a declaration that the ministry was in breach of the PSA and Yemeni law. The tribunal found in favor of Yemen. Although the details are not available, there were reports that the tribunal found that the agreement did not permit only one member of the consortium (and not the named lead) to take over for the other members of the contractor.[13]

E. Environmental

Environmental clauses in model PSCs may reference domestic environmental law, international environmental law, or both (some with or without regard of the hierarchy between domestic and international law). Some refer to "generally accepted standards," "good oilfield practices," or "good production practices." Some clauses are ambiguous, and others more precise.[14]

i. Kashagan oil field dispute

Kashagan is an offshore field located in the Kazakhstan section of the north Caspian Sea and is considered the world's biggest oil field after the Prudhoe Bay located on Alaska's North Slope. The Kashagan oil field is developed by North Caspian Operating Company (NCOC), which is owned by several of the world's leading oil companies and includes local Kazakh share owners.

There had been an earlier accident at the onshore facility refining Kashagan oil on September 24, 2013 when hydrogen sulphide started leaking from a ruptured pipe. Hydrogen sulphide is a dangerous

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[13] The award is not public.

[14] *See generally* Kyla Tienhaara, *Foreign Investment Contracts in the Oil & Gas Sector: A Survey of Environmentally Relevant Clauses*, 11 Sustainable Dev. L. & Pol'y 15, 16 (2011).

associated gas found in large amount at the Kashagan field located in the Kazakhstan section of the Caspian Sea. Because of the accident residual gas from the refinery and the oilfield was redirected to the flare devices.

According to the inspection report the total amount of excessive flaring made 2.8 million cubic meters. NCOC, as operator, and Agip KCO were fined US $737 million in court by Kazakhstan's ecological authorities for excessive flaring after an accident at Kashagan. The fine was issued by the Ecology Department for Atyrau Oblast and was based on a determination that Agip KCO and NCOC responsible for harming the environment with polluting emission when flaring sour gas at their refinery.

F. Stabilization

Protections such as stabilization clause are often included as contractual protections in PSCs; however, instead of targeting a sovereign's actions (as BITs and MITs are commonly found to do), stabilization clauses create a "mechanism of contracting with regard for the implication of damages for breach of obligation – a move from a predominantly public law perspective to one based primarily on commercial contract law."[15]

i. AGIP Co. SpA v. Government of the Popular Republic of the Congo, ICSID Case No. ARB/77/1, 30 Nov. 1979

The parties created an oil company established under "Congolese law supplemented by principles of international law." The parties agreed a "Protocol of Agreement" signed on 2 January 1974 between AGIP and Congo which was signed before Congo's nationalization of its oil sector. Under the agreement, Congo held 50 percent of company. In addition, the agreement contained an arbitration clause

[15] Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 Tex. Int'l L.J. 215, 218-19 (1996).

appointing ICSID and designating Congolese law as applicable law. Included within this agreement was the "stabilization clause" in which the government promised not to change unilaterally the company's articles of incorporation, even if changes are made in company law. Congo however, on 12 April 1975, decided to nationalize the company. In return AGIP invoked arbitration against Congo. An arbitral tribunal held that, under the applicable law, Congo violated the stabilization clause in the agreement and was required to compensate AGIP for damages suffered from the nationalization.

G. Changed Circumstance Claims

OPEC countries commonly used the doctrine of changed circumstances to argue that old concessions were no longer operable. Under the changed circumstances doctrine, one must look at the changes in surrounding circumstances, their magnitude, and the effect the changes have had on the mutual expectations the parties had when they entered into the concessions.[16]

The principle of "changed circumstances" provides that, if a factual situation undergoes a radical change of circumstances that was unforeseeable at the time the contract was executed, and that change creates a fundamental disequilibrium in the performance of the parties, the doctrine entitles a tribunal to terminate the contract or to adapt the terms of the contract to the changed circumstances. The related concept of "hardship" is found in Article 6.2 of the UNIDROIT Principles of International Commercial Contracts. There is "hardship" when the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and:

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[16] *See* Ernest E. Smith & John S. Dzienkowski, *A Fifty-Year Perspective on World Petroleum Arrangements,* 24 Tex. Int'l L.J. 13, 46 (1989).

(a) the events occur or become known to the disadvantaged party after the conclusion of the contract;

(b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;

(c) the events are beyond the control of the disadvantaged party; and

(d) the risk of the events was not assumed by the disadvantaged party.

Whether an alteration is fundamental in a given case depends upon the circumstances. If, however, "the performances are capable of precise measurement in monetary terms, an alteration amounting to 50 percent or more of the cost or the value of the performance may amount to a 'fundamental' alteration." These principles of adaptation and hardship may limit or preclude otherwise valid claims for breach of an international contract. They may also provide an opportunity for a party disastrously disadvantaged by a changed circumstance to modify or terminate the contract.[17]

H. Force Majeure

i. *NOC (Government of Libya) v. Libyan Sun Oil Company*, ICC Case No. 4462, 31 May 1985, 23 Feb. 1987[18]

An EPSA, governed by Libyan law and effective as of 20 December 1980, provided for an oil exploration program in Libya. In 1981, the Claimant Sun Oil invoked the force majeure clause in the EPSA, claiming that the U.S. Government orders (1) declaring all U.S. passports were no longer valid for travel to Libya, (2) banning Libyan

[17] *See* R. Doak Bishop et. al., *Strategic Options Available When Catastrophe Strikes the Major International Energy Project*, 36 Tex. Int'l L.J. 635, 644 (2001).

[18] The ICC Award was "entitled to recognition and enforcement" in the United States under the New York Convention. See *Nat'l Oil Corp. v. Libyan Sun Oil Co.*, 733 F. Supp. 800, 813, 822 (D. Del. 1990).

oil imports to the United States, and (3) rejecting Sun Oil's license to export oil technology to Libya amounted to an act of force majeure.

The tribunal held that Sun Oil's performance was not excused by the force majeure clause because the circumstances did not make performance of the EPSA obligations "absolutely impossible." The tribunal observed the Libyan law definition of force majeure, which had three conditions, required that an event must (1) be beyond the control of the parties; (2) be unforeseeable at the time the agreement was entered into; and (3) render the performance of the obligation *absolutely impossible*.

The tribunal noted that the Parties could have modified the legal requirement by mutual agreement within the EPSA (noting that international long-term agreements sometimes contain provisions that define force majeure as any "event beyond control of the parties which renders the performance of the agreement *very difficult and/or more expensive*"), and analyzed the EPSA's force majeure clause. The tribunal held, however, that the force majeure clause did not give any indication to modify the Libyan law requirement.

The tribunal held that "it was at all times possible" for Sun Oil to perform its obligations under the contract with non-US personnel and other equipment not subject to the US license. The tribunal rejected Sun Oil's argument that it was outside the intention of the Parties to use non-US personnel or equipment.