HYDROCARBONS LEGISLATION

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12 NATIONAL REGULATION OF THE HYDROCARBONS INDUSTRY

13 CONTRACTUAL REGULATION AND SETTLEMENT OF DISPUTES
The sovereignty of states over their natural resources

10.1.1 The end of the Second World War and the tendency of states to extend their sovereignty

After the end of the Second World War there seemed to be a marked tendency by states to extend their sovereignty over their natural resources, both horizontally and vertically. On the horizontal level – in so far as relationship between states is concerned –, rules of general international law were established that increased coastal states’ sovereignty over their land and territorial seas, providing for the exclusive jurisdiction of states over the exploitation of resources in their continental shelves, as well as the exclusive right to exploit those resources located within 200 miles of their coasts. On the vertical level – within each state –, the powers enjoyed by the states concerning their own territories, continental shelves and exclusive economic zones have been specified in terms of permanent sovereignty over their own natural resources.

The importance of these phenomena has not however failed to be balanced out by restrictions aimed at preventing excesses of creeping national jurisdiction capable of giving rise to conflicts that could constitute a threat to peace. Thus, coastal states’ claims over the seabed have been limited according to the principle that the exclusive powers of such states over their continental shelves and their exclusive economic zones cannot be extended beyond a certain distance from the coasts, that is 200 miles. Beyond that limit, coastal states must give way – with respect to the resources of the seabed – to the application of a regime inspired by the idea of “common heritage of mankind”, expressed in United Nations General Assembly Resolution No. 2749-XXV of 17 December 1970 entitled Declaration of principles governing the seabed and the ocean floor, and the subsoil thereof, beyond the limits of national jurisdiction (Mengozzi, 1971). From another point of view, obligations to protect the marine environment and promote international trade have been asserted which have involved different forms of international cooperation, as well as sometimes complex mechanisms, designed to facilitate and guarantee respect for those obligations.

Such phenomena has failed to affect the hydrocarbon regime, having repercussions on: a) the extension of states’ exclusive rights of exploration and exploitation of the maritime areas beyond the territorial sea; b) the rules governing concessions with respect to such areas; c) the consequences of accidents which may arise from the extraction and transport of hydrocarbons; d) the way in which each state must interact with the others as far as the management of hydrocarbons is concerned.

10.1.2 The powers of coastal states

The exclusive powers of states with respect to the exploration and exploitation of marine resources and the criteria for establishing the boundaries of the areas

The extension of the coastal states’ powers over the use of the resources in their continental shelves, as well as the assertion of their right to establish an exclusive economic zone – leading also to the claim of permanent sovereignty over the hydrocarbons to be found therein – have posed the problem of the delimitation of such areas and the definition of the boundary lines.

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Footnote 1: On the developments that followed with respect to general international law, see Mengozzi, 1977 and 1980-1981.
relationship between coastal states’ rights and the maritime freedoms of all other states.

With reference to the first of these two problems it is worth specifically recalling the judgment of the International Court of Justice of 20 February 1969 in the dispute related to the delimitation of the North Sea continental shelf between the Federal Republic of Germany on the one hand, and the Netherlands and Denmark on the other (North Sea Continental Shelf, Judgment, 1969). In this judgment, the International Court of Justice held non-applicable the equidistance criterion, which according to the 1958 Geneva Convention operates both in the case of states whose coasts are opposite each other and also in the case of two adjacent states. The judgment pointed out that with reference to adjacent states – and the three states party to the dispute were adjacent to one another – the application of the equidistance criterion could lead to an increase in the portion of the continental shelf of states with a convex coast (as is the case of Denmark and the Netherlands), as the boundary line tends to open up towards the open sea whereas, vice versa, it leads to a reduction in the portion of the continental shelf of states having concave coasts (as is the case of Germany). As a result, the Montego Bay Convention of 10 December 1982 (Byrne and Boyle, 1995) abandoned the equidistance criterion and stipulates in art. 83 that the delimitation of the continental shelf between states with opposite or adjacent coasts shall be effected by agreement between the states involved. This is in order to achieve an equitable solution, in line with numerous other decisions of the International Court of Justice and arbitration tribunals.

The coastal state’s powers over the exclusive economic zone and the rights of oil tankers flying the flag of a foreign state

The question of the relationship to be established between the coastal state’s rights over its exclusive economic zone and the traditional maritime freedoms of the other states, with specific reference to activities concerning hydrocarbons, was first addressed in art. 59 of the Montego Bay Convention and then by the International Tribunal for the Law of the Sea of the United Nations in its decision of 1 July 1999 (M/V Saiga case n. 2, 2000).

Art. 59 of the Montego Bay Convention – in line with what had been established by the International Court of Justice in its judgment on the delimitation of the North Sea continental shelf and specifying the criteria expressed therein concerning the delimitation of the continental shelf between states with adjacent coasts – states “in cases where this Convention does not attribute rights or jurisdiction to the coastal State or to other States within the exclusive economic zone, and a conflict arises between the interests of the coastal State and any other State or States, the conflict should be resolved on the basis of equity and in the light of all the relevant circumstances, taking into account the respective importance of the interests involved to the parties as well as to the international community as a whole”.

In the aforementioned case, the International Tribunal for the Law of the Sea had to establish whether a coastal state, in its own exclusive economic zone, could sanction the refueling and sale of fuel by a foreign ship to other ships by applying its own customs laws. The International Tribunal decided that the coastal state could not do so, even though nothing on this matter is mentioned in the provisions of the Montego Bay Convention on the freedom of navigation that must also exist with respect to exclusive economic zones. To this regard, importance has been given not only to the functional nature of the coastal state’s rights with respect to the zone in question but also to the interests of the “international community as a whole”.

10.1.3 Oil concession contracts and stabilization clauses

While the above-mentioned problems have arisen and continue to arise with significant acuteness, problems concerning the rules governing concessions underlying hydrocarbon activities are certainly no less sensitive. Such problems arose in the years following decolonization, and although less intense now, are still current.

In particular, it is a matter of defining the value of the stabilization clauses contained in contracts establishing such concessions. These clauses are inserted in concession contracts concluded between

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2 For an analogy between what has been enunciated in the mentioned judgment of the Court of Justice of the European Communities ruling of 24 November 1992 in Case C-286/90, paras. 25-26, see Conforti, 2002. In this judgment the Court of Justice affirmed that a European Community regulation prohibiting the transport on board by non-Community ships in the exclusive economic zone of European Union member States (and in other areas over which the European Community has jurisdiction) of certain species of fish caught beyond that very same exclusive economic zone cannot be applied.

3 For the definition, with reference to the Italian legal system and in particular to Law No. 613/1967, of publicly established explanations for the cultivation of hydrocarbons as well as for prospecting and research as concessions, see Guglielmi, 1970; for an illustration of the various types of contracts concluded between host countries and multinational oil companies, see Smith and Dzienkowski, 1989.
Contracts governed by the law of the host state

Stabilization clauses are of varying importance, depending on whether or not their regulations and those of the concession contracts where the clauses are inserted, are subject to the legal order of the state hosting the activities for which the concession has been granted. This being either because those regimes have been chosen by the parties or because of the consequences of the private international law rules applicable to such contracts.

If a concession contract containing a stabilization clause is governed by the law of the host state, given that a contract in itself cannot bind the legislator and the government, all the more reason that one of its clauses cannot do so. A contract governed by one state’s law, however that contract has been drafted, cannot alter the powers of that state to the extent of requiring it to renounce its sovereign rights. A foreign investor cannot invoke legitimate reliance on the stabilization as foreseen in the concession contract, since the foreign investor, by exercising due diligence, can be aware of its invalidity from the standpoint of the host state’s law. In the same way, legitimate reliance on respecting the stabilization clause contained in such a contract cannot be invoked by the foreign investor, even in the case in which a law of the country expressly provided for the clause’s validity. Also, in this case, the state, in exercising its sovereign rights, could revoke such a rule, while accepting the possible consequences, such as being obliged to pay an indemnity (Wälde and Ndi, 1996).

Recourse by the parties to international law

The situation is different if the state and the foreign investor, in light of the principle of autonomy which is certainly applicable to international contracts,4 insert in the concession contract containing a stabilization clause a provision expressly providing that the contract be governed by international law. Such a choice is made in an arbitration clause whereby settlement of any dispute that might arise will be submitted to an international arbitration institution or to a person completely independent of the state granting the concession. In such a case, if the state authority that signed the concession contract had the power to insert such a clause, one can speak of the internationalization of the contract. This is, at least, in the sense that the arbitration body that may actually be called upon to decide on the validity and/or on the legal consequences of a stabilization clause would have to proceed on the basis of the application of the rules of international law (Charpentier, 1956; Mann, 1975).5

4 On the limits the application of this principle encounters, see Lalive, 1977.
5 For an observation, however, that the internationalization of a contract can be further consolidated in the case in which the host state is party to the Washington Convention for the settlement of investment disputes between states and nationals of other states, which was prepared in the framework of the activities of the International Bank for Reconstruction and Development giving rise to the establishment of the International Centre for Settlement of Investment Disputes, see Rosenberg, 1983.
The decision to be taken by such an arbitration body in this case is not easy. It implies fixing coordination and equilibrium among the three principles or rules clearly belonging to the international legal order: the pacta sunt servanda principle; the rebus sic stantibus rule; and the principle of sovereignty.

10.1.4 The principle of permanent sovereignty of states over their natural resources and developing countries

In developing countries and in countries that have just undergone a process of decolonization, the principle of sovereignty has gained particular importance. This is as a result of the emphasis given to the affirmation by the United Nations’ General Assembly of the principle of permanent sovereignty of states over their natural resources. This principle – formulated with reference to hydrocarbons, as belonging to the category of non-renewable resources (Elian, 1976) – was first articulated in the Declaration on the granting of independence to colonial countries and peoples, contained in Resolution No. 1514-XV of 14 December 1960 adopted by the United Nations’ General Assembly. This resolution states that “peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law”. The theme is picked up again more strongly in the subsequent Resolution No. 1803-XVII of 14 December 1962 (Declaration of permanent sovereignty over natural resources), according to which “the right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned” (Mengozzi, 1967).

These General Assembly resolutions were firstly followed by the Declaration on principles of international law concerning friendly relations and co-operation among states in accordance with the Charter of the United Nations (United Nations General Assembly Resolution No. 2625-XXV of 24 October 1970). This was followed by the Charter of Economic Rights and Duties of States (United Nations General Assembly Resolution No. 3281-XXIX of 12 December 1974). The former affirmed that “each State has the right freely to choose and develop its political, social, economic and cultural systems”. The latter added that every state has the right to do both “in accordance with the will of its people, without outside interference, coercion or threat in any form whatsoever”. It also stated the right to regulate foreign investment, to nationalize and expropriate foreign property according to its own domestic laws. It therefore excluded recourse to international law and the jurisdiction of tribunals other than those of the nationalizing and expropriating state to settle any dispute that might arise (art. 2, para. 2, c).6

The doctrine most careful to interpret the orientation of developing states and those that have just undergone a process of decolonization has shown that both principles – the one affirming that each state may freely choose its own economic system and the other proclaiming each state’s permanent sovereignty over its natural resources – derive from the principle of sovereign equality of states enshrined in art. 2 of the Charter of the United Nations. The former specifies that states have the right to self-determination on the economic and social level without interference by other states. The latter specifies the effects over time of the use of this free choice of the right to self-determination or re-organization, above all when foreign economic interests are at play (Giardina, 1980-1981; Abi-Saab, 1991).

With the clear and declared intention of gathering rules from the assertions contained in the aforementioned resolutions, that doctrine does not fail to point out that the absolute and exclusive nature of the power inherent in internal sovereignty – as well as the freedom of choice and of action that sovereignty implies – must be understood as being within the limits of international law. However, the violation of the obligations deriving from that law as a consequence of agreements concluded by one state’s government leaves sovereignty whole and intact at domestic level even if it gives rise to an international responsibility of that state. Indeed, sovereignty is defined in the aforementioned resolutions as permanent sovereignty, and subsequently is reaffirmed as such in art. 2, para. 1 of the Charter of economic rights and duties of states (adopted by United Nations General Assembly Resolution No. 3281-XXIX of 12 December 1974).

The logical explanation given to this state of affairs is deduced from art. 1 of the Covenant on civil and political human rights of the United Nations, according to which “the right of self-determination (à disposer d’eux-mêmes) includes permanent sovereignty over their wealth and resources”. According to the doctrine in question “the rights other States may claim may in no case deprive a people of

6 For the stressing of such characteristics of this resolution, see Feuer, 1975.
its own means of subsistence” (Jimenez de Arechaga, 1978). In light of this assertion, the same doctrine maintains that sovereignty over natural resources is permanent as it is a fundamental right of the people. Moreover, it aims to protect that right against the weakness of state governments and make it prevail over any agreement governments may have concluded that might place a significant limitation on that right.

The consequence of this way of viewing things, as concerns the stabilization clauses in oil concession contracts, is that a concession concluded for too long a period of time would be contrary to the permanent sovereignty of the territorial state (Abi-Saab, 1991). Furthermore, if a concession is revoked and the structures built for the purpose of carrying out the activity for which the concession has been granted are nationalized, only an indemnity would be due to the nationalized enterprises. The adequacy of the indemnity, according to the Charter of economic rights and duties of states, ought to be determined "taking into account its relevant laws and regulations and all circumstances that the State considers pertinent. The indemnity could be determined by the judges of the same State unless it has been concluded in an agreement, freely signed by the interested State or States, after the dispute has arisen, to submit the question to international arbitration or judicial settlement".

10.1.5 The *pacta sunt servanda* principle in western literature and in arbitral case law

Great importance has been given to the *pacta sunt servanda* principle not only by numerous western authors (Wei, 1974; Lalive, 1983) but also by arbitral awards specifically concerning hydrocarbons and the stabilization clauses contained in agreements concerning them.7

**The Texaco case**

Particularly illustrative of the aforementioned direction is the award of 12 April 1977 delivered in the *California Asiatic Oil Company and Texas Overseas Petroleum Company v. Government of the Libyan Arab Republic case*, also known as the Texaco award.

In this case, the Libyan government had proceeded to the nationalization of the structures of the two American oil companies that had initiated arbitration proceedings even though the structures had been created on the basis of a concession contract that contained, in art. 16, an intangibility clause and a stabilization clause (for 50 years) concerning the rights granted to the concessionaries. The contract provided that any dispute between the parties would be settled by an arbitration tribunal, to the establishment of which both parties would contribute. Whereas the companies had appointed an arbitrator of their choice, the Libyan government refused to do likewise invoking its permanent sovereignty over its natural resources and claiming that, in conformity with the terms of art. 2, para. 2, c, of the 1974 Charter of economic rights and duties of states, the problems that had arisen be settled according to Libyan law and only by a Libyan court. Another provision of the concession contract was therefore applied whereby, in such a situation, the President of the United Nations’ International Court of Justice had the task of appointing a sole arbitrator. Thus Sole Arbitrator René-Jean Dupuy was appointed.

Since the arbitrator considered himself able to proceed even though the Libyan government was absent, Dupuy considered it his duty, in deciding the matter, to analyse the Libyan government’s arguments for excluding the applicability of the arbitration clause contained in the concession contract in the case of the nationalizations in question. The Sole Arbitrator admitted that the United Nations Resolutions on the question of the permanent sovereignty of states over their own natural resources were meant to have an important impact on the content of contemporary international law. Moreover, he said that the resolutions could contribute to establishing the content of rules as indicated by doctrine that expresses the orientations of developing countries and those having just gone through a process of decolonization.

However he specified that the legal value the content of each resolution can acquire is not equal to that of the other resolutions. Its legal value depends on whether or not there has been consensus on it by a “large number of States representing the whole of geographical regions and, at the same time, the whole of economic systems”7. Now, according to Sole Arbitrator Dupuy, this condition is not satisfied by the provision of the Charter of economic rights and duties of states invoked by the Libyan government. It is on

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the other hand satisfied by Resolution No. 1803-XVII of 14 December 1962, approved by a majority (87 votes in favour, 2 against and 12 abstentions) which included, in addition to numerous Third World Countries, many western countries with developed market economies, including the United States.8

In line with this analysis, the Sole Arbitrator felt that he could attribute to art. 28 of the concession contract all the relevance resulting from its content. Art. 28 reads: “This concession shall be governed by and interpreted in accordance with the general principles of the law of Libya common to the principles of international law and in the absence of such common principles [...] then by and in accordance with the general principles of law, including such of those principles as may have been applied by international tribunals”. For the purposes of its application the arbitrator pointed out that according to the shari’a, the sacred law of Islam, and according to arts. 147 and 148 of the Libyan Civil Code, contracts must be respected: contracts can be terminated or modified only on the basis of mutual consent or for reasons established by law and must be performed in good faith (Anderson and Coulson, 1964) and that the pacta sunt servanda principle is a general principle of law and an essential basis of international law.9

Consequently the article in question would have had the effect of making international law and in particular the pacta sunt servanda rule applicable to the contract; as the nationalizations in question contravened that rule, on account of their contrast with the intangibility and stabilization clauses contained in the contract concluded by the parties, Libya ought to have proceeded to a remedy by means of restitutio in integrum, as this “is, both under the principles of Libyan law and under the principles of international law, the normal sanction for non-performance of contractual obligations and it is inapplicable only to the extent that restoration of the status quo is impossible”.

Sole Arbitrator Dupuy added an observation: according to the arbitration clause contained in the concession contract (art. 28, para. 5), “In giving a decision, the arbitrators, the umpire or the Sole Arbitrator, as the case may be, shall specify an adequate period of time during which the party to the controversy or the dispute against whom the decision is given shall conform to the decisions, and such party shall not be in default if that party has conformed to the decision prior to the expiry of the period”.

In his opinion the fact that the arbitration clause was worded in such a way was in line with a certain flexibility that, de lege ferenda, legal literature tends to assign to contracts between states and private parties and had given the party, who had failed to fulfil its obligations, two possibilities. First and foremost, the possibility of proceeding to restitutio in integrum as long as the period of time in which to do so had not expired and, secondly, the prospect of being ordered to compensate the damage that, should it be the case, would have compensated specific performance if, from the legal point of view, one day non-performance definitely became a reality.

In reaching this conclusion however Arbitrator Dupuy had to demonstrate that he was able not to take into account the decisions rendered with reference to Serbian and Brazilian loans in which the Permanent Court of International Justice in a solomonic way had stated that “any contract that is not a contract between States acting as subjects of international law is based on national law”. If he had been influenced by this precedent, there is no doubt that Arbitrator Dupuy would have had to take into account the law of Libya and the Libyan government’s assertion that the application of Libyan law and the jurisdiction of Libyan courts was to be considered imperative. Thus he considered himself able to overcome that precedent by considering it outdated. In line with an interpretative trend concerning the new general international law, already followed by others (García-Amador, 1959; Seidl-Hohenveldern, 1975), he declared that international law had developed over time as a regime which applies – even if it be with particular rules that do not coincide with those governing inter-state relations – also to the relations between states and entities other than states. Thus, as particular rules are applicable to relations between states and international organisations, the same is also true with respect to relations between a state and enterprises operative on an international level. Consequently, when such a state intends to internationalize its relations with one of these enterprises and to that end concludes a contract with it, the state attributes international character to the enterprise, with a constitutive effect. In this way such international rules governing their relationship

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8 For a comment according to which this United Nations Resolution is not innovative seeing that long before it the right of every state to expropriate or nationalize the property of foreigners had been established, see Verwey and Schrijver, 1984. For an extensive bibliography on the effect United Nations Resolutions can have with respect to the crystallization of the rules of general international law and the progressive development of them, see Arangio Ruiz, 1972a, 1972b; Treves, 2005.

9 As far as this is concerned, see the arbitration awards rendered in 1958 in the Aramco case and in 1963 in the Sapphire case.
will constitute a system in light of which their contract will be considered de-localized.

In such a system the *pacta sunt servanda* rule – unequivocally strengthened when the contract concluded contains intangibility and stabilization clauses such as those occurring in the case in hand – dominates. In order to establish when a state manifests this intention to consider an enterprise a subject of international law and the contract it concludes with such enterprise internationalized, Sole Arbitrator Dupuy considered that it might be useful to verify in the case in hand the existence of three factors: the intention of the parties (as apparent from the indication of international law as the most important source of law governing the contract), the international character of the arbitration proceedings (shown by the fact that the parties requested the President of a United Nations body, the International Court of Justice, to perfect the process for initiating arbitral proceedings) and the placement of the contract in question in the context of economic development agreements (Verdross, 1959; Bourquin, 1960).

**Doubts concerning the Texaco award and open questions**

Although attractive, what comes out of this complex reasoning cannot fail to leave doubt, at least for the following two reasons. First of all, on account of the premise on which the award is based. That is, the attribution to the will of the state (that makes a contract with an enterprise at an operating on an international level) of the constitutive power to attribute to that enterprise the nature of being a subject of international law and in turn subject to a particular (and reduced) series of rules of international law. From another point of view, particularly important with reference to the thesis expounded, in relation to the capability of these rules to confer such a strong value on intangibility and stabilization clauses, as Arbitrator Dupuy held, that the state that violates them must, in principle, proceed to *restitutio in integrum*.10

In so far as the first point is concerned, even if the idea is accepted that, in the international legal order, there are different kinds of subjects governed by different groups of rules, it cannot be deemed that the rules according to which an entity can be qualified as subject are such with reference to one specific state only and not to all the others. It is not worth adding anything to the observations contained in important scientific contributions on this matter, according to which subjectivity, in the international legal order as in all other legal orders, is a status that cannot but exist *erga omnes* (Arangio-Ruiz, 1951, 1972a, 1972b).

As to the second point, there is no doubt that the insertion of intangibility and stabilization clauses in a concession contract, especially in the case of concessions for the prospecting, exploration and cultivation of hydrocarbons, renders particularly acute the host state’s traditional obligation to respect the property and activity of foreign investors. It cannot fail to bear on the consequences of the exercise of the power to nationalize arising from the permanent sovereignty of states over their natural resources and wealth. If for no other reason because all the rules and principles of international law, even those that became particularly firmly established in the wake of the principles of the Charter of the United Nations, must be applied bearing in mind the principle of good faith. This principle is destined to make itself felt – even in the international order – and is one that must be held in particular consideration in relations in the context of cooperation for development.11

Investor protection deriving from the clause in question cannot however be absolute. This is, above all, because it is impossible to maintain that the international law in force can be interpreted in the terms in which Dupuy interprets it. It is true that, as Dupuy points out, “the highest doctrinal authorities” favour *restitutio in integrum* (Lauterpacht, 1927; De Visscher, 1935; Reitzer, 1938; Schwarzenberger, 1945; Guggenheim, 1954; Reuter, 1961; Jimenez de Areechaga, 1968; Ténekidès, 1969). However, apart from the fact that doctrine does not fail to specify that *restitutio in integrum* constitutes a remedy preferable to compensation or to assume that the advantages that the former presents must be taken into account in determining the *quantum* of the latter, the current content of general international law cannot be definitely identified with the assumption on which the doctrine invoked by Dupuy is based. The content of general international law can be the result only of the

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10 For a critique, however, of the idea contained in the decision according to which the concession would not violate Libya’s permanent sovereignty over its oil resources as it would be a concession concerning only a part of such resources and would be limited in actual time: Verhoeven, 1975. The author stresses that the concession was granted for a period of 50 years and that at the end of this period the Libyan oilfields could be close to exhaustion, if not already exhausted.

11 For a utilization of the principle in question in this context, see Castañeda, 1974. The author holds that this principle is applicable with respect to all matters dealt with in that Charter, including art. 2 thereof (according to which, concerning the rules governing natural resources, each state has the right to proceed to nationalize and expropriate foreign property according to its domestic law, excluding therefore recourse to international law and settlement of any disputes that might arise by tribunals other than those of the state that proceeds to said nationalization and expropriation).
opinio juris of the states resulting from the practice that comes about on account of their conduct: in other words from the usus and from the opinio juris sive necessitatis.

For some time international case law and predominating diplomatic practice have recognised that restitutio in integrum is possible only in exceptional cases (when pecuniary compensation appears to be a manifestly insufficient measure). Moreover, in the majority of cases, the international responsibility of one state that gives rise to a nationalization in conflict with a commitment to stabilize the regime to which an investment is subject, gives rise only to the payment of pecuniary compensation (Fatouros, 1962; El Chiati, 1988).

10.1.6 The need for a link between the pacta sunt servanda principle and the rebus sic stantibus rule

On the other hand, even apart from this reality of contemporary international law, the pacta sunt servanda principle and the principle of good faith make up only part of the legal framework in light of which the action of a state that has concluded a contract containing a stabilization clause must be assessed. The social, economic and political components of the relationship in which such a contract occurs are sure to change over time and to have an effect on the related equilibrium. This change is necessarily destined to acquire relevance because of the working of the rebus sic stantibus rule that cannot fail to accompany the application of the pacta sunt servanda principle and the principle of good faith (Higgins, 1986; El Chiati, 1988).

To establish that the failure to respect a stabilization clause is a violation of the legitimate expectation determined by that clause is not justified by the operation of the rebus sic stantibus rule in relation to a contract like that considered by Sole Arbitrator Dupuy is a sensitive matter.

In theory, one can imagine that this reasoning could be influenced by the fact that the arbitrator, if an expert international lawyer was likely to proceed according to a methodology based on the use of criteria typically used in public international law cases or, if not, according to criteria of international trade law. In the former case the arbitrator can pay attention to factors external to the contract particularly taken into account by international law, namely the rules of the Vienna Convention on the Law of Treaties, whilst in the latter case, to the text of the contract (Wälde and Ndi, 1996).

In actual fact, however, clauses of this type, especially if drawn up in a post-colonial period, are included in contracts concluded in the framework of cooperation for development. In considering oil concessions granted on the basis of contracts stipulated in such context, an arbitrator cannot, in any case, fail to examine with particular care the content of the contracts. This is since these contracts typically place the concession in a balanced ensemble of commitments that take into consideration: on the one hand, the enterprise’s need to have a certain financial equilibrium ensured with respect to the high costs and risks inherent in the search for and discovery of resources; on the other hand, the state’s need to obtain not only fiscally advantageous revenues and the achievement of social programmes of employment and training of local personnel which usually accompany the said concessions (Franko, 1978), but also to meet needs of a more general nature.

It is also for this reason that, in addition to the fact that the contracts in question are long-term contracts, their forecasted stabilization is often tempered by clauses which, when any difficulties arise, provide for particular consultation procedures aimed at overcoming the difficulties bilaterally.12

The consequence of this series of data is that an arbitrator called on to decide on the violation of a clause such as the one in question, even if he admits that the state concluding a concession contract can terminate it prematurely, will be able to oblige the state to make compensation that goes well beyond the emerging damage. The same arbitrator, on the other hand, cannot fail to grant the host state – in which exploration and/or extraction activity gives rise to serious ecological problems that were unforeseen or could not have been foreseen at the time of conclusion of the concession contract – the possibility to impose additional burdens with respect to the provisions of the contract on the said activities of the company in question in order to solve those problems.

The assertion made with reference to ensuing ecological problems cannot fail to extend to other developments in the situation in which an oil concession finds itself. Indeed, if it is true that an arbitrator, in view of the above-mentioned considerations, has to take into account the financial

12 Point IV of the Papua New Guinea – Bougainville Copper Co. Agreement of 6 June 1974, for example, provides that “the parties would meet at intervals of seven years to consider in good faith whether the Agreement was operating fairly to each of them and, if not, to use their best endeavours to agree upon changes to the Agreement as may be requisite in that regard”; on the practice of inserting clauses of this sort in the contracts under consideration, see Asante, 1979.
balance of the investor – because of which the host state has managed to obtain the commitment of the investor with respect to the areas over which the state has sovereignty and jurisdiction – it is unthinkable that the arbitrator, in order to achieve contractual balance (Higgins, 1986), i.e. for the purpose of maintaining the same “contractual balance desired by the parties”, should not also take into account unforeseen circumstances that diminish beyond any possible expectation the advantages that the host state could have legitimately expected to obtain from the concession.

Even if the so-called théorie de l’imprévision has been accepted by the legal orders of oil producing countries with reference to civil law (El Chiati, 1988) and, in actual fact, in favour of the parties to the contract obliged to make performance in money, it cannot be denied that it leads back to a principle, expressed in the rebus sic stantibus rule, also applicable to all parties of an internationalized oil contract. The problem of reconciling – with reference to a contract of that sort – the possibility of invoking the théorie de l’imprévision and the rebus sic stantibus rule with a stabilization clause in it, indeed, consists only in the problem of keeping such a possibility within reasonable limits and avoiding abuses. For this reason it is advisable, if not even fundamental, to include in such types of contracts, consultation procedures aimed at overcoming problems that may arise during performance as well as clauses providing for international arbitration to be applied in the case in which settlement cannot be made bilaterally.

That phenomenon, underway in community law and in the law of individual member states, of moderating the pacta sunt servanda principle by an increasingly broad application of the principle of good faith and of the prohibition of abuse of rights must be held as operative, in the sense indicated, also with reference to internazionalized contracts, even if the legal system in which they are considered to be rooted (enracinés) is international law.

10.1.7 Bilateral joint exploitation agreements concluded between coastal states with reference to common oilfields or awaiting definitive delimitation of the continental shelves

The legal problems raised by the exploration and exploitation of hydrocarbons are not limited to those concerning the oil concessions a state grants to private undertakings. Legal problems also arise on a more traditionally international level. First of all, with reference to the exploration, cultivation and commercialization of oil resources located in parts of the seabed adjacent to the coasts of more than one state and with respect to which problems of delimitation arise. Second, with reference to the carriage by sea of such resources from the place where they were extracted to where they are destined to be marketed. Third and last, with reference to the conditions to be established under which the sale of such resources is permitted.

The fact that the Montego Bay Convention followed the International Court of Justice in endorsing the inapplicability of the equidistance criterion for the delimitation of the continental shelves of states with opposite or adjacent coasts – establishing that such delimitation must be fairly reached by agreement of the states involved – has given rise to many disputes concerning the establishment of a fair delimitation between two or more states with opposite or adjacent coasts. Some of these disputes have been brought before the International Court of Justice. For example, in the case of the dispute between Libya and Malta (Bundy, 1995).

In other cases, however, forms of cooperation have been found that over time have been viewed with ever-increasing favour: the disputed area is identified and agreement concerning it is reached for joint exploration and exploitation. This, for example, was achieved with the treaty between Australia and Indonesia on cooperation in the Timor Gap Zone signed in December 1989 and with the treaty concluded between the United Kingdom and the Netherlands concerning oil and natural gas fields, concerning at the same time, the part of the continental shelf under the jurisdiction of one state and the part under the jurisdiction of the other state.

It is interesting to note how, after this second agreement, the governments of the United Kingdom and of the Netherlands established a joint exploitation programme of a part of the shelf known as the Markham field. By virtue of this programme, the two countries were committed to requesting from the groups of companies – that had previously obtained exploration and exploitation licences from each

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13 For the use of this other expression see point 42 of the award rendered by Sole Arbitrator Dupuy in the California Asiatic Oil Company and Texaco Overseas Petroleum Company v. Government of the Libyan Arab Republic case.

14 See in community case law, for example, the decision of the Court of First Instance of 22 January 1997 in the Opel Austria v. Consiglio case T-115/94, see Mengozzi, 1997; Mengozzi, 2004.
country – the settling between themselves of an agreement to regulate the exploitation of that field and to designate a single licensee to act as Unit operator. This Unit operator has been given the task of submitting to the two governments a proposal concerning the identification of the extension of the field to be exploited, as well as details on the way in which the oil should be shared among the two groups of companies that had previously each obtained its own licence to exploit in each part of the continental shelf resulting from delimitation. The governments of the two countries have retained the power to approve this proposal, although provision is made for having recourse to a neutral expert if an agreement between the two countries is not reached. The sharing of the quantities of oil or natural gas, resulting from the two countries’ approval of the Unit operator's proposal or from the neutral expert’s determination, is taken by the agreement as the basis on which taxes and royalties payable by the licensees to each of the two contracting parties are calculated.

A different example of cooperation can be identified in the agreement concluded between Thailand and Malaysia concerning an area of the Gulf of Thailand over which not only Thailand and Malaysia but also Cambodia and Vietnam claimed jurisdiction. As Thailand and Malaysia were able to reach a delimitation agreement concerning only a limited part of that area, in 1979, they concluded a Memorandum of understanding, identifying a triangular area as a joint development area. After lengthy negotiations the two parties concluded a joint development agreement in 1990 which resulted in the establishment of a joint authority.

What appears evident from these two examples is that, when faced with problems deriving, in the first case, from deposits extending beyond both sides of the line of delimitation and, in the other case, from difficulty in reaching an agreement leading to such a delimitation, the parties to the two agreements made reference to the obligation placed on states by art. 83 of the Montego Bay Convention. The fulfilment of this obligation (namely, to delimit their respective continental shelves by agreement) was seen by them as achievable, albeit with difficulty, in harmony with the other criterion (equitable solution) set out in the same art. 83 of the Montego Bay Convention, at least in a transitional stage, through forms of joint development.

In these two cases, does the fact that the obligation to use the two criteria envisaged in art. 83 has undoubtedly been considered capable of being fulfilled by means of the establishment of forms of cooperation, namely the creation of joint development zones, mean that a principle of cooperation has emerged that binds in a general way states and individuals and entities operating at international level and requires them to seek settlement of their conflicts of interest by negotiation and agreement?

Such a conclusion may perhaps be excessive. What can nevertheless be observed is that – as concerns the specific matter of exploration and exploitation of hydrocarbons, at the level of relations between states, thanks also perhaps to the disappearance of the strong forms of assertion of state sovereignty characteristic of the cold war period – a principle of cooperation among states, at least among neighbouring states, is taking shape. In this regard, one cannot disagree with the idea that what was provided for in art. 3 of the Charter of economic rights and duties of states, adopted by the United Nations General Assembly Resolution of 12 December 1974 according to which “in the exploitation of natural resources shared by two or more countries, each State must cooperate on the basis of a system of information and prior consultations in order to achieve optimum use of such resources without causing damage to the legitimate interest of others” is becoming a rule of general international law (Bundy, 1995).

### 10.1.8 Cooperation among states: the Reformulated and Conventional Gasoline case

With reference to the exploration, cultivation and exploitation of hydrocarbons, forms of cooperation have progressively accompanied the claim of sovereignty. As has been seen, this has occurred at the bilateral level, as concerns hydrocarbon deposits in the continental shelves of states with opposite or adjacent coasts and in the framework of agreements concluded among several states, in relation to cases of pollution caused by incidents involving ships carrying such resources.

One may wonder whether these forms of cooperation are the expression of the free choices made by the states which have initiated them or are a sign of awareness by those states of the emergence on this matter of a principle sanctioning the obligation to cooperate.16 No precise reply can be given to this

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15 For a precedent to such a solution in the agreement on the delimitation of the continental shelf concluded in 1965 between the United Kingdom and Norway and in the related special Agreement on the Frigg Field Reservoir, see Brownlie, 1979.

16 Specifying, respectively, the way in which art. 83 of the Montego Bay Convention, illustrated above, must be applied and the idea according to which ships of all states must be ensured freedom of maritime transport – including the freedom to carry hydrocarbons – so that no one must suffer on account of that freedom.
question with reference to the specific problems set out above. One can only affirm that the application of such a principle in the cases considered is the manifestation of a trend in international relations. A reply to a question of this sort, in the second of the two directions indicated above, can however be given, with reference to the rules governing the marketing of such resources. This is in the light of a report by the Appellate Body of the World Trade Organization (WTO), which in its opinion revised the report adopted by a Panel on 29 January 1996 (WT/DS/R, United States – Standards for Reformulated and Conventional Gasoline) and which the Dispute Settlement Body of the WTO adopted on 20 May of that very year (AB-1996-1, WT/DS2/AB-R) in a dispute between Brazil and Venezuela, on the one hand, and the United States, on the other.

The dispute arose following an amendment made in 1990 to the Clean Air Act of 1955 of the United States (42 U.S.C., paras. 7401-7671q). By this amendment the United States Environmental Protection Agency (EPA) established the so-called Gasoline Rule. In other words, a rule concerning the composition and effects of gasoline emissions for the purpose of reducing pollution in the air in the United States. The Gasoline Rule permitted the sale only of reformulated gasoline in the most heavily polluted areas of the country. For the rest of the country a regime was envisaged that was destined to be applied to all refineries, blenders and importers of gasoline in the United States and aimed to prevent the gasoline marketed from being more polluting than the gasoline marketed in 1990 (conventional gasoline). By establishing this regime, the EPA, on the one hand, required that US refineries that had been operating for at least six months in 1990 establish an individual refinery baseline which was to represent the quality of gasoline produced by that refinery in 1990. On the other hand, the EPA itself had defined ex officio a statutory baseline, aimed at representing the average quality of gasoline sold in the United States in 1990. This statutory baseline was meant to have been the reference parameter for the United States refineries that had not been operative for the required time in 1990, as well as importers and blenders of gasoline.

In the proceedings conducted at the seat of the WTO, Venezuela and Brazil asserted that the Gasoline Rule was incompatible, amongst others, with art. III of the General Agreement on Tariffs and Trade (GATT) 1994, as it led to a discrimination between United States producers and those from other states (that had to follow the different baselines established for the United States producers) and could not be justified by the exception provided in art. XX of the GATT 1994 establishing that “nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures […] relating to the conservation of exhaustible natural resources” can benefit.17 The Appellate Body, however, held that the exception in question ought formally to be applied, as the expression relating to must not necessarily be understood as necessary to and attention had to be paid to the fact that the EPA's measures ought to have been qualified as adopted “in conjunction with restrictions on domestic production or consumption” according to the text of art. XX, as those measures were applicable also to United States refineries not operating in the United States, for the required length of time, in 1990. It however concluded, as the Panel already had, that the US measures were incompatible with the GATT. This was because the conduct of that country, although “in the disguise of a measure formally within the terms of one of the exceptions provided for in Article XX”, constituted a “disguised restriction on international trade” and did so because – and it is this it stressed – it was a violation of a United States’ duty to cooperate with Brazil and Venezuela (Nogueira, 1996; Cho, 1998).

17 The air is also one of the natural resources considered in para. 6. 36 of the Report, but the measures “relating to the conservation of exhaustible natural resources” must be understood as only those relating to its protection.
The United States had tried to justify the imposition of statutory baselines on the oil importers from these countries on the grounds that the application of individual baselines to foreign refineries would have created administrative difficulties. The Appellate Body rejected this justification pointing out that the documentation submitted in the proceedings “did not reveal what efforts the United States may have made towards cooperating with the governments of Venezuela and Brazil to mitigate the administrative difficulties they complained of”.

It has been said that, by deciding in this way, the Appellate Body “left a potentially significant legacy in its analysis: trans-governmental regulatory cooperation” (Cho, 1998). Even if this statement is a little too emphatic, there is no doubt that in today’s interdependent global economy, problems arising with reference to the search for, cultivation and marketing of hydrocarbons increasingly determine the need to reconcile protection of investments and trade with protection of the goals of a public nature of states and of the entire international community.

True, effective cooperation among the protagonists of the vicissitudes concerning the sector is necessary because, more than recourse to techniques for choosing the applicable law and provision for international arbitration, or at any rate together with both techniques, it can concretely lead to such conciliation. It is therefore particularly wise that the Appellate Body of the WTO stated what has been indicated above (Baroncini, 2005).

References


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