Fundamentals of International Oil and Gas Law

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collected into the codes. **Special legislation** may also be enacted to address special issues of interest to the legislators.)

- The role of the judge in the civil law (code) system is separated from any law-making role and is generally limited to finding, interpreting, and applying the correct and applicable general rule from the code to a specific factual dispute. Civil law system judges, in other words, are not engaged in making law.
- In presenting or deciding legal disputes in court, the lawyers' reliance on and a judge's deference to prior judicial decisions as precedent is reduced or eliminated. However, in some civil law countries a court might defer to a prior decision of a higher court, but the deferring court may not be obligated to defer to the prior decision.

The civil law (code) system is loosely derived from the Justinian legal code from Roman antiquity, but takes its more recent ancestry from Napoleon, thanks to whom it prevails at the present time throughout continental Europe. The system is also typical of legal systems of countries in those parts of Africa, Latin America, and elsewhere that are former colonies of continental European countries. It also exists selectively in a number of other important countries (Turkey, Japan, and China) that have modified and enacted various continental European codes (for example, commercial codes) as their basic law.

The differences between common law and civil law (code) systems extend to basic differences in the style of enacted legislation. Civil law (code) legal systems often have a mining or petroleum code that is systematic and comprehensive, collecting in one place most rules that govern a wide variety of oil and gas issues. Examples of mining or petroleum codes are those of Romania and Hungary.[8] This systematic and comprehensive character of a civil law mining or petroleum code contrasts with the very noncomprehensive nature of enacted legislation dealing with oil and gas in common law countries, which tends to address only specific issues or segments of the industry. An example of the US piecemeal approach to enacted law is the Oil Pollution Liability and Compensation Act,[9] which addresses a specific problem and is located in statutes separate from much of the other oil and gas legislation. Likewise in the United Kingdom, the Petroleum Act of 1998 regulates *offshore* pipelines, while the separate Pipelines Act of 1962 and Gas Act of 1995 regulate *onshore* pipelines.[10]

Islamic Law

A third major category of the world's legal systems important to the oil and gas industry is Islamic law. Islamic law's special application to international oil and gas derives from the fact that substantial amounts of the world's energy resources are in countries in which Islamic law (often referred to by its Arabic name, **Sharia**) either is the basis for or influences national legal systems.

Islamic law is based on the Holy Scripture of divine revelations (the **Quran**) given to the Prophet Muhammed and on the tradition (**Sunnah**) of what Muhammed said or did during his life, as established by authenticated reports (**hadith**). In addition, relevant in most schools of Islamic law are the consensus (**ijma**) of the Islamic community as reflected in the interpretations (**fatwas**) given by Islamic law scholars, along with valid sale to the government of all earlier Saudi oil concessions. In formal legal argument, the Saudis said:

> "The principle of change of circumstances, like any other legal principle, may be abused, but the idea itself is a good idea, and ought not to be discredited. . . .
>
> "As a matter of fact, the theory of change of circumstances is not confined to the law of individual states. It actually received international acceptance when it was incorporated in the wording of article 19 of the League of Nations Charter, which gave the League the right to reconsider international treaties and positions, whenever they become inapplicable, or when their continuation would constitute a threat to world peace. Hence, we see that the idea of changing circumstances is accepted almost unanimously as a principle in the context of various legal systems."[17]

A state's unilateral changes in or revocation of its treaty or contract obligations create doubt whether an international legal order is possible, because a promise that is good only as long as the promisor state wants to comply with it is no promise at all. And because there will always be some reason, real or manufactured—such as changed circumstances—why a state decides to disregard its treaty or contract obligations, the Saudi argument if adopted as a matter of policy or practice presents similar issues.

International Law and National Law in the Hierarchy of Law

International law does not necessarily occupy a place in the hierarchy superior to the national law of a country in the same way that national law often is superior to the law of (say) one of the cities or political subdivisions within the country. Ultimately, it is national law that determines whether international law will subordinate one or more aspects of national law, and on this issue countries disagree. An important issue in questions of the place of international law in the legal hierarchy is that of reversibility: If a state can adopt international law as its supreme law, is there any reason why it cannot later go back to subordinating international law to national law?

Under the national law of most countries, such as the United States, the national constitution is the highest law, higher than not only other kinds of national law (such as enactments of legislature and administrative agency regulations), but also higher than international law. Indeed, in the United States, international treaty law occupies a place hierarchically below the constitution and on the same level as national legislation.[18] By contrast, the national law in a minority of countries elevates international law to a place hierarchically *above* the highest national laws of the countries, including the national constitutions. In other countries, an individual treaty's obligation becomes the highest law, but only upon some special legislative action.[19] Some members of the European Union differentiate between the law of the EU and other types of international law. Although there are no express provisions in the core EU treaties regarding the primacy of EU law

The Organization of Petroleum Exporting Countries (OPEC)

A multinational exporting-state treaty of special interest to international oil is the treaty creating the Organization of Petroleum Exporting Countries (OPEC). As of mid-2014, the list of OPEC members and their most recent dates of admission is as follows:

- Saudi Arabia, 1960
- Iran, 1960
- Iraq, 1960
- Kuwait, 1960
- Venezuela, 1960
- Algeria, 1969
- Libya, 1962
- Nigeria 1971
- Qatar, 1961
- The United Arab Emirates (UAE), 1967
- Ecuador, 2007 (it first became a member in 1973 but suspended its membership from 1992 to 2007)
- Angola, 2007

Like many other treaties, OPEC's founding treaty (called its **statute**) is on deposit with the UN secretariat. The organization now seeks to maximize long-term prices and revenues by imposing production quotas (also called **output targets**) on individual member states, setting each state's maximum allowable production.[35] In addition to setting and adjusting maximum production quotas for member states, OPEC maintains price stability through agreements between OPEC and nonmember producing states. Cheating by member states that exceed their production quotas has been an historical obstacle to OPEC's efforts to support minimum prices.[36] The temptation of individual members to cheat by overproducing is especially strong when prices are low and the need for solidarity is greatest: with low prices, a cut in production is a call on member states to combine low prices with lowering sales volumes, in effect punishing member states twice. Because important OPEC decisions must be made by unanimous consent of member states, enforcement measures against noncomplying members are a practical impossibility. Obviously, where production in OPEC member states is controlled by private or foreign operators from non-OPEC countries, a member state's ability to comply with cartel-set production quotas will involve provisions in contracts between member states and private operators obligating operators to alter production rates when and as directed by the host country (the OPEC member state) or its state oil company.[37]

OPEC membership consists only of net *oil* exporters and not *natural gas* exporters as such. Officials from the separate 11-nation Gas Exporting Countries Forum explained OPEC's limitation as due to "intrinsic differences" between oil and gas that make gas exporters incapable of affecting gas prices through production quotas. Since gas is largely sold under long-term, oil-indexed contracts, producer influence on pricing is reduced, and

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National Export Controls, Foreign Investment Restrictions, Sanctions, Embargoes, and Boycotts

General Considerations

International trade—movement of goods, services, and investment capital across national boundaries—can be obstructed by measures restricting or burdening *imports*. As discussed in chapter 3, import restrictions include tariffs and quotas along with government subsidies for goods and services produced domestically within an importing country. It is to such common import measures that trade treaties like the WTO agreement are commonly directed. But burdens on international trade are not limited to import measures. This chapter discusses several such other measures important to the oil and gas industry: export controls; foreign investment restrictions; and sanctions, embargoes, and boycotts.

That restricting *exports*, for example, would be a concern only for the exporting country alone and would have no impact on the importing country can be easily refuted with the example of US natural gas exports to Mexico: The big jump in unconventional US natural gas production beginning in 2008–2009 dramatically increased supply in the US, reducing US gas prices. US gas producers then began increasing exports to Mexico, with US gas exports increasing 50% between 2013 and 2014. Gas prices paid by Mexican industries dropped 37% from ten years earlier. Lower gas costs for Mexican industries meant large productivity gains for them, lowering their production costs and increasing their profits. And since Mexico's manufactured goods are exported largely to the US, lower production costs for Mexican goods meant lower costs for US buyers of the goods.

Customary international law generally allows states to enact national laws restricting exports, foreign investments, and business done with other countries. Some treaties specifically authorize, require, or limit such national laws. Free trade area agreements (discussed in chapter 3), for example, may address not only import tariffs and quotas, but also laws restricting export and investment flows between signing states.

The result is that export controls; foreign investment restrictions; and sanctions, embargoes, and informal boycotts have been common or commonly authorized by national law everywhere. These national laws differ widely in how the practices operate. Common especially for national oil and gas resources have been national laws restricting foreign ownership or control. Some countries not only claim ownership of

US sanctions at that time were intended to prohibit trade and investments between Iran and the US, but Iranian oil deliveries to the US or through US companies were excluded from the sanctions, and US companies' activities with Iran outside the US were also not affected. In 1987, President Reagan extended the embargo to prohibit Iranian oil deliveries to the US, but the results were that Iran shifted its oil sales to Asia (especially China) and that non-US companies (unaffected by the 1987 extension) increased activities in Iran, in effect replacing US companies. In 1996, new US president Bill Clinton added a prohibition on US banks doing business with Iran, but the prohibition did not include Iran's selling its oil for US dollars if the dollars were purchased from non-US banks. (International oil transactions then and now are commonly settled in US dollars.) And Iran responded to the restriction on US banks by shifting its financial operations from US banks to non-US banks for settling dollar purchases and sales, so the new restriction in effect inconvenienced Iran very little, but rewarded non-US banks and penalized US banks.[94] These changes also threatened sanctions for non-US companies investing more than $20 million per year in the Iranian energy sector, but the restriction remained unenforced for ten years.[95] Still, though legally unenforced, many energy companies with large US investments observed the prohibitions as a way of maintaining US regulatory goodwill.

New US concerns about Iran surfaced in 2006. Evidence indicated Iran was operating a program to enrich uranium to weapons grade levels—a program threatening to make serious conflicts in the Middle East even worse—so the UN Security Council approved three resolutions calling on member states to impose limited sanctions on Iran: prohibiting trade in nuclear and dual use technology with Iran, freezing the assets of 40 named individuals and entities, and restricting Iranian travel. (From the beginning, Iran has insisted its enrichment program is not weapons-related, but also asserting its sovereign rights to enrich uranium for any purpose, including weapons development.) Obtaining Security Council approval for sanctions presents several difficulties. Chief among them, Russia and China have Security Council veto rights they have used to protect Middle Eastern allies in which they are heavily invested. Also, not all other permanent and non-permanent Council members are sympathetic with imposing Iranian sanctions or agree that Iranian uranium enrichment threatens Middle Eastern peace or justifies international intervention into the domestic affairs of a sovereign state (Iran).

So, for its part, the US then extended US-law sanctions to ban doing business with specific Iranian banks and extended then-existing bans on US banks to include US-connected non-US banks. Thus, a British bank doing business in the US would be subject to US sanctions prohibiting the British bank from doing business with Iran. And the US began a program of enforcing 1996 prohibitions on non-US companies. Unless the US (then principal sponsor of Iran sanctions) could convince EU, Asian, or other states to join in its sanctions program, extending the US prohibitions to foreign companies doing business in the US ran an obvious risk: it asserted US regulatory and enforcement jurisdiction in ways the foreign home states of the affected companies might find objectionable. The French company Total, for one, announced in 2006 it was a French company and so not bound to observe US restrictions on its Iranian investments (though by 2008 Total had had second thoughts and announced it would comply with US prohibitions).[96] And US expansion of sanctions enforcement to non-US companies disputing parties might agree after a dispute arises to arbitrate some or all of the dispute, but otherwise the cases will not be arbitrated because the required consent is lacking.

Litigation remains important for several other reasons: Even where parties have a contract requiring arbitration, the contract's arbitration provision may be so limited in scope that it fails to require arbitration of the specific dispute at issue. Possible, too, is that some party may fail or refuse to comply with a contract arbitration obligation, in which case litigation may be necessary to establish the obligation or to enforce an arbitrator's decision. Or one or both parties might decide that litigation is more advantageous than arbitration, or there is no obligation compelling them to arbitrate.

So, understanding alternatives of dispute resolution in international oil and gas matters requires familiarity with litigation.

Applications: Examples of Nonarbitrable Litigation

What kinds of international oil and gas disputes end up in litigation in government courts rather than in arbitration? The range is potentially unlimited:

When a dispute arose between China National Petroleum Corporation, the largest oil company in China, and Russia's major oil company, OAO Lukoil, in regard to a $4.18 billion acquisition of PetroKazakhstan, a company based in Calgary, Alberta, but producing and refining oil in Kazakhstan, it was a Canadian government court that resolved the dispute and approved the Chinese takeover.

In 2006, a government court in Spain temporarily suspended a hostile $26.77 billion bid by the Spanish company Gas Natural SDG, SA, for the utility Endesa, SA, pending a court ruling on whether the acquisition would violate EU competition law.

Three outside directors of China Aviation Oil (Singapore) Ltd. were prosecuted and pleaded guilty in a court in Singapore in a criminal case alleging they had engaged in insider trading and had had a role in CAO's failure to disclose company losses to the Singapore Exchange.

In mid-2006, Russia's state-owned oil company OAO Rosneft's first day of trading in an initial public offering (IPO) ended with large losses in stock value in London. In a London court, lawyers for the major Russian oil company OAO Yukos sought to block the IPO by arguing the stock sale constituted money laundering under a British criminal statute, where 70% of the stock value came from the taking of Yukos assets. The UK's Financial Services Authority had earlier refused to accept the Yukos argument.

In 2012, the US District Court in New Orleans began a consolidated, government court trial of issues from more than 100,000 claims seeking to establish liability for compensation for damages arising out of the Macondo oil spill that occurred in the US Gulf of Mexico in 2010, as detailed in applications notes below.

- Details on judicial review of the award, including any waiver of appeal. The parties should consider drafting a provision making errors of law subject to appeal to avoid the problem of legal error by nonlawyer (or lawyer) arbitrators.
- Details on enforcement of the arbitration agreement and award
- The language in which arbitration will occur
- Replacement of arbitrators, and the arbitrators' authority to rule on their own jurisdiction
- The effect of an **ex parte** proceeding (that is, where one party fails or refuses to participate, and the other party proceeds to arbitrate alone)
- Arbitrator qualifications
- Restrictions on publicity (for example, that there be no publicity without consent by the other party)
- Provisions protecting the confidentiality of proceedings and of their outcome, in case an arbitration institution's rules are inadequate
- Whether there are to be conditions precedent to the arbitration (for example, that the parties first seek to negotiate or mediate in good faith)
- The possibility of consolidating arbitrations where there are several disputes between the parties or where a dispute involves more than two parties
- Addressing sovereign immunity issues. For example, obtaining express state waivers of objections to arbitration and to enforcing the agreement and award, including (or excluding) waiver of any objections to execution on state assets to apply to the award.

The Institutional Procedures

Although rules of arbitration institutions vary in important ways, the 2012 rules for the International Chamber of Commerce (ICC) illustrate how an arbitration in one institution typically proceeds. The following description assumes the parties' agreement has not modified the process.

To commence an arbitration, a party sends a written request to the ICC secretariat, describing the dispute, the relief sought, the relevant agreement(s) (especially in regard to arbitration), and the requested location, choice of law, and choice of language for the proceedings. The requesting party also must pay the advanced expenses required by the rules.

The opposing party responds to the request or allegations within 30 days or such extended time if and as granted by the secretariat and also files any counterclaim. In the event the arbitration agreement is clear in requiring the parties to arbitrate the dispute, the ICC arbitrators can and will proceed to arbitrate, even if the opposing party fails or refuses to participate.

The ICC will appoint a single arbitrator if the parties have not agreed there will be three. If the parties have agreed on three, each party nominates one arbitrator (who to require US companies and their non-US subsidiaries operating outside of the country to comply with US laws such as those restricting business with prohibited countries, the European community and individual European states contested the US position as outside of a state's proper regulatory jurisdiction.[9] One specific dispute at the time related to a Soviet Trans-Siberian pipeline in 1982: A French buyer had ordered gas compressors from a French corporation that was a subsidiary of Dresser Industries, a US corporation, and the buyer intended to use the compressor parts for construction of the pipeline in the USSR. The compressor technology was owned by the US parent Dresser and licensed to its French subsidiary. Dresser-US owned all of the stock of Dresser-France and had created Dresser-France to serve the purposes of the Dresser-US enterprise, but the French subsidiary had no direct operations in the US, and French law and government considered the subsidiary to be a citizen of France. US export controls, issued in response to then-recent Soviet actions in Poland, forbade export of oil and gas technical data and equipment to the Soviet Union by US companies (or companies owned or controlled by US companies). When the French government ordered Dresser-France to proceed with the sale, the US government imposed sanctions on Dresser-US, prohibiting further exports to Dresser-France, after the compressors were delivered in violation of the export controls but pursuant to the French government's order.[10]

Against what are alleged to be unlawful exercises of regulatory jurisdiction by a state, as in the case of the Soviet pipeline example, other states sometimes respond or retaliate by enacting so-called **blocking statutes** that forbid their own nationals from complying with foreign laws.[11] Blocking statutes create potentially impossible compliance dilemmas for parties subject to contradictory laws. Some authorities have tried to limit controversial assertions of regulatory jurisdiction by disallowing it where it is "unreasonable" considering "all relevant factors," including "the likelihood of conflict with regulation by another state."[12] Whether such limits have practical meaning or effect is debatable.

Enforcement Jurisdiction

International and national law may also authorize or restrict a state's jurisdiction to *enforce* its laws. The line between regulatory and enforcement jurisdiction is sometimes unclear, but the following example illustrates where the difference lies. As indicated in an applications note in chapter 22, for reasons related to environmental protection, a coastal state might have regulatory jurisdiction to require all vessels (even foreign flag vessels) within its territorial waters to meet certain construction standards (regulatory jurisdiction). But the coastal state might also be limited in stopping and inspecting a foreign-flag vessel exercising its right of innocent passage through the coastal state's territorial waters (enforcement jurisdiction).

International law generally has imposed three conditions on enforcement jurisdiction:[13] First, the regulation to be enforced must be one the state has regulatory jurisdiction to prescribe. Second, an enforcement measure must be **reasonably related** to the regulation to be enforced and proportional to its importance, and punishment for noncompliance can occur only after prior determination that a violation has occurred. And third, where a party against whom enforcement is sought is located outside the enforcing state's territory,

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Special Defenses for States and State-Owned Oil and Gas Companies

Countries or their state-owned companies often join with private parties in international oil and gas transactions or occurrences, making it inevitable that disputes and claims against states will occur. If there were special defenses available to states to bar claims against states in these disputes, then asserting legal rights against states for their wrongdoing would be impossible, and state promises might be unenforceable. Issues of special defenses available to states and their state-owned companies are then obviously important to the international oil and gas industry.

Most countries have long had national laws prohibiting or restricting lawsuits brought by private persons against *their own* governments, and legal scholars have advanced various theoretical justifications to support these restrictions. But states' immunity from suits by their own citizens produced real injustices, and such immunities have fallen out of favor. The result has been that states increasingly have consented to being sued by their own citizens, at least in their own law or administrative courts and at least for certain kinds of cases.[1]

The status of the case of lawsuits or proceedings brought by a party against a *foreign* state or government is more complex but comparable: customary international law as observed in national legal systems traditionally prohibited or restricted such lawsuits, but these traditional prohibitions and restrictions are now being limited. Moreover, states and their state-owned companies have found that unless they consent to making themselves available to lawsuits, no one will do business with them in the global economy. As a consequence, a state's sovereign immunity from suit by foreign creditors has diminished, either by the state's consent or by changes in national laws.

For present purposes, the two most common and important special defenses that continue to be applicable in some form, uniquely to litigation involving foreign states and foreign state conduct, are the separate but related defenses of **sovereign immunity** and the **act of state doctrine**.[2] These defenses apply to legal proceedings against a foreign state or state-owned company or to proceedings in which the legality of some public act of a foreign state has been challenged. The special defenses ultimately derive from international law—from the idea that states are sovereign and equal and therefore that no state can be judged by the courts of some other state. But the specific form and application of these defenses remain those of national law and so vary somewhat from state to state.