World Petroleum Congress

Second Regional Meeting

Qatar

8 – 11 December, 2003

Managing Risk and Uncertainty in the Modern Petroleum Industry

Anthony Connerty

anthonyconnerty@lambchambers.co.uk

anthonyconnerty@yahoo.co.uk

Contents

Contact Details

More information about the various organisations referred to in this Paper can be obtained from the following websites:

International Court of Justice: www.icj-cij.org

Permanent Court of Arbitration: www.pca-cpa.org

International Centre for the Settlement of Investment Disputes: www.worldbank.org/icsid

World Intellectual Property Organisation: www.arbiter.wipo.int

International Chamber of Commerce: www.iccwbo.org

London Court of International Arbitration: www.lcia-arbitration.com

China International Economic Trade Arbitration Commission: www.cietac.org.cn

The Chartered Institute of Arbitrators: www.arbitrators.org

Managing Risk and Uncertainty in the Modern Petroleum Industry

By Anthony Connerty

A. Overview

This Paper for the World Petroleum Congress 2nd Regional Meeting in Qatar in December 2003 concentrates on one particular aspect of risk management: the avoidance and resolution of disputes in the legal field.

The nature of risk in the petroleum industry may be said to be changing. Risk existed, and still exists, in the technical sphere in relation, for example, to safety.

But risks in the legal sphere have increased as the complexity of global relationships have increased. At a Workshop organised in Dallas in 2001 by the Institute of Transnational Arbitration, Prof Michael Reisman of Yale Law School said that "*the need for petroleum as for many other materials, requires the maintenance of a vast and complex international legal infrastructure for exploration, exploitation, transportation and distribution and for resolving disputes concerning these activities.*"

Managing "legal" risks connected with disputes involves two areas: dispute avoidance and dispute resolution.

B. Dispute Avoidance

It is obviously preferable to avoid disputes arising in the first place. A common thread can be seen in steps taken in various industries around the world aimed at minimising and managing risk. These steps include:

i) <u>Planning</u>

- ensuring that contractual documents are clear, precise and fair
- maintaining accurate records
- anticipating potential problem areas
- defining problems when they arise

ii) Schemes to lessen the risk of disputes arising

Partnering is one example. This is a concept used originally in the construction industry. The aim is to establish a working relationship between the contracting parties involved in a project: through cooperation and teamwork the parties should achieve their mutual goals. Good faith is obviously a vital component.

iii) Resolving disputes before they escalate

Contracts can include provisions for dealing with disputes as they arise, in an effort to stop them escalating:

- Dispute Review Boards. A number of respected professionals are nominated before the project starts. They familiarise themselves with the project and keep abreast with developments as work proceeds. Disputes are referred to the DRB for a non-binding ruling. If that does not resolve the dispute, the matter is referred to a further dispute resolution process.

- A similar concept is the Standing Neutral who, for example, will conduct neutral fact-finding exercises.

- Multi-Step Dispute Resolution. This is a "filtering" process. If the first stage of the dispute resolution process – for example the DRB – is not successful, the dispute is moved to the next step. This might be a formal mediation process.

- One form of multi-step ADR (alternative dispute resolution) is the "wise man" procedure used in the oil and gas industries. The wise men will be respected executives in the companies concerned, but who are not involved in the particular project. They investigate the dispute. If they are unable to resolve matters the dispute proceeds to the next stage. This might be arbitration.

iv) Specific Schemes

Dispute avoidance schemes can be used for all aspects of a project. For example, an Oil and Gas Industry Bulk Liquid Terminal Scheme for the avoidance of industrial disputes provides for a step-by-step process for settling labour grievances.

Work is to continue during the period of those negotiations.

C. Dispute Resolution

I. Introduction

This part of the Paper looks at methods of dispute resolution in the Petroleum Industry.

There is probably little doubt that the two major methods of dispute resolution are still litigation and international arbitration.

But it is clear that other dispute resolution processes are being used, amongst them ADR and Expert Determination.

To state the obvious, which type of dispute mechanism will be used in any particular case will depend upon the precise nature of the dispute: a jurisdiction dispute arising out of an international contract is likely to be settled by litigation rather than, say, expert determination.

II. Methods Of Dispute Resolution Used In The Industry

Because of the special nature of the Energy Sector, disputes between States and disputes between corporations and national governments are likely to arise. Resolution of these disputes may be by way of machinery contained in international Conventions or in domestic legislation passed by national governments.

On the commercial front, many of the dispute resolution processes used in the Petroleum Industry will obviously be similar to those used in other areas of international trade.

Given the international nature of many of the contractual arrangements in the Industry, it is understandable that, in addition to litigation in national courts, disputes are likely to be resolved by way of international commercial arbitration.

For the future, increased use may be made of two other dispute resolution processes. First, Alternative Dispute Resolution (ADR) in its various forms (particularly mediation/conciliation). Second, expert determination.

Set out below are some of the Dispute Resolution organisations and processes which are available for use in the Petroleum Industry. Some of these derive from international conventions.

III. Organisations Providing Dispute Resolution Facilities

(1) "Supra-National" Organisations

Dispute resolution bodies can be divided into what may be broadly described as the "supra-national" and the "international commercial" dispute resolution organisations.

Amongst the supra-national are the International Court of Justice (ICJ) and the Permanent Court of Arbitration (PCA), both in The Hague. Another is the International Centre for the Settlement of Investment Disputes (ICSID) in Washington. The UN's World International Property Organisation in Geneva (WIPO) is at first sight an unlikely organisation to assist the Petroleum Industry. But the WIPO Domain Name Dispute Resolution system has been involved in successfully dealing with the "cyber-squatting" of oil company domain names.

(2) International Commercial Organisations

There are many international organisations concerned with dispute resolution.

It is not possible to consider them all, but they include the International Chamber of Commerce in Paris (the ICC), the London Court of International Arbitration (the LCIA), the Chartered Institute of Arbitrators, and the China International Economic and Trade Arbitration Commission (CIETAC).

IV. International Conventions

There are various international conventions which deal with or which include provision for dispute resolution.

There are three such conventions which are of particular interest to the Petroleum Industry.

(1) The Washington Convention

The Convention for the Settlement of Investment Disputes, Washington 1965 (commonly known as the ICSID Convention) was formulated by executive directors of the World Bank.

The preamble to the Convention refers to the need for international cooperation in relation to economic development and investment. Such investment may give rise to disputes. Those disputes should be settled on the basis of international methods of dispute settlement. The Washington Convention established the International Centre for the Settlement of Investment Disputes for the purposes of dealing with such investment disputes.

The provisions of the ICSID Convention and the services of the ICSID Centre are now being widely used, particularly in relation to Bilateral Investment Treaties (BITs).

(2) UNCLOS III

The third United Nations Conference on the Law of the Sea (commonly known as UNCLOS III) states in Article 2 that:

> *"(1) The sovereignty of a coastal State extends beyond its land, territory and internal waters... to an adjacent belt of sea, described as the territorial sea.*
>
> *(2) This sovereignty extends to the air space over the territorial sea as well as to its bed and subsoil.*
>
> *(3) The sovereignty over the territorial sea is exercised subject to this Convention and to other rules of international law".*

Articles 3 and 5 deal with the breadth of the territorial sea and the "normal baseline" and Article 3 provides that:

> *"Every State has the right to establish the breadth of its territorial sea up to a limit not exceeding 12 nautical miles, measured from baseline determined in accordance with its Convention".* Article 5 states that: *"... The normal baseline for measuring the breadth of the territorial sea is the low water-line along the Coast...".*

Given the complexity of the subject matter of UNCLOS III it is unsurprising that the dispute resolution processes contained within the Convention are themselves complex. Part XV contains provision for the settlement of disputes. Article 279 provides that States which are parties to the Convention *"shall settle any disputes between them concerning the interpretation or application of this Convention by peaceful means..."* Article 287 says that States shall be free to choose one of the methods of dispute settlement set out in the Convention. These methods include Conciliation in Annex V, Arbitration in Annex VII and *"Special Arbitration"* in Annex VIII.

(3) The New York Convention

The ultimate object of referring a dispute to international commercial arbitration is the enforcement of the award made by the Tribunal. The United Nations' Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 is intended to provide for the mutual recognition and enforcement of arbitral awards made in countries which are parties to the Convention.

Most of the world's trading nations have ratified the New York Convention. Take the example of a dispute between UK and German companies. An award made against the UK Company could be enforced by the German company in the United Kingdom through the UK courts. And if the UK company had assets in, say, France and Italy, the German company could likewise enforce the award through the French and Italian courts since both France and Italy have ratified the Convention.

The New York Convention has been described as *"... the most important international treaty relating to international commercial arbitration. Indeed, it may be regarded as one of the major contributing factors to the rapid development of arbitration as a means of resolving international trade disputes",* Redfern and Hunter *"Law and Practice of International Commercial Arbitration".*

V. Commercial Contracts

Introduction

The contractual provisions dealing with dispute resolution in commercial contracts are of vital importance. Provision will normally be made as a minimum for the following:

1. *Forum: in what country should the dispute resolution process take place?*

2. *Choice of Law: which country's law is to govern the contract? It is, of course, always open to the parties to provide for a choice of laws rather than a choice of law and to provide that disputes will be resolved by way of reference to general principles of international law or* ***lex mercatoria****. However, the choice of a national law is likely to be the norm.*

3. *Dispute Resolution Process: broadly speaking, there are four dispute resolution processes in common use: litigation, arbitration, ADR and expert determination.*

- *If litigation, which country's courts are to have jurisdiction?*

- *If arbitration: is this to be institutional or* ***ad hoc****? If institutional, which institution? LCIA, ICC, etc.?*

- *If ADR, should some form of ADR filter mechanism be inserted in the contract, arbitration then only being triggered off in the event that the ADR process fails?*

- *Or is expert determination the appropriate way to resolve disputes?*

This Section looks at those four dispute resolution processes.

1. Litigation

Litigation in the national courts is probably - despite the increasing use of international commercial arbitration backed up by the New York Convention - still the major international dispute resolution process in use.

In the context of international contracts the major problem in relation to litigation is the prospect for one of the parties of that litigation taking place in the courts of a foreign country, conducted in a foreign language and under a foreign system of law.

However, litigation may be the dispute resolution process used for various reasons: more than 80% of the cases heard in the Commercial Court in London have no connection with England in the sense that either the subject-matter of the contract has no connection with England or one or more of the parties is not English.

2. Arbitration

There is no international court to deal with international commercial disputes. Therefore if no provision whatever is made in a contract for dispute resolution, any disputes arising out of that contract (which cannot be resolved by negotiation between the parties) are likely to have to be dealt with by litigation in the national courts.

The way to avoid the problem is to make provision for some other method of resolving disputes.

One obvious dispute resolution process to include in an international contract is arbitration. The parties can agree that, instead of their disputes being dealt with in the national courts, any disputes will be heard by an arbitral tribunal. Because arbitration is a consensual process, the parties can decide who will resolve their disputes, in which country the arbitration should take place, what law should be applied to the resolution of that dispute and which language shall be used for the purposes of the dispute hearing.

Many commercial contracts in which the parties have agreed to have their disputes resolved by arbitration will specify one of the well- known international arbitral bodies such as the International Chamber of Commerce in Paris or the London Court of International Arbitration.

ICC Arbitration

As an arbitral body, the ICC is amongst the world's foremost arbitral institutions. Its revised arbitration Rules came into force in 1998. The Rules deal with the commencement of the arbitration; the appointment of and challenge to arbitrators; the service of the Claimant's Request and the Respondent's Answer; provisions as to the place of the arbitration, the language of the arbitration and the procedures to be followed at the arbitration hearing; and the provisions relating to the Award and scrutiny of that Award by the ICC Court in Paris.

LCIA Arbitration

Like the ICC, the LCIA is a truly international organisation. It will arrange and administer arbitrations under any system of law in any part of the world. It will do so either under its own Rules or under the UNCITRAL Rules. There is no more need for an LCIA arbitration to be conducted in London than there is for an ICC arbitration to be conducted in Paris. The LCIA's own Rules have been translated into many languages.

3. ADR

ADR: development

There is nothing new in the concept of ADR: mediation and conciliation have been used in the East for centuries. What is new is the kind of techniques which have been developed in the United States. America has led the way in developing new methods of dispute resolution other than by way of litigation and arbitration.

To a great extent those developments were driven by concern at the delays and excessive costs of both litigation and arbitration. That concern was not restricted to the United States: hence the increasing interest in ADR in England (particularly by the English Courts) and the emphasis now laid upon Alternative Dispute Resolution in the English Civil Court system.

ADR in an international context

Although ADR in its present form developed in the United States, it is now in use worldwide.

Many of the major international arbitration institutions, such as the ICC, the LCIA and the China International Economic & Trade Arbitration Commission in Beijing (CIETAC), offer a wide range of dispute resolution processes which include both arbitration and ADR.

4. Expert determination

Expert determination and arbitration

The use of experts to determine technical or valuation matters has been known to English law for hundreds of years. The parties agree to instruct a third party to determine a specific matter.

The system has been used in the Petroleum Industry for redetermination and for the resolution of specific matters identified in the relevant contract.

It may be at times difficult to distinguish between expert determination and arbitration. But the differences between the two are significant.

An expert is appointed to obtain the benefits of his expert opinion. It is that expert opinion which will be used to arrive at the determination. Very often the matters to be decided will involve the expert in a valuation exercise. "Due process" may be conspicuously absent from the system of expert determination: the parties may not necessarily present their case or submit evidence. In England, at any rate, there are no statutory provisions governing expert determination.

VI. Examples Of Petroleum Related Disputes

Set out below are some examples of disputes concerning the Petroleum Industry. Examples are taken of cases and arbitrations dealt with by the International Court of Justice, the Permanent Court of Arbitration, the ICSID Centre and the World Intellectual Property Organisation.

Two examples are then given of disputes decided in the English courts.

International Court of Justice:

An International Maritime Boundary Dispute

Libyan Arab Jamahiriya and Malta:

International Court of Justice, June 1985. This case concerned a dispute on the delimitation of the continental shelf between Libya and Malta. The International Court of Justice considered the relevance of the 1982 United Nations Convention on the Law of the Sea.

Libya and Malta agreed to submit their dispute to the ICJ. The Court was asked to decide what principles and rules of international law were applicable to the delimitation of the area of continental shelf between Malta and Libya.

The parties to the dispute were broadly in agreement as to the sources of the law applicable. Both parties had signed the 1982 United Nations Convention on the Law of the Sea, but at that stage the Convention had not entered into force and was therefore not operative as Treaty-law. However, the parties agreed that the dispute was to be governed by customary international law: the 1982 Convention was therefore not irrelevant since the parties agreed that some of the Convention's provisions constituted, to a certain extent, an expression of customary international law.

By 14 votes to 3 the Court found that the principles and rules of international law applicable for the purposes of the delimitation were to be effected in accordance with equitable principles, taking into account all relevant circumstances so as to arrive at an equitable result. Circumstances to be taken into account in achieving this "equitable delimitation" included the general configuration of the coasts, the disparity in the lengths of the relevant coasts and the distance between them.

A report of this case can be found in International Legal Materials.

Permanent Court of Arbitration:

A Dispute Concerning Territorial Sovereignty

Eritrea-Yemen Arbitration

This was an arbitration under the auspices of the Permanent Court of Arbitration.

The arbitration concerned a sovereignty dispute between Eritrea and Yemen in relation to a group of Islands.

One aspect of the dispute brought in evidence concerning the significance of the granting of oil concessions.

Evidence was presented to the Tribunal by Yemen of the granting of oil concessions which it was claimed confirmed the Yemeni title. Yemen submitted various agreements and maps showing the granting of concessions in relation to some of the Islands.

According to Eritrea, the concession evidence put forward by Yemen was irrelevant.

Eritrea argued that both under the Law of the Sea and customary international law, mineral rights could not be acquired or lost through unilateral appropriation.

A report of the arbitration can be found on the PCA's website.

International Centre for the Settlement of Investment Disputes:

A Dispute Concerning Oil Distribution Activities

Agip Company v Popular Republic of Congo

Agip established in the Congo a company under Congolese law. Agip held 90% of the shares in that company, the remaining 10% being held by a Swiss company. Agip started oil distribution activities.

The oil products distribution sector in the Congo was nationalised. Agip had signed an agreement with the Government. That agreement provided that any differences arising "*shall be definitely settled in accordance with the Convention on the Settlement of Investment Disputes between States and Nationals of Other States of …*

1965, ratified by the Popular Republic of the Congo …through an Arbitration Tribunal consisting of three arbitrators… Congolese law, supplemented if necessary by any principles of national law, shall be applicable."

Agip wrote to the Secretary-General of the International Centre in Washington, DC requesting an arbitration. The Centre registered the request and a Tribunal was constituted.

A full report of the arbitration can be found in International Legal Materials.

The World Intellectual Property Organisation:

A Domain Name Dispute

Statoil ASA v Magne Espelund

The Complainant made an application to the WIPO Arbitration and Mediation Center concerning a domain name which had been registered by the Respondent. The disputed domain names were "statoil-gas.com" and "statoilgas.com".

The Complainant was an oil and gas company founded in 1972 with thousands of employees in 25 countries. Statoil is amongst the leading suppliers of gas to the European market. Statoil complained that the domain names were virtually identical to its trademark "STATOIL". The addition of the suffix "gas" strengthened the impression that the domain names belonged to the Complainant and were therefore confusingly similar. The Respondent did not reply to Statoil's contentions.

The Panel found that the Respondents had no rights or legitimate interests in the contested domain names and ordered that those names be transferred to the Complainant.

The WIPO domain name dispute resolution system has recently registered its 5000th case. Other oil related domain name cases, and a report of this case, can be found on the WIPO website.

Disputes in National Courts

The examples taken are cases decided by the English courts.

Shell International Petroleum Co. Limited v. Coral Oil Co. Limited [1999] 2 Lloyds Reports 606

Both companies were English companies, Coral having once been part of the Shell Group, but in 1976 there had been a management buy-out and a name change to Coral. Three agreements were made between the parties, a supply agreement, a lubricant and technical services agreement and a trademark licensing agreement. Each of those agreements contained either exclusive jurisdiction or arbitration clauses. Shell gave notice to terminate the service and trade mark agreements. Coral protested and threatened to bring proceedings in Lebanon. Shell sought an injunction in the English Courts to restrain Coral from pursuing that claim. An injunction in relation to part of the matters in dispute was granted by Mr. Justice Moore-Bick and subsequently a second injunction was sought in relation to further matters from Mr. Justice Thomas. In considering which Courts had jurisdiction, Mr. Justice Thomas took into account the following facts in finding that the English Courts had jurisdiction:

(a) Both companies were English;
(b) Coral had agreed in relation to other matters to English jurisdiction;
(c) Shell had no direct business interests in the Lebanon;
(d) Some but not all of the events took place in the Lebanon;
(e) Coral's documentary evidence was in the Lebanon but Shell's was in London;
(f) One of the individuals involved in the case was resident in Lebanon but could be made subject to the jurisdiction of the English Courts;
(g) The claim was governed by the law of the Lebanon.

The Judge concluded that, taking those factors into account, both England and the Lebanon could be regarded as *a* natural forum. But in all the circumstances of the case the English court could take jurisdiction: on the unusual facts the English Court's "indirect interference with the foreign court" was justified and an injunction could therefore be granted by the English court.

Glencore International v. Metro Trading International & Itochu Petroleum;
AND Singapore Petroleum & Banque Trad-Credit Lyonnais (France) S.A. (third party) & Metro Trading v. Itochu Petroleum and Banque Trad-Credit (third party) [1999] 2 Lloyds Reports 632

This case was part of extensive litigation arising out of a collapse in 1998 of Metro Trading. Whilst it had carried on business, Metro had provided storage facilities for oil products and vessels stationed off Fujairah and had also acted as an oil trader in its own right. Metro had entered into various contracts for the sale of cargoes of bunker fuel. Each contract was subject to English law and included an exclusive English jurisdiction clause. Cargoes were loaded and Bills of Lading issued to the order of the French Bank which had financed Metro's business operations. Actions were started in the English and French Courts. Mr. Justice Moore-Bick said that all parties before the Court wished to ensure that there was only one set of proceedings between them, but whereas the Bank and SPC wished those proceedings to be held in France, Itochu, Glencore and the Receivers wished the proceedings to be determined in England: *"This is, therefore a battle about jurisdiction and it is common ground that it must be decided in accordance with the rules laid down in arts 17, 21 and 22 of the Brussels Convention"*. The Judge laid emphasis on the fact that the effect of article 17 providing for exclusive jurisdiction clauses to have overriding conclusive effect gave precedence to that article over the provisions of articles 21 and 22. The stay of the third party proceedings was therefore refused.

D. Summary

Disputes inevitably arise in commercial relationships.

Greater emphasis is now being placed on taking steps to avoid such disputes arising in the first place.

But dispute avoidance measures alone are not sufficient. Provision needs to be made for dealing with disputes which arise notwithstanding the avoidance measures.

The type of dispute resolution processes likely to be used in the Petroleum Industry have been considered in this Paper: litigation, arbitration, ADR and Expert Determination.

Some of the organisations providing facilities for dispute resolution on a "supra-national" basis were looked at: the International Court of Justice, the

Permanent Court of Arbitration, the ICSID Centre and the World Intellectual Property Organisation.

On the international commercial level, reference could only be made in this Paper to a few of the many international commercial institutions: the ICC, the LCIA, the Chartered Institute of Arbitrators and CIETAC. There are many more: the Stockholm Chamber of Commerce and the Cairo Regional Centre for Commercial Arbitration are but a few of the many well-known and respected institutions operating internationally.

Further information on the organisations referred to in the Paper can be found at the website addresses listed earlier.

Anthony Connerty
Lamb Chambers
Temple
London