

# The Brief

March 2009

## Oil & Gas Update

### Algeria: lessons from the first competitive tender

Since 2005, the legal regime applicable to hydrocarbons activities in Algeria has undergone a transformation. A modernised hydrocarbons law was enacted on April 28, 2005<sup>1</sup> which established a new institutional and contractual framework. This law was then amended significantly by an ordinance dated July 26, 2006<sup>2</sup>, which abandoned most of the market liberalisation that had been contemplated initially. However, until recently, the new legal regime established by this body of laws (together the "2005 Hydrocarbons Law") had not been applied in practice as the necessary implementing legislation had not been passed. That has now changed with the enactment of 15 pieces of implementing legislation since May 2007. This implementation has been achieved by means of presidential or executive decrees and enables a better understanding of the legal mechanisms established by the 2005 Hydrocarbons Law. Also, it has allowed ALNAFT,<sup>3</sup> the State agency in charge of the development of the hydrocarbons sector, to launch the first national and international competitive tender in July 2008. As a result, new *contrats de recherche et/ou d'exploitation*, i.e. exploration and/or production contracts ("CRE"), were signed between ALNAFT and foreign partners beginning of January 2009.

Before discussing the first competitive tender and particular lessons which the process has taught us, we pause to provide a brief reminder of the legal regime applicable in Algeria.

.../...

<sup>1</sup> Loi n° 05-07 of April 28, 2005 relative aux hydrocarbures.

<sup>2</sup> Ordonnance n° 06-10 of July 10, 2006 modifiant et complétant la loi n° 05-07 of April 28, 2005 relative aux hydrocarbures.

<sup>3</sup> Agence nationale pour la valorisation des ressources en hydrocarbures.



Gide Loyrette Nouel

Abu Dhabi  
Tel. +971 (0)2 667 69 72  
gln.abudhabi@glde.com

Algiers  
Tel. +213 (0)21 23 94 94  
gln.algiers@glde.com

Beijing  
Tel. +86 10 65 97 45 11  
gln.beijing@glde.com

Belgrade  
Tel. +381 (0)11 30 24 900  
gln.belgrade@glde.com

Brussels  
Tel. +32 2 231 11 40  
gln.brussels@glde.com

Bucharest  
Tel. +40 21 223 03 10  
gln.bucharest@glde.com

Budapest  
Tel. +36 1 411 74 00  
gln.budapest@glde.com

Casablanca  
Tel. +212 (0)5 22 27 46 28  
gln.casablanca@glde.com

Dubai  
Tel. +971 (0)4 365 0172  
gln.dubai@glde.com

Hanoi  
Tel. +844 3 946 05 05  
gln.hanoi@glde.com

Ho Chi Minh City  
Tel. +848 3 823 85 99  
gln.hcmc@glde.com

Hong Kong  
Tel. +852 2536 9110  
gln.hongkong@glde.com

Istanbul  
Tel. +90 212 385 04 00  
gln.istanbul@glde.com

Kyiv  
Tel. +380 44 206 0980  
gln.kyiv@glde.com

London  
Tel. +44 (0)20 7382 5500  
gln.london@glde.com

Moscow  
Tel. +7 495 258 31 00  
gln.moscow@glde.com

New York  
Tel. +1 212 403 6700  
gln.newyork@glde.com

Paris  
Tel. +33 (0)1 40 75 60 00  
info@glde.com

Prague  
Tel. +420 222 871 111  
gln.prague@glde.com

Riyadh  
Tel. +966 1 217 77 54  
gln.riyadh@glde.com

Saint Petersburg  
Tel. +7 812 303 6900  
gln.saintpetersburg@glde.com

Shanghai  
Tel. +86 21 53 06 88 99  
gln.shanghai@glde.com

Tunis  
Tel. +216 71 891 993  
gln.tunis@glde.com

Warsaw  
Tel. +48 22 344 00 00  
gln.warsaw@glde.com



## General principles of the 2005 hydrocarbons law

The legal regime governing hydrocarbons activities in Algeria established by the 2005 Hydrocarbons Law altered the legal nature of petroleum contracts. Under the previous legal regime,<sup>4</sup> petroleum contracts were contracts of partnership ("*association*") between Sonatrach and the petroleum companies, based on a production-sharing mechanism. The 2005 Hydrocarbons Law abandoned the production-sharing mechanism. The new contractual regime is close to a concession regime and is based on the following principles:

1. Oil contractors (foreign parties or Sonatrach) are required to enter into a CRE with ALNAFT in order to perform exploration and production activities in Algeria.
2. The mining title is granted to ALNAFT and is issued for the total duration of the CRE, covering both periods of exploration and production.
3. The CRE is entered into after a competitive tendering process<sup>5</sup> which is fair and transparent.
4. If a discovery is made, the commercial rights to production in respect of any commercial discovery are obtained via approval of the relevant development plan by ALNAFT.
5. All hydrocarbon production from the deposit is allocated to the contracting parties, subject to the payment of the relevant taxes and royalties to ALNAFT / the Algerian government; dry gas sold outside Algeria is to be jointly marketed by the contracting parties.
6. Sonatrach will hold a minimum 51% participating interest in any CRE:
  - the foreign partner and Sonatrach enter into a joint operating agreement within 30 days of the approval of the development plan by ALNAFT;
  - the model joint operating agreement is attached to the CRE;
  - the foreign partner bears all costs and expenses in relation to exploration activities;
  - Sonatrach assumes investment and production costs relating to the development plan for each commercial discovery in proportion to its participation in the CRE; and
  - the joint operating agreement includes the terms and conditions governing the reimbursement by Sonatrach of exploration costs and expenses.

<sup>4</sup> *Loi n° 86-14 of August 19, 1986 relative aux activités de prospection, de recherché, d'exploitation et de transport par canalisation des hydrocarbures.*

<sup>5</sup> The 2005 Hydrocarbons Law provides for exceptions, in particular with respect to acreage already held by Sonatrach at the time of enactment of the 2005 Hydrocarbons Law.

## Procedure governing the competitive tender

The competitive tender process was governed by Decree n°07-184 dated June 9, 2007 and a document issued by ALNAFT, which set out the procedure for participating in the national and international tender.

### Purpose of the competitive tender

The Algerian authorities, through the Ministry of Energy and Mines, launched a competitive tender for hydrocarbons exploration opportunities in Algeria in June 2008. There were 16 onshore blocks selected. Of these 16 blocks, eight blocks were free of any hydrocarbons activities and ALNAFT was mandated to run the tender and to select oil companies. The proposed transaction consisted of a new CRE between ALNAFT on the one hand, and Sonatrach and one or more foreign partners on the other.

Already being operated by Sonatrach, were eight other blocks, which were pursuant to CREs entered into between ALNAFT and Sonatrach on September 18, 2006. For these, the proposed transaction involved one or more foreign partners acquiring a participating interest in the existing CREs from Sonatrach by signing a participating interest assignment agreement. The purpose of the competitive tender was to select the foreign partner or the group of foreign partners with whom the CRE or the participating interest assignment agreement would be signed.

### Prior approval

Oil companies must have first obtained prior approval as an operator/investor from the Algerian authorities in order to be entitled to submit an offer, either alone or together with other companies that have been preapproved, either as an operator/investor or as a mere investor.

Pre-approved oil companies may set up a consortium for the bid. The consortium members should be oil companies, of which at least one must have been pre-approved as an operator/investor, and the consortium must then be approved by ALNAFT.

### Selection criteria

Under the 2005 Hydrocarbons Law and the regulations governing the competitive tendering process, ALNAFT must choose to apply one of the following criteria in order to select a preferred bid:

- the works programme for the first exploration phase;
- the amount offered as signature bonus;
- any increment offered above the statutory royalty rate.

Under the first ever competitive tender, the criteria applied by ALNAFT to select the preferred bid were the additional works programme proposed by the bidder together with the minimum work programme provided with the CRE.

### Standard CRE created by ALNAFT

The CREs "negotiated" and signed between ALNAFT and Sonatrach set a precedent for the CREs that were entered into by ALNAFT and the foreign partners. Indeed, bidders



had little scope or ability to influence the drafting of the CRE and its annexes. It is worth noting that under the new concession regime, the financial conditions applicable to the CREs are defined by the applicable regulatory laws and are not therefore susceptible to alteration by negotiation under a CRE.

The attachment to the CRE of a form of model JOA, to be entered into between the foreign partners and Sonatrach, which is a compulsory partner, constitutes a guarantee for prospective foreign partners that the terms of the JOA may not be challenged later by Sonatrach.

### **Necessary clarifications provided by the contractual background**

The CRE submitted by ALNAFT put into practice the legal regime set out by the 2005 Hydrocarbons Law and its implementing decrees.

#### **Issues related to the absence of mining title**

Pursuant to the 2005 Hydrocarbons Law, ALNAFT is the exclusive holder of mining titles and is entitled, as such, to enter into CREs with oil companies. To date however, no mining title has yet been granted by ALNAFT. We may assume that the corresponding mining title will be delivered when the new CREs are signed. However, as regards CREs already entered into with Sonatrach, a mining title should have been issued at the time when the CREs were approved. This absence of mining title raises serious legal concerns.

#### **Clarification as to the duration of the CRE**

The maximum term of any CRE is limited to 32 years. Such term includes the exploration period (up to seven years) and, in case of commercial discovery, the production period (at least 25 years).

#### **Possibility of a retention period**

The CRE may be extended beyond the 32-year term in the event that the contractor benefits from an optional retention period under the CRE. Indeed, in the event that a discovery cannot be declared commercial due to limitations in pipeline transportation infrastructure or absent a market for gas production, the contractor may retain an area for a retention period of up to three years for oil or wet gas and five years for gas. A foreign partner should understand that carrying out production activities on such a field will require significant investment in transportation infrastructure. The retention period system provides an answer to the foreign contracting parties' concerns over transportation.

#### **Limited role of Sonatrach during the exploration period**

Although Sonatrach acquires a vested interest in the CRE "after the approval of the development plan by ALNAFT", Sonatrach is a contracting party to the CRE from the very beginning. However, Sonatrach will not participate in the financing of exploration activities, and the foreign partner is solely liable for the financing of all exploration costs and expenses.

Clearly, the foreign partner bears responsibility for the exploration operations. However, as a consequence of being a contracting party, Sonatrach acquires certain rights during the exploration period, in particular through the creation of a joint consultative technical and financial committee. It allows Sonatrach to be kept informed of important issues relating to exploration activities carried out. Although the rules governing this committee are not yet known, it is to be expected that Sonatrach will not be entitled to impose its views on the foreign partner in relation to exploration issues, nor to participate in the decision on the commercial viability of a discovery. It is anticipated that Sonatrach's position during the exploration period will, globally speaking, be similar to the position that Sonatrach enjoyed under the previous regime.

#### **Option as to the operating body during the production phase**

It is only from the beginning of the production phase that Sonatrach really becomes part of the project. The parties enter into an operating agreement and set up a management committee. Responsibility for the operation of the field rests with an operating entity created by Sonatrach and the foreign partner. Such entity may, at the sole discretion of the parties, consist of:

- either a *Groupement*,<sup>6</sup> consisting of a legal structure having legal capacity, but completely transparent and with no share capital. A model draft articles of association for this structure is appended to the CRE; or
- a purely contractual joint venture between the parties, with no legal capacity, and functioning on the basis of general principles appended to the CRE.

#### **Reimbursement by Sonatrach of exploration investments**

Sonatrach will reimburse the foreign partner any expenses which it has incurred during the exploration period and which related directly to the discovery of the commercial hydrocarbons find, namely expenses covering seismics, discovery well and the delineation programme. Sonatrach and the foreign partner should first agree between them the reimbursable amount of the exploration costs, which will then need to be approved by ALNAFT.

Sonatrach will reimburse the exploration costs in proportion to its participating interest. Sonatrach will make the reimbursement by paying the foreign partner's share of any cash calls made by the operator corresponding to the payment of the royalties during the production period. This reimbursement mechanism means that the foreign partner bears the risk of financing exploration costs over an extended period.

<sup>6</sup> The *Groupement* is governed by articles 796 and seq. of the Algerian Commercial Code (*ordonnance n° 75-59 of September 26, 1975 portant Code de Commerce de la République Algérienne Démocratique et Populaire, together with the Décret législatif n° 93-08 of April 25, 1993*).



## Conclusion

In the past three years since the enactment of the 2005 Hydrocarbons Law, the Algerian authorities have had time to enact the necessary implementing legislation and to set out the relevant contractual documentation. Algeria now possesses the required legal tools to boost hydrocarbons exploration on its territory, where reserves are estimated to about 50 billion barrels. The number and quality of offers that are submitted by bidders have allowed a better assessment of the merits of this regime.

Although it had initially seemed that the reform had been well received in the oil and gas community - certain press releases<sup>7</sup> reported the "rush" of oil companies to the new

blocks: 73 oil companies had pre-qualified, including the majors Exxon, Shell, BP, Chevron and Total, together with other notable players, including CNPC, Conoco Philips, Anadarko, Gaz de France, Repsol and ENI - the number of offers submitted on December 13, 2008 was very limited and only 4 blocks, out of the 16 that were offered, were awarded in the end.

Should we consider that this is the sole result of the current economic crisis, as the Algerian Minister of Energy and Mines, Mr Chakib Khelil, has suggested?

*Contributed by  
François Krottoff and Benoît Brossard*

## New rules for foreign investment in Algeria

Two new instructions have been issued by the Algerian Council of Ministers, following the meeting of 7 December 2008:

### **#0061/Inst/SP/PM dated 21 December 2008 relating to the rules applicable to foreign investment and related transfers of currency abroad**

Considering the actual financial crisis and the necessity for Algeria to maintain a positive budgetary balance, the Council of Ministers outlined the current main impairments of Algeria, namely mainly excessive importations (which have increased by 300% over the last six years), excessive advantages granted to foreign investment for the transfer of currency abroad and the insufficient market share of the Algerian production in Algeria.

The Council of Ministers provides certain measures aimed at ensuring that foreign investment benefits to the local economy. Main measures include:

- The requirement for any foreign investment to be held in majority by national shareholders altogether, although foreign investors remain the largest shareholder;
- The requirement for any investment contract to include a clause binding foreign investors to keep a positive currency balance in favour of Algeria;
- The requirement for foreign investors to fund investments within local banks in Algeria; and
- The off-set of any customs and tax advantage granted to foreign investors against profits that are transferable abroad;
- The requirement to submit foreign investment, prior to formalisation, to the National Council of Investments for review and consultation. It is not clear however whether such consultation would be binding or not.

The scope of this instruction is particularly wide as it refers to any sector, including the finance and the hydrocarbons sectors. Any member of the Government and director of any public company shall abide by the same.

### **#062/Inst/SP/PM dated 22 December 2008 related to the reduction of imports and the promotion of the Algerian production.**

The Council of Ministers also confirms its intention to enforce existing regulations relating to public contracts awards; in particular articles 11 and 19 of decree #02-250 dated 24 July 2002, which award a priority right to any Algerian production, within a margin of up to 15%, in the context of any international and national public contract award in Algeria, as well as any mutually agreed contracts. The instruction does not provide however additional information related to the 15% margin assessment.

The scope of this instruction is particularly wide as it refers to any public contract award in Algeria. Any administration and public company, without any exception, shall abide by the same. Presidents of the national, ministerial and local markets commissions and public companies shall enforce this instruction. The Minister in charge of Finance may ultimately object to expenditures that do not comply with this instruction.

It is difficult to assess whether and to which extent past and future investments in the hydrocarbons sector, especially the hydrocarbons contracts with SONATRACH and ALNAFT, would be impacted, at this stage.

*Contributed by  
Nicolas Bonnefoy and Alix Deffrennes*

<sup>7</sup> *Inter alia* Algeria Watch, *Rush des compagnies étrangères sur les nouveaux gisements*, July 27, 2008.



## Living with resource nationalism

### Introduction

Since the start of the 21st century, the lack of spare capacity, the growing demand for energy together with other major political and economic developments worldwide, has progressively managed to drive up oil prices to unprecedented levels generating massive profits for international oil companies ("IOCs"). In this context, resource nationalism has resurfaced in recent years, with states imposing tougher terms on IOCs or taking greater control in their national resources, the alleged reasons being commercial, political and/or environmental considerations.

In *Venezuela*, the State required IOCs to turn over majority control of their oil projects to a State-owned company, thereby expropriating oil and gas assets; in *Russia*; certain leading operators were required to turn over majority control of their gas projects to a State-owned company, and; in *Bolivia*, the State nationalised the entire industry. In Africa too, countries such as, for instance, *Chad*, *Tanzania*, *Guinea*, and the *Democratic Republic of Congo* have established government aligned committees to review hydrocarbons contracts. *Angola* and *Nigeria* have started to reconsider their arrangements with IOCs, *Libya* has recently announced its intention to nationalise the oil & gas industry, while *Algeria* has finally managed to enter into the first hydrocarbons contracts with IOCs, which is governed by the recently enacted hydrocarbons law that had significantly increased the State's share in hydrocarbons contracts.

The recent spate of resource nationalism is not an anomaly. History shows that states periodically seek to (re)gain control over their oil and gas resources: Following the end of the Second World War, demand for oil and gas resources increased exponentially, and the control of oil production and prices by IOCs until the 1960s triggered a cycle of increasing resource nationalism, while the 1980s were a period of low resource nationalism as non-OPEC production increased without the OPEC cartel maintaining control over production rates. Still, resource nationalism may trigger significant instability in hydrocarbons operations.

Resource nationalism can take various forms - change in the legal/regulatory framework, forced renegotiation of the hydrocarbons contract, breach of the hydrocarbons contract, unilateral modification of the hydrocarbons contract, confiscation or even expropriation or nationalisation. Resource nationalism can be implemented immediately or incrementally over a determined period of time, further to a succession of mechanism and measures that progressively reduce or deprive the IOC from access to, control over, or value of their investment<sup>8</sup>, a concept known as indirect expropriation.

<sup>8</sup> Examples of indirect expropriation include revocation of permits and/or licences, certain tax measures or environmental sanctions.

In this context, IOCs must address and monitor resource nationalism with care and appropriate tools in order to protect their investment over the performance duration of their hydrocarbons contract. Other than commercial options available, IOCs must have in mind legal means to try and pre-empt the effects of resource nationalism by the State for example by seeking to negotiate stabilisation provisions in the hydrocarbons contract. In cases where direct or indirect expropriation has already occurred, IOCs may be able to make a claim for compensation under an international investment treaty, although in practice the route to fair and effective compensation may prove long and difficult.

### Stabilisation clauses: pre-empting & negotiating the effects of resource nationalism

Hydrocarbons contracts are negotiated on the basis of prevailing economic and financial conditions, including the legal/regulatory framework, and are expected to remain in force for significant periods of time. Stability of the contract is a key requirement given the long term, capital intensive nature of the investment necessary for exploration, subsequent development and commercial production.

Stabilisation clauses aim at reducing risk associated with unexpected changes in the legal/regulatory framework, and their consequent impact upon the economic and financial conditions previously agreed in the long-term contract in question.

Classic stabilisation clauses which provide for a straightforward "freezing" of the legal/regulatory framework existing at the time of entering into the contract have unsurprisingly proved difficult to implement in practice. Stabilisation clauses now often include more sophisticated mechanisms, for instance provisions which allow IOCs to benefit from a change in the applicable legal/regulatory framework, or provisions which are designed to protect the investor by requiring renegotiation in the event of a detrimental change in the legal/regulatory framework<sup>9</sup>.

In this context, the most constructive approach is probably not to focus on whether states can unilaterally change the rules of the game - which rules States can legally and unilaterally change - but to focus rather on trying to pre-empt and respond creatively with the consequences of such unilateral changes, perhaps via the inclusion of specific mechanisms which are triggered by changes in the legal/regulatory regime and which are designed to restore the economic balance to the hydrocarbons contracts in question<sup>10</sup>.

<sup>9</sup> E.g. in the contractual tax or customs provisions.

<sup>10</sup> See "Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors", Peter Cameron for the Association of International Petroleum Negotiators (July 2006).



Provided they are well-drafted, such mechanisms can be an efficient way of maintaining a satisfactory degree of long term commercial equilibrium in a changing legal/regulatory environment. A carefully drafted clause will notably include a definition of the laws/regulations to be stabilised, the determination of the changes triggering the application of the clause and a description of the consequences of a failure to reach an agreement, as well as a clear definition of the ambit of the obligation to re-negotiate.

In this respect, the enforceability of agreements to renegotiate a contract may be assessed differently depending on the applicable law of the hydrocarbons contract<sup>11</sup> and the jurisdiction under which any dispute is to be heard. Common law & civil law approaches may differ in this respect. By way of example, English courts traditionally consider that, in the absence of certainty, an agreement to negotiate is legally unenforceable<sup>12</sup> and that "there is no general obligation to negotiate in good faith"<sup>13</sup>. Meanwhile, under French law, agreements to negotiate are enforceable<sup>14</sup> and parties who have agreed to renegotiate a contract must do so in good faith<sup>15</sup>. The enforceability of an agreement to negotiate is limited to the duty to carry out the negotiations in good faith (an *obligation de moyens* in French law), and does not extend to any compulsion to reach binding agreement<sup>16</sup> (an *obligation de résultat*.)

In order to avoid any unexpected judicial/ arbitral revision or "adaptation" of the terms of their contract, parties should also consider specifying whether arbitrators or the courts have any power to revise the hydrocarbons contract should negotiations between the parties fail. While many national systems of law do not allow judges to "adapt" a contract in cases of hardship<sup>17</sup>, such a power is specifically envisaged by the *Unidroit Principles of International Commercial Contracts 2004*<sup>18</sup>, which may on occasion be

<sup>11</sup> See ICC Award n°5961, JDI 1997.1051.

<sup>12</sup> See *Walford v. Miles* (1992) 64 P. & C.R. 166 HL.

<sup>13</sup> Per Mummery LJ in *Cobbe v. Yeomans Row Management Ltd* [2006] EWCA Civ 1139, [2006] WLR 2964, in the context of pre-contractual negotiations.

<sup>14</sup> For the enforcement of an agreement to renegotiate a contract, see the decision of the Paris Court of Appeal of 28 Sept. 1976, JCP 1978. II. 18810.

<sup>15</sup> Article 1134-3° of the French Civil Code provides that contracts must be performed in good faith.

<sup>16</sup> This view has been expressed in arbitral case law in the context of oil and gas contracts. See *Wintershall AG and others v. Government of Qatar*, 28 ILM 795 (1989), where Qatari law was applied. The Arbitral Tribunal considered that, if there was a duty to negotiate in good faith, "it is clear that such a duty does not include an obligation on the part of the respondent to reach agreement with respect to the proposals made by the claimants" and refers to justifiable behaviour "under normal commercial practice".<sup>2</sup>

<sup>17</sup> English and French law converge on this principle.

<sup>18</sup> Article 6.2.3 (Effects of hardship) of the *Unidroit Principles of International Commercial Contracts 2004* provides :

"(1) In case of hardship the disadvantaged party is entitled to request renegotiations. The request shall be made without undue delay and shall indicate the grounds on which it is based.

(2) The request for renegotiation does not in itself entitle the disadvantaged party to withhold performance.

(3) Upon failure to reach agreement within a reasonable time either party may resort to the court.

taken into consideration by an arbitral tribunal, for example as an element of trade usage<sup>19</sup> or *lex mercatoria*.

Of course, in situations where a direct or indirect expropriation - the ultimate form of resource nationalism - has already occurred, then stabilisation clauses & negotiations notwithstanding, IOCs may seek to claim compensation on the basis of international investment treaties.

### International investment treaties: compensating for the consequences of resources nationalism

Bilateral<sup>20</sup> and multilateral<sup>21</sup> treaties generally acknowledge the right of states to expropriate, provided that such expropriation is made for public purposes, in a non discriminatory manner, and in accordance with procedures governed by law. Such procedures should envisage fair compensation for the victim of expropriation, and may provide guidelines for calculating compensation.

For example, Article 6 of the 2004 United States model Bilateral Investment Treaty provides:

"1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation; and (d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment] (1) through (3).

2. The compensation referred to in paragraph 1(c) shall: (a) be paid without delay; (b) be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("the date of expropriation"); (c) not reflect any change in value occurring because the intended expropriation had become known earlier; and (d) be fully realizable and freely transferable."

By adopting such standards, in the oil and gas context, investment treaties reconcile the conflicting principles of inviolable private property rights and of permanent sovereignty of states over their natural resources<sup>22</sup>.

Investment treaties generally protect against both direct and indirect expropriation, the latter being sometimes referred to as "creeping expropriation"<sup>23</sup>. Although indirect expropriation is not precisely defined in investment

(4) If the court finds hardship it may, if reasonable,

(a) terminate the contract at a date and on terms to be fixed, or

(b) adapt the contract with a view to restoring its equilibrium."

<sup>19</sup> See Article 17(2) ICC Rules (1998).

<sup>20</sup> For example, Article 5 of the United Kingdom - Kenya BIT (2000).

<sup>21</sup> For example, Article 1110.1 of the NAFTA and Article 13.1 of the Energy Charter Treaty (ECT).

<sup>22</sup> This principle was affirmed by the General Assembly of the UN in its resolution 626 (VII) of 21 December 1952 and in its Resolution 1803 (XVII) of 14 December 1962.

<sup>23</sup> See *Middle East Cement Shipping and Handling Co. v. Republic of Egypt*, ICSID case No. ARB/99/6, award of 12 April 2002, at no. 107.



treaties, international arbitration awards indicate a number of defining factors, such as the impact of state's action on the IOC's assets<sup>24</sup>, the legitimate expectations of IOCs<sup>25</sup> or the purpose and proportionality of the actions taken by the state<sup>26</sup>.

Any victim of expropriation, whether direct or indirect, should assess whether there is a viable claim for compensation under an investment treaty. Yet perhaps unsurprisingly, neither investment treaties nor arbitration awards have so far led to the development of any precise guidelines for property valuation. Last but not least, the enforceability of arbitration awards may be uncertain<sup>27</sup>.

## Conclusion

With the recent significant drop in oil prices in the context of the current financial crisis, there can be little doubt that a new resource nationalism cycle is beginning - yet this time who can say what it will bring? Whatever happens, it seems unlikely that resource nationalism will recede or disappear, whilst States are willing to ensure their rights of ownership to their natural resources.

A means to handle this drive for nationalism of natural resources is for the IOCs to gain a true understanding of what legal and practical measures of investment protection are available in a country by carrying out a comprehensive due diligence review prior to signing the hydrocarbons contract. A thorough review would cover not only potential stabilisation measures but also the availability of investment protection afforded by the state's existing laws, the existence or not of any operative investment treaties, the availability and enforceability of *force majeure* and dispute resolution provisions envisaging arbitration, and perhaps mediation /conciliation depending on the local dispute resolution culture.

Another - perhaps obvious - potential safeguard against resource nationalism is for IOCs to employ a pro-active management style to detect and deal with potential problems & disputes early. Effective monitoring of a contract in performance, clear substantive analysis, rapid identification of positional strengths and weaknesses, and good strategy and timing are key to achieving the best possible protection for the investment made.

More specifically, since resource nationalism is often triggered further to the State's perception that the economic balance of the hydrocarbons contract - as it was initially agreed - has changed to the favour of the IOCs, hydrocarbons contracts should provide the necessary mechanism that allows for the economic balance to progressively adapt to changes, including not only legal/regulatory change but also any change of the economic and/or financial conditions, which may impact the economic balance of the hydrocarbons contract.

Contributed by  
Nicolas Bonnefoy and Irene Monyo



<sup>24</sup> See *Biloune v. Ghana Investments Centre*, awards 27 October 1989 and 30 June 1990; *CME Czech Republik B.V. v. Czech Republic*, UNCITRAL partial award of 13 September 2001, at no. 604; and *Impreglio S.p.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, award of 22 April 2005, at no. 278-279.

<sup>25</sup> See *Metalclad Corp v. The United Mexican States*, ICSID Case No. ARB (AF)/97/1, award of 30 August 2000 and *Técnicas Medioambientales, Tecmed S.A. v. Mexico* (ICSID Case No. ARB(AF)/00/2), award of 29 May 2003.

<sup>26</sup> See for example *Azurix Corp v. Argentine Republic*, ICSID Case No. ARB/01/12, award of 14 July 2006, at no. 310 -312.

<sup>27</sup> See "Expropriation of Oil & Gas Investments: historical, legal and economic perspectives in new age of resource nationalism", by Plexus Energy Ltd and Ince & Co. for the Association of International Petroleum Negotiators (June 2008).

You can also consult this Brief, and our other newsletters,  
in the News/Publications section of our website: [www.gide.com](http://www.gide.com)

The Brief – Oil & Gas Update (the "Newsletter") is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide Loyrette Nouel's clients and business associates. The Newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The Newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee.

In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communications Department ([privacy@gide.com](mailto:privacy@gide.com)).

#### **Gide Loyrette Nouel LLP**

125 Old Broad Street  
London EC2N 1AR – United Kingdom  
Tel. +44 (0)20 7382 5500  
Fax +44 (0)20 7382 5501  
[gln.london@gide.com](mailto:gln.london@gide.com)  
[www.gide.com](http://www.gide.com)

#### **Contacts**

**François Krotoff, Partner**  
[krotoff@gide.com](mailto:krotoff@gide.com)

**Benoît Brossard, Associate**  
[brossard@gide.com](mailto:brossard@gide.com)

**Nicolas Bonnefoy, Associate**  
[bonnefoy@gide.com](mailto:bonnefoy@gide.com)

**Irene Monyo, Associate**  
[imonyo@gide.com](mailto:imonyo@gide.com)



**Gide Loyrette Nouel**