Aramco: The Story of the World's Most Valuable Oil Concession and its Landmark Arbitration

by

A. Timothy Martin
# Bahrain Chamber for Dispute Resolution
## INTERNATIONAL ARBITRATION REVIEW

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<th>Volume 7</th>
<th>June 2020</th>
<th>Number 1</th>
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Aramco: The Story of the World’s Most Valuable Oil Concession and Its Landmark Arbitration

A. Timothy Martin*

ABSTRACT

The Aramco story is a fascinating and colourful history of the world’s most valuable oil concession, the challenges overcome by its original American owners and the orderly transfer of control of the world’s largest oil company to the Kingdom of Saudi Arabia. It involved the largest American overseas investment, a cornerstone of U.S. foreign policy, the stabilization of global energy markets and the Middle East region, along with the transformation of a medieval society into a modern state.

Unlike some of the other states in the region, Saudi Arabia never intended to nationalize or expropriate Aramco. Instead, it worked closely with its American investors and the American government to maximize production for the benefit of all the parties involved. The parties did this within a long tradition of “friendship and good will.” Despite their best efforts, they did come to blows in a landmark arbitration, the Saudi Arabia v. Arabian American Oil Company (Aramco) Arbitration, which is one of the most historically important investor state arbitrations of the last century. This article describes that case with insightful detail, along with how the parties maintained their “friendly relationship” long after the end of the arbitration.

1 THE CONCESSION AGREEMENT

On 29 May 1933, the government of Saudi Arabia signed an oil concession contract (sometimes referred to as the “1933 Agreement,” the “Al-Hasa Agreement” or the “Principal Agreement”) with Standard Oil Company of California.

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1 A copy of the original Al-Hasa oil concession agreement between the Government of Saudi Arabia and the Standard Oil Company of California is provided in Volume V, Annex 1 of Aramco’s First Memorial in the Saudi Arabia v. Arabian American Oil Company (Aramco) Arbitration, all of which can be found in the Law Library, University of California at Berkeley. The concession agreement can also be found at the British Library in its India Office Records and Private Papers under the file: Coll 6/48 Oil Concessions in Saudi Arabia (Hasa), Ref IOR/L/PS/12/2115. The parties also signed a Letter of Agreement of the same date referred to as the “Second Principal Agreement”. The 1933


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California (“Socal”) covering the Al-Hasa region of eastern Saudi Arabia. This agreement became the most valuable oil concession in the world, the foundation of the world’s largest oil company and the seeds for one of the earliest and most significant investor state disputes in the international arbitration world.

This was not the first oil concession in Saudi Arabia. That was the concession granted on 6 May 1923 to the Eastern and General Syndicate controlled by Major Frank Holmes, which also covered the Al-Hasa region in Saudi Arabia, followed by a subsequent concession awarded to his company in the Neutral Zone between Saudi Arabia and Kuwait in 1924. These two Saudi concessions came to naught and subsequently lapsed. In addition to his Saudi concessions, Major Holmes also acquired an oil concession on the island of Bahrain in 1925. Rather than attempt to develop it on his own, he convinced an American oil company, Gulf Oil, to take an option on the Bahraini concession in 1927.

However, in 1928, Gulf became part of the American group in the Turkish Petroleum Company, later renamed the Iraq Petroleum Company (“IPC”), and thus a party to the “Red Line Agreement”, which prevented any of the IPC shareholders from operating independently inside of the “red line.” This ruled out Saudi Arabia and Bahrain for Gulf Oil. But it did not apply to Kuwait, where Gulf, along with the Anglo-Persian Oil Company (“AIOC”), successfully acquired a concession in 1934 with the formation of the Kuwait Oil Company (“KOC”). Rather than withdraw from the Red Line Agreement, Gulf Oil decided not to exercise its option on the Bahraini concession. Instead of simply walking away from its option, Gulf brought the Bahraini concession to the attention of Socal, which

Principal Agreement and the 1939 Supplemental Agreement (described later in this article) were apparently obtained by the British Political Agent at Bahrain during a visit he made to Dhahran, Saudi Arabia (which was the Casoc headquarters) in May 1939. Both agreements are available online at the Qatar Digital Library: https://www.qdl.qa/en/archive/81085/vdc_100000000555.0x00028d.

Saudi Arabia v Arabian American Oil Company (Aramco), Award of 23 August 1958, 27 International Law Reports 117 (1963) (the “Aramco Arbitration” or what is sometimes referred to as the “Onassis Arbitration”).

Frank Holmes was born on a farm in New Zealand in 1874. He traveled around the world for two decades as an itinerant mining engineer. During the First World War, he was a major in the British Army in the capacity of a quartermaster. After the war, Major Holmes set up a company called the Eastern and General Syndicate with a group of investors to pursue business opportunities in the Middle East. Its first venture was a drugstore in Aden, Yemen. Major Holmes subsequently turned into a legendary oil promoter, who pursued deals in Saudi Arabia, Bahrain, Kuwait and Iraq. Over time, he became known in the Middle East as “Abu al Naft” (or the “Father of Oil”).

The Anglo-Persian Oil Company changed its name to the Anglo-Iranian Oil Company (“AIOC”) at the insistence of Shah Reza Pahlavi in 1933. AIOC later transformed into British Petroleum (“BP”). Kuwait at the time of Gulf Oil’s investment was a British protectorate within the Trucial States under which the British government required that British companies be involved in any significant investment. This allowed AIOC (later BP) to become a 50/50 joint venture partner with Gulf Oil in KOC.
was not subject to the Red Line Agreement, at a meeting of the American Petroleum Institute in Chicago in 1928.\footnote{Charles W. Hamilton, Americans and Oil in the Middle East (Gulf Publishing Company, 1962) at 60.}

At the time, Socal was mostly a regional oil company in the western United States that was seeking more reserves to replace its declining oil fields in California. It had spent approximately $50 million over the prior decade on unsuccessful ventures in Mexico, Venezuela, Colombia, the Philippines and the Dutch East Indies, and was now focusing its attention on the Arabian Gulf to meet its future crude oil needs. In response to Gulf Oil’s suggestion, Socal agreed to step into its shoes and took up the Bahraini concession. However, the British government objected to a non-British company acquiring a concession in Bahrain, which was a British protectorate at the time. Socal’s solution was to incorporate a Canadian subsidiary, the Bahrain Petroleum Company (“Bapco”), to hold the concession.

Bapco began drilling on the island in October 1931, which resulted in an oil discovery on May 31, 1932. This success piqued the interest of Socal to pursue further opportunities twenty miles away over the water straits on the mainland of the Arabian Peninsula, which had similar geology as Bahrain. Socal’s assessment that there were potential oil fields in eastern Saudi Arabia was also the conclusion of a geological report produced by an American mining engineer, Karl R. Twitchell, based on his field research in the area between 1931 and 1932 to find water and mineral resources. His research was independently financed by a wealthy American philanthropist, Charles R. Crane, at the request of Harry St John Philby, an advisor to the ruler of Saudi Arabia, Abdul Aziz bin Abdul Rahman bin Faisal al Saud (“Abd al-Aziz” or “Ibn Saud”). Based on this report, the Saudi King asked Twitchell to find an American company to find oil in his kingdom, which he did by approaching the Texas Company (later “Texaco”), Gulf Oil, Standard Oil of New Jersey (later “Exxon”) and Socony-Vacuum (later “Mobil”).\footnote{Standard Oil of California, Standard Oil of New Jersey and Standard Oil Company of New York (“Socony-Vacuum”) were originally part of the Standard Oil Trust created by John D. Rockefeller, which was the world’s largest oil refiner. The U.S. Supreme Court ruled under the Sherman Antitrust Act in 1911 that the Standard Oil Trust was an illegal monopoly; that resulted in the breakup of the trust into 34 smaller companies, which included the above three companies. Later, Standard Oil of California changed its name to Chevron, Standard Oil of New Jersey to Exxon, and Socony-Vacuum to Mobil. Exxon and Mobil merged into ExxonMobil in November 1999 to form the largest American oil company. Chevron acquired Gulf Oil in 1985 and Texaco in 2000. Texaco was founded in Beaumont, Texas as the Texas Fuel Company in 1901. Gulf Oil was established in Pittsburgh, Pennsylvania in 1901 by the Mellon banking family. Neither Texaco nor Gulf were part of the original Standard Oil Trust. All five companies were part of the so called “Seven Sisters” that dominated the international oil word for nearly fifty years and at one time controlled approximately 85% of the world’s oil reserves. The other two companies were Shell and BP. They all turned down the opportunity.} They all turned down the opportunity.
When approached by Twitchell, Socal expressed its interest, and so began the negotiation of the Al-Hasa concession agreement.\textsuperscript{8} The King’s treasury was bare at the time as a result of a decline in the Haj pilgrimage during the depression years and was thus desperately seeking a solution to his financial problems. As Philby had observed, Abd al-Aziz’ income never matched “his generous conception of his functions and obligations as a ruler.”\textsuperscript{9} Thus the stage was set for the discovery of the largest oil fields in the world.

Socal was, however, not the only company interested in acquiring a concession in the Al-Hasa region. The British, through the Anglo-Persian Oil Company, were keenly interested in obtaining a Saudi concession, but not for the same reasons as Socal. The British were mostly interested in keeping out competition in Saudi Arabia, as they busily pumped oil in Iran at the D’Arcy concession, which was discovered by APOC in 1908. They conducted their negotiations through the Iraq Petroleum Company; since as a shareholder of IPC, APOC was also subject to the Red Line Agreement and could not therefore go it alone. Ibn Saud eventually decided to strike a deal with Socal because he was not interested in allowing the British to expand their influence in the region.\textsuperscript{10} But more importantly, the King decided to accept Socal’s offer because the company was willing to provide a large upfront payment, which met his immediate need for a significant increase in revenue for his treasury. APOC was not so willing to pay a large signing bonus, and thus walked away from Saudi Arabia.\textsuperscript{11}

The 1933 Agreement that Lloyd Hamilton, Socal’s lawyer, and Sheikh Abdulla Suleiman Al Hamdan, the Saudi Minister of Finance (who represented Ibn Saud), signed followed a similar pattern as other oil concessions in the region at that time. Their standard conditions were relatively simple and drafted in favour of the international oil company (“IOC”) receiving the petroleum grant. Middle Eastern oil concessions of this era were best described as follows:

Summarizing the conditions obtaining prior to 1950, one can say that the period from 1901 to 1950 was characterized by:

1) the large areas and long periods of oil concessions;
2) the small number of operating companies;

\textsuperscript{8} Karl S. Twitchell, Saudi Arabia: With an Account of the Development of its Natural Resources (Princeton University Press, 2nd ed., 1953) at 148-149. Harry St John Bridger Philby, Arabian Oil Ventures (Middle East Institute, 1964) at 77-78.

\textsuperscript{9} Harry St John Bridger Philby, Saudi Arabia (Ernest Benn, 1955) at 333. Harry St John Philby was well-known for another reason; his son, Kim Philby, was an MI6 officer who was also a very effective double agent for the Soviet Union.

\textsuperscript{10} Daniel Yergin, The Prize: The Epic Quest for Oil, Money and Power (Simon & Schuster, 1991) at 280-292.

\textsuperscript{11} Philby, supra note 8 at 133. Socal retained both Philby and Twitchell (who were supposedly advisors to the King) as consultants during the concession negotiations, which proved to be an advantage for Socal.
3) the relative uniformity and simplicity of concession terms;
4) the royalty concept which constituted the principal financial basis of oil concessions;
5) the comparative moderateness of the financial terms of concessions which was a consequence of the lower value of, and lesser demand for, crude oil during that early period; and
6) the slow evolution in the terms and conditions of concessionary agreements which was tantamount to stagnation and rigidity.\(^\text{12}\)

This type of concession agreement was first used in 1901 for the D’Arcy concession in Iran, and subsequently used throughout the region for the next fifty years. They typically granted ownership of the oil to IOCs without any or minimal host state interference in the exploration, development and production of the oil field. They often covered entire countries, or at least a major portion of the country. The IOC paid a nominal initial price for the acquisition of the concession and agreed to pay royalties on future production. These early oil concessions no longer exist as a result of their termination or renegotiation by governments by the middle of the last century (with the exception of the Aramco concession as explained later). Royalty/tax systems, production sharing contracts and risk service agreements have since replaced this classic hydrocarbon granting contract.

Article 1 of the Al-Hasa Agreement granted Socal:

... the exclusive right, for a period of sixty years from the effective date hereof, to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export petroleum, asphalt, naphtha, natural greases, ozokerite, and other hydrocarbons, and the derivatives of all such products. It is understood, however, that such right does not include the exclusive right to sell crude or refined products within the area described below or within Saudi Arabia.\(^\text{13}\)

The concession required Socal to provide Saudi Arabia with:

- an initial loan of £30,000 in gold or its equivalent;
- a loan of £20,000 in gold or its equivalent after 18 months;
- a loan of £50,000 in gold or its equivalent upon the discovery of oil;
- an annual payment of £5,000 in gold or its equivalent; and

\(^{12}\) \text{HENRY CATTAN, THE EVOLUTION OF OIL CONCESSIONS IN THE MIDDLE EAST AND NORTH AFRICA} (“EVOlUTION OF OIL CONCESSIONS”) (Oceana Publications, New York, 1967) at 4. This description is also referred to in \text{RUdolf Dolzer and Christoph Schreuer, Principles of International Investment Law} (Oxford University Press, 2008) at 72-73.

\(^{13}\) \text{Saudi Arabia v. Aramco, supra note 2, at 175. The various provisions of the Al-Hasa Agreement can be found in the Aramco Award, the two books of Henry Cattan on the law and the evolution of oil concessions in the MENA Region, in the full copy of the original concession stored at the British Library (which is in digital format in the Qatar Digital Library), and included in the Memorials from the Aramco Arbitration at the Law Library of the University of California at Berkeley.}
– a royalty of four shillings in gold or its equivalent per ton of oil produced after deducting oil required for operations.\textsuperscript{14}

To put the financial terms of the 1933 Agreement in perspective:

Judged by today’s values, the financial terms of the earlier concessions seem modest. Although some concessions made provision for rents or tax commutation payments or fringe benefits, such as loans or the supply of petroleum, or exceptionally, as we shall see later, for some form of profit sharing, the principal financial feature of the oil concession was the royalty. The royalty was generally fixed at four shillings gold or three rupees per ton of crude oil. Without attempting to develop precise figures for revenue, costs or profits for the early period of oil concessions which would obviously vary as to time and country, it can be said that four shillings gold per ton, when compared with the then existing prices of crude oil, constituted at the time a considerably more valuable consideration than that which it seems to represent today.\textsuperscript{15}

Socal’s oil concession covered a vast area, first defined in Article 2 of the 1933 Agreement as all of eastern Saudi Arabia to the westerly edge of the Dahana (a sand stream that separated eastern and western Saudi Arabia), which covered an area of approximately 371,000 square miles. Article 3 of the agreement granted Socal a preferential right to an area further west, the Neutral Zone to the north, and the Gulf waters and islands to the east. Article 9 stated that Socal was to relinquish “such portions of the concession area as the company may decide not to explore or prospect further or to use otherwise in connection with the enterprise.”

The area was expanded in i) a Supplemental Agreement dated 31 May 1939 that covered more of northern and southern Saudi Arabia, along with the “Saudi Arab-Kuwait Neutral Zone” and the “Saudi Arab-Iraq Neutral Zone” to cover about 496,000 square miles and ii) an Offshore Agreement dated 10 October 1948 that extended the concession to the whole of the offshore area of Saudi Arabia in the Arabian Gulf. This extension was fixed at six nautical miles from Saudi Arabia’s shoreline by its Royal Proclamation of 28 May 1949.\textsuperscript{16}

The 1933 Agreement also provided that:

– The concession was for 60 years. (Article 1)
– The company was to commence exploration work within three months and drilling operations as soon as a suitable structure was found. Once

\textsuperscript{14} Articles 4-7, 11-12 and 14 of the Al-Hasa Agreement. The annual payments ceased upon the commercial discovery of oil. Socal had the right to recover the loans from one-half of the royalties due to the Saudi government. If the loans were not recovered upon termination of the contract, then the government was to repay the unrecovered amount to the company. It should be noted that the government did not have an option to take its royalty in kind in the original concession agreement.

\textsuperscript{15} CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 3-4.

\textsuperscript{16} Saudi Arabia v. Aramco, supra note 2, at 118-121.
commenced, these operations were to continue diligently until oil was found in commercial quantities or the contract was terminated. After the date of discovery of oil in commercial quantities the company was required to continue drilling operations by using at least two strings of tools. (Articles 9 and 10)

- In times of national emergency the use of the company’s transportation and communication facilities by the Government would entitle the company to fair compensation for any loss it may sustain, whether through damage to the company’s facilities, equipment or installations or through the obstruction or interference with the company’s operations. (Article 22)

- The enterprise was to be directed and supervised by Americans who were to employ Saudi Arab nationals as far as practicable. (Article 23)

- No failure or omission on the part of the company to carry out or to perform any of the terms or conditions of the contract gave the Government any claim against the company or be deemed a breach of the contract insofar as such failure or omission may arise from force majeure. If through force majeure the fulfilment of any term or condition of the contract should be delayed, the period of the delay, together with such period as may be required for the restoration of any damage done during such delay, were to be added to the terms or periods fixed in the contract. (Article 27)

- The contract was drawn up in English and Arabic, but ... it was agreed that while both texts had equal validity, nevertheless in case of any divergence of interpretation as to the company’s obligations under the agreement, the English text was to prevail. (Article 35)

- The breach of certain obligations entitled the Government to give notice to the company to remedy such breach and in the event of failure to remedy the breach, the Government could terminate the contract. However, the penalty for the breach by the company of any of its obligations were damages to be determined by agreement or arbitration. (Article 30)

With the signing of the Primary Agreement in 1933, Socal faced incredibly daunting challenges on the ground:

Except for a number of oases, the area was barren, desolate and hot. The economy of Saudi Arabia in the 1930s was medieval. Every piece of equipment needed by the Company to explore and prospect for oil, and, later, to produce, transport and export it, had to be
imported by California Arabian Standard Oil Company (Casoc), Socal’s subsidiary that was formed to handle the Arabian concession.\footnote{Stephen M. Schwebel, The Kingdom of Saudi Arabia and Aramco Arbitrate the Onassis Agreement, Vol. 3, No. 3, JOURNAL OF WORLD ENERGY LAW & BUSINESS, (2010) at 245-246.}

Despite those challenges, Socal began its quest to discover and develop the world’s largest oil fields\footnote{Saudi Arabia now has 17.2\% of the world’s proven oil reserves as described in the 2019 BP Statistical Review of World Energy. It has the largest onshore oil field (Ghawar) and largest offshore oil field in the world (Safaniya) as described in the American Association of Petroleum Geologists (AAPG) dataset, which is retrievable at: https://worldmap.harvard.edu/data/geonode:giant_oil_and_gas_fields_of_the_world_co_yxz. The Saudi mega oil fields are:} as described by the Arbitral Tribunal in its Aramco award:

The results of Aramco’s early efforts were somewhat discouraging. The Company’s geologists were sent into the sandy and rocky regions of Eastern Arabia by the end of 1933. The first drilling operations started in April 1935; they revealed the presence of little oil and gas, which were insufficient for commercial exploitation. Other attempts were made, in carefully selected places, at enormous cost, but they also proved disappointing. It was only on 16 August 1938 that oil was finally discovered in Dhahran in commercial quantities. The first cargo of oil sent to a foreign destination was loaded on 1 May 1939, at Ras Tanura, on a tankship chartered by Aramco and expressly sent for that purpose by the Standard Oil Company of California, the Company which had signed the Principal Concession Agreement of 1933 with the Government. A first pipeline was built by Aramco to connect the oilfields with the port. H.M. the King, who had come especially from Riyadh for that occasion, opened the valves which started the flow of Saudi Arab oil into the markets of the world. This was the dawn of an era of great prosperity for the Kingdom of Saudi Arabia.\footnote{Saudi Arabia v. Aramco, supra note 2, at 122.}

2 THE CALIFORNIA ARABIAN STANDARD OIL COMPANY

Socal assigned its entire interest in the concession to its wholly owned subsidiary, the California Arabian Standard Oil Company (“Casoc”), in November 1933. In
1936, Socal decided to assign a 50% ownership in Casoc to the Texas Company (Texaco) for $21 million. This was the result of Socal forming a 50/50 joint venture company called “Caltex” with Texaco. Socal had a major problem at the time. It did not have global markets for its increasing international crude oil production, which at the time was from Bahrain. Texaco, on the other hand, had the opposite problem. It had an extensive refining and marketing network in Europe, Africa and Asia, but no oil production from that region, and was thus forced to ship crude from the United States to its European and Asian refineries to meet its crude oil supply requirements. The two companies therefore decided to pool all of their upstream and downstream assets “East of Suez” in a consolidated area that was demarcated by what they called the “Blue Line.” Socal placed its Bahrain and Saudi oil concessions into the joint venture. Bahrain was already producing 13,000 barrels per day (“bpd”) with an estimated potential capacity of 30,000 bpd.

Meanwhile, Socal geologists were still searching for their first discovery in the Saudi desert. And then in 1938, Casoc discovered oil with Well Number 7 at the Dammam Dome near Dhahran, Saudi Arabia, “just as the CASOC Board was deliberating in San Francisco whether to abandon the concession due to the lack of positive results after five years of drilling.”

Everything changed dramatically with this discovery. Production reached 14,000 bpd by the start of World War II with a workforce of more than 3,000 personnel. The company had big plans to expand production. However, drilling, exploratory and development operations were shut down during the war for lack of supplies. While operations were grinding to a standstill in Saudi Arabia during the war, the U.S. government’s interest in Saudi Arabia and the Casoc concession was instead picking up momentum.

3 SAUDI ARABIA AND THE U.S. GOVERNMENT

The view of the United States government towards Saudi Arabia changed dramatically during World War II. In 1938, the United States was producing more than 60% of the world’s annual crude oil production, while exporting more than 12% of its production. By 1948, it was consuming more oil than it was able to

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20 In 1948, W.S.S. (“Star”) Rodgers, the President of Texaco, testified to the U.S. Congress that the Texas Company had paid Socal $21 million for its 50% interest in Casoc as part of the Caltex deal. See: Irvine Anderson, Aramco, the United States, and Saudi Arabia: A Study of the Dynamics of Foreign Oil Policy, 1933-1950 (Princeton University Press, 1981) at 122, footnote 36.

21 Yergin, supra note 10, at 298-302.


23 Anderson, supra note 20, at 111.
produce. The United States was thus transitioning in the 1940s from being a net exporter to a net importer of petroleum, all the while providing the fuel for the Allied forces war engine. In May 1943, a study prepared by the vice chief of naval operations for the Joint Chiefs of Staff estimated the proven reserves of the United States at 20 billion barrels, while Middle Eastern reserves were estimated in excess of 56 billion barrels. As a result, the United States government began to take a strategic interest in the Middle East, in particular the Al-Hasa concession held by Casoc in Saudi Arabia, and more particularly, the continuing American control of that concession.

In the early 1940s, the British were making substantial advances to the Saudi Arabian government in cash and supplies, made possible by wartime aid that the British government was receiving from the United States through its Lend Lease program. At the same time, the Saudi government was experiencing a severe shortage of hard currency as a result of wartime hoarding of gold and silver. The British treasury proposed to the Saudi government that it should issue a paper riyal to deal with this problem backed by reserves provided by the British government, but only on the condition that it was controlled by the British Currency Control Board.

This development was alarming to Socal and Texaco since it raised concerns over the rapidly increasing British economic influence in Saudi Arabia, which could work against the interests of American companies in the country after the war. As a countermeasure, the two companies made a proposal in February 1943 to the U.S. Petroleum Administrator for War that the United States provide money directly to Saudi Arabia under its Lend Lease program instead of indirect aid through the British. In return, the two companies offered the U.S. government an equivalent amount of oil on favourable terms. They specifically suggested that the British creditor position in Saudi Arabia be transferred to the United States by crediting to the British government’s Lend Lease debt the amount now owed by the Saudi Arabian government to the British government. As it turned out, President Roosevelt signed a Lend Lease order for Saudi Arabia in that same month on a recommendation from the Department of State, rather than at the request of the two oil companies. Nevertheless, this event brought the issue of U.S. access to foreign oil reserves to the attention of key people in Washington, who were quickly realizing that the United States was facing a decrease in its own petroleum reserves with an increase in its national consumption, and that Saudi Arabia and the Casoc concession could be the solution to their problems.

On 30 June 1943, the U.S. government formed the Petroleum Reserves Corporation ("PRC"), which was charged with acquiring an interest in Saudi oil reserves. It considered a number of alternatives, including negotiating a new concession directly with the Saudis as a naval fuel oil reserve, an options-contract
with Casoc and other American companies holding oil reserves outside of the United States, and the buying of a controlling interest in Casoc. PRC opted for the third alternative and President Roosevelt subsequently approved a plan for PRC to purchase 100% of Casoc from Socal and the Texas Company, with PRC reimbursing the two companies for their investment while allotting them a percentage of future production. Socal and the Texas Company were to be initially given a contract to manage the Saudi operation, which could be granted to other oil companies in the future on a competitive basis. There appears not to have been any advance consultation with the two companies or the oil industry in general on this new policy, which was driven by “an exaggerated concern that America was running out of oil and a desire to ensure access to foreign reserves.”

The U.S. government then entered into negotiations with Socal and the Texas Company demanding a 100% interest in Casoc and its concession. It quickly became clear that the companies would not sell their 100% ownership. The government then reduced its demand to 51% of Casoc, in line with the British government’s ownership in APOC. This reduced offer was quickly refused by the two companies. They did, however, indicate a willingness to consider the sale of a 1/3 interest in return for the U.S. government financing a planned refinery at Ras Tanura, Saudi Arabia. The two sides came to a tentative agreement in October 1943, in which the U.S. government would pay $40 million to the two companies for a 1/3 interest in Casoc. The U.S. government would also acquire a pre-emptive right to purchase 100% of Casoc’s production in wartime and up to 51% in peacetime, with a right to block sales to third parties who it considered adverse to American national interests. The U.S. government also agreed to advance the funds for the refinery, which would be repaid from future earnings. However, one item remained unresolved between the parties around “war costs” incurred from building excess capacity beyond what the companies thought was needed in normal operations after the war. This excess capacity issue arose as a result of the U.S. military wanting a refinery of 100,000 barrels per day being built in Saudi Arabia at an estimated cost of $100 million for its anticipated military supply needs.

Anderson, supra note 20, at 54. Professor Anderson’s book provides a detailed and informative narrative of the U.S. government’s involvement in Aramco and Saudi Arabia during the war period, which is summarized in this section. His analysis is based on a detailed review of U.S. government records from that period and the diaries of and interviews with the individuals who were involved in those activities. Much of the referenced information and documentation were disclosed in i) the U.S. Senate Committee on Foreign Relations Hearings and Report on Multinational Corporations and U.S. Foreign Policy (1974) chaired by Senator Frank Church, ii) the U.S. Federal Trade Commission Report on The International Petroleum Cartel (1952), and iii) the records of the Reconstruction Finance Corporation (1932–1964) regarding the Aramco Claim against the Petroleum Reserves Corporation.
Before any deal could be struck, opposition quickly arose in the American oil industry to this tentative agreement. Major oil companies, in particular, the Standard Oil Company of New Jersey and Socony-Vacuum, objected on the basis that direct governmental participation in the oil business would have a dangerously disruptive effect around the world, with no real improvement in the government’s existing ability to draw on corporate reserves during a national emergency. Jersey’s and Socony-Vacuum's objections were also probably based on the fact that they had a long standing interest in accessing the Saudi concession, which would not have been possible if the U.S. government had taken an interest in Casoc. In any event, the government’s plans to acquire Casoc were quickly and permanently shelved in November 1943, with no such deal ever being completed.

As an alternative to the Casoc stock purchase plan, the U.S. government then considered forming a commission with the British government to oversee and regulate the production and marketing of Middle Eastern oil. This idea had been fermenting within government circles since 1941 and gained momentum in December 1943 after the cratering of the Casoc deal. It arose as a result of the American and British oil majors’ concerns that the huge oil fields being discovered in the Middle East would lead to uncontrolled competition, price wars and a destabilizing reduction in royalties to the producing countries, and the concern of the U.S. and British governments in securing access to Middle Eastern oil reserves for their increasing energy needs. The formation of a global petroleum commission advanced to the point that a draft treaty on an “Anglo-American Petroleum Agreement” was negotiated between the two governments and then considered by the U.S. Senate for ratification.

This bilateral agreement and the constitution of such a joint petroleum commission would have been consistent with the long range interests of companies already established in the Middle East, such as Socal, Texaco, Jersey, Socony-Vacuum and Gulf, who initially supported the idea. However, Texas-based independent companies who were not established in the Middle East feared that the worldwide regulation of production and oil imports into the United States would work to their disadvantage. They were thus vehemently opposed to the idea, which resulted in the U.S. Senate not approving the proposed treaty in 1944. Discussions around the agreement and the idea of a global oil regulatory commission were allowed to linger on to 1947 when they came to a quiet end. Ironically, this was a precursor to the formation of OPEC in which the oil producing countries took the regulation of oil production and the setting of prices into their own hands.

During this same time period, the Petroleum Reserve Corporation began considering the building of a pipeline from the Persian Gulf to the Mediterranean for both Casoc’s Saudi production and Gulf Oil’s Kuwaiti production. The PRC
was convinced that some form of direct government participation in Middle Eastern oil was essential to strengthen the American position in the region. Both Socal and Texaco were agreeable to the U.S. government financing the pipeline to open up a post-war European market for Saudi oil, given the significant size of the investment, especially since they had just lost government aid for the Ras Tanura refinery. The three companies agreed that the U.S. government would construct a main trunk pipeline system from Saudi Arabia and Kuwait to a port at the eastern end of the Mediterranean. The estimated cost was between $100 and $120 million, which was to be amortized over a 25 year period through toll fees paid by the companies. In addition, the companies agreed to maintain a one billion barrel reserve for potential purchase by the government at a 25% discount.

The deal was initially delayed because Socal and Texaco could not agree on how much of the pipeline capacity would be allocated to Gulf. In the meantime, opposition to the government financing the pipeline was growing within the American oil industry. Both the Texas independent oil companies and the non-participating majors objected to the pipeline scheme because they thought that the three companies and Middle Eastern oil were being given an unfair competitive advantage that would work against them. By mid-1944 the government backed pipeline project was allowed to disappear. This forced Socal and Texaco to consider other financing operations for its future Trans-Arabian Pipeline (“Tapline”) between Saudi Arabia and Lebanon. As explained by Wallace E. Pratt, a vice president of Standard Oil of New Jersey at that time:

The reason Jersey and Mobil went into Aramco after the war was that when the federal government pulled out of the Saudi Arabian picture, neither California nor Texaco had enough money to either build a pipeline or to handle other agreements made.\(^{25}\)

This period of the U.S. government attempting to be directly involved in Saudi Arabian oil and the Saudi concession came to an end with the liquidation of the Petroleum Reserves Corporation at the end of the war. All of this was done without the participation (or even knowledge) of the Saudi government. Nevertheless, the U.S. government continued to forge a close relationship with Saudi Arabia and Aramco in the implementation of its foreign oil policy over the coming years with many significant events unfolding in Saudi Arabia.

4 THE FORMATION OF ARAMCO

At the time Socal and Texaco were discussing the participation of the U.S. government in Casoc in 1943, the two companies decided that a name change would be appropriate. The original plan was to change the name to the American

\(^{25}\) Anderson, supra note 20, at 80, footnote 37.
Arabian Oil Company, similar to what the British had used for the Anglo-Iranian Oil Company. However, the two companies thought this would convey the wrong message to Abd al-Aziz, the ruler of Saudi Arabia. They therefore reversed the order of the name and instead called it the Arabian American Oil Company (“Aramco”) with the incorporation of a new company in Delaware, USA on 31 January 1944.

The decision was a fortuitous one, for Abd al-Aziz increasingly came to look upon the Arabian American Oil Company as an instrument for the achievement of his purpose in Saudi Arabia. As early as 1944, he began to press for the transfer of Aramco’s corporate headquarters to Saudi Arabia so that his government could have easy and frequent access to the highest authorities in the company. His demand was not met until the 1950s, but increasingly Aramco developed into a channel for the conveyance of Saudi interests to the inner circles of the parent corporations and the American government, as well as a highly profitable source of supply for the parent corporations.26

As production ramped up after the war, Aramco once again faced the same problem that Socal previously had on its own. “The reason was an embarrassment of riches, the very scale of the Saudi oil fields, which meant an enormous need for capital and markets.”27 Even though Aramco was rich in crude oil production, its two shareholders, Socal and Texaco, lacked sufficient refining and marketing networks to sell its increasing production rates; and the capital required to expand facilities in Saudi Arabia and infrastructure into the European and Asian markets was daunting for the two companies. Since the potential deals with the U.S. government to participate in and finance Aramco’s expansion had failed to materialize, the solution was to expand the Aramco consortium. This resulted in the inclusion of the two other major American oil companies who had previously declined entering Saudi Arabia, but who were now keen to join, Standard Oil of New Jersey (Exxon) and Socony-Vacuum (Mobil). Discussions began in early 1946 when Socal first approached the Jersey company, which talks were expanded to include Socony.

These two new companies had unrivaled marketing assets in Europe and the Far East, and strong balance sheets to finance the required expansion. But they also satisfied King Ibn Saud’s explicitly stated wish that Aramco should remain American to avoid any extension of British influence in the region and the U.S. government’s strategic goal that the concession remain under American control. However, in order to make the deal work, Exxon and Mobil had to first extricate themselves from the “Red Line Agreement” and out of the clutches of Calouste

26 ANDERSON, supra note 20, at 115.
27 YERGIN, supra note 10, at 410.
Gulbenkian ("Mr. Five Percent"), and to structure the deal to avoid US antitrust concerns, which they accomplished by December 1948.\textsuperscript{28}

Texaco first demanded $650 million for a 1/3 interest in Aramco. The parties then negotiated a final price that resulted in Standard Oil of New Jersey and Socony-Vacuum agreeing in November 1948 to pay Socal and Texaco $470 million\textsuperscript{29} for 40\% of Aramco:

So Aramco decided they had to have two other companies to put up capital and market the oil. They offered to let Exxon, then Standard Oil Company of New Jersey and Socony-Vacuum (now Mobil) join the venture. Well they were both interested, but Socony-Vacuum, as they'd been in the past twenty years, were very conservative, and they didn't want to take too big a stake in this because they thought they were risking a lot of money. So they would only take 10 percent. Exxon, or Standard (New Jersey) was very happy on that; that meant the other three could have 30 percent. So it was 30, 30, 30, 10.\textsuperscript{30}

Meanwhile, Aramco had achieved a 25-fold increase in crude oil production from 20 thousand bpd in 1944 to 550 thousand bpd in 1950, which was quickly changing the dynamics and expectations of the parties to the concession agreement.

5 THE RENEGOTIATION OF THE CONCESSION

As described by the Tribunal in the Aramco Arbitration:

As shown by the memorials and oral arguments of both Parties, the present arbitration is a friendly one, whose purpose is to decide what is just and right in the dispute which has arisen between the Parties, so that they may resume and maintain the friendly and fruitful co-operation which has characterized their relations for nearly a quarter of a century.\textsuperscript{31}

This "friendly relationship" was a result of Aramco being willing to renegotiate, adapt and revise its original concession with the Saudi government by

\textsuperscript{28}\textit{Id.} at 410–416. Compagnie Française des Pétroles (C.F.P.) and Calouste Gulbenkian, who were parties to the Red Line Agreement, initiated a series of claims and counterclaims against Jersey and Socony in the English courts demanding that they participate in the Aramco purchase pursuant to their preferential rights under the agreement. The two American companies argued that the agreement was "frustrated," under the doctrine of "supervening illegality," rendering it null and void as a result of C.F.P. and Gulbenkian becoming enemy aliens during the Nazi occupation of France. The parties settled the day prior to the trial commencing, with Jersey and Socony conceding a number of financial terms to C.F.P. and Gulbenkian.

\textsuperscript{29}This consisted of an initial payment of $102 million ($79.8 million to reimburse Socal and Texaco for their investment in Aramco up to that date and $22.2 million for a dividend payable to them) and $367.2 million to be paid out of Jersey's and Socony's share of Aramco's future earnings over a number of years. As disclosed in U.S. Congress Hearings, \textit{International Petroleum Cartel} at 119-128, and reported in \textit{Anderson}, \textit{supra} note 20, at 151-158.

\textsuperscript{30}Interview with William L. Owen, former Aramco General Counsel in \textit{American Perspectives of Aramco, the Saudi-Arabian Oil Producing Company, 1930s to 1980s} (Carole Hicke, ed., Regional Oral History Office, Bancroft Library, University of California, Berkeley, 1995) at 299-300.

\textsuperscript{31}Saudi Arabia v. Aramco, \textit{supra} note 2, at 134-135.
ensuring that both parties were mutually benefiting throughout the term of the agreement as circumstances changed with the ultimate goals of Aramco retaining control over the concession for as long as possible and the Saudis maximizing their economic rent. The parties did so from the inception of the Principal Agreement and ultimately up to the point when the Aramco partners agreed to a settlement that allowed the Saudi government to acquire the company and transform it into what is known today as Saudi Aramco. This was shown in the various supplements and amendments to the Principal Agreement over the years.

5.1 SUPPLEMENTAL AGREEMENT OF 31 MAY 1939

The Supplemental Agreement of 1939 was entered into shortly after the Dammam oil discovery of 1938, which reflected the confidence of the Casoc partners to commit to the development of the concession. It provided that:

– The concession was extended to “all lands, islands, waters, territories and interests” as described in the original concession (without defining what were “territorial waters”) and to “all right, title and interest” of the Government in the “Saudi Arab-Kuwait Neutral Zone” and the “Saudi Arab-Iraq Neutral Zone”, which was essentially the exercise of the option under Article 3 of the original concession agreement. This provision effectively increased the concession area from approximately 371,000 square miles to about 496,000 square miles.

– The company had no obligation to relinquish any portion of the concession area for ten years. Afterwards, it could relinquish those areas that it decided not to explore or use.

– The term of the concession was extended from 60 to 66 years.

– The company would pay £140,000 in gold to the Government upon the effective date of the Supplemental Agreement, an annual rental of £20,000 in gold and £100,000 in gold upon the discovery of oil. This provision effectively increased the cash payments to the Saudi government from what was originally agreed upon in the 1933 Agreement.

32 “The challenge was to keep the Saudis sufficiently happy to maintain Aramco’s position because this was the most important concession in the entire world and we didn’t want to take any chances of losing it.” Quote of Howard Page, Exxon’s director responsible for the Middle East in Yergin, supra note 10, at 533.

33 The various amendments to the Principal Agreement are listed in Cattan, Evolution of Oil Concessions, supra note 12, at 160.

34 Cattan, Evolution of Oil Concessions, supra note 12, at 3.
5.2 Amendment of 10 October 1948

The 1948 Amendment addressed a number of issues that had developed since the 1933 Agreement, including relinquishment, offshore rights, the Neutral Zones and minimum royalty payments.

Article 9 of the 1933 Agreement provided that the company was to relinquish to the Saudi government “such portions of the concession area as the company may decide not to explore or prospect further or to use otherwise in connection with the enterprise.” This was reiterated in Article 7 of the 1939 Supplemental Agreement, with the clarification that no relinquishment would occur within ten years after the 1939 Supplemental Agreement. The parties agreed in the 1948 amendment that Aramco was required to relinquish portions of the concession area in stages over a 22 year period amounting to a total of 198,000 square miles to be relinquished. By 1963, Aramco had relinquished acreage totaling 144,000 square miles under the 1948 amendment. The parties then agreed upon a further relinquishment schedule in a 1963 amendment. These revised relinquishment requirements had a “significant and momentous” impact on other concessions in the Middle East, which resulted in newcomers and smaller oil companies appearing in the MENA region.\(^{35}\)

Saudi Arabia confirmed in the 1948 Amendment that Aramco had the hydrocarbon rights over the offshore area in the Arabian Gulf, including the seabed and subsoil over which the government had or may have had dominion, control or ownership. This confirmation was a recognition of the advancing offshore technology in the oil industry and the evolving claims being made by sovereign states over their maritime jurisdictions.

Most of the early oil concessions in the Middle East (such as the 1901 D’Arcy concession in Iran) made no reference to the inclusion of territorial waters within the geographical area of the concession. Offshore oil exploration and production simply did not exist at the time. Article 2 of the 1933 Agreement did state that the concession area included “islands and territorial waters,” which Article 5 of the 1939 Supplemental Agreement reiterated. But it was never defined in those agreements as to what that exactly meant.

As offshore oil production became a reality, Saudi Arabia recognized the significant value of potential oil fields in its Arabian Gulf waters. This prompted Saudi Arabia in its Royal Proclamation of 28 May 1949 to abandon the traditional three-mile limit and to extend its territorial waters to six nautical miles off its coast. At the same time, other coastal States were extending their rights and jurisdiction over the continental shelf contiguous to their territorial waters. This...

\(^{35}\) Id. at 3-5 and 11-12.
concept was first advanced by the United States of America in 1945, which set the precedent of claiming jurisdiction over mineral deposits on its continental shelf. Based on similar principles, the 1949 Royal Proclamation declared Saudi Arabia’s ownership, jurisdiction and control over the subsoil and seabed of those areas of the Arabian Gulf seaward from the coastal sea that were contiguous to its coasts. In June 1949, Bahrain, Qatar, Kuwait and the Trucial Sheikhdoms (which are now the UAE) issued proclamations making similar claims. Saudi Arabia repealed this Royal Decree on 16 February 1958 and replaced it with another Royal Decree that extended its territorial waters to twelve nautical miles.

The establishment of these principles allowed the coastal states in the Arabian Gulf to negotiate demarcation agreements that defined the boundaries of the seabed outside territorial waters between Saudi Arabia, Bahrain, Iran, Kuwait and Qatar. These legal developments, both within international law and the amendments to oil concessions such as the Aramco concession, allowed the development of offshore oil and gas fields in the Middle East. Examples of offshore fields that were developed as a result of co-operation between coastal states in the Gulf and Aramco are:

- The first offshore field in the Middle East was the Safaniya field, which is offshore Saudi Arabia. This field was discovered by Aramco in 1951 and to this day is still the largest offshore oil field in the world.
- Saudi Arabia and Bahrain fixed their maritime boundaries in an agreement dated 22 February 1958. This allowed the development of the Abu Sa’fah oil field, which straddles both countries’ maritime boundaries. That agreement provided that Saudi Arabia, in the person of Aramco, would operate that field on the condition that 50% of the net revenue would go to Bahrain.
- Saudi Arabia and Kuwait concluded an agreement on 7 July 1965 that divided the Neutral Zone between them without prejudice to their rights to natural resources in the entirety of the divided zone, regardless of when they would be discovered. This allowed the development of the concession granted to the Arabian Oil Company (a Japanese company) by Saudi Arabia and Kuwait, which consisted of offshore fields in the territorial waters of the Neutral Zone that straddled into Saudi Arabia. Aramco’s Safaniya field and the Arabian Oil Company’s Khafji field belong to the same geological structure. This agreement facilitated the development of the Khafji field.

The 1948 Amendment also addressed the Neutral Zones, to which Aramco had acquired a right in Saudi Arabia’s interest in them through exercising its option to these territories in the 1939 Supplemental Agreement. Aramco agreed to relinquish such rights, which facilitated the awarding of oil concessions in the
Saudi Arab–Kuwait Neutral Zone to other oil companies. Kuwait had already granted a concession to Aminoil in their Neutral Zone in 1948. Saudi Arabia followed up with the awarding of an oil concession to Pacific Western Oil Company (Getty Oil) on 20 February 1949.36

Finally, Aramco guaranteed to the government an annual minimum royalty of $2 million from offshore oil production, which reflected the expectations of both parties regarding the development of offshore fields, such as the Safaniya field.37

5.3 INCOME TAX AMENDMENT OF 30 DECEMBER 1950

Under the original 1933 Agreement, the company provided a number of loans to the government and paid a royalty of four shillings in gold per ton of net crude oil. When the Saudi government wanted a greater share of the production revenue, Aramco agreed to do so in 1950:

The Government insisted on obtaining more revenue from oil, and consequently an Agreement was signed on 30 December 1950, corresponding to 20 Rabie al Awal 1370, under which the Company agreed to submit to an income tax which, together with other payments already made by Aramco, secured to the Government fifty per cent of the Company’s net operating income.38

The equal sharing of oil profits, i.e., a 50/50 split, between a producing country and oil companies first emerged in Latin America in 1943 when Venezuela was successful in extracting this concession from IOCs, in particular from Standard Oil of New Jersey (through its Creole subsidiary), which was both the main producer in Venezuela and a shareholder in Aramco at that time. The Jersey company, along with Gulf Oil (which with Shell were the next biggest producers in the country), negotiated a new fiscal arrangement with the Venezuelans in February 1943. The Venezuelans relied upon American advisors, in particular Herbert Hoover, Jr. (the son of the former U.S. President) and Max Thornburg (a former Bapco vice president) in those negotiations, which resulted in a new Venezuelan petroleum law being enacted on 13 March 1943. This new law split the profits fifty-fifty between the companies and the government, which was meant to increase Venezuela’s oil revenue by 80%. However, the petroleum law did not quite produce the results anticipated, and so Venezuela enacted a

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36 It should be noted that the generous terms of the Getty concession was one of the factors that increased the expectations of the Saudi government as to what it should be getting from the Aramco concession, which resulted in the 1950 Amendment. The Getty concession terms included a royalty of $55/bbl, a signing payment of $9.5 million, annual rental payments of $1 million, 1/8 of production profits, 1/4 of refinery profits, and a right to purchase shares in the Getty company, Pacific Western.
37 CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 14-18 and 42.
38 Saudi Arabia v. Aramco, supra note 2, at 123.
corporate income tax law in November 1948 that guaranteed a 50/50 division of profits.\textsuperscript{39} The American companies accepted this change in fiscal terms on the basis that they could deduct their increased Venezuelan taxes against their U.S. taxes under a 1918 U.S. tax law.

In an agreement dated 30 December 1950, Saudi Arabia and Aramco introduced this concept into the Middle East, which was a turning point in the financial evolution of oil concessions in the region. Over the passage of time, the value of oil in relation to gold had increased and had become an unequal economic bargain. Aramco thus agreed to change the fiscal terms of its concession:

The change involved two major consequences. First, the concessionaire’s payments to the producing country were associated with profits in addition to the fixed amounts previously payable per unit of production and, secondly, the parties adopted the concept of the equal sharing of profits or equivalence of contractual advantages between them.\textsuperscript{40}

Saudi Arabia first issued a Royal Decree on 27 December 1950 that imposed an income tax on companies engaged in the production of petroleum or other hydrocarbons, which resulted in combined payments of royalty and tax of 50% of their “net operating income.” Aramco then agreed on 30 December 1950 to pay that income tax. Article 1 of that agreement provided that in no case was the total of income taxes and all other taxes, royalties, rentals and payments to the government for any year to exceed 50% of the company’s gross income after such gross income had been reduced by Aramco’s costs of operation, including loss and depreciation, but not reduced by taxes, royalties, rentals or exactions.\textsuperscript{41}

The concept of equal profit sharing replaced the royalty as the principal financial feature of oil concessions and resulted in a threefold to fourfold increase in the revenue previously provided to the Saudi government under the standard royalty rate of four shillings gold per ton. This principle found its way into concession agreements in Kuwait, Iraq, Qatar and Bahrain in the Middle East and in new concessions granted in Libya, Iran, Algeria, Tunisia, Morocco and Egypt in North Africa. This was accomplished by mutual agreement between the parties, with the one exception of Iran.\textsuperscript{42}

Although the Anglo-Iranian Oil Company (“AIOC”, the successor company to the Anglo-Persian Oil Company) and Iran had attempted to revise their 1933 agreement since 1945, discussions broke down in 1951, which resulted in Iran nationalizing the oil industry and vesting AIOC’s assets in the National Iranian


\textsuperscript{40} \textit{EVOLUTION OF OIL CONCESSIONS}, supra note 12 at 9-10.

\textsuperscript{41} \textit{Id.} at 44.

\textsuperscript{42} \textit{Id.} at 66 and 119-120.
Oil Company (“NIOC”). In response, the Government of the United Kingdom submitted an application on behalf of AIOC to the International Court of Justice (“ICJ”) on 26 May 1951 which instituted proceedings between it and the Imperial Government of Iran, on the grounds of invoking the right of diplomatic protection for one of its subjects. The ICJ rejected the claim on the basis that it did not have jurisdiction. AIOC was then forced to form a Consortium, consisting of itself, Shell, five American companies (including the four Aramco shareholders plus Gulf Oil) and a French state company, Compagnie Française des Pétroles. That Consortium reached a new agreement with Iran in 1954, which provided compensation on a similar basis.

Aramco also agreed with the Saudi government in 1950 that it had the right to nominate two Saudi individuals to the Aramco Board of Directors, which was the first step towards the Saudis actively participating in the operations and finances of Aramco.

5.4 FOREIGN INCOME TAX ADJUSTMENT OF 13 FEBRUARY 1952

Foreign taxes were at first treated as deductible expenses by IOCs operating in the Middle East, thus reducing the host government take. Similar to other IOCs, Aramco deducted the U.S. taxes it paid as an expense before it calculated the 50/50 profit split. This understanding was reflected in the Saudi Arabian Royal Decree of 27 December 1950 which provided in Article 2 that income taxes paid or payable to any foreign country were to be subtracted from net operating income. This fiscal arrangement became unacceptable to Saudi Arabia as its treasury required more funds. The parties, with support from the U.S. State Department, found the solution in American double-taxation regulation. Instead of Saudi Arabia increasing its royalty rates, Aramco would now deduct the Saudi taxes imposed on it from the company’s U.S. tax liabilities. This arrangement was based on Aramco’s understanding of the 1918 U.S. tax law, which was not ultimately confirmed until the IRS conducted a tax audit on Aramco in 1955, since the policy of the IRS was not to provide a tax opinion on hypothetical cases.

As a result, the Kingdom’s revenues were doubled overnight without any real impact on Aramco’s bottom line. In order to facilitate this change, Article 2 of the 1950 Decree was replaced by a Royal Decree promulgated in 1952. Other Middle Eastern countries subsequently revised their concession agreements or petroleum

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43 Anglo-Iranian Oil Company Case (United Kingdom v. Iran), ICJ Reports 93 (1952).
44 Interview with William Owen, former Aramco General Counsel, supra note 30 at 356.
legislation to provide that foreign income taxes were not allowed as deductions from income.\textsuperscript{45}

5.5 \textbf{ONGOING RENEGOTIATIONS DURING THE ARBITRATION}

Aramco and the Saudi government continued on with their business while their lawyers fought it out in their arbitration. This included continuing to renegotiate and adapt Aramco’s concession agreement. On 3 October 1954, the parties agreed to increased prices for Aramco’s crude oil production in which the government could benefit through their profit sharing arrangement, and on 25 June 1956, the parties agreed upon revised billing practices to meet the government’s requirements.\textsuperscript{46}

5.6 \textbf{AMENDMENT OF 24 MARCH 1963}

Aramco continued to agree to the revision of its original agreement with the Saudi government after the issuance of the arbitral award. In 1963 it agreed to an expanded relinquishment program, the setting of crude oil prices, which essentially removed any discounts to the owner companies, and to revisions in its accounting practices. Another settlement agreement was signed at the same time that dealt with pricing claims on the Tapline, which was owned by Aramco’s shareholders.\textsuperscript{47}

Aramco had agreed on 10 October 1948 to relinquish a total of 198,000 square miles over a period of 22 years. By 1963 it had relinquished a total of 144,000 square miles when it entered into a new and expanded relinquishment program on 24 March 1963. Under this program, Aramco agreed to an immediate surrender of 125,000 square miles, with an ongoing program of relinquishments every five years over a 30 year period so that the area retained by the company

\textsuperscript{45} \textit{Cattan, Evolution of Oil Concessions, supra note 12, at 57.}

\textsuperscript{46} \textit{Id. at 122.}

\textsuperscript{47} The Trans-Arabian Pipeline Company (“Tapline”) was originally set up as a separate, distinct company with the same shareholdings as Aramco. The Aramco shareholders intentionally did not make Tapline a subsidiary of Aramco because they wanted Aramco to only do business in Saudi Arabia, along with wanting to insulate Aramco from the governments of the neighbouring countries where the pipeline route could transit to the Mediterranean Sea, in the event of any diplomatic disagreements. That changed in 1964 when the Trans-Arabian Pipeline Company became a wholly owned subsidiary of Aramco. The Tapline began operations in 1947 and exclusively carried Aramco crude oil. It was the world’s largest oil pipeline system when it was built, running more than 1,200 km from Abqaiq, Saudi Arabia to its export terminal at Sidon, Lebanon with a maximum capacity of 500,000 bpd. The section of the pipeline from Jordan to Lebanon ceased operations in 1976, with the remainder of the line operating at reduced capacity until 1990. Saudi Aramco fully closed the Tapline company in 2002.
would amount to no more than 20,000 square miles, i.e., about 4% of its original concession area.\textsuperscript{48}

The resolution of how the pricing of Aramco crude oil was set was the primary concern of the Saudis in this round of negotiations:

... that thing was part of the price negotiation stuff we had had for years, and it’s just when we unilaterally changed the price downward that we knew we were in trouble…. So it wasn’t just because of that; that was what triggered it. They were unhappy with the fact that the price and their income was controlled solely by the owner companies, and they had no place in it.... And Brougham and I [Aramco Chairman and General Counsel] felt the government had a point. The owner companies didn’t....

Well, the pressures began to build up, not for participation, but for pricing in the early fifties, from 1950 on, from the time we signed the December 30, 1950 agreement where we were going to pay an income tax to the Saudi government and the other governments in the world, because that all happened, they all went on a taxation basis at about the same time, all concessionaire companies. The countries had a real, what I thought, legitimate interest in what the price was going to be, because their income depended on it. So the pressures built upon that.

We largely dissipated them by the March 24, 1963 agreement, which was a culmination of all the negotiations we had had for 10 years on the subject.... The main problem had been the pricing.... They were interested in the price matter with Aramco, and once we settled that, everything else fell into place.\textsuperscript{49}

The 1963 agreement also laid down detailed provisions regarding the accumulation and deduction of exploration and intangible development costs. The former were to be amortized at a rate of 5% per annum while the latter were to be amortized at a rate of 10% per annum, provided that costs for the relinquished areas would be fully deductible in the year of their relinquishment.\textsuperscript{50}

The Tapline pricing claim (called the “Sidon Price Claim” because of its terminus at that town in Lebanon) was the one other occasion when Aramco initiated an arbitration against the Saudi government, but which was settled at the last minute:

So then in that same era ... we had the Sidon Price Claim come up, which was where the Saudi government felt that Aramco owed money on the oil that was transported through Tapline’s thousand mile pipeline to the Mediterranean, even though Tapline had paid its portion and they wanted to double dip. We were really right in it, but we finally settled that. They were claiming $283 million and we settled for $180 million on it, because of another thing. We had won the Onassis case....

We had won that, and Faisal – then Crown Prince, later King, who was our friend, was a little stung by that, and not very happy. That meant so much to us that we felt, “Okay, we’re not going to push our point.” We did take them to arbitration on the Sidon Price

\textsuperscript{48} CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 11-12.

\textsuperscript{49} Interview with William Owen, former Aramco General Counsel, supra note 30 at 361-362 and 372.

\textsuperscript{50} CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 59.
Claim, and Faisal got mad. He said, “You guys should be able to settle this short of arbitration.” So we negotiated – we appointed our arbitrator and they appointed their arbitrator – but Faisal didn’t want it to go ahead. He wanted us to settle it. So we were very generous in the settlement, and settled that, primarily because we felt we could, after we had upheld our rights to ship oil worldwide in the Onassis case.51

5.7 Expensing of Royalties on 25 January 1965

When Aramco agreed to the equal profit sharing concept in 1950, it was on the understanding that the total of the royalty and income tax it paid to the government would be equal to 50% of net profits, which would be Saudi Arabia’s overall share. Consequently, royalty payments were not deducted from income as an expense item in computing income tax, but were instead credited against the tax payable to Saudi Arabia.

Saudi Arabia, along with other members of OPEC, began challenging this accounting methodology in 1962. They argued that a royalty payment was made to the owner of the mineral resources in consideration for the depletion of that resource and for that reason, should be paid to the government independently of any income tax. Saudi Arabia and OPEC were ultimately successful in their argument, with Aramco and other IOCs agreeing to treat royalty payments as an expense in computing income tax instead of a credit against the income tax. Aramco agreed to “expensing” royalties in its accounting records as of 25 January 1965. Henceforth, royalties were not taken into account in determining the 50% of annual profits which were payable to the Saudi government.52

In addition to dealing with the expensing of royalties, the agreement made on 25 January 1965 granted an option to the government to take crude oil in lieu of royalty, which it did not previously have under the original concession agreement.53

5.8 Third Party Discounts on 30 September 1966

Starting in 1947, Aramco entered into offtake contracts for the sale and transportation of crude oil and refined products from its concession to its shareholder companies and other buyers around the world.54 This ensured the sale and worldwide distribution of the crude oil produced from the Aramco concession through its four shareholders’ downstream companies.

51 Interview with William Owen, former Aramco General Counsel, supra note 30 at 318-319.
52 CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 41 and 66.
53 Id. at 37.
54 Saudi Arabia v. Aramco, supra note 2, at 125.
In April 1966, OPEC adopted a resolution recommending to member countries to apply posted prices or reference prices for the purpose of determining the tax liabilities of oil companies. Given its offtake contracts with its shareholders’ affiliates, Aramco accounted for income tax purposes to the Saudi government until 1966 on the basis of posted prices for its sales to affiliates and on the basis of realized prices for sales to non-affiliated purchasers. On 30 September 1966, Aramco agreed to stop its practice of accounting for sales on a realization basis, and instead, to bill its offtakers on the basis of published prices reduced by marketing allowances and the allowances established in accordance with an OPEC formula. This settlement also covered Aramco’s long-standing discounted sales to the U.S. navy, which was a third party offtaker.

6 THE ONASSIS AGREEMENT

Despite their long tradition of “friendship and good will,” there was one dispute that Aramco and the Kingdom of Saudi Arabia (“KSA”) were unable to negotiate and resolve on their own. It arose when the Kingdom awarded a 30-year exclusive crude oil shipping contract to the Greek shipping tycoon Aristotle Onassis in 1954 without consulting Aramco. This conflict resulted in the two parties embarking on an historic ad hoc arbitration, which resulted in an award that was issued in 1958.

Aristotle Onassis, who at the time owned one of the largest crude oil shipping companies in the world, first obtained the approval of the government in 1954 to form a company in Saudi Arabia called the Saudi Arabian Maritime Tankers Company (“SATCO”). The government then signed a shipping contract with SATCO on 20 January 1954, which gave it a “right of priority” to transport all the oil produced under the Aramco contract from Saudi Arabia and from its pipeline terminus in Sidon, Lebanon to foreign markets for a period of thirty years. SATCO was to pay the government a royalty on every ton of oil shipped abroad on SATCO tankers, along with SATCO being granted an exemption from income tax. Onassis undertook to maintain a fleet of tankers with Saudi names under the Saudi flag and to establish a maritime school in Jeddah that would train Saudis to be employed on SATCO tankers. The Saudi government undertook to compel Aramco to export its oil on SATCO tankers. The Onassis Agreement was ratified by a Royal Decree and Aramco was subsequently informed that the ratified contract had the force of law.

55 CATTAN, EVOLUTION OF OIL CONCESSIONS, supra note 12, at 52-55.
56 Interview with William Owen, former Aramco General Counsel, supra note 30 at 376.
57 Saudi Arabia v. Aramco, supra note 2.
58 Schwebel, supra note 17, at 246.
The Aramco shareholders were prepared to negotiate many of the concession agreement terms with the Saudi government, but the threat of losing control of the transportation and distribution of the production from their largest oil fields crossed the line:

... we knew Aristotle Onassis had been in Saudi Arabia at least once; it turned out later he’d been there many times. Everybody in the world sort of distrusted Aristotle Onassis, and we wondered what he was up to and how it could affect us, but we didn’t have much input into it, and waited back to see.\textsuperscript{59}

As a result, Aramco refused to comply with the SATCO contract and did not allow Onassis to transport the crude oil produced from the concession:

It maintained that its implementation would violate the letter and spirit of the Aramco Concession Agreement; conflict with longstanding business arrangements and practices concluded in reliance on that Agreement; and be wholly impracticable. The prospect of Onassis controlling its export lifeline was not one that Aramco – or the international oil industry at large – could accept.\textsuperscript{60}

This set the stage for the first, and only, arbitration between Aramco and the Kingdom of Saudi Arabia. Unlike many of the investor state arbitrations that arose in the region at that time, this arbitration was a narrow dispute concerning the transportation rights of Aramco’s crude oil production and refined products, rather than about a unilateral change in the concession’s fiscal terms or an expropriation of its investments by the government.

7 THE ARBITRATION AGREEMENT

Article 31 of the original 1933 Agreement provided that any dispute between the government and the company would be resolved through final, binding \textit{ad hoc} arbitration. That article stated the following:

If any doubt, difference, or dispute shall arise between the Government and the Company concerning the interpretation or execution of this contract, or anything herein contained or in connection herewith, or the rights and liabilities of the parties hereunder, it shall, failing any agreement to settle it in another way, be referred to two arbitrators, one of whom shall be chosen by each party, and a referee who shall be chosen by the arbitrators before proceeding to arbitration. Each party shall nominate its arbitrator within thirty days of being requested in writing by the other party to do so. In the event of the arbitrators failing to agree upon a referee, the Government and the Company shall, in agreement, appoint a referee, and in the event of their failing to agree they shall request the president of the Permanent Court of International Justice to appoint a referee. The decision of the arbitrators, or in the case of a difference of opinion between them, the decision of the

\textsuperscript{59} Interview with William Owen, former Aramco General Counsel, \textit{supra} note 30 at 331.

\textsuperscript{60} Schwebel, \textit{supra} note 17, at 246.
referee, shall be final. The place of arbitration shall be such as may be agreed upon by the parties, and in default of agreement shall be The Hague, Holland.\textsuperscript{61}

Similar to other early oil concessions in the Middle East,\textsuperscript{62} this was a relatively short, simple dispute clause that had a number of deficiencies, including that it did not provide for the procedural rules to be followed or for the governing law of the contract to be applied by the tribunal. In addition, the appointing authority referenced in the arbitration clause no longer existed.

That clause, similar to other concessions in the region of the same vintage, gave the power of appointment to the President of the Permanent Court of International Justice, a court that was dissolved along with the League of Nations in 1946. Article 37 of the Statute of the International Court of Justice (that replaced the Permanent Court of International Justice) did however provide that:

\begin{quote}
Whenever a treaty or convention in force provides for reference of a matter to a tribunal to have been instituted by the League of Nations, or to the Permanent Court of International Justice, the matter shall, as between the parties to the present Statute, be referred to the International Court of Justice.
\end{quote}

Despite the apparent ability to turn to the International Court of Justice, which was established as the principal judicial organ of the United Nations in April 1946, to overcome the deficiency in Article 31 of the original agreement, the parties decided to negotiate and agree upon an entirely new four-page arbitration agreement dated 23 February 1955 (the “1955 Arbitration Agreement”). It can be found as a note at the end of the Aramco award.\textsuperscript{63} That arbitration agreement established the process for appointing the Tribunal, the venue of the hearing and the questions the parties wanted the Tribunal to address and resolve. It also provided that the Tribunal could adopt such rules of procedure as it deemed necessary after consulting with the parties. The new arbitration agreement required that all the decisions and the award of the Tribunal be reasoned. It did not prescribe a time limit for issuing an award, but merely required the Tribunal to make the award as soon as conveniently possible.


\textsuperscript{62} Similar arbitration clauses could be found in the concession agreements made with the Iraq Petroleum Company (1925), Kuwait Oil Company (1934), Anglo-Persian Oil Company in Qatar (1935), Petroleum Developments (Trucial Coast) Ltd. in Abu Dhabi (1939) and Pacific Western Oil Corporation (Getty) in the Saudi/Kuwait Neutral Zone (1949). It was the Consortium’s agreement with Iran in 1954 that for the first time introduced a comprehensive and carefully worded arbitration clause in Middle East concession agreements. See: Henry Cattan, The Law of Oil Concessions in the Middle East and North Africa [“Law of Oil Concessions”] (Oceana Publications, New York, 1967) at 143-145 and 168.

\textsuperscript{63} Saudi Arabia v. Aramco, supra note 2, at 229 to 233.
8 THE ARBITRATION

The 1955 Arbitration Agreement resulted in the parties proceeding with an ad hoc arbitration that established a three-member tribunal led by Professor Georges Sauser-Hall of Switzerland, Dean of the Geneva Law School, as Referee. Professor Pierre Lalive (Swiss) was designated as the Secretary-General of the Tribunal. The Saudi government appointed Dr. Helmy Bahgat Badawi (Egyptian) and Aramco appointed Dr. Saba Habachy, the former Egyptian Minister of National Economy during World War II and a law professor, as co-arbitrators on the following basis:

Now, we had used him [Saba Habacy] on boundary matters before, but by our rules of the game – and they’ve changed since the Onassis arbitration. Generally, all ... arbitrators are required to be impartial now. They were not at that time. We were allowed to appoint anyone we wanted, even though it was someone who represented us in other matters and would plead our cause inside the tribunal, and so was the Saudi government.... So we both appointed very partial arbitrators.... These days, if you appoint an arbitrator, he’s got to be impartial, and you don’t even touch him. You don’t make a telephone call to him. You have no communication with him. In those days, we were able to talk with Saba daily.64

As to the counsel retained by the parties:

Each side constructed powerful legal teams. That of the Government – in whose formation Onassis played an influential part – was led by Professor Myres McDougal of Yale Law School, Professor Roberto Ago, and a former British Attorney General, Sir Lionel Heald. McDougal was a famous academic whose distinctive prose some saw as especially academic, but he was in fact a formidable, fully comprehensible advocate. Ago was described by Lord McNair as ‘clever as a bag of monkeys’ – and clever he was. Aramco’s team was led by White & Case, which then had a single office, in New York; a senior partner of that firm, Lowell Wadmond, was its chief trial counsel. Aramco built a tower of international legal talent. At the summit were Lord McNair, recently retired President of the International Court of Justice, and Maurice Bourquin, a renowned Belgian international lawyer. I [Judge Stephen Schwebel, a junior lawyer at the White & Case law firm at the time of the arbitration, and subsequently a President of the ICJ] was at the bottom of the tower, doing the research, writing memoranda and preparing first drafts of the written pleadings.65

Three rounds of extensive written memorials were exchanged simultaneously. Eight weeks of hearings were held in Geneva, Switzerland between July and September 1956 in forty-two sittings. Dr. Badawi passed away on 4

64 Mr. Owen made the following observations on this arbitrator appointment process many years later: “... how stupid a system it is where you have partial arbitrators. It just adds another layer of counsel, and you really end up with just one arbitrator to settle it. It just adds to the expense and delay, and it makes no sense.” Interview with William Owen, former Aramco General Counsel, supra note 30 at 334.

65 Schwebel, supra note 17, at 247. Aramco’s legal team was led by George Ray, its General Counsel at the time; and Spike Spurlock, its Associate General Counsel. Other White & Case lawyers included: Oliver Marsdan, who later became President of the American Bar Association and Hal Fales, who later became head of White & Case.
March 1957 and was replaced by Judge Mahmoud Hassan (Egyptian). The final award was issued on 23 August 1958.66

Despite the arbitration being a “friendly one,” the Aramco Arbitration faced a number of initial challenges in establishing such matters as the proper procedural law of the arbitration, the governing law of the concession contract, the nature of the concession, and the impact of Islamic law in determining the dispute, before the tribunal could address the conflict between the Onassis Agreement and the Al-Hasa Concession Agreement held by Aramco. This reflected both the lack of clarity in the original 1933 Agreement on these points and the embryonic stage of international arbitration at the time.

8.1 PROCEDURAL LAW

The 1933 Agreement did not provide for any particular procedural rules. Nor were there any widely accepted *ad hoc* arbitration rules, such as the UNCITRAL Arbitration Rules, to reference at the time of the arbitration. As a result, the parties had agreed in Article VI of the 1955 Arbitration Agreement that the “Arbitration Tribunal, by majority vote, as soon as convenient, shall adopt such Rules of Procedure as the Tribunal may deem necessary.”67 The Tribunal did establish such a bespoke set of procedural rules, which it modified and supplemented eight times.68

In determining the procedural law that applied to the arbitration, the Tribunal decided that since one of the parties was a sovereign state, the arbitration itself was governed by the Law of Nations, rather than the law of the seat of the arbitration, which was the Canton of Geneva, Switzerland:

> Although the present arbitration was instituted, not between States, but between a State and a private American corporation, the Arbitration Tribunal is not of the opinion that the law of the country of its seat should be applied to the arbitration....

> Considering the jurisdictional immunity of foreign States, recognized by international law in a spirit of respect for the essential dignity of sovereign power, the Tribunal is unable to hold that arbitral proceedings to which a sovereign State is a Party could be subject to the law of another State. Any interference by the latter State would constitute an infringement of the prerogatives of the State which is a Party to the arbitration. This would render illusory the award given in such circumstances. For these reasons, the Tribunal finds that the law of Geneva cannot be applied to the present arbitration.

> It follows that the arbitration, as such, can only be governed by international law, since the Parties have clearly expressed their common intention that it should not be governed by the law of Saudi Arabia, and since there is no ground for the application of the

66 Saudi Arabia v. Aramco, supra note 2, at 135-139.
67 Id. at 231.
68 Id. at 135-136.
American law of the other Party. This is not only because the seat of the Tribunal is not in the United States, but also because of the principle of complete equality of the Parties in the proceedings before the arbitrators. It is true that the practice of the Swiss Courts has limited the jurisdictional immunity of States and does not protect that immunity, in disputes of a private nature, when the legal relations between the Parties have been created, or when their obligations have to be performed in Switzerland. The Arbitration Tribunal must, however, take that immunity into account when determining the law to be applied to an arbitration which will lead to a purely declaratory award. By agreeing to fix the seat of the Tribunal in Switzerland, the foreign State which is a Party to the arbitration is not presumed to have surrendered its jurisdictional immunity in case of disputes relating to the implementation of the ‘compromis’ itself. In such a case, the rules set forth in the Draft Convention on Arbitral Procedure, adopted by the International Law Commission of the United Nations at its fifth session (New York 1955), should be applied by analogy.

In considering that the arbitration, as such, is governed by the Law of Nations, the Arbitration Tribunal does not intend to apply this Law to the merits of the dispute, since the law governing the merits is independent of the law governing the arbitration itself.69

There were a number of other oil and gas Investor State arbitrations from the MENA region during this time period that had a similar problem of establishing the proper procedural law. A number of them referenced the Aramco award on this issue, with some tribunals rejecting the Aramco Tribunal’s approach in determining the procedural law of the arbitration while others adopted its approach.

Judge Pierre Cavin was the sole arbitrator in an ad hoc arbitration between Sapphire Petroleums Ltd (“Sapphire”) and the National Iranian Oil Company (“NIOC”) in 1963.70 Under Article 41(7) of the concession agreement, he fixed the place of the arbitration in Lausanne, Canton de Vaud, Switzerland.71 Unlike the Aramco tribunal, Judge Cavin determined that the procedural law of the arbitration was governed by the law of the place of the arbitration and therefore subject to the Code of Civil Procedure of Vaud. In doing so, he relied on the implied intention of the parties and on the rule that “in the default of agreement by the parties, the arbitration is submitted to the judicial sovereignty of the seat of the arbitration at the place where the case is heard.”72

In dealing with the issue of the correct procedural law, Judge Lagergren, the sole arbitrator in the 1973 BP v. Libya case,73 stated that “The first issue which falls...
to be considered in that context is whether the proceedings, on account of the fact that one Party is a sovereign State, are governed by international law or by some other body of law not being a particular municipal legal system.” He first considered the Aramco case that rejected the place of arbitration as determining the procedural law on the grounds that a sovereign state cannot be subject to the law of another state. He did not share that view, and instead referred to the Sapphire case that held that the relevant procedural law was the law of the seat of the arbitration. He therefore determined that the procedural law of the arbitration would be Danish law, since the seat of that arbitration was Copenhagen.

Professor Dupuy, the sole arbitrator in the TOPCO case against Libya in 1977, concluded that he had the authority to determine the procedural law of the arbitration based upon what the parties had provided for in Clause 28(2) of their agreements: “... the Sole Arbitrator, shall determine the applicability of this Clause and the procedure to be followed in the Arbitration.” He determined that law as follows:

The Arbitral Tribunal must now state precisely what law or what system of law is applicable to this arbitration, it being understood that the parties themselves are entitled freely to choose the law of procedure applicable to the arbitration and it is only, as is the case here, in the absence of any express agreement between them that the Arbitral Tribunal must determine the law or system of law applicable to the arbitration. Two solutions are theoretically possible.

Professor Dupuy first considered the application of municipal law, which generally would be the place of arbitration. He made reference to the reasoning adopted in the Sapphire case, but decided that there was no reason to adopt that approach. Instead, he determined that all the elements of the TOPCO case supported the adoption of a second solution which was to consider the arbitration as being directly governed by international law. In doing so, he adopted the reasoning of the Aramco case. He concluded that the parties wanted to remove the arbitration from any national sovereignty. He therefore adopted international law to govern the procedural aspects of the arbitration and issued rules of procedure for the arbitration on that basis.

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74 Id. at 308.
76 Id. at 407.
77 Id. at 431.
78 Id. at 431-436. See also Andrew Newcombe and Lluis Paradel, Law and Practice of Investment Treaties: Standards of Treatment (Wolters Kluwer, 2009) at 438.
8.2 Governing Law

There was no choice of law (or governing law) clause in the original 1933 Agreement or in any of its amendments or supplements. Article 31 of the original agreement was simply lacking any reference to what law applied to the contract. As a result, the parties provided in Article IV of their 1955 Arbitration Agreement that:

The Arbitration Tribunal shall decide this dispute:

(a) in accordance with the Saudi Arabian law, as hereinafter defined, in so far as matters within the jurisdiction of Saudi Arabia are concerned;
(b) in accordance with the law deemed by the arbitration tribunal to be applicable in so far as matters beyond the jurisdiction of Saudi Arabia are concerned.

Saudi Arabian law, as used herein, is the Moslem law

(a) as taught by the school of Imam Ahmed ibn Hanbal
(b) as applied in Saudi Arabia.\(^\text{\footnote{Article IV of the 1955 Arbitration Agreement found in Saudi Arabia v. Aramco, }^{\text{\textsuperscript{ supra} note 2, at 231.} }}\)

In reliance of the above agreement of the parties, the Tribunal determined that:

This agreement regarding the law to be applied is in conformity with the rules of private international law adopted in most civilized States and it must be observed by the Arbitration Tribunal. However, the Parties did not stipulate the application of a single law to their dispute but also envisaged the application of a law to be determined by the Arbitration Tribunal in so far as matters beyond the jurisdiction of Saudi Arabia were concerned.

Both Clauses are legally on the same level and both Parties, when introducing this distinction into Article IV of the Arbitration Agreement, were fully aware of the fact that various systems of law must be applied to the different matters connected with the operation of an oil concession.

In the Tribunal’s opinion, the delimitation between the domains of those legal systems must be made according to two criteria: the legal nature of the matters under consideration, combined with the principles of private international law.\(^\text{\footnote{Id. at 154.} }}\)

The Tribunal then engaged in a detailed twenty-page discussion of what law should apply in determining the merits of the questions posed by the parties. It first rejected the laws of i) Saudi Arabia because “the Parties have intended from the very beginning to withdraw their disputes from the jurisdiction of local tribunals;” ii) the country of the arbitration’s seat (Geneva, Switzerland) because a sovereign state cannot be subject to the law of another state; iii) the United States because the seat was not in that country and the principle of complete equality of
the parties before the tribunal, and iv) the Law of Nations because the law governing the merits was independent of the law governing the arbitration itself.\footnote{Id. at 153-156.}

As a result of its analysis, the Tribunal’s decision on the choice of law to determine the merits of the dispute was that:

- The concession agreement was the fundamental law of the parties;
- That law must be supplemented by general principles of law, by the custom and practice in the oil business and by notions of pure jurisprudence;
- The sale and transport of oil as governed by custom and practice in maritime law and the international oil business would apply; and
- Public international law applied to matters such as transport by sea, the sovereignty of the State on its territorial waters and the responsibility of States for the violation of its international obligations.\footnote{Id. at 168-172.}

Unfortunately, the Tribunal’s conclusions on the law that applied to the concession agreement were overly complex and confusing, even to the parties to the arbitration:

The tribunal tried to be confusing...The arbitration clause in the agreement at that time does not say, which is an omission that I hope nobody has made since. It doesn’t give you any guidance. So we wanted them to say that it was the law of Saudi Arabia, so long as it was consistent with the general principles of international law. The Saudis wanted them to say that it was the Saudi-Arab law, period. That was the issue. You can read it as siding with us, or you can read it as siding with them. We won, so I give up, that’s to the scholars of the future to look at and decide what they really meant. I don’t think anybody will ever know what they meant.\footnote{Interview with William Owen, former Aramco General Counsel, supra note 30 at 336.}

8.3 Islamic Law

The Aramco Tribunal heard different arguments on the nature of oil concessions under Islamic law, which varied amongst the different Shari’ah schools. Some Islamic schools held that minerals were part of the State domain. Other schools considered that they followed the ownership of the surface land. Islamic law also recognized the acquisition of the right to a mine by its first discovery.

The government’s Shari’ah expert in the Aramco Arbitration stated that the 1933 Agreement conflicted with the rules in the Hanbali school pertaining to minerals:

The Hanbali doctrine as far as Ibn Kodama has stated it, can be summarized as this: minerals are free, he who finds a mineral is entitled to take his need thereof by priority to
others, after which he must go away to let others satisfy also their needs; he cannot appropriate the vein or mine or deposit except with and as a result of his appropriation of the grounds where such vein or mine or deposit is found; this appropriation may be through an iqtā’ or a grant from the Imam or through occupancy and reclaiming it if it is a mawat (dead land), which has no owner. No one is permitted to collect or dig out a mineral contained in the property of someone else because the ownership of the land comprises the owner of its apparent and hidden parts and layers. Liquid minerals in particular are, according to the prevalent opinion, always free and not liable to be appropriated by iqtā’ or occupancy or by whoever owns the ground where they are found if they happen to be found in an owned property.

According to the prevailing opinion in the Hanbali school, liquid minerals whether apparent or hidden are not liable to private appropriation either through discovery and occupancy or through an iqtā’ or grant by the Ruler. (See Ibn Kodama’s book Al Moghni, Volume 5, pages 521, 522, 524 and 528)

A contrary opinion was provided by Aramco’s expert, Sheikh Mohamed Abu Zahra, who stated that the legality of an oil concession can be supported under the Shari’ah by the rules relating to iqtā’ or to first discovery:

As to its legality (the concession), it is to be considered as coming within an Islamic legal institution known as iqtā’ al mawat (literally, allotting of undeveloped land), or as a grant of the right to take possession of minerals. It is well established that an iqtā’ for minerals which are under the ground is recognized by the Shari’a. In such an iqtā’, the leader of the Moslem community (Imam) grants permission to one or more persons to explore a specified area and to take out whatever minerals he may discover. It is established and accepted that whoever first takes possession of a buried mineral has the best claim to it. He has the right to continue to take the mineral and no other person has a right to compete with him for it. (Tashihal-Furu’, Vol. 3, p. 846).

As a result, the Arbitration Tribunal observed that Moslem law remained “embryonic” on the regime of oil concessions and that the Hanbali school, in particular, contained no precise rule about such oil concessions:

The regime of mining concessions, and consequently, also of oil concessions, has remained embryonic in Moslem law and is not the same in the different schools. Hanbali law contains no precise rule about mining concessions and a fortiori about oil concessions.

The Tribunal therefore concluded that the Saudi King, in his capacity of theocratic ruler, had the power to enter into the oil concession contract, which was the Saudi Arabian law that applied to the parties, as long as it was not contrary to Shari’ah, which it was not, since it was in conformity with two fundamental principles of the whole Moslem system of law, i.e., the principle of liberty to

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85 Aramco’s First Memorial at 351-352, as published in CATTAN, LAW OF OIL CONCESSIONS, supra note 62, at 57-58.
86 Saudi Arabia v Aramco, supra note 2, at 163.
contract within the limits of Divine Law, and the principle of respect for contracts.\footnote{\textit{Id.} at 163.}

This problem between Islamic schools on the granting of oil concessions “... has now been largely solved in practice in the Arab countries either by constitutional provisions or mineral and petroleum laws and, in their absence, by custom. It is now generally recognized in the Middle East and North Africa that petroleum and other minerals form part of the State domain. They can be exploited only by the State or by its permission given in the form of a concession agreement. The terms and conditions of exploitation are determined by the concession agreement or by statute or both.”\footnote{\textit{CATTAN, LAW OF OIL CONCESSIONS}, \textit{supra} note 62, at 58.}

This issue has now been addressed in Saudi Arabia under its Basic Law of Governance, which clarifies that the State owns and has the sole right to grant all the mineral resources within the country:

\begin{quote}
All natural resources that God has deposited underground, above ground, in territorial waters or within the land and sea domains under the authority of the State, together with revenues of these resources, shall be the property of the State, as provided by the Law....

No concessions or licenses to exploit any public resources of the country shall be granted unless authorized by provisions of the Law.\footnote{Articles 14 and 15 of \textit{THE BASIC LAW OF GOVERNANCE}, Dated 27th Sha’ban 1412 H (1 March 1992).}
\end{quote}

8.4 Oil Concessions

The Arbitration Tribunal observed that concessions that are granted by a State can vary in their object, type and legal nature:

\begin{quote}
As was pointed out in the Memorial of the Reparations Commission in the arbitral proceedings which took place between that Commission and Germany ... the concept of the concession is very wide and varied; it may extend, according to the legislation and the doctrines concerned, from the grant of titles of nobility or of a burial ground to that of certain public functions....

Even the legal nature of economic concessions is not the same in the case of public service concessions, or of public works concessions, or of concessions for the occupation of the public domain or the exploitation of State resources, or of port concessions, or of concessions of water works or of land, for instance in the colonies, or, lastly, of mining concessions. It does not seem possible to subsume all these various concessions under a common concept; this was recognized by the French Conseil d’Etat in its Opinion of 19 and 26 December 1907 about various questions relating to mining concessions (Daloz Periodique, 1908, 3rd part, p. 46). Finally the legal nature of the concession is not the same in the different systems of law.\footnote{\textit{Saudi Arabia v. Aramco}, \textit{supra} note 2, at 157.}
\end{quote}
Given that variance, the Tribunal concluded that with regards to the Aramco concession:

The Concession Agreement is thus the fundamental law of the Parties, and the Arbitration Tribunal is bound to recognize its particular importance owing to the fact that it fills a gap in the legal system of Saudi Arabia with regard to the oil industry....

Matters pertaining to private law are, in principle, governed by the law of Saudi Arabia, but with one important reservation. That law must, in case of need, be interpreted or supplemented by the general principles of law, by the custom and practice in the oil business and by notions of pure jurisprudence, in particular whenever certain private rights – which must inevitably be recognized to the concessionaire if the Concession is not to be deprived of its substance – would not be secured in an unquestionable manner by the law in force in Saudi Arabia.91

The Arbitration Tribunal recognized the validity of stabilization clauses in international law and noted that the 1933 Agreement provided such stability, which was in the nature of oil concessions, when it stated that:

By reason of its very sovereignty within its territorial domain, the state possesses the legal power to grant rights which it forbids itself to withdraw before the end of the Concession with the reservation of the clauses of the Concession Agreement relating to its revocation. Nothing can prevent a state, in the exercise of its sovereignty, from binding itself irrevocably by the provisions of a concession and from granting to the concessionaire irretactable rights. Such rights have the character of acquired rights.92

8.5 Administrative Law

The Saudi government argued that administrative law, in the sense of droit administratif under French law, should be applied to oil concessions, such as the 1933 Agreement. Aramco argued that oil concessions were not administrative contracts as William (“Bill”) Owen, Aramco’s former General Counsel, explained in a speech to the Fifth Arab Petroleum Congress at Cairo on 31 March 1965:

... under French law, not all contracts between the State and private parties are treated as administrative contracts....This concept is limited to concessions for services to the public, such as the supply of light, water, communication or transportation—ordinarily referred to as “public utilities”. In all those cases it is clearly understood in advance between the parties before making the contract that the State retains the right to supervise the performance of the service. For instance, the concession ordinarily states an amount per kilowatt of electricity, per cubic meter of water or per kilometre of transportation which the concessionaire may charge at the outset. Nevertheless, it is recognized in advance by both parties that the State may from time to time alter, increase or decrease the

91 Id. at 168-169.
concessionaire’s charges for such services to the public. This type of concession, and this type of concession alone, carries the legal consequences mentioned by the speaker.

An oil agreement, whether described as a concession, an agreement, or a contract, or a mining lease, differs fundamentally from an administrative contract. In oil agreements, the principal object is not that the concessionaire perform a service to the public for which a charge is made to the users of the service. Rather, the essence of such agreements is the production of petroleum and its export to other countries. The concessionaire does not collect a revenue from the public. Instead, he pays an agreed financial consideration to the State in return for the right to produce a mineral resource and export it.

The Arbitration Tribunal dismissed the Saudi government’s arguments regarding the applicability of administrative law to oil concessions on the following basis:

In the course of the proceedings, the Government has attached a great deal of importance to the applicability of French administrative law, alleged to be of universal value inasmuch as its principles should be considered as an expression of the general principles of law recognized by civilized States in respect of concessions. Owing to the conspicuous role which this contention played in the Government’s argument, the Tribunal feels bound to stress that there is obviously no special reason to apply French law to a dispute between Saudi Arabia and an American corporation – a dispute which has no connection whatsoever with France. None of the theories which are held in France by some writers or by some judicial decisions has ever been ‘received’ in Saudi Arabia.

Moreover, it is superfluous to observe that the rules of French administrative law, although technically much perfected, originated in concepts and needs peculiar to French society. They cannot be directly transposed to a theocratic monarchy such as Saudi Arabia, where there is no Conseil d’Etat which could review and possibly annul any administrative act alleged to be illegal, and where the regulatory power of the State has not even been provided for in the law. The autonomous notion of the ‘administrative contract’, at any rate, was evolved in French law at a fairly recent date. It is the product of a very long evolution, which is still continuing and fluctuating today. It is closely connected with the principle of the ‘separation of powers’, which is not recognized in Saudi Arabia, and with the duality of jurisdictions, civil and administrative, which is unknown in that State. Its aim is to avoid any interference of the ordinary Courts in administrative affairs. It is the result of conditions which are specifically French.

The conclusion of the Aramco Tribunal that the theory of administrative contracts had no place in international law, and in particular to its application to oil concessions, was also endorsed and adopted by Professor Dupuy, the sole arbitrator in the TOPCO v Libya case.

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93 CATTAN, LAW OF OIL CONCESSIONS, supra note 62, at 80-81.
94 Saudi Arabia v. Aramco, supra note 2, at 215-216.
95 TOPCO v. Libya, supra note 75, at 433. See also DOLZER AND SCHREUER, supra note 12, at 159.
8.6 Conflict between the Aramco Concession and the Onassis Agreement

The Onassis Agreement was first entered into between the Kingdom of Saudi Arabia and Aristotle Onassis on 20 January 1954 and was amended several times up to 5 June 1955 by a series of letters between those two parties. It had 16 articles, the majority of which were not relevant to the dispute. The cause of the dispute was Articles IV and XV of that agreement, which provided that SATCO was to have a right of priority for the transport of oil for a period of thirty years, renewable for a further period by mutual agreement. Article IV, in particular, provided that:

The Company [SATCO] will have the right of priority to ship and transport oil and its products exported from Saudi Arabia to foreign countries by way of the sea whether shipment is effected from Saudi Arabian ports or from the terminals of pipelines abroad and whether that shipment is effected by the concessionary companies themselves or their parent companies or the buyers (of oil and its products).66

This right of priority was conditioned by the following two requirements:

a) The concessionary companies, their parent companies or the buyers had the right to renew or replace such tankers, provided that the total tonnage did not exceed the total tonnage of the tankers engaged prior to 31st December 1953.

b) The rate of freight to be charged by SATCO shall not exceed the average cost of transportation of the offtakers as reflected by the Quarterly Average Freight Rate Assessment.

Saudi Arabia argued that Aramco was not entitled to the absolute right to transport oil beyond Saudi territorial waters, since that right was not expressly provided in the concession agreement. It further argued that even if Aramco was conferred such a right, it was in breach of the concession by transferring those rights to a third party, i.e., their buyers. Aramco submitted that it had, by virtue of its agreement, the exclusive right to transport petroleum extracted by it to any place overseas and upon such terms as it chose.

The Tribunal found that Aramco’s rights under Article 1 of its concession agreement granted it the exclusive right to:

a) search for petroleum, which was expressed by the words: explore and prospect;

b) extract oil, which was expressed by the words: drill for and extract;

66 Saudi Arabia v. Aramco, supra note 2, at 207.
c) refine petroleum and produce its derivatives, which was expressed by the words: *treat* and *manufacture*; and

d) transport petroleum, to sell it abroad and to dispose of it commercially, which were expressed by the words: *transport, deal with, carry away* and *export.*

The Tribunal held that the terms used in Article 1 must be understood in their plain, ordinary and usual sense, which is the sense accepted in the oil industry. It further found that the right of preference provided in Article IV (A) of the Onassis Agreement was illusory, since it excessively limited the exercise of Aramco’s rights under Article 1 of its concession agreement, in particular, its exclusive right to transport its crude oil:

It is obvious that Article IV of the Onassis Agreement is incompatible with Aramco’s exclusive right, in that it provides that the Government undertakes to compel all present and future concessionary oil companies in Saudi Arabia to ship and carry the oil and its products exported from Saudi Arabia to foreign countries whether shipped by the concessionary companies themselves or by their parent companies or by their buyers on board the tankers belonging to the Saudi Arabian Tankers Company Limited.

8.7 Dispositives of the Award

The Tribunal’s conclusions dealt with the conflict between Article 1 of the Aramco Concession and Article IV of the Onassis Agreement by addressing the three questions posed by the Kingdom and the one question posed by Aramco in Article III of their 1955 Arbitration Agreement. Its award did not deal with damages of any sort. Rather, it was declaratory in nature, confined to the proper interpretation of the 1933 Agreement and to Aramco’s exclusive rights under that agreement:

It is appropriate to note that neither of the Parties claims damages for an alleged injury. The dispute is clearly limited to legal questions; it relates to the meaning of the 1933 Concession, to its interpretation and not to its validity. The question to be decided is whether, through an interpretation of the 1933 Concession Agreement, Aramco itself, or its parent companies or buyers, can be compelled to use for the transportation of oil and oil products on the high seas tankers which they have not freely chosen, and whether the rights granted to Aramco under its Concession Agreement authorize the Company lawfully to resist the implementation of Article IV of the Onassis Agreement, ratified by Royal Decree No. 5737. The Parties are seeking an exact determination of their respective

97 Id. at 176.
98 Id. at 179.
99 Id. at 208.
100 Id. at 210.
rights and obligations in order to be able to do what is right and just in the matter and to resume their traditional friendly relations.\textsuperscript{101}

The Tribunal therefore concluded that:

\begin{enumerate}[a)]
\item Aramco had the exclusive right under its Concession Agreement to transport its oil and products by land or by sea within Saudi Arabia, within the territorial waters of that State and on the high seas to all foreign countries overseas, as it chooses, by such means and on such terms as it deemed advisable;
\item The Aramco Concession was contractual in character, and not a public service concession, and could not be modified by the granting State without the Company’s consent;
\item Aramco exercised its exclusive right to transport and export by sea its crude oil and products in a manner consistent with its Concession Agreement;
\item Aramco did not make an assignment of its exclusive right of transport to its buyers, or to any other person, company or corporation;
\item Sale terms in the international oil industry did not involve the assignment of any rights of the concessionaire;
\item Saudi Arabia could not compel Aramco to give the right of using its installations to any third parties;
\item Aramco cannot be forced to recognize a right of priority or preference, contrary to its exclusive right, in favour of any tankers, by whomsoever they may be owned or whatever flag they may fly;
\item Aramco’s offtakers and buyers acted in conformity with the rules of the Law of Nations, which guarantees all foreign merchant vessels free access to territorial waters and foreign ports and which cannot be impeded by an agreement concluded by the State of Saudi Arabia with third parties, granting them rights of priority or of preference for such transport;
\item The Onassis Agreement was neither a Law of the State of Saudi Arabia nor a government regulation. It was a contract concluded by the government with a third person and it cannot have any effect as regards Aramco or its offtakers and buyers;
\item Saudi Arabia may not compel Aramco to recognize a right of priority or preference to tankers flying any flag whatsoever, irrespective of any consideration of the economic consequences of this right; and
\end{enumerate}

\textsuperscript{101} Id. at 144-145.
k) Article IV of the Onassis Agreement was in conflict with the Aramco Concession Agreement and was not effective against Aramco.\(^{102}\)

As a result, the majority of the Tribunal held that:

Aramco must succeed in the arbitration. The transport provisions of the Agreement with Aramco must prevail over those of the Onassis Agreement and Aramco retained the exclusive right to transport the oil in question. That right was in the nature of an acquired right and could not be modified without Aramco’s consent. The Onassis Agreement, which was concluded by the Saudi Arabian Government with a third party, could not have any effect on Aramco or on those who purchased its oil.\(^{103}\)

Mr. Hassan, the Kingdom’s appointee, delivered a dissenting opinion that Aramco could not have been granted a right to maritime transport by “implication” and that “in 1933 the Parties could not have envisaged the grant of an exclusive right to transport by sea of the oil which could have been eventually discovered.”\(^{104}\)

9 IMPACT OF THE ARBITRATION

The issuance of the Aramco arbitral award was felt in the Kingdom of Saudi Arabia in a number of ways.

9.1 ACCEPTANCE OF THE ARBITRAL AWARD

The Kingdom of Saudi Arabia lost the case, but accepted the Tribunal’s decision, even though it understandably disliked the award. It complied with the arbitral award and took no action to enforce the SATCO contract with Aristotle Onassis. King Faisal explained the Kingdom’s position as follows:

Peace on earth will not be attained unless the grounds of right and justice have been firmly rooted in each state where citizens and non-citizens alike may enjoy them, so that all are assured of the authority of law to uphold their dignity, protect their possessions and help them exercise their freedom.

In compliance with the Muslim (Shari‘ah Law) provisions, which we strictly apply in our country, we place right and justice in such a position that no one can detract from it. All are equal before the Law, and all appear before the courts as claimants or defendants without distinction or immunity to anyone even though he be the Head of State. Nor does the hatred of us by any foreign community prevent us from upholding justice in its favor, even against ourselves. The Koran enjoins us, “let not the hatred of a people incite you not to act fairly; act fairly, that is nearer to piety”. In this connection, the Kingdom of

\(^{102}\) Id. at 226-228.

\(^{103}\) Id. at 134.

\(^{104}\) Id. at 229.
Saudi Arabia has set a magnificent example for all the nations of the world. We implement the ruling which an arbitration court rendered in favor of a foreign company and against the Government with the same strictness and alacrity as we implement a ruling rendered in our favor. This we do voluntarily and willingly because we are executing one of the injunctions of God Almighty.\(^{105}\)

Despite its loss, the Saudi government continued to work with Aramco on a co-operative and friendly basis, within an evolving relationship:

To its great credit, the Government of the Kingdom of Saudi Arabia acted in compliance with the Award. It made no further attempt to enforce the Onassis Agreement. It abstained from international arbitration for decades thereafter. But it permitted Aramco to maintain and expand its operations to their immense mutual benefit.\(^{106}\)

Despite the government accepting the award, the Aramco arbitration did, however, have a far reaching impact on the Kingdom’s legal system, which resulted in the government severely restricting the use of arbitration for many years.

\subsection*{9.2 Arbitration in the Kingdom}

The primary reaction to the Aramco arbitral award was that the Saudi government adopted a negative view of arbitration as a means to resolve its disputes. As a result, it required the use of the Saudi courts, which applied Shari’ah in the Arabic language, in its government contracts:

As a result of the disappointment within the Kingdom that arose from the Aramco case, the Saudi Council of Ministers enacted Resolution No. 58, which prevented Saudi government ministries and agencies from participating in arbitration.\(^{107}\)

On June 25, 1963, the Saudi Council of Ministers issued Resolution No. 58 that limited the government’s power to include an arbitration clause in its contracts or the selection of any law other than the law of Saudi Arabia to any contract made with the Saudi government, other than in exceptional cases, which required special permission from the responsible minister in the government:

The law applicable to disputes to which the State is a party shall be determined in accordance with the established general principles of private international law, the most important of which is the principle of the application of the law pertaining to the place of

\begin{itemize}
\item \(^{106}\) Schwebel, supra note 17, at 255-256.
\item \(^{107}\) Saud Al-Ammari and A. Timothy Martin, \textit{Arbitration in the Kingdom of Saudi Arabia}, Arbitration International, Volume 30, Number 2, (June 2014) at 389.
\end{itemize}
performance. Government agencies may not choose any foreign law to govern their relationship with individuals, companies or private organizations.\textsuperscript{108}

From that point onwards, even Aramco with its dominant position in the Saudi economy could not include an arbitration clause in its agreements with the government:

I was involved continually in the one problem that it [the Aramco arbitral award] created, which was arbitration. This thing was settled by arbitration, except that in the future when the settlements didn’t come out in their favor, governments said, “Hey wait a minute, arbitration cannot prevail over sovereignty.” And so although we tried for years in various ways to put an arbitration clause into our contracts with the government, the government adamantly refused. So we were hamstrung for a long time because of this Onassis arbitration result.\textsuperscript{109}

This negative perception of arbitration within the Saudi government slowed down Saudi ratification of the New York and ICSID Conventions. That began to gradually change with Saudi Arabia’s ratification of the ICSID Convention in 1980, the Riyadh Convention in 1985 and the New York Convention in 1994. Saudi Arabia enacted an arbitration law in 1983, but that law “... allowed Saudi courts to intervene throughout the arbitration process, resulting in arbitrations being stymied and arbitration awards not being enforced. Saudi courts regularly re-examined the merits of arbitration awards when asked to enforce them with the result that parties were often forced to re-litigate arbitrated cases in the Kingdom’s courts.”\textsuperscript{110}

Saudi Arabia turned a new leaf with the enactment of a new arbitration law in 2012 that was based on the UNCITRAL Model Law on International Commercial Arbitration, and which is meant to encourage the use of arbitration in the Kingdom and the recognition of foreign arbitral awards. However, it took more than fifty years after the Aramco award to get to the point that arbitration was encouraged and supported in the Kingdom.

10 "PARTICIPATION" AND THE CREATION OF SAUDI ARAMCO

Saudi Arabia, along with other OPEC members, continued to engage throughout the 1960s and 1970s in attempts to increase its share of oil revenues. In 1974, the Gulf States, which included Saudi Arabia, adopted the “Abu Dhabi Formula,”

\textsuperscript{108} Resolution No. 58. Petroleum Legislation, Middle East, Supplement No.V, E-1.
\textsuperscript{109} Interview with Frank Jungers, former Chairman of Aramco in AMERICAN PERSPECTIVES OF ARAMCO, THE SAUDI-ARABIAN OIL PRODUCING COMPANY, 1930S TO 1980S (Carole Hicke, ed., Regional Oral History Office, Bancroft Library, University of California, Berkeley, 1995) at 34.
\textsuperscript{110} Al-Ammari and Martin, supra note 107, at 389.
which provided for further increases in tax and royalty rates. However, a more radical restructuring of the industry was underway in that producing countries wanted greater control of their natural resources. Some OPEC countries, such as Libya and Iran, opted for the route of expropriation to gain sovereign control over their oil production. That route was not for Saudi Arabia who wanted a more gradual approach, rather than a radical overturning of the existing oil order, in order to avoid financial instability that could have led to political instability.

Saudi Arabia therefore pursued a strategy of “participation,” i.e., joint ownership with the IOCs rather than their ejection. This would maintain the world’s global oil markets, transfer technology and knowledge to the producing countries, and ensure that the government received a greater share of the oil revenues. As Sheikh Ahmed Zaki Yamani, the Saudi oil minister of the time, said “this would create a bond that would be indissoluble, like a Catholic marriage.”

This was to be the inevitable conclusion of many years of negotiations between Aramco and the Saudi government, as anticipated by Aramco’s senior management from an early date and throughout their relationship:

Now, back in ’53, when Spike Spurlock met me and told me to take over price negotiations from him in Schiphol Airport in Holland ... he said to me “Bill, you know what’s going to happen. We’ll hold the line on prices as long as we can, but eventually, we’re going to end up pumping oil for the Saudi government, and so is every other American and British oil company.” ... ’53, he predicted it. And that’s what we’re heading toward.112

But it was a forgone conclusion to some of us, first Spike Spurlock in ’53. It became more evident that we were fighting a delaying action all the way through, and very successful in that.113

For the most part, it was a continual rear guard action, trying to retain all of the concession terms, the tax terms, convincing the Saudi government and others that it was necessary to retain the system that worked. We used every effort and tactic to try to hold, knowing we couldn’t, knowing that it was going to erode as we went along. Aramco really did the best job of holding on. You could see the nationalizations taking place elsewhere for all kinds of reasons, but we managed to avert actual nationalization, which was the worst solution for both parties...

This was the history of what really happened and the events that were leading up to the formation of OPEC and the negotiation of ownership, negotiating away the ownership of these concessions with the various countries and the nationalizations that resulted from not negotiating and so on. We were trying desperately to hang on to the concessions that we had as an industry and give them up only when we felt we had gotten

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111 VERGIN, supra note 10, at 584. Sheikh Yamani passed away on 23 February 2021, which marked the passing of an historically important era in the global petroleum world.

112 Interview with William Owen, former Aramco General Counsel, supra note 30 at 377.

113 Id. at 380.
all the payment that we could for them. That would be far short of what they were worth.\textsuperscript{114}

So we fought the participation question as a rear guard action in which the shareholders, for all of the reasons that you can think of, didn’t want to go the participation route until the very last ditch. And it was sort of my job, as I saw it, to carry these arguments as far as I could, to hold the line until I truly felt that we were either going to have participation or we were going to be nationalized. It was only then that the shareholder companies could evaluate what I was trying to tell them and we’d kind of give a little.\textsuperscript{115}

The discussions around “participation” involved multiple governments and multiple companies, and not just Aramco and the Saudi government:

Participation was a series of negotiations that we had, many of which were held by several companies with several representatives of OPEC, several governments, with U.S. Department of Justice clearance.\textsuperscript{116}

This transition and the change in control took shape with the signing of a “Participation Agreement” in late 1972 between Saudi Arabia and the shareholders of Aramco, in which Saudi Arabia was granted a 25% participation share in Aramco as of 1973, with the expectation of gradually rising to a 51% participation by 1982. That changed, however, when in June 1974, Saudi Arabia acquired a 60% share in Aramco. By the end of 1974, the Saudis were insisting upon a 100% acquisition of Aramco, which the Aramco shareholders strongly resisted since ”their number one dictum was never to give up the concession. It was the most valuable in all the world.”\textsuperscript{117} It took nearly two years to negotiate this new agreement. Finally in 1976, the American shareholders agreed that Saudi Arabia by 1980 would take over the entire shareholding of Aramco by compensating the four Aramco partners for all their holdings in the Kingdom over a period of time.\textsuperscript{118}

The compensation that the Saudi government paid to the Aramco shareholders was calculated on the net book value of Aramco.\textsuperscript{119} Based on what it paid for 25% of Aramco, the Kingdom likely paid in the range of $2 billion for 100% ownership of Aramco:

The $500 million the Saudis have so far agreed to pay for a quarter of Aramco is less than 25% of the estimated $2.5 billion Aramco investment figure, since it covers only the crude facilities and excludes the refinery, LPG facilities, and “Tapline,” as the Trans Arabian Pipeline is called. In the negotiation over how Aramco was to be valued, [Frank Jungers,\textsuperscript{118}

\begin{itemize}
  \item Interview with Frank Jungers, former Chairman of Aramco, supra note 109 at 83.
  \item Id. at 89.
  \item Interview with William Owen, former Aramco General Counsel, supra note 30 at 378.
  \item Yergin, supra note 10, at 581.
  \item Id. at 584. See also Kultgen, supra note 22, at 154.
  \item “... the two sides came together by inventing a new accounting concept, ‘updated book value,’ which included inflation and large fudge factors.” Yergin, supra note 10, at 584 and 652.
\end{itemize}
Aramco Chairman] says, “The initial argument was over the value of Aramco as a going business. The producing countries wouldn’t accept that foreign companies could own the oil in the ground, so they negotiated on book value.”

In addition to agreeing upon a sale price, the parties also agreed to maintain their “marriage” with an ongoing relation:

But the agreement did not by any means provide for a severing of links. The two sides needed each other too much. It was the same old issue that had tied the Aramco partners together in the first place: Saudi Arabia had enough oil to last several lifetimes, while the four companies had the huge marketing systems required to move large volumes of that oil.

The Saudis therefore agreed to pay the Aramco shareholders a 22¢/barrel fee to a separate company they formed called STEMCO (which stood for Socal, Texaco, Exxon and Mobil Company) for several years. In return, STEMCO and its shareholders provided their technology along with continuing to second their management personnel to support the transition to full Saudi ownership and control.

The valuation of Aramco was a similar approach as used in Kuwait, when the Kuwaiti state agreed with Gulf Oil and BP to acquire 100% of the Kuwait Oil Company. Kuwait argued in the Aminoil case that this method of valuation for an oil concession “had generated a customary rule valid for the oil industry – a lex mercatoria that was in some sort a particular branch of a general universal lex mercatoria.”

The Tribunal rejected Kuwait’s arguments against Aminoil for a number of reasons, including that negotiations on compensation were both complex and uncertain; but more importantly, that, in addition to monetary compensation, a preferential relationship was often instituted or maintained between the State and the major oil companies that held the original concession. This latter point was likely one of the reasons that motivated the Aramco shareholders in reaching a settlement over the appropriate compensation for their interests in Aramco.

121 Yergin, supra note 10, at 651.
124 Id. at 605.
Interestingly, the Saudi government did not sign that agreement until 1990, fourteen years after it had been agreed upon. As explained by one of Aramco’s negotiators, the Saudis “... got what they wanted – full control – but they didn’t want to disrupt Aramco.” The former Treasurer of Aramco put it more colourfully:

[T]he amazing thing was that while we were continuing to operate and just pretending that everything had been signed, nothing had been signed. It was all just a concept, and we were operating under the concept, which presented our bookkeepers with some incredible challenges.

This transfer of control ultimately resulted in the creation of Saudi Aramco, the world’s largest oil company, which was now totally owned and controlled by the Saudi state. But the process to get there was not straightforward:

When I left in ‘85, Aramco as a legal entity was still a Delaware corporation of which the four U.S. companies owned all the stock, but Aramco’s assets were owned by the government. So it was very confusing for everybody ... and finally there was a royal decree organizing this Saudi company called Saudi Aramco.

Saudi Aramco is still operating under the original concession agreement but now has the exclusive right to explore and produce hydrocarbons throughout the entirety of the Kingdom (including the lands relinquished by Aramco) with the exception of the Neutral Zone, which is jointly governed with Kuwait under a unique legal regime.

Saudi Aramco operates under the terms of the concession agreement inherited from its American predecessor, Aramco. The concession now covers the entire Kingdom. Saudi Aramco manages proven conventional crude oil reserves of over 260 billion barrels (approximately 20 per cent of the global resource) and conventional gas reserves of about 285 trillion standard cubic feet of natural gas. Average daily crude production in 2012 was 9.5 million barrels per day. Total oil production for 2012 was 3.5 billion barrels – about one in every eight barrels of the world’s total crude oil production. In contrast to the 1970s and 1980s when the USA and Europe were Aramco’s leading export markets, today close to 75 per cent of its exports go to the Far East, with over one million barrels per day going to China.

125 YERGIN, supra note 10, at 584 and 651-652.
126 Interview with Baldo Marinovic, former Treasurer and Assistant to Chairman of Aramco in AMERICAN PERSPECTIVES OF ARAMCO, THE SAUDI-ARABIAN OIL PRODUCING COMPANY, 1930s TO 1980s (Carole Hicke, ed., Regional Oral History Office, Bancroft Library, University of California, Berkeley, 1995) at 245-246.
127 Schwebel, supra note 17, at 245.
128 Interview with Baldo Marinovic, former Treasurer of Aramco, supra note 126, at 270.
Downstream, Saudi Aramco and its subsidiaries own or have equity interests in domestic and international refineries, with a total refining capacity of almost 4.5 million barrels per day. Saudi Aramco’s equity share is 2.4 million barrels per day, making the company the world’s sixth largest refiner.  

In December 2019, Saudi Aramco issued an IPO that quickly valued the company at more than $2 trillion. This valuation was in stark contrast to the initial loan of £30,000 that the Standard Oil Company of California paid to acquire the Al-Hasa concession from King Abdul Aziz bin Abdul Rahman bin Faisal al Saud in 1933. And that market valuation did not take into account the enormous wealth that had been continuously extracted from the Al-Hasa concession over the prior 75+ years.

11 CONCLUDING REMARKS

The signing of the Al-Hasa concession agreement went virtually unnoticed in the world when a Socal lawyer and the Saudi Finance Minister executed their contract in 1933 in the newly formed Kingdom of Saudi Arabia. Nobody, except for a few optimistic Socal geologists, believed that oil would be found. And if it were to be found, no one had any idea of the magnitude of that discovery or the significance of its impact on the world.

The timing of the discovery of the Saudi oil fields was fortuitous. The world was entering into a global war and the most powerful nation in the world was transitioning from a net exporter to a net importer of oil. Once World War II had been resolved, the world’s economies were ready to recover and were thirsty for the oil to fuel their growth. The stage was thus set for a high stakes drama.

The Aramco concession quickly became the most valuable oil concession in the world. The company (along with its four American shareholders) that was formed to manage it played a leading role in setting global energy policy and the price of crude oil for many years. The U.S. government and its foreign policy establishment took an active interest in Aramco and Saudi Arabia, forming a “special relationship.” The largest oil companies in the world, the U.S. government and the rulers of the Kingdom of Saudi Arabia formed a unique coalition built on a “friendly relation” to ensure that Saudi oil reserves were developed and delivered to the western world. They set precedents on how other oil concessions in the Middle East evolved. And their co-operation displayed how a host country and concessionaire can best sustain a mutually beneficial relationship over an extended...
period, with finally providing for the transition of control of one of the world's most valuable resources from foreign investors to the host government.

Amidst all these dynamics, the coalition partners had a major falling out over who was going to control the transportation of their primary asset to global markets. It was stirred up by a wily Greek shipowner, Aristotle Onassis. The result was the Aramco Arbitration, one of the most important investor state arbitrations of the last century that became an historical milestone in the development of international arbitration:

The Onassis Award stands as one of the earliest, most searching and substantial – and uncompromising – of the arbitral awards passing upon the regime of oil concessions. Its forthright analysis on questions of lasting importance, such as the exercise of sovereignty, acquired rights that a granting government cannot lawfully retract, competing concession claims and the characteristics and limitations of a government's regulatory powers, merits more contemporaneous attention than it appears to attract.\textsuperscript{131}

\textsuperscript{131} Schwebel, supra note 17, at 256.