Ownership of the Oil and Gas Resources in the Caspian Sea: Problems and Solutions

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ARBITRATING THE CASPIAN SEA ISSUES

1. Introduction

A large portion of the oil and gas reserves in Central Asia are believed to lie under the Caspian Sea. The extent to which this belief is in fact true remains to be established. For a number of reasons, it is difficult to measure the true wealth of the Caspian Sea. On the one hand, it would seem that the littoral states typically have an interest in exaggerating the potential of the Caspian Sea, primarily with a view to maintaining its attractiveness to outside investment. On the other hand, foreign oil companies interested in the oil and gas resources in the Caspian Sea have a tendency to downplay the potential, presumably in the hope of being able to strike better deals. Even though the Caspian oil reserves cannot match those of Saudi Arabia or other states in the Persian Gulf region, it is clear that Caspian oil has the potential of playing an important role for future worldwide oil supply and thus for oil prices. This is in short the explanation why the question of the ownership of the Caspian oil and gas resources, including the right to license and tax their development is being debated by the Caspian littoral states, i.e. Russia, Kazakhstan, Iran, Azerbaijan and Turkmenistan.

The legal status of the Caspian Sea became a potential issue as the result of the dissolution of the Soviet Union in 1991. Overnight the number of foreign states around the Caspian Sea rose from two – the Soviet Union and Iran – to five. The issue *de facto* came onto the international agenda in 1994 when the Russian Ministry of Foreign Affairs sent a note to the British Embassy in Moscow saying that the ownership of Caspian resources remained to be settled, a statement made in connection with an investment agreement signed by the Azeri government and a British Petroleum led consortium.

During the last decade the debate has been going on between the littoral states on ownership and other issues. Even though some bilateral agree-

ments have been signed – and in certain cases also ratified – there is still a large number of issues outstanding.

The dispute over the Caspian Sea concerns a multitude of crucial issues, such as ownership and exploration rights, delimitation, fishing, navigation as well as environmental and military security, and raises many complicated issues of international and municipal law, including state responsibility, state succession, territorial sovereignty, environmental law and the law of treaties. The difficulties with many of the issues are compounded by the almost complete lack of rules and guidelines to apply and/or follow. This in turn is partially explained by the difficulties in charactering the Caspian Sea as a sea or a lake. In the former case the law of the sea would presumably be applicable, which would facilitate a resolution of the various issues. Today there would seem to be agreement among many commentators that the Caspian Sea is a *sui generis* case, requiring its own approach and solution.

There would also seem to be agreement that the two treaties which exist on the Caspian Sea – the 1921 Treaty of Friendship between the USSR and Iran, and the 1940 Treaty of Commerce and Navigation, also between the USSR and Iran – do not provide any guidance in this respect.

Given the legal vacuum surrounding the Caspian Sea, there is strictly speaking only one way forward, *viz.,* the agreement of all the parties concerned. As referred to above, some bilateral arrangements have been entered into between some of the littoral states. Many issues remain unresolved, however. It is against this background that attention is beginning to focus on arbitration as an established method of settling disputes.

The purpose of this brief contribution is to explain why and how international arbitration would be an efficient and smooth way of resolving the Caspian issues.

2. Why Arbitration?

As mentioned above, arbitration is a well established method of settling international disputes. Arbitration has a number of distinctive features which set it apart from judicial forms of dispute settlement such as, for example, the International Court of Justice.

First among these distinctive features is the swiftness and flexibility of arbitration. Any arbitration is based on the agreement of the parties. As long as the parties agree, they can arrange for almost any kind of procedural rules and time limits for the conduct of the arbitration. This possibility usually results in arbitration being swifter and more flexible than most other alternatives.

The second distinctive feature is the fact the disputing parties choose their own arbitrators. As a matter of principle, the parties are unlimited in their choice. This means that the parties can appoint arbitrators with the necessary expertise, experience and background, and persons in whom they have confidence. Having said this, it must be pointed out that arbitrators must be impartial and independent. They cannot act as counsel or representatives of the party who appointed them, unless the parties agree otherwise.

Another important advantage with arbitration is that the resulting award is final and binding on the merits. If the parties do not agree otherwise, the award can thus not be retried on the merits. This means that the substantive aspects of the award are final and binding on the parties to the arbitration once the award has been rendered. The final and binding effect of an award also means that arbitration is swifter than most other alternatives, since no appeals are possible. It should be noted, however, that under most municipal legal systems arbitral awards may be challenged and set aside, but only on narrowly defined procedural grounds. In interstate arbitration, it is, as a rule, not possible to challenge awards, unless the parties have so agreed.

A final distinctive feature of traditional international arbitration, at least of commercial arbitration, is the confidentiality surrounding the arbitration. This aspect is usually of great importance to businessmen, but may be less important in interstate arbitration. In arbitrations involving states it is *ex rerum naturae* difficult to keep the arbitration confidential. This notwithstanding, international arbitration does at least offer the possibility to maintain confidentiality to an extent that is not possible under other forms of dispute settlement.

Based on the brief enumeration of distinctive features above, I submit that it is clear that arbitration would be an efficient, reliable and efficient way of resolving the Caspian issues. Some commentators have, however, suggested that it is Utopia to believe that the littoral states would ever agree to arbitration, it is – they say – unrealistic. The question to be addressed then is: is arbitration realistic?

3. Is Arbitration Realistic?

As mentioned above, any arbitration presupposes some kind of agreement of the parties. In order to arbitrate the Caspian issues in a final and binding way, all the five littoral states must agree on arbitration. Whether such an agreement will be entered into, is at the end of the day, a matter of political will. If the will is there, an arbitration agreement may very well be signed.

Some observers take the view, however, that no arbitration agreement will be signed – even if there is political will *per se* – because the respective governments are afraid of losing control of and influence on the resolution of the issues, if they were to be handed over to a third party, i.e. to an arbitral tribunal. This fear of losing control and influence will effectively preclude any form of third party involvement, according to the same observers. It is a well-known – and not very surprising phenomenon – in the settlement of interstate disputes that governments are hesitant and unwilling to give up this control and influence.

In my submission, however, this fear can be alleviated by drafting the arbitration agreement properly, as will be described below. In particular one could provide for the possibility of appointing a government official as one of the arbitrators.

It is also worthwhile to point out, that third-party decision methods, such as an arbitral tribunal, are sometimes welcomed by politicians and government officials. The reason is simply that such third-party decision makers relieve the politicians of responsibility and insulate them from the consequences of the third party decision, i.e. the arbitral award. The extent, to which this is in fact the case, will vary from country to country and with the circumstances of the individual case.

Based on the foregoing, I submit that with a properly drafted arbitration agreement, the fear of losing control and influence can be adequately addressed.

4. Proposed Arbitration Agreement

In the following, I shall briefly outline some of the key elements which must be included in an arbitration agreement aiming towards a final and binding resolution of the Caspian issues. Needless to say, these key elements would require further elaboration and detail before being submitted for approval and signature.

As mentioned above, a crucial aspect of a multi-party arbitration of this kind is the *number of arbitrators.* In a traditional bi-partisan arbitration, each party would appoint one arbitrator, and the two party-appointed arbitrators would agree on a chairman. In a dispute involving five sovereign states the approach must be different. Each state should have the right to appoint two arbitrators, thus a total of ten party appointed arbitrators. One out of the two must be neutral, i.e. impartial and independent and of another nationality. The second arbitrator could, however, be a non-neutral arbitrator, for example, a government officer or the like. This non-neutral arbitrator could ensure that his government is provided with some degree of control and influence in the arbitral process. As a result the tribunal would have five neutral and five non-neutral arbitrators.

The next crucial key-element is the *chairman* of the tribunal. Given the proposed structure, it is very important that he enjoys the complete confidence of all the party-appointed arbitrators. The Chairman should therefore be elected unanimously by the ten party appointed arbitrators. Should they fail to do so within a specified period of time, the Chairman should be appointed by a well-respected international organization, such as the International Court of Justice, the Permanent Court of Arbitration, the Stockholm Chamber of Commerce, or the International Chamber of Commerce.

Another critical aspect in a tribunal of this nature would be the *voting rules.* As a matter of general principle, it would of course be possible to agree on detailed voting rules, perhaps distinguishing between different issues to be decided. Experience shows, however, that such detailed rules may often create more problems than they solve. The standard approach would rather be to provide for majority vote, giving the chairman the casting vote. In my view, the efficiency of the voting rules are to a large extent dependant on the experience and prestige of the arbitrators. On the assumption that the tribunal outlined above consists of experienced and prestigious international arbitrators, I submit that the standard formula for voting is sufficient, indeed the most suitable one.

For a tribunal of the kind outlined above to serve its purpose, it is desirable that as many issues as possible are decided by it. A fourth key-element in an arbitration agreement would therefore be to identify, list and define all *the issues which are to be resolved* by the arbitrators, i.e. defining the subject-matter jurisdiction of the arbitral tribu-

nal. The best approach would probably be to use rather broad categories of definitions, rather than to try to regulate everything in detail. Again, on the assumption that the arbitrators have the required experience and expertise, it is better to entrust *them* with the task of interpreting and/or applying provisions concerning their own jurisdiction, rather than for the parties to try to cover every jurisdictional aspect in the agreement.

The parties may also want to specify *the law and/or rules to be applied* to resolve the issues. Since the parties would all be sovereign states, it goes without saying that international law would be applicable, unless the parties agree otherwise. As I pointed out in the introduction, there are, however, few rules of international law which would seem directly applicable to the Caspian See dispute. The parties would therefore be well-advised to try to agree on the rules and/or principles to be applied by the arbitral tribunal, for example the parties might want to agree that 1982 United Nations Convention on the Law of the Sea should be applied ex *analogia,* or perhaps *mutatis mutandis.*

A final key-element to be included in an arbitration agreement is to provide for an *award period,* i.e. a period within which the arbitral tribunal must render its award. Generally speaking, disputing parties want the dispute to be resolved as quickly as possible. The Caspian Sea dispute is no exception. On the contrary, the uncertainty and unpredictability still surrounding investment in the Caspian Sea suggest a prompt resolution of the issues, as prompt as the complexity of the issues permits. The arbitration agreement must also set forth a mechanism for prolongation of the award period. In a multi-party arbitration of this kind it is not a good idea to require the agreement of the parties in this respect. Rather, the right of prolongation should lie with the chairman, or with a well-known and well-established international organization such as the ones mentioned above. In this context, the parties should also include provisions in the arbitration agreement to the effect that the award is final and binding.

It is my belief that if the littoral states could agree on an arbitration agreement along the lines suggested above, all the Caspian Sea issues could be finally resolved in a relatively short period of time. As mentioned above, this requires political will. I submit that the hesitancy over arbitration that lingers in many government quarters could be overcome if the possibilities of interstate arbitration were properly explained to government officials.