5th Dr. PARAS DIWAN MEMORIAL INTERNATIONAL ENERGY LAW MOOT COURT COMPETITION, 2-5 APRIL 2015

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

WASHINGTON D.C.

IN THE PROCEEDING BETWEEN

NIXIO PETROLEUM LIMITED

(CLAIMANT)

AND

REPUBLIC OF GONDWANA

(RESPONDENT)

(ICSID CASE NO. ARB/11/86)

PART I

Gondwana is known in the oil industry circles as Asia's 'hottest offshore exploration frontier'. Exploration has been taking place across the entire Shamime basin, a deep water block in the Gondwanan Ocean. In carrying out the exploration three out of the nine oil-prospecting blocks established by the government is currently allocated to private companies. Current estimates put the country's oil potential at around 2.5 billion barrels of recoverable reserves from the three blocks that have so far been drilled. Some analysts anticipate that Gondwana's CO DWN-98 basin may hold more than 6 billion barrels of oil which, if explored, will place Gondwana among the foremost Asian oil producers. However, given the volatility of oil prices, it is difficult to estimate Gondwana's likely revenues from oil. Yet, if production goes ahead without complications, the country's budget is likely to receive a major windfall – potentially doubling Gondwana's revenue base within six to ten years.

Gondwana's industrialization depends largely on how its energy resources (oil, gas, bitumen, coal, lignite) are harnessed either as fuel or as industrial feedstock. Over-dependence on oil is evident from the fact that oil revenue, as a percentage of the nation's total export earnings, soared from 10.5 per cent in 1981 to 40.5 per cent in 1999. Since then crude oil production has accounted for 30 per cent of GDP and about 80 per cent of total government revenue. With the completion of the Khilo export-marketing condensate facility, and of Phase 1 of Gondwana's petrochemical project, as well as the commencement of the export of liquefied natural gas to Europe, there is no doubt that the energy sector will continue to be an important factor in the Gondwanan economy for the foreseeable future.

Keeping all these factors in light, Gondwana embarked on an ambitious expedition to develop its oil fields and to increase its oil production. It introduced Exploration and

Production License Regime (EPLR), a policy mechanism that opened doors to foreign oil companies to invest, explore and produce oil & gas in the sovereign territory of Gondwana. Like many resource-rich countries Gondwana too executed their development and exploration model through Production Sharing Contract (herein after PSC) Model. Under this policy, government invited bids through an international competitive bidding system **(ANNEXURE I).** After the bidding rounds, the government entered into PSC with the successful bidders after which they become the contractors. The policy offered several fiscal benefits to the contractors to attract investments in the country.

In the year 2001, the Ministry of Petroleum & Natural Gas came out with the third round of bidding under EPLR. The government invited tenders to bid for blocks located in the offshore coasts of Province of Shahime, Gondwana Ocean. In response to the said invitation, Gondwana Oil Corporation Ltd. and Nixio Petroleum (hereinafter Nixio) formed a consortium to participate in the bidding. The consortium of Gondwana Oil Corporation Ltd. and Nixio Petroleum became the successful bidders. A PSC in respect thereof was entered into between the Government of Gondwana and the Contractor on 13 November 2001. The contract area as recorded by the PSC was identified as CO DWN-98-3, a deep water block.

PART II

On 15 December 2001, the two company Gondwana Oil Corporation Ltd. And Nixio entered into a Joint Operating Agreement in conformity with Article 7 of the PSC to define the rights and liabilities of the parties under the contract. Nixio was appointed as the operator under the agreement.

BRIEF ON THE COMPANIES

Gondwana Oil Corporation Ltd. is a national oil company established in the year 1985 under the Gondwana Oil Corporation Act, 1985. It is a company incorporated and registered as per company laws prevalent in Gondwana. The government holds majority shares of the company. The company was established with the purpose of planning and promoting programmes for development, production and sale of petroleum and petroleum products. The Company dominated Gondwanan oil industry along with its smaller subsidiaries before liberalization and the EPLR regime. Gondwana Oil Corporation Ltd. continued to remain prominent even after EPLR, winning major bids in both the first and the second round of bidding. The company since its inception has strived to develop in-house expertise in all aspects of exploration and production business.

On the other hand Nixio Petroleum is a company incorporated according to the laws of Republic of Cedonda. Established in the year 1955, it has grown to become a super major oil and gas company in the world. It is a company operating in almost all areas of oil and gas industry including exploration and production, power generation, petrochemicals etc. Nixio has been ranked number one amongst private E&P companies in Asia and third amongst global private E&P companies. It figures in the Fortune Global 500 list of 2007 and was awarded 'Superbrand' status, 2011. Due to their impeccable and advanced technologies they have emerged as a leading brand in E&P sector and are responsible for oil and natural gas exploration, development and production activities in more than 80 countries.

PART III

In the year 2002, Nixio started exploration activities and by 2005 a significant discovery was made in the basin. The development plan submitted to the government suggested that the basin had one of the largest reserves of the nations. This discovery could potentially reduce the crude oil imports and make the nation move towards much needed self-sufficiency in the light of the fact that Gondwana is expected to be the world's third largest energy consumer. The company started production in the year 2006.

Following table illustrates the production for the ensuing six fiscal years:

Crude Oil(MMT)	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**
	32.03	33.37	35.58	35.67	31.08	25.09

Concerned over the sudden decrement in production, the government sought clarification from the operator. In response to this, the operator sent a letter dated 12 March 2012 to the government stating that certain geological factors were impeding production. Quoting from the letter;

> Within the reservoir, the flow of fluids is the governing factor for the extraction process. In order to be produced, the hydrocarbon fluids must reach the production wells and consequently, the rock properties affecting fluid mobility is having a major influence on the amount that can be extracted and also on how fast it can be extracted.

The Director General of Hydrocarbon (Upstream sector regulator in Gondwana) conducted an inquiry comprising of prominent national oil company members and found that the reasons cited by Nixio were baseless. The production estimates provided by DGH far exceeded the actual production. The report also stated that Nixio is showing front-load expenditure thereby cutting down on the profit oil share of the government and undermining the capacity utilization of the reserve. Further, in May 2012, the Income Tax Department raided the office of Nixio at New Ankara (capital of Gondwana). DGH's report also bought forth that the essentiality certificate issued for the equipment had to be cancelled as many of the drilling equipment's were no longer put to use, making Nixio liable for taxes on the equipment's.

PART IV

Acting upon the report of the DGH and income tax department, the government terminated the contract as per Article 30.3 of the PSC through a show cause notice dated 5 September 2013**(ANNEXURE II).** Moreover, the participating interest of Nixio was transferred to Gondwana Oil Corporation as per Article 30.3 of the PSC.

After the termination of the contract, Minister of Petroleum and Natural Gas at a press conference on 12 September, 2013 stated;

> We were forced to terminate the contract of Nixio as they were indulged in various malpractices causing huge losses to the exchequer of the nation. The company has been concealing material facts from the government because of which the government's share of petroleum was substantially affected. Such acts will not be tolerated. We won't let the foreign investors loot the nation.

However, Nixio denied such allegations stating that such activities were politically motivated to hoard more cash from the investors. Nixio's Chairman Mr. Jeofrey Martin also gave his statement to the press,

> The government of Gondwana has been harassing our company since we made the discovery. We categorically deny all charges. Such activities of the government show that it is not a very investor friendly nation. If the government continues to act in this manner, it will slowly lose all its investors.

Immediately after the termination of the contract, Nixio invoked arbitration under Article 33 of the PSC contesting the validity of the termination. The arbitral tribunal gave an award against Nixio and held the validity of the termination.

Immediately after the arbitration proceedings, a newspaper report, '*The Nixio Oil Crisis"* was published in the Gondwanan Economic Times on 15th July, 2014 which analysed the arbitration award.

The excerpt of the report is given below:

> The National Oil Companies have dominated the Gondwana's Oil Sector. One of the major reasons for this is the Government support which the NOCs get. The presence of bureaucracies' have further deterred the scenario and has prevented the formation of coherent policy. There exists a belief that the biddings remains biased towards NOCs. An instance can be traced to a similar arbitral award between the government of Gondwana and Terra Petroleum Ltd over validity of the termination of the PSC. And now again, another company in the nation's third round of bidding has challenged the actions of the government and the administration of justice becomes questionable. The situation becomes worse by the fact the son of Mr. Ganesha Jhah, the minister of petroleum and natural gas is a shareholder in Gondwana Oil Corporation Ltd.
>
> These kinds of policies have become a major reason for inhibition of growth of Oil Sector in Gondwana. The nation has been liberalized in name but not in essence. In my opinion, it is nothing more than pseudo liberalization.

Although the contract has the most obvious connection with the legal system of Gondwana, by actions of the host state (Gondwana) it is evident that the Gondwanan legal system has failed to administer justice or has been fair. Therefore, Nixio seeks a 'neutral' forum which would share its values in the form of international arbitration outside the jurisdiction of the host state.

Nixio alleges that the Gondwanan government, the national legislature, judicial authorities and other public authorities and agencies deliberately created numerous problems for them and refused or unreasonably delayed the adoption of adequate corrective measures.

These actions and omissions, according to Nixio, caused and are still causing material damage to the operations in CO DWN-98-3 block and have had, and still have, a direct negative impact on the reputations and market values of the respective Nixio group companies. Gondwana's actions and omissions violate the Energy Charter Treaty (ECT) to which both countries are parties. Nixio Oil seeks an award of damages for breaches of the treaty and compensation for expropriation.

By the letter dated 21 August 2014, Nixio, filed a request for registration of arbitration with the International Centre for Settlement of Investment Disputes ("ICSID" or "the Centre") against the Republic of Gondwana the request invoked the ICSID arbitration provisions, along with the Energy Charter Treaty ("ECT") provisions. The Government of Gondwana contented that the ICSID did not have jurisdiction in the matter as the contractual forum mentioned in the Production Sharing Contract is New Ankara as well as the governing law is Gondwana. Moreover, arbitration has already been concluded under the PSC and thus arbitration in a different forum on the same issue cannot be evoked. Above all the Republic of Gondwana has not given any written consent to evoke ICSID.

However on 19 September 2014, the Centre in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (the "ICSID Institution Rules") acknowledged receipt of the request and on the same day transmitted a copy to the Republic of Gondwana.

THE ISSUES INVOLVED

1. Whether the claim made by claimant fall within the jurisdiction of ICSID.
2. Whether the actions of the Gondwana (Responded) amount to violation of Art. 2 and Art. 26 of the Energy Charter Treaty.
3. Whether the Respondent can evoke Art. 17 part III of the Energy Charter Treaty.
4. Whether the termination of the PSC amounts to violation of Art. 10 and 21 of the Energy Charter Treaty.
5. Whether transferring of participating interest in the PSC amounts to expropriation by the government under Art. 10,12 and 13 of the Energy Charter Treaty.

**The nations of Cedonda and Gondwana are both parties to the Energy Charter Treaty and ICSID.*

** All laws of Republic of Gondwana are in pari materia with that of the Republic of India (PSC model of India, DGH, NELP and other laws of India)*

**The Production Sharing Contract referred to in this compromis follow the format in EPLR IX*

ANNEXURE I

PARAMETERS FOR BID EVALUATION

Following main parameters will be considered while evaluating the bids:

i) **Technical capability:**

Evaluation of technical capability of the bidding companies/consortia, among other things, will be based on the production and reserves of oil and gas, acreages holding and operatorship experience of the companies/consortium. In case of a parent company guarantee, the technical parameters of the parent company would be considered for evaluation.

ii) **Operatorship experience:**

For deep water blocks, bidding company/consortium must have experience as an operator in the area of exploration and production of oil and natural gas for their bid to be further considered for evaluation.

iii) **Financial capability of the bidding company/consortium:**

Evaluation of financial capability of the bidding companies/consortia, among other things, will be based on the net worth, debt/equity ratio and profit before tax. In case of a parent company guarantee, the financial parameters of the parent company would be considered for evaluation.

iv) **Work programme:**

Only the committed minimum work programme by the bidding companies/consortia will be considered for evaluation purposes. Any contingent/ conditional work programme will be ignored, while evaluating the bids. Work programme offered in the first exploration phase will be given higher weightage in evaluation. Bidders would be required to commit exploration well(s) in the second and third exploration phases

v) **Fiscal package:**

The profit sharing offered by the bidders along with proposed annual cost recover limit will go into evaluation

viii) Government may also take into account the past performance of the company including the track record of the company or the consortium in respect of court cases against it or any other basis and on this consideration or any other consideration, at the sole discretion of the Government, it may accept or reject any or all bids.

ANNEXURE II: SHOW CAUSE NOTICE

To
Mr. Varun Patel
Country officer (Gondwana)
Nixio Petroleum Ltd.
B-224
New Ankara -1100234

SUBJECT: SHOW CAUSE NOTICE

Sir

It has been reported by the Director General of Hydrocarbon through an inquiry report that your claims of low fluidity in the CO DWN-98-3 basin is baseless. It has also been reported to the Ministry that the production estimates provided by DGH far exceeds the actual production. The company is seen to be undermining the capacity utilization of the reserve. The company has been showing front-load expenditure thereby cutting down on the profit oil share of the government and undermining. This is causing significant loss to the nation' exchequer.

It has also been noted in the DGH report that the equipments imported for petroleum operation were no longer put to use in the operations. As per Article 17.6 imported equipments no longer in use for petroleum operations are liable to be taxed with custom duties which you have not paid.

The above acts amount to violation of the Production Sharing Contract. Hence, the government is forced to terminate the production sharing contract signed between the government and Nixio Petroleum Ltd. Concealment of material facts from the government as well as failure to make monetary payments form grounds under Article 30.3 for termination of contract. The contract will stand terminated on expiry of 90 days of show cause notice i.e., 5th November 2013.

Regards

Ganesh Jhah

Ministry of Petroleum and Natural Gas

Tel Bhavan

New Ankara

*This problem was drafted by the Moot Court Association under the supervision of Ms. **Mary Sabina Peters** Special acknowledgement to **Ms. Shubhangni Jain** and **Mr Siddhant Satapathy.***