Iranian oil award survives Israeli challenge

Sebastian Perry • Wednesday, 27 July 2016 *(12 hours ago)*

An Israeli state-owned entity has lost its challenge against a US$1.12 billion award that compensates Iran's national oil company for crude oil deliveries made just before the Iranian revolution of 1979.

The Israeli port of Eilat on the Red Sea (Credit: tzahiV/istockphoto)

In a judgment dated 27 June, the Swiss Federal Supreme Court in Lausanne rejected a challenge by Israeli-owned Trans-Asiatic Oil to an award in favour of the National Iranian Oil Company (NIOC) and its Liechtenstein subsidiary Fimarco.

An ad hoc arbitral tribunal seated in Zurich issued the award in May 2015 after a 26-year arbitration over withheld payments for oil delivered to Israel in the last days of the reign of the Shah of Iran, who was toppled in the Islamic revolution that led to the severing of diplomatic and commercial ties between the two states.

Remarkably, the politically sensitive arbitration between two Middle Eastern adversaries took place largely out of the public eye, though some details had already emerged before Iranian state media announced the award last year. The Swiss court's judgment redacts the names of the companies but not of the two governments.

The dispute has also been marked by tragedy. The judgment reveals that the original chair of the tribunal died in November 2012. The timing makes it highly probable that he was **Daniel Wehrli**, a vice president of the Swiss Arbitration Association whose death aged 62 was reported by *GAR*. The chair who replaced him has not been named but is understood to be another well-known Swiss arbitrator. The Israeli side's first appointee to the panel, former justice minister **Haim Zadok**, also died in 2002 and was replaced by **Avigdor Klagsbald**, a Tel Aviv-based lawyer. Klagsbald spent several months in prison after being convicted in 2006 of causing the deaths of a young woman and her son in a car accident, but continued to serve on the tribunal. The Iranian side also appointed one of their own nationals as arbitrator – **Mohsen Aghahosseini**, a former judge at the Iran-United States Claims Tribunal in The Hague.

A secret partnership

The dispute relates to the Eilat-Ashkelon Pipeline Company in Israel, a joint venture secretly agreed between the two states in 1968, under which Iranian oil was shipped from the Persian Gulf to the Israeli port of Eilat on the Red Sea. A specially constructed pipeline transported the oil from Eilat to the city of Ashkelon on Israel's Mediterranean coast, where it was exported for sale in Europe (to customers including the Franco government in Spain).

NIOC and Israel jointly established various offshore entities to conceal Iranian involvement in the project, including Panama-registered trading company Trans-Asiatic Oil (TAO). As part of a complex web of transactions, NIOC's wholly owned subsidiary Fimarco signed a contract with TAO in 1969 providing for the establishment of another Liechtenstein entity – Freegate – that would receive oil deliveries from NIOC under annually renewed contracts.

The project, which received West German financing, operated for almost a decade before Iran ceased deliveries in the wake of the Islamic revolution. Israel later took control of the joint venture companies, the pipeline and related assets including oil terminals and a fleet of tankers.

Fimarco brought the claim against TAO in 1989 under an arbitration clause in their 1969 contract. It alleged that TAO had withheld payments of US$455 million for 50 deliveries made between September and December 1978. The shipments were made under a 1978 contract between NIOC and Freegate providing for delivery of almost 15 million tonnes of crude oil in that year.

Decades of delay

It took several years of court proceedings before the arbitral tribunal was formed, and the first phase of the arbitration only ended in 2003 with an interim award on liability that upheld Fimarco's claim for US$455 million and postponed a ruling on interest and potential counterclaims by TAO.

TAO brought counterclaims in 2004 that would have wiped out any recovery by the Iranian side. It claimed for a "shortfall" of almost 3 million tonnes of crude oil that had not been delivered under the 1978 contract. It also claimed for non-delivery of a further 15 million tonnes under a different contract allegedly concluded for 1979; and for breach of an obligation to continue to enter into annual supply contracts until 2017. The counterclaims were also brought against NIOC and Freegate, both of which TAO sought to join to the arbitration.

Hearings on the counterclaims closed in 2007, but the parties had still not received a final award when the president of the tribunal died five years later. A new president took over the case early in 2013, who refused TAO's request for an additional hearing.

After further delays and apologies from the new tribunal president, who said he had seriously underestimated the complexity of the task, the final award was issued by majority in May last year, with TAO's appointed arbitrator issuing a dissenting opinion.

The final award upheld jurisdiction over NIOC though not over Freegate (which was by this time in liquidation). The majority rejected the bulk of TAO's counterclaims, holding that no contract had been agreed for 1979 and that no damages were owed for the failure to enter into new contracts until 2017.

It held that TAO was only owed damages with respect to the 1978 shortfall, in an amount of US$99 million plus interest. Offsetting that amount, the award required TAO to pay US$1.12 billion to Fimarco and NIOC, along with interest calculated from January 2015 on the sum of US$362 million based on the LIBOR rate.

TAO did not seek to set aside the entire award in its Swiss court challenge but argued that the tribunal should be required to reconsider certain findings with respect to the 1978 shortfall. As a result, the latest judgment sheds light on only one element of what one can infer was a much more complex dispute.

“A lack of imagination”

In its challenge, TAO argued that the tribunal majority breached due process through the manner in which it treated issues affecting the calculation of damages for the 1978 shortfall.

The majority had held that NIOC ought to have resumed delivering the remaining oil on 5 March 1979, as soon as the situation of force majeure created by the revolutionary unrest in Iran had disappeared, and that the deliveries would have been completed by April.

TAO argued in the arbitration that delivery of the remaining oil should have been “evenly spread” across the whole of 1979, which would have allowed it to benefit from a steep increase in oil prices in that year. But the majority said that these arguments were premised on a hypothetical delivery schedule for a 1979 contract that was never concluded.

The majority instead relied on the evidence of one of TAO’s own witnesses in support of its view that the parties had agreed ahead of a meeting in December 1978 that the remaining oil under that year’s contract would be delivered as soon as possible.

Before the Swiss court, TAO argued there was an “irreducible contradiction” in the majority’s reasoning and that it had reached its conclusions in a manner that was unforeseeable, without giving the parties an opportunity to respond.

Dismissing the challenge, the court said TAO had oversimplified and distorted the majority's reasoning and that there was nothing unforeseeable about the way it had reached its conclusions; rather, TAO had shown a "lack of imagination" in not anticipating the consequences of the rejection of its claim regarding the 1979 contract.

TAO also alleged that the new tribunal president had ignored a "practice" established by his predecessor of presenting the parties with further questions. But the court said this did not amount to a breach of the right to be heard, even if it could be proven that the practice had become a procedural rule.

The president of the tribunal made his own submission to the court rejecting the grounds of the challenge, but the court was not persuaded that this represented the views of the tribunal majority rather than the president alone, and declared it inadmissible. The court also said the dissenting opinion by the Israeli arbitrator was of no relevance in deciding TAO's challenge.

It ordered that TAO should bear the court costs of 200,000 Swiss francs and pay costs of 250,000 Swiss francs to Fimarco and NIOC, which would be taken from funds that TAO had already paid to the court as security.

The court also warned that TAO's debt to Fimarco and NIOC potentially fell within the scope of a Swiss ordinance adopted in November 2015 concerning sanctions against Iran, and that it would send a copy of the judgment to Switzerland's State Secretariat for Economic Affairs.
It is unclear from the judgment whether the "debt" means only the court's costs order or the entire award debt – but *GAR* has been told that NIOC is not in any event covered by the current Swiss sanctions regime against Iran, which has been considerably relaxed in the wake of the July 2015 agreement that Iran signed with six other states regarding its nuclear programme.

A bigger claim against Israel in the pipeline

Israel has yet to comment on the Swiss court's decision, and has previously said it will not honour the award. The Israeli government has come under increasing domestic pressure to disclose details about the Eilat-Ashkelon Pipeline Company, which has long been the subject of a confidentiality decree.

The interest has intensified as a result of a disastrous pipeline leak at Eilat in December 2014, which has led environmental campaigners to bring a number of lawsuits against the state. Israeli newspaper *Haaretz* has also publishedinvestigative reports about the pipeline deal with Iran and the decades-long arbitrations arising from it.
These include a much larger ad hoc arbitration that NIOC has been pursuing against the state of Israel under their 1968 participation agreement for the pipeline project, details of which have emerged as a result of related French and Swiss court actions.

NIOC filed that case in 1994 but it took 19 years to get under way thanks to a problematic arbitration clause that provided for disputes to be heard initially by a two-person panel, without specifying an arbitral seat or applicable law.

The Swiss Federal Supreme Court ruled in 2013 that the case could proceed, upholding a partial award in which the two-member panel found it had been properly constituted. In that case, NIOC originally demanded US$800 million, representing half of the value of the assets related to the 1968 participation agreement; as well as damages corresponding to the amount that another, unidentified company "could be found owing at the end of another pending arbitration". *GAR* understands that the other arbitration referred to is the *TAO* case, and that NIOC seeks a declaration from the two-member panel that Israel is liable for the billion-dollar award against the Panamanian entity – presumably in the belief that an award in the state's name will have better enforcement prospects.
The *NIOC v Israel* arbitration is now understood to be worth around US$7 billion, a figure that includes interest and substantial counterclaims by Israel. Aghahosseini is again NIOC's appointee to

the panel. French-Israeli **Théo Klein** was the arbitrator originally appointed on Israel's behalf but he is understood to have resigned from the panel some time ago; his replacement has not been identified.

It will likely take some time for that case to see a final award. If the two arbitrators cannot resolve the dispute by mutual agreement, the arbitration clause provides that they should try to agree on the appointment of a third arbitrator – with the president of the International Chamber of Commerce stepping in to make the appointment if they cannot agree.

In 2001, NIOC also won a US$97 million award against a Swiss company owned by the Israeli government over its failure to pay for crude oil shipments destined for three Israeli companies. That case, commenced in 1985, was heard by a Tehran-seated tribunal. The Swiss Federal Supreme Court in 2014rejected arguments by the award debtor that enforcement would breach Swiss public policy and international sanctions against Iran.

NIOC is believed to have been represented in the three arbitrations and related court proceedings by **Wolfgang Peter** of Peter & Partners and**Homayoon Arfazadeh** of Python (the firm Peter co-founded in 1981 beforebreaking away last year).

In the latest Swiss court challenge, TAO relied on **Dominique Brown-Berset**and **Dominique Ritter** of Geneva-based boutique Brown&Page, along with**Eric Haymann** and **Daniel Bloch** of Froriep in Zurich.

It is thought that Brown&Page has also been acting for TAO and Israel in their arbitrations with NIOC, but the firm has declined to confirm this. Israeli Prime Minister Benjamin Netanyahu reportedly blocked a freedom of information request by *Haaretz* earlier this year concerning the legal expenses the state has incurred in the dispute.

Iran settles with US over Shah assets

In January, Iran also succeeded in settling another dispute dating back to the Iranian revolution. A day after the US and EU lifted their nuclear-related sanctions against Iran, US Secretary of State John Kerry announced with little fanfare that the US had paid Iran around

US$1.7 billion to settle a long-standing claim at the Iran-US Claims Tribunal – the body established in The Hague in 1981 to help unravel the commercial ties between the US and the Shah's regime.
The payment represented the balance of US$400 million left in a trust fund used by the Shah to purchase US military equipment, along with "a roughly US$1.3 billion compromise" on interest. Kerry said Iran's recovery represented a "reasonable rate of interest" and would spare US taxpayers from having to pay a much larger sum if the tribunal had determined the rate.

GAR understands that the settlement addresses one element of a much larger claim by Iran against the US, known as B/1, which concerns alleged non-delivery of services and inappropriate billings under the US's foreign military sales programme. The case is believed to be worth around US$20 billion including interest. Eversheds partners **Will Thomas** in Paris and **David Sellers** in London are understood to be advising Iran on aspects of the case.
Relations between Iran and the US remain strained, however. In June, Iranlodged a case with the International Court of Justice, alleging that the US has breached a 1955 treaty through judicial and legislative measures that have allowed some US$2 billion in frozen assets owned by Iran's Central Bank to be used to compensate victims of terrorist attacks allegedly linked to Iran. US firms Chaffetz Lindsey and MoloLamken acted for Iran's Central Bank in a related appeal to the US Supreme Court that was dismissed in April.
Before the Swiss Federal Tribunal (Case No. 4A 322/2015)

- Judges Kiss, Kolly and Hohl

Counsel to Trans-Asiatic Oil

- Brown&Page

Dominique Brown-Berset and **Dominique Ritter** in Geneva

- Froriep

Eric Haymann and **Daniel Bloch** in Zurich
Counsel to Fimarco and National Iranian Oil Company

- Peter & Partners

Wolfgang Peter in Geneva

- Python

Homayoon Arfazadeh in Geneva