39-394 CLAIMS TRIBUNAL

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Case No. 39 Date of filing: 18 July 89

** AWARD - Type of Award _____
- Date of Award _____
_____ pages in English _____ pages in Farsi

** DECISION - Date of Decision _____
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** CONCURRING OPINION of _____
- Date _____
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** SEPARATE OPINION of _____
- Date _____
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** DISSENTING OPINION of _____
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** OTHER; Nature of document: Supplemental To Statement by Judge Khalilian
- Date 18 July 89
16 pages in English _____ pages in Farsi

R/12

In the Name of God

CASE NO. 39
CHAMBER TWO
AWARD NO. 425-39-2

PHILLIPS PETROLEUM COMPANY IRAN,
Claimant,

and

THE ISLAMIC REPUBLIC OF IRAN,
THE NATIONAL IRANIAN OIL COMPANY,
Respondents.

Supplemental to the Statement by Judge Khalilian made on 30 June 1989

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1. On 30 June 1989, I filed a Statement which set forth the process that led to the signing of the Award in Case 39 by two of the three arbitrators in Chamber two: namely, Messrs. Briner and Aldrich. In that Statement, I briefly touched upon certain improprieties in the circumstances surrounding this Award without discussing the detailed facts related thereto. I, however, feel that I would be bothered by a guilty conscience if I remain silent about the events which have significant implications for understanding the true nature of an award amounting to $110 million, including interest, issued in this Case. My decision to issue this Supplemental is, therefore, motivated by my conscience and the commitment I have towards the cause of justice, which

outweighs all other considerations. In issuing this Supplemental Statement, I shall endeavor not to disclose the matters discussed in those deliberation meetings which were held in accordance with the rules of arbitral proceeding.

2. It was on 22 June 1989 that I received a copy of the Draft Award whereby it had been suggested that $130 million, including interest, was to be paid to the Claimant in the Case. This Draft was distributed without holding any deliberations with regard to the most important meritorious issues involved in the Case, viz, the projection of oil reserves, the projection of oil prices, and production costs as well as the discount rate and risk factors to be applied in the case. The Draft was accompanied by a note from Mr. Briner which invited me to a signature ceremony scheduled for 29 June 1989. The Draft contained no reasoning or calculation whatsoever to help my imagination to crack its riddles and gain some understanding of the process followed by Mr. Briner in arriving at the colossal amount of the $130 million, which he was adamant to award as compensation in this Case. My repeated demands for explanation in this regard were also to no avail.

3. It happened that on 27 June 1989, I came across a Memorandum that had previously been communicated by Mr. Aldrich to Mr. Briner, but about which I had been kept in the dark by these gentlemen. The inquiries that I subsequently made, and the conclusive evidence which I obtained as a result of these inquiries, left me in no doubt that the computations attached to that Memorandum contained the underlying formula whereby Mr. Briner and Mr. Aldrich had arrived at their assessments of the final compensation figure to be paid to the Claimant. Indeed, the computations indicated not only the formula but also the discount rate as well as the quantities of oil reserves and the oil price projection which they had used in arriving at the net present value of the cash flows projected by them for the

remaining 20-year period of the agreement in dispute in the Case. This was the first time I became aware of the discount rate of 15% they were contemplating to apply in the Case, about which they had previously refused my repeated calls for discussions and deliberations. Indeed, they had been adamant that no discussions were necessary in this connection as any reference to such a discount rate in the final award would make us wide open to outside criticism.

4. As I was perusing the contents of Mr. Aldrich's Memorandum, I noticed some schedules and computations in connection with the assessment of the compensation to be awarded in the Case. These computations, which I had so far been unsuccessfully groping for in the dark corridors of the Draft Award, came to me as a revelation. I was, however, perturbed when I found out that those computations contained a fundamental error in basic mathematics as a result of which the figures of compensation arrived at by Mr. Briner were grossly overstated by an astronomical amount of $80 million, including interest, even if all their assumptions and premises about oil quantities and prices over the next 20 years were to be regarded as valid. This mistake that Mr. Briner had committed in conjunction with Mr. Aldrich was simple as is indicated in Annex 8 to my Statement dated 30 June 1989, which I briefly explain in the following paragraph.

5. In order to arrive at the net present value of the cash inflow (income) projected for the Claimant for each of the years in the 20-year period leading to year 2000, Mr. Aldrich had used a formula which is normally applied in an analysis of the sort he was undertaking in this Case, viz.

$$\text{Present value} = \frac{\text{Future Cash Flow}}{(1 + r)^t}$$

where "r" in the denominator stands for the discount rate and "t" for the number of periods. Thus, in order to calculate the denominator in, say, year 15 (1994) at the discount rate of 15%, one had to multiply (1 + 0.15) by itself 15 times. But, Mr. Aldrich had incorrectly calculated this denominator as 1+(0.15X15). As a consequence of this basic and simple error, the net present value for the revenue in that year 15 had been determined at $3,462,476 million instead of $1,382,887 million, which was the proper amount if the formula had been correctly applied. Overstatements of a similar magnitude had obviously been committed in each of the remaining 19 years in the 20-year period of the projection that Mr. Aldrich had undertaken and Mr. Briner had blindly adopted! The cumulative effect of these overstatements over the 20-year period amounted to approximately $80 million, including interest.

6. As already explained, these computations -- which should have constituted a major part of the Chamber's deliberations -- had not yet been disclosed to me. Thus, I could only assume that they had been conducted in anticipation of the possibility that some day the Chamber might be forced to explain the underlying rationale for the assessment of the gigantic sum of $130 million which was being contemplated as the compensation amount in this Case. Failing that assumption, one would have been left wondering whether the miscomputation was the result of ignorance of basic mathematics of the DCF formula or the outcome of a skillful manipulation of the figures. Whatever the cause of the miscalculation might have been, I had to concern myself with the urgent task of getting it rectified before the approaching deadline of the signature ceremony fixed for midday on 29 June 1989, about which Messrs Briner and Aldrich were unyielding.

7. As Mr. Briner was in Geneva at that time, I took steps to inform him of my concern for the mistake which had been

committed in determining the compensation in this Case. I was told that he would be available at the Tribunal from 8:30 AM on 29 June, at which time I could raise the issue with him. Mr. Briner was not, however, in a position to appreciate from distance the enormity of the miscalculation which he had committed in association with Mr. Aldrich. He, therefore, believed that I could simply explain the problem to his assistant who was present at the Tribunal in The Hague.

8. I immediately arranged for the problem to be discussed with his assistant who compared my discoveries with his copy of the secretly communicated Memorandum, and, afterwards, confirmed the miscalculation which had been committed. I subsequently received information that Mr. Aldrich and his assistant had also confirmed the miscalculation. That day, the consensus amongst those present in Chamber Two in The Hague was that a grave mistake had been committed about which they were clearly upset. Nonetheless, everyone agreed that the situation had to be rectified. I was also informed that even Mr. Briner had subsequently acknowledged the miscomputation. However, neither Mr. Briner nor Mr. Aldrich had, as yet, fully realized the sheer size of the consequence of their massive mistake!

9. In the meantime, I had received a telefax from Mr. Briner reminding me of the deadline for the signature ceremony at his office at midday on 29 June 1989. I could not afford to lose any time in putting on record the discussions which had been held in the Chamber in connection with the massive fallacy on which the compensation in the Award was being based. On 28 June 1989, I distributed a Memorandum in which I quantified the full effect of the mistake committed by Messrs. Briner and Aldrich and invited them to discuss the issue as soon as possible. See Annex 8 to my Statement dated 30 June 1989. As soon as my Memorandum was out, everyone in the Chamber realized the full

ramifications of the false computation on which the Award was being based. With less than 24 hours left to the signature ceremony, the final version of the Award was faltering. Mr. Briner's office was quoted as having said that "we have to do something about it!"

10. Mr. Briner made his way back from Geneva to the Tribunal late in the afternoon on 28 June to gain a first hand account of the event! He immediately began his consultantions. I assumed that he was addressing himself to the task of rectifying the mistake. The developments of the following day, however, revealed that the consequences of such a rectification was too far-reaching for him or for Mr. Aldrich to accept.

11. At 8:30 AM on 29 June 1989, I phoned Mr. Briner to inform him that I was on my way to his office to discuss the problem as previously agreed. He asked for a postponement. It appeared to me that he was still hesitant about his attitude towards the problem. An hour or so later, Mr. Briner asked to see me privately. At this private meeting, he stated that he had not received the erroneous computations the revelation of which had rocked the Chamber in his absence. Mr. Briner then added that we would meet each other at 10:30 AM. At that time there was no doubt in my mind that he was seeking to allow himself more time to ponder over the approach he was going to adopt vis-à-vis the problem he was facing. I sensed a lot of activity in the Chamber as I was walking back to my office.

12. As soon as I returned to my office to wait for the 10:30 discussions, I wrote a Memorandum to Mr. Briner and asked him for a written confirmation of his denial that he had received the computations from Mr. Aldrich. He declined to confirm his denial in writing.

13. I attended Mr. Briner's office at 10:30 A.M. with my legal assistants. I once again explained to him the miscalculation which had been discovered and invited him to address the problem and take necessary steps towards rectifying the $80 million miscomputation which he had committed. But, to my surprise, I heard Mr. Briner once again denying the existence of the calculations which Mr. Aldrich had made and he had himself used as a basis for arriving at his decision. I was astonished at realizing that, after hours of reflection and consultation, Mr. Briner was adopting a position of outright denial.

14. In order to talk Mr. Briner out of his position of outright denial, I decided to recount the events of the two previous days in case his memory was letting him down. I, therefore, reminded Mr. Briner that if he had not received the communication containing the computations from Mr. Aldrich, he must have some other calculations to support the $130 million compensation fixed between them. I added that these calculations of which I now had a copy were apparently the only one used by them. Moreover, I pointed out to Mr. Briner that his office was still in possession of a copy of the Memorandum and the computations attached thereto. Indeed, I added, it had very recently been confirmed by his office that the computations had been used as a basis for arriving at the $130 million. By then he realized that the evidence refuting his outright denial was overwhelming.

15. Mr. Briner decided to change course and maneuver himself into a new position. He stated that some time ago he had received the computations from Mr. Aldrich's assistant. He further stated that he "had immediately returned those computations"! I was overwhelmed with amazement at hearing the new account of events which was being invented by Mr. Briner. Of course, I could not believe him since I knew it for a fact that the Memorandum and the computations attached thereto had been seen at his office the day before.

I reminded Mr. Briner that the discovery of the error had been confirmed even by himself on the basis of the copy of the computations which he still had in his possession. I pointed out to Mr. Briner that his memory was once again failing him. I reminded him that the day before they had all acknowledged the relevance of the computations and were contemplating "to do something about it".

16. I, therefore, stated that I could not now understand the ambivalent and ever-changing positions being adopted during the meeting. I pointed out that I could not reconcile his first position of outright denial of the existence of the computations, with his subsequent position of admitting their existence but claiming to have subsequently returned them. At this stage, Mr. Briner came up with a novel idea! He, all of a sudden, abandoned the idea of justifying the figure with reference to a sound "DCF" computation. He proposed what he considered to be a compromise solution. In an attempt to make a deal, he suggested that he would reduce the compensation by $20 million, including interest, which had to be unconditionally accepted by me. He said that the compensation figure was now $110 million instead of $130 million, and added that I should either "take it or leave it".

17. In so doing, Mr. Briner revealed the true nature of their decision making process. It was obvious that Messrs Briner and Aldrich had no basis whatsoever for arriving at the figure of compensation with which they were so easily fiddling about! They were not even faithful to their so-called Discounted Cash Flow approach. They were only interested in a deal. But, I once again invited their attention to the gravity of the problem and insisted that the full extent of the mistake had to be recognized and rectified. Mr. Briner was not in the least interested in further reasonings. It was obvious that he had a definite bottom line, and was in no way prepared to go below it. He

held fast to the figure of $110 million, including interest. And, finally, he threatened me by stating that: "if you continue arguing, I will increase my figure from $55 million [amounting to $110 million including interest] to $60 million [i.e. $120 million in principal and interest]"!

18. I sensed that Mr. Briner's figure had been taken out of the thin air and was being tendered on a "take it or be penalized basis". I, therefore, found it impossible to initiate any meaningful discussions which could constitute a starting point of any deliberations worthy of the word. Our preliminary exchange of views was not obviously conducive to any deliberations. My misgivings about the handling of the Case by Mr. Briner were not just based on the events of the final two days leading to the signature ceremony on 29 June 1989. Indeed, the events of those two days were not isolated incidents, but were the culmination of a series of questionable circumstances surrounding the proceedings of the Case. All these events were inter-related and designed to award a hefty amount, no matter on what basis, to the Claimant in this Case. The history of the Case is rife with such dubious circumstances, some of which I can briefly enumerate as follows:

a) In 1979/1980, the Claimant had filed a report with the Securities and Exchange Commission (SEC) of the United States in which it had stated its share of the Iranian oil reserves at 15 million barrels. For the purpose of its claim filed with the Tribunal, however, the Claimant had changed its estimate of the same reserves to over 60 million barrels. Messrs. Briner and Aldrich were using this latter estimate as a justification to

award between 46.5 and 48.5 million barrels to the Claimant. See Award, para. 124.[1]

The Claimant had thus withheld its true estimate of the oil reserves from the Tribunal. Nevertheless, Respondents filed copies of these SEC filings with the Tribunal as soon as they came across them. The arrival of the SEC filings placed Mr. Briner and Mr. Aldrich in a dilemma. They had to choose between the reality of the oil reserves, as reflected in those SEC filings, which was 90 million barrels, and the purely speculative scenario put together by the Claimant in the course of this litigation, which Mr. Briner and Mr. Aldrich were adopting as a framework for arriving at their imaginary estimate of 290 million barrels.

Instead of facing the reality and taking judicial notice of the facts contained in the SEC filings (known as 10-K forms), Messrs Briner and Aldrich found their contents very damaging to the scheme they had put together. Therefore, these gentlemen decided to dismiss the filings on the frivolous ground that they were filed too late in the process of the proceedings and that the Claimant had not indicated the context in which those SEC filings had been made and has had no opportunity to do so in the Case before us.

I pointed out to them that those filings were made by the Claimant itself and needed no further comments as they were clearly prepared under SEC guidelines which

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[1] All these estimates have to be multiplied by 6 to arrive at the total reserves. In other words, total reserves had been estimated in the 10-K forms filed with SEC at 90 million barrels whereas Messrs Briner and Aldrich have awarded the Claimant on the basis of 290 million barrels.

are public knowledge and the Tribunal could independently look at them. Moreover, I pointed out that in view of the significant discrepancy between the SEC filings and the Claim filed with the Tribunal, the Claimant could still be given the opportunity to comment upon its own SEC filings. But, Mr. Briner and Mr. Aldrich were determined not to accept those filings, nor take any judicial notice of the facts contained therein.

b) It had initially been decided by the Chamber that the Tribunal would not follow the Discounted Cash Flow method. I, however, subsequently realized that Mr. Briner had merely expressed this opinion at a time he needed to win support when the question of his presidency of the Tribunal was a point of intense controversy between the American and Iranian Arbitrators. Once he was appointed as the President of the Tribunal by the Appointing Authority, he simply changed his decision and adopted a new position in favour of DCF, to which I vehemently objected at the time.

c) I had on a number of occasions pointed out to Mr. Briner that any determination of oil reserves and projection of oil prices, and the incorporation thereof into a DCF model of valuation, necessitated certain expertise which was clearly outside the fields in which Messrs Briner and Aldrich were engaged. But, these two gentlemen repeatedly refused to heed my demands for the reference of the Case to an expert;

d) The plan put together by Messrs Briner and Aldrich was not restricted to Case 39. Indeed, it went beyond the boundaries of that Case and extended to the territories of other cases, particularly that of Case 55 from which Mr. Briner had previously withdrawn defeatedly due to a challenge proceeding. In Paragraph 127 of the Award,

Messrs Briner and Aldrich are basing their decision on a price forecast filed in Case 55 and describe it as the "most conservative referred to in evidence." Such a description of that price forecast is obviously prejudicial to the Respondent in the undecided Case 55 on which Mr. Briner was successfully challenged. One should not also forget that the said price forecast was the same one which had already been dismissed in another case, namely Case 56, where it was heavily criticized by Chamber 3 of this Tribunal. See Partial Award 310-56-3, para. 237. Indeed, Chamber 3 highlighted the speculation and the risk inherent in that very price forecast by referring to the discrepancy which can be observed between that price forecast "and the actual evolution of prices from 1979 to 1987." Ibid, Para. 237. In order to demonstrate this discrepancy, I explained to Mr. Briner that the price he was forecasting for, say, 1989 (i.e. 10 years after the date of the alleged taking) in nominal dollars (i.e. including inflation) stood at $75 per barrel which was more than three times the actual price of less than $20 per barrel currently prevailing in the market. In order to disguise the sheer size of this large discrepancy between their projection and the reality in the outside world, Mr. Briner had, however, decided to adopt a tactic of putting forward his price projection of up to $36.53 exclusive of inflation, as suggested by the Claimant and Mr. Aldrich. See Award, para. 126. Yet, even on the basis of this misleading comparison, the projection suggested in the Award exceeds the actual price currently prevailing in the market by over 60 percent! They, however, insisted upon giving legitimacy to the price forecast in the unrelated Case 55 from which Mr. Briner had withdrawn after suffering a defeat which impinged upon his integrity as an impartial chairman entrusted with the task of upholding justice. It was obvious to me that Mr. Briner was once

again attempting to get in through the back door in order to pave the way for what he had failed to achieve in Case 55 as a result of the successful challenge.

e) In order to complete the scenario that Messrs Briner and Aldrich had put together and in order to dilute the effects of the SEC (10-K) filings, and in a futile attempt to make up for the lack of any reasoning in the Award, Mr. Aldrich hurriedly took up the duty of presenting an analysis in his Concurring Opinion, supposedly

> "to lay to rest any concerns that the Award's conclusions on this issue might have been arbitrarily reached or resulted from only superficial examination of the evidence." Ibid, p. 5.

Having been aware of the arbitrary nature of their Award, Mr. Aldrich issued as an annex to his 5-page Concurring Opinion an analysis of the oil reserves pretending that it was an analysis which had been done by the Tribunal. Indeed, this scenario, which itself rested on another scenario put together by the Claimant in the course of this litigation, was nothing more than a reproduction of a previous paper by Mr. Aldrich himself of which I happen to have a copy. This reproduction is virtually identical in layout, wording and content with the original production of Mr. Aldrich. Only this time, Mr. Aldrich has made some cosmetic changes to his previous output by replacing any reference to his own name with that of the Tribunal simply to give the appearance that the Tribunal had gone through a detailed analysis of the oil reserves. The remaining changes in Mr. Aldrich's reproduction compared to his original text are those relating to the figures of reservoir estimate. Strangely enough, identical arguments and wording had previously led Mr. Aldrich into concluding that over 306 million barrels

of oil were remaining under the ground. This time, however, this figure was replaced by the range of 280 million to 290 million barrels suggested in the Award, as if no changes in arguments or analysis or even wording were required to alter the end result by almost 20 million barrels. Mr. Aldrich could have indeed arrived at any other figure he would have liked without necessarily changing even a word in the substance of his analysis!

f) On account of his wife's illness, Mr. Briner cancelled, on 23 June 1989, the Hearings in Cases Nos. 10502 and 12458, which had been scheduled for Wednesday and Thursday, 28 & 29 June 1989. These Hearings were cancelled despite all the hardships that such cancellations would undoubtedly bring about to the Parties and the members of the Tribunal. Yet, he was unwilling to cancel the signature ceremony in Case 39, and travelled from Geneva to make himself available at the Tribunal in The Hague on the very same day only for the purpose of signing the Award in this Case. He did so despite my repeated demands for putting off that signature ceremony by at least a few days during which time, I suggested, the Chamber could digest and respond to certain fundamental deficiencies I had identified and commented upon with regard to their valuation models and assumptions. After the discovery of the $80 million miscomputation which had been committed even on the basis of the premises adopted by themselves, still Messrs Briner and Aldrich disregarded my demand for spending at least one more day in order to fully digest the far-reaching implications of that colossal mistake in this huge case.

g) In the ambiguous circumstances of the Case, and without deliberating or discussing such important issues as the estimate of oil reserves, the projection of oil prices,

the assessment of production costs, and the applicable discount rate, all of a sudden, Mr. Briner distributed successive drafts of the various sections of the suggested Award in this huge Case over a short span of time, as follows:

- 10 March 1989: A 54-page Draft on the Facts and the Merits of the Case

- 29 March 1989: A 6-page Draft on the Standard of Compensation

- 14 April 1989: A 21-page Draft on the Counterclaims

- 28 April 1989: a 28-page Draft on the Valuation

These drafts were later amended and integrated into one complete Draft which was distributed on 1 June 1989. The Draft mainly followed Mr. Aldrich's views and in many parts even reflected his words verbatim. The Draft was very vague in its reasoning for the findings particularly on the oil estimates, price projections, and the risks involved and had certain unexplained and questionable blank spaces with regard to the quantification of the compensation which was contemplated to be awarded in this Case. The deadline set for finalizing all these drafts was 21 June 1989.

It should be pointed out that in this three-month period alone (i.e. between March and June), I was also involved in hearing, reviewing, deliberating, issuing awards, commenting, or filing opinion on thirteen cases in addition to the twenty five other cases dealt with over the previous year or so during which I have been acting as a member of the Tribunal.

14. It was, therefore, vividly clear to me that these two gentlemen were following a misguided policy for arriving at their decisions, which were certainly not based on the facts of the Case and were devoid of any arbitral ethics and moral principles. They were not bound by any legal framework, or any valuation principle, methodology or calculation. All they had in mind was a hefty sum on which they had reached a secret understanding.

15. In conclusion, I would like to emphasize that I would not reproach a Chairman for forming a majority with either member of the Chamber towards a just finding in favor of either of the parties involved in a case provided such a majority is reached after a due process of deliberation. What I am reproaching Mr. Briner for is the manner and tactics adopted to manipulate the process of deliberation by avoiding to discuss important issues on the merits of the Case and excluding me as a member from certain crucial discussions held with another member. Moreover, Mr. Briner's tactics and attitude in dealing with the miscomputation in his underlying assessments, about which I had been kept in the dark, demonstrated his unwillingness to engage himself into any meaningful deliberation for arriving at a sound decision based on the facts of the Case. It was this attitude on the part of Mr. Briner that I found extremely unfair to the party against which the Award was being made. For this reason, I warned Mr. Briner against hastily signing the Award in this huge Case. Unfortunately, however, my warning was to no avail.[2]

The Hague, 27 Tir 1368/18 July 1989

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[2] As I was finalizing this Supplemental Statement, I received Mr. Briner's Separate Statement as well as his Memorandum in that connection to which I will reply as and when necessary.