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A cautionary tale of settlement negotiations: Azpetrol v. Azerbaijan

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It is always satisfying for an academic when research interests contribute to teaching. So, as I began teaching first year contracts this year, I read the 8 September 2009 award in *Azpetrol International Holdings B.V., Azpetrol Group B.V. and Azpetrol Oil Services Group B.V. v. The Republic of Azerbaijan*, ICSID Case No. ARB/06/15 (*Azpetrol*) with particular interest. The question before the tribunal in *Azpetrol* was whether an exchange of emails between counsel for the parties resulted in a binding settlement agreement. Applying English contract law principles, the tribunal found that there was a binding settlement agreement. As a result, the tribunal held that it lacked jurisdiction under Article 25(1), ICSID Convention, because there was no longer a legal dispute between the parties. The award serves as a cautionary tale for counsel negotiating settlement agreements.

Azpetrol and a companion case, *Fondel Metal Participations B.V. v. The Republic of Azerbaijan* (ICSID Case No. ARB/07/01), involved proceedings against the Republic of Azerbaijan for alleged breaches of the Energy Charter Treaty. At oral hearings on preliminary objections in *Azpetrol*, a director of the Claimant companies testified that he had bribed officials in Azerbaijan. The parties then jointly applied for a general adjournment of the proceedings and, in August 2008, Azerbaijan filed an application to dismiss the proceedings on grounds of international public policy. Settlement negotiations ensued. On 19 December 2008, the Claimants wrote to the tribunal stating that "the parties have agreed an in principle settlement of the arbitration. The parties have therefore agreed an immediate procedural standstill until close of business in London on 31 December 2008 in order to finalise the in principle agreement." (para. 8). On 31 December 2008, the Respondent wrote to the Tribunal stating that the Respondent had waived the requirement for further documentation of the settlement agreement and requested that the Tribunal terminate the proceedings. The Claimants wrote the same day denying that there was a settlement agreement.

The dispute between the parties centered on an exchange of emails in December: a counter-offer to settle by the Respondent (consisting of an email and an appendix of seven numbered paragraphs) and its acceptance by the Claimants. The parties differed on the meaning of the Respondent's counter-offer. The Respondent viewed it as an offer to settle the proceedings by binding agreement, subject to a condition subsequent (the terms were to be formalized in an agreement by 31 December) that could be waived by Azerbaijan. The Claimants characterized it as an offer to a standstill in the proceedings until 31 December during which time a settlement agreement would be concluded.

Claimants' and Respondent's counsel were both located in London and agreed that English law was the applicable law with respect to whether a settlement agreement was concluded, and, if so, what it meant. The issue before the tribunal was a classic case of contract formation and interpretation. The Claimants argued that: (1) there was no intention to create legal relations beyond the conclusion of a standstill agreement; (2) there was no meeting of minds on anything other than a standstill agreement; (3) the offer and acceptance were incomplete since they did not include terms which the parties regarded as essential to the conclusion of a settlement agreement; and (4) both the record of negotiations and the subsequent conduct of the parties showed that the exchange of emails on 16 and 19 December was not intended to amount to a binding agreement to settle (para. 69).

The tribunal rejected each of the Claimants' arguments and characterized the Respondent's email as an offer to settle the proceedings by binding agreement. With respect to the intention to create legal relations, the Claimants accepted that there was a standstill agreement. As a result, in the view of the tribunal, the issue was not whether there was an intention to create legal relations but about how far that intention went. With respect to the meeting of minds, the tribunal applied the objective test of whether a reasonable observer would conclude that the parties had agreed upon something and found that they had. The tribunal rejected the argument that the agreement was incomplete because it lacked indispensable terms. It found that provisions on governing law or dispute resolution were not indispensable. Finally, the tribunal found that, unlike under international treaty law where prior negotiations or subsequent practice is admissible in interpreting a treaty, under English law recourse to the negotiations and the subsequent conduct of the parties is not admissible as an aid to the interpretation of a contract.

The *Azpetrol* case is instructive in how careful counsel must be in making and accepting settlement offers. Although applicable law was not an issue in the *Azpetrol* case because counsel were both located in London, settlement offers in international arbitration often occur between counsel in different jurisdictions. Counsel need to ensure it is clear which law applies to any settlement offers. Second, the award demonstrates the ambiguity of the term "agreement in principle". It is perhaps better avoided. Third, the award demonstrates the importance of clarity in any conditions. In particular, counsel are well advised to ensure that they clarify, as did Respondent's counsel, whether a condition subsequent is for the benefit (and waivable) by one of the parties. The last place that counsel want to be is in the witness box giving evidence on their settlement negotiations.

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