THE LEGALITY, UNDER INTERNATIONAL LAW,

OF THE DEVELOPMENT OF UNITED KINGDOM

OIL LAW

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SUMMARY

The 'traditional' law of concessions is regarded as that set out in the case of Aramco v. Saudi Arabia.[1] This has much in common with many Western states' domestic laws of contract and may be summed up by the doctrine of sanctity of contract or 'pacta sunt servanda' as the principle is known in International Law. The ratio of the Aramco case is that even a sovereign state is not entitled to repudiate or unilaterally alter contracts into which it enters in good faith with foreign nationals, except under recognised exceptions such as nationalisation - and then only on certain conditions; further, that such contracts and alleged breaches thereof, may be subject to the scrutiny of the judicial organs applying International Law.

There are those who contend that this principle has been altered since Aramco by subsequent events, such as the OPEC revolution, various United Nations General Assembly resolutions, and cases where compromises have been reached, some or all of which are claimed to have brought about changes in the customary international law to the effect that states may exercise their sovereign rights to gain a greater share of the benefits

of the exploitation of their natural resources at the expense of the foreign investors developing those resources.

Undoubtedly many of the early concessions (such as the one in issue in the Aramco case) resulted in a disproportionate share of the financial rewards of natural resource production being won by the foreign companies rather than the producing states. This was often due to the collective political power of the multinational oil companies.[2]

There was therefore a strong moral argument that some compromise be reached and a fairer deal be given to the states involved. Perhaps unfortunately however, law is not necessarily dictated by morality. Moreover the law deals in principles and will inevitably lead to inequitable results in some individual cases, but this does not necessarily mean that the law changes, or even that it should change, at least until the merit of certainty in the law is outweighed by the number or the seriousness of the individual cases of injustice which it causes. It will be shown that the law did not change during the period since Aramco and indeed has been affirmed by recent cases.

The U.K. position is then to be examined in the light of the present international law which, it is argued, is still substantially as laid down in the Aramco case. Thus critically studied, it is intended to show that the developments in U.K. legislation in 1975 directed at the oil industry were illegal inasmuch as they constituted unilateral amendments to contracts with foreign nationals (i.e. the licences conferring rights upon many non-U.K. oil companies). It is no objection to this conclusion, and no justification of the Government's actions that the legality of the legislation was not judicially challenged by those affected since the companies affected took the view that their best interests lay in accepting the inevitable and negotiating the least damaging compromise which could be achieved in the circumstances.

It is suggested that, even if moral arguments justified derogations in some of the earlier instances of the exploitation of poor, undeveloped states by sophisticated multinational corporations, this could hardly be applied to the situation of the United Kingdom in the 1970s, particularly considering its substantial stake in British Petroleum, one of the "Seven Sisters", and an oil company with as much experience as any other in exploration and production abroad.

Notes

1. (1963) 27 I.L.R. 117.

2. See generally Anthony Sampson, The Seven Sisters.

CHAPTER 1.

CONFLICTING ATTITUDES

ATTITUDES OF STATES TO FOREIGN INVESTMENT

Foreign investment began as a natural progression from trading between states when, in certain cases, it was more efficient to produce goods elsewhere than at the producer organisation's base when this required subsequent shipment of the goods. It could take either the form of an organisation establishing itself where the raw materials were available and then shipping the goods to where they were required, or setting up a base where the market existed, which would entail no subsequent movement of goods.

The former was the position as regards the 'colonisation' of parts of the world by certain states which went prospecting for sources of such commodities as sugar, rubber, tobacco, gold or other minerals. The latter tended to follow on from this, as the world began to consume more of everything, thus creating new markets; then organisations realised the potential benefits of having a base near these new markets, rather than simply exporting their goods to them.

The practice of following markets tends not to be so controversial as the practice of following supplies since the organisation's foreign branch can become almost part of the host state - working in it to supply its population. Friction is much more likely to occur when that branch is operating in one state to supply the needs of another. For centuries there have been disputes between 'colonies' and the colonising states exploiting their resources, for example, between 1503 and 1660 the Spanish shipped some 16.8 million kilos of silver and 181,000 kilos of gold from the area of South America occupied by the Incas and the Aztecs.[1] Whilst one may argue that this was theft, it was seen then as exploitation of a colony. On this subject Norman Girvan says,[2]

> "Once established, the consolidation and spread of the Industrial Revolution were enormously facilitated by the cheap food and raw materials secured from the colonies and quasi-colonies".

This practice was widespread while 'colonies' in the old sense existed, most notably perhaps in Africa where exploitation went as far as slave trading, the ultimate exploitation of a state's resources, and at its height quite legal.

This process becomes relevant to the present paper at the stage when the state being colonised or 'invested in' takes a more prominent role than that of a mere colony: when it takes a hand in its own economy by regulating the economic activities of aliens within its territory. The stage at which this occurred in different countries is a question of history, but the action calls for a degree of autonomy, which is a requirement of statehood, not present in a mere colony. Article 1. of the Montevideo Convention of 1933 enumerates the following attributes:

> "The State as a person of international law should possess the following qualifications:
>
> (a) a permanent population
>
> (b) a defined territory
>
> (c) a Government (to which the population renders habitual obedience)
>
> (d) a capacity to enter into relations with other states".

Certainly once a State with a Government comes into being, the question of how it will react to foreign investment must arise - it must formulate some kind of policy. One cannot generalise about states' attitudes to foreign investment beyond a certain degree, as an illustration of which a few examples may be examined.

At one extreme we can see a denial of the principle of free private investment and trade, which does not attempt to solve the problem of the state-investor relationship but denies that any such relationship should exist.

On December 15th, 1917 the Supreme Council of National Economy (known as Vesenkha) was set up in Russia with power to "confiscate, requisition or sequester".[3] Initially nationalisation was "punitive", meaning that the motive was to defeat or punish the resistance or sabotage of the capitalists; it was not done through a central authority, but by workers on the spot. The first nationalisation of a whole industry in Russia was by decree of May 1918 which affected the sugar industry, followed in April by nationalisation of the oil industry.

In 1917 Lenin spoke of "declaring all limited companies to be state property".[4] In 1919, 80% - 90% of large scale industry in Russia had been nationalised. By decree of 22nd April, 1918 all foreign trade was nationalised and all commercial transactions with foreign states or trading concerns abroad were to be conducted exclusively "in the name of the Russian republic by organisations specially authorised for the purpose". At this time there was to be no compensation paid to those who had lost through the nationalisations. Thus we see a complete denial of the role of the private investor, abroad or domestically. The only level recognised was the diplomatic one.

The Russian economy collapsed after the Revolution, so the Government became desperate for credit, and their position became that they were prepared to compensate former owners of nationalised property in return for long-term credits. It was also hoped that the fulfilment of private owners' claims would encourage the re-establishment of the major concessions thereby attracting capital and skill to selected branches of industry. This was the Russian standpoint at the Anglo-Soviet Conference in 1924: any kind of compensation was "merely expediency" in the words of Lenin himself, saying further that the right of foreign creditors to compensation would be recognised only in return for fresh foreign credits.

Even the Russian Revolutionaries then, were forced to recognise the need, and pay the price, of foreign investment in practice, although ideologically they virtually denied its existence. The events of the Russian Revolution may be seen as the most extreme means to attempt to control not only foreign capital, but a whole economy.

The Russian case is interesting and important in its own right, but will not be discussed here since its political ideology puts it outwith the scope of the international legal rules concerning foreign investment which Soviet legal theory tends to ignore rather than discuss.[5]

It is not possible to give a general statement of the way in which states regard investment from abroad due to the wide range of approaches to it; however, an example may be taken from the Guidelines laid down in July 1968 by the Organisation of Petroleum Exporting Countries' Conference which perhaps demonstrates the typical attitude of states, although the means which different states adopt may differ greatly, in the regulation of investment:

> "taking into account the fact that foreign capital, whether public or private, forthcoming at the request of the Member Countries can play an important role inasmuch as it supplements the

efforts undertaken by them in the exploitation of their hydrocarbon resources, provided that there is government supervision of the activity of foreign capital to ensure that it is used in the interest of national development and that returns earned by it do not exceed reasonable levels ...."[6]

From this general policy statement one can detect an apparently reluctant recognition on the states' part of the need for foreign capital in large ventures, together with an endeavour to utilise it in a manner which the states can themselves control. On the question of initial entry, the question is how much a state has to offer as an inducement to entice foreign investment into it. Within the seeming acceptance of foreign investment as a necessary evil, an individual state's willingness or otherwise to accept it tends to be dictated by local politics which are not, as such, relevant to the legal issues until they are manifested in the form of legal controls.

One fairly clear tendency is for less advanced states to impose financially non-quantifiable conditions on investment. This is partly because many states simply do not have the facilities or the expertise to deal with such large financial structures as the multinationals possess, as was pointed out by Smith and Wells in their article "Mineral Agreements in Developing Countries"[7]:

> "The multinational enterprise brings with it a bundle of problems that are usually inadequately covered by the legal system of the developing country. For example, company pricing among affiliated entities in different countries creates difficulties for tax and exchange control authorities. The income tax laws and exchange control regulations in many developing countries ...... simply do not contain the principles and regulations to handle transactions among affiliated companies."

Another reason for this tendency is that these countries often want those representatives of the advanced world to give material aid to their social development by, for example, building roads, railways and schools and educating and training their youth, rather than just supplying the revenue, by way of taxation, for the state to do so itself. This is a way for a developing state to acquire modern technology and know-how from its investors, which may be much more valuable than pure cash aid. However, as the host state advances it will place more and more emphasis on fiscal measures as instanced by the United Kingdom's highly complex system of taxation in relation to the North Sea investment. The U.K. Government may be much concerned with such social ailments as unemployment and lack of investment, but it wants to solve them itself, using revenues from the oil - external sources of money are welcomed by the U.K. but not so external advice. Witness the willingness to accept the International Monetary Fund's loans and the reluctance to accept its economic theories.[8]

THE ATTITUDE OF THE CORPORATIONS

This paper is concerned with investment of capital by corporations outwith the state which has predominant legal control over that enterprise. The legal effect of this is that the company will have access to remedies of international law which are not available under a purely domestic relationship. For example, had Aramco[9] been a Saudi Arabian company with a contract under Saudi Arabian law with the Saudi Arabian Government, no question of recourse to international law could have arisen. The company must, in general, persuade an appropriate government[10] to pursue a claim on its behalf, thus in theory raising the debate to an inter-state level.

The major effects of this 'international' relationship are arguably non-legal ones: namely, the economic importance of capital and skill entering a state's economy, and the political significance of one state's assets being invested in another. Both of these points can work for and against each party. Economically the company may fare badly because of unduly heavy taxation or even expropriation by the host state, or the state may suffer through being tied to a badly drafted concession enduring for decades. Politically the corporation may gain great bargaining power through the economic and social importance which a large investor may acquire, through the amount which it pays to the Treasury in taxation or through the amount of local people it employs. Conversely, it is vulnerable to the effects of an unstable local political system which may turn extremely nationalistic and try to eradicate foreign influences, perhaps by nationalisation without compensation which may be illegal, but that fact will not be of much consolation to a company which is losing a great deal of money.

The ways in which these aspects of the relationship operate tend to depend mostly upon the relative strengths of the corporation and the host state which vary from one extreme to the other. One may consider, at one end of the scale, the frailty of the position of a small private investor, caught up in the force of the Russian Revolution, virtually powerless to protect his investment, or to have much chance of redress against a new revolutionary Communist Government.

To illustrate the opposite situation, i.e. the potential dominance of the company, a few economic figures may be put forward. In 1967 the four largest companies were as follows:

Company	Headquarters	Sales ($m)	Assets
General Motors	Detroit	20,026	13,273
Standard Oil	New York	13,266	15,197
Ford Motor	Detroit	10,516	7,967
Royal Dutch/Shell	s/Gravenhage	7,377	6,512

Against this, one might contrast three small states: Senegal in 1966 had a Gross National Product (G.N.P.) of $770m; the Ivory Coast had a G.N.P. of $880m, and Tonga had an area of 270 square miles, a population of 77,429, total exports of $2.6m and imports of $4.3m.[11]

Not only are these corporations huge financial undertakings, but in difficult situations they might well expect the backing of such a mighty political organisation as the United States Government. This would present a formidable adversary to such small states as the above.

Thus it can be seen that statehood need not guarantee economic sovereignty against such odds. A small state would be in an unenviable bargaining position if it desires, for example, to increase substantially the taxation on a multinational company against the company's ultimate sanction of cutting its losses and withdrawing an investment which could previously have been the country's largest source of income.

This potential for exploitation by both state and investor is conducive to creating heated arguments, with debaters coming to the defence of one side or the other and putting forward examples of unjust expropriations on the one hand or capitalist exploitation by the multinationals on the other, depending largely on their political inclinations, a tendency which should be avoided when studying the legal aspects of investment.

As mentioned above, the first reason for foreign investment was to exploit resources which happened to be available abroad, which naturally entailed companies from the more developed states expanding to where there were resources untapped by local concerns, the local authorities being largely content to benefit, through royalties, from someone else doing the work.[12] This paper is, however, not a historical study of foreign investment, but an examination of multinational investment which relates not only to utilising the principle of comparative advantage but to supplying foreign markets (which one may also have created). In this sense the principle of comparative advantage is taken to mean a 'natural' advantage - an inherent advantage in producing in one place rather than another, as opposed to the sole advantage being the situation of the market. Thus there is a natural comparative advantage in producing Whisky in Scotland as opposed to the South of England, since Scotland has abundant supplies of exceptionally pure water. To produce it in England would involve transporting vast amounts of water over a large distance to create a small amount of good distilled whisky, hence there is a clear advantage in producing where the raw material is situated and merely transporting the refined product, the bulk of which is relatively small, despite the fact that the largest market for whisky may be in the South of England.

This is quite distinct from the situation where a company, such as Ford, wants to expand to a foreign country, such as the United Kingdom, because there is a market there for the product. There can be little, if any, advantage to Ford to produce motor cars in the United Kingdom which periodically suffers particularly bad industrial relations, and very high rates of taxation for corporations, except that it brings the manufacturer into the heart of the market. (It is, of course, recognised that there are many other factors involved in an investment decision, other than the existence of a market - one hardly believes, for example, that the size of the market in the Channel Islands is the reason for so many companies being registered there).

The significance of the attraction of the market, as opposed to the basic principle of comparative advantage as defined above, is that it has helped create multinational investment throughout the world, over and above companies merely having investments in foreign resources. As markets have been created world-wide, so companies have become multinational in expanding into these markets rather than merely exporting to them. As a result, investment between and among states, especially developed Western states, is now extensive, and foreign investment by advanced states in underdeveloped nations is no longer the predominantly important type of investment by companies outwith their own national state. Foreign investment in the U.K.'s area of the North Sea (£1,000m. capital inflow in 1978[13]) provides a good example of the amount of capital which may be invested by multinational companies in a major expansion area of an advanced Western state's economy including the capital of some of the world's largest corporations, such as Exxon, Gulf, Mobil, Texaco, Conoco, Phillips and Chevron.

Thus multinational investment has been created as much by the existence of markets as by the existence of resources. Whatever the reasons for particular investment decisions, the overriding aim of a company in expanding abroad will be to increase profits - a public company will not go out of its way to lose money deliberately.

As in the case of the host state, one cannot generalise about companies' attitudes to foreign states, since they vary enormously, depending on such factors as the size of the corporation, the product manufactured, the amount of the investment, the return on the capital, diplomatic relations between the investor's state and the host state, even the Chairman's character; the factors not only change, but are quite unpredictable. Hence it may be suggested that the degree of altruism of the investor may vary, but the profit motive is the fundamental element in all investment.

This interface between state and multinational investor may become particularly apparent at three stages.

Firstly, when the initial investment is to be made. This is becoming a more and more complex area; one only has to look at Investment Codes such as the Chilean Code[14], the Andean Code[15] or the Canadian Foreign Investment Review Act[16] to realise how many factors an investor has to consider before going abroad, as compared to the attitude of the British investors in the height of the British Empire, heedless of the totally inadequate legal systems of the colonies.

The Aramco Case[17] (discussed below) shows how straightforward were the provisions of concession agreements until relatively recently, indeed the consequences of this broad grant of extensive rights to a foreign investor, fully elucidated by the arbitration, were indicative of the changes which were inevitably to follow if multinational enterprises were not to take over economic control of small states.

Secondly, during the company's operations, when most state-investor conflicts will be financial, as the operation of the initial agreement tends to work to the benefit of one party to the alleged detriment of the other. This may be caused by many factors: an unexpectedly high or low quality of natural resource, an unexpectedly large or small amount of it, rising prices or costs, a rise or fall in world demand, etc. It is all these possibilities which the initial agreement should seek to cover by specific provisions.

Many problems at the second stage may be avoided at the time of the initial entry by a well constructed and comprehensive agreement allowing for periodic review and renegotiation within defined limits, according to changing circumstances. The lessons of Aramco seem to have been learned, since such broad-termed concessions are not generally in use now.

The final stage where conflict is likely to occur is when the ongoing relationship ceases, or threatens to do so - when "the Crunch" is reached. This may take the form of threats of, or actual expropriation by the state, or threats of, or actual withdrawal by the investor.

At this stage, there is no legal restraint on the company pulling out, or on the state nationalising the company's assets, given that certain specific conditions are met. The question then becomes: who has most to lose from the rupture of the relationship? The answer to this is really a question of politics rather than law. The termination of the relationship is in any case outwith the scope of this paper since the international contractual relationship of investor and host state has terminated and there is no longer any foreign investment to control or regulate.

Notes.

1. O. Sunket and P. Paz, El Subdesarrollo Latinamericano y la Teoria del Desarrolla, page 290 (1970).

2. In Lillich, The Valuation of Nationalized Property in International Law, Vol. III, Chap. VI, p.153.

3. E. H. Carr, The Bolshevik Revolution 1917-1923, Vol. II, p.87.

4. A Nove, An Economic History of the U.S.S.R., p.54.

5. See generally Tunkin, Theory of International Law.

6. I.L.M., 1968, p.1183.

7. A.J.I.L., 1975, Vol. 69, p.564.

8. See for example The Times, Oct. 6, 1976, p.19 and generally thereafter on the negotiations with the I.M.F.

9. See Aramco v. Saudi Arabia (1963), I.L.R. Vol. 27, p.117.

10. For a discussion of the appropriate government see Barcelona Traction Co. case 1970, I.C.J. Rep., pp.35-51.

11. Oxford Economic Atlas of the World, 4th Edition.

12. Even the United Kingdom's system of regulating investment in the North Sea by means of licensing and royalties was relatively crude prior to the creation in 1975 of an appropriate and effective means of taxation on oil and gas extracted by the companies involved. See Dam, The Pricing of North Sea Gas in Britain, (1970) 13 Journal of Law and Economics, p.11 at p.17.

13. "North Sea Energy Wealth" by Christopher Johnson, Financial Times, 1979.

14. I.L.M., 1974, p.1176.

15. I.L.M., 1972, p.126 amended I.L.M., 1977, p.138; see also the Andean Code on Multinational Enterprises I.L.M., 1972, p.157.

16. I.L.M., 1973, p.1136.

17. I.L.R., 1963, Vol. 27, p.117.

CHAPTER II

THE LAW OF THE CONCESSION

The law of concessions - contracts between states and foreign investors, usually for the exploitation of natural resources - is the most relevant area of international economic law for the oil industry since the major oil companies have for a long time found it necessary to extract oil from territory outwith their national state, and have had to obtain concessions from foreign governments to do so. These concessions constitute the legal basis upon which most of the world's oil production depends.

Normally the law of a state contract is the municipal law of the contracting state. In this case the state may disappoint the investor's expectations in two ways: firstly, by a breach of the contract which is a breach under the local law, in which case the investor's remedy lies in the domestic courts (should this remedy prove ineffective there may be a delictual action under international law, but that is a separate question from the contractual position under review). Secondly, the more problematic method of changing the local law, in which case there is no breach according to the proper law of the contract and of which Dr. F. A. Mann said:

> "In this type of case where there is no room for the problem at all under customary public international law, no breach of contract in fact occurs and, consequently, the principle of pacta sunt servanda is not infringed ..... Contracts are governed by the law determined by the private international law of the forum. That law 'not merely sustains but, because it sustains, may also modify or dissolve the contractual bond.' These words of Lord Radcliffe express a principle of universal application. It is nowhere doubted, and has frequently been affirmed ..... that a contract is subject to its proper law as it exists from time to time."[1]

In this article Dr. Mann argues that there cannot be a remedy for an alleged breach of such a contract, since there is no breach; the only possible remedy being founded on a distinct international delict, such as a denial of justice of such a delict should incidentally have occurred.

This argument, as Professor Jennings points out in his article "State Contracts in International Law"[2] rests on an interpretation of international law which presupposes the primacy of national law, over international law, which today is generally regarded as untenable.[3] As practical examples, one might look at the Nationality Decrees Case[4] as contrasted with the later Nottebohm Case[5] in which Liechtenstein's domestic law on nationality was put under scrutiny of international law, and the latter was applied by the court. This example shows how international law is extending its scope not only horizontally, covering new territory, but also vertically downwards into the realms of what used to be regarded as matters within the 'exclusive jurisdiction' of states. This growth in the sphere of international law at the expense of exclusive domestic jurisdiction (perhaps most notably in the field of human rights law[6]) diminishes the strength of the arguments, such as Mann's, for the primacy of domestic systems of law. If international law was subservient to the local laws of each state at any given time, there could be no such thing as international law; at best it would be a voluntary code of conduct between states whose recognition of it could change from day to day.

The real question then is only whether or not international law actually applies to any particular situation or dispute. An international court or tribunal must first decide whether or not international law governs the case in question. If it does not, then it is because international law dictates this, and not because the state can exclude the application of international law by its own legislation. Thus Dr. Mann's view cannot be permitted to deny a remedy to a foreign investor whose expectations have been disappointed by the local legislation of a state in contravention of a concession agreement - the local laws are not the end of the matter if, but only if, the dispute also falls within the ambit of international law.

The foreign investor will have a remedy if he has acquired a right which international law recognises and which no change of domestic law can legally terminate. The existence of the doctrine of "acquired" or "vested" rights, Professor Jennings says,[7] "is now hardly open to question", citing several cases in footnotes as authority.

The authority for this contention to be examined here is the Aramco Case,[8] partly because it concerned the oil industry which is looked at in more detail later in this paper, and partly because it is generally thought of as epitomising the classical view of the traditional type of concession agreement, and thus constitutes a foundation for a study which, of necessity, involves tracing developments in a changing area of law.

The facts of the Aramco case were uncontested. A concession agreement was signed between Saudi Arabia and the Arabian American Oil Company (Aramco) on 29th May, 1933 and thereafter ratified by both parties. Article 1 of this concession read:

> " The Government hereby grants to the Company on the terms and conditions hereinafter mentioned, and with respect to the area defined below the exclusive right, for a period of sixty years from the effective date hereof, to explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export, petroleum, asphalt, naptha, natural greases, ozokerite and other hydrocarbons, and the derivations of all such products. It is understood, however, that such right does not include the exclusive right to sell crude or refined products within the area below described or within Saudi Arabia."

At this time nobody knew whether or not there was oil in Saudi Arabia, and whether or not any oil would be in commercial quantities. Not until 1938 was oil discovered in commercial quantities but very large resources were then found and production reached 352,239,912 barrels in 1955.

In 1950 the Saudi Arabian Government had persuaded Aramco to submit to an income tax which, together with other payments made by Aramco, secured to the government fifty per cent of the Company's net operating income. Since local sales never exceeded 400,000 barrels a year (in total less than one per cent of production), the oil revenues relied upon exports which were largely achieved through Aramco's international organisation. In most cases the purchaser of the oil sent ships to collect the oil from Saudi Arabian ports. For twenty years the government and Aramco cooperated to their mutual advantage.

On 20th January 1954 the Saudi Arabian Government concluded an agreement with Aristotle Onassis, the relevant articles of which (IV and XV) gave the Saudi Arabian Maritime Tankers Company Ltd. ("Satco"), a company to be set up in Saudi Arabia by Mr. Onassis, a right of priority for the transport of oil for a period of thirty years from the date of signing.[9]

The parties' arguments, briefly, were: The Government argued that the 1933 concession gave Aramco no exclusive right to transport petroleum by sea, since this was not specifically stated in the agreement and an agreement could not by implication alone, limit a sovereign state.

Aramco is in the same position as any other inhabitant of Saudi Arabia in that it must comply with any restriction adopted by the government in connection with its oil legislation. The company has no ownership in these products which would immunise it, or its buyers, from governmental action.

The government remains sovereign and thus retains its competence to control all activities occurring within its domain. Therefore the government maintained that it could lawfully compel Aramco to ship its oil on Satco tankers.

The government emphasised that these contentions did not conflict with the meaning of the 1933 concessions in any case.

Aramco argued that its Concession Agreement gave it an exclusive, absolute and unrestricted right to export and transport overseas any oil found in the exclusive Concession Area of Saudi Arabia, and that this was the very purpose of the concession - for Aramco to conduct the entire operation for a legitimate profit. Further, this procedure had continued for 17 years with the government's approval.

Aramco concluded that the government was not entitled to limit, by a unilateral decision, the company's rights by granting another concession. Any attempt to compel Aramco to sell its oil on condition that the oil be transported on tankships flying the Saudi Arabian flag was in breach of the concession and incompatible with the obligations assumed by the government in exercise of its sovereignty.[10]

Thus the state argued that the two Agreements did not conflict, and that in any case the foreign company was bound by Saudi Arabian law - that the State retained full sovereignty within its own territory.

The company argued that it had a vested right under the terms of the Agreement, which was granted in exercise of the government's sovereignty, and could not be altered without the company's consent.

Much of the argument concerned whether or not the Onassis Agreement conflicted with the 1933 Concession, which is a matter of interpretation of the particular agreements in question. It was held that the transport provisions were in conflict and that the earlier agreement must prevail over those of the later.

This would seem the only logical conclusion from the language of the two agreements, and the lesson learned from this was that agreements must contain more flexible provisions than the traditional grant of exclusive powers over vast areas of land. Having decided that the two agreements in fact conflicted, the question became one of principle: had a sovereign state the power unilaterally to change the terms or the effect of an agreement it had entered into with a foreign company?

If the company were domestic, the matter would fall under municipal law and be decided domestically by the state's normal judicial process. If the agreement were between states, it would be a matter of International Law and outwith the domestic jurisdiction of either, or indeed any other state. So the tribunal looked into the sources of law to apply to the relationship between a state and a private foreign investor.

The crucial question was the nature of the Aramco Concession. If this was contractual then neither party could unilaterally resile; if, on the other hand, it was seen as merely unilateral regulation of its affairs by a sovereign state, then the state could alter that regulation at will, without breaching a contract, since none existed.

To decide this question, the Tribunal looked at Swiss and German law, in which it said a mining concession was "a unilateral act of the state, even when it results from an exchange of wills between the state and the individual..... This instrument has the character of a kind of constitution and must be strictly observed by the parties."[11] Thus the concession was regarded in Swiss and German law as a unilateral act of the state, but nevertheless it bound both parties and further, the Tribunal went on, it was enforceable against third parties thus creating even wider rights and obligations than a contractual relationship.

Looking to French law, the Tribunal said "In conclusion, it may be said that a mining concession in French law is an act _sui generis_ which cannot be completely assigned to any other category. It is an act which partakes of the nature of a unilateral act in that it depends on the authorisation of the state, and of that of a contract in that it requires an agreement of the respective wills of the state and of the concessionaire."[12]

The Tribunal also concluded that Moslem law would render the Aramco Concession contractual; this resulted from two basic principles: first, that 'men shall be permitted to make all the transactions they need, unless these transactions are forbidden by the Book or by the Sunna' and second, 'Be faithful to your pledge to God, when you enter into a pact.'

The Tribunal concluded from all this that the Aramco concession was of a contractual nature. The implication of this was that it could not be altered unilaterally by either party against the will of the other, so Saudi Arabia could not succeed in its argument that 'in the exercise of its territorial sovereignty, the Government retained its competence to control all activities occurring in its domain'[13].

When the Tribunal comes to consider the law applicable to this contractual concession, its reasoning becomes very difficult to follow. On p.167 it says "The Tribunal decides to follow the solutions prevailing in British and Swiss practice ..... this is the law of the country with which the contract has the closest natural and effective connection, unless another law is designated by the conclusive conduct of the parties". If any national law, as opposed to international law, could be said to be connected with this concession, it could only be Saudi Arabia's, since the law of the company - American - is far more remote, and could in any case not be imposed upon another sovereign state.

The Tribunal then says "Guided by this criterion, the Arbitral Tribunal comes to the conclusion that some of the effects of the concession agreement cannot be governed by the law of Saudi Arabia, both because of objective considerations and because of the subsequent conduct of the parties."

Then it says[14] "The Concession Agreement is thus the fundamental law of the Parties and the Arbitral Tribunal is bound to recognise its particular importance owing to the fact that it fills a gap in the legal system of Saudi Arabia with regard to the oil industry." This means that the law governing the parties' relationship is the Concession Agreement itself. This is true of the Concession as it is true of every enforceable contract between two parties, but a contract is only enforceable if it is referrable to a system of law which states that this is so and determines how it is to be interpreted and applied.

Since the Tribunal has rejected Saudi Arabian law in this respect, it must mean that the Concession is subject to International Law, at least where Saudi Arabian law is silent. This is supported by the statement of the Tribunal that "Nothing can prevent a state in the exercise of its sovereignty from binding itself irrevocably by the provisions of a concession."[15] This is clearly derived from the two principles of International Law: that entering into international obligations is an exercise of sovereignty (Wimbledon Case[16]) and pacta sunt servanda.

The Tribunal then concludes, "Because of the fundamental similarity [between Saudi Arabian law and the laws of Western Countries] the Tribunal will be led, in the case of gaps in the law of Saudi Arabia, of which the Concession Agreement is a part, to ascertain the applicable principles by resorting to the world-wide custom and practice in the oil business and industry; failing such custom and practice, the Tribunal will be influenced by the solutions recognised by world case - law and doctrine and by pure jurisprudence."[17] It is submitted that International Law can apply to some parts of a concession, while domestic law applies to others, but one system cannot apply to part simply because the other did not appear to provide a solution. Either one system or the other must apply to each section, and within that system a solution must be found; failing an answer, the party upon which the burden of proof falls loses the point; but one cannot simply turn to a different legal system because the one which properly applies provides no positive answer.

"Lastly, the Tribunal holds that public international law should be applied to the effects of the Concession, when objective reasons lead it to conclude that certain matters cannot be governed by any rule of the municipal law of any state, as is the case in all matters relating to transport by sea, to the sovereignty of the state on its territorial waters and to the responsibility of states for the violation of its international obligations."[18]

At last the Tribunal decides to apply one system of law to certain areas of the agreement. The areas referred to cover virtually the whole area of dispute and so the Tribunal seems here to be saying, rightly, that it will apply public international law to the problem.

This is borne out by the rest of the judgement which relies for its authority mainly on cases in international law, such as the five PCIJ and ICJ cases quoted in the judgement[19] to interpret the Aramco agreement which, if anything, was a candidate for the application of Saudi Arabian law.

So, despite the initial confusion as to which legal system to apply, the Tribunal in fact adopts public international law as it sees it.

On the interpretation of the Aramco Concession, the Tribunal concludes, "Considering all the facts, the Arbitration Tribunal is bound to conclude that the Parties, by their conduct in the application of the contract, have recognised that the Agreement granted Aramco the exclusive right to transport its oil across the territorial and maritime frontiers of Saudi Arabia" and further,[20] "In its capacity as concessionaire, Aramco enjoys vested exclusive rights which have the character of acquired or "vested" rights and which cannot be taken away from it by the Government by means of a contract concluded with a second concessionaire, even if that contract were equal to its own contract from a legal point of view. The principle of respect for acquired rights is one of the fundamental principles both of public international law and of the municipal law of most civilised states..... It (The Tribunal) holds that Aramco is justified in resisting any infringement of the rights granted to it."[21]

This final sentence is the ratio of the case, and its lasting importance. A concessionary agreement gives the investor vested rights according to the (public international) legal interpretation of the terms of that concession. The Tribunal did, however, not hold this out as an absolute right. An Arbitral Tribunal's powers only extend to answering the specific questions which it is asked, and even in doing this the Tribunal avoided making any wider statement of principle, saying:

> "The Onassis Agreement of 20th January 1954, corresponding to 15 Jamad al Awal 1373, is neither a law of the state of Saudi Arabia nor a government regulation. It is a contract concluded by the Government with a third person and it cannot have any effect as regards Aramco or its offtakers and buyers."[22]

This may be seen as a restriction to the statement that 'Aramco is justified in resisting any infringement of the rights granted to it.' (Supra)

Strictly speaking then, the Aramco case means that a sovereign state cannot unilaterally affect the rights of a concessionaire by concluding another contract.

The Aramco Concession was an example of the traditional concession which typically granted extensive rights over vast areas for long periods of time, payment being made to the government of the host state by means of royalties. This was acceptable at the time of the Aramco Concession since many states were then content to give an investor sufficient freedom to carry out its operations as it wished, in return for a secure revenue which was easy to administer.

What the Aramco arbitration emphasised was that such a wide grant for such a long period inhibited the state unnecessarily to its detriment, financially, since royalties alone did not guarantee a fair return, and politically since states could gain more than merely currency from large-scale investment. The Aramco decision reinforced those defects by saying that the parties were bound to adhere to the letter of their agreement, and in particular that the state could not evade its obligations by an act of sovereignty.

Notes.

1. A.J.I.L. 1960 (Vol. 54), p.572 at p.580.

2. B.Y.I.L. 1961, p. 156.

3. For a discussion of the two Monistic theories of law see H. Kelsen, The Pure Theory of Law, pp. 332-347 and H.L.A. Hart, Kelsen's Doctrine of the Unity of Law, in Ethics and Social Justice.

4. (1923) P.C.I.J. Series B, No. 4, 1 W.C.R. 145.

5. I.C.J. Rep. 1955, p.4.

6. See generally, I. Brownlie, Basic Documents on Human Rights.

7. B.Y.I.L. 1961, p.156 at p.173.

8. (1963) I.L.R., Vol.27, p.117.

9. ibid. pp. 118-130.

10. ibid. pp. 140-144.

11. ibid. p.159.

12. ibid. p.161.

13. ibid. p.140.

14. ibid. p.168.

15. ibid. p.168.

16. (1923) Series A, No.1, 1 W.C.R. 163.

17. Aramco Case op. cit. p.171.

18. ibid. p.172.

19. ibid. p.198.

20. ibid. p.202.

21. ibid. pp. 205-206.

22. ibid. p.228.

CHAPTER III.

POST-ARAMCO DEVELOPMENTS

"The provisions and concession agreements vary widely among countries and industries, often reflecting the relative bargaining positions of the government and the investor."[1] Differing bargaining power is a fact of life, domestic and international, and must be accepted as such since it would make a nonsense of contracts, and therefore the certainty required for modern life, if every agreement made by parties of different standing could be set aside on that basis.[2] Extremes of such bargaining positions may be seen by contrasting the relative naïvety of Saudi Arabia three decades ago, with the experience of the group of western corporations comprising Aramco, as evidenced by the broad grant of powers in the Aramco Concession which no modern oil-producing state would now contemplate grating to an oil company since there is no longer such an imbalance of relative strengths.

Katz and Brewster[3] cite four main considerations which might curb a government's desire to win a better bargain when it has decided that its initial concessions were unduly generous: (1) fear that it would be so costly as to cripple the concessionaire's ability to compete in his export markets (and thus to earn taxes and foreign exchange for the government); (2) fear that the concessionaire would shift the scene of its new investments; (3) fear that, if the concessionaire limited or abandoned its activities, the government would have difficulty operating or finding other parties to operate the enterprise or exploiting the foreign markets developed by the concessionaire; and (4) fear of repercussions of the bargaining on relations with other potential investors or with the investors' home governments. The outdating of these considerations, written in 1968, demonstrates the shift of power which has taken place since then. Taking them in order: (1) Most oil exporting countries now have sufficient resources to sustain themselves for fairly lengthy periods without daily accruing oil revenues as evidenced by the number of Arab states investing large amounts of their oil revenues in Europe to avoid the inflationary effects of allowing so much cash into their own economies too quickly; (2) the OPEC cartel has ensured that oil companies can no longer set one oil producing state against another, as for example, they did to cause the downfall of Mossadeq in Iran in 1953,[4] but OPEC members now stand together to form a united opposition to any such ploy by the oil companies,

" 'We just took a leaf out of our Master's book'. The Western nations now found themselves, to their bewilderment, confronted with a cartel, not of companies, but of sovereign states"[5]; (3) Considering the profits to be made out of oil production due to the present day price of crude oil, little difficulty would be encountered in finding another company to develop or produce proven oil fields. In addition, many oil producing states have now gained considerable expertise in production, through training programmes etc. and are able to operate their own enterprises; (4) Oil is becoming an increasingly valuable commodity due to its high price and the growing awareness of its finite nature, so it is unlikely that many oil importing nations could afford to adopt lofty attitudes to oil exporters with whose policies they disagreed.

All this is summed up thus: "The negotiations and discussions ..... which I have used by way of illustration have all taken place under the umbrella of the basic Concession Agreement and are governed in last analysis by the spirit in which the Agreement was negotiated. Actual textual reference to the Concession Agreement is, however, relatively rare. A great deal more depends on the working relationships between the foreign investors and representatives of the Government at all levels."[6]

Indeed, the vast majority of disputes over concession agreements have been settled by direct negotiation between the parties, or through negotiations involving the investor's government.

This, then, is the background to the study of the law regarding concessions - the relative strengths and weaknesses of the parties, the practical, as opposed to the theoretical operation of concessions, the politics of the governments directly or indirectly involved, and increasingly, the enormous value of oil. Although awareness of these non-legal elements is essential to an understanding of the realities of foreign investment, they must be disregarded in examining the legal framework. Their only relevance to the legal position lies in the changes in the law which they cause. For example, in itself, the shift in the balance of power from the majors (the seven largest oil companies) to the OPEC Cartel is not of significance to this study except as regards the manifestations of that shift in the attitudes adopted by oil producing states concerning their right to control their natural resources, which, it may be argued, brought about a change in the customary law.

Starting from the legal position which existed after the Aramco case, it is essential now to assess whether the law of concessions has changed, in order to evaluate the actions of the U.K. Government regarding investment in the United Kingdom's oil and gas resources.

The General Assembly adopted a resolution in 1952[7] on the right to exploit freely natural wealth and resources which included the proposition that "the right of peoples freely to use and exploit their natural wealth and resources is inherent in their sovereignty ...." but went no further in expanding this principle. This resolution was brief and vague in its terms, and was passed by a majority of only twelve votes over the total of votes against and abstentions and did not therefore constitute sufficient consensus to alter the law in this respect, but nevertheless set the tone for subsequent developments.

In 1955 the Third Committee of the General Assembly adopted a draft article, as a part of the Human Rights Covenants, on the right of self determination, the second paragraph of which provided:

> "The peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of

international economic cooperation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence."[8]

A further General Assembly Resolution in 1958[9] established a commission to conduct a full survey of the status of the principle of 'permanent sovereignty over natural wealth and resources'. The work of this body, together with the Economic and Social Council resulted in the adoption of probably the most important of the United Nations' pronouncements on this subject; the General Assembly Resolution of 1962 on Permanent Sovereignty Over Natural Resources.[10]

Various views were expressed by the nations involved in the General Assembly debate on the resolution as to its legal effect but the general feeling then was that it was "intended to express existing law; no claim was made that the General Assembly could establish "new law" or indeed had any legislative authority."[11] (France and Japan were the notable dissidents from the view that the resolution expressed existing international law[12].) Gess[13] concludes that "the General Assembly intended to set forth, within the solemn vehicle of a declaration, the basic principles and modalities of the exercise of permanent sovereignty over natural resources, subject to the overriding requirement that both principles and modalities of exercise be in conformity with the rights and duties of states under existing international law, and, further, that the principles set forth reflect minimum standards."

In his brief introductory commentary to the Resolution, Ian Brownlie states "Resolution 1803 XVII of the General Assembly of the United Nations provides an important index, albeit not always very precise, of the present position".[14] As Brownlie indicates, most of Resolution 1803 is so vague and ambivalent that it is clearly a resolution tailored to gain the support of as many different political points of view as possible.[15] For example, it is difficult to reconcile the Preamble which states:

> "..... Considering that any measure in this respect must be based on the recognition of the inalienable right of all States freely to dispose of their natural wealth and resources in accordance with their national interests and on respect for the economic independence of States ....."

with Declaration 8 which begins "Foreign investment agreements freely entered into by, or between sovereign states shall be observed in good faith."

"Inalienable", according to the Oxford English Dictionary, means "that cannot be transferred from its present ownership or relation". That this contradicts Declaration 8 can be demonstrated by reference to the Aramco problem.

Article 1 of the Aramco Agreement granted Aramco the right for sixty years to "explore, prospect, drill for, extract, treat, manufacture, transport, deal with, carry away and export, petroleum" etc. This undoubtedly purports to be the transfer to Aramco, for sixty years, of the right to dispose of part of Saudi Arabia's natural resources, most importantly, petroleum. If Saudi Arabia's right is indeed an inalienable right, then it cannot be transferred, and any purported transfer of it is void. Yet, Declaration 8 states that "foreign investment agreements ..... shall be observed in good faith." Is the agreement to be enforced, as Declaration 8 requires, or is it void, since it purports to alienate an inalienable right ?

It is submitted that what is meant by "inalienable right" is "sovereignty", and that the granting of concessions is an exercise of sovereignty. This is consistent with Declaration 8 and the law as stated in Aramco, and utilises the argument of the Wimbledon case[16], since although sovereignty itself may be inalienable, rights flowing from it may be transferred by the state, and when transferred contractually, that contract becomes binding on both parties equally. If the rights themselves were inalienable, foreign investment agreements could not exist.

Foreign investment agreements do of course exist, and their binding nature is affirmed in Declaration 8. The clarity of the first section of Declaration 8 is, however, detracted from by the remainder of it: "States and international organisations shall strictly and conscientiously respect the sovereignty of peoples and nations and their wealth and resources in accordance with the charter and the principles set forth in the present resolution." Although this requires states and international organisations (which, it is assumed, refers also to multinational corporations) to respect state sovereignty, this does not derogate from the duty of states to observe their agreements, since respect for sovereignty must be 'in accordance with' the other principles of the Resolution, and is not a principle upon which a state may rely in answer to a claim for breach of contract on an international level.

The meaning then, of Resolution 1803, in the context of concessions, is that state sovereignty includes the sovereign right to decide how to dispose of its natural resources, but that foreign investment agreements are an exercise of sovereignty, and, assuming they are entered into 'freely' (which will depend on the facts of each case), are to be observed in good faith.

This differs from the Aramco judgement only in respect of emphases. Resolution 1803 is called a resolution on 'Permanent Sovereignty Over Natural Resources' and stresses the importance of natural resources, and their exploitation to the states having sovereignty over them. This is obviously a less legalistic approach than that of the tribunal in the Aramco case. A significant distinction, which is potentially a narrowing of the application of the Aramco judgement is the phrase "Foreign investment agreements <u>freely</u> entered into ..... shall be observed in good faith". Coercion in domestic law will generally render a contract void,[17] as it would in international law, but a contract not 'freely entered into' appears to fall some way short of one involving 'coercion'.

Hence Resolution 1803 may open the door, in Aramco type disputes, for a state to argue that it was not acting freely since, for example, it did not know all the material facts (the extent of its oil resources, the value of oil, its actual profit share, etc.) or that it was in such desperate need of foreign exchange that it had no choice but to accept the terms offered to it.

The difficulty in determining whether a contract has been freely entered into where there is inequality between the parties was raised during the General Assembly's debate on the resolution[18], but no amendment to the resolution was made, and indeed the view was expressed that international law, by which the principles of the resolution were governed, was based on the observance of agreements freely entered into.[19]

Despite this apparently sympathetic attitude to states trying to develop their natural resources, and the opening of a possible argument on the basis of a lack of free choice, short of coercion, Resolution 1803 does not relax the doctrine of pacta sunt servanda and indeed Declaration 8 affirms it in its most reasonable and acceptable form. In a recent arbitration[20], the arbitrator, Rene Jean Dupuy said of Resolution 1803, "The result is that a state cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and cannot, through measures belonging to its internal order, make null and void the rights of the contracting party which has performed its various obligations under the contract."

A further Declaration was made by the General Assembly in 1966 on Permanent Sovereignty over Natural Resources.[21] This Resolution took into account "the fact that foreign capital, whether public or private, forthcoming at the request of the developing countries can play an important role inasmuch as it supplements the efforts undertaken by them in the exploitation and development of their natural resources, provided that there is government supervision over the activity of foreign capital to ensure that it is used in the interests of national development ....." and "recognises the right of all countries, and, in particular of the developing countries, to secure and increase their share in the administration of enterprises which are fully or partly operated by foreign capital and to have a greater share in the advantages and profits derived therefrom on an equitable basis ....." (paragraph 5). It further declares that the United Nations should undertake a "maximum concerted effort" to enable countries to exercise their "inalienable right" of permanent sovereignty over natural resources.

The terms employed in the resolution are not sufficiently clear to amount to anything more than an affirmation of the general principle of permanent sovereignty and a declaration of the desirability of capital importing countries gaining some interest in the foreign investors operating within their borders.

The U.S. spokesman, in explaining the United States' abstention, made his country's position quite clear:

> "National participation in the administration of foreign enterprises is desirable in principle and is generally desirable in practice. However it would be a mistake to state that there is a right to secure and increase a share in the administration of an enterprise regardless of the practical considerations, the contractual obligations and the equities of the case. Similarly, it is impossible for us to agree that under all circumstances there is a right of countries to secure and increase their share in the advantages and profits from the exploitation of their natural resources when it is fully or partly carried out by foreign capital.
>
> [Paragraph 5] does not state with sufficient clarity the fact that no country can escape the

obligations arising out of international law and economic cooperation and out of contractual arrangements which have been mutually accepted ... . This resolution, which is primarily concerned with the economics of permanent sovereignty over natural resources does not change applicable international law or contracts one iota."[22]

This, it is submitted, is correct since to alter such a basic principle of international law as pacta sunt servanda would require a great deal more authority than such vague declarations as are contained in this resolution.

Since these resolutions the United Nations has tended to avoid the issue of the nature of concession agreements, presumably on the basis that its introduction could prevent substantial agreement on other aspects of foreign investment. For example, in the Charter of Economic Rights and Duties of States[23] an amendment to Article 2 which stated <u>inter alia</u>:

> "Each State has the right ..... (b) to enter freely into undertakings relating to the import of foreign capital which shall be observed in good faith ..."[24]

was rejected, and omitted from the final Resolution, thus avoiding any reference to the status of such agreements.

No expression of state practice made through the United Nations permits any basis for a deviation from the principle of pacta sunt servanda. Although more emphasis has been placed upon the permanent sovereignty of states over their natural resources, this is quite compatible with the observance in good faith of a state's obligations under concession agreements which are methods of exercise of state sovereignty.

Of the force of these General Assembly resolutions the arbitrator in the Texaco v. Libya arbitration (infra) said "It is particularly important to note that the majority voted for this text [Res. 1803], including many States of the Third World, but also several Western developed countries with market economies, including the most important one, the United States. The principles stated in this Resolution were therefore assented to by a great many States representing not only all geographical areas but also all economic systems ..... On the contrary, it appears to this Tribunal that the conditions under which Resolutions 3171 (XXVII), 3201 (S-VI) and 3281 (XXIX) (Charter of the Economic Rights and Duties of States) were notably different" and concludes "on the basis of the circumstances of adoption mentioned above and by expressing an opinio juris communis, Resolution 1803 (XVII) seems to the Tribunal to reflect the state of customary law existing in this field."[25]

A stronger, if less broad-based, plea for the precedence of permanent sovereignty over the obligation to observe contractual obligations began in the Middle East through the vehicle of the Organisation of Oil Exporting Countries (OPEC) in the 1970s.

At the invitation of the Iraqi Government, representatives of the large oil-exporting countries of Iran, Kuwait, Saudi Arabia and Venezuela convened in Baghdad during September 1960 and as a result of their deliberations OPEC was founded.[26] Its objectives are to be found in the resolutions passed at that conference:

> "That Members can no longer remain indifferent to the attitude heretofore adopted by the oil companies in effecting price modifications;
>
> That Members shall demand that Oil Companies maintain their prices steady and free from all unnecessary modifications .....

That if as a result of the application of any unanimous decision of the Conference any sanctions are employed ..... by any interested company against one or more of the Member Countries, no other Member shall accept any offer of a beneficial treatment, whether in the form of an increase in exports or an improvement in prices ..... with the intention of discouraging the application of the unanimous decision reached by the Conference .....

The Conference decides to form a permanent organisation called The Organisation of the Petroleum Exporting Countries, for regular consultation among its Members with a view to coordinating and unifying the policies of the Members .....

The principal aim of the Organisation shall be the unification of petroleum policies for the Member Countries and the determination of the best means for safeguarding the interests of Member Countries individually and collectively ....."[27]

The warning was thus sounded by the creation of a cartel of producing countries, potentially far more powerful than a collection of private companies operating collusively. At least to begin with, however, OPEC was a defensive mechanism to "maintain" prices and "safeguard" its Members' interests.

A shift from this stance occurred with the OPEC Policy Statement of June 1968 which recommended that posted and tax-reference prices should be fixed by the governments and linked to the prices index of manufactured goods traded internationally.[28]

The Statement also included the following demands:

> "..... (1) that changing circumstances should call for the revision of existing concession agreements (2) ..... the Government may acquire a reasonable participation on the grounds of the principle of changing circumstances ..... (6) that guarantees of fiscal stability to operators are to be renegotiated if for any year just ended the company is found to have realised "excessively high net earnings after taxes" and ..... (10) to invoke against the companies the rule of "the best of current practices" for such matters as incorporation, labour relations, royalties, taxes and property rights."[29]

The terms of this statement, the basis for the so-called "OPEC Revolution", are a major departure from the traditional principles of the sanctity of contract: pacta sunt servanda.

Many people first heard of OPEC in February 1971 when an extraordinary meeting of OPEC was convened in Teheran and the Members presented a united front to the world, to the amazement of the oil companies who clearly had not expected such solidarity. At this twenty-second Extraordinary Conference, Resolution 131 was passed which threatened to impose sanctions, including an embargo, on companies which failed to reach agreements with the hawkish Libyan and Algerian governments which were demanding considerably more advantageous deals. The companies acceded and the Teheran Agreement of 14th February 1971 was signed by OPEC and the oil companies, which gave the Gulf States new financial benefits, including a rise in the rate of income tax from 50 to 55 per cent, an immediate increase of 33 cents per barrel and cancellation of all discounts off posted prices.[30]

The Teheran Agreement had a great impact on the industrialised world, largely because of the resulting increase in oil prices but, more importantly, has been regarded with hindsight as the turning point in the confrontation between the producing states and the companies,[31] with the balance tipping towards the states which largely achieved what they wanted, against the wishes of the oil companies. The Teheran Agreement was stated to be binding for five years and therefore left little scope for new demands by the states in the areas which it covered, most importantly, pricing. The states then turned back to one of their repeated demands: participation, and for the next two years this took over from the battle for prices. Already in February 1971, Algeria, after bitter disputes about prices, had nationalised 51 per cent of all French interest in her oil and at the end of 1971 Libya announced the nationalisation of all B.P's assets.

After the OPEC Conference of January 1972, negotiations between OPEC Members, led mainly by Sheikh Zaki Yamani (oil minister of Saudi Arabia - a Harvard graduate and director of Aramco since 1962) and the oil companies began in earnest. Yamani wrote "the June war, with all its psychological repercussions, has made it absolutely essential for the majors - and not least Aramco - to follow suit (i.e. to agree to some form of partnership with the Members of OPEC) if they wish to continue operating peacefully in the area. Partnership with the host governments is a must; any delay will be paid for by the oil companies concerned."[32] On another occasion, Yamani said "(participation) will save them from nationalisation."[33]

Additional ammunition was given to the Arabs in 1970 when the U.S. Department of Commerce produced estimates that the net assets of the petroleum industry in the Middle East were $1.5 billion, yielding profits of $1.2 billion, a return of an investment of 79 per cent, compared with, for example, 13.5 per cent average from smelting and mining industries in the developing countries. This was noted by OPEC.[34]

Although the companies publicly retained their attitude that participation was "intolerable", most of the companies were inclined slowly to give way to participation since they depended heavily on supplies of crude oil for their profits and the pronounced shortage at this time made security of supply a high priority. They also believed Yamani's threats.

The companies signed a "General Agreement" in Riyadh in December 1972 under which they would give up 25 per cent of the established concessions, rising to 51 per cent in 1983. In September 1973 the Aramco partners also gave in to Yamani's terms[35], thus marking the demise of the greatest thorn in the flesh of OPEC.

The achievement of this degree of participation, the shortage of oil, and the Arab-Israeli war combined in 1973-74 to seal the power of OPEC, largely through the doubling of the posted prices, the imposition of an embargo of all oil to the U.S.A. and the Netherlands, and a severe cutback in production. The oil companies, although predominantly American, had no choice by virtue of their now much closer relationship with the OPEC States, but to act as the agents of the Arabs in enforcing an embargo designed openly to change United States foreign policy, i.e. end U.S. support for Israel. If the embargo did not succeed, Yamani warned that the next step would "not just be more of the same", which Frank Jungers, President of Aramco, had no doubt meant complete nationalisation.[36]

"After the embargo had been lifted by the middle of 1974, the consuming countries were having to face the apparently unalterable fact that the world's oil was now controlled by a cartel of sovereign states."[37] The shift of power had gone as far as most OPEC Members wished, since, as Dr. Amouzegar, the Iranian finance minister said, "Why abolish the oil companies, when they can find the markets for us and regulate them ? We can just sit back and let them do it for us."[38]

OPEC had succeeded, through forming an effective cartel to avoid being played one against the other by the oil companies, in gaining control of the supply of oil, the price of oil (to some extent through having control of the supply, as well as by taxation methods), and the oil itself by participation in both the equity of some companies, and the ownership of varying percentages of the oil produced. Indeed, by the end of 1975, by means either of participation or of partial nationalisation, all Middle Eastern and North African countries owned 50 to 100 per cent of their petroleum production.[39]

Although OPEC history contains many "agreements" with the oil companies (the Teheran Agreement, the Tripoli Agreement, the General Agreement of Riyadh, etc.) the truth lies in the negotiations behind the public agreements, as evidenced by the stern warnings issued by the OPEC representatives about the consequences of failure on the part of the oil companies to "agree" to the proposals. The dependence of the oil companies on supplies of crude oil, indeed the large profits to be gained from its production even on much less favourable terms than previously, made capitulation the only possible course in the face of the alternatives of nationalisation, or the cutting off of supplies. The revised concessions were therefore no more freely entered into by the companies than were the original concessions by the states. The oil-producing countries collectively used their bargaining power to amend unilaterally the concessions.

There may have been sound economic, political and even moral justification for revising the terms upon which the oil companies operated in the producing states, but this did not alter the legal principle of pacta sunt servanda which governed the concessions.

Vociferous objections were made by the oil companies to most of the measures by which the OPEC Members increased participation and prices, but finally, in most cases, agreement was reached between the states and the oil companies on a new basis of operation. The oil companies' assets were frequently nationalised by producing countries, sometimes in implement of threats made in the event of failure to reach "voluntary" agreement[40], so the companies were well aware that it was better to accept the state's policy and negotiate the most favourable deal which could be achieved in the circumstances. Their lack of litigious retaliation was a matter of commercial judgement in each instance, since it could achieve little benefit to the oil companies in the face of a state's determination to carry out its policy regardless of the opposition to it.

The absence of more forceful reaction from the Western governments was due to several factors: the political sensitivity of the Middle East, especially for the U.S.A. in the mid-seventies with regard to Israel; the threat of the imposition of embargos upon any importer which went too far, which would be potentially disastrous for any industrialised nation; some lack of sympathy for the oil companies who had made huge profits - often avoiding domestic taxation; and a lack of national identity with the now multinational oil corporations. In any case, the oil companies had a tradition of fighting their own battles.[41]

There were strong reasons then, why neither the companies nor their home governments on their behalf, initiated legal proceedings against the OPEC Members' actions, but preferred negotiation and compromise. It cannot therefore be argued that legal principles were changed by the so-called OPEC Revolution, first because so few states advocated the principles of the OPEC Resolutions and subsequently applied them, and secondly because the apparent lack of hostility to this was based upon commercial judgement and not acceptance of the right of the states involved to act as they did. The hands of the states which most strongly disagreed with the action of OPEC were tightly bound by their dependence upon oil from the Middle East to keep their industries and economies running.

That state practice did not change during this period of activity of OPEC has recently been confirmed by a recent arbitral award, Texaco Overseas Petroleum Company and California Asiatic Oil Company v. Libyan Arab Republic, 1977.

On 1st September, 1973 and 11th September, 1974 Libya promulgated decrees purporting to nationalise all rights, interests and property of Texaco and The California Asiatic Oil Company in Libya granted to them jointly by fourteen Deeds of Concession. The companies objected to this action on the basis that it violated the terms of the Concessions.

The companies, in accordance with the arbitration clauses of the concessions, appointed an arbitrator, but Libya failed to do so. Again in accordance with the contractual arbitration provisions, the companies then asked the President of the International Court of Justice to appoint a sole Arbitrator. Libya opposed this request, claiming that the dispute was not subject to arbitration because the nationalisations were acts of sovereignty. After consideration, the President appointed a sole Arbitrator who, at each stage in the proceedings, invited the submissions of both parties, and, in the absence of any further Libyan submissions, considered the points raised in the Memorandum submitted initially by Libya before it refused to participate in the arbitration.[42]

Thus the Arbitrator was independently selected in terms of the agreement between the parties, and considered the arguments raised initially by Libya, although not subsequently submitted to the Arbitrator when called for.

The Arbitrator, citing numerous authorities, held that he was entitled to determine his own jurisdiction[43] and that arbitration clauses survive the cancellation of the contract containing them,[44] that International Law was to be applied to the dispute[45] and that he was therefore entitled, and obliged, to decide the case in accordance with International Law.

The Arbitrator held that a contract could be "internationalised" inter alia by the fact that it "takes on a dimension of a new category of agreements between states and private persons: economic development agreements."[46]

Several elements characterise these agreements: (1) particularly broad subject matter, (2) long duration, and (3) the purpose of cooperation in which the contracting party must participate with the State and the magnitude of the investments to which it agreed. Further, the Arbitrator said, the effect is also to ensure to the private contracting party a certain stability which is justified by the considerable investments which it makes in the country concerned. The investor must in particular be protected against legislative uncertainties, that is to say the risks of the municipal law of the host country being modified, or against any government measures which would lead to an abrogation or recission of the contract.[47]

This classification will bring almost all concession agreements, particularly those relating to oil exploration and production, within the category of internationalised contracts and hence within the scope of international law.

The defence that the concessions were administrative contracts was rejected on the grounds that they had not even the three characteristics required by Libyan law, let alone International Law, to be such, i.e. (1) to have for their objects the management or the exploitation of a public service, (2) to have been entered into by an administrative authority, and (3) to confer upon that administrative authority rights and powers which are not usually found in a civil contract, such as the power to amend or abrogate unilaterally the contract if the public interest so requires, or - to use the terminology of French law (the basis of this type of contract) - to include provisions "which go beyond the ambit of ordinary law" ("clauses exhorbitantes du droit commun").[48]

Although the undoubted authority of states to nationalise was recognised by the Arbitrator[49], he went on to say that a state "cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty".[50]

The Arbitrator pointed out that the fact that various nationalisation measures in disregard of previously concluded agreements had been accepted by those affected, either private companies or states of which they were nationals, could not be interpreted as recognition by international practice of such a rule since the amicable settlements which had taken place had been inspired basically by considerations of expediency and not legality.[51]

The Arbitrator went on, applying these principles to the facts of the case, to hold that (1) the Deeds of Concession were binding upon both parties, (2) the Libyan Government, by its legislation, had breached its contractual obligations, (3) the Libyan Government was legally bound to perform the contracts and give them full effect, (4) the Libyan Government had five months to advise the Tribunal of the corrective measures taken by it, (5) failing compliance by Libya, further proceedings were reserved, but for the present, expenses were to be borne by the plaintiffs, and (6) the award be filed with the Registry of the I.C.J.[52]

This decision reaffirms the ratio of the Aramco case, and moreover, clearly states that despite certain General Assembly Resolutions and any apparent contrary practice, nothing has altered the principles established by Aramco in the intervening period.

Notes.

1. M. Katz and K. Brewster, International Transactions and Relations (Materials and Text) p.371.

2. Although, for example, U.K. law, in the Unfair Contract Terms Act 1977 goes some way to protect consumers and parties forced to accept standard term contracts from 'unreasonable' provisions incorporated into such agreements by the dominant party.

3. op. cit. p.374.

4. Anthony Sampson, The Seven Sisters, Chap. 6.

5. ibid. p.259 (quoting one Kuwaiti leader in conversation).

6. Powell, LAMCO : A Case Study of a Concession Contract, 1967. Proceedings of the American Society of International Law, p.80.

7. G.A. Res. 626 (VII) Dec.21, 1952.

8. U.N. Doc. A/C. 3/L. 489.

9. G.A. Res. 1314 (XIII) Dec.12, 1958.

10. G.A. Res. 1803 (1962) Dec.14, 1962.

11. Gess, Permanent Sovereignty over Natural Resources 13 ICLQ (1964) p.398 at p.409.

12. ECOSOC, 32nd Sess., 1178th mtg. at 176; G.A. (XVII), A/C. 2/SR 859 at 13-14; A/PV. 1194 at 13 and ECOSOC, 32nd Sess., 1178 mtg. at 172 respectively.

13. op. cit. p.411.

14. I. Brownlie, Basic Documents in International Law, p.140.

15. Of this resolution Schachter in The Relation of Law, Politics and Action in the United Nations, 109 Academie de Droit International, Receuil des Cours 165, 181 (1963) said, "a declaration which achieved near-unanimity of support by its deference to diverse (and perhaps not entirely consistent) objectives aided by a measure of vagueness and equivocation."

16. (1923), Series A, No. 1, 1 W.C.R. 163.

17. see, for example, Walker, Contracts, Chaps. 14 and 15, Chitty on Contracts 1977, Chap.7.

18. eg. U.S.S.R. A/C. 2/SR. 851 at 18, Cuba A/C. 2/SR. 854 at 11.

19. Brasil A/C. 2/SR. 852 at 9.

20. Texaco v. Libya 1977 (infra)

21. G.A. Res. 2158 (XXI) Nov.25, 1966.

22. Statement by U.S. Ambassador to the 21st Session of the General Assembly appearing in Press Release No. 4987 of the United States Delegation Nov. 25, 1966.

23. G.A. Res. 3281 (XXIX) Jan. 15, 1975.

24. 1975 I.L.M. p.262.

25. Texaco v. Libya 1977, Award on Merits pp.66-71.

26. Mana Saeed Al-Otaiba, OPEC and the Petroleum Industry, Chap.6.

27. ibid.

28. ibid. p.115.

29. Resolution XVI.90 adopted at OPEC's 16th Conference June 1968, I.L.M. 1968 p.1183.

30. Mana Saeed Al-Otaiba, op.cit.p.122.

31. Anthony Sampson, op.cit. p.226.

32. Middle East Economic Survey, June 1968.

33. 3rd Seninar of Economics of the Petroleum Industry, American University of Beirut, 1969.

34. Abdul Amir Kubbah: OPEC Past and Present, Vienna 1974, p.78.

35. Anthony Sampson, op.cit. p.238.

36. Hearings for Report of U.S. Senator Church's Subcommittee on Multinational Corporations and U.S. Foreign Policy Part 7, p.517.

37. Anthony Sampson, op.cit. p.283.

38. ibid. p.301

39. Rustow and Mungo, OPEC: Success and Prospects p.24.

40. eg. Libya's nationalisation on February 11th, 1974 of three American oil companies which did not agree to 51 per cent participation by Libya.

41. see Anthony Sampson, op.cit. on the history of the 'Majors'.

42. Arbitral Award, Introduction.

43. Preliminary Award p.13.

44. ibid. pp. 16-20.

45. Award on the Merits pp.12-15 and p.27.

46. ibid. p.34.

47. ibid. p.35.

48. ibid. p.43.

49. ibid. p.48.

50. ibid. p.54.

51. ibid. p.55.

52. ibid. p.90

CHAPTER IV

THE UNITED KINGDOM LAW

INTRODUCTION

Although British nationals and non-British nationals may suffer equally through adverse changes in the United Kingdom's oil and gas legislation, British citizens have no title to complain of such changes on the level of international law. Their complaints are purely domestic, unless internationalised by the terms of their contractual arrangements (which is not the case with oil and gas licences), and their only recourse is to the courts of the United Kingdom.

Foreign nationals however are entitled to bring their complaint onto the international forum, either in pursuance of a contractual provision to that effect, or by its espousal by their national government.

A great proportion of licensees having an interest in the Continental Shelf of the United Kingdom are not British companies for this purpose (see North Sea Newsletters, published monthly by Wood Gundy), particularly the majors, of which only B.P. (and arguably Royal Dutch/

Shell) would be treated as British by an international tribunal. Even when applicants for licences were required to be citizens of, or incorporated in the United Kingdom, they would still have been regarded as foreign nationals since a "shell" company incorporated in the United Kingdom to comply with this provision would have been owned and controlled by its foreign parent, thus rendering it a foreign company for the purposes of locus standi under international law in the event of a claim being made on the basis of the actions of the U.K. Government examined in this chapter (Barcelona Traction Case, I.C.J. Rep. 1964, p.7).

EARLY DEVELOPMENTS OF THE LAW

The U.K. Government began to exert control over the country's oil resources in 1917 following on advice presented to a committee presided over by the Civil Lord of the Admiralty to the effect that oil probably existed in parts of the U.K. A Bill was introduced in 1917 providing that the exclusive right to search and bore for, and get petroleum lying under U.K. soil, was vested in the Crown. Although this bill was rejected at the time, it is interesting that its terms were largely the same as the present legal provisions regarding oil under the Continental Shelf in accordance with the Convention on the Continental Shelf

1958[1]. The final Act[2] passed in 1918 did not deal with the question of ownership of oil as opposed to the right to deal with it, perhaps due to the complexity of the problem of ownership of a fluid substance in its natural state.

Such questions as the property in oil in pools lying beneath the land of two or more adjoining proprietors extracted through wells drilled on the land of one were left unanswered. The Act merely forbad the searching or boring for oil otherwise than by persons acting on behalf of the Government or holding a licence granted by the Minister of Munitions. Little activity occurred after this act, indeed only seven licences were issued under it, and none of these were to a recognised oil company. Three of these licences were still in force by 1934, but otherwise the 1918 Act was 'a dead letter'.

In 1934 the Government made a clear exercise of the principle of territorial sovereignty by passing the Petroleum (Production) Act of that year, vesting in the Crown the property in all petroleum <u>in situ</u> in the U.K., together with an exclusive right of searching and boring for it. This showed an awakening on the part of the Government to the fact that oil could be a major resource and, particularly in wartime, too important for exploration and production to be hampered by uncertainties over rights of property or rights of access through the surface to the potential wealth below.

This may be contrasted with the situation obtaining in many American States, for example Texas where "the landowner is regarded as having absolute title in severality to oil and gas in place beneath his land"[3] including a right to drain the whole resources of a 'common pool' also lying beneath adjoining land to his own. This difference means that the U.K. Government can control not only the revenue it earns from oil production, but also how much oil is extracted, from where, by whom, and by what method, in line with Article 1 of Resolution 1803 of the U.N. General Assembly[4] which provides that:

> "The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the state concerned."

The Petroleum (Production) Act 1934 remains the foundation of the law of the U.K. in this field for two reasons: firstly, it states the fundamental principles of ownership of oil <u>in situ</u>, and that power to extract it is vested in the Crown. It is inconceivable that these principles would be changed by any government of the U.K. Secondly, it is an enabling act, and it is the regulations made in pursuance of it which tend to be changed according to the changing policies of governments, and not the Act itself.

Thus in 1934 the legal position of oil under U.K. soil was made clear: it was owned by the Government, which could grant licences to other parties to exploit it, subject to the duty to make payment of royalties to the Government as mineral proprietor. This was clearly an implementation of the legal principle of territorial sovereignty which was described thus in the Island of Las Palmas Arbitration[5]; "Sovereignty in the relation between states signifies independence. Independence in regard to a portion of the globe is the right to exercise therein, to the exclusion of any other state, the functions of a state"[6]. As regards offshore resources however, the position was not always quite so clear. The first claim by a state to the resources of its continental shelf is generally regarded as having been that of the United States in 1945 - The Truman Proclamation[7]. In this proclamation, the United States claimed "the natural resources of the subsoil and sea-bed of the continental shelf beneath the high seas but contiguous to the coasts of the United States as appertaining to the United States, subject to its jurisdiction and control". The claim was for such powers as were necessary for the conservation and prudent utilisation of resources of the 'shelf' around the United States' coastline which extended from the outer limit of the territorial sea to a depth of 200 metres[8]. This claim was founded upon two principles: first, the need to exercise jurisdiction over the conservation and prudent utilisation of the resources of the shelf as a national prolongation of the land. Whatever the legality of this claim in 1945 it was followed by many claims of a similar nature, although some states claimed broader rights or larger areas. This growth of interest in the continental shelves of the oceans gave rise to a report by the International Law Commission as a result of which the United Nations Conference on the Law of the Sea at Geneva adopted a Convention on the Continental Shelf[9]. Despite the fact that no more than one third of the international community has ratified the Convention, articles 1 to 3 thereof have been held to be the customary international law also, and therefore binding on all states[10]. Thus each state exercises exclusive sovereign rights for the purpose of exploration and exploitation of its mineral, non-living, and living sedentary resources (Art. 2), over (a) the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea, to a depth of 200 metres or, beyond that limit, to where the depth of the superadjacent waters admits of the exploitation of the natural resources and (b) the seabed and subsoil of similar marine areas adjacent to the coasts of islands (Art.1). These rights do not affect the legal status of the superadjacent water as high seas, nor that of the air space above these waters (Art.3).[11]

This then was the framework of international law within which the United Kingdom properly enacted the Continental Shelf Act 1964 which provided *inter alia* that "Any rights exercisable by the United Kingdom outside territorial waters with respect to the sea bed and subsoil and their natural resources, except so far as they are exercisable in relation to coal, are hereby vested in Her Majesty"[12]. Sections 2 and 6 of the Petroleum (Production) Act 1934 are adopted in relation to offshore resources, extending the landward regime of regulations and licensing to the Continental Shelf. The main difference between landward and offshore resources, which are otherwise subject to the same legal framework lies in the fact that the Continental Shelf Act 1964, unlike the Petroleum (Production) Act 1934, does not vest in the Crown the property in the resources, but only "any rights exercisable by the United Kingdom".

Such legal rights could only be conferred on the United Kingdom by international law; this must refer to the sovereign rights contained in the Convention on the Continental Shelf, i.e. rights "for the purpose of exploring (the continental shelf) and exploiting its resources" - something short of a right of property. Hence the United Kingdom's claim to the mineral resources of its Continental Shelf was in accordance with the rights conferred upon it by international law.

Thus the ownership of resources <u>in situ</u> outside the territorial sea was not settled by the Continental Shelf Act in 1964. On this question, Mr. R. W. Bentham[13] says "The conclusion to be drawn from this is that, on the U.K. Continental Shelf petroleum in its natural state is res nullius until, applying, inter alia, the law of capture, the licensee reduces the petroleum into possession and hence becomes its first legal owner". The question of the ownership of offshore oil may be left aside for the moment, since it is a matter not dealt with by U.K. legislation.

Of this basic system, Kenneth Dam[14] says "The main outlines of the U.K. system for exploitation were undoubtedly determined as much by tradition as by logic. Exploration and production of petroleum on public lands in most countries has traditionally been carried out by private companies under licence from government". The system would appear to be dictated not so much by tradition however, as by necessity. Few, if any, governments have the financial or technical resources or could take the risks required to explore and exploit even onshore petroleum deposits. The undertaking would almost inevitably require the resources of a company experienced in such operations, at least in the early stages. The North Sea serves as a clear example of this point since the initial costs were extremely high (B.P. for instance borrowed £360 million in 1972 to develop the Forties Field) and the technology required, very advanced due to the harsh North Sea weather conditions, and the U.K. Government had no choice but to allow the oil companies to develop the resources. However, having been forced to grant licences to private companies the state then tried to gain as much control as possible over the whole North Sea business, demonstrating that the calling in of the oil companies was a necessarily evil, to be remedied as quickly as possible. The methods employed by the U.K. Government to regain control over the North Sea oil will be discussed in detail in a later section of this chapter; suffice it to say here that the Government's subsequent measures to control its oil indicate that the concessions to the oil companies at the earlier stage were not so much a matter of maintaining a tradition as a necessity. On this point, Mr. Varley, the Secretary of State for Energy in 1975 said, "The establishment of a complete capability under national control will reduce our dependence on the oil companies. We value their expertise. They have been pioneers in one of the most difficult projects ever known, requiring immense technical skill ..... We want to continue to attract their expertise and to work in partnership with it. But no other major producer outside the United States has thought it wise to be completely dependent on the oil companies, and all over the world the companies have accepted that."[15]

Of the subsequent change of government policy, a critical editorial article in the Oil and Gas Journal[16] said "In the first place, the government approach repeats a familiar pattern set by other countries who have cut themselves a share of oil assets either by seizure, nationalisation or participation. Operators were welcomed in with their capital and technology to take the initial risks. Then, when oil and gas were discovered and hefty profits appeared assured, the governments moved in."

This should not be construed as meaning that the U.K. Government initially gave the oil companies carte blanche to extract oil from the North Sea, and then repossessed the oil once the bulk of the costly work had been done. Indeed the regulations applying to the companies working in the North Sea were in operation prior to the commencement of major operations there and have not been so radically altered by the Government since then as to change fundamentally the role of the companies. The changes which have occurred, principally in 1975, have greatly increased the state's role in the North Sea, but not so much by a straightforward proportionate reduction in the role of the companies as by an erosion of their profits and a narrowing of their rather exclusive powers to deal with the oil which is discovered.

To examine the changes brought about in 1975, it is necessary to look first at the regime existing prior to that date. The basis of the system is that licences are granted by the Secretary of State for Energy, as ultimate successor to the Board of Trade. Exploration licences, giving the right to conduct preliminary surveys over large offshore areas, allow oil companies to assess the probability of the existence of an oil field in a particular location; the companies, and any other interested persons, are then publicly invited by the Secretary of State to apply for the necessary licence (a "production licence") to conduct detailed surveys of, and if desired to produce any oil discovered in the area covered by the licence. The terms of both these types of licence are dictated by model clauses set out in regulations laid down from time to time by the Secretary of State which are to be incorporated into each such licence unless the Secretary of State determines otherwise.

THE PETROLEUM (PRODUCTION) REGULATIONS 1966.

The first regulation of offshore activity was set up by the Petroleum (Production) (Continental Shelf and Territorial Sea) Regulations 1964,[17] which more or less repeated the landward regulations which were little changed since their original establishment in 1935. The two significant differences between the landward and the offshore regulations were first, that whilst production licences for landward areas were granted in response to individual, unsolicited application, offshore production licences were to be granted over specified areas ("blocks") in respect of which applications for licences were to be invited from time to time, in licensing "rounds". Secondly, the licences to be granted for offshore production were to contain provisions that half of the area licensed was to be surrendered after a period of 6 years, to expedite exploration by encouraging the licensees to discover as quickly as possible which parts of the block have the greatest potential. This desire of the Government for speedy development was also pursued by means of a work programme, agreed between the companies and the Ministry of Power to be annexed by schedule to the licence.

The offshore regulations (with subsequent minor amendments) were consolidated with the landward ones to constitute the Petroleum (Production) Regulations 1966[18] and these, with minor amendments to the offshore regulations in 1971[19] and 1972[20] formed the legislation applicable to offshore petroleum activity until 1975. The first two rounds of licensing, in 1964 and 1965, were carried out under the 1964 Regulations, and the third and fourth in 1969 and 1971 respectively, under the 1966 Regulations, thus all the licences prior to the controversial fifth round in 1975 were awarded subject to very similar terms and conditions.

We look then to the 1966 Regulations as amended as being the pre-1975 framework. The 1966 Regulations are stated[21] to apply to, and the model clauses to be included in, licences in respect of (a) landward areas and (b) seaward areas, as defined in the Regulations,[22] unless the Minister of Power sees fit to modify or exclude them in any particular case.[23] The precise dividing lines between landward and seaward areas set out in Schedule 1 of the Regulations have remained unchanged and can now be accepted as definitive for the purposes of ascertaining whether a landward or a seaward licence is required for a particular operation. The Regulations provide for four different types of licence[24] and lay down model clauses separately in respect of each. The four types are: landward production licences, seaward production licences, exploration licences and methane drainage licences.

Licences may be applied for by persons who are citizens of the United Kingdom and Colonies and resident in the United Kingdom or who are bodies corporate incorporated in the United Kingdom.[25] This provision means that any foreign or multinational company wishing to participate in the United Kingdom's oil business required to incorporate a company, usually a subsidiary, in the U.K. The advantages of this to the U.K. Government were twofold: that that part of the company dealing with oil found in the U.K.'s jurisdiction would be unquestionably subject to U.K. taxation; and that the company would be subject to general U.K. legal control from the details required by law to be included in companies' published accounts, to the possibility of expropriation, should that be legislated for. By being able to control the operators a government should be able to control what happens to its oil and be able to guarantee the revenue accruing therefrom.

A distinction is made between invited and non-invited applications[26] for production licences, the latter being for landward areas not included in areas specified in a Gazette (i.e. London, Edinburgh and Belfast Gazettes) notice unless the Minister has published a notice to the effect that he is once more prepared to receive non-invited applications in respect of such an area, and the former being for blocks specified in a Gazette notice. In practice all landward production licences have been non-invited and all seaward production licences 'by invitation only'.

Applications for exploration licences are, by implication, non-invited and may be made in respect of (a) seaward areas and (b) any area between the dividing lines contained in Schedule 1 and the low water line.[27] Thus only areas below the low water line are subject to exploration licences, which are non-exclusive licences to search for petroleum in the area defined as seaward area in Schedule 1 plus any additional area below the low water line. There were not created any comparable licences for landward areas and since the exclusive right of "searching and boring for and getting" petroleum in strata in Great Britain is vested in the Crown[28], the only way in which one can explore for petroleum in a landward area is to obtain a production licence. Thus in landward areas one would have to hold a production licence to make any kind of exploration of the area licensed, whereas the seaward regime is that all holders of exploration licences may explore the whole seaward area except for such parts as are included in production licences granted by the Minister to other licensees.

The remaining form of licence dealt with by the Regulations is the methane drainage licence[29]. The model clauses contained in Schedule 6 reveal that this confers a right on the licensee "to get natural gas in the course of operations for making and keeping safe mines"[30] in the relevant area under certain conditions as to records, accounts, etc. This form of licence is necessitated by the exclusive rights conferred by the Petroleum (Production) Act 1934 on the Crown of getting "petroleum" which includes "natural gas existing in its natural condition in strata"[31]. Without such a licence the removal of such gas, even for safety reasons, would be contrary to the terms of the 1934 Act. This type of licence was an expedient required by the wide terms of the 1934 Act, in relation to landward mines, has remained unaltered since its creation and need not be looked at further in this study.

Fees are stipulated in respect of applications for each kind of licence[32]. These fees are not a means of payment for the licence but relatively low amounts (from £20 - £200) to cover the expense of the administrative work involved in handling licence applications and possibly also to discourage frivolous applications. Finally, the Regulations provide that one person may apply for, and be awarded, more than one licence.

This, then, is the general framework of the licensing system applicable to all four types of licence. The substance of the licences is contained in the statutory schedule applicable to each particular type of licence.

SEAWARD PRODUCTION LICENCES

Seaward production licences are the most important type for the purposes of this study since their development was the most contentious from both the legal and the financial points of view. It was indeed the potential financial rewards of the large deposits discovered in the North Sea which prompted reconsideration by the Government of the legal regime of seaward production licensing[33].

The holder of a seaward production licence under the 1966 Regulations is granted "exclusive licence and liberty during the continuance of this licence and subject to the provisions hereof to search and bore for, and get, petroleum in the sea bed and subsoil under the seaward area comprising an area of square kilometres more particularly described in Schedule 1 hereto ....."[34]

Only one such licence is granted in respect of each area, so that nobody but the licensee may even search for petroleum in the area specified in the licence and exploration licences are specifically stated to exclude areas thus licensed for production. The licence confers power to "bore for and get" petroleum; neither this nor any other part of the licence deals with ownership of the petroleum extracted, hence the question of property in offshore oil and gas was not answered by the model clauses. This is perhaps not surprising since it is unclear whether or not the Crown has a right of ownership itself because the Crown's rights rest upon the Continental Shelf Convention 1958 and the relevant customary rules of International Law, which, as mentioned above, do not explicitly confer full ownership. It may be noted that the terms of the actual grant of seaward licences[35] are identical to those in the landward licences[36] where the Crown, applying the principle of territorial sovereignty, has title to the resources whose production is licensed.

The area licensed will be that awarded to the licensee in one of the "Licensing Rounds". These "Rounds" are formally initiated by the Minister publishing a Gazette Notice[37] inviting applications in respect of 'blocks'[38] described and specified in such notice. A licence may be awarded covering more than one block.

The licence is granted for a period of six years,[39] subject to determination by the licensee on giving six months' notice.[40] On giving to the Minister notice at least three months before the expiry of the six year period, the licensee may apply for the licence to be continued for a further forty years in respect of not more than half the area originally comprised in the licence.[41] Providing the licensee has performed the obligations contained in the licence and providing the surrendered area meets the requirements of clause 7(1) the continuation will occur. This is to encourage licensees to undertake speedy exploration of their areas, to determine which half (if either) should be retained for further exploration and/or development.

The consideration for the licences is the royalty or other payment specified in schedule 2 of the licence[42]. Thus, the consideration is in theory agreed individually in each licence for the initial period of six years and for the subsequent forty where relevant. So every licence is governed solely by its own terms in respect of the consideration due therefor.

The licensee is required to measure or weigh all petroleum won and saved from the licensed area by methods customarily used in good oilfield practice, and the Minister has power to test and examine appliances used for this purpose.[43] The licensee is also bound to keep accounts of the quantity of petroleum, in the form of gas or otherwise, won and saved, of the names and addresses of persons supplied with petroleum and the details of the consideration passing and of such other particulars as the Minister directs[44], abstracts of such accounts to be delivered to the Minister half-yearly[45]. A "statement of value" must be submitted by the licensee to the Minister half-yearly stating the value of all quantities of petroleum won and saved in the licensed area during that period.[46] There are specific requirements as to how the value is to be computed.[47] These provisions as to weighing, measuring and accounting should allow the Minister to ensure that the Government receives the revenue proportionate to the amount of petroleum actually won and saved in the North Sea.

One of the briefest, but most important clauses is Clause 12, which provides that the licensee carry out with due diligence the programme set out in Schedule 3 to the licence. The negotiation and agreement of this scheme is a fundamental part of the licensing system since the licensee companies must, in the Government's view, be working in the national interest, which involves exploiting the resources of the North Sea as fully and efficiently as possible. The optimum rate of extraction may vary according to economic circumstances (as is evidenced by developments in the second half of the 1970s in the Middle East) or political considerations (such as the Arabs' attitudes to Israel or some Scottish Nationalists' views on 'Scotland's Oil') but as a rule a state will want exploration done speedily, at least to find out what resources it has, if not to go ahead and exploit them as quickly as possible.[48] The programme agreed with each licensee can be adapted to the circumstances of that licence award, taking into account the operator's resources, other North Sea commitments, the licensed area and so on, so that the precise working obligations are very much a matter of individual negotiation and agreement, i.e. contractual, in contrast to the rather standard form of many of the model clauses. The working obligations represent the most direct control which the Government has over the manner in which oil is exploited, since they allow it to dictate what work must be done in a specified time as if to a sub-contractor, in a normal, domestic contract.

The consent of the Minister is required before the licensee may commence, or after abandoning, recommence, or abandon any well.[49] The licensee must use methods customarily used in good oilfield practice for confining petroleum obtained[50], to control the flow and to prevent the escape or waste of petroleum, to conserve the licensed area for productive operations, etc.[51] The licensee shall not interfere unjustifiably with navigation or fishing[52] and shall comply with instructions from time to time given by the Minister for securing the safety, health and welfare of employees in the licensed area[53]. These provisions are largely regulatory - to secure the efficient and safe development of the North Sea and to ensure that the least possible disturbance to marine life occurs. The Minister's influence is seen clearly in the detailed provisions of these articles in that his consent will often be required by a licensee in the course of developing and producing an oil field, and in his powers to give instructions with which the licensee must comply. It is this capacity of the Minister to act unilaterally without limitations placed upon his exercise of these powers in the licence itself that renders these clauses regulatory in effect. They are not regulatory in themselves, since they constitute part of a contract - the whole licence being agreed upon and executed by both parties - but in the fact that one party may thereafter impose conditions on, and without consent from, the other without provision in the contract for how these acts are to be done or within what limitations they are binding on the other party.

Clause 14 stipulates that without the consent of the Minister, no well may be drilled or made within 125 metres from any boundary of the licensed area. This provision is to ensure an orderly development of the various blocks by avoiding wasteful competitive drilling by operators of adjacent blocks racing to develop a common pool of oil. Should an oil field be across two or more licensed areas the Minister has power, if he considers that it is in the national interest in order to secure the maximum recovery of petroleum and in order to avoid unnecessary competitive drilling, to require the licensees concerned to produce 'a development scheme' for the working and development of the oil field as a unit by the licensees concerned in cooperation[54]. This is an answer to the question of common pools previously mentioned above. Since ownership of oil in situ is practically impossible to enforce, the law of capture has invariably been adopted. In the situation envisaged by clause 19 this would undoubtedly lead to a race between the licensees concerned, each striving to extract the oil through his own licensed area, thereby acquiring title to oil which may originally have lain under the other licensee's area. It may be noted that the Minister will not follow the procedure of clause 19 unless he considers "that it is in the national interest in order to secure the maximum ultimate recovery of petroleum", in other words if the Minister's view was that the national interest was not affected, or indeed that to allow competitive drilling to take place would increase the total recovery of petroleum, even if that severely prejudiced one licensee, he could not require a development scheme for unit development of the field. There is not even anything in clause 19 to compel the Minister to require such a scheme even if the conditions for doing so do exist - he is authorised, not obligated, to do so. Thus this clause cannot act as a method of settling questions of common pools unless first, it is in the national interest to do so and secondly, the Minister decides to act accordingly.

The licensee is bound to ensure that all petroleum won and saved from the licensed area is delivered on shore in the United Kingdom, except for that consumed in drilling, production or pumping operations, unless the Minister agrees to the contrary, which agreement may contain conditions such as to the place of delivery, the price, or time of delivery.[55] Security of supplies of oil has always been one of the cornerstones of British oil policy, dating back to our oil burning warships in the First World War.[56] This concern has been increased by more recent events which have demonstrated the vulnerability of states relying heavily on imported oil, such as the turning off of the oil taps by Iran following the Revolution in January 1979, and the numerous price escalations made possible by the united strength of the middle eastern oil exporting states. This provision as to delivery gives the U.K. Government potential possession of all oil produced in the North Sea should it so require, either in the interests of national security if other supplies were at risk, or to ensure its revenue from companies operating in the North Sea, in the event of an oil company refusing to pay money owed to public authorities, most likely the Inland Revenue. It is also a useful devise for the Minister to have power to impose conditions such as to the place of delivery[57], the price[58], time and manner of payment[59] and that payment must be made to a United Kingdom resident[60] so that he may, if necessary, carry out his Government's policy despite having permitted oil companies to carry out their business with a degree of independence from governmental control, in order to facilitate trading efficiency.

Clause 22 requires the licensee to keep records of its activities in the licensed area, including the results of drilling operations, which the Minister has power to inspect. Clause 23 requires the licensee to make detailed monthly returns to the Minister of each well drilled, the kind of work done, the petroleum, water, mines or workable seams of coal encountered and the amount of petroleum won and saved in the licensed area. The licensee must keep samples of any petroleum and water discovered in the licensed area[61], which the Minister may inspect and analyse. The Minister may authorise persons to enter into and upon the licensee's installations or equipment to examine the same and to install any equipment which the Minister is entitled to install to check on the licensee's operations.

These last few provisions, stated briefly, demonstrate the degree of control which the Government, through the Minister, retained in relation to the exploitation of the North Sea. It is entitled to full records of the technical and financial activities of the licensees in the North Sea, has power to ensure that the information it is given is accurate through inspection, and ultimately, control of the oil produced if such control proved necessary. These powers, although written into the licence, have the appearance of regulation rather than agreement. They are not unlike the general powers of the Inland Revenue to enter premises, call and search for documents, etc.[62], but are even more extensive in that the Minister may invoke them entirely at his discretion; for example, he need not have any reasonable grounds to suspect a criminal offence has been committed to enter the licensee's property and carry out inspections[63], as the revenue authorities would have to have to act in such a manner. The Minister may, in certain circumstances, even execute works necessary to ensure that licensees comply with specified terms of the licence[64].

In the event of a licensee failing to pay any of the considerations payable in terms of the licence, clause 29 gives the Minister the right of distress, or summary diligence as it applies to Scotland, against the licensee. This is specified to be exercisable "in like manner as a landlord" and indeed is not unlike the consent to registration for execution which one is accustomed to seeing in deeds, such as Standard Securities or leases, in domestic Scottish contracts. The alternative clause 29 for licensed areas in, or waters adjacent to, Scotland, or areas in respect of which an order in Council has been made making provision for the determination of questions in accordance with the law in force in Scotland serves as a reminder that two different legal systems may have cause to construe such licenses, therefore licenses have to be framed in such a way as to receive the same effect in either Scotland or England.

The licensee may not, without the consent in writing of the Minister, assign or part with any of the rights conferred by the licence.[65] It is natural that the Minister, having gone to considerable trouble to select suitable licensees, should not allow them to transfer the licence to any other company or individual of their choice, particularly since a licensee wishing to sell its licence would be applying different principles in choosing a purchaser from the principles adopted by the Minister, the former being primarily concerned with profit, the latter with broader considerations such as the national interest, the orderly development of oil and gas resources, the financial standing and technical expertise of the licensee, the licensee's past record and so on.

As is often the case in domestic leasing, provision is made for the landlord (the Minister) to terminate the lease (licence) if the tenant (licensee) breaches any material condition thereof.[66] This would be a drastic remedy appropriate only for the most serious breaches, since it would involve an absolute termination of the licensee's rights in the licensed area, with no contractual right to compensation for work already done there or money spent in the expectation of future profits. On considering the huge investment - hundreds of millions of pounds - which may be made in a field before any oil is produced, it is apparent that the Minister would be very reluctant to revoke a licence for anything short of complete non-cooperation from a licensee, which would be such a foolhardy practice that no oil company is likely to indulge in it.

The final clause of the licence[67] provides for arbitration to settle any dispute or difference arising between the Minister and the licensee arising under or by virtue of the licence except such matters as the licence stipulates are to be determined by the Minister. The appointment of such arbiter, and the arbitration itself, are governed by the law of England, Scotland or Northern

Ireland, as the case may be. Again it can be seen that different legal systems may govern individual licences, and different interpretations may arise as a result. This is unlikely to be a major problem however, since the U.K. legal systems do not diverge greatly in most areas of company law and contract and all would be dealing with the same material in the Regulations. The real significance of this clause lies not in the fact that there are different domestic legal systems, but that it is domestic law, rather than international law, which is stated to govern the arbitration proceedings.

THE CHANGE OF POLICY

These Regulations and model clauses were effective for the first four rounds of offshore licensing, but changes in policy began to be discussed seriously at the time of the General Election in 1974. The Labour Party's policy was thus expressed: "Labour's determination to ensure not only that the North Sea and Celtic Sea oil and gas resources are in full public ownership, but that the operation of getting and distributing them is under full Government control with majority public participation."[68]

Having won the election, the Labour Party published a White Paper[69] which laid down the details of the policy of the Government, which were followed through into the Petroleum and Submarine Pipelines Act 1975. There were new proposals to help Scotland and Wales, and proposals to amend the corporation tax legislation but the main policy innovations were fivefold: first, to impose an additional tax on the oil companies; secondly, to require State participation in all future licences when the Government so wished; thirdly, to achieve "voluntary" participation with respect to already existing licences; fourthly, to set up a British National Oil Corporation, through which the Government was to exercise its participation rights and which would build up a powerful and expert supervisory staff and fifthly, to extend the Government's powers to control physical production and pipelines, including control of the rate of depletion, and to take royalty payments in kind. By these means the Government intended to make "the sort of provisions that should have been made before the fourth licensing round"[70], i.e. by the previous Conservative government. The provisions introduced in implement of these aims may now be looked at in the light of the foregoing analysis of the position up to and including the fourth licensing round.

The changes made by the Government of this time fall into two distinct categories: first, those made by the Petroleum and Submarine Pipelines Act 1975 ("The 1975 Act") and the Oil Taxation Act, 1975, and secondly, those made for the Fifth Round by the Petroleum (Production) Regulations 1976[71] ("The 1976 Regulations"). The significance of the distinction lies in the fact that the 1976 Regulations were laid down to govern future licences to be awarded in the fifth and subsequent rounds. If the oil companies perceived them as being unfair, they were under no obligation to apply for further licences and could simply ignore them. The 1975 Act also laid down new regulations, but did so by amending the 1966 Regulations which meant that the conditions of existing licences were altered retrospectively by the Government. The significance in this distinction lies not in the retroactivity of the 1975 Act itself but in that the 1975 Act was a purported unilateral amendment of an agreement in the nature of a contract. The latter phrase, "in the nature of a contract", is important since the legality or illegality of the 1975 Act, under International Law, hinges upon the legal nature of the production licence. If the licence is of the nature of what is generally thought of as a licence in the United Kingdom, a standard administrative method of regulating individual exemptions from legislative prohibitions (such as television[72], driving[73], betting shops[74], public houses or clubs[75]) then it can undoubtedly be amended as the Government may amend most national laws. If, however, the licence is in the nature of a contract, the contracting parties (here the Government and the oil company) acquire vested rights which cannot be altered other than by mutual consent. On the nature of these licences, Daintith and Willoughby[76] say "It is not surprising, therefore, that the licences should be contractual in form and should display certain elements of a commercial transaction ..... at the same time the licences contain a strongly regulatory flavour" and then refer to "the admixture of contractual and regulatory techniques represented by petroleum production licensing". It is essential to bear in mind the significance of the answer to the contractual/regulatory question when considering the changes made by the 1975 Act to the licences. (It should be noted that the 1976 Regulations are not subject to challenge since they are new, prospective regulations, which have no effect on licences awarded prior to the fifth round).

THE LEGISLATIVE CHANGES OF 1975 AND THE FIFTH ROUND

The term of the licences remained unchanged by the 1975 Act, but the 1976 Regulations changed this provision. The current licences have an initial term of four years, with an option on the licensee to continue it for a further three, subject to having fully complied with its obligations under the licence[77]. This provides the Minister with an earlier chance to review compliance by the licensee with the licence's requirements, in particular the work programme, than under the old clause which granted an initial period of six years. The proposal contained in the Fifth Round Consultative Document[78] that one-third of the licensed area be surrendered at the end of the initial period was not adopted in the 1976 Regulations, presumably as a result of the oil industry's opposition to it. Instead, two-thirds of the licensed area requires to be surrendered at the end of the seven year period, prior to the third term of thirty years[79].

The 1975 Act introduced the computation of royalty payments into the licence itself[80], together with provision for payment of royalties in petroleum instead of money[81]. There is little significance in bringing the amount of royalty payments from the schedules annexed to individual licences into the model clauses themselves except, if anything, to make the matter appear somewhat more regulatory. This is because the model clauses are to be incorporated in every licence unless the Minister sees fit to do otherwise; whereas there are no "model" schedules for annexation to licences, rather, each schedule, at least in theory, lays out terms agreed for each particular licence. The schedular form has much more of the essence of a contract, the details of which are agreed by the two parties, than the model clause method which is more susceptible of a regulatory interpretation. Thus this change may have been a step in the direction of altering the amount of royalty due but did not go so far itself, as it merely confirmed the rate at 12½% of the wellhead value of petroleum (changed to 12½% of the landed value of oil won and saved for the Fifth Round).

Despite this slight alteration in the status of the royalty payments, they are still an unusual kind of taxation through being specified in individual contracts and not laid down in general legislation to apply to anyone who becomes chargeable. Hence, while Parliament has a great deal of discretion in amending the rates or the structure of the country's tax system, it is not clear that it has power to alter the rate of royalties on petroleum without consent of each licensee concerned, on account of the nature of the payments which is at least partly contractual rather than fiscal.

An innovation in the 1975 Act was the power given to the Minister to require a licensee to deliver to him part of the petroleum won and saved in place of payment of royalties in money[82]. Such petroleum is called "royalty petroleum" and may take the form of condensate, natural gas and natural gas liquids, or crude oil of different specified qualities, or any of those indifferently. The shortage of oil suffered by Western states as a result of the OPEC Revolution of 1974 clearly demonstrated the wisdom of the Government guaranteeing for itself at least a part of the oil being produced within the country, which may be required for the operation of essential services during an oil shortage or the replenishing of reserves in anticipation of or after a shortage. It may also be financially preferable for the Government to require oil rather than its landed value at a certain time.

The wisdom of this measure does not alter the fact that its introduction was a unilateral alteration of the licences already granted to the oil companies. It would have been unobjectionable for Parliament to legislate in general terms that debts owed to the Treasury could, if so required, be recovered, not in sterling, but in petroleum, and thereafter apply the provision in practice only to royalties in respect of oil recovered, since this would form part of the general law of the land from which nobody within the jurisdiction of the U.K. courts would be immune. It is objectionable, however, for Parliament to import this additional condition into pre-existing licences of the nature of offshore production licences which have this substantial contractual element which gives rise to vested or acquired rights, which may not be altered or reduced except by mutual agreement of all parties[83]. The Government by adding this provision to licences interfered with the rights of the licensees, as stated in each licence. It should be noted that the same result could have been achieved by the statutory creation of a right in favour of the Government to require a percentage of oil landed to be handed over to it, with a corresponding obligation upon the Government to refund an equivalent amount of royalty payment received from the licensee from whom the oil was required. This would amount to expropriation of such oil, but as long as it was applied in a non-discriminatory fashion and upon payment of prompt, adequate and effective compensation (by returning or waiving royalty payments) it would be acceptable under international law[84]. This would be a more complex method of achieving the desired result, and certainly much less politically acceptable, but would have avoided the legal problems of unilaterally introducing new conditions into a contractual arrangement.

As with the royalty payments, the 1975 Act replaced a reference to a schedule with detailed provisions in respect of the working obligations of the licensee. The substantive obligations remain in schedular form but the procedures for submission of appropriate programmes by licensees, approval by the Minister, obtaining consents and so on are set out in the licence itself[85]. So the Minister can now, during the second (or since 1976, the second or third) term of the grant, require the licensee to submit an appropriate programme for exploration of the licence area. This may involve the holder of a licence granted prior to 1975 being required to submit and then carry out work programmes not envisaged at the time of the initial grant of his licence.

Among the provisions introduced in this section of the 1975 Act were limitation notices, which may be served by the Minister and which permit the Minister to issue further notices varying for a specified period the maximum or minimum quantities of petroleum indicated in the licensee's programme.[86] Thus any development and production programme may be modified to require a slower, or a faster rate of production under certain circumstances, although this is mitigated in practice by the assurance made at the Committee stage of the 1975 Bill[87] that effect would be given in any limitation notice to the guidelines already laid down by the Government[88].

Pre-1975 licensees could accordingly find themselves under an obligation to carry out much more onerous work programmes than they would desire and in some cases, at a time when a licensee may have reckoned that his expensive exploration work had been finished. Although this new regulation did not ipso facto modify the licensees' obligations, it provided the mechanism for the Minister to require an increased amount of exploration activity than laid down in the licences. This is another unilateral interference with the licensee's vested rights, enabling even greater deviations from the operation as originally envisaged in the agreement.

The sanction of revocation has always been present in offshore production licences[89], as in most other types of licence, but it was amended by the 1975 Act to allow the Minister to revoke licences, in certain circumstances, with respect to a part only of the licensed area[90].

This, far from being a diminished threat, may be a more powerful weapon than was previously available to the Minister. A Minister now has a penalty which he may reasonably impose upon a licensee who is proving uncooperative as regards working obligations (the imposition of which would incidentally return some potentially valuable area of sea to the control of the state) as opposed to having only the power of total revocation, the use of which is virtually inconceivable due to its severity. This drastic remedy of total revocation is retained by the 1975 Act, and would prove necessary if a licensee were unwise enough to persist with a policy of non-cooperation sufficiently long to drive a Minister to such desperate measures; a more realistic sanction by far would be the gradual reduction of the licensed area by as many partial revocations as were required to ensure compliance with the terms of the licence. Any part of the licensed area in which the licensee is complying with the terms of the licence is protected from this sanction of partial revocation.

This innovation is a further amendment to the pre-existing licensee since it goes beyond the previous provisions and is not justified by the domestic law of the U.K., which contains no authority for one party to a contract imposing such a penalty upon the other. In domestic law, in the event of failure to perform a contract amounting to a breach thereof by one party, the innocent party's remedies would be to treat the contract as discharged and sue for damages or to affirm the contract and sue for any loss sustained[91] if he was under English jurisdiction. The appropriate Scottish remedy would be to sue for breach of contract with or without rescinding of the contract[92]. It is doubtful that the partial revocation provision of the licence would be given effect to by a court, if contained in a domestic contract since it is in the nature of a penalty clause - as opposed to a genuine estimate of the loss likely to be sustained by the party not in breach (a liquidate damages clause) and therefore unenforceable[93]. The power of revocation is closely analogous to the power of a landlord, often stipulated for in domestic leases, to terminate the lease in the event of a breach of any of its conditions by the tenant. The partial revocation provision is not encountered in domestic leases and as mentioned above, would be unenforceable in any case. This licence provision is then peculiar to this mode of regulation and, like the changes made to the royalty clauses, another example of a change from a highly contractual formula to a more regulatory form.

Like the change in the statement of the working obligations, this amendment may not itself effect a practical alteration of the terms under which the licences are operated, but provides the procedural machinery for the licences to be controlled by the Minister in a way significantly different from that provided for in the original grants.

Closer supervisory control is given to the Minister in respect of the working methods adopted by licensees. New provisions were added on commencement and cessation of development wells[94] and more detailed regulation on the avoidance of harmful methods of working[95], the most significant parts of which are the subsections on the flaring of gas. Basically a licensee must justify an application to flare gas extracted from a field, which application may then be accepted or refused by the Minister. This was introduced when it was appreciated by the Government that a significant amount of gas would be lost through flaring, if allowed to continue unabated and this realisation became the more significant as the value of all energy sources was enhanced as a result of the shortage caused by the crisis of 1974. Desirable though it was to stop such wastage of energy resources, this was another condition unilaterally imposed into pre-existing contracts. The licensees had accepted licences which did not in any way restrict the common practice of flaring, or burning off, the gas which is released from oil fields along with the oil being extracted from the production wells; they then found themselves involved in considerable expenditure to save this gas, the production of which had hitherto not been thought a viable proposition by the oil companies. The desirability of such energy saving measures, and their public support, is undoubted, neither would it be denied that such provisions ought to have been contained in all licences, but it has never been a proposition of British or International Law that a condition generally acknowledged to be in the best interests of the public can be imported or introduced into contracts unless previous agreement has provided for such addition or amendment.

Another innovation of the 1975 Act was the obligation on the licensee to ensure that no other person exercises any function of an operator of the licence, without the Minister's consent in writing[96], provided that the Minister shall not refuse to give such consent if the person is competent (presumably in the reasonable opinion of the Minister) to exercise the function in question[97].

This new section, apart from excluding co-licensees of the operator, would appear to add nothing to the original provision of the 1966 Regulations[98] which prohibited any assignation by the licensee of any of the rights granted by the licence. The 1975 Act retained the general prohibition on assignation[99] (or "assignment" as it is known in English law) again adding detailed paragraphs on specific matters relating to the disposal of petroleum.[100] These additional paragraphs are in fact an extension of the prohibition on assignment since their effect is to strike at agreements whereby the petroleum or any proceeds from its sale is assigned if, when the agreement is made, the petroleum has not yet been won and saved from the licensed area (except with the Minister's prior approval). Thus an agreement not amounting to an assignation of a right conferred by the licence is affected by this new clause. The right to dispose of petroleum won and saved is not contained in any U.K. production licence, which grants "EXCLUSIVE LICENCE and LIBERTY during the continuance of this licence and subject to the provisions hereof to search and bore for, and get, petroleum in the sea bed and subsoil under the seaward area ....". The licensee's title to the oil is by virtue of the principle of the law of capture albeit that the capturing is a right conferred by the licence.[101] It is therefore a right arising by operation of law, and not a contractual one, which this clause limits. This must be regarded as an even greater wrong than the amendments unilaterally imposed which amend vested contractual rights, since this is a purported restriction on a right of property conferred directly by international law itself rather than a breach of an agreement, which gives rise in the first place to domestic remedies on the secondary level of national law.

This provision can affect a licensee's financing arrangements since these are often achieved by "forward oil sales". This involves the licensee obtaining finance for development and/or production of a field in return for granting to the lender the right to a specified amount of petroleum or money from the sale of petroleum when it is won and saved. This was the method utilised by B.P. in financing the Forties Field.[102] In essence the lending banks and B.P. established a financing company which agreed to buy the oil from B.P. as it was produced. The banks supplied the financing company with funds, and these were made available to B.P. by way of advance payment for the oil to be sold by B.P. to the financing company. As the oil is actually produced it is sold to the financing company which requires B.P. to re-purchase the oil, thus generating the revenue within the financing company which it in turn pays to the banks to service and repay the monies advanced by the banks. In the unlikely event of the amount of the petroleum falling short of the necessary amount, the banks had recourse to

B.P. itself for any balance remaining unpaid.[103] Any such arrangement now adopted would require the consent of the Minister, otherwise it would fall within the prohibition of clause 38.

Clause 38 is a measure to prevent avoidance of the requirement that all petroleum won and saved by the licensee be delivered on shore in the United Kingdom unless the Minister gives his consent to do otherwise.[104] This gives the government potential possession of all oil produced from the U.K. Continental Shelf, and thus a greater degree of control over activity in the North Sea and other oil producing areas of the U.K. sea. It would not defeat this objective, since the Government would not necessarily have to observe any forward oil sale agreement made by an oil company, to allow licensees to sell oil not yet produced, but it would present unnecessary complications to the Minister in the event of an emergency in which he desired immediate control of oil produced by the U.K. to discover an unexpectedly large amount of oil committed to financiers, often resident outside the U.K.

The original provisions on unit development or 'unitisation' were not altered by the 1975 Act; an example of their operation was provided by the Frigg Field Reservoir Agreement 1976.[105] The Agreement was made between the Governments of the United Kingdom and Norway to make provision for the exploration of the Frigg Field Reservoir. which straddles the U.K.-Norway dividing line, as a single unit. Such an agreement cannot itself be binding upon licensees in the North Sea[106] but may be implemented by the issuing by the Minister of directions requiring the licensees to cooperate in the execution of the Agreement if they are unwilling to do so by mutual consent[107].

The only change of significance in the total revocation provisions[108] is the addition of the power of the Minister to revoke a licence if control of a licensee company changes and remains so changed despite notice by the Minister of his intention to revoke the licence on this account. This may be seen as replacing the former ground of revocation that the licensee had ceased to be resident in the United Kingdom or to have its central management and control in the United Kingdom in the case of a company, which disappeared when, in 1975, it became no longer necessary for applicants for licences to be citizens of or incorporated in the United Kingdom. This requirement became illegal as regards E.E.C. residents and companies by virtue of E.E.C. Council Directives 64/428 and 69/82[109], but rather than extend the qualification to persons resident or companies incorporated within the E.E.C., the residence/incorporation requirement was dropped altogether. The Minister still has discretion as to which applicant is to be awarded a licence and so the new revocation provision is necessary to prevent the exercise of this discretion from being defeated by subsequent changes in the nature of a company.

These were the major changes effected by the 1975 Act, which by statute, unilaterally altered the pre-existing licence terms. The Government never admitted any allegation that these amendments were illegal, but some statements failed to rebut the charge, as evidenced by the following exchange in the House of Commons:-

Mr. Skeet: "Is it not fair to say that in that list(of countries which changed their oil policy) many of the countries have not abrogated the existing terms under the existing licences ? Why is the Minister seeking to do it here ?"

Mr. Varley (introducing the Second Reading of the 1975 Act as a bill): "Because most of those Governments had already made provisions, the sort of provisions that should have been made before the fourth licensing round."[110]

It was perhaps caused by the animosity between the Labour and Conservative Parties of the time which resulted in many about-turns in policy and legislation, as governments lost, and then regained office, but Mr. Varley's theory seems to have been that the fact that previous governments had failed to create the kind of licensing conditions which the Labour Party wanted, did not prevent the latter subsequently imposing those conditions it thought desirable. The many enactments and repeals by consecutive governments seem to have strengthened the idea of parliamentary omnipotence at the expense of recognition that Parliament had exercised its sovereignty in creating vested rights which legislation could not legally alter or detract from, since binding contracts, and not merely administrative regulations, had been created.

BNOC AND PARTICIPATION

The awards of licences are governed by criteria laid down prior to each Licensing Round in notices in the London, Edinburgh and Belfast Gazettes. The legality of the content of those notices is not per se challengeable since they are purely prospective to the respective licensing rounds to which they relate. They intimate the basis of the award of licences and the expected conditions applicable to the operation of the licence not ascertainable from the regulations or model clauses. Thus these notices are statements of intent, not binding upon the Government or the licensee, and are wholly superseded by the terms subsequently agreed between the parties to future licences. The relevance of these notices lies in their value as statements of Government policy aimed not at politicians or public opinion, but directly at potential licensees.

The notice announcing the fourth round of licences[111] specified the consideration for the licence, that applicants must be citizens of, or resident or incorporated in the United Kingdom, the procedure for applications for the blocks detailed, by tender for that particular round, and the considerations (inter alia) to be borne in mind by the Secretary of State in examining applications. The five criteria specifically laid down for the fourth round were (a) where a body incorporated in a country outside the United Kingdom holds a controlling interest in the applicant, the extent to which equitable reciprocal treatment is accorded in such other country; (b) the extent to which the applicant will further the thorough and rapid exploration of the oil and gas resources on the United Kingdom Continental Shelf, particular attention being paid to the financial and technical ability of the applicant to carry out an acceptable work programme, details of which to be called for when the applications are considered; (c) exploration work already done by or on behalf of the applicant which is relevant to the areas applied for; (d) where the applicant already holds a production licence(s), his previous overall performance and (e) the extent of the applicant's contribution, past or planned, to the economy of the United Kingdom.

These criteria were retained in the fifth round notice, but with the following additions. First, whether the applicant is willing to grant reasonable access to representatives of independent trade unions to offshore installations, having in mind the Government's objective to negotiate a memorandum of understanding on this matter. This merely reflects the change to a more socialist government since the previous round, and the opportunity to make a little political capital. Secondly, whether the applicant subscribes to the Memorandum of Understanding between the Secretary of State and the United Kingdom Offshore Operators Association (UKOOA) to ensure that full and fair opportunity is provided to U.K. industry to compete for orders for goods and services and the applicant's past performance in this respect. This emphasises the more nationalistic approach of the Labour Government of 1976 and is another condition implementing the policy to keep as much as possible of the oil-related profit within the United Kingdom.

Thirdly, and most significantly: the degree to which the applicant, or any existing licensee in whom he has a controlling interest, or any existing licensee who has a controlling interest in the applicant, has demonstrated his agreement to the conceding to the state of a majority share in any discovery made under existing licences. Section 1 of this notice, headed "Majority State Interest" states that "licences will be granted on the basis that the British National Oil Corporation (BNOC) (or another state corporation), or one of its subsidiaries, is from the grant of the licence a co-licensee entitled to a 51 per cent share in all the benefits of the licence". The latter provision, not unreasonably, represented the practical introduction of a state enterprise into the operation of every licence thereafter to be granted for oil production on the United Kingdom Continental Shelf.

The British National Oil Corporation (BNOC) was created by the 1975 Act[112]. It is not a servant or agent of the Crown[113] but has _inter alia_ power "to do anything required for the purpose of giving effect to agreements entered into by the Secretary of State with a view to securing participation by the Government of the United

Kingdom, or by the Corporation or any other body on behalf of the Government in activities connected with petroleum beneath controlled waters."[114] BNOC is dependent upon governmental approval to carry out its operations. For instance, it requires the Secretary of State's approval to search for or get petroleum outside Great Britain and controlled waters, to refine crude liquid petroleum or to treat, buy, sell or otherwise deal in anything derived from petroleum, to promote or participate in the formation of, or acquire or relinquish membership of or any interest in or security issued by, a body corporate, or to borrow or lend money, to charge any of its actual or future assets or to guarantee the performance by another person of any obligation[115]. Further, the Secretary of State has power to give such general or specific directions as he thinks fit to the Corporation[116]. From this, it is apparent that BNOC, although not formally part of the governmental structure, would not be able to continue its operations for any significant length of time without government approval.

Although the state had some involvement in offshore activity prior to BNOC's creation through the National Coal Board, the Gas Council (later the British Gas Corporation) and indirectly through the Government's shareholding in British Petroleum, a greater degree of participation was desired by the new Labour Government as it began to appear that the state might lose the profits of exploiting its natural resources to the oil companies[117], as well as the opportunity to build up the oil industry in Britain, bolstering the economy and creating employment and expertise. Taking a greater degree of participation also presented a chance to adopt a generalised system of involvement by a custom-built oil company, rather than ad hoc interests taken by a coal and a gas company.

Hence BNOC was set up by the 1975 Act as a means of ensuring participation in existing licences covering fields which had been or would be proven commercial, and in all future licences[118]. Participation, as stated, was made a condition of the award of licences in the licensing rounds subsequent to the announcement of this policy, and as such is unobjectionable on legal grounds. The clarity of the paragraph setting out this aim contrasts with the opaqueness of the one following, which deals with the more contentious matter of participation in existing licences, which runs as follows:-

"It is the Government's belief that majority state participation in the existing licences for commercial fields provides the best means for the nation to share fully in the benefits of North Sea oil without unfairness to the licensees since the state contributes its share of the costs, including past costs. Certainly this is the solution adopted with the consent of the oil companies in almost every major oil and gas producing country in the world, not only those in the Middle East. Indeed, public sector participation has worked successfully in the British shelf without injury to the oil companies' interests through the National Coal Board and British Gas - whose present shares will be accepted as a share in the total public participation. The Government hope that the companies will recognise the strength of their views on this. They want the oil companies to continue to invest in the North Sea on profitable terms. They will be ready to listen to what the companies say and consider with them how the common interest can best be served. They are sure the industry will want to submit their views at the earliest possible moment and to enter into talks on this basis. The Government will be inviting them to do so shortly."[119]

This was the Government's published policy; what followed was that participation agreements were signed by all North Sea licensees. They were not imposed upon licensees as a whole, but reached individually, and no formula appears to be excluded, from full participation in capital costs of development, to limitation of BNOC's rights to pre-emption of 51 per cent of the oil produced[120]. The doubt as to the legality of the practical implementation of this policy may first be perceived by contemplating why it was that within a relatively short period, at a time when many fields were beginning to justify the massive investment put into them, all existing licensees suddenly wished to renegotiate their licences to incorporate into them, an untried and inexperienced partner closely allied to the government. Renegotiation, resulting in genuine consensus between the relevant parties to amend a contract is unquestionably legally competent, but the exertion of undue pressure by one party upon another may be such as to negate the true consent of the latter, reducing the result to a unilateral amendment of a vested contractual right. The fact that the weaker party signs, and thereafter abides by the terms of a new contract does not necessarily vitiate this conclusion since such action may represent the minimisation of the party's loss - making the most of a bad situation. This should not disguise the fact that the change of conditions of contract may have been contrary to law.

There is little available documentary evidence that the oil companies did not voluntarily renegotiate the terms of their licences by the acceptance of BNOC as a co-licensee since the negotiations were in the nature of private meetings relating to private contracts - even if the results are known in principle, the methods of reaching them are not disclosed. There are however many indications that the uneven balance of power of the two parties had some influence on the negotiations.

First, and purely as circumstantial evidence: the degree of compliance with the policy statement. It seems unlikely that no licensee, given total freedom of choice, would have preferred to carry on without a state partner particularly in the light of the great potential which, by that time, had been proven in many fields[121]. Secondly: the fact that the granting of licences in the fifth round was to take into account the record of applicants in reaching agreement to conceding to the state a majority interest in any discovery under existing licences[122]. In other words, an oil company which had failed to 'voluntarily' agree on participation terms with the Government was unlikely to receive any more licences to produce oil from an area proved rich in petroleum deposits. This aspect is not objectionable as a condition of future licences, but is subject to challenge as a means of exerting undue pressure on existing licensees to introduce a partner into contractual arrangements which did not provide for any such change. Thirdly: there were statements from the government and the oil industry which indicated that renegotiation was not entered into by the full will of both parties concerned - that the apparent consensus reached was not entirely true to the facts.

An example of such a statement was made by Clifton C. Garvin, Chairman of Exxon, who said in London, "When the government said participation was voluntary we took them at their word. We are not volunteering."[123] Despite this clearly stated attitude of defience, Exxon, through Esso Petroleum Company Limited, had signed participation agreements, along with 41 other companies, as soon as the end of 1977[124].

An indication of the government's approach to the problem of achieving participation was given by Mr. Harold Lever (a Cabinet Minister) in the House of Commons:-

Mr. Prost: "How can the right honourable gentleman claim that the negotiations are voluntary when the Secretary of State for Energy has admitted that he will use his patronage to allocate future licences in the North Sea only to those who surrender participation ?"

Mr. Lever: "With great respect to the Honourable Gentleman, I must say that he misunderstands the meaning of the word "voluntary". Very few things in this life are voluntary in the somewhat wide metaphysical sense that it is understood by the Honourable Gentleman. By voluntary negotiations we mean that we have taken no legal powers and we do not feel such powers will be necessary."[125]

It is suggested that doing something for any reason short of the force of law is not necessarily to do it "voluntarily"[126] Even if legislation was not actually required, the threat of it must be seen as detracting from the "voluntariness" of the renegotiations:

Mr. Lever: "I made it absolutely plain to the oil companies, first that the Government would scrupulously honour all their contractual and commercial obligations. Secondly, I made clear that if they did not feel able to participate on the terms I outlined, or if they preferred not to participate at all, I have no statutory powers. I had to tell them that it was very possible that if they did not feel free to participate, the Cabinet would be free

> (interruption) feel obliged, if it were unable to satisfy its objectives, which seem to us fair and reasonable and not incompatible with the interests of the oil companies, by voluntary agreement with them to nationalise that proportion of the licences that it thought right to nationalise."[127]

Thus there were open threats of legislation, going as far as nationalisation of oil interests, if "voluntary" agreements were not reached. Licensees were therefore left little choice but to offer participation deals to BNOC, since they would be unlikely to receive further licences if they failed to do so and, if that were not sufficient compulsion, it was strongly indicated that participation would be achieved by legislation, which may have been much less favourable than negotiated terms, even if negotiations were conducted under some duress.

The conclusion drawn from this is that, as regards BNOC, the Government did not lay down in writing, whether in consultative documents, Gazette notices, legislation or otherwise, anything which is per se illegal under International Law, particularly since nothing with any compulsion attached had retroactive effect. The action of the Government in introducing BNOC into licences awarded prior to 1975 was subject to challenge by the oil companies because it amounted to a unilateral alteration of the vested rights of the licensees created by those licences by the use of undue pressure including the threat of no further licence and the threat of partial expropriation. Two points should be noted as regards these unlawful amendments.

First, they were not, unlike the statutory changes in the model clauses discussed earlier, laid down by force of law which would have made their illegality all the clearer, but rather they were achieved by renegotiation, the "voluntariness" of which was emphasised by the Government, unless voluntariness flagged, in which case the alternatives were emphasised.

Secondly, there was no public outcry or litigation, on the part of the oil companies. The nature of the pressure applied upon them by the Government was such that, having recognised that the Government's policy could not be changed and that legislation would be introduced if necessary, the oil companies saw that their best approach was to enter negotiations and try to achieve the best deal possible in the circumstances. The vast investment already put into the North Sea and the remarkable rise in potential profits due to the OPEC

Revolution had effectively rendered withdrawal from the North Sea unthinkable at that time, which must have been a factor of which the Government was well aware when presenting its new terms to the licensees.

TAXATION OF OIL REVENUES

For the period up until the North Sea began to appear as an important source of natural resources (and revenue), companies operating there were treated no differently from any other company for tax purposes. Basically this meant that companies resident in the U.K. were subject to Corporation Tax on their total profits including capital gains, irrespective of where they arose[128] and non-resident companies carrying on a trade in the U.K. on profits arising through that branch or agency[129]. The only qualification to the general statement is that licensees were obliged to pay the 12½% royalty due in terms of their licences, but this is more in the nature of a contractual provision than a true tax since it is not laid down by Public General Statute but rather in individual agreements. For this reason royalties will not be discussed per se in this section on taxation.

Oil companies and profits derived from oil were not then regarded as special cases by the revenue authorities prior to 1973. The Finance Act 1973 was the first significant modification to this approach. The effect of the provisions of this Act[130] was to extend the definition of the U.K. for most tax purposes to include U.K. territorial waters as far as the three mile limit and to bring within the charge to Corporation Tax "any profits or gains from exploration or exploitation activities" accruing to a non-U.K. resident as if it were a profit or gain arising in the U.K. through a branch or agency. Thus all profits deriving from the U.K. Continental Shelf would be subject to U.K. taxation, irrespective of the nationality or residence of the company concerned (subject of course to the application of any relevant double-taxation Treaty).

This extension was not prejudicial to companies involved in the oil business, but merely a response to a new situation i.e. that due to new technology, profits could be made within an area to which the U.K. had exclusive rights which had previously not been capable of exploitation and hence had never been considered seriously enough to trouble bringing within the general scope of Corporation Tax. This legislation did not put companies working in the North Sea in a worse position than others operating in the U.K. but rather put them on an equal footing by closing gaps which may have permitted certain parties to avoid U.K. taxation.

Subsequent changes in corporate taxation did, however, strike at oil companies in a way in which no other companies were legislated against. The most important enactment in this respect was the Oil Taxation Act 1975 which created a new and separate oil taxation regime (at more or less the same time as the Petroleum and Submarine Pipelines Act 1975 restructured the licensing system for oil exploitation). The preamble to the Oil Taxation Act 1975 states that it is "An Act to impose a new tax in respect of profits from substances won or capable of being won under the authority of licences granted under the Petroleum (Production) Act 1934 or the Petroleum (Production) Act (Northern Ireland) 1964; to make in the law relating to income tax and corporation tax amendments connected with such substances or with petroleum companies; and for connected purposes."

CORPORATION TAX

As mentioned above, Corporation Tax is the general system by which the U.K. taxes companies based or operating within its territorial jurisdiction, and as such is dealt with in detail in many textbooks.[131] The purpose of this study is not to narrate in any detail the statutory provisions on Corporation Tax or their effect, but to look at the international legal validity of its specialties as regards the oil industry.

Every company subject to U.K. taxation is required to file with the Inland Revenue an annual statement of taxable income[132]. This normally takes the form of its audited statutory accounts together with a schedule of adjustments. These adjustments add back items such as depreciation, normally deducted from gross profits for accounting purposes which are not allowable deductions as such for tax purposes, and deduct tax-allowable items such as capital allowances such as industrial buildings allowances, regional development grants, tax already paid as advance corporation tax, and allowable interest payments. Once an adjusted profit (or loss) has been computed, corporation tax is currently payable thereon at the rate of 52%, subject to reduced and marginal rates for small companies.

The major differences in the application of this scheme to the oil companies are in two areas: the valuation of the gross profit figure, and the principle known as "the Ring Fence".

<u>Valuation</u>

One of the most important powers of the Inland Revenue is the power to look behind an inter-company transaction to examine whether the relative accounting entries in the books of the companies concerned give a true view of the nature of the transaction. "Where any property is sold and (a) the buyer is a body of persons over whom the seller has control, or the seller is a body of persons over whom the buyer has control, or both the seller and the buyer are bodies of persons and some other person has control over both of them; and (b) the property is sold at a price less than the price which it might have been expected to fetch if the parties to the transaction had been independent persons dealing at arms length, then, in computing the income, profits or losses of the seller for tax purposes, the like consequences shall ensue as would have ensued if the property had been sold for the price which it would have fetched if the transaction had been a transaction between independent persons dealing as aforesaid."[134]

This prevents companies from determining in which section of an organisation comprising several associated companies profits are to be shown in the accounts, hence preventing companies avoiding U.K. taxation by showing little or no profits made in the U.K. by transferring these earnings (on paper) to associated companies outwith the scope of U.K. taxes. Section 485 ensures that profits cannot, by pure accounting methods, avoid attracting tax where they were actually earned. The proviso to this substitution of arm's length prices is, broadly speaking, where the buyer and the seller are both U.K. resident trading companies.

This section is tightened up in its application to "petroleum companies" by Schedule 9 to the Oil Taxation Act 1975. A "petroleum company" is defined as a company carrying on any of the following activities:-

(a) the acquisition or disposal of petroleum or of rights to acquire or dispose of petroleum[135];

(b) the importation into or exportation from the United Kingdom of petroleum products or the acquisition or disposal of rights to such importation or exportation[136];

(c) the acquisition otherwise than for importation into the United Kingdom of petroleum products outside the United Kingdom or the disposal outside the United Kingdom of petroleum products not exported from the United Kingdom by the company making the disposal[137];

(d) the refining or processing of crude petroleum[138];

(e) the extraction of petroleum, either under rights authorising it or under contractual or other arrangements with persons by whom such rights are exercisable[139];

(f) the ownership, operation or management of ships or pipelines[140] used for transporting or conveying petroleum or petroleum products[141].

A company is also a petroleum company if it is associated with a company whose activities include those above described and whose own activities include the ownership, operation and management of ships or pipelines used for transporting or conveying petroleum or petroleum products[142].

The first major extension of the Revenue's powers with regard to this section is in the situation where a U.K. resident petroleum company is a buyer or seller. Then the U.K. resident buyer or seller proviso to s485 is nullified where:-

(a) either party to the transaction is a petroleum company or both are petroleum companies, and

(b) the activities of either or both are to include activities satisfying the following conditions:-

(i) that profits of the activities are or would be subject to overseas tax qualifying for double-taxation relief in the U.K.; or

(ii) that the activities are exploration or exploitation activities within the meanings of Section 38 of the Finance Act 1973, and

(c) the transaction is part of such activities or is connected with them[143].

The effect of this extension is to allow the Revenue to impose arm's length prices upon a transaction involving two U.K. resident affiliated companies where the above conditions are fulfilled. This extension was made because by using two U.K. resident companies, a group involving petroleum companies could put the whole group profit into the one of the group - by appropriate use of transfer pricing - which would also be making payments of tax due in foreign states on account of foreign operations. These tax payments to the foreign state would be covered by credit in the U.K. for foreign tax, hence restricting or avoiding altogether the group's liability to U.K. tax[144]. By imposing market-values upon inter-company transactions, transfer pricing (i.e. pricing at under-value) cannot be used to shift the profits for tax purposes of a group of companies from the member or members of the group actually producing the profits to any other company or companies in the group. This extension was an anti-avoidance provision, and it may be argued that a similar restriction would be imposed upon any other sphere of commerce which began utilising transfer pricing to avoid U.K. taxation to the extent that oil companies were alleged to have done.

Like the territorial extension of U.K. taxation discussed above, this may be seen as a measure to prevent the oil industry securing undeserved taxation advantages by the nature of its international business, rather than as a measure discriminating against foreign companies which would be challengeable under international law.[145] This view is further supported by the fact that the extension of the ordinary taxation provisions applies where two U.K. resident affiliate traders are concerned, and cannot therefore be said to discriminate in any way against foreign nationals.

The second extension of the Revenue's power to impose arm's length prices arose because it was thought that the oil industry was diverting profits out of the U.K. by means of a series of linked transactions world-wide, which would not necessarily be caught by the common-control proviso of s485. It was enacted that the arm's length rules can be applied without the need for common control where any property is sold and either the buyer or seller (or both) is a petroleum company, and

(a) the sale is part of a transaction or a series of transactions (whether or not between the same persons) and its terms are affected by those of the remainder of the transaction or transactions; or

(b) what is sold is petroleum extracted under rights exercisable by a company other than the buyer and not less than 20% of that company's ordinary share capital is owned at the time of the sale directly or indirectly by the buyer or a company associated with the buyer[146].

Although this also represented a departure from the normal taxation provisions, it cannot be attacked as being discriminatory since it is an anti-avoidance provision directed at all petroleum companies which may have been attempting to avoid U.K. taxation by means of elaborate schemes of linked transactions. It does not extend the tax system but merely closes a gap in an existing scheme.

These measures on valuation of transactions are all legitimate anti-avoidance provisions, merely preventing the oil industry from using its very nature to avoid payment of the amount of taxation to which it would be liable under the general scheme of U.K. corporate taxation. They do not penalise the oil industry but merely ensure that it bears an equal share of the burden of taxation.

The Ring Fence.

The ring fence principle was introduced by the Oil Taxation Act 1975 as a means of ensuring that the corporation tax arising on profits made by oil companies in the U.K. is not diluted by any other activities of the companies involved. Its effect is to isolate profits from 'oil extraction activities' in the U.K. or on the U.K. continental shelf and profits attaching to 'oil rights', from other activities of the company or group of companies, for the purpose of assessing corporation tax. It acts like a valve, preventing loss relief from flowing into ring fenced activities from outside, whilst permitting reliefs arising within a ring fence to be applied outwith it. Any oil crossing the fence is valued at full market price[147].

For corporation tax, losses and capital allowances can normally be dealt with by (a) carrying them forward to set against future profits of the same trade[148], (b) relieving them against profits of any kind of the same company arising in the same or previous accounting periods and/or[149] (c) relief against the profits of any company or companies in the same group arising in the same accounting period[150]. The ring fence principle permits only losses arising from oil extraction activities and the acquisition, enjoyment or exploitation of oil rights to be set against profits arising therefrom[151].

Ring fence oil extraction activities broadly cover the following types of operations in the U.K. or on the U.K. continental shelf: (a) searching for oil, (b) extracting oil, (c) transporting oil extracted offshore to dry land in the U.K., and (d) initial treatment and storage of oil won.[152] The other ring fence activities are those relating to the acquisition, enjoyment or exploitation of 'oil rights' which are defined as rights to oil to be extracted in the U.K. or a designated area of the U.K. continental shelf or the interests in or to the benefit of such oil.[153]

These ring fence activities are treated as a separate trade from any other which a company may carry on and separate accounts have to be prepared of income and expenditure relating to these activities for a separate computation of corporation tax to be made.

The existence of ring fence activities brings into effect the special provisions relating to profits and losses within, and in particular cases, across the ring fence, but the details of these arrangements will not be discussed in this study since they are primarily the concern of the oil companies' taxation advisers. The important legal issue is the isolation of one activity for the purpose of taxation.

The potentially challengeable aspects of such treatment of an industry are that it amounted to creeping expropriation or that it discriminated against foreign companies.[154]

Taxation of companies by its nature, involves no direct quid pro quo, and would therefore be an illegal means of expropriation since it would not involve any element of compensation which is a requisite of legal expropriation. It is submitted, however, that nothing in these corporation tax changes was unduly onerous or sufficiently outwith the general scheme of the tax so as to amount to expropriation. Further, the ring fence principle as applied to corporation tax does not adversely affect foreign companies to any greater extent than U.K. companies. Indeed the reverse is likely to be the case, since a U.K. company is more likely than a foreign company to have loss reliefs recognised for U.K. corporation tax which it would be able to set against its oil-related profits if it were not for the ring fence principle.

There is, then, no corporation tax provision sufficiently penalising to amount to expropriation, creeping or otherwise, and those measures aimed directly at the oil industry are more objectionable to U.K. companies than foreign investors. No amendments to the corporation tax legislation therefore exceed the sovereign authority of a state to tax those within its jurisdiction by amounting to discrimination or confiscation and cannot therefore be challenged by International Law.

Petroleum Revenue Tax.

Petroleum Revenue Tax (PRT) was introduced by Part I of the Oil Taxation Act 1975 and represented ...

concept in U.K. taxation. It operates separately from the main body of U.K. corporate taxation and utilises quite different principles[155]. PRT is levied on profits from oil (which term includes natural gas) won under the authority of licences granted under the various enabling provisions.[156]

It would be inappropriate to discuss the detailed provisions of PRT at length here[157], but an explanation of the basic principles is necessary.

PRT is payable (initially at 45%, then successively at 60%[158] and 70%[159]) on assessable profits accruing to participators after 12th November 1974, and is assessed field by field on the basis of half-yearly periods ending on 30th June and 31st December in each year after the critical half year[160]. The critical half year is the first half year ending after 12th November 1974 at the end of which the total oil won and saved from the field exceeded 1,000 long tons[161].

Separate returns must be made of income and expenditure (no distinction being made between capital and revenue expenditures) for each field for the assessment of PRT. These must be made within one month of the end of the chargeable period[162] by the 'responsible person' who will have been nominated for each field by the participators or the Inland Revenue[163]. More detailed returns must be made by the participators themselves within two months of the end of the chargeable period[164]. Any relevant claims having been made by the participators and responsible persons for expenditure and losses, the Inland Revenue makes its assessment three months after the end of the period[165] and PRT is payable four months after the end of the period[166].

It can be seen that a great deal of the administrative burden of PRT falls upon the taxpayers who require to prepare these detailed returns twice in each year for each field in which they have an interest - a much greater workload than any other tax involves on the part of the taxpayer.

The assessment is computed by taking the sum of certain 'positive amounts' and ' negative amounts', the difference between the two resulting in either an assessable profit or an allowable loss[167]. Any PRT payable is deductible in computing income for corporation tax purposes. The positive amounts are gross profit, licence credits and the amount credited in respect of expenditure[168]; the negative amounts are gross loss, licence debit and the amount debited in respect of expenditure[169].

The rules for determining gross profit are much more restrictive than for corporation tax. In particular, for actual sale proceeds to be accepted, the transaction must be 'at arm's length' which is narrowly defined for PRT as being a contract where:

(i) The contract price is the sole consideration for the sale, and

(ii) the terms of the sale are not affected by any commercial relationship (other than that created by the contract itself) between the buyer and the seller or persons connected with the buyer or the seller, and

(iii) neither the seller nor a connected person has any interest, direct or indirect, in the subsequent resale or disposal of the oil or any product derived therefrom[170].

If these stringent conditions are not met, the realised price will be ignored and a market value as at the middle of the relevant month will be substituted[171].

Royalty and periodic payments are included in the computation as licence debits or credits and will accordingly usually be applied in reducing the profit chargeable to PRT.

In addition to specific allowances such as expenditure on long term assets[172], abortive exploration expenditure[173] and otherwise unrelievable loss from an abandoned field[174], the following constitute the categories of normal expenditure allowed for each field:-

(a) searching for oil in, and within 5,000 metres of, the field

(b) initial licence payments to the Secretary of State

(c) ascertaining the extent or characteristics of any oil bearing area wholly or partly within the field, or the reserves thereof

(d) winning oil from the field

(e) measuring the oil won or to be won from the field

(f) transporting oil won from the field to the U.K.

(g) initial treatment or storage of oil

(h) disposing of such crude oil in arm's length sales

(i) closing down all or part of the field for reasons of safety or the prevention of pollution[175].

There are, in addition, certain special concessions made to participators to alleviate potential hardship caused by PRT.

The first is the valuable expenditure supplement or "uplift"[176]. This is a supplement of 75% (now 35%[177]) on to certain expenditure to replace the interest cost of capital expenditure which would otherwise not be deductible for PRT purposes[178], and covers substantially all development plan expenditure incurred before and after the field comes on stream.

The oil allowance was devised to encourage the development of marginal fields. It exempts from PRT the first 500,000 long tons of oil (or gas equivalent) from each field in each chargeable period subject to an overall limit of ten million long tons per field[179]. This allowance is given in respect of each field and must therefore be shared by the participators in accordance with their share of production during the relevant period.

There is an annual limit of PRT payable which does not constitute a deduction, but is made as a separate calculation and if the amount of PRT assessed should exceed this maximum amount, this maximum amount will be the total PRT payable for that calendar year. The annual limit is

80% of the amount by which a participator's adjusted profit (i.e. assessable profit, before reduction for losses and oil allowance, plus expenditure qualifying for uplift) for that year exceeds 30% of his accumulated capital expenditure (i.e. qualifying for supplement) at the end of that year[180]. This safeguard is another method of assisting marginal field development, by ensuring that a participator's return on his investment does not fall to an unacceptably low level on account of PRT. It should be mentioned that BNOC, formerly exempt from PRT[181], was brought within the charge to PRT by the Finance (No.2) Act 1979[182].

The main principles of PRT which set it apart from the general system of U.K. taxation may be summarised as follows:

(a) As regards expenditure, there is no distinction between capital and revenue;

(b) It is assessed separately on each participator for each oil field, as determined by the appropriate authority[183].

A participator may not set losses sustained in one field against profits arising in another, except where abortive exploration expenditure has been incurred or where a field has permanently closed down. This is similar to the 'ring fence' created for corporation tax in respect of oil extraction and related activities, but much more restrictive since for PRT, each oil field is fenced-in, and subject to the above minor exceptions, nothing can cross the fence in either direction.

(c) The substitution of market values for actual sale proceeds is not so much the exceptional case in PRT assessments, but almost the rule, due to the stringent test for arm's length transactions.

(d) The greatest administrative burden of PRT is placed upon the taxpayers rather than the Inland Revenue, which makes PRT not only a lucrative source of income but also an easy tax to collect. It is collected half-yearly.

(e) PRT affects a very small section of the community (although bringing in huge revenues - B.P. alone had a PRT liability of £781.9m in 1979[184]) and indeed is expressly addressed in the charging provisions to a certain group of bodies (i.e. those having an interest in licences).

A state's sovereign right to impose taxes upon those within its jurisdiction may be restricted, under International Law, by two principles: the rule that expropriation without compensation is illegal and that of pacta sunt servanda[186].

Taking of the property of aliens by means of increasingly harsh taxation is illegal since by its nature it involves no compensation - the state simply takes an increasingly large proportion of the benefits of a foreign investment without giving anything in return. For such measures to be illegal, they need not discriminate against aliens, rather they are only illegal inasmuch as they affect aliens since otherwise international law has no application. There are many foreign companies involved in oil production in and around the U.K.: Chevron (operator of Ninian Field), Texaco (operator of Tartan Field), Phillips (operator of Maureen Field), Mobil (operator of Beryl Field) etc. Therefore if the legislation of 1975, involving no compensation and affecting these foreign nationals as it did, amounted to a taking of property, it was illegal.

The Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens[187] stated in Article 10 3(a) :-

"A 'taking of property' includes not only an outright taking of property but also any such unreasonable interference with the use, enjoyment or disposal of property as to justify an inference that the owner thereof will not be able to use, enjoy, or dispose of the property within a reasonable period of time after the inception of such interference."

Although not specifically mentioning creeping expropriation by means of taxation, Professor G. C. Christie[188] deals with the subject of the taking of property by means of creating effective monopolies. This is the situation which would be brought about by excessively high, discriminatory tax rates, especially when accompanied by a statutory corporation with such broad financial and regulatory powers as BNOC possesses. Professor Christie says:-

"The few actual cases ..... have normally involved situations where a state has granted, or assumed itself, a monopoly over a particular industry. Although the damages in these situations are, for the sake of convenience, often referred to as damaged to the "good-will" of a business, substantial loss of value even in physical assets may be involved. For example some of the physical assets may be such as to be of no use at all in any other type of endeavour, or the cost of conversion to other uses may be too great to be practicable; and it may simply be too expensive to make it worthwhile to transport the equipment to another country."[189]

This type of situation could be argued to have been created by the U.K. Government in 1975. It created BNOC with a compulsory 51% interest in future licences and "voluntary" majority interest in existing licences, and power to buy, compulsorily, oil from other licensees at predetermined prices. Together with BNOC came PRT, a tax discriminating against the oil industry, and potentially amounting to an expropriation of oil revenues by the Government. This would clearly have been a "taking" had PRT been levied at 100%; licensees would then have been operating purely for the benefit of the U.K. Government and would have been able to claim compensation also on the grounds that their physical assets had been taken, since moving the bulk of the equipment relating to oil production would be almost impossible, and it would be useless in any other business.

Thus the legislation in 1975 was in a form which lent itself to a nationalisation of the oil industry in the U.K. It would certainly have amounted to nationalisation had BNOC's interests and the rate of PRT each been 100%, instead of 51% and 45% respectively. It was by virtue of these latter two percentages that licensees were permitted to operate with some degree of autonomy and to retain sufficient profit from their operations to make it worthwhile to continue to work in the U.K.

The 51% participation level, and the 45% rate of PRT fell short of the kind of measures required to constitute a taking or property, examples of which are contained in the Oscar Chinn case[190] and the Savage Claim[191], since these levels permitted the companies to continue operating with a degree of independence and making large enough profits to keep them in the North Sea. One may pause, however, to consider whether the oil companies would not have made much stronger appeal to international law, complaining of expropriation, had PRT been introduced at the present level of 70% instead of the original 45%. Might this, coupled with the imposition of BNOC not have come very close to a taking of property ?

The second possible ground for challenging the legality of PRT is the principle of pacta sunt servanda discussed above. A contract such as a U.K. oil production licence cannot restrict the capacity of Parliament to alter the state's general tax regime or even from raising corporation tax by say 30% - a measure which would certainly have an adverse effect on participators under production licences. The licence may however be seen as setting out the special relationship between the licensees and the state vis-a-vis the licensee's oil extraction activities inasmuch as they are not governed by the general law of the land. Thus there are two elements to the whole relationship between companies with licence interests (here called 'oil companies') and the state: first, the general laws of the state, including the taxes acts (the general relationship), and secondly, the terms of the licences (the special relationship). The former remains within the prerogative of Parliament to alter, revoke or create; the latter being in the nature of a contract, cannot be amended except by agreement of both parties.

The charging provisions of PRT[192] state that it shall be charged "in respect of profits from oil won under the authority of a licence granted under either the Petroleum (Production) Act 1934 or the Petroleum (Production) Act (Northern Ireland) 1964."[193] Although PRT was introduced as a part of a Public General Act, it is not a general tax affecting the community at large, but is clearly expressed to be directed only at those making profits through the licences. General taxes, such as income tax, capital transfer tax, capital gains tax and corporation tax are aimed at anyone making gains of specified kinds, in countless different ways. They are not directed at specific, small sections of the community or to particular activities or products. PRT is directed at one, identifiable group of persons and more specifically at their rewards from working with a particular product in strictly defined geographical areas. The "profits" which PRT charges need not be real, since market values are so readily substituted for actual prices, and losses from outside each ring fence are disallowed. This is a major distinction from the general taxes where the imposition of theoretical values is an unusual, anti-avoidance measure. PRT is a means of securing a pre-determined percentage of the value of oil produced, independently of the financial affairs of the companies concerned. For this reason PRT is better viewed as part of the conditions of operating a U.K. production licence, than as part of the general tax system. This can also be seen by its resemblance to the royalties payable under the licences. Both are directly and wholly dependent upon the amount of oil extracted from specified areas (the licence area for the royalty, the oil field for PRT) under the authority of the licence, by a restricted group of potential taxpayers.

These factors render PRT part of the special relationship between the oil companies and the state, since it is too closely connected with the oil companies' licence activities to be classed as part of the general law.

The dichotomy between contract and regulation - licence and general law - has therefore been broken; a matter which, like the royalty payments, is of fundamental importance to the special relationship, has been imposed on the oil companies through the medium of the general relationship.

The consideration for oil companies operating their concessions is a contractual matter - as evidenced by the inclusion of the initial payments, royalty payments, etc. in the terms of the licences - and therefore part of the special relationship. The licence stands as the statement of that special relationship and the oil companies are entitled to expect that, apart from agreed changes to the licence, they can be affected only by changes in the general law. A change in the rate of corporation tax, for example, would constitute a legitimate change in the general relationship, but the introduction of a special tax affecting only those with interests in licences is a change in the special relationship, the sole measure of which should be the licence. The 'ring fence' around the licence as the measure of the special relationship was thus broken by the introduction of PRT, just as it was by the unilateral amendments to the terms of the licences discussed earlier. Since both the changes to the licences and the introduction of PRT amounted to breaches of state contracts, in the instances where those contracts involved a foreign national, that foreign national through its own national state, acquired a claim against the U.K. Government for compensation for breach of contract.

The numerous political and economic reasons for such claims not being espoused, not being relevant to the legal basis of those claims, will not be examined here. In short, it is clear that the oil companies perceived it to be in their best interests to accept the inevitability of a change of government policy, and to renegotiate and liaise with the Government rather than provoke a confrontation over strictly legal issues, which would be unlikely to achieve any significant financial advantage, and would certainly do irreparable damage to a relationship which the oil companies could ill afford to allow to deteriorate[194].

Notes

1. 1964 U.K.T.S. No. 39, Cmnd. 2422.

2. Petroleum (Production) Act 1918.

3. Elliff v. Texaco Drilling Co., Supreme Court of Texas 1948, 146 Tex. 575.

4. 1962/63 I.L.M. Vol.2, p.223.

5. P.C.A. (1928) No. XIX.
Minquiers and Ecrehos Case I.C.J. Rep.(1953) p.47.

6. See further: North Sea Continental Shelf Case (1969) I.C.J. Rep. p.3 at p.40, 41 I.L.R. 29.

7. Department of State Bulletin No. 327, Sept.30 1945 p.485; (1946) 40 A.J.I.L. (Supp.)45.

8. See press release accompanying the Proclamation.

9. 1964 U.K.T.S. No.39, Cmnd.2422.

10. North Sea Continental Shelf Case (1969) I.C.J. Rep.3 at p.40, 41 I.L.R.29.

11. See Greig, International Law p.159.

12. Section 1(i)

13. The Law of the Sea and Natural Resources - The Concept of a Continental Shelf and the Financial Problems of Exploitation in The Law of the Sea and Natural Resources. Proceedings of the 5th Commonwealth Law Conference 1975.

14. Oil and Gas Licensing and the North Sea, Journal of Law and Economics 1965, p.54.

15. H.C. Deb. Vol.891, col.487, 30th April 1975.

16. Aug.5th 1974, p.23.

17. S.I. 1964 No.708.

18. S.I. 1966 No.898.

19. S.I. 1971 No.814.

20. S.I. 1972 No.1522.

21. Reg.3.

22. Reg.3(i)(b).

23. Reg.10.

24. Reg.10.

25. Reg.4.

26. Regs. 6 and 7.

27. Reg.8.

28. Petroleum (Production) Act 1934 s.I.(1)

29. Reg.9.

30. Clause 2.

31. S.I.(1) and (2)

32. Reg.11.

33. See First Report from the Committee of Public Accounts 1972-73, North Sea Oil and Gas H.C. 122 1973.

34. Petroleum (Production) Regulations 1966, S.I. 1966 No.898, sched.4, clause 2.

35. ibid.

36. ibid sched. 3, clause 2.

37. as defined, ibid, Reg.2(1).

38. as defined, ibid, Reg.7(2).

39. ibid, sched. 4, clause 3.

40. ibid, clause 4.

41. ibid, clause 5.

42. ibid, clause 8(1).

43. ibid, clause 9.

44. ibid, clause 10(1).

45. ibid, clause 10(4).

46. ibid, clause 11(1).

47. ibid, clause 11(2) - (8).

48. First Report from the Committee on Public Accounts, op.cit. paras. 15 and 18.

49. 1966 Regs. op.cit, clause 13.

50. ibid, clause 15.

51. ibid, clause 16.

52. ibid, clause 17.

53. ibid, clause 18.

54. ibid, clause 19.

55. ibid, clause 21.

56. Daintith and Willoughby, U.K. Oil and Gas Law p.10.

57. 1966 Regs. op.cit, clause 21(a).

58. ibid, clause 21(b).

59. ibid, clause 21(c).

60. ibid, clause 21(d).

61. ibid, clause 24.

62. Taxes Management Act 1970 s20.

63. 1966 Regs. op.cit. clause 27.

64. ibid, clause 28.

65. ibid, clause 32.

66. ibid, clause 33.

67. ibid, clause 34.

68. Labour Party Manifesto 1974.

69. United Kingdom Offshore Oil and Gas Policy Cmnd. 5696/74.

70. H.C.Deb. Vol.891 Col.486, 30th April 1975 (Mr. Varley, Secretary of State for Energy).

71. S.I. 1976 No. 1129.

72. Wireless Telegraphy Act 1949.

73. Road Traffic Acts 1972, 1974 and Road Traffic (Drivers Ages and Hours of Work) Act 1976.

74. Betting and Gaming Act 1960 s5.

75. Licensing (Scotland) Act 1959 ss.36,174.

76. Daintith and Willoughby, United Kingdom Oil and Gas Law, p.26.

77. Petroleum and Submarine Pipe-Lines Act 1975, Sched.2, Part II, clauses 3 and 4.

78. U.K. Offshore Petroleum Production Licensing, A Consultative Document, published 27th May 1976.

79. Petroleum (Production) Regulations 1976, Sched.5, Clause 5(2)(a).

80. 1975 Act op.cit. clause 9.

81. ibid, clause 11.

82. ibid.

83. German Interests in Polish Upper Silesia Case (1926) Series A, No.7 at p.42.

84. Chorzow Factory Case (1928) Series A, No.13. G.A.Res.1803 (1962) Dec.14, 1962, declaration 4.

85. 1975 Act op.cit. clauses 14-16.

86. ibid, clause 16(2).

87. H.C.Deb. (Standing Committee D.) Col.1973, 8th July 1975.

88. H.C.Deb. Vol.882, Cols. 648-650, 6th December 1974.

89. See 1966 Regulations model clause 33.

90. 1975 Act op.cit. clause 16(8).

91. See Chitty on Contracts 24th Ed. p.693.

92. See D.M. Walker, Civil Remedies.

93. Robophone Facilities Ltd. v. Blank (1966) 3 All E.R. 128 pp. 141-142 (Diplock L.J.)

94. 1975 Act op.cit. clause 19.

95. ibid, clause 21.

96. ibid, clause 22(1).

97. ibid, clause 22(2).

98. 1966 Regulations model clause 32.

99. 1975 Act op.cit. clause 38.

100. ibid, paragraphs 3-5.

101. R.W.Bentham, The Concept of a Continental Shelf and the Financial Problems of Exploitation op.cit.

102. ibid, section XIII.

103. ibid.

104. 1975 Act op.cit. clause 27, 1966 Regs. model clause 21.

105. Cmnd. 6491 (1976).

106. Le Parlement Belge (1880) 5 P.D. 197.

107. 1975 Act op.cit. clause 26.

108. ibid, clause 39.

109. O.J.E.C. 1964 p.1871 and 1969 L.68 p.4 respectively.

110. H.C.Deb. Vol.891, Col.486, 30th April 1975.

111. London, Edinburgh and Belfast Gazettes, 22nd June 1971.

112. Part I s.1(1).

113. ibid, s.1(5).

114. ibid, s.2(1)(e).

115. ibid, s.2(4).

116. ibid, s.4(1).

117. First Report from the Committee of Public Accounts op.cit.

118. Department of Energy, United Kingdom Offshore Oil and Gas Policy (1974) Cmnd. 5696 p.5.

119. ibid.

120. Daintith and Willoughby, U.K. Oil and Gas Law, p.17.

121. See Development of the Oil and Gas Resources of the United Kingdom - A Report to Parliament by the Secretary of State for Energy, April 1978, Appendix 2.

122. ibid.

123. Oil and Gas Journal, February 9, 1976 p.48.

124. Development of the Oil and Gas Resources of the United Kingdom op.cit. Appendix 10.

125. H.C.Deb. Vol.907, col.28, 8th March 1976.

126. See The Philosophy of Action ed. Alan R. White.

127. H.C.Deb. Vol.886, col.1340, 19th February 1975.

128. Income and Corporation Taxes Act 1970 (I.C.T.A.) s.238.

129. ibid, s.246.

130. See, in particular, s.38.

131. See for example, Butterworths Yellow Tax Handbook, Simons Taxes (Part D), British Tax Encyclopaedia, Pinson, Revenue Law.

132. Taxes Management Act 1970 ss.10 and 11.

133. Finance Act 1974 s.9 (as amended).

134. I.C.T.A. s485

135. Oil Taxation Act 1975 Sched.9, para 2(a).

136. ibid, para 2(b).

137. ibid, para 2(c).

138. ibid, para 2(d).

139. ibid, para 2(e).

140. as defined in Pipe-Lines Act 1962 s65.

141. Oil Taxation Act, ibid, para 2(f).

142. ibid, para 1(b).

143. ibid, para 3(1).

144. See First Report from the Committee on Public Accounts 1972-73 op.cit. Minutes of Evidence p.100-102.

145. See G.C. Christie, What Constitutes a Taking of Property in International Law ? B.Y.I.L. (1962) XXXVIII p.307.

146. Oil Taxation Act Sched.9, para 5.

147. ibid, s.14.

148. I.C.T.A. s.177(1).

149. ibid, s.177(2).

150. ibid, s.258.

151. Oil Taxation Act 1975 s.13(1).

152. ibid, s.19(1)

153. ibid.

154. See G. C. Christie, op.cit.

155. See Daintith and Willoughby, U.K. Oil and Gas Law, p.107, Business Tax Handbook, Section B9.

156. Oil Taxation Act 1975 s.1(1).

157. For further reference see Daintith and Willoughby (supra) Chapter 5.

158. Finance (No.2) Act 1979 s.18.

159. Budget, 26th March 1980.

160. Oil Taxation Act 1975 s.1(3).

161. ibid, s.1(4).

162. ibid, Sched.2, para 5.

163. ibid, Sched.2, para 4.

164. ibid, Sched.2, para 2.

165. ibid, Sched.2, paras 10-12.

166. ibid, Sched.2, para 13.

167. ibid, s.2(2).

168. ibid, s.2(3)(a).

169. ibid, s.2(3)(b).

170. ibid, Sched.3, para 1(1).

171. ibid, Sched.3, para 3.

172. ibid, s.4.

173. ibid, s.5.

174. ibid, s.6.

175. ibid, s.3(1).

176. ibid, s.3(5).

177. Finance (No.2) Act 1979 s.19(1).

178. Oil Taxation Act 1975 s.3(4).

179. ibid, s.8. Exemptions are now 250,000 metric tonnes and five million metric tonnes respectively (Finance (No.2) Act 1979, s.21).

180. ibid, s.9(1).

181. 1975 Act s.9(1).

182. s.22(1).

183. ibid, Sched.1, para 1.

184. B.P. Accounts 1979.

185. Chorzow Factory Case (1928) Series A, No.13.
G.A. Res. 1803 (1962) Dec.14, 1962, declaration 4.

186. supra, chapter 11.

187. reprinted A.J.I.L.55 (1961) p.558.

188. G.C. Christie, op.cit.

189. ibid, p.319.

190. P.C.I.J., 1934, Series A/B, No.63.

191. Moore, International Arbitration (1898) Vol.2, p.1855.

192. Oil Taxation Act 1975, Part 1.

193. ibid, s.1(1).

194. See the Arbitrators comments on the extra-legal
factors in Texaco v. Libya, Award on Merits p.55.

CHAPTER V.

CONCLUSIONS

The growth in foreign investment by companies dealing in natural resources is seen most spectacularly in the field of petrochemical operations, partly because of the importance of oil and gas to the modern world and partly because of the enormous economic and political power of the oil companies. On account of the massive investment required for oil production and the huge potential rewards for successful operations, it is a business in which all parties concerned are very determined to maximise their gains. For this reason the strict legal position has sometimes been sacrificed to other, particularly commercial, considerations.

The Aramco case quite clearly affirmed in 1963 that the principle of pacta sunt servanda governed concession agreements. This principle has not always prevailed in practical situations because of the relative ease with which a state can defeat the intended meaning of concessions by unilateral action (such as legislation) and the great incentives for oil companies to compromise provided by (a) the substantial profits to be made even from a reduced share of the rewards of production, (b) the lack of means of enforcing judgements of international tribunals against states and (c) in some cases, the threat of complete nationalisation resulting in even greater losses of revenue if "voluntary" agreement cannot be reached.

For these reasons the law laid down by the Aramco case has not always been applied to subsequent concessions, most notably the many concessions which were affected by the OPEC Revolution. The oil and gas resources of the Middle-East are so vast that the oil companies involved in their exploitation could not have risked losing their massive investments there or their far more massive future profits by referring the OPEC actions to judicial determination and insisting upon strict application of the law without compromise. The OPEC nations would never have submitted to the principle of pacta sunt servanda which would have required them to accept the meagre terms of their original concessions and would perhaps have ousted the foreign oil companies altogether. As the oil companies were not prepared to risk everything they naturally yielded to the pressure and compromised with the OPEC nations to secure a reduced, but still substantial share of the profits of Middle-East production.

There has been no event or judicial pronouncement which has in any way diminished the authority of the Aramco decision. There is not even a resolution of the General

Assembly which contradicts the Aramco principle and a catagorical statement would be required to alter such a fundamental principle of International Law as pacta sunt servanda. It is not sufficient that, for example, Resolution 2158 (supra) refers to the "inalienable right" of permanent sovereignty over natural resources with reference to the rule of pacta sunt servanda to infer that the rule has been altered, especially in the light of statements such as that of the U.S. spokesman (supra) which indicate clearly that there was not the kind of consensus of national wills required to create customary law, let alone change one of its most fundamental principles.

It has been shown that recent case law (such as Texaco v. Libya (supra)) has reaffirmed the principles applied in the Aramco case so as to dispel any doubts of its continuing authority.

When the actions of the U.K. Government in 1975 are examined in the light of the law as stated, there are clearly aspects which are subject to challenge as being contrary to international law.

The early development of the U.K. law in the field of oil and gas exploration and production was unexceptionable, being in implement of the principle of territorial sovereignty, as extended by the Convention on the Continental

Shelf 1964.

The changes to the regime in 1975/76 were in two parts: first, the 1975 Act and the Oil Taxation Act 1975, and secondly, the 1976 Regulations. The 1976 Regulations related only to future licences and did not affect existing licences in any way, and were therefore valid. As concluded in the previous chapter, several aspects of the 1975 legislation are, however, illegal.

The licences granted to companies by the U.K. Government to produce oil and gas from the North Sea were negotiated individually and, upon execution, created contractual relationships between the licensees and the state, conferring vested rights upon both parties, which cannot be altered except by mutual agreement. The amendments made retrospectively and unilaterally to these licences by the 1975 Act (particularly in the areas of royalty payments, working obligations, powers of revocation and the prohibition of gas flaring) were therefore contrary to the principle of pacta sunt servanda and should be compensated.

The creation of BNOC and its participation in future licences was a valid exercise of sovereignty, but the introduction of BNOC as a dominant partner into existing licences, not being obtained by genuinely voluntary consent of the licensees, constituted another unilateral alteration of the contractual basis upon which the licensees were operating and was a further breach of the principle of pacta sunt servanda.

The introduction of PRT was probably not at such a level as to amount to expropriation, even accompanied by the imposition into all licences of BNOC as a majority partner, and even if it could be argued to amount to genuine expropriation, could not be legal as such since it was not accompanied by compensation of any sort. The principle of sovereignty permits states to levy and vary taxes within their jurisdiction. PRT, however, was not part of the existing general taxation system of the U.K. prior to 1975, but was introduced and addressed directly against holders of production licences and therefore, on the analogy of the royalty provisions, directly affected the special or contractual relationship between each licensee and the state. As such, it is suggested that this tax is subject to challenge under International Law as not being in reality a "tax", but rather an additional payment required by the government by reference to existing contracts (the licences), thereby unilaterally altering the financial terms upon which the licensee contracted with the state, by means of an act which could have been performed by only one of the parties to that contract, thereby internationalising the contract by a wrong for which the foreign party is entitled to compensation.

In so far as these breaches of International Law affected companies which were not U.K. nationals, of which there are many with interests in the North Sea, they are challengeable under International Law by the espousal by the national governments of the companies concerned of their claims.

The absence of such challenge does not detract from the illegality of the acts or imply acceptance of any derogation from the principle of pacta sunt servanda, but rather, demonstrates that the economic reality of the oil industry, first clearly shown by the OPEC Revolution, is that such large investments, profits and revenues are at stake that none of the parties involved can afford to risk losing out altogether, but must reach financial compromises at various stages irrespective of their legal rights, in order to secure a share of the rewards to be won.

ABBREVIATIONS

A.D.	-	Annual Digest of Public International Law Cases.
A.J.I.L.	-	American Journal of International Law.
B.J.I.L.	-	British Journal of International Law.
Cmnd.	-	British Command Papers.
E.C.O.S.O.C.	-	Economic and Social Council of the United Nations.
G.A.Res.	-	Resolution of the General Assembly of the United Nations.
H.C.Deb.	-	House of Commons Debates.
I.C.J.Rep.	-	International Court of Justice Reports.
I.C.L.Q.	-	International and Comparative Law Quarterly.
I.L.M.	-	International Legal Materials.
I.L.R.	-	International Law Reports.
O.J.E.C.	-	Official Journal of the European Communities.
P.C.A.	-	Permanent Court of Arbitration.
P.C.I.J.	-	Permanent Court of International Justice.
P.D.	-	Probate Division Reports (British).
R.I.A.A.	-	United Nations Reports of International Arbitral Awards.
S.I.	-	Statutory Instrument (British).
Series A	-	P.C.I.J. Judgements and Orders 1922-30.
Series B	-	P.C.I.J. Advisory Opinions 1922-30.
U.K.T.S.	-	United Kingdom Treaty Series.
W.C.R.	-	Hudson, M.O. - World Court Reports.

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