MULTINATIONAL PETROLEUM CORPORATIONS AND GOVERNMENTS:

The Impact of Synergistic Relationships on International Law

Thesis

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CONTENTS

ILLUSTRATIONS

SUMMARY

The Introduction begins with David Haberman's graphic description of multinational petroleum corporations as "private supranational government organizations" in which he calls for the "orderly disposition of world petroleum resources between the producing and consuming nations ... on a sovereign level, i.e., as between governments through multilateral treaties, international arbitration and enforcement, etc...."

A review of recent criticism of multinational corporations in conjunction with the Third World call for a New International Economic Order is explored as major reasons for the timely study of the nature of MNC relationships.

Current trends in the discipline of international law are examined indicating a propensity toward utilizing an interdisciplinary approach. A survey of literature on multinational corporations in relation to international law is presented suggesting a concensus only insofar as agreement that the law should take cognizance of the fact that private corporations are now active participants in areas formerly reserved for states which have been the traditional subjects of international law. The question as to how this should be accomplished remains open to debate.

Many international law theorists have seemingly been stymied by attempting to define multinational corporations and to decide the degree to which they may be said to have international legal personalities. Evidence that MNCs function on an equal basis with states is cited from chapters in this thesis. The possible transformation of municipal law or practice to international customary law is also exemplified with

instances from the paper including the practice of refusing to buy hot oil.

A perusal of international organizations which impact on MNCs is included along with an examination of the current direction and status of such impacts. The OECD Guidelines and the work of the U.N. Commission on TNCs are contemplated as two of the more important contrasting results of the call for NIEO by the Group of 77. In particular the Competition section of the OECD Guidelines is scrutinized with emphasis on the restriction of trade precedents found in the EEC Treaty of Rome and the U.S. Sherman Antitrust Act.

With a cursory reference to the obvious economies of scale involved, the selection of British Petroleum as the unique perspective from which to view the relationship between multinational petroleum corporations and governments is presented, with a concluding survey of current steps being taken by organized international society to recognize MNCs as subjects of international law.

Chapter 2 describes the infancy of the petroleum industry in which precedents are established for government regulation. Specifically deliberated are the events leading to the development of the Standard Oil Co. as the prototype of monopolistic restraint of trade on the part of industry and the application of the Sherman Act in order to curtail such antitrust practices culminating in the U.S. Supreme Court's Dissolution Decree of 1911.

The second part of Chapter 2 delineates the effects of a global emergency on government-industry relationships in which maximum cooperation for efficiency supercedes the need for protection of the free enterprise system of competition.

Chapter 3 scrutinizes the origins of British Petroleum and the paradoxical nature of her structure indicative of government participation in an industry vital to national defense. Due to her lack of indigenous oil at the time, security of supply was of particular concern to both Britain and BP and her diplomatic activities with Iran on behalf of the company were merely the first of many to come. The concession agreement itself was also to set a precedent for many years.

Chapter 4 elucidates the effects of various synergistic MNC relationships, in which the strength of alliances are altered in order to manipulate global events leading to the most expeditious means of enhancing profit. The American majors, citing depletion of indigenous crude as reason for acquiring foreign sources of oil in the Middle East, engage State Department assistance in gaining market entry into a traditionally British sphere of influence. The U.K. Government was similarly exercizing diplomatic influence in order to retain her impregnable position through BP of controlling all the known world reserves outside the U.S.

The principle of reciprocity was utilized in the U.S. Mineral Leasing Act of 1920 threatening to refuse domestic foreign-owned corporations the right to operate in America were similar privileges denied U.S. nationals. The San Remo Agreement, the first post-war redistribution of the Iraq Petroleum Co. which excluded U.S. participation, brought forth not merely strong State Department protests but the unprecedented application of the Open Door Policy to the area of Middle Eastern oil concessions. The resulting renegotiation of the Iraq Petroleum Co. culminated in the Red Line Agreement, a secret treaty between multinational oil corporations, in effect, dividing the world among themselves.

Chapter 5 explores the example of Texas as a model for regulation examining the short and long term effects of the Texas Railroad Commission as an effective regulatory body.

Chapter 6 details the implementation of synergism between governments and oil companies by explicating the complexities involved in maneuvering issues through the American municipal legal regime by reviewing the chaotic Roosevelt Era.

World War II from the American perspective as portrayed in Chapter 7 reflects the dichotomy of American foreign and domestic policy especially regarding antitrust and government involvement in industry financing. It also further exemplifies the implementation of synergism in attaining partisan goals. Precedents for settling offshore disputes over sovereignty are found in the Submerged Lands Act also discussed in this time setting as is the ultimate negation of the Red Line Agreement by the conclusion of a new Iraq Petroleum Co. agreement reflecting the shift of political power as a result of World War II.

Chapter 8 begins with a discussion of the Iranian oil embargo and deliberates the events involving petroleum in the Middle East through the 1950s, 1960s, and 1970s. Such implications for international law as the application of the principle of hot oil on the part of BP and the difficulty she had in finding a court which would hear her complaints are emphasized as well as home government diplomatic and/or clandestine participation on the part of industry.

The use of Price-Waterhouse as a binding third-party reviewer of financial capacity of companies as a prerequisite for participation in the revised Iranian concession is suggested as a precedent which could be followed by some future international regulatory body.

Qadaffi's model of concession agreements favoring independents is explored as is the leapfrog precedent and other cartel activities responsible for the radical impact of OPEC.

On the other hand, relaxation of domestic American antitrust enforcement is explored as well as the implications of the refusal by the Seven Sisters to sell oil directly to the British and American fleets during the 1973 Arab Oil Embargo.

Chapter 9 utilizes a thorough discussion of BP's entry into the American market and the development of Alaskan oil to portray the modern American legal regime. Many of the issues which confront those organizations involved in drafting codes of conduct for MNCs are examined in light of customary practice in America.

Chapter 10 uses the North Sea to review the status of the British legal regime in a similar review of current issues in the British legal regime.

Chapter 11 goes a step further by illuminating a loophole in organized world society by graphically outlining the manner in which BP systematically broke UN sanctions against Rhodesia which had been called for by the British Government, BP's major stockholder. The implications for international law are quite clear concerning financial disclosure about subsidiaries and the need for some method of enforcement which would be effective in regulating MNCs on a global -- not merely municipal -- level.

Chapter 12 concludes this study by reviewing the current status of the international dialogue on MNCs regarding international law, and by exploring the popular theories concerning the future of MNCs.

The synergistic nature of the relationship between MNCs and governments is exemplified by a review of the congruent goals of home states and companies regarding security of supply whether for national security or profit maximization. This symbiosis is further illustrated by outlining precedents established throughout the paper with implications for future developments.

Following is a survey of American antitrust policy as a model for review of an issue as it has effected the development of petroleum law. Other issues are summarized as are some of the personalities who have effected the industry.

After a cursory review of current steps on the part of organized world society to recognize MNCs as subjects of international law in specific instances, a creative approach to the problem of effectively regulating the conduct of multinational corporations is presented. A confederacy of countries having signed a treaty or other international agreement would be entitled to enforce sanctions or levy fines against MNCs accused of nonconformance with established codes of conduct. These fines could be collected according to a fixed percentage of net profits per country by all signatory nations for every offence. Thus, any charge brought by any signatory could be punished by fine in all signatory countries. Therefore, the impact of the synergistic relationships between petroleum corporations and governments could be effectively regulated.

CHAPTER 1

INTRODUCTION

The oil cartel ... [presents] a classic study of the impact of a handful of the world's largest most powerful multinational corporations upon foreign and domestic policies of not only the United States, but, indeed, upon the several nations of the world with respect to a vital world commodity, namely, oil ... Middle East government actions, and the world oil crises which they precipitated, represented but a logical extension, indeed the inevitable culmination of a long, well defined historical process that was set in motion by these very oil companies at least 40 or 50 years ago. That process saw the evolution and exploitation of a most complex and extraordinary symbiotic relationship between these seven major international oil companies on the one hand, and the several governments of the United States, Western Europe and the Middle East on the other ... a kind of private supranational government, an intricate system which has grown up through close to a half century of closely coordinated and cooperating joint ventures and arrangements around the world among these seven international companies ... a private United Nations ... its members severally and collectively possess massive wealth and resources, including an exchequer, shipping fleets, production facilities, pipelines, refineries, etc., which exceed by far the resources available to many nations of the world. Furthermore, these companies have shared for many years a broad community of interest and a functional unity of policies and actions in the dispositions of such wealth and resources. This has been facilitated by the highly developed technical and diplomatic capabilities which these companies have frequently and effectively exercised en bloc in sophisticated high-level dealings with the governments of the world.

Like many other world government organizations, this private government emerged from a period of internecine economic warfare among these companies that was finally resolved by a series of "peace treaties" in 1928. In their exercise of virtually sovereign power, this bloc of companies has consistently promoted and exploited national economic needs and international differences, government ignorance, and the gaping lacunae in the fabric of international regulatory control mechanisms ... in pursuit of their private commercial goals.

... affected governments have not always been unwitting accomplices. Indeed, in many instances governmental policies have been lodged in the hands of officials who had themselves been involved either directly or indirectly with these same corporations ... several nations sought in various ways over the years to regulate these companies for their respective

> national interests ... the resulting general patchwork of country-by-country regulation has fallen far short of the comprehensive system required for effective control of international cartel activities operating far beyond national boundaries ... (the U.S. and U.K.) government (have), to date, shared the general failure to regulate those companies effectively ... the signal shortcoming of (American and British) national policy and, indeed, that of the Western European nations on this issue, has been our collective failure to recognize, at least since the end of World War II, the central proposition that the orderly disposition of world petroleum resources between the producing and consuming nations must ultimately be resolved internationally on a sovereign level, i.e., as between governments, through multilateral treaties, international arbitration and enforcement, etc....[1]

The call for a new economic order has given impetus to the need for the international legal regime to enact an enforceable regulatory code applicable to multinational corporations. The rapid expansion of these multinational corporations coupled with strong home states who are primarily interested in maintaining their own sovereignty and protecting Western interests has created a synergenic relationship of such proportions as to preclude submission to any international legal body, thereby preventing effective regulation on any scale more extensive than municipal law.

Beginning in the 1960s and through the first half of the 1970s, criticism of multinational corporations became remarkably widespread, resulting in demands for increased regulation and control of international companies by some government officials and international civil servants. On the other hand, others recommended only improved transparency and better self-policing. Developing country governments, acting through the United Nations and other international agencies, are now calling for a "New International Economic Order" (NIEO) in which additional constraints will be imposed on the operations of multinational corporations, and they have spoken out on such issues as permanent sovereignty, information disclosure/reporting, technology transfer, restrictive business practices, equity ownership, taxation, transfer pricing, and accounting standardization. At times, these pressures have overshadowed the responsible inquiries being pursued by governmental bodies seeking ways to cope effectively and fairly with, and to benefit from, the phenomenon of the multinational corporation as it affects the national interests of nation-states.

> ... with the enormous advance of modern science and technology which has occurred over the last decades of our age and which faced the law-maker with a number of new problems to be resolved in the international and municipal legal orders ... great new possibilities for the development of mankind have been opened. A development competition enbracing all countries and continents has begun, being accelerated by the increased rate of social and economic progress. The law (both municipal and international) is an important means for regulating the direction of these developments. It should not hamper the process of further economic, scientific and technological development of all states and nations. It may, however, channel the directions of this development, rationalize it to such an extent that it does not endanger mankind and its natural environment. There is thus a need to develop and perfect the law in that respect in order to adjust it to the requirements of the changing world.[2]

If the rules of international law prescribe appropriate standards of social conduct,[3] then the formation of these rules in the case of petroleum law with which this paper deals, since the commodity plays such an important role in global society.

> Today it would be inconceivable to study problems of [oil] law while ignoring the contribution of sociology, [politics], [economics], and statistics. Likewise, on all the points where law enters into contact with technology -- exploration of outer space, information systems, use of nuclear energy, protection of the environment -- cooperation with representatives of other disciplines, often within the exact sciences, is becoming indispensable.

> ... interdisciplinary studies now are the fashion in all fields of research. It would be unjust to see this as a passing vogue, for it meets a positive need emanating from the interpenetration of different disciplines of the human sciences, indeed between the humane and the exact sciences.[4]

A review of international law in relation to multinational petroleum corporations -- in particular, the Seven Sisters[5] -- from three complementary perspectives provides a basis for better understanding of the problems inherent in the law creating process.

> The interdisciplinary treatment of international law makes it possible to view international law from the outside, especially in sociological, historical, and ethical perspectives. In the sociological perspective, it is possible to offer an explanation of the social functions fulfilled by international law. The historical perspective provides insight into the growth potential of international law. The ethical perspective furnishes a normative measuring rod by which to test the moral adequacy of any particular system and rule of international law.[6]

Whatever may be the content of the law applicable to multinational corporations, its very nature incurs definitional complications. When such law can be found and defined, it must be decided whether to classify it as public or private international law. Perhaps the only adequate answer is that it partakes of the nature of both.

The definition of multinational corporations is, in itself, a controversial issue. It is significant that both the United Nations Center on Transnational Corporations and the Organization for Economic Cooperation and Development have maintained that it is possible to carry on practical work without a precise definition. The main reason for avoiding a clear-cut definition is political, according to Wang, for a number of countries, notably the socialist states and several developing countries, insist that their enterprises should not be lumped together with those of monopoly capitalism.[7]

From a substantive point of view, different definitions may very well be adopted for different purposes. For example, the definition for purposes of national regulation may vary from the definition to be used in an international code of conduct; the definition for a general code may be different from that for international standards of accounting and reporting. For the purpose of this paper, the term multinational corporations (MNCs) may be understood in the broad sense offered by the Group of Eminent Persons and be used interchangeably with multinational enterprises or transnational corporations.

A survey of the literature on multinational corporations in relation to international law indicates that it has been suggested in recent years that a new body of substantive law be developed and applied to international economic transactions. Although this international economic law has been varously referred to as international law (Mann, Haight),[8] transnational law (Jessup),[9] a new law Merchant (Schmitthof)[10] and general principles of law recognized by civilized nations (McNair, Friedmann, Schwarzenberger),[11] its proponents have been motivated by one strong consideration, namely that the law should take cognizance of the fact that private corporations are now active participants in areas formerly reserved for states which have been the traditional subjects of international law.

Some writers suggest that this new body of international economic law should constitute a separate juridical order, divorced from international law (Verdross, McNair).[12] Others, that this international economic law should just be an extension of public international law (Mann, Friedmann, Schwarzenberger).[13]

> Whether this is a complete independent body of law or is subordinated to international law or to some other, more inclusive body of law, is in itself immaterial, as long as it is understood that it is distinct from the traditional body of international law. The need for determining its relative position with respect to international law cannot be denied.[14]

Since the participation of private corporations at the level of international law would now seem to be a fait accompli, they should be recognized as at least limited international legal personalities, subject to the rights and duties of sovereign states. In so doing, multinational corporations would be entitled to the right of arbitration under the ageis of the International Court of Justice, as well as subject to the duties and responsibilities of sovereign states.

Even though traditionally, sovereign states have been considered the principal subjects of international law, nothing prevents states from recognizing dependent states with limited international personality. According to Schwarzenberger, "International personality may be unlimited, as in the case with independent states, or limited as in the case of dependent states or international institutions." Similarly, states are free to recognize, for all or limited purposes, nontypical subjects such as international institutions, and even individual persons as subjects of international law. "In relation to itself, each subject of international law is free to recognize any other entity as a subject of international law."[15]

Bishop also feels that "there is no inherent reason why international legal personality may not be conferred upon private organizations."[16]

Friedmann would modify this argument by limiting subjectivity. "There is no reason why there should not be different degrees of subjectivity in international law."[17] He goes on to say, "It would be as dangerous to uncritically accord subjectivity to the private corporation in international law as it would be to deny its factual participation in the evolution of public international law."[18]

In each case, whether any entity has been so recognized is merely a question of evidence.

Schwarzenberger further explains:

> The chief participants [in the international legal regime] -- the sovereign states, especially the strongest among them -- tend to view themselves as ultimate ends and are inclined to insist on control of the means indispensable for their survival in any crisis .... They form alliances and counteralliances for aggressive and defensive purposes, create precarious systems of balance of power and, as they see fit, pursue policies of involvement or isolation.
>
> In such situations, the primary function of law is that of a law of power; i.e., the law assists in maintaining the supremacy of force and the hierarchies established on the basis of power and gives to such quasi-orders the respectability and sanctity of law. International law in unorganized international society serves these purposes in a variety of ways; e.g., the independence of states is one of the cornerstones of international customary law, [which] includes ... access to raw materials and markets .... Similarly, whether a state decides to participate in an international congress or conference depends on its own will. Moreover, in the absence of agreement to the contrary, unanimity is required for any decision reached in the assembly of any such international gathering. Finally, any binding third-party settlement of a dispute by reference to law or equity depends on the consent of the parties concerned.[19]

Access to raw materials and markets is discussed throughout this paper, as is voluntary participation in international gatherings (See particularly the discussion of the Red Line Agreement in Chapter 4 and the London Policy Group in Chapter 8.)

> ... international customary law puts at the disposal of its subjects the right to apply measures short of war by way of reprisal against alleged breaches of international law ....
>
> In fields less central to the systems of open power politics or power politics in disguise, international law is permitted also to fulfill the functions of a law of reciprocity and a law of coordination. Thus, for example, on the basis of innumerable treaties over the centuries, a body of international maritime law, now largely codified in the 1958 Geneva Conventions on the Law of the Sea, has grown up.[20]

The Law of the Sea is discussed in relation to the North Sea in Chapter 10.

> The two constitutive elements of international customary law are (1) a general practice of states on a universal, general,

or regional basis, and (2) the acceptance by the states concerned of this practice as law.

> The origin of international customary law is frequently found in earlier treaty clauses, which, subsequently, were taken for granted, as with the rules regarding the minimum standard applicable to foreign nationals and their property. Occasionally, as in the law of the sea ... individual rules of international law have developed out of roughly parallel practices of the leading powers.[21]

The practice of refusing to buy "hot" oil which was well established as a general practice by the major petroleum companies in East Texas (Chapter 5), was later not merely accepted, but specifically called for by BP in Iran under Mossadeq. BP obviously accepted the practice of refusing to buy "hot" oil as law, per se, since she threatened to take any offenders to court -- "any court in the world which would hear her case" (See Chapter 8).

This illustrates the process of establishing a practice which becomes accepted as law on an international basis -- in effect, then, the development of quasi-international customary law.

> The basic rules of international customary law, essentially the international law of unorganized international society, can be summarized in the following fundamental principles: sovereignty, recognition, consent, good faith, freedom of the seas, international responsibility, and self-defense.[22]

Perhaps the best example of MNCs exercising quasi-sovereignty is the refusal by BP to sell oil to the British fleet during the 1973 Mid East Crisis, despite a direct order from her part-owner home government. Exxon's similar refusal to the American fleet helps emphasize the audacity of the MNCs in challenging their own home government's sovereignty over them at a time of national alert. The companies, for their part, were seemingly more concerned about future profits than in patriotic duty or submission.

When commercial law is practiSed on an international scale, the definitional quagmire again appears. As a private enterprise, a company is free to do business with whomever she pleases. Under international law, an international legal personality is free to enter into any kind of consensual engagement; to grant recognition in such events as the co-option of new subjects which might be indicated as a result of the signing of such consensual engagements as a business contract or concession agreement; and to execute and fulfill such consensual engagements in good faith. Some of the major concession and other international agreements of the Seven Sisters -- and in particular, those of BP -- are traced from Iran and the Middle East (Chapters 7 and 8), through Alaska (Chapter 9), the North Sea (Chapter 10), and even some of the more clandestine agreements in Rhodesia (Chapter 11).

The rules on the freedom of the high seas, now largely codified in the 1958 Geneva Conventions on the High Seas and on Fishing and Conservation of the Living Resources of the High Seas, reinforce the principle that use of the high seas, and the sea bed must be exercised with reasonable regard for the interests of others. The Conventions of 1954, 1962, and 1969 for the Prevention of Pollution of the Sea by Oil provide a limited implementation of this rule. The implications of this principle in light of the nature and scale of the global petroleum industry and modern technological capabilities are unlimited.

The principle of international responsibility gives impetus to this and all other rules of international law in that "the breach of any international obligation constitutes an illegal act or international tort, the commission of which implies duty to make reparation."[23]

By granting limited personality to MNCs, these companies would then be obligated under this principle of international responsibility to abide by all applicable rules of international law; on the other hand, they would also be entitled to participate directly in the law creating process, contributing their technical expertise to the process. The international organizations which impact on MNCs could conceivably benefit from company input, especially in the current effort to devise a petroleum code of ethical practices -- reminiscent of the role of the American Petroleum Institute in devising a similar code for the American municipal regime in the Roosevelt Era. A detailed account of such contributions may be found in Chapter 6.

Since ultimate responsibility for international regulation lies with international law in organized world society, according to Schwarzenberger, then a review of the accomplishments and limitations of such international organizations is indicated.

Some of the strongest pressures for controls have originated in the international organizations, which mainly developing country governments have used to air their concerns on MNCs over a broad range of issues. Most of these organizations are considering or developing MNC Codes of Conduct, Guidelines, or specific industry studies and recommendations and are engaged in other activities which, taken as whole, are now shaping the future "regulatory" environment for MNC global operations.

The developing countries, over the past couple of years, have been moderating their anti-MNC rhetoric. But, at the same time, the developing countries have been actively supporting the development of the established bureaucracies in the UN system, such as the UN Centre on TNCs, whose staffs will carry on the regulatory work program born in the New

International Economic Order and delve into new issues affecting business.

The most publicized regulatory activities affecting MNCs, and the most significant as well, are those involving codes of conduct in the following five international bodies: (1) United Nations Commission on Transnational Corporations, where the prime objective is to draft a broad code of conduct to be adopted by the UN's Economic and Social Council (ECOSOC) and General Assembly; (2) Economic and Social Council, where a working group is attempting to draft a legally-binding multilateral treaty to eliminate corporate bribery and curb extortion pressures; (3) United Nations Conference on Trade and Development (UNCTAD), in which the developing countries are pressing for a legally-binding code of conduct on technology transfer following completion and adoption in 1980 of an agreement to end restrictive business practices by MNCs; (4) Organization for Economic Cooperation and Development (OECD), which has been implementing a package for MNCs and OECD governments, and where guidelines on transborder data flows were completed in 1980 and crucial new initiatives in this area undertaken.

A number of other international and regional organizations are either considering or have already made proposals affecting the MNCs. For instance: (1) International Labor Organization (ILO) -- Geneva; (2) World Intellectual Property Organization (WIPO) -- Geneva; (3) Organization of American States (OAS) -- Washington, D.C.; (4) United Nations Regional Economic Commissions -- Africa, Asia and the Pacific, Europe, Latin America, and Western Asia; (5) European Economic Community (EEC) -- Brussels; (6) Council of Europe -- Strasbourg, France; (7) United Nations Industrial Development Organization (UNIDO) -- Vienna;

(8) Non-Aligned Nations Centre on Transnational Corporations -- Havana; and (9) The World Health Organization (WHO) -- Geneva. For a complete glossary of international organizations impacting on MNCs and an accompanying organizational schematic diagram, see Appendices A and B.

Their already significant impact on MNCs can be expected to grow since demands for legally-binding codes of conduct and even drafts for model legislation continue to emerge from such nongovernmental organizations as the International Confederation of Free Trade Unions (ICFTU) and the OECD's Trade Union Advisory Committee (TUAC), thereby serving to buttress the work of the international governmental bodies.

The push for extensive regulation of MNCs by host countries both through the international organizations and individually is largely an outgrowth of developing country demands for a New International Economic Order (NIEO).[24]

Briefly, the logic on which NIEO is based is a replacement of the existing international economic system, which allegedly did not take into account the developing world, with a new system in which the less developed countries (LDCs) will be entitled to special economic benefits. Consequently, NIEO calls for a rejection of the concepts of a market system, private business decision-making and free trade. Instead, emphasis has been shifted to the primacy and needs of states, a condition in which government-owned and government-regulated institutions form the basis for national and international economic growth.

Rather than an improvement in the existing system, the new strategy calls for its total replacement, and is designed to redistribute the world's wealth from the rich to the poor countries as reparation for alleged past developed country sins of exploitation. The shift is from a system based on profit to one based on equity. As significant forces in the existing economic order, multinational corporations, or transnational corporations, as they are now called in the UN system, have received a barrage of criticism from the developing nations, which accuse MNCs of colonial exploitation of their vital resources.

The efforts to establish a NIEO are being made by the "Group of 77", an informal group of developing countries, now actually numbering about 117, under the leadership of Mexico, Jamaica, Venezuela, Algeria, India and a few other key LDCs. The LDCs' demands are set forth in a number of landmark General Assembly Resolutions, including the "Declaration and Programme of Action on a New International Economic Order" and "Charter of Economic Rights and Duties of States."

Those nations demanding the "New Order" are, in fact, calling for a replacement of the existing international market-oreinted economic system, which they contend unduly discriminates against the LDCs, with a new system in which these countries will be entitled to special preferences. The international organizations where NIEO achieves its strongest support are ECOSOC and the UN Commission on TNCs, UNCTAD, ILO, and the Organization of American States. In these bodies, whether over debate on MNC codes of conduct, model laws, or international conventions, developing countries are calling for increased control of multinational companies, for regulation of the market place, and for the imposition of governmental decision-making as the key to economic development. In the past, their arguments have been pictured as little more than rhetoric, but their demands are now being carefully weighed; and the developed countries have begun significant conciliatory efforts to answer them.

Multinational corporations, which have both aided and benefited from the existing economic system, have become targets of continuous attacks by developing countries. These nations, which are advocating NIEO, see MNCs as agents of neo-colonialist (capitalist) domination and exploitation of their scarce national resources. They, consequently, have set as their goal regulation of MNC subsidiaries with the ultimate intention of forcing them to act as sources of national economic growth.

The inspiration for the LDCs' new tactics derives from the phenomenal success achieved by OPEC in quadrupling oil prices over several months at the beginning of 1974. The shift in bargaining power which OPEC achieved is a primary objective of NIEO.

The potential impact of NIEO on multinational corporations can be outlined as follows: (1) NIEO encourages nationalization by calling for strict state regulation of all economic activities within the state's borders. (2) The practice of expropriation according to national rather than international law may yield little or no compensation for the confiscated property, since absolute national sovereignty gives a state a choice as to whether or not it need pay compensation. (3) The practice of restricting profit repatriation may limit the efficient allocation of financial resources. (4) If a host government determines that an MNC investment is not socially beneficial to its populace, that investment may be prohibited. (5) NIEO supports commodity cartels and thereby rejects market forces of demand and supply for governmental decisions on prices and production levels. And (6) passage into national law of provisions of the many codes of conduct for MNCs now being drafted could have serious consequences for such companies. For instance, one such provision would be information disclosure. Information would include detailed financial data (profit levels, return on investment, etc.) by product division and by country. Another such provision would be transfer of technology. An impact would result from national regulation of technology transfer (including the possible reduction of payments for the technology), MNC guarantees that the technology conforms to host requirements, special treatment for LDCs, and dispute settlement according to national law only.

In December 1974, however, another NIEO-inspired resolution was adopted by the United Nations. Entitled a "Charter of Economic Rights and Duties of States,"[25] it laid out the sovereign rights of all states, including the following four: (1) to exercise full permanent sovereignty over all wealth, natural resources, and economic activities within a country's borders, meaning locally-determined compensation when foreign-owned property is expropriated; (2) to form primary commodity producer cartels; (3) as far as LDCs are concerned, to be granted generalized preferential, non-reciprocal treatment in all international economic activities; and (4) to use price indexation to maintain stable commodity export prices.[26]

In recent years, criticism of multinationals has reached such proportions that viritally every government employee, legislator, or policy-maker and every member of the public in general has heard charges against the way they conduct business. Most governments want the benefits that these corporations can bring to their countries: employment opportunities, capital, technology and access to markets. But they are concerned over such attendant problems as foreign ownership and control of key economic sectors, inroads against political sovereignty, and assaults on traditional cultural values. Thus host countries seek benefits from multinational corporations while attempting to avoid undesirable side effects -- prosperity on their own terms.

The problem is that the companies are not oriented to the individual development goals or economic requirements of their host countries. They have their own profit and other business motives. While governments pursue a variety of economic and social objectives to protect the welfare of their citizens, the chief goals of multinational corporations are those of all business enterprises: profit and growth. Because of their size and the nature of their activities, multinational corporations possess significant power and influence. This is even more pronounced in the petroleum industry due to the global dependence on oil.

In the conduct of their regular business activities, corporations make decisions which may have far-reaching consequences for the societies in which they operate. This is true regardless of whether the "society" in question is a small town somewhere in the United States, or a country in Western Europe or a country in the Third World.

Multinational corporations are creatures which, after all, owe their existence to the domestic laws of the countries in which they operate. The power of governments to regulate their activities through the enforcement mechanism of the law must neither be dismissed nor forgotten. The multinationals are often accused of conducting their business in an unlawful way. While this is probably true in a small percentage of cases, it is manifestly false the great majority of the time. Most multinationals carry on their activities well within the confines of municipal law. Problems arise because the goals of host country societies have changed and the laws of enforcement mechanisms have not changed to meet them.

Over the last several years, the belief has developed that because of the corporations' multinational character, international legal instruments are needed between countries to effectively "break the corporate horse to bridle." To this end, various codes of conduct have been proposed by international organizations in the belief that through these mechanisms multinational corporations could be steered into supporting the objectives of local development and other policies.

Generally speaking it is difficult to come to grips with any body of law which of itself might be considered to govern the conduct of multinational corporations. Rather, it is a loose network of various domestic laws aimed at controlling commerce within the territory of individual nations, and to some extent controlling the activities of corporations outside national territories when it is in the interest of the home, or occasionally host, country to do so and within its power to enforce such control. It is therefore not legislation which is designed to regulate the conduct of multinational corporations, but rather domestic commercial enterprises.

Eventually choices will have to be made concerning the legal nature, form, language and machinery necessary to complement the goals of companies and governments. In the meantime, all of the participants in this international arena seem to be working on solutions. Multinational corporations have themselves become more cautious in their dealings with governments. Some individual corporations have established formal codes and standards for themselves. Their collective efforts have resulted in a set of guidelines for international investment sponsored by the International Chamber of Commerce.

Of the various codes of conduct which have been promulgated in the international forum, two have emerged as preeminent: the OCED package and the code eminating from the UN Commission on Transnational Corporations.

The Organization for Economic Cooperation and Development has been the first intergovernmental organization to produce guidelines for the conduct of multinational enterprises. The OECD Guidelines thus warrant careful review, not only because of the signatories (twenty-three industrialized countries, accounting for 60 percent of the world's industrial production, 70 percent of world trade, and whose members are the home countries for over 90 percent of the world's multinational corporations), but also because, since it represents a working code, other codes being developed cannot help but take it into consideration.

The Guidelines comprise one of five sections of the larger OECD "Declaration on International Investment and Multinational Enterprises." The other sections concern: (1) the national treatment of foreign enterprises by member countries in whose territory these enterprises operate, (2) international investment incentives and disincentives, (3) consultation procedures under which business and labor organizations have input through their representative governments, and (4) a review of the entire Declaration within three years to evaluate its effectiveness and suggest ways to improve international cooperation.

To describe the OECD package is to underline vital differences between it and the UN Commission. Though there have been substantial differences in attitudes of OECD member governments toward the MNC, the tone of the resultant debate is quite different from that of the UN.

That the OECD has only developed nation members has perhaps as important psychological as economic implications.

However, the composition of the Commission is not the most appropriate for achieving a balanced result susceptible of wide approval, either. Among its forty-eight members only ten came from the "WEO" group, i.e., from Western and other market-economy states. Yet, these states are the home states of most multinational corporations and almost any action concerning MNCs would require their cooperation. By contrast LDCs appear to be overrepresented in the Commission,[27] as two-thirds of the activities of MNCs take place between states belonging to the WEO group.[28]

A brief summary of major MNC impact issues, then, include consumer protection, employment/industrial relations, environmental protection, illicit payments, information disclosure/reporting, international accounting standards, investment subsidies (incentives/disincentives), patents, licensing, and trademarks, restrictive business practices/antitrust, taxation/transfer pricing, technology transfer, transborder data flows, and worker participation in management.

Norms for MNCs are established by the OECD Guidelines in a number of areas.

As matters of general policy, standards are established which state that enterprises should take fully into account the policy objectives of member countries in which they operate. While the OECD is of course an organization of limited membership, there seems to be no reason for restricting application of a general principle of this nature to member countries. In fact, most of the other criteria in the general policies section are not so limited: cooperation between the local community and business interests, filling posts by taking "due account of individual qualifications without discrimination as to nationality," abstaining from illegal political contributions, not giving (or being solicited for) bribes, and supplying national entities with information which may be needed relevant to the activities of those entities in such jurisdictions, with due account for business confidentiality, all seem principles capable of general application.

The disclosure criteria of the OECD Guidelines are rather carefully circumscribed. This has been a controverted and sensitive area. The OECD standards go to information which should be published "on a regular basis within reasonable time limits but at least annually." They in general describe the type of information normally published by enterprises under most reasonably sophisticated national laws or customs. A principal issue here, as it is likely to be in the UN Commission, is that of the appropriate geographic area for which enterprises should report; most MNCs are reluctant to publish country-by-country operating results, especially if those results reveal profits, and most particularly if profits are to be reported on a product line basis. There is nonetheless a considerable amount of detail called for by the OECD text, which makes a contribution to that "transparency" which has been often suggested.

The provisions on competition reflect policies familiar to those knowledgeable in either American antitrust law or Articles 85 and 86 of the Rome Treaty. The generality of some of the phrases, such as the admonition to "refrain from actions which would adversely affect competion in the relevant market by abusing a dominant position of market power," and certain of the examples of such abuse, such as "anticompetitive abuse of industrial property rights," have caused some concern to MNCs.

The financing guideline is one which is susceptible to highly subjective interpretation -- that in managing their activities, MNCs should "take into account the established objectives of the countries in which they operate regarding balance of payments and credit policies." By way of contrast, Annex I of the Report on the First Session of the UN Commission (E/5655, E/C.10/6) lists as one of the areas of concern of the Group of 77, "Excessive outflow of financial resources from host countries due to practices of TNCs and a failure to generate expected foreign exchange earnings in the host country." Thus, the Commission has proposed a standard of conduct in regard to the effect of the MNC on the balance of payments much different from that of OECD.

The taxation guideline refers both to the furnishing of information necessary to calculate taxes correctly and refraining from use of "particular facilities available to" MNCs "such as transfer pricing which does not conform to an arms-length standard, for modifying in ways contrary to national law the tax base on which members of the group are assessed." Transfer pricing is, of course, one of the topics most discussed in other forums, both national and international. It reflects a common concern -- that artificial pricing may deprive one government or another ot its rightful share of the profit base on which taxes might be levied. Because of accounting difficulties and complexities, and because of company practices which may have been established with no purpose other than convenience in mind, it is also a topic of only illusory simplicity.

The guidelines also contain rather detailed provisions on both Employment and Industrial Relations and on Science and Technology. The one attempts to set up principles essential to good labor relations and to collective bargaining; the other seeks a compromise between the activities of MNCs and the policies of nations "to the fullest extent possible" and "with due regard to the protection of industrial and intellectual property rights," the rapid diffusion of technologies.

To a large extent, the technique of providing timely and relevant information and reports will assist in avoiding not only conflicts between MNCs and governments, but also between national governments. Such conflicts are not likely to be eliminated. The competing interests are both numerous and important. One MNC competes with another. Labor, even within national boundaries, has diverse objectives: one sector will support a liberal trade policy, while another will find good reason to oppose it. Consumers and environmentalists may be opposed to strongly-held labor views. National governments seek to benefit their own constituencies. Philosophies may differ: some labor organizations see much benefit in co-determinism; others see it as a device for reducing the bargaining strength of labor. The list of such resources of conflict is long. But the informational and reporting approach, combined with an open and continuing forum for discussion and conciliation, offers good hope for a maximum degree of useful harmonization.

Both the OECD and the UN Commission represent attempts to establish uniform norms for the activities of MNCs. Were either code to be successful, it would establish, at least within the area of its jurisdiction, a generalized standard. In the case of OECD, the standard is reasonably well articulated; in the case of the Commission, the schedule calls for discussion of such a standard only during the 1978 meeting of the Commission. OECD, while it does not set up any authoritative mechanism for either interpretation or dispute-settlement, does provide for frequent consultation and inquiry into the manner in which the code is operating. What sort of supervisory or other mechanisms may be suggested by the Commission remains to be seen. In each case, examination of the results of a code will be aided by the existence of a permanent and competent staff.

The only way to make such a code on multinational corporations obligatory would be the conclusion of a treaty. However, in order to be meaningful, any such treaty would have to be adhered to by at least the USA, EEC, Canada, and Japan, as well as by the leading socialist and developing countries. Given the very conflicting areas of concern indicated by the Group of 77 to the Commission on Transnational Corporations, it seems hopeless to draft a treaty which would obtain the required world-wide approval.

While voluntary compliance with a code of conduct, on the other hand, may not have the legal weight of such a treaty; in practice, as Seidl-Hohenveldern points out, a voluntary code may be effective.

> OECD has provided quite a machinery in order to ensure at least a certain measure of compliance with these rules. Any alleged violation of the OECD Guidelines may be discussed before OECD panels to be established for that purpose. Again, these measures remain below the expectations of the Developing Countries, which want binding rules, protected by enforceable sanctions against any violation of such rules. By comparison, the adverse publicity gained by a hearing before an OECD panel of inquiry appears to be a very mild measure indeed. Yet, experience with other OECD panels shows that such hearings are a quite efficient way to ensure effective compliance with rules edicted by OECD. Thus a meeting of minds along these lines will in all likelihood give much more to Developing Countries than they could ever hope to obtain by adamant adhesion to their original very far-reaching demands. Let us hope that

all interested countries will gradually come to see these points.[29]

Many of the precepts basic to the OECD code are anathema to the majority of the Commission. There are many differences in point of view among the OECD members; yet they are slight compared to those which exist between the members of the UN Commission. Essential to an understanding of those latter differences is recognition of the fact that the concept of a balanced code which is fundamental to the OECD documents is not accepted by the majority of the Commission. In the view of the Group of 77, articulated clearly throughout the debates, the code is to be one element in a re-orientation of the terms of international trade and investment, within the concepts of the New International Economic Order. It is therefore regarded as an instrument for rectifying, not achieving, a balance -- a balance which is believed to have been and to be unjust to developing nations. If, as this suggests, the objective is to enhance the negotiating power and improve the bargaining position of the developing nations, "balance" within the four corners of the code is logically irrelevant at best and harmful at worst.

Whatever the merit of these assumptions or this logic, that a code must be balanced is a basic tenet of those nations roughly defined as the OECD group. In the circumstances, and given the disputatious character which, in the United Nations, has attached to even such a phrase as "in accordance with principles of international law," it might seem that little advance toward either unification or harmonization of law as it applies to MNCs will emerge from the Commission's labors.

The basic Western position on code of conduct negotiations in the UN Commission on Transnational Corporations, in UNCTAD and in any other organization involved in international investment issues, has long been based on the following basic premises: (1) that all codes be voluntary in nature; (2) that all codes provide for obligations and responsibilities for both companies and governments; (3) that the firms covered include those of private, mixed and public ownership; (4) that governments not discriminate against MNCs in favor of national companies or vice versa; and (5) that standards of international law govern all commercial dealings.

The Guidelines section of the Declaration was the most difficult to negotiate. The United States was the strongest, but by no means the only, advocate of voluntary rather than mandatory guidelines. The decision to call these principles "guidelines" rather than a code reflects the essential point that they are only suggestions to member nations and their corporations. The Guidelines do not change existing laws nor do they add a single new one.

The Guidelines were designed in such a way as to insure that they would not introduce distortions into the flows of international trade, either in the treatment given by national governments to multinationals or in the competition among multinationals. This raised such issues as equitable laws on national disclosure of information and consistent standards of corporate conduct to be applied by all companies in all circumstances. These problems had to be resolved in such a way as not to inhibit the growth of multinational corporations which the OECD members consider to be valuable tools for continued international economic expansion.

Each company may voluntarily decide whether to adhere to the standards of conduct of the Guidelines or to ignore them; there is no requirement to sign on and no official list of subscribers will be maintained. The Guidelines recognize different territorial conditions, varying product mixes and the diversity in corporate structures. Therefore, each company is allowed to decide for itself how to apply the standards in light of its own circumstances, keeping in mind that this must be accomplished in the context of local laws, regulations, and customs.

Since the Guidelines are voluntary, critics of the OECD effort question whether this effort will make any appreciable difference in the behavior of multinational corporations or host countries. Yet in the United States, for example, both the State Department and such business and industry groups as the United States Chamber of Commerce, the National Association of Manufacturers, the USA-Business and Industry Advisory Committee to the OECD, and the United States Council to the International Chamber of Commerce have all urged their members -- through meetings, publications, letters, and discussions -- to seriously consider the Guidelines as a "constructive and balanced attempt to resolve some of the present and potential difficulties related to international investment," and make a "significant effort to promote widespread understanding" of the Guidelines.

The long history of attempts to negotiate codes of conduct, stretching back at least to the abortive Charter of the International Trade Organization, in 1948, indicates that while general codes of broad application are extremely difficult to agree on, understandings of more limited scope have often been worked out, formally or informally. Thus, while fundamental questions of the allegedly extraterritorial application of antitrust laws remain unresolved, practical arrangements, like the consultative procedures which have long been in effect between the

United States and Canada, or within the Restrictive Business Practices Committee of the OECD, have very substantially mitigated if not eliminated actual cases of conflict.

Another ameliorating factor has been the gradual harmonization in fact, sometimes without formal agreement, between national laws. Thus, development of doctrine under Articles 85 and 86 of the Rome Treaty and the United States Sherman Act have substantially narrowed differences. In another area, the inflow of foreign direct investment capital has resulted in the proposal of legislation which would regulate such investment and, in some cases, prohibit it.

What these bodies may discuss, propose or approve in terms of MNC codes, guidelines, or other measures, may serve in whole or in part as models for national legislation to be adopted as binding law by home and host governments. Furthermore, public opinion throughout the world will be strongly influenced by the actions and decisions taken by these organizations, as witnessed by several recent moves undertaken by the World Health Organization which impact the operation of several MNCs.

On the other hand, such codes can often have a reverse effect by imposing obligations and controls on governments as well. This balancing of responsibilities is an integral part of the OECD's international investment package, and many MNCs have already been active in promoting it. In addition, involvement by MNCs in the deliberative process could be useful in the shaping of constructive proposals to serve their own enlightened self interest.

For all the theoretical hopes and dreams pinned on the MNC codes of conduct as an implement for accommodating global society's changing social, economic, and political character, a closer evaluation of one specific issue -- that of antitrust -- will exemplify many of the implied technicalities. For this purpose the Competition section of the OECD Guidelines will be analyzed.

The Competition Guideline contains three substantive paragraphs and one procedural paragraph. Generally speaking, Paragraph 1 condemns abuses of dominant position of market power, Paragraph 2 concerns vertical restrictions imposed on purchasers, distributors and licensees, and Paragraph 3 concerns participation in unlawful cartels and restrictive agreements. Paragraph 4 exhorts multinationals to consult and cooperate with antitrust enforcement authorities, with the most important aspect being the clause concerning provision of information.[30]

While several attempts to formulate common competition principles or international codes have been made in the past,[31] the Competition Guideline of the OECD Guidelines is the first such effort to gain approval by an international body. It must be viewed against the historical background of a substantial increase in foreign antitrust legislation since World War II, notable in the Common Market,[32] West Germany,[33] and the United Kingdom.[34]

Multinationals face a growing and sometimes conflicting proliferation of competition rules and enforcement policies. This situation is complicated by the demand of LDC's for international regulation of restrictive business practices and transfers of technology. For example, the UNCTAD Group of Experts on Restrictive Business Practices[35] is presently studying, inter alia, the formulation of a model antitrust law for LDC's.[36] The OECD has also been active in the restrictive business practices area. Recommendations for voluntary consultation and cooperation among antitrust officials have been issued[37] as well as reports on various antitrust topics, such as refusals to deal,[38] market power,[39] and patent and license restrictions.[40] The OECD Committee of Experts on Restrictive Business Practices[41] was also responsible for the Competition Guideline. The result was the formulation of a very broad statement of principles whose exact content and application may be quite difficult for multinationals endeavoring to follow the Competition Guideline to determine.

This difficulty is compounded by the fact that the OECD does not now contemplate publication of a legislative history of the Competition Guideline which would certainly aid in its interpretation. However, some of that history is known. Of particular significance, the Working Party of the Committee of Experts on Restrictive Business Practices submitted its draft of the Competition Guideline subject to a number of reservations.[43] First, the Competition Guideline does not imply that multinationals engage in restrictive business practices, or that such practices are more prevalent among multinationals than among national companies, or that multinationals are more of an anti-competitive force.[44] Second, standards of behavior dealing with difficult legal and economic concepts such as "abuse of market power" do not provide simple rules for business executives, and such concepts have been given real meaning only through interpretation by competent tribunals or some other body.[45] Third, the Working Party had not yet concluded that standards of behavior or guidelines were the best approach for eliminating those restrictive business practices which multinationals do engage in.[46]

The primary purpose of the OECD Guidelines is to ensure that the operations of multinationals are in harmony with national policies. The purpose is not to create a multinational code of conduct, nor is it necessarily, or primarily, intended to harmonize the competition laws of OECD member countries. Although many of the principles invoked in it are based to some extent upon rules which have evolved in the Common Market and certain OECD member countries, notably the United States and West Germany, the Competition Guideline does not simply reflect existing national antitrust laws. It is more a recital of certain antitrust concepts articulated in sufficiently broad terms so as to permit OECD member countries to interpret them consistently with their respective national policies. Thus, multinationals must continue to emphasize compliance with national rules, and should not view the Competition Guideline as a surrogate. They should expect, however, that these national laws might be influenced by the OECD Competition Guideline.

Given the substantial differences among OECD member countries toward competition policy,[47] it remains to be seen how much specific guidance the Competition Guideline can provide to multinationals. Some clarification may result from the eventual use of the consultation procedure established under the Declaration.[48]

Because of the generality of language, the Competition Guideline is not intended to be applied so as to judge or evaluate particular business practices of specific multinationals. In other words, multinationals should view the Competition Guideline not as a code or statute applicable to a particular arrangement or business practice, but rather as an expression of areas of antitrust concern to OECD member countries.

Before discussing each specific provision of the Competition Guideline, three other general comments should be made. First, the singling out of multinationals for separate treatment, as contrasted with purely domestic entitites, may not be entirely appropriate in the competition area. Those antitrust principles for which there is the greatest acceptance rest on economic and sociopolitical premises of competition between all business entities. Therefore, it is questionable whether a distinction should be made, for antitrust purposes, on the basis of whether a business entity, either privately or government-owned, is "multinational" or not. One result of such a distinction could be to place multinationals at a competitive disadvantage vis-a-vis purely domestic traders and producers. This possibility is somewhat mitigated by Paragraph 9 of the Introduction to the Guidelines which states that:

> The Guidelines are not aimed at introducing differences of treatment between multinational and domestic enterprises; wherever relevant they reflect good practice for all. Accordingly, multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the Guidelines are relevant to both.

The Competition Guideline should be read in light of that paragraph.

The second comment concerns the possible invocation of the Competition Guideline by non-OECD members, notably LDC's. For example, a developing country might informally invoke or refer to the Competition Guideline when objecting to the business conduct or policy of a multinational. While technically speaking the Guidelines apply only to those operations of multinationals which are within the OECD member countries, or at least the twenty-three member countries which signed the Declaration, there is nothing to prevent an LDC from saying to a multinational, "You are violating your voluntary Guideline." A multinational faced with such an informal invocation of the Guidelines, as contrasted with the formal promulgation of the Guidelines as national legislation, should point out the limited nature and inherent difficulties of the Competition Guideline and that the Guidelines comprise part of a broader package which also deals with non-discriminatory treatment of foreign investment incentives and disincentives.

The ambiguous and broad language of the Competition Guideline, together with the unfamiliarity of many Third World officials with Western antitrust concepts, could raise difficult problems for multinationals should Third World countries attempt to use the Competition Guideline to pressure multinationals doing business in their countries. Moreover, the absence of any enforcement mechanism or procedural safeguards under the OECD Guidelines could magnify those problems. In a sense, the "voluntary" nature of the Guidelines could be a double-edged sword whenever the Guidelines are informally invoked by a developing country. That is a possible danger; whether or not it is a significant one remains to be seen.

The third general comment is that the fundamental question remains as to whether the Competition Guideline can be applied, or is even comprehensible, in non-market or centrally-directed economies. Indeed, state intervention frequently alters the underlying premises and conditions of the competitive process which exist in the so-called market economies. Such state intervention exists to an even greater extent in the international trade area where balance of payments policy, national security concerns and protectionist policies, to name only three examples, frequently modify and override competition policies. Since the Guidelines apply only to companies engaged in international trade, it is questionable to what extent the Competition Guideline can or will be interpreted with any degree of consistency.

Moving to the Competition Guideline itself, the opening language states that "enterprises" should conform "to official competition rules and established policies of the country in which they operate ...."[49] There are several problems here. It is not clear what "enterprises" are included. The crucial factor is multinational or transnational operations, whether or not those operations are through subsidiaries or branches. Questions of coverage do exist. For example, it is doubtful whether the mere licensing of foreign patents or participation in foreign joint ventures would bring a U.S. firm within the meaning of this term. There is also the question whether the term "enterprise," referring to a global entity such as a parent and subsidiaries, will make a parent responsible for all its subsidiaries and vice versa. Introductory Paragraph 8 of the Guidelines states that they "are addressed to the various entitites within the multinational enterprise ... according to the actual distribution of responsibilities among them ....[50] For example, a U.S. parent and its wholy-owned subsidiary in West Germany may be treated as a single "enterprise" under the Guidelines and each may be held accountable for the actions of the other with respect to their observance. This becomes especially important with respect to Paragraph 4 of the Competition Guideline which exhorts, inter alia, cooperation with antitrust enforcement officials, particularly with respect to disclosure of information.[51] Thus, a U.S. parent may be asked to provide documents located in New York to officials of the German Cartel Office as part of an investigation of a German subsidiary. Under U.S. and Common Market law a parent and its subsidiaries are considered under certain circumstances a single unit. While the U.S. case law is not entirely clear, the determining factor for single treatment might be described as "control" by the parent of the subsidiary.[52] While Introductory Paragraph 8 of the Guidelines does not expressly adopt the "control" standard, it offers no substitute standard and a U.S. company might employ the "control" test at least as a rule of thumb. Had such a principle been in effect, the Rhodesian experience might have been quite different (See Chapter 11).

There is also some inconsistency or at least tension in the opening language of the competition guidelines between treating the entire multinational operation as a single unit and requiring that the multinational, viewed as a single unit, conform "to official competition rules and established policies of the countries in which [the whole unit] operates ...."[53] It is somewhat difficult to see how the multinational enterprise as a single unit can be expected to conform to what are often conflicting national laws and policies in the competition area. In many instances, separate parts of the multinational may be compelled to follow conflicting laws and policies of the different national jurisdictions in which they operate.

This inconsistency or tension in the opening language of the Competition Guideline points up the probable purposes underlying the Guideline's treatment of a multinational enterprise as a single unit, which are twofold: (1) to facilitate antitrust investigations of local activities by fostering the obtaining of information from foreign parents and affiliates; and (2) to place "responsibility" on parents for nonobservance of the Competition Guideline by subsidiaries and affiliates. Since the Guidelines are voluntary, are without binding legal effect, and are not to be applied to evaluate the particular conduct of a specific enterprise, the nature and gravity of such "responsibility" is quite unclear.

Two final points should be noted about the introductory clause of the Competition Guideline. First, the term "enterprise" includes any form of commercial activity, e.g., individual, partnership, corporation. Second the clause emphasizes that existing national competition laws take precedence over the OECD Competition Guideline.

Paragraph 1 of the Competition Guideline deals with the abuse of a dominant position.[54] The general concept of "abuse of a dominant position" by a single firm reflects well settled antitrust law in the Common Market and is roughly analogous to the American concept of "monopolization" under Section 2 of the Sherman Act.[55] Paragraph 1 contains three conditions: There must be a "dominant position of market power," abusive conduct, and an adverse effect on competition in the relevant market. Since Paragraph 1 is derived primarily from Article 86 of the Treaty of Rome,[56] it is instructive to look at the Common Market's interpretation of an "abuse of a dominant position" in order to ascertain what the OECD language might mean.

Three cases may be cited. First, a U.S. manufacturer with a worldwide monopoly of a raw material necessary for the production of medicine discontinued selling the raw material to an Italian customer, with whom it was competing, or was about to compete, in the sale of an end product. This also could be described as a supply squeeze by a vertically integrated monopoly. It was held to be an abuse of a dominant position because of the monopoly's refusal to deal.[57] Second, a U.S. manufacturer holding through European subsidiaries a dominant position in the German market for certain types of metal cans acquired a competing manufacturer. The horizontal acquisition was held to be an abuse of a dominant position.[58] Third, and most important, a U.S. banana producer was held to have abused its dominant position by engaging in the following practices: charging different prices (30 to 50 percent differentials) in different countries for equivalent transactions without objective justification; imposing resale restrictions; and charging "unfair" or "excessive" prices.[59] Unduly high or excessive prices standing by themselves probably would not constitute a violation of Section 2 of the Sherman Act. Such prices might be used as evidence of monopoly power; yet, in themselves probably would not constitute abusive or bad conduct which gives rise to monopolization.[60]

There is, however, a similar basis for such interpretations in the American municipal regime. As described in Chapter 2 of this work, Rockefeller's model for abuse of a dominant position to achieve monopolization provoked the initial imposition of the Sherman Act, and his tactics are still effective today. BP, as another example, marked her official entry into the American market by running into antitrust problems before she even concluded the merger with SOHIO (See Chapter 9).

While Paragraph 1 of the Competition Guideline closely parallels Section 2 of the Sherman Act, substantial differences exist between them. Perhaps most importantly, Paragraph 1 is at first glance much narrower in its coverage than Section 2 in that the former does not apply until an enterprise has already achieved a "dominant position" and has thereafter abused it.[61] On the other hand, Section 2 prohibits conspiracies or attempts to attain a monopoly or dominant position. For example, U.S. courts have found a violation of Section 2 where a company engaged in "predatory" or "exclusionary" practices even where that company had a small market share well under what could be considered monopoly power or a dominant position within a relevant market.[62]

On the other hand, the European concept of "dominant position" may be more flexible with less emphasis on market share percentages than is the case with the American concept of "monopoly power" which usually implies at least a 60 or 70 percent market share in addition to abusive conduct. By contrast, the Common Market has placed less reliance on market share percentages in establishing a dominant position under Article 86 and has frequently relied upon other factors such as access to financial resources,[63] raw materials and consumer markets,[64] geographic spread of output,[65] and technological predominance.[66] Reliance on such factors could result in the finding of a dominant position even though a firm's market share is well below the threshold figure under U.S. antitrust law. Similarly, under German antitrust law a dominant market power is rebuttably presumed where a single firm has only one-third of the market.[67] Thus, multinationals might anticipate that other OECD members might take a broader and stricter view of "dominant position" than that generally given "monopoly power" under Section 2 of the Sherman Act. It would seem that each of the Seven Sisters run the risk of being declared to be in a dominant position in some markets merely by definition rather than percentage share of the market.

Other questions also remain unanswered under Paragraph 1. For example, must the dominant position exist in the same market where competition is adversely affected? Could France, for example, justifiably invoke Paragraph 1 against a U.S.-based multinational which holds a world-wide dominant position in the manufacture of a product and discontinues selling to a French dealer, where the manufacturer has only 5 percent of the market in France?[68] There is also the question whether independent enterprises can be grouped together in order to demonstrate a dominant position, i.e., the case of a "shared monopoly". This concept has been rejected under U.S. antitrust law,[69] but has been accepted in some OECD countries, notably West Germany.[70]

The concept of "abuse" in Paragraph 1 appears to parallel the U.S. monopolization concept of "predatory", "exclusionary", or otherwise anti-competitive or unfair business conduct.[71] A U.S.-based multinational that is not engaged in conduct which would constitute actual monopolization under U.S. antitrust laws can be somewhat secure that it is not committing an "abuse" under Paragraph 1 as that term may be interpreted by other OECD nations. There are some very significant exceptions, most of which concern either high or excessive prices or different prices to purchasers in different countries.

Five examples of abuses of a dominant position are set out in Paragraph 1. The list should not be considered exhaustive, since Articles 85 and 86 of the Treaty of Rome give examples, and they are not considered exhaustive.[72]

Paragraph 1(a) concerns anti-competitive acquisitions and is based primarily on the Continental Can case in the Common Market which held that the acquisition of a competitor by a holder of a dominant position constituted an abuse.[73] U.S. law is much broader in that it prohibits mergers which may merely lessen competition in the future; a dominant position is not needed to invalidate the merger.[74] The efficacy of Paragraph 1(a) is highly doubtful for several reasons. First, municipal policies toward merger control differ radically among even the OECD member countries.[75] Moreover, where a country imposes merger controls on competition grounds, the question whether an acquisition is "anti-competitive" is a very complex one which cannot be answered in the abstract and which likely would be answered in varying ways by different nations.[76] Second, many OECD countries already screen foreign takeovers or acquisitions of domestic firms.[77] Compliance with the formal, or as in the French case informal,[78] conditions for government approval of a foreign takeover will take precedence over the OECD Competition Guideline. Thus, Paragraph 1(a) offers little or no guidance to multinationals contemplating an acquisition in an OECD country.

Paragraph 1(b) concerns predatory behavior toward competitors and reflects a generally accepted principle which on its face is consistent with U.S. antitrust law. The generality of the language, however, may permit wide divergencies of interpretation. Nonetheless, Paragraph 1(b) reflects existing U.S. antitrust law. The problem is that there is substantial controversy surrounding the "predatory" nature of some practices. For example, in many situations it is not clear whether pricing is "competitive" or "predatory".[79] There is also the question whether business activity harmful to a competitor should be proscribed when there is no apparent or short-run harm to competition and consumers.[80]

Paragraph 1(c), which concerns unreasonable refusals to deal, is also largely consistent with existing U.S. and most other antitrust laws.[81] The main question under Paragraph 1(c) is whether it prevents exclusive distributorships, as well as refusals to license patented or unpatented technology, trademarks, copyrights and other industrial property. It would seem likely that it does not, since the Common Market has specific rules on exclusive distributorships.[82] Including token independents as appeasement in such joint ventures as the Iraq Petroleum Co. (Chapters 4 and 7) and Alyeska (Chapter 9) might be considered refusals to deal.

Paragraph 1(d) concerns the anti-competitive abuse of industrial property rights. The extreme generality of this provision prevents it from providing any meaningful guidance in this highly complex area of antitrust and industrial property law. While most antitrust laws prohibit specified licensing and other arrangements on certain grounds, municipal rules vary and conflict to such a degree[83] that at the present time multinationals should look to them rather than to this guideline. Paragraph 1(d) is highly important, however, not as a Guideline, but rather as a signal that many countries are and will be taking a harder antitrust look at the use of industrial property rights.

Paragraph 1(e) is one of the most important. It can be best understood as having two separate clauses, each of which covers different types of pricing practices by a firm with a dominant position: (1) discriminatory or unreasonably differentiated pricing; and (2) anti-competitive transfer pricing. The prohibitions in each clause raise potentially serious problems for multinationals.

The first clause deals with discriminatory, that is, unreasonably differentiated, pricing. However, it is unclear whether this clause refers to price discrimination among purchasers within a single country, a Robinson-Patman type provision;[84] or to price differences between or among different countries, a <u>Chiquita (United Brands)</u> situation;[85] or to the selling or dumping of goods in one country at a price below the fair market value in the country of manufacture.[86] In view of the concern in the Common Market regarding differences in pricing of the same goods in different countries, it would seem likely that the second category is intended. The activities in the East Texas oil fields (Chapter 5) exemplify the dangers inherent in price cutting.

This part of Paragraph 1(e) seems to reflect the European rather than the American concern. But the remedy of ordering a roll-back of prices or of setting maximum prices which was adopted by the Europeans[87] is rejected in the United States as an antitrust remedy.[88] Price-fixing, although a hotly debated issue during the Roosevelt Era, was never passed into law in America (See Chapter 6). A U.S.-based multinational with a dominant position which sells the same product in different countries at substantially different prices must be prepared to face the possibility of complaints under Paragraph 1(e).

The second clause of Paragraph 1(e) deals with pricing transactions between affiliated entities. Here again, the concerns underlying the guideline are mainly European and not American. The provision is apparently intended to reach two marketing situations. The first is "subsidization" whereby higher profits obtained elsewhere permit a particular subsidiary or affiliate to engage in local below-cost pricing to gain entry or increase its market share.[89] The second is discrimination by a vertically integrated multinational against independent retailers in favor of company-owned outlets.[90]

The former, if it consisted of below-cost pricing, would probably be unlawful in the United States, but it is far less clear whether it would be unlawful in the absence of other illegitimate practices.[91] OECD concerns in this area must be seen against the background of a more vocal Third World concern with the transfer pricing of multinationals[92] The provision should be understood, then primarily as an expression of growing concern with such pricing practices on the part of certain OECD member countries and the Third World concern with transfer pricing. It is doubtful, however, whether transfer prices ordinarily implicate antitrust policies -- unless there is a classic price squeeze situation -- rather than taxation, customs and other municipal policies.

With regard to discrimination by vertically integrated firms, U.S. law does not generally require such firms to sell their products to independent retailers at exactly the same price as they charge company-owned retail outlets.[93] An interpretation of Paragraph 1(e) which requires such uniformity would be a significant departure from U.S. antitrust law.

Paragraph 2 concerns vertical restrictions imposed on downstream purchasers, distributors, and licensees.[94] A dominant position or monopoly need not exist in order for Paragraph 2 to apply. However, unlike U.S. or Common Market law, no conspiracy or concerted action is necessary.[95] The expressions "freedom to resell, export, purchase" and "to develop their operations", together with such concepts as "trade conditions" and "sound commercial practice" have no clear meaning in the antitrust field. Given these ambiguities, together with the breadth of the exeptions of conditions, it is doubtful whether this paragraph will provide a great deal of practical guidance beyond calling attention to certain concerns of foreign countries.

The primary concern underlying Paragraph 2 is with restrictions on exports and re-exports imposed on local licensees, distributors and other resellers.[96] Common Market and developing countries are particularly sensitive about such restrictions. Paragraph 2 could be interpreted as going beyond U.S. antitrust law or perhaps as being contrary even to other U.S. laws such as the Trading With the Enemy Act.[97]

Joint ventures appear to be excluded and restrictions on subsidiaries should be not covered in view of the legislative history of this provision which in an earlier form covered "competitively important, wholly-owned subsidiaries."[98]

The phrase "freedom to ... purchase" is apparently intended to cover tie-ins and should not be interpreted as imposing an obligation on multinationals to sell to whoever demands. Given the broad language and enumerated conditions, Paragraph 2 cannot be expected to provide much practical guidance with respect to tie-in arrangements; it is more an expression of OECD concern about the imposition of tie-ins upon unwilling purchasers and licensees. As the emphasis is on "freedom" of purchasers and licensees to resell, etc., the Paragraph is apparently not directed to restrictions voluntarily entered into.

International and domestic cartels are the subject of Paragraph 3.[99] This is a significant declaration by twenty-three industrialized nations accepting U.S. antipathy to cartel arrangements such as price-fixing, division of markets, allocation of customers and limits on production. Like Section 1 of the Sherman Act and Article 85 of the Treaty of Rome, concerted action or a conspiracy is required.[100]

While the general condemnation of cartels in Paragraph 3 raises no particular problems for U.S.-based multinationals, its language raises two points worthy of comment. First, earlier drafts which barred "cooperation" with cartels or restrictive agreements[101] raised fears that presumably innocent activity, such as mere purchasing from a cartel, might be covered by the Guideline. "Cooperation" was replaced by the phrase condemning actions "purposely strengthening the restrictive effects" of cartels. While this amendment certainly removes mere purchasing from a cartel as a proscribed action, it does not remove all doubts concerning a situation where a multinational is compelled by a foreign government to participate in or aid a nation-state cartel, like OPEC. For example, a foreign government compulsion defense to an antitrust claim exists under U.S. law.[102] The final qualifying clause relating to cartels which "are not generally or specifically accepted under applicable national or international legislation" raises many questions and is subject to a plethora of interpretations.

Paragraph 4 concerns consultation and cooperation.[103] This final paragraph is unique in being the first international guideline or statement of principles to include a procedural provision. The apparent concern is that enforcement of antitrust law with respect to multinationals is hampered by the refusal of parent companies to provide information demanded by investigators.

Exactly what consultation and cooperation entails is unclear. The scope, however, is broad. Parents and subsidiaries are treated as a single unit and the Guideline can be interpreted to require cooperation and the provision of information to any nation "whose interests are directly affected" even though the multinational has no subsidiary or branch there. It also is not at all clear what is meant by "safeguards normally applicable in this field." It is doubtful whether such safeguards exist.

In summary, the Competition Guideline is not a multilateral code of conduct reflecting the existing antitrust legislation and policies of OECD member countries. Rather the Competition Guideline should be viewed by multinationals as identifying those areas of antitrust concern which are shared by OECD member countries. Despite these shared concerns, the generality of the Competition Guideline will permit each OECD member country to impart a content to the Guideline consistent with its own municipal policies. Multinationals should continue, therefore, to emphasize compliance with municipal antitrust rules and policies and should not treat the Competition Guideline as a surrogate.

This does not mean, however, that the Competition Guideline will have no practical significance. First, the extensive work which went into the formulation of the Competition Guideline, its acceptance by the OECD member countries, and the consultation procedures may very well move OECD member countries and, perhaps more importantly, their antitrust officials toward stronger and more pro-competition national policies and enforcement. The educational effect of the increasing exchange of information and views among officials can be a real and substantial one. Such a movement toward stronger antitrust enforcement can certainly occur even without a "harmonization" of municipal laws in the formal or technical sense.

Second, it can be expected that Paragraph 4 of the Competition Guideline and the consultation procedures of the Guidelines generally will themselves encourage greater cooperation among national enforcement officials. For example, multinationals should contemplate that Paragraph 4 will be invoked by national authorities in order to facilitate investigations of local activities by seeking informations from foreign parents, subsidiaries and affiliates. More specifically, Paragraph 4 may result in increased pressure on multinationals to disclose information to enforcement officials pursuant to antitrust investigations and actions.

The theory of antitrust policy is that certain kinds of restraints are undesirable when they affect competition in some defined market. This general premise applies to the Competition Guideline as well. It is clear that the Guideline is directed at and is limited to certain kinds of effects which result from either collusive or predatory conduct. Furthermore, there is obviously a market notion in the Competition Guideline. It employs the concept of territoriality, analogous to the Sherman Act, which limits U.S. antitrust jurisdiction to acts affecting the domestic or foreign commerce of the United States,[104] or the antitrust provisions of the Treaty of Rome.[105] The latter provisions are not directed at export restraints that have no impact in the Common Market. Their purpose is to encourage free trade within the Community, and in a broader sense, to facilitate the economic integration of the Community. These provisions encompass extraterritorial conduct only when that conduct has an impact within the Common Market. As a jurisprudential matter, this is generally true of any particular municipal law. Municipal laws are obviously limited to the extent that the jurisdiction of a given country is recognized by other countries.

The second problem is that, unlike other legislation, the political history and the political setting of the Competition Guideline is unclear. The Sherman Act had a political history in that it was enacted as the result of a populist movement against trusts.[106] It also had a legal history in the sense that, although the common law concept of restraints of trade was expanded in the Sherman Act, it also provided a point of reference in case law.[107] The Sherman Act also had an ethical setting in that notions like predatory behavior toward competition were developed as a model against which certain kinds of restraints and their effects could be measured.

The motivation behind the provisions of the Treaty of Rome is also known. It was to encourage the growth of trade within the Common Market and to facilitate the economic integration of the nations of the Community.[108] The municipal laws of a number of Third World countries which focus on issues like technology transfer also have a political base in that they are attempting to encourage the self-sufficiency of local enterprises, discourage restraints on their export capability, and the like. The political purpose and the political setting of the Competition Guideline, however, is much less clear.

The third problem with the Competition Guideline is that it contains some very sweeping phrases and no process by which concrete meaning can be given to them. The Treaty of Rome and Sections 1 and 2 of the Sherman Act also contain some very broad language, but in those laws there is at least the comfort of knowing that there is a developing body of case law for guidance. It would appear then, that the Competition Guideline is not law, but a "brooding omnipresence in the sky" in the words of Justice Holmes,[109] just as the Sherman Act came back to haunt the very companies which supported its passage.

These observations lead to one empirical note with regard to how multinationals might use the Competition Guideline. To the extent that companies have municipal antitrust compliance procedures, they will look to the Competition Guideline fairly late.

For companies based in the United States, the internal review process would first consider the body of law that has evolved as a consequence of the Sherman Act. If the company has operations within the Common Market, it then would consider the kinds of practices that have been attacked, challenged or condemned in the case law under the Treaty of Rome. If the company has an operation in Germany, obviously it would look at German municipal law. Similarly, if the company has an operation in Argentina or Mexico, it would look at their provisions on technology licensing, and so on.

The Competition Guideline does not change this process. The internal review process should begin with those antitrust provisions which have been enacted into law, to which sanctions are attached, on the basis of which there will be a body of judicial interpretation, and which can be evaluated in terms of their political and social purposes.

This does not mean that the Competition Guideline can be ignored. Perhaps a more appropriate way to look at it is that occasionally it will shed some light on the direction in which municipal law will move. It certainly may throw some light on the direction in which Common Market law will continue to evolve. The Competition Guideline also may indicate what in the way of municipal antitrust legislation may develop over time in Third World countries, and may show how those countries will interpret some of their existing laws. Therefore, the Competition Guideline is a sort of checklist, albeit a supplemental checklist.

The Guidelines -- not just the Competition Guideline but the overall document -- should be reviewed in historical perspective. Obviously, the world at large is engaged in a growing international dialogue on the conduct of multinational companies. In this regard the Guidelines are perhaps significant in terms of identifying trends, and to that end are helpful in discerning the direction or movement of the law.

On the other hand, as has been documented, much of the basis for the principles laid out in the Guidelines emanates from municipal law, especially in the case of American antitrust law. The petroleum industry is the obvious vantage point from which to view the MNC. Each of the Seven Sisters, as individual units, dwarf every other MNC; yet, as an oligopoly, they present such an awesome magnitude of resources that even Western governments find it difficult, if not impossible, to compete with such a cartel.

An examination of the Trans-Canadian Pipeline proposal, suggested by the Canadian Government as an alternative to the Trans-Alaskan Pipeline (TAPS) -- the largest privately-financed construction project in history -- shows that Canada, for example, lacked not only the technical expertise, but also the financial capabilities to develop such a massive project. Chapter 9 details the various alternatives to TAPS which were considered and the financial and technical problems surmounted by ALYESKA, the consortium of private companies formed for the express purpose of designing, financing, building, and operating TAPS.

While the Alaskan investment would be impressive in and of itself, it must be considered in conjunction with the global actions of these mammoth enterprises, including the simultaneous development of the North Sea and of virtually all other known petroleum reserves throughout the world.

Having considered the size of the oligopoly, and realizing the extent of the world's dependence on oil, it follows that the American Government -- as home government to five of the Seven and host to the others; as the only industrialized country unscathed by World War II, and as such, the leading proponent of free enterprise; and as both the largest producer and consumer of oil, herself -- should have developed the most mature, sophisticated municipal regulatory system with which to foster such an industry. It stands to reason, then, that her body of law would set precedents and become one of the main contributors to the establishment of accepted general practice in unorganized world society.

It is, therefore, important to trace the development of petroleum law in America -- especially that of antitrust law -- from social, historical, and ethical perspectives in the attempt to come to a workable solution to the antitrust issue on a global scale.

Even Britain in the 1960s did not have the technical expertise or the financial capabilities to develop her own indigenous oil in the North Sea. Yet, British Petroleum would appear the ideal vehicle through which to examine the overall developments of the industry. As the sun sets on the British Empire, BP remains as one of the few great remnants of that era, in that she still operates in over 130 countries today. Not only was she the first great oil company outside America, almost as old as Exxon herself, her global rank with Exxon and Shell today is unquestioned. When she did enter the American market, in which she controls 11 percent of the proven indigenous oil and gas reserves, she chose to do so through the auspices of the Standard Oil Company of Ohio (SOHIO), a direct offspring of Rockefeller's great monopoly. Steeped in the tradition of both common and international law, her contributions to the industry in general, and specifically her influence on American municipal law -- especially that of antitrust -- was apparent long before she actually entered the American market. BP's close history of working relationships with the biggest of the American majors, particularly in view of her British nationality, would appear to render her a more objective observer, offering a slightly different slant in her relationship with the U.S. Government as well.

It is her paradoxical relationship with her own part-owner home government, however, which allows for exploration of the implications inherent in a mixed economy such as Britain's.

These various relationships are examined over an extended period of time under diverse circumstances in order to fully analyze their synergistic nature.

Therefore, this thesis utilizes an interdisciplinary approach to international law in respect to multinational corporations and their various symbionic relationships with states. The actual functioning of MNCs in unorganized world society has been traced from social, historical, and ethical perspectives, the result of which indicates that MNCs already exhibit a degree of at least quasi-sovereignty in their dealings in the international arena. As a result, the organized world society should recognize MNCs as limited international legal personalities in their own right and commence the process of defining what limits are inherent in their nature.

One of the more obvious definitional problems involves the concept of sovereignty with its traditional implication of territory. The issue of sovereignty over a state's own natural resources becomes inextricably muddled when -- in practice -- MNCs exercise quasi-sovereignty over the lands they own, lease, or for which they contract for mineral extraction rights. In fact, the entire history of concession agreements -- usually with states or state-owned corporations formed for the express purpose of contracting with multinational corporations -- indicates that such sovereignty is, in effect, negotiable, and bound by contract as an implement of international law.

Such concession agreements involve state development in varying degress and as such traverse the thin line dividing private and public international law. Therefore, as Friedmann points out, corporations which participate in international economic development agreements perform functions which pertain to the sphere of public rather than private international law and this must be reflected in their legal status.[110] In many of these agreements, arbitration clauses accord equal status to the governmental and private participants. The need for this treatment as equals has been reflected recently in the provision made by the World Bank-sponsored Convention on the Settlement of Investment Disputes for a conciliation and arbitration procedure between governmental and private participants in investment transactions on a level of equality.[111]

The European Community treaties also give procedural standing equal to that of governments to private enterprises and associations. Under Article 33 of the ECSC, enterprises and associations have a right to appeal against decisions and recommendations of the High Authority on the grounds of legal violations of the Treaty. Under Article 173 of the EEC Treaty, any "natural or legal person" has a right of appeal against the decisions, as distinct from the recommendations or opinions of the Council and the Commission, provided that the decisions or regulation in question is "of direct and specific concern."[112]

These, then, are the first steps of recognition of MNCs as international legal personalities by organized international society. Another, albiet less direct, indication of imminent recognition is the UN General Assembly's unanimous adoption of Resolution 2501 (XXIV) on 12 November 1969 which

> recommends that the International Law Commission should study, in consultation with the principal international organizations, as it may consider appropriate in accordance with its practice, the question of treaties concluded between states and international organizations or between two or more international organizations.[113]

Agreements such as the Red Line Agreement -- in effect, a "treaty between two or more international organizations" -- would finally achieve "validity", having had the "quality" of international law conferred upon it (See Chapter 4).

It can no longer be denied that multinational corporations -- especially those in the petroleum industry -- are an ipso facto part of the international legal regime and that their international political, social, and economic functions as structural components of systems of the world order "can only be neglected at our peril."[114]

Notes to Chapter 1

[1]David I. Haberman, attorney in the Antitrust Division of the U.S. Department of Justice from 1953 to 1968, described the history of relationships between cartel members and governments leading to the 1953 prosecution of the Oil Cartel Case. His portrayal before the MNC Hearings of 1974 (Part 7, p. 122) illustrates the continuity of this pattern. See U.S., Senate, Foreign Relations Committee, Subcommittee on Multinational Corporations, Multinational Petroleum Companies and United States Policy, Hearings before the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee, 9 vols., 93rd Cong., 1st and 2nd. Sessions 1974, (hereafter cited as MNC Hearings).

[2]Jerzi Rajski, "A Comparative Approach to International Law," International Law and the Comparative Perspective, ed. W. E. Butler (1980), pp. 131-132.

[3]These concepts of international law have been compiled from the following works of Georg Schwarzenberger and will hereafter be cited as Schwarzenberger. ________, Power Politics: A Study of World Society, 3d ed., (New York: Praeger, 1964); ________, Second Report on the Review of the Charter of the United Nations, (London: 1956); ________, A Manual of International Law, 6th ed./by Georg Schwarzenberger and E. D. Brown, (Milton, Eng.: Professional Books, 1976); ________, International Law, 3d ed., (London: Stevens, 1957); ________, International Law and Order, (New York: Praeger, 1971); George W. Keeton and ________, Making International Law Work, 2d ed. (London: Stevens & Sons Limited, 1946); ________, The Dynamics of International Law, (Abingdon, Eng.: Professional Books, 1976); ________, Economic World Order? A Basic Problem of International Economic Law, (Manchester: Manchester University Press, 1970); ________, Foreign Investments and International Law, (New York: Praeger, 1969); ________, The Frontiers of International Law (London: Stevens, 1962); ________, The Inductive Approach to International Law (London: Stevens, 1965).

[4]Alexandre Charles Kiss, "Comparative Law and Public International Law," International Law and the Comparative Perspective, ed. W. E. Butler (1980).

[5]The term "Seven Sisters" became widely used in the 1950s to refer to the seven major integrated oil companies which include British Petroleum, Exxon (Esso in Europe), Gulf, Mobil, Socal (Chevron in Europe), Shell, and Texaco. Anthony Sampson has institutionalized the term in his book by the same name (London: Hodder and Stoughton Ltd., Coronet Edition, 1977). Since many of the firms have changed their official names in the course of history, current names have been used except in certain instances for sake of clarity.

[6]Schwarzenberger.

[7]N. T. Wang, "Trade and Development," Competition in International Business: Law and Policy on Restrictive Business Practices, eds. O. Schachter and R. Hellawell, (New York: Columbia University Press, 1981).

[8]Fritz Alexander Mann, "Reflections on a Commercial Law of Nations," British Yearbook of International Law, 33 (1957):20; F. A. Haight, The Choice of Public International Law as the Applicable Law in Development Contracts with Foreign Governments.

[9]Philip Carl Jessup, Transnational Law (1956).

[10]Clive M. Schmitthof, "International Business Law: A New Law Merchant," Current Law and Social Problems, 2 (1961):129.

[11]A. D. McNair, "The General Principles of Law Recognized by Civilized Nations," British Yearbook of International Law, 33 (1957):P.I.; Wolfgang Friedmann, "The Uses of General Principles in the Development of International Law," American Journal of International Law, 57 (1963):279.

[12]McNair, pp. 6, 10, and 19; A. Verdross, "Quasi-International Agreements & International Economic Transactions," Yearbook of World Affairs (1964), pp. 230-234.

[13]Mann, "The Proper Law of Contracts Concluded by International Persons," British Yearbook of International Law (1959), p. 34 et. seq.; Friedmann, Changing Structure of International Law (hereafter cited as Changing Structure), (New York: Columbia University Press, 1964), pp. 222-224.

[14]A. A. Fatouros, Government Guarantees to Foreign Investors, (New York: Columbia University Press, 1962), pp. 288-289.

[15]Schwarzenberger.

[16]William Warner Bishop, International Law: Cases and Materials, 2d ed., (Boston: Little, Brown, 1962), pp. 257-258.

[17]Friedmann, Changing Structure, p. 218.

[18]Friedmann, "The Changing Dimensions of International Law," Columbia Law Review, 62 (1962):1147-1148.

[19]Schwarzenberger.

[20]Schwarzenberger.

[21]Schwarzenberger.

[22]Schwarzenberger.

[23]Schwarzenberger.

[24]U.N. Resolution 3201 (S-VI).

[25]U.N. Resolution 3281 (XXIX).

[26]For a detailed article by article analysis, see Kenneth R. Simmonds, "Foreign Investment, The International Law Standard, and the Multinational Corporation -- An Overview," Legal Problems of Multinational Corporations, ed. Kenneth R. Simmonds, (London: The British Institute of International and Comparative Law, 1977).

[27]Seymour J. Rubin, "Reflections Concerning the United Nations Commission on Transnational Corporations," American Journal of International Law, 70 (1976):74.

[28]ICC Document 191/83 ¶2.

[29]Ignaz Seidle-Hohenveldern, "The United Nations and Transnational Corporations," Legal Problems of Multinational Corporations, ed. Kenneth R. Simmonds, (London: The British Institute of International and Comparative Law, 1977), p. 64.

[30]There are many current perspectives on the Guidelines available. See, e.g., Mark R. Joelson, "The Proposed International Codes of Conduct as Related to Restrictive Business Practices," Law and Political International Business, 8 (1976):837.

[31]Joelson, p. 840. See generally U.S. Department of State, Pub. No. 3206, Commercial Policy Series 114, Havana Charter for an International Trade Organization, Art. 46 (1948); General Agreement on Tariffs and Trade, 30 October 1947, 61 Stat. A3, T.I.A.S. No. 1700, U.N.T.S., 55:187; Abram Chayes, Thomas Erlich, and Andreas Lowenfeld, International Legal Process, 1 (2d ed., Boston: Little, Brown, 1968):576-631.

[32]European Economic Community, Sixth Report on Competition Policy, (April 1977), (hereafter cited as Competition Policy Report); Valentine Korah, Competition Law of Britain and the Common Market (London: Elek, 1975); Dimitri Barounos, D. F. Hall, and Rayner James, EEC Antitrust Law (London: Butterworths, 1975).

[33]See Common Market Report ([CCH] Comm'n:1973), ¶23.509; Competition Policy Report, p. 49.

[34]Korah.

[35]See United Nations, UNCTAD, Report of the Ad Hoc Group of Experts on Restrictive Business Practices in Relation to the Trade and Development of Developing Countries, U.N. Doc. TD/B/C.2/119/Rev. 1 (1974), supplemented in UNCTAD Secretariat, Review of Major Developments in the Area of Restrictive Business Practices, U.N. Doc. TD/C.2/159 (1975).

[36]See generally Seymour J. Rubin, "Harmonization of Rules: A Perspective on the U.N. Commission on Transnational Corporations," Law and Political International Business, 8 (1976):875.

[37] See OECD, Recommendation of the Council Concerning Co-operation Between Member Countries on Restrictive Business Practices Affecting International Trade, adopted 5 October 1967, OECD Doc. 6(67):53, reprinted in Antitrust Bulletin 13(1968):370. See also OECD, Recommendation of the Council Concerning Consultation and Conciliation Procedure on Restrictive Business Practices Affecting International Trade, adopted 20 December 1973, OECD Doc. C(73)99, reprinted in Antitrust Bulletin, 19 (1974):283.

[38] OECD, Report of the Committee of Experts on Restrictive Business Practices, Refusal to Sell (1969).

[39] OECD, Report of the Committee of Experts on Restrictive Business Practices, Market Power and the Law (1970).

[40] OECD, Report of the Committee of Experts on Restrictive Business Practices Relating to Patents and Licenses (1972).

[41] See I. J. Zisler, "The Work of the OECD Committee of Experts on Restrictive Business Practices," Antitrust Bulletin 19 (1974):289.

[42] In 1953, the OEEC (Organization for European Economic Cooperation) established a Group of Experts on Restrictive Business Practices, which later became the Committee of Experts on Restrictive Business Practices of the OECD in 1960 (when the OEEC was reconstituted as OECD). The committee's Working Party No. 11 dealt with matters related to multinational corporations. OECD, Working Party No. 11 of the Committee of Experts on Restrictive Business Practices, OECD Doc. DAF/RBP/WP.II/39 (1975), (hereafter cited as Working Party No. 11).

[43] Working Party No. 11.

[44] Working Party No. 11.

[45] Working Party No. 11.

[46] Working Party No. 11.

[47] See "Recent Measures to Strengthen Competition Policy," OECD Observer, 17 (September-October 1975):38 (developments in competition policy in OECD member countries); OECD, Annual Reports on Competition Policies in OECD Member Countries (1977).

[48] See OECD, Declaration on International Investment and Multinational Enterprises, (21 June 1976).

[49] See OECD, Guidelines for Multinational Enterprises, Annex to OECD, Declaration on International Investment and Multinational Enterprises, (21 June 1976), (hereafter cited as Guidelines), Competition.

[50] Guidelines, Competition, Introductory ¶8.

[51] Guidelines, Competition, ¶4.

[52]See, e.g., United States v. Yellow Cab Co., 332 U.S. 218 (1947); United States v. Watchmakers of Switzerland Information Center, Inc., 133 F. Supp. 40 (S.D.N.Y. 1955); Commercial Solvents Corp., (1973-1975 Transfer Binder), Common Market Report, ([CCH] Comm'n:1972), ¶9543.

[53]Guidelines, Competition, ¶4.

[54]Guidelines, Competition, ¶1.

[55]15 U.S.C. §2 (Supp. V, 1975).

[56]Treaty Establishing the European Economic Community, done 25 March 1957, 298 U.NT.S. 3 (hereafter cited as Treaty of Rome). Article 85 of the Treaty roughly corresponds to §1 of the Sherman Act, 15 U.S.C. §1 (Supp. V, 1975). Article 86 is similar to §2 of the Sherman Act, with the major exception that Article 86 prohibits certain conduct only after a "dominant position" has been attained, thus, exempting from its coverage activities that would be condemned under §2 as a conspiracy or attempt to monopolize.

[57]ICI & Commercial Solvents Corp. v. EC Comm'n (1974 Court Decisions) Common Market Report, ([CCH] Comm'n:1974), ¶8209; aff'd Commercial Solvents Corp., (1973-1975 Transfer Binder) Common Market Report, ([CCH] Comm'n:1973), ¶9543.

[58]Continental Can, (1970-1972 Transfer Binder) Common Market Report, ([CCH] Comm'n:1971), ¶9481; aff'd in relevant part, Europemballage Corp. v. EC Comm'n, (1971-1973 Court Decisions) Common Market Report, ([CCH] Comm'n:1973), ¶8171.

[59]Chiquita (United Brands), 2 Common Market Report, ([CCH] Comm'n:1975), ¶9800.

[60]See, e.g., American Tobacco Co. v. United States, 328 U.S. 781, 804-808 (1946).

[61]See, e.g., Europemballage Corp. v. EC Comm'n, (1971-1973 Court Decisions) Common Market Report, ([CCH] Comm'n:1973), ¶8171.

[62]See, e.g., United States v. Yellow Cab Co., 332 U.S. 218 (1947); United States v. Consolidated Laundries Corp., 291 F.2d 563 (2d Cir. 1961).

[63]See "Decision of 9 June 1967," 19 O. J. Eur. Comm. (No. L 223) 27 (1976), Commission found Hoffman-LaRoche in violation of Art. 86 of Treaty of Rome for abusing dominant market position in manufacture of vitamins; Roche appealed to the ICJ. See Competition Policy Report, p. 88.

[64]Competition Policy Report, p. 88.

[65]Competition Policy Report, p. 88.

[66]Competition Policy Report, p. 88.

[67]See Common Market Report, ([CCH] Comm'n:1973), ¶23,509.

[68]Cf. United States v. Griffith, 334 U.S. 100 (1948).

[69]There are two "shared monopoly" cases concerning the ready-to-eat cereal market and the oil industry pending under §5 of the FTC Act. Kellogg Co., (1970-1973 Transfer Binder) Trade Reg. Report, ([CCH] FTC:1972), ¶19,898 (complaint); Exxon Co., (1970-1973 Transfer Binder) Trade Reg. Report, ([CCH] FTC:1973), ¶20,388.

[70]See Common Market Report, ([CCH] Comm'n:1973), ¶23,509.

[71]Puerto Rican Am. Tobacco Co. v. American Tobacco Co., 30 F.2d 234 (2d Cir.), cert. denied, 279 U.S. 858 (1929) (predatory or exclusionary conduct may include temporary price cutting); Northern Pac. R.R. v. United States, 356 U.S. 1 (1958); Eastman Kodak Co. v. Southern Photo Co., 273 U.S. 358 (1927) (refusals to deal and discriminatory treatment); United States v. Terminal R.R. Ass'n., 224 U.S. 383 (1912) (so-called Bottleneck Cases).

[72]In the Continental Can case, (1970-1973 Transfer Binder) Common Market Report, ([CCH] Comm'n:1971), ¶9481, aff'd in relevant part, Europemballage Corp. v. EC Comm'n, (1971-1973 Court Decisions) Common Market Report, ([CCH] Comm'n:1973), ¶8171, the court stated, "The list [of examples in Articles 85 and 86] is given only by way of examples and does not exhaust the types of abuses of dominant position that are prohibited under the treaty."

[73]Continental Can Case (1970-1973 Transfer Binder) Common Market Report, ([CCH] Comm'n:1971), ¶9481; aff'd in relevant part, Europemballage Corp. v. EC Comm'n, (1971-1973 Court Decisions) Common Market Report, ([CCH] Comm'n:1973), ¶8171.

[74]Clayton Act §7 15 U.S.C. §18 (1970) (Celler-Kefauver Amendment). §7 has been called an "incipiency" statute. Brown Shoe Co. v. United States, 370 U.S. 294,317 (1962).

[75]OECD, Report by the Committee of Experts on Restrictive Business Practices, Mergers and Competition Policy (1974).

[76]See "Why Mergers Should be Controlled," OECD Observer, 74 (March-April 1975):34.

[77]E.g., The Canadian Foreign Investment Review Act, Can. Stat:(1973-1974), Ch. 46, passed by 29th Parl., 1st Sess.

[78]See OECD, Annual Reports on Competition Policy in OECD Member Countries (1977); OECD, Report of the Committee of Experts on Restrictive Business Practices, Mergers and Competition Policy (1974).

[79]See D. F. Areeda and W. R. Turner, "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act," Harvard Law Review 88 (1975): 697. Compare Telex Corp. v. IBM Corp., 367 F. Supp. 258 (N.D. Okla. 1973) with 510 F. 2d 894 (10th Cir.), cert. denied, 423 U.S. 802 (1975), which reversed the district court decision.

[80]Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967).

[81]Compare Six Twenty-Nine Prods., Inc. v. Rollins Telecasting, Inc., 365 F. 2d 478 (5th Cir. 1966) with ICI & Commercial Solvents Corp. v. EC Comm'n, (1974 Court Decisions) Common Market Report, ([CCH] Comm'n: 1974), ¶8209.

[82]See, e.g., E.E.C., Reg. No. 67/67, Application of Article 85, Paragraph 3, of the Treaty to Groups of Exclusive Distributor Agreements (1967), O. J. Eur. Comm. (No. 57) 849 (1967) (exemption for specific types of agreements and exceptions to prohibited clauses).

[83]See OECD, Annual Reports on Competition Policy in OECD Member Countries (1977); Ulmer, "The Law of Unfair Competition and the Common Market," Industrial Property (1963), p. 33.

[84]Clayton Act §2, 15 U.S.C. §§13, 13a, 13b, and 21a (1970).

[85]Chiquita (United Brands), Common Market Report, ([CCH] Comm'n:2 [1975]), ¶9800.

[86]See generally J. Viner, Dumping: A Problem in International Trade (reprint 1966).

[87]See Treaty of Rome; Arts. 85(1)(d), 86(c); E.E.C., Reg. 17, "Concerning the Implementation of Arts. 85 and 86, Art. 17", O. J. Eur. Comm. 5 (1962):204.

[88]See F. D. Note, "EEC Antitrust -- An Exercise in Prior Restraint," Law and Political International Business, 7 (1975):143.

[89]Guidelines, Competition.

[90]See FTC complaint against Exxon Co., (1970-1973 Transfer Binder) Trade Reg. Report, ([CCH] FTC:1973), ¶20,388.

[91]This situation is analogous to price discrimination by one firm between its different product lines, with higher prices in the line with less competition subsidizing the lower prices required in the more competitive line. See United States v. United Shoe Mach. Corp., 110 F. Supp. 295 (D. Mass. 1953), aff'd per curiam, 347 U.S. 521 (1954); Telex v. IBM, 367 F. Supp. 258 (N.D. Okla. 1973).

[92]The United Nations Conference on Trade and Development (UNCTAD) and the Commission on Transnational Corporations of the United Nations Economic and Social Council (ECOSOC) have served as forums for Third World concerns with transfer pricing of multinationals. See UNCTAD, Report of the Second Ad Hoc Group of Experts on Restrictive Business Practices, ¶38; U.N. ESCOR, Supp. (No. 5) 23(b)(i), U.N. Doc. E/5782, E/C.10/16 (1976).

[93]See Report of the Attorney General's National Committee to Study the Antitrust Laws 34 (1955): Mark Joelson and E. Kintner, An International Antitrust Primer 71 (1974).

[94]See Guidelines.

[95]Compare Sherman Act §1 with §2, 15 U.S.C. §§1-2 (1970).

[96]See, e.g., Consten & Grundig v. EC Comm'n, (1961-1966 Court Decisions) Common Market Report, ([CCH] Comm'n:1966), ¶8064.

[97]50 U.S.C. app. §§1-44 (1970). For a relevant discussion see W. G. Hodges, "The Trading with the Enemy Act of 1917 and Foreign-Based Subsidiaries of American Multinational Corporations: A Time to Abstain from Restraining," San Diego Law Review, 11 (1973):206, 219.

[98]Hodges, p. 219.

[99]Guidelines.

[100]E.g., Timkin Roller Bearing Co. v. United States, 341 U.S. 593 (1951); Suiker Unie UA v. EC Comm'n (Re the European Sugar Cartel), (1975 Court Decisions) Common Market Report, ([CCH] Comm'n:1975), ¶8334, aff'd, (1973-1975 Transfer Binder) Common Market Report, ([CCH] Comm'n:1973), ¶9570.

[101]Letter from T. Vogelaar, Special Consultant to OECD's Secretary-General on International Investment and Multinational Enterprises, to Y. Michand, Secretary-General, Business and Industry Advisory Committee to OECD, 16 October 1975.

[102]Under the "sovereign compulsion" doctrine, when anticompetitive conduct employed by United States parties is required by foreign law and is undertaken as the result of foreign government compulsion, the conduct is not subject to attack by American antitrust officials. See Interamerican Ref. Corp. v. Texaco Maracaibo, Inc., 307 F. Supp. 1291 (D. Del. 1970), appeal withdrawn, (3d Cir., 25 August 1970); Note, "Development of the Defense of Sovereign Compulsion," Michigan Law Review, 69 (1971):889.

[103]See Guidelines.

[104]Sherman Act, 15 U.S.C. §§1-2 (1963).

[105]Treaty of Rome, Arts. 85-94.

[106]See A. D. Neale, The Antitrust Laws of the U.S.A., (2d ed., 1970), pp. 12-18; M. Letwin, "Congress and the Sherman Antitrust Law: 1887-1890," University of Oklahoma Law Review 23 (1956):221.

[107]See Neale, p. 14. Senator Hoar, one of the sponsors of the Sherman Act, stated that the phrase "in restraint of trade" was believed to be a term of art based in the common law.

[108]For a general description of the EEC competition programs, see J. W. R. Thompson, "The Competition Policy of the European Community," Journal of World Trade Law, 9 (1973):79.

[109]Southern Pac. Co. v. Jensen, 244 U.S. 205, 222 (1917) (Holmes, J., dissenting). "The common law is not a brooding omnipresence in the sky but the articulate voice of some sovereign or quasi-sovereign that can be identified."

[110]Friedmann, "The Extension of Subjects of International Law Beyond the States," (hereafter cited as "Extension of Subjects"), Hague Academy Recuel Des Cours, 11 (1969):120-121.

[111]Friedmann, "Extension of Subjects," also A. Broches, Proceedings of the American Society of International Law (1965).

[112]Eric Stein and Peter Hay, Law and Institutions of the Atlantic Area (Ann Arbor, Michigan: Oberbeck, 1967), pp. 144-145; see also Friedmann, "Extension of Subjects," p. 123.

[113]International Legal Materials, 9 (No. 1, 1970):226.

[114]See generally George Modelski, "The World Corporation in World Society," The Year Book of World Affairs (1968), pp. 64-78.

CHAPTER 2

STANDARD OIL: FOUNDATIONS OF SYNERGISM

> The development of the doctrine of international law followed only slowly in the wake of the practice of international law. In the early days of international law, it sufficed to have lawyers trained in the canon and civil law. They tended to apply to novel situations the concepts of municipal law with which they were familiar. This accounts for the long continued overemphasis in the doctrine of international law on analogies from more mature systems of internal community law to a differently structured society law.
>
> Georg Schwarzenberger

> ... represented but a logical extention, indeed the inevitable culmination of a long, well defined historical process that was set in motion by these very oil companies at least 40 or 50 years ago.
>
> David I. Haberman

The interdisciplinary treatment of municipal law makes it possible to view international law objectively, especially in the sociological, historical, and ethical perspectives, providing insights into the practice of international law today. Thus, an understanding of British Petroleum's position in unorganized international society presupposes consideration of the development of the Standard Oil Co. For not only did the Standard become the first big oil company, the American Government's attempts at regulating her provided the basis for most future regulation of oil companies. It should be noted that it was through Standard Oil Co. that BP later entered the U.S. market. Thus, in order to better understand the factors contributing to the complexities of British Petroleum's various relationships in the international legal community, it becomes imperative to begin with the Standard.

John D. Rockefeller and his skillful organization, with profit motivation and the need for stability as impetus, developed the Standard Oil Co. into the industry's first big monopoly by systematically setting out to control the exploration and producing, transporting, refining, and marketing aspects of the industry.

> The Standard's financial and industrial success could only have been attained by men with remarkable business acumen, tremendous energy, and an indomitable determination to succeed. Business success is measured in pecuniary terms. These men attained it. With an eye open always to the main chance, they quickly seized opportunities as they presented themselves ... and, whenever advantageous, created new opportunities for increasing the scope of the operation.[1]

The need for price stability was evident in the early 1860s when production was low, causing prices to be high: the production in 1860 was 500,000 barrels a day; the price was $20.00 a barrel. In 1861 production hit a high of 2 million barrels a day and the price stumbled to $0.10 a barrel. As the extreme fluctuations continued, Standard attempted to stabilize prices by eliminating competition and by increasing demand beyond production capabilities.

The Standard Oil Co. was accused of engaging in unfair practices, including interfering with the construction of independent pipelines whether by purchasing land along the proposed routes of the independents or by securing rights of way of her own across such routes. Frequently the support of the railroads was enlisted so that they would refuse to extend rights of way across their routes to rivals of the Standard. In states where pieplines were given the right of emminent domain, this would cause nothing more than delay, litigation, and expense; but in states where pieplines were not extended this right, it served effectively to defeat the independent pipeline projects. Another method employed several times by the Standard interests was to obtain control of independent pipeline enterprises by purchasing a part of their stock. A method more frequently resorted to was to force independents out of business by paying premiums on crude oil at the wells to those producers in the immediate vicinity of an independent line.

In view of the wide scope of the Standard's operations the company could afford to practice price discrimination of this sort in limited areas when competition may have been especially keen without influencing, to an appreciable degree, the average price which it paid. The small independent, however, in meeting this competition on all or a major portion of his business, frequently did so at an absolute loss. In some instances, in order not to prejudice its business at other points, the Standard organized "bogus" independent companies in whose name the discriminating practices were conducted. When these methods failed in their objectives the Standard in some cases purchased outright the oil wells or refineries upon which the independent pipelines were dependent for their continued existence. Either expedient served to deprive the pipeline of the business which it had formerly handled. In one case, the transportation company lost the source of traffic; in the other, its customers, for the purchase of the crude transported. And all along, the Standard consistently refused either directly or indirectly to transport oil for other than Standard refineries.

It is frequently contended that one of the chief influences which gave forces to the general movement toward combination in industry during the closing decades of the nineteenth century was the desire to secure economies which presumably inhere in large-scale production. An early study of the petroleum industry, however, does indicate that once the Standard's monopoly control was established, her larger scale of operations afforded economies which served to fortify further her position of power. This seems particularly true of its pipeline and refinery operations.

There is no doubt that the Standard's larger pipeline system could be operated more economically than the smaller lines of the independents. Likewise, the greater number of its refineries and the larger scale of operations at particular plants enabled her to do business at lower cost than could the smaller independents. Her refineries were scattered widely over the country and were conveniently located with reference to population centers.

Thus in 1906 the Standard Oil Co. controlled the output of 20 refineries located in 12 states. The Standard was thereby enabled to keep her transportation charges low on refined products through the elimination of cross-freights. The larger size of the individual plants -- the Standard's Bayonne refinery and her Philadelphia refinery each distilled 50 percent more illuminating oil in 1904 than all the independents combined -- undoubtedly contributed to her economic superiority. A large-scale plant can afford to install the apparatus necessary to extract from petroleum its full range of values, thus giving it an advantage over the small plant.[2]

In order to establish a monopoly, one may either control one of every step of the production process (horizontal monopoly) or all of any one stage of the production (vertical monopoly). John D. Rockefeller and his organization set out to accomplish both feats simultaneously.

In 1862 Rockefeller and Samuel Andrews established a small refinery in Cleveland, Ohio. By 1865 Rocekfeller had divested himself of all other holdings to devote his full energy to oil. In 1870 various refineries combined to form the Standard Oil Co. which controlled 10 percent of the total refineries in America. The Standard had already begun to secure a few markets by this time. By 1872 the South Improvement Co., controlled by a group of Philadelphia and Pittsburgh refiners, was established to obtain favorable railroad freight rates.

The South Improvement Co. began by making secret agreements with several leading railways whereby open freight rate on oil shipments was to be considerably increased, yet the South Improvement Co. was to be allowed a substantial rebate on oil shipped not only by herself but also by her competitors. A premature announcement of these plans led to fierce opposition in the oil community culminating in a demand for a congressional hearing. The railroads concerned quickly repudiated their contracts. Meanwhile, the Standard Oil Co. had used the power inherent in the impending arrangements to acquire (sometimes by coersion) twenty-one of the twenty-six independent refineries in Cleveland, thus increasing her refinery capacity from 1,500 barrels a day to 10,000 barrels a day. In addition, the Standard managed to secure for herself favorable freight discriminations with the railroads just a few weeks after the collapse of the South Improvement Co. deal.

It should be noted that although the South Improvement Co. failed in her express purpose of concluding a favorable deal with the railroads, an important by-product -- that of information gathering -- was discovered to be invaluable in future to Standard in evaluating strengths and weaknesses of competitors and in perfecting the timing of Standard's ultimate plan for monopolistic acquisition. This pattern has been incorporated on a global scale as standard practice by the major oil companies. By looking at this series of events in historical perspective, it becomes evident that through skillful scientific business management, Standard Oil Co. manipulated the system to her advantage.

The Petroleum Refiners' Association (PRA), headed by Rockefeller and Standard, controlled four-fifths of all American refineries. By 1874 the Central Association of Refiners replaced the PRA. This new association not only was led by Rockefeller, but through him was controlled by the Standard Oil Co.; the Standard was given the responsibility for making all purchases of crude oil and for making allotments to the member refineries. Standard Oil was also given control over sales of refined products, and negotiation of all freight and pipeline expenses. This, in effect, gave Standard Oil Co. a working horizontal monopoly.

By 1875 Standard had increased its stock by 300,000 shares and had begun absorbing refineries all over the U.S. Standard used the additional capital raised from the 300,000 new stock issues to secure control over most of the leading independent refineries by affecting a secret exchange of her own stock for stock in the independent companies. In this manner it secured control over refineries located in Brooklyn, Philadelphia, Baltimore, and Parkersburg, and practically all of the independent refineries in the Oil Creek region. So rapidly had the process of absorption and combination been progressing that from 1870 to 1879 the Standard's control of refined petroleum products had increased from approximately 10 percent to the monopolistic figure of 90 percent.[3]

The formation of the first Standard Oil Trust in 1879 was an attempt to consolidate the control of all the various companies owned into a centralized power structure coordinating all activities. In the interest of efficient management, the thirty-seven stockholders (there had been only three or four at the time of Standard's organization) entered into a trust agreement whereby they turned over the stock which they owned in more than thirty separate companies to a board of three trustees who in turn agreed to manage the stock in the interests of the stockholders.

The extreme hazards involved in the oil field-production aspects of the industry were generally left for the speculative wildcatter. Thus, this high risk area was the last aspect of the industry to be attacked by Standard. She never did enjoy a monopoly over production -- nor was it necessary in light of her exclusive rights to buy crude -- but the Forest Oil Co., established by Rockefeller in 1879, became the largest single producer in America and remained so until the 1911 dissolution.

The Tidewater Pipeline Co. completed a pipeline in June 1879 from oil regions west of the mountains to the seaboard as a feeder to independent refineries near New York City. This was a direct attempt by the independent companies to skirt the pipeline and railroad control of Standard, thereby maintaining their independent existence.

Standard reacted promptly and decisively to this threatened new competition: (1) She lowered transportation rates by rail and pipeline; (2) She acquired control of many of the independent refineries for which the Tidewater was a feeder; (3) She began construction of a transmountain pipeline of her own. These three factors effected a compromise with Tidewater through a purchase of minority interest in the company's stocks.

Standard marketing subsidiaries systematically divided the nation geographically, each section being sub-divided into smaller areas with local agents actively pursuing all potential markets. To establish and maintain this marketing control, detailed information regarding activities of competitors was very useful. Such were the original plans of the South Improvement Co. who had bound the railways to file detailed daily reports on all oil shipped, including the shipper, the quantity and kind of oil, the name of the consignee, the destination and cost of the freight. Although the surreptitous plans of the South Improvement Co. were abandoned, the Standard's spy system, which utilized local freight agents, oil salesmen, and local dealers, secured at one time or another virtually all the information in regard to oil movements of competitors that the South Improvement Co. originally had hoped to provide. Thus, monopoly of the marketing aspects of the industry was established by Standard in record time.[4]

By 1882 the first Standard Oil Trust was replaced simply by exchanging stock. A board of trustees consisting of nine members, issued stock certificates to the stockholders equal to the face value of the properties acquired in exchange for the actual stock. The trustees did not acquire absolute ownership of the stocks, but rather retained control of the stocks on behalf of the joint account of holders of trust certificates; i.e., the holders of trust certificates lost their title to particular stocks or properties but received instead a proportional interest in all the stocks and properties. This new trust comprised the entire capital stock of fourteen oil companies, a major portion of the stock in twenty-six other companies, and the interests of some forty-six individuals. Thus, the control and coordination of activities among the various components of Standard Oil was now consolidated.

In 1890 the Sherman Antitrust Act was passed, which ...

> made it illegal to "monopolize trade" and outlawed all "combination or conspiracy in restraint of trade". On paper, this act represented a major advance over the previous common-law restrictions on monopolistic conspiracies. But it was adopted with little discussion, indeed without attracting much attention of a favorable or unfavorable nature; and beyond an antipathy toward "monopolizing", there is no evidence that anyone had clear notions as to which actions were to be regarded as legal or illegal.[5]

The Hepburn Act, passed in 1906, declared that all pipelines crossing state lines were common carriers and as such were subject to regulation by the Interstate Commerce Commission. This was designed primarily to restrain the Standard Oil Co. from lowering its pipeline rates below cost in unfair competition with independent companies. The law was evaded, however, and Standard's pipelines never acted as common carriers until after the 1911 dissolution.[6]

In 1903 under Republican leadership the Bureau of Corporations was established as an investigating body to function under the direction of the newly created Department of Commerce and Labor. Its duties were to investigate the affairs of corporations engaged in interstate commerce. Soon after its organization, it began an investigation of the Standard Oil Co. The first report on this organization, covering the field of transportation, was submitted by the commission in May 1906. Soon afterwards a two volume report covering the entire petroleum industry was made public. This was a comprehensive and detailed analysis of the history and activities of the Standard. In the investigation, special attention was directed toward the extent of the Standard's monopolistic control and the methods by which this control had been secured.[7]

As a result of the Bureau of Corporations' investigation, prosecution proceedings were instituted by the Department of Justice against the Standard Oil Co. in U.S. Circuit Court, Missouri district. A bill was filed in November 1906 alleging violation of the Sherman Antitrust Act. The trial extended over a period of approximately three years. The testimony and records filled some 23 volumes and covered more than 12,000 pages. Facts established during the trial indicated that the Standard Oil Company of New Jersey directly owned stock in 65 companies and controlled indirectly, through ownership of stock in subsidiaries, 49 other companies, a total of 114 concerns. In the original bill, 71 corporations and 7 individuals had been named as defendants.[8]

A decision was handed down in November 1909. The decree ran against the Standard Oil Co. of New Jersey, thirty-six domestic subsidiaries, and one foreign subsidiary. The Court held that the stock of these thirty-seven corporations was acquired and held by means of illegal combination in violation of the Sherman Act. Accordingly, the Standard was enjoined from voting the stock of these subsidiary companies and from exercising or attempting to exercise control over their actions. The subsidiary companies were also enjoined from paying dividends to the parent organization. Dissolution of the combination was ordered. The dissolution was to be effected by distribution of "the shares to which [the shareholders of the principal company were] equitably entitled in the stocks of the defendant corporations."[9]

Appeal was made by the Standard to the Supreme Court of the United States. The decision was handed down in May 1911. "In condemning these flagrant monopolies, the Supreme Court enunciated the mentioned 'rule of reason': Only unreasonable restraints of trade (agreements, mergers, predation, and the like) were to be considered illegal."[10]

Chief Justice White in setting forth the opinion of the Court reviewed briefly the intent of the antitrust law:

> [The debates] show conclusively, however, that the main cause which led to the legislation was the thought that it was required by the economic condition of the times, that is, the vast accumulation of wealth in the hands of corporations and individuals, the enormous development of corporate organizations. The facility for combination which such organizations afford, the fact that the facility was being used, and that combinations known as trusts were being multiplied, and the widespread impression that their power had been and would be exerted to oppress individuals and injure the public generally.[11]

The monopolistic combination was ordered to dissolve itself in order that competition might be restored. However commendable the law and its interpretation may have been, in its application to the oil industry, it seems to have been practically invalidated at the outset by the method of dissolution agreed upon. The stocks of the various subsidiary corporations affected by the decree were distributed to the holders of stock in the New Jersey Corporation on a pro-rata basis; i.e., according to the amount of stock held in the holding company. Thus, the holders of a majority of the stock in the Standard Oil Co. of New Jersey now became the holders of a majority of the stock in each of the constituent concerns, and as such exerted a controlling influence in all. But the Court had done its duty, and the Department of Justice seemed satisfied with the dissolution.

The immediate effect of the 1911 dissolution of Standard was an intensified atmosphere of competition among independents (including those corporations formerly associated with Standard). Each independent now sought expansion in order to attain the organizational effectiveness of a truely integrated firm, such as Standard had become before dissolution, following the basic pattern established by Standard, although progress was slow due primarily to the political atmosphere.

The long-term results show dissolution to be a turning point in the U.S. petroleum industry from monopolistic to oligopolistic in nature. Although increased dependence on petroleum and technological changes occur during this time period, their combined effect is gradual until World War I provides the impetus for a more pronounced effect. Just as the independents had been the controlling factor in spurring the U.S. Government to take action regarding Standard's monopoly, so the trend continues and develops thus establishing a precedent whereby the U.S. Government reflects the needs of the oil industry, often justified as a special case -- as is exemplified during World War I when the government policy moves from negative legislation (antitrust, e.g.) to positive regulation demanded by the industry itself.

The Standard Oil experience in America set several patterns: (1) The petroleum industry was an industry of immense scale; (2) It was an industry dominated by entrepreneurs; (3) Its financing was shrouded in subterfuge and secrecy; (4) Ethics were pragmatically applied; (5) Secure supply was crucial; and (6) Government regulation was attempted through hearings and antitrust legislation. These patterns, as will be illustrated in later chapters, have affected the practice of international law which, according to Schwarzenberger, precedes the development of the doctrine of international law; therefore, Standard Oil and the American Government can be said to have set precedents for the future international legal regime to consider.

World War I also had a profound impact on the pattern of American government-industry relationships: a new policy of maximum cooperation for wartime emergencies superceded the need for dissolution of monopoly and antitrust actions.

The demand for oil, both from the private sector and -- like the U.K. -- from the Navy and other branches of the armed services, combined with the petroleum industry's concerns for conservation and price stability, increased until in 1917, after considering the additional factor of the extensive buying of the Allied Purchasing Commission, President Wilson established a series of commissions designed to coordinate the joint government-industry efforts for cooperation in maximum production for the war effort (See Figure 1). These commissions were headed and staffed primarily by personalities from the industry itself, which despite the conflict of interests, led to the effectual self-regulation of the industry.

Many business leaders were enthusiastic about the new cooperative relationship between the federal government and the oil industry. Citing Herbert Hoover, Standard's A.C. Bedford told the Western Petroleum Refiners Association in October 1917: "We must keep our eyes on the goal of a still more complete and wholehearted cooperation, of a more perfect coordinated unity of aims and methods." The possibility of stabilizing competition within an industry through consultation represented an unusual opportunity -- what pools, trusts, and mergers had been unable to accomplish because of antitrust laws, could be achieved under this new device for intra-industry cooperation. At the same time these committees facilitated greater cooperation between the oil industry and the federal government, and thus allowed officials a greater measure of

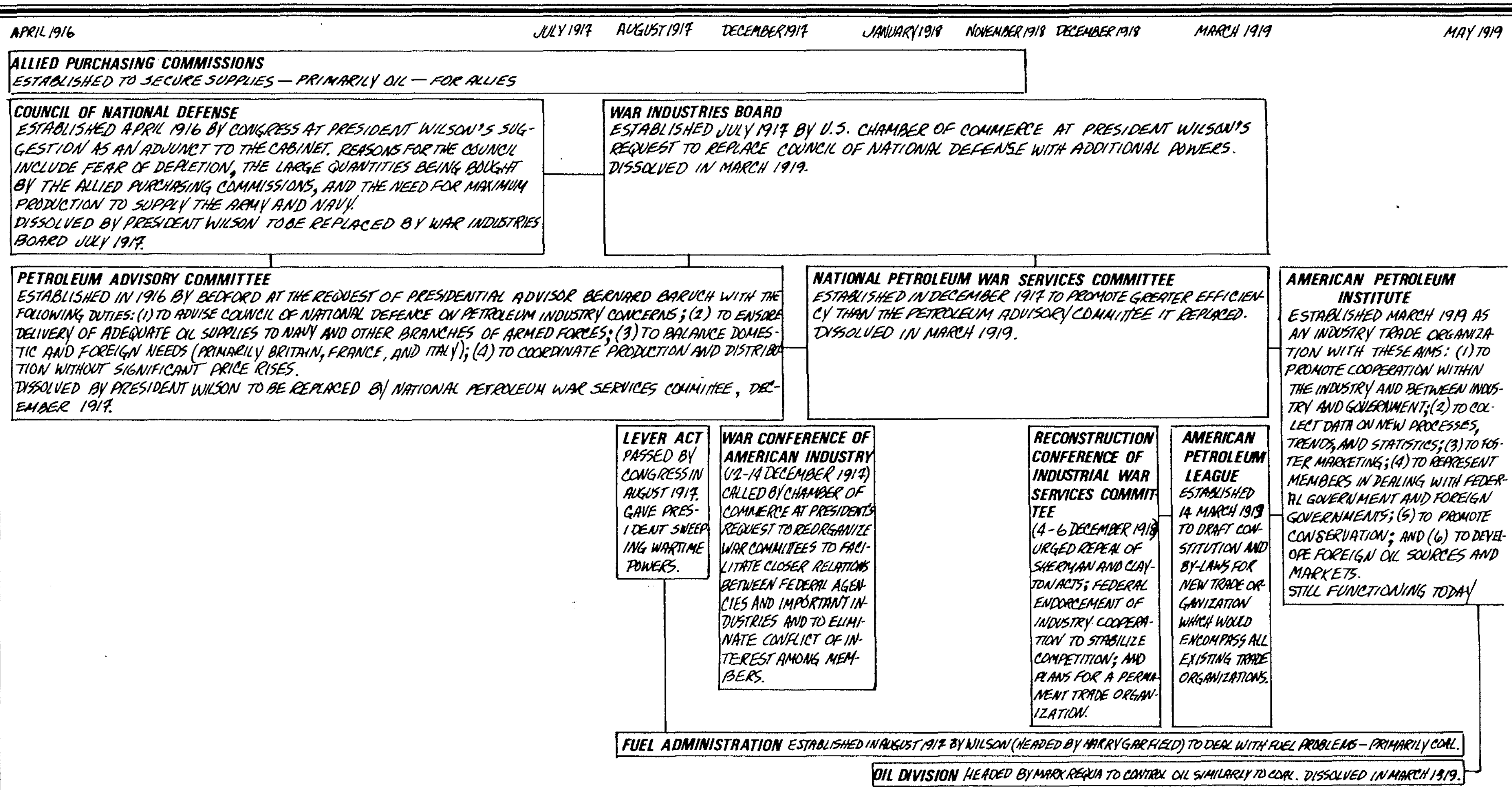

FIGURE 1
WORLD WAR I REGULATORY COMMISSIONS

control in regulating business practices. The Great War created the atmosphere for optimum efficiency, and fostered the idea of scientific management.

Stabilization of the oil industry as a common goal of government and business was a theme emphasized repeatedly by Bedford, the acknowledged leader of the oil industry. "Such cooperation and mutual forbearance may not be in strict accord with the law of competition," he told the convention of the Western Petroleum Refiners, "but it is not contrary to the laws of fair dealing."[12] Cooperation and not competion would lead to greater efficiency. Not only would it increase profits, but it would aid in conserving the visible exhaustible supply of oil. "Government control does not necessarily signify disaster to an industry," Bedford admonished.

> If the zonal distribution of petroleum products is necessary to supply national needs, zonal distribution will be accomplished. If pooling of tank cars and ships will more efficiently meet national demands, those facilities will be pooled. If well drilling supplies must be allocated ... if licensing of jobbers and others is necessary ... everything that is necessary will be done.[13]

Thus, the thinking of business leaders such as Bedford was leading to a changed conception of cooperation within the industry and its relationships with the federal and state governments.

The conflict between independent oil producers and a monopolistic Standard Oil Co. had abated. When the National Petroleum Association, a leading organization for independent oilmen, met in 1918, it supported resolutions endorsing cooperation rather than competition within the oil industry. Perhaps the change was best dramatized by the association's dinner in honor of Bedford, who represented the company that less than a decade before had been its archenemy and foe.[14] An industry "rent asunder by bitter competition" now worked for cooperation in many spheres to achieve stabilization. Public policy recognized the change by encouraging voluntary self-regulation among oilmen under the aegis of federal supervision.

The pressure of wartime demands for petroleum led to the development of similar attitudes within government. As head of the Oil Division, Mark Requa urged above all for cooperation -- not competition -- in the industry. Requa held the ends such a policy could achieve to be beneficial for both. Like Bedford, he argued that the greater efficiency and, thus, increased profits, would be immediate results of the diminution of competition. Moreover, he too was concerned with the depletion of the nation's oil supply and the necessity for adoption of conservation measures.[15] The cult of efficiency, growing out of the scientific management movement at the turn of the century, had made as deep an impression on managers in business as it had on those in government.

Several important developments emerged during this time which were to have long-term effects for the industry. The importance of the oil depletion allowance arose from the need for conservation. Oilmen were urged to improve the technical efficiency of their methods in drilling, producing, and refining; Requa even threatened to close refineries that in his opinion were inefficient. Requa used his influence to promote tax reductions for oil producers by favoring a depletion allowance, which Congress provided in the Revenue Act of 1913, allowing oil producers to deduct 5 percent of the gross value of their annual oil and gas production. The Revenue Act of 1916 removed the percentage deduction, allowing instead a "reasonable" allowance for depletion, not to exceed the actual cost of discovery. As the wartime mobilization program continued to increase it tempo, oil producers urged Congress in 1917 to liberalize the depletion allowance. The U.S. Senate Finance Committee held lengthy hearings on the problem in April, 1918, at which Requa and Bedford and other leading petroleum industry representatives testified. The gist of their argument was that in most cases deductions of the cost of discovery did not allow producers to replace their exhausted properties. The Senators were sympathetic, especially since they were desirous of encouraging maximum production of oil now that it was becoming a strategic mineral resource. The report of the Committee reflected this aim quite openly. It recommended a reduction of surtaxes and excess profits "to stimulate prospecting and exploration." Meanwhile, several Congressmen introduced bills in the House to increase the depletion allowance for oil in view of its important role.

The Senate accepted these recommendations by increasing the depletion allowance in the War Revenue Act of 1918. The specific provisions that applied to petroleum producers did not allow them to base their "reasonable" deductions either on discovery cost or on "fair market value" of their properties. This provided them with far more flexibility than earlier laws provided. In most cases the market value of mineral properties greatly exceeded direct discovery costs, and thus Congress provided oil producers with a vastly improved basis for securing tax benefits. Since this privilege was designed to increase production -- in the interest of national defense -- the depletion allowance reflected a consensus among government and businessmen in wartime.

Requa encouraged pooling of fuel oil within the industry in order to meet all petroleum needs. In addition the Administration sought price stabilization, because increasing demands for petroleum inevitably provoked rising prices. When this met opposition from many small independent operators who felt they would be driven out of business, Requa and Bedford met the independents and a compromise was worked out. The significance of the compromise transcended the immediate issue, for it reflected the industry's ability to govern itself. As Bedford said, "The plan is unusual and unique in that it is wholly a voluntary action of the industry."[16]

The government's convenient disregard for antitrust infringements is explicated by the resolution of the dispute between the Federal Trade Commission (FTC) and the Fuel Administration. Understandably, the members of the recently created (1914) Federal Trade Commission, established to enforce antitrust legislation, had not yet caught the new drift in policy. Since their prime function was to maintain competition in American industry and to prevent concentration and consolidation of business corporations within the conceptual framework of the New Freedom, Requa's version of the New Nationalism seemed strong, indeed. In April, 1918, the FTC issued a much publicized report, accusing oil producers and refiners of profiterring; it also charged Standard Oil of Indiana with violation of the FTC and Clayton Acts in her marketing practices. If the federal government was to meet her oil requirements, the report noted, nationalization of the indstry might well be necessary.[17] It should be noted, however, that these charges were based on inquiries made in 1915, three years before publication. If outdated, they nevertheless revealed an effort by the FTC to challenge Requa's policies.

But the New Nationalism prevailed. Requa and his Oil Division immediately sprang into action to prevent formal proceedings by the FTC.

Requa argued that the Lever Act, under which he exercised authority, took precedence over the Federal Trade Commission Act. Still, he was willing to discuss compromise. Under an agreement made between the FTC and the Fuel Administration, the Federal Trade Commissioners could proceed to charge Standard of Indiana with false advertising and with making exclusive agency contracts to restrain trade. In turn, the FTC would do nothing to interfere with industry pooling agreements for the allocation of supplies under the Oil Division's directions. The FTC also agreed to abide by all future decisions of the Fuel Administration, although the latter was to keep the Commission informed of any actions that infringed upon the antitrust laws in peacetime. Although the matter was not noted officially, apparently Requa also promised the FTC that he would use his powers to prevent an anticipated rise in crude oil prices. In a letter to Standard's Bedford he stated publicly that he would look most unfavorably on such an increase.[18]

While this system of wartime regulating commissions achived its ultimate goal of maximum production and government-industry cooperation, the end of the war heralded the legal necessity for dismantlement. However, both government and industry recognized the need for some such mechanism to continue close government-industry cooperation.

Therefore, the American Petroleum Institute (API) was established virtually at the very moment of dismantlement of the wartime machinery. Its aims were: (1) to promote cooperation within the industry and between the industry and government; (2) to collect data on new processes, trends, and statistics; (3) to foster marketing; (4) to represent members in dealing with the federal government and foreign governments; (5) to promote conservation; and (6) to develop foreign oil sources and markets. The American Petroleum Institute developed into a powerful organization which still functions today (Refer to Figure 1).

By the end of World War I, then, petroleum was recognized as one of the most important elements in determining a nation's strength. This recognition was reflected by both the British and American Governments in their domestic and foreign policies, a precedent which has continued until today. Although these actions took different paths due to such factors as indigenous oil or the lack of it, both governments fostered the development of their respective oil industries, often treating them as special cases.

For the next seventy-five years the American oil companies, while limited by antiturst at home, continued to strive for maximum efficiency in order to best control supply and thus price. They followed Rockefeller's pattern, expanding it to a global scale.

The British petroleum industry developed in quite another way because of its lack of indigenous oil. Her primary concern was security of supply for national defense.

Notes to Chapter 2

[1]George Ward Stocking, The Oil Industry and the Competitive System: A Study in Waste, (Boston: Houghton and Mifflin Co., 1925). The following discussion is based on this account unless otherwise specified.

[2]See U.S., Department of Commerce and Labor, Bureau of Corporations, Report of the Commissioner of Corporations on the Petroleum Industry (hereafter cited as Bureau of Corporations Report on Petroleum Industry), 3 vols. (Washington, D.C.: Government Printing Office, 1907-1909), 1, pp. 25-26; 2, p. 650.

[3]See Bureau of Corporations Report on Petroleum Industry, 1, pp. 48 et seq.

[4]See Ida Tarbell, History of the Standard Oil Company, 2 vols. (New York: 1904), 2, pp. 34-41.

[5]From Samuelson, pp. 523-524.

[6]See Bureau of Corporations Report on Petroleum Industry, 1, pp. 26-29.

[7]See U.S., Department of Commerce and Labor, Bureau of Corporations, Report of the Commissioner of Corporations on the Transportation of Petroleum (hereafter cited as Bureau of Corporations Report on Transportation), 2 May 1906, (Washington, D.C.: Government Printing Office, 1906).

[8]See Bureau of Corporations Report on Transportation.

[9]See U.S. v. Standard Oil Co. of New Jersey, 221 U.S. Reports 45; and U.S. v. Standard Oil Co. of New Jersey, 173 Federal Reporter, p. 199.

[10]Samuelson, p. 534.

[11]From U.S. v. Standard Oil Co. of New Jersey, 22 U.S. Reports 50.

[12]Speech from Oil and Gas Journal, 4th April, 1918.

[13]Speech from Oil and Gas Journal, 4th April, 1918.

[14]New York Sun, 10th October, 1918.

[15]Requa's speech, National Petroleum News, 29th May, 1918.

[16]Oil and Gas Journal, 16th August, 1918.

[17]U.S., Federal Trade Commission, Investigations into the Price of Gasoline, April, 1916, (Washington, D.C.: Government Printing Office, 1916).

[18] National Petroleum News, 12th June, 1918, and 15th May, 1919.

CHAPTER 3

BRITISH PETROLEUM: FOUNDATIONS OF SYNERGISM

> Law is primarily conditioned by its social environment rather than the reverse.
>
> Georg Schwarzenberger

> That process saw the evolution and exploitation of a most complex and extraordinary symbiotic relationship between these seven major international oil companies on the one hand, and the several governments of the United States, Western Europe and the Middle East on the other ....
>
> David I. Haberman

Since petroleum was not indigenous to the British Isles in any commercial quantities,[1] the need for secure supplies forced the British to seek oil abroad and intensified the British Government's involvement in the industry from the outset, creating a social environment which caused her role to be much more direct than that of the U.S. Government in the American industry.

British Petroleum was actually founded due to the impulsive speculation of another strong personality, William Knox D'Arcy, in 1901.

> D'Arcy had only recently returned to England from Australia with the fortune he and his father, a lawyer, had made in the Mt. Morgan Gold Company, Queensland, Australia, in 1882. Various sources disagree as to whether the fortune was made by D'Arcy or his father.[2]

He was a man who ...

> seemed bent on dazzling London with his new-found wealth. He had the only private box at Epsom, apart from the royal family's, and at his town house in Grosvenor Square, he entertained on a grand scale; on one memorable occasion Caruso and Melba both sang to his guests on the same evening, and he never tipped servants less than a gold sovereign. With his walrus moustache and enormous girth he looked the typical hedonist of the Edwardian era, but like a good Edwardian he believed that money should be put to work as well as spent.[3]

D'Arcy, seeking investments for his millions, had been spurred by accounts of Spindletop. Thus, upon learning from two archiologists in Paris that the Director General of the Persian Customs, General Antoine Kitabji, an Armenian and an influential financial figure under the Shah, had acquired certain Persian oil concession rights and was attempting to sell these rights -- an offer which had been refused by another Armenian, the professional go-between in oil matters, Calouste Gulbenkian -- D'Arcy sent two French geologists to investigate the rumors of "the land of eternal fires".

On 28 May 1901 he concluded a deal with the Shah of Iran in which a sixty-year concession was granted. The concession was granted in return (apart from bribes) for a cash payment of £20,000, shares equalling £20,000 to £30,000, an additional £20,000 in shares for the Prime Minister and the two ministers who negotiated the terms, plus 16 percent of any forthcoming profits.[4] It covered 480,000 square miles, the entire country exclusive of the five northern provinces near Russia. This had been an attempt to pacify the Russians. O'Connor notes on p. 278 that "it was necessary to get the grant signed in a surreptitious manner in the absence of the only Russian Embassy expert who could read Persian." D'Arcy was obligated to begin work within two years. General Kitabji, for his part, received £50,000 for his rights and a job at £1,000 a year as Imperial Commissioner to supervise the concession.

The ambiguity of financial arrangements, following Rockefeller's example, was reinforced by D'Arcy's agreement with Kitabji. In arriving at the terms of the concession agreement D'Arcy set the precedent for dealing with the ethical problem of graft which remains evident in less developed countries today. Iran was compared by the British Minister, Sir Arthur Hardinge, with a "long mismanaged estate, ready to be knocked down at once to whatever foreign power bid the highest or threatened most loudly its degenerate and defenseless rulers."[5]

Calouste Gulbenkian, an individual of great importance, later regretted the day he failed to pick up the Persian Concession:

> But we all thought it was a wildcat scheme and it looked so speculative that we thought it was a business for a gambler and not at all for our trio [Sir Henry Deterding, one of the founders of Royal Dutch Shell, Sir Frederick Lane, the oil promoter, and Gulbenkian himself] ... D'Arcy is considered a great pioneer of the oil industry, but to tell the truth he was a great gambler and his success was due to sheer luck, rather than to any industrial or economic foresight.[6]

Tugendhat and Hamilton's commentary of the negotiations on p. 64 depict Iran as welcoming D'Arcy's offer:

> The imperial ministers dealt with Marriott [D'Arcy's secretary] more as if they were the servants of an impoverished and spendthrift landowner wishing to raise money on his estate than as the representatives of an independent state. They had little idea of oil's value, and no interest in its future. They were concerned more with getting money out of D'Arcy than in imposing conditions on his operations, and they were successful in achieving their objective ... The Persians' 16 per-cent. share of the profits was rather generous compared with the 12 1/2 per-cent. royalty usually paid to landowners in the United States, but both sides thought they had done well: the company because the arrangement would give them protection in bad years, and the Persians because they thought profits would always go on rising.

D'Arcy's drilling operations began in 1902 by G.B. Reynolds, who encountered numerous difficulties from the onset. G.B. Reynolds was a former official in the Indian Public Works Department, who had once drilled for oil in Sumatra. He was forced to contend with such astounding conditions as bribing the local chiefs with protection money; tolerating the hot summers which were known to have temperatures of 110 degrees Fahrenheit in the shade before seven o'clock in the morning; sustaining delays due to shipment of equipment from England via Basrah;

surviving an outbreak of smallpox which broke out in the neighboring settlement upon which the expedition relied for food and water; and enduring a plague of locusts. Oil was finally struck in January 1904 only to dry up again by May.

D'Arcy continued to live in his quasi-royal life-style, and after having lost £225,000 personally, beginning to feel the financial strain of his Middle Eastern venture, he sought financial backing from Sir Ernest Cassel, the London financier, the Rothchilds, and others. However, most financiers "would have nothing to do with the matter till oil was found."[7]

At about this same time the British Navy became interested in the technological advantages of oil. While conferring with Baron de Rothschild in Cannes, D'Arcy received notice from an emissary of the British Admiralty to return to London. Among officers of the Royal Navy the belief in the technological advantages of oil versus coal had steadily gained in popularity to the point that upon being named First Sea Lord, Admiral Lord Fisher appointed an Oil Committee chaired by the Civil Lord of the Admiralty, E.G. Pretyman, to investigate the possibilities of changing the Navy from coal to oil -- despite the fiasco which occurred when the HMS Hannibal first tested oil fuel.

The proposition of replacing the Navy's use of coal with that of oil would depend, according to the Admiral and his advisors, on a source of oil controlled by a British company in an area dominated by Britain and located a reasonable distance from Europe. With this end in mind, the Navy brought D'Arcy and the Burmah Oil Co. together to form a joint enterprise. Burmah, a small but experienced oil company, thus promised to supply the necessary working capital and to develop any field that might be found. Members of the Concessions Syndicate were also reassured by a statement from the Foreign Office: "... your clients or any British company formed to acquire and work the Concession can count on such support and protection as British subjects are always entitled to expect from HM Government."[8]

Although this statement was actually intended as protection from the Russians, it soon became necessary to provide protection from the various Persian tribes as well, since Teheran's control was only nominal.

Therefore, without the permission of the Persian Government, the Bakhtiari received some $10,000 a year for "protecting" the oil fields, $5,000 for similar duties on the pipeline, and 3 percent of prospective profits, all of which was paid out of the government's 16 percent. In addition to a troop of Bengal Lancers which the Army sent as protection, the Navy detached HMS Comet to the scene; however, she ran aground on a mud bank on the way.

After two more dry wells and four unsuccessful months of drilling at Masjid-i-Salaman (the Mosque of Solomon), the concession holders were tiring of the substantial financial drain which included the problems of developing the field, transporting the oil to tidewater, building port, and marketing the product.

Sir Arnold Wilson, who had been sent as a young officer to head the Bengal Lancers' troops, wrote indignantly to Sir Percy Cox, British Resident at Bushire in charge of Empire affairs around the Persian Gulf:

> It amazes me that the director ... should be in a position to risk the complete loss of a concession ... without consulting with the Foreign Office and without telling you or the Minister or the Government of India. They have all the vices of absentee landlords. Cannot Government be moved to prevent

> these fainthearted merchants, masquerading in top hats as pioneers of Empire, from losing what may be a great asset?[9]

Reynolds decided to wait for confirmation on the cable recalling him to London. Although Lt. Wilson quotes from the cable in his diary (See Longhurst, as quoted in Tugendhat and Hamilton, p. 66), no copy of the cable has been traced, and the mailed instructions were to carry on until reaching 1,600 feet before giving up.

Meanwhile, Reynolds continued drilling past the 1,100 feet mark until two weeks later at 4.30 am, on 26 May 1908 the well gushed 50 feet in the air.

The custodians of the Empire called in Burmah Oil whose Scotsmen founded Anglo-Persian Oil Company by investing £2 million; at the suggestion of the Admiralty, 88-year-old Lord Strathcona, of Canadian Pacific fame, was called out of retirement to chair the company.

In Glasgow, where the shares were issued, the enthusiasm was so great that lines of applicants five and ten deep struggled for places at the bank counter, and among the most pressing of the distinguished figures asking for special favors was Field Marshal Lord Kitchener, who had learned of the oil fields from a Daily Telegraph correspondent just back from Persia.

Expenses in developing the Persian oil field again surpassed all estimates: building a refinery and a 130-mile pipeline to the coast were prerequisites to exporting the oil. By 1913 no oil had yet been sold, and the young company was once again in financial straits, until Well F7 in 1914 suddenly increased her production from 33,000 gallons per day to 600,000 -- earning the distinction of the most celebrated Persian gusher. The Abadan refinery was now strained by Well F7's output alone.

The great well justified the faith that Winston Churchill, who had become First Lord of the Admiralty in 1911, had placed in oil. Churchill was interested in building ships which would not only be faster than those of the Germans, but also more heavily armed. If coal was retained as the fuel it would be possible to achieve the necessary speed, but only at the cost of sacrificing a turret to accommodate the extra boilers.[10]

> The advantages conferred by liquid fuel were inestimable. First speed. In equal ships oil gave a large excess of speed over coal. It enabled that speed to be attained with far greater rapidity. It gave 40 per-cent. greater radius of action for the same weight of coal. It enabled a fleet to refuel at sea with great facility. An oil burning fleet can, if need be, and in calm weather, keep its station at sea, nourishing itself from tankers without having to send a quarter of its strength continually into harbour to coal, wasting fuel on the homeward and outward journey. The ordeal of coaling ships exhausted the whole ship's company. In wartime it robbed them of their brief period of rest; it subjected everyone to extreme discomfort. With oil a few pipes were connected with a tanker or the shore and the ship sucked in its fuel with hardly a man having to lift a finger ... The use of oil made it possible in every type of vessel to have more gun power and more speed for less size and cost. It alone made it possible to realize the high speeds in certain types which were vital to their tactical purpose.[11]

His address before the House of Commons on 7 June 1914 adds to his argument:

> If we cannot secure the access to this island of oil ships, we cannot secure the access to this island of the whole of the great volume of our trade on which we shall depend in war as in peace, if we are to maintain ourselves effectively ... The proposition that the Navy should be able to keep our ports open and to keep our trade routes safe in time of war for all the vast merchant fleets which traffic with this island, and yet should lack the power to bring in the comparatively few but from our point of view, specially interesting oil cargoes, is a proposition which is naturally, inherently and, if need be, demonstrably absurd ... Nobody cares in war time, how much they pay for a vital commodity, but in peace -- that is the period to which I wish to direct the attention of the Committee -- price is rather an important matter, and as we hope that there will be many years of peace to every week of war, I cannot feel that we are not fully justified in taking up the

> time of the Committee in considering how, in years of peace and in a long period of peace, we may acquire proper bargaining power and facilities with regard to the purchase of oil. The price of oil does not depend wholly or even mainly on the ordinary workings of supply and demand.[12]

He stressed the commercial consequence as opposed to the strategic significance of the government's financial involvement in oil although he was acutely attentive to the Navy's logistical problems. One of the corollaries of the share purchase detailed a long-term contract insuring Naval supplies. Sir Edward Grey, MP, summarized Churchill's arguments in the House of Commons Debates of 7 June 1914 (See Hartshorn, p. 233): "What you want is an independent source of supply which is, as far as possible, uncontrolled by any agency which can exact undue prices or what the customer considers undue prices."

Royal Dutch Shell, BP, and even Standard of New Jersey had been considered as potential Naval suppliers by the Royal Commission on Oil Supplies, led by that "oil maniac" Lord Fisher. In his investigation of Royal Dutch Shell, he concluded that Henry Deterding was "Napoleonic in his audacity and Cromwellian in his thoroughness".

Deterding considered oil the most extraordinary article in the commercial world, citing production as the only impediment to its sale.

> There is no need to look after the consumption, and as a seller you need not make forward contracts, as the oil sells itself. Only what you want is an enormous long, long purse to be able to snap your fingers at everybody, and if people do not want to buy it today to be able to say, all right; I will spend a million sterling in making reservoirs, and then in the future you will have to pay so much more.[13]

The idea of allowing a Dutch firm with close German ties to become chief supplier of the Navy was abhorrent to Churchill's "imperialist principles". Deterding, however, was not so concerned with the politics involved as he was in selling as much oil as possible to both sides at as high a price as attainable. Thus, when a considerable faction of Tories, supported by Deterding and Shell, objected to Churchill's proposition of governmental acquisition of a majority control of BP, Churchill retorted: "We have no quarrel with the Shell. We have always found them courteous, considerate, ready to oblige, anxious to serve the Admiralty and to promote the interests of the British Navy and the British Empire -- at a price. The only difficulty has been the price ...." He then included Standard when he added that "the oil supplies of the world are in the hands of vast oil trusts under foreign control .... Oil has to be bought in a monopoly-ridden market."[14]

Nonetheless, a large contingent still favored coal-powered ships primarily due to the security of supply in time of war.

Churchill outlines his reasons for favoring oil at this time:

> For many years the policy of the Foreign Office, of the Admiralty, and of the Government of India has been to conserve independent English interests in the region of Persia, and, above all, to prevent this region falling under the control of the Shell or any other foreign or cosmopolitan company ... Our ultimate policy is that the Admiralty should become the independent owner and producer of its own supplies of liquid fuel, first, by building up in this country an oil reserve sufficient to make us safe in war and able to override price fluctuations in peace; secondly, by acquiring the power to deal in crude oils as they come cheaply into the market ... This second aspect of our ultimate policy involves the Admiralty being able to refine, retort, or distil crude oil of various kinds, until it reaches the qualities required for naval use ... The third aspect of the ultimate policy is that we must become the owners, or at any rate, the controllers of the source, of at least a proportion of the supply of natural oil which we require.[15]

Concerned over the socialistic implications, the suggestion was made that Churchill's aims could be achieved by means of contract rather than by outright purchase. But Churchill refused to be swayed, arguing that any contract would enormously enhance the company's profit, and it would be to the government's advantage to participate in this profit.

He promised that the government would not intervene in the private enterprise aspects of BP. Two directors would be appointed by the government who would hold a restricted veto power which would be applicable only in political and diplomatic concerns; they would not be involved in administration.

Parliament, thus convinced, ratified the proposal by a vote of 245 to 18, giving the government a voting interest of just over 50 percent.

When BP purchased the chemical interests of the Distillers Company in 1967, part of the payment was made in shares. As a result, the government's shareholding was reduced to slightly under 50 percent.[16] No increase in the number of governmental directors has ever been suggested; nor has any direction over the company's commercial policy been attempted. However, the question of governmental intervention in foreign affairs for mutual benefit has long been debated. The extent to which the British Government intervened specifically to advance the interests of the British oil companies (as contrasted to intervention for military reasons or as part of a more general economic policy relating to areas under its control or tutelage) has been widely disputed. Gibb and Knowlton in their history of Standard Oil (especially Chapter 11) see the negotiations as a struggle between "British imperialism" through the Foreign Office and the American demand for the "open door". Elizabeth Monroe, on the other hand, finds very little support for the argument that the government actively supported British "concession hunters":

> Apart from the efforts that the British Government made before 1914 in the Ottoman Empire, and the few words that it spoke to the Persian Grand Vizier in 1901 in support of D'Arcy, it seldom used its influence on behalf of concession hunters. Even in places where it was entitled by pledge or treaty to approve the nationality of the concessionaire (as it was in Kuwait or Bahrain), it preferred to leave British aspirants to fend for themselves. The list of occasions on which it gave

> no help is very long. It gave none, for instance, to the British negotiator in Jidda in 1933 when he sought from Ibn Saud the prize (now the Arabian American Oil Company fields in Eastern Arabia) that he saw pass to an American rival because the Iraq Petroleum Company had authorised him to "speak only of rupees, where gold was demanded". It gave none when the western Arabian concession, later fruitless, was negotiated in 1936; none when the Turkish (later Iraq) Petroleum Company negotiated and re-negotiated agreements with the Iraq Government in 1924-5 and 1931; none in Syria in 1937-8; while in Bahrain in 1929-30 it was amenable about waiving exclusive British rights, and agreed to operations by American firms which took Canadian nationality for the purpose.
>
> Developments in Kuwait were less straightforward, but the end-product was the same; the British Government never tipped the scales with the Ruler in the two years (1932-3) during which the American Gulf Oil Company and APOC [Anglo-Persian Oil Company] waited on his decision between them ...[17]

Many countries including Pakistan and Venezuela have forbidden concessions to BP on the basis of its governmental complexion. Lord Strathalmond, a Managing Director, summed up the suspicions with admirable British restraint: "... even in Persia, they were never quite convinced that I had not come straight from Whitehall."[18]

Thus it was that Britain's investment in her own oil company became the prototype despite the continuing enigma of division of interests. According to Hartshorn, p. 233, "It ... must have proved perhaps the most profitable investment of British public money in any industrial operation in our time." Churchill later estimated the value of government holdings in BP at £40 million, boasting that the initial expenditure had not cost the taxpayer a penny thanks to the return on BP which by 1937 had repaid the Treasury £16 million in interest and dividends.

Although BP failed in her primary objective to fuel the Navy during World War I mainly due to the efficiency of German submarines, the company prospered. Yet, in reality, it was the coal-powered ships that roamed the seas while most oil-fueled warships remained empty at anchor.

"To make doubly sure that they would stay in port, the German consul at Bushire liked to go shooting game around Ahwaz, which happened to be the nearest center to the fields and pipelines."[19]

The British reacted to the eventual cutting of the pipeline by landing at Fao at the mouth of the Shatt-al-Arab, bringing the entire area under direct military control. They dealt directly with Sheik Khazaal, ignoring Teheran -- an arrangement which lasted until 1924 when the province of Kuzistan was finally forced to submit to the authority of the Persian Government.

Despite the problems of the British Navy, World War I transformed oil from a mere source of revenue for tycoons and speculators to a strategic raw material. Its importance was exemplified in the first few weeks when Paris taxis rushed troops to the Battle of the Marne. Thereafter, the allied armies became increasingly dependent on the internal-combustion engine.

> By the end of the war the British Army alone had 79,000 cars and trucks and another 34,000 motor bicycles in service compared with the 827 cars and 15 motor bicycles with which its expeditionary force entered the fray; tanks took over from the cavalry as the spearhead of the advance, while in the air the "aviators" added a touch of glamor to the squalor of the trenches.[20]

Or, as Lord Curzon is so frequently quoted as saying, "Truly posterity will say that the Allies floated to victory on a wave of oil," (New York Times, 23 November 1918).

The founding of British Petroleum followed many of the patterns established by the rise of Standard Oil in America: (1) Churchill, among others, recognized the emensity of the scale of the industry and proceeded accordingly; (2) the industry was dominated by such strong personalities as D'Arcy, Strathcona, and Churchill; (3) its financing was enigmatic; (4) graft was an accepted part, especially in the Middle East; (5) while secure supply was crucial to the American industry in terms of profit, it became important to Britain because of defense of Empire. These parallel developments of the American and British petroleum industries create a social environment conditioning any future international law, thus assuring a Western bias to any future deliberations in the international legal regime.

Notes to Chapter 3

[1]The Duke of Devonshire was producing 1700 gallons per week by 1919. See Terence Daintith and G.D.M. Willoughby, North Sea Oil and Gas Law, (London: Printed in Great Britain by Ebenezer Baylis and Son Ltd., The Trinity Press for Thomson Scottish Petroelum Ltd., 1977), p. 11.

2 See Harvey O'Conner, World Crisis in Oil, (London: Elek Books Ltd., 1962), p. 277; Edith T. Penrose, The Large International Firm in Developing Countries, (London: George Allen and Unwin Ltd., Printed in Great Britain by Simpson Shand Ltd., 1968), p. 109; and Christopher Tugenhat and Adrian Hamilton, Oil: The Biggest Business, (London: Eyre Methven, Printed in Great Britain by Cox and Wyman Ltd., rev. ed., 1975), p. 63.

[3]Tugendhat and Hamilton, p. 63.

[4]Accounts vary as to the details of the agreement. See O'Connor, pp. 277-278, and Tugendhat and Hamilton, pp. 64-65.

[5]Arthur H. Hardinge, A Diplomatist in the Middle East, as quoted in Tugendhat and Hamilton, p. 63.

[6]Calouste Gulbenkian, Memoirs, as quoted in O'Connor, p. 278.

[7]Henry Longhurst, Adventure in Oil: The Story of British Petroleum.

[8]O'Connor, pp. 278-279.

[9]O'Connor, p. 279.

[10]See Tugendhat and Hamilton, pp. 66-67.

[11]Winston Churchill, The World Crisis 1911-1914, as quoted in Tugendhat and Hamilton, p. 67.

[12]House of Commons Debates, 7 June 1914, as quoted in J.E. Hartshorn, Oil Companies and Governments, p. 232.

[13]O'Connor, pp. 281-282.

[14]O'Connor, p. 282.

[15]O'Connor, p 282.

[16]See Tugendhat and Hamilton, p. 68.

[17]Elizabeth Monroe, Britain's Moment in the Middle East, pp. 105-106. For a contrary view regarding Persia, see Zuhayr Mikdashi, A Financial Analysis of Middle Eastern Oil Concessions: 1901-65, Ch. I.

[18]O'Connor, p. 282.

[19]O'Connor, p. 283.

[20]From Tugendhat and Hamilton, p. 71.

CHAPTER 4

THE RED LINE AGREEMENT: QUASI-INTERNATIONAL LAW

> International law should also be distinguished from quasi-international law; that is to say, the law governing relations similar to those covered by international law, but outside the pale of international law because at least one of the parties lacks international personality. Concession agreements between oil companies and sovereign states fall into this category. In case of doubt, they are subject to the municipal law of the state granting the concession.
>
> Georg Schwarzenberger

> Like many other world government organizations, this private government emerged from a period of internecine economic warfare among these companies that was finally resolved by a series of "peace treaties" in 1928.
>
> David I. Haberman

Up to this point the oil companies in the United States had been satisfied with their own North American sources of oil; they were producing 64 percent of the world's oil by the end of World War I. These companies now became interested in developing foreign sources for three reasons: (1) the deep-seated fear that America was depleting her petroleum reserves; (2) the cost of leasing from private landowners (usually at a one-eighth royalty rate) was generally higher than securing rights from governments, even before the use of the foreign tax credit; and (3) the widespread concern over a foreign monopoly of all foreign oil resources.

The burgeoning of petroleum use in American industrial expansion prompted major domestic companies to secure oil concessions in Mexico; however, it should be noted that this was the exception rather than the rule. By the early 1920s the situation altered dramatically. The following statements illustrate the breadth of this widespread fear of depletion.

"The position of the United States in regard to oil can best be characterized as precarious" (G.O. Smith, Director of the U.S. Geological Survey, New York Times, 1 January 1920). He predicted the exhaustion of American petroleum reserves within ten years and urged drastic action (New York Times, 5 January 1920). He pointed to American exploration of foreign oil sources as the solution.

W.C. Teagle, Standard Oil Co. of New Jersey's chairman of the board, felt that the great problem of the future was to meet the tremendous pressure of new demands -- diverse uses of petroleum were raising American consumption by about 9 percent a year. Teagle urged world-wide prospecting to meet the heavy demands for petroleum products (New York Times; 5, 30 January 1920).

Herbert Hoover, president of the American Institute of Mining and Mechanical Engineering in 1920, noted that the great need of the age was to apply scientific principles in the oil industry to eliminate waste (New York Times; 18, 19 February 1920).

A report from the U.S. Bureau of Mines emphasized that the U.S. was rapidly using up its oil supplies, estimated to last no longer than 20 years (U.S. Bureau of Mines Bulletin No. 177 [Washington: Government Printing Office, 1919] pp. 5-7).

Mark Requa, head of the Oil Division of the Fuel Administration, pointed to the gap between increasing consumption and production (New York Times, 6 October 1920).

According to an industry source, "Fear of an oil shortage in the United States was uppermost as a factor in international relations after

World War I. It was a holdover fear from a narrow escape from scarcity in 1917-1918 when in the midst of war."[1]

The known major reserves of petroleum outside North America were controlled by foreign interests, primarily by British Petroleum and Royal Dutch Shell. "The British position is impregnable," boasted Sir Edward Mackey Edgar, a public relations man and share-pusher for Shell's Venezuelan company. "All the known oil fields, all the likely or probable fields outside of the United States itself, are in British hands or under British management or control, or financed by British capital. We hold in our hands the secure control of the future of the world's oil supply."[2]

In response to the Senate request of March 1920 that the President report to it on the restrictions being imposed on American citizens wishing to explore for petroleum in foreign countries, [3] the State Department supplied a series of reports, shockingly portraying the measures being taken to exclude American interests from foreign oil fields, especially from those under the control of Britain and the Netherlands.[4]

One of the resulting proposals was to establish a government corporation to develop oil resources abroad -- in striking resemblance to the British establishment of BP in 1914.[5] This proposal, however, has never been approved by the U.S. oil companies, although it has been repeatedly suggested throughout the years.

Instead, Congress established the principle of reciprocity by passing the Mineral Leasing Act of 1920, which made U.S. public lands available to domestic foreign-owned corporations for exploitation of oil and other minerals, with the understanding that, were similar privileges denied U.S. nationals, they would not be allowed to "buy stock ownership, stock holding, or stock control own any interest in any lease acquired under the provisions of this act."[6]

This principle of reciprocity was soon tested when the American Consul in Jakarta learned of the Dutch Government's intention to grant the sole oil exploration concession of "the most valuable mineral oil-fields in the whole colony" of the Netherlands East Indies (Djambi residency of South-eastern Sumatra) to a new Dutch company half owned by Royal Dutch Shell, with her English connection.[7] The State Department strongly protested to the Netherlands who refused to alter their position, prompting the U.S. Government to inform the Dutch in no uncertain terms that:

> No foreign capital may operate in American public lands unless its Government accords similar or like privileges to American citizens, and, furthermore ... in the light of the future needs of the United States such very limited and purely defensive provisions ... might become inadequate should the principle of equality of opportunity not be recognized in foreign countries.[8]

To emphasize the American posture, the Department of the Interior refused -- on the grounds of Dutch discrimination against American business -- to grant Shell an oil exploration permit on certain public lands in Utah. In 1927 the Dutch finally capitulated and requested that the United States consider her a "reciprocating" country under the Mineral Leasing Act. The threat of denying investment privileges in the world's greatest petroleum producing and consuming country proved to be too much to ignore and an agreement was soon worked out allowing the American companies to explore in the Netherlands Indies in return for the U.S. declaring the Netherlands a reciprocating country.

The American oil companies found it necessary to solicit governmental assistance as leverage in enacting the principle of reciprocity for the express purpose of entering foreign markets previously considered the Empire's spheres of influence. This is an early example of the synergistic relationship developing between the American Government and the American oil industry, at least outside of domestic operations. The American Government seemingly has little difficulty in adjusting to a dichotomy of policies regarding restraint of trade and antitrust at home, and total cooperation, pooling, etc., abroad.

Elsewhere, we see international law being utilized to disguise power politics. Gulbenkian had brought various parties together to form the Turkish Petroleum Co. just prior to World War I. Almost half was owned by BP who already had the nearby Iranian Concession, a quarter by Royal Dutch Shell, and the remaining quarter by the German Deutsche Bank, who had financed the Baghdad railway. Of course, Gulbenkian claimed 5 percent as his commission. O'Connor points out on p. 304 that the Turkish Government later claimed the concession had never been signed, merely initialed.

> During the war Churchill, convinced that the future control of the Empire demanded transit through the Near East, sponsored the disastrous Dardanelles campaign and ordered the occupation of Abadan and the Persian oil fields, using the island of Bahrein in the Gulf as a base. In the Sykes-Picot agreement of 1916, Britain's paramount rights in southern Mesopotamia were recognized, while France held suzerainty in Mosul. At Lord Curzon's insistence, Clemenceau in 1918 yielded the claim to Mosul in return for an assurance of access to its oil. This upset the French empire-builders, and a tussle ensued in 1919, with Paris threatening to call in Standard as an ally. At the San Remo conference in 1920 matters between the Allies were patched, with Britain retaining Mosul but granting the Deutsche Bank's 25 percent interest in Turkish Petroleum to the French who had to promise however to permit Mosul oil to pass duty-free through the French mandates of Syria and Lebanon.[9]

Gulbenkian, of course, managed to retain his original 5 percent.

The Ottoman Empire itself had been divided into British and French mandates as spoils of war. There was also an attempt to "ensure that oil rights throughout the area would be in the hands of British, British/Dutch and French Companies."[10]

> [The San Remo Agreement] was a classical European horse-trade, and it deliberately excluded the United States, on the semi-plausible grounds that America had not declared war on Turkey and was not therefore concerned with the peace treaty. But the Americans were outraged when the agreement came to light. The American Ambassador in London delivered a strong note to the Foreign Office implying that Britain was trying to corner the world's oil, and recalling (in stately language) that America had helped to win the war and was entitled to a share in the spoils. Lord Curzon, the British Foreign Secretary, replied that oil from the British Empire and Persia amounted to 4.5 per-cent. of the world's production, whereas the United States controlled (with Mexico) about 82 per-cent.[11]

The State Department viewed the San Remo Agreement as the final exclusion of American initiative in the Middle East. Since Britain had already secured agreements with the Sheikdoms of Kuwait and Bahrein that their oil development would be entrusted only to British subjects, the State Department feared that Britain was using her political supremacy in this area to establish her economic supremacy in world oil commerce.

Thus news of the San Remo Agreement brought strong protests from the State Department: "It is not clear how such an agreement can be consistent with the principles of equality understood and accepted during the peace negotiations at Paris."[12]

The American oil industry actually gave impetus to these diplomatic initiatives on the part of the State Department. Exxon had first expressed an interest in Iraq in 1919 but had been informed that the Department could not support merely a single company, although it would help an American cartel.

Therefore, the American Petroleum Institute formally adopted a resolution asking for State Department assistance in correcting the developing pattern of Middle Eastern exclusion of American enterprise. "If, under a protectorate or any other form of control," the resolution declared,

> ... Britain and French interests ... should be permitted to gain and maintain an exclusive right of development in Persia and in Turkey, to say nothing of the other oil-bearing lands embraced within the peace settlements ... we do not hesitate to say that the results to the American petroleum industry might eventually prove to be disastrous.[13]

The API was informed by the Secretaries of State and Commerce in August 1921 that preliminary geological surveys in Iraq should be undertaken by the API on behalf of all interested members (which, in addition to Exxon, included Texaco, Gulf, Atlantic Refining, Sinclair, and the Standard Oil Co. of Indiana). By November 1921 Secretary of State, Hughes, told the companies that he would inform them as soon as he had learned "that permission for prospecting in Mesopotamia [was] being or may be granted by the authorities in that territory ...."[14]

Exxon, however, as the companies' representative, engaged in negotiations over an American interest in Iraq with BP, who apparently had been persuaded by Gulbenkian that it would be better to join with the Americans rather than fight them and suffer the ensuing commercial and diplomatic repercussions. The State Department pragmatically responded to Exxon's private negotiation:

> It is not the desire of the Department ... to make difficulties or to prolong needlessly a diplomatic dispute or so to disregard the practical aspects of the situation as to prevent American enterprise from availing itself of the very opportunities which our diplomatic representations have striven to obtain.[15]

The U.S. companies, backed by their government, insisted on applying their Open Door policy to this area of oil concessions, specifically that favored treatment not be accorded nationals of any one country, that concessions not be so large as to be exclusive, and that no monopolistic concession be granted.

> The Open Door policy was established in 1899 and 1900, according to U.S. Secretary of State John Hay's notes, to preserve the commercial Open Door to, and the territorial integrity of, China, and to protect the vulnerable Phillippines from Japanese attack. It was confirmed in the Root-Takahira Agreement of November 30, 1908, by which Japan and the United States agreed to help maintain the status quo in the Pacific, to respect each other's territorial possessions, and jointly to support the Open Door in China and the independence and territorial integrity of that country. In a statement to the Japanese and Chinese governments on May 11, 1915, it was again confirmed. This statement, drafted by Robert Lansing, Counselor of the U.S. State Department, declared that the United States would not recognize any Sino-Japanese agreement violating the political and territorial integrity of China and the Open Door policy. Under steady Anglo-American pressure the Japanese yielded their imperialistic ambitions and approved an agreement that reaffirmed the historic American policy of the Open Door and non-interference, by signing the Nine Power Treaty, February 6, 1922, along with representatives of the United States, Britain, Japan, France, Italy, China, the Netherlands, Belgium, and Portugal. It pledged the signatories to respect the sovereignty, independence, and integrity of China; to give China full opportunity to establish a stable government; to uphold the Open Door in China; and to refrain from seeking special rights and privileges in China that would impair the rights of friendly states. Thus, the Open Door had been established as the right to trade with the people of the Orient regardless of the claims of foreign governments to suzerainty, spheres of influence, and monopoly trading rights. Its application in Iraq, however, was the first such imposition outside the Far East.[16]

> As an FTC staff report explains:

> ... in fact, they made the acceptance of this policy a sine qua non of their participation in [Iraq Petroleum Co.]. In this they were actively supported by the American Government. In its initial stages the "open door" policy was broadly interpreted to mean freedom for any company to obtain, without discrimination, oil concessions, in mandated areas, particularly in Mesopotamia .... The "open door" policy which had been so strongly advanced was discarded in subsequent years

> without a single test of its adequacy as a practical operating principle.[17]

The negotiations concerning the Iraq Petroleum Company (IPC) involved three main points: (1) the shareholding for each company; (2) the extent of the concession and the member companies' relationship with each other; and (3) the taxation arrangements.

> The question of the shareholding was the most important and provided plenty of scope for intercompany in-fighting. Deterding and Gulbenkian both remembered with bitterness the way the British Government had secured 50 per-cent. for Anglo-Persian at the 1914 Foreign Office Conference, and they were determined to reduce its influence. Meanwhile the American group, led by Walter C. Teagle of Jersey Standard, argued that as a point of prestige they could not accept less than Shell or the Compagnie Francaise des Petroles. This combined pressure was too much for Anglo-Persian, and in the end it had to accept the principle of equality: each group was given 23 per-cent. of the shares, with the remainder going to Gulbenkian to make up his 5 per-cent., and Anglo-Persian was allowed to take 10 per-cent. [reduced to 7 1/2 per-cent. in 1931] of the output for free as compensation.[18]

The debate over the extent of the concessions and the relationship between member companies was much more complex, and continued in a series of secret conferences of the summer of 1928, culminating in the Red Line Agreement, the "most famous example of an arrangement to curtail competition ever made in the international oil industry." The notorious red line actually encircled a map of the old Turkish Empire.

> Deterding invited Walter Teagle, the head of Jersey Standard, and Sir John (later Lord) Cadman, the head of Anglo-Persian [and who in 1913 had headed the Cadman Commission of Inquiry into Persian oil for Churchill before the Government decided to buy its way into Anglo-Persian], to Achnacarry House in the Scottish Highlands, a hunting lodge belonging to the Cameron of Lochiel, which he had ostensibly hired for the grouse shooting. The house is situated in a wild stretch of moorland country, and the scene when the three most powerful men in the oil world gathered there could have been taken straight out of the pages of one of those John Buchan thrillers in which powerful anonymous men would spend weekends at Scottish castles planning great *coups* for the destruction of Britain's enemies.[19]

Officially entitled the "Pool Association of 17 September 1928" and also known as the Achnacarry Agreement and the "As is" Agreement, the Red Line Agreement detailed seven principles governing the entire world outside the United States and the Soviet Union, which attempted to stem the rising competion by freezing the market in its existing mold. By combining interests and sharing facilities -- refineries, storage tankers, et al. -- the major oil firms would effectively stymie companies attempting to penetrate new markets, price cutters, and other disturbing elements. Each company would supply the markets nearest to it, thereby saving the cost of unnecessarily long tanker voyages.

The Principles of the Red Line Agreement (taken from Tugendhat and Hamilton, pp. 100-101) are as follows:

> 1. The acceptance by the units of their present volume of business and their proportion of any future increases in consumption.
>
> 2. As existing facilities are amply sufficient to meet the present consumption, these should be made available to producers on terms which shall be based on the principle of paying for the use of these facilities, an amount which shall be less than which it would have cost the producer had he created these facilities for his exclusive use, but not less than the demonstrated cost to the owner of the facilities.
>
> 3. Only such facilities to be added as are necessary to supply the public with its increased requirements of petroleum products in the most efficient manner. The procedure now prevailing of producers duplicating facilities to enable them to offer their own products regardless of the fact that such duplication is neither necessary to supply consumption nor creates an increase in consumption, should be abandoned.
>
> 4. Production shall retain the advantage of its geographical situation, it being recognized that the value of the basic product of uniform specifications are the same at all points of origin or shipment and that this gives to each producing area an advantage in supplying consumption in the territory geographically tributary thereto which should be retained by the production in that area.

5. With the object of securing maximum efficiency and economy in transportation, supplies shall be drawn from the nearest producing area.

6. To the extent that the production is in excess of the consumption in its geographical area, then such excess becomes surplus production, which can only be dealt with in one of two ways: either the producer to shut in such surplus production or offer it at a price which will make it competitive with production from another geographical area.

7. The best interests of the public as well as the petroleum industry will be served through the discouragement of the adoption of such measures, the effect of which would be materially to increase costs, with the consequent reduction in consumption.

Accounts vary as to who actually drew the red line on the map: some say Gulbenkian; others say the French delegation. However, sources agree that although the British said it was historically inaccurate, they accepted the arbitrary line categorically and encouraged the Americans to follow their example.[20]

The State Department, however, urged the American companies to avoid any restrictive agreements -- an objective which proved to be impossible to uphold. America's bargaining position was strong in that her firms supplied nearly three-fifths of the total foreign demand (Exxon alone controlled over 50 percent of the U.K. market). She was also armed with the combination of knowledge that Shell was searching for crude oil in the western part of the United States coupled with the reciprocity clause from the Mineral Leasing Act. Thus, negotiations, which had begun in 1922, were concluded in 1928 to include America in the Iraq Petroleum Co.

Gulbenkian insisted on retaining the original clause in which each partner undertook not to seek concessions in the former Ottoman Empire except through the company. That was, of course, as the State Department pointed out, completely contrary to any principle of the Open Door, although they eventually conceded. It was the pattern of many future consortia.

> Throughout the negotiations the British and French companies were supported by their governments, and at every turn the interests of Calouste Gulbenkian had to be taken into account. He was determined to hold on to the 5 per-cent. share in the project which he had been guaranteed by Shell and Anglo-Persian at the 1914 Foreign Office Conference, and with his experience going back to his 1890 report to Sultan Abdul Hamid he knew more about the whole question than anybody else. He had also become a major figure in the international oil industry in his own right. Nobody could quite say how; he never actually ran an organization or seemed to own any physical assets; yet in concession deals all over the world he had become an indispensable middle man. His grasp of the industry's politics, his knowledge of each company's strengths and weaknesses, and his memory for the actions and promises of companies and governments were all unrivalled. On this occasion he had much less power than the other negotiators, but his ultimate deterrent was the threat to expose their deals and treaties in the courts, and it worked very well.[21]

"Never," Gulbenkian later wrote, "was the open door so heremetically sealed."[22]

As the industry develops the body of quasi-international law evolves. The Mineral Leasing Act utilized the principle of reciprocity -- that set of legal rules, compliance with which rests normally on mutual advantages, rather than the fear of the application of external sanctions -- which, according to Schwarzenberger, intrudes even into spheres that are closer to power politics.

The San Remo Agreement, which incited America to apply her Open Door policy to Iraq; the 1914 Foreign Office Conference; as well as the series of conferences between 1922 and 1928; which established the Iraq Petroleum Co., may be easily categorized as quasi-international law, which again according to Schwarzenberger, includes agreements to which at least one of the consignees lacks full international personality.

The Red Line Agreement fails to fall so neatly into place, however, since none of the parties involved hold full international personality in that they are not recognized as sovereign states in the formal definition of terms. The agreement also falls outside the restrictive parameters of any municipal law. Therefore, the Red Line Agreement marks the initial embarkation of the major world oil companies into an uncharted area of international agreements in which they more resemble quasi-sovereign states than private corporations. Since their actions directly effected the development of international customary law in this area, the Red Line Agreement itself should be considered quasi-international customary law.

Notes to Chapter 4

[1]See John M. Blair, The Control of Oil, (London: MacMillan Press Ltd., printed in U.S.A. by R.R. Donnelley and Sons, Crawfordsville, Indiana, 1977), p. 32.

[2]From Sperling's Journal, August 1919. See Sampson, p. 83.

[3]U.S., Senate, S. Res. 331, 66th Cong., 2d Sess.

[4]See e.g., U.S., Senate, S. Doc. No. 272, 66th Cong., 2d Sess.; U.S. Senate, S. Doc. No. 39, 67th Cong. 1st Sess.

[5]U.S., Senate, S. 4396, 66th Cong. 2d Sess.

[6]41 Stat. 437.

[7]See Foreign Relations of the United States, 1920, (Washington, D.C.: Government Printing Office, 1920) Vol. III, p. 262.

[8]U.S. Senate, S. Doc. No. 39, 67th Congress, 1st Session, p. 3.

[9]O'Conner, pp. 304-305.

[10]Penrose, p. 57.

[11]Sampson, p. 83.

[12]U.S., Senate, S. Doc. No. 39, 67th Congress, 1st Session, p. 3.

[13]MNC Hearings, Part 8.

[14]MNC Hearings, Part 8.

[15]For. Rel. of the U.S., 1922, (Washington, D.C.: Government Printing Office, 1922), vol. II, p. 337.

[16]Complied from Cortez A.M. Ewing and Jewell Case Phillips, Essentials of American Government, (New York: American Book Co., 1962), p. 378, and Arthur S. Link, American Epoch: A History of the United States Since the 1890s, in the New American Nation Series, ed. by Henry Steel Commager and Richard B. Morris, (New York: Harper and Row, 1954; Harper Textbooks, 1963), pp. 152, 154, 160, and 345.

[17]U.S., Senate, Small Business Committee, The International Petroleum Cartel, Staff Report of the Federal Trade Commission, 1952, 82nd Cong., 2nd Sess., pp. 109-110.

[18]Tugendhat and Hamilton, p. 83.

[19]Tugendhat and Hamilton, p. 99.

[20]See Tugendhat and Hamilton, p. 84; Sampson, p. 84.

[21]Tugendhat and Hamilton, pp. 82-83.

[22]MNC Hearings, Part 7, p. 135.

CHAPTER 5

TEXAS: A MODEL OF REGULATION

> While international law is a legal system that actually exists, the term municipal law is an abstraction from the multitude of legal systems that are internal to the individual subjects of international law....
>
> Ultimately, any municipal organ is governed by its own municipal law and must, if needs be, give priority to it.
>
> Georg Schwarzenberger

> The oil cartel ... [presents] a classic study of the impact of a handful of the world's largest most powerful multinational corporations upon foregin and domestic policies of not only the United States, but, indeed, upon several nations of the world with respect to a vital world commodity, namely oil....
>
> David I. Haberman

The Red Line Agreement resulted in the formation of a global oligopoly in the decade following World War I which arbitrarily divided the world oil supply among the few and limited production to maintain price stability and thus profit for the few.

The most effective method of checking such a cartel would be governmental regulation on a world basis. Since no world organization exists with the power necessary to regulate such a cartel, the possibilities are limited to home and host governments or voluntary intra-industry regulation.

The Red Line Agreement had established a framework for voluntary intra-industry regulation -- only the "industry" was limited to cartel members. In effect, the Red Line Agreement recognized the majors to the exclusion of the independents; and therefore, any self-regulation on the part of the cartel members precluded self-regulation on the part of the independents. It was the actions of these independents in America which, if left unregulated, would effect the world-wide balance of production and price stability established by the oligopoly members. If production fluctuations in America went unchecked, as was the case in the East Texas oil fields in 1931, then British Petroleum's production in Iran would be effected, since no cartel member would want to contribute to a world glut of oil which would lower the market price. Therefore, those cartel members based in America strongly lobbied for federal regulation to limit independents.

When this was not forthcoming due to the total inaction of President Hoover, the majors turned to the state governments for regulation. Texas, in particular, held a unique position: since she entered the union as a sovereign republic, she was entitled to keep her public lands which gave her greater regulatory powers than other states who had entered the union as territories. This concurrent right to regulation underlies the recurring conflicts between federal and state regulation.

The use of state regulation actually held several advantages for the majors: only in America under her federal system was such an option available; the oil producing states were limited to about four or five at this time; the political power of the majors was greatly multiplied in these oil-producing states due to their dependence on the oil industry and its revenues, etc.; and by using state governments, the cartel members could easily apply the doctrine of divide and conquer so well established by Standard in applying monopolistic pressures on smaller firms.

Texas, sole producer of at least 25 percent of America's oil at this time was first to initiate regulation on the state level.

Extensive oil explorations during World War I had resulted in market surpluses that led the Texas Legislature to pass the Conservation Act of 1917, designed to eliminate waste in oil. The needs to alter income distribution, to allocate scarce resources, and to advance public policy objectives all come into play as issues upon which the Legislature took action. Under the Act, the Railroad Commission of Texas was to enforce law. Two years later a more comprehensive act enabled the Commission to exercise broad powers to enforce the prohibition of waste.

The Texas Railroad Commission in 1919 began to regulate oil production by holding hearings and conducting investigations of oil wastage in the state. By November 1919, it had gathered sufficient information to issue conservation rules. Perhaps the most famous of these was No. 37, which ordered proper spacing of wells -- at forty-foot intervals -- in the interests of oil conservation. Yet, until 1929, even after the 1924 discoveries, the Commission did not enforce its orders too strictly.[1]

By 1927 the Commission already found over-production to be its primary problem. Even then, major Texas oil producers were considering plans for restricting output, but their voluntary efforts to enforce curtailment programs broke down repeatedly. Many of these oilmen thus approached legislators to seek state aid in limiting the amount of oil produced. In 1927, the oeprators in the Yates field made a prorationing agreement to limit production which the Railroad Commission approved. In the following year the Commission ordered operators in the Hendricks field in Winkler County to develop a similar plan for control of production, for the increasing glut was threatening to demoralize the oil industry in the state, and indeed, to affect its entire economy.[2]

But voluntary efforts by individual groups of producers were increasingly less effective in dealing with the tremendous volume of unwanted oil that poured from the rich Texas earth during the Hoover years. Early in 1930 a group of influential Texas oil producers filed a petition with the Railroad Commissioners urging them to initiate direct statewide control of production. During the summer of that year the Commission held hearings on this request and on the gravity of conditions in the industry. Testimony of the oilmen who appeared before the Commission clearly revealed that they considered conservation programs a means for limiting production and for raising prices.[3]

The crisis in the industry demanded immediate action, and guidance from Washington was nil. Therefore, while Hoover was urging voluntary cooperation, on 27 August 1930, the Texas Railroad Commission issued its first mandatory statewide prorationing order, designed to enforce rules and at the same time limit production to market demand. The Commission limited statewide production to 750,000 barrels a day, about 50,000 barrels a day less than production of the preceding year.

Governor Ross Sterling, himself a former president of Humble Oil Co., as well as many legislators, looked on this ruling with suspicion: they feared that it reflected an effort by the industry to manipulate prices, yet the order was also specific in requiring adoption of conservation practices by producers. The Commission allocated total production among Texas fields and then among individual operators. It determined monthly quotas through information secured at hearings and by reliance on the production forecasts of the U.S. Bureau of Mines.[4] Thus conservation and stability were paradoxically intertwined.

The Texas courts defended the Railroad Commission's power to regulate oil production. In a suit in which an independent oil company challenged prorationing, the Texas Supreme Court endorsed the Commission's actions. The company contended that the order was not designed to eliminate waste but to fix prices and that it violated the State Conservation Act of 1929. But the judges held that prorationing was mainly designed to eliminate physical waste and that any effects this policy might have on price levels was merely incidental.[5]

As the Texas Railroad Commission was just beginning its task of stabilizing conditions in the state's oil industry, most of its labors were rudely disrupted in the spring of 1931 by the discovery of the rich East Texas fields. Exploitation of these pools could not have come at a less propitious time, for they had disastrous effects: their production of 800,000 barrels a day totaled more than that of all existing Texas oil wells combined.[6]

To cope with this new development the Commissioners tried to extend production control to the fields. In April 1931, they issued their first prorationing order for East Texas, now in the midst of a wild, frenzied boom. But many operators simply refused to obey the Commission's orders, and their large number made the Commission's task of enforcement virtually impossible. Some oilmen even threatened the Commission's agents with violence should they cut off the flow of the wells. Hundreds of others initiated court suits asking for injunctions to stay the Railroad Commission's orders. Meanwhile, they continued maximum production accompanied by wanton waste which further demoralized the already weak price structure of crude oil, with its global reverberating effects. By the summer of 1931, in the depths of the Great Depression, the East Texas oil situation created utter chaos as crude oil sold for ten cents a barrel (compared with $3 a barrel in 1919).[7]

While the President and his advisors did little more than to take notice of the situation, Governor Ross Sterling called a special session of the State Legislature for 14 July 1931. He asked it to enact a new conservation law that would specifically empower the Railroad Commission to limit oil production to reasonable market demand. There was much sentiment for such legislation among oil producers, for Oklahoma's pioneering regulations appeared to be reasonably effective. But the lawmakers were split over a variety of other alternatives.[8]

As the debate on the issue developed, suddenly, on 4 July 1931, a federal district court in Texas declared the Texas Railroad Commission's prorationing orders in East Texas invalid. Seriously divided, on 12 August 1931, the Legislature enacted a weak conservation act that prohibited physical waste only, granting the Railroad Commission no power to limit production to market demand. As the press interpreted this law, it annulled all of the Railroad Commission's prorationing orders promulgated during 1930 and 1931.[9]

Under the new Conservation Act the Railroad Commission was also restricted in issuing orders; it was required to give operators ten days' notice and a hearing. As in Oklahoma, therefore, the federal courts were seriously interfering with the efforts of state authority to deal with the immediate economic crisis.

At this same time (July and August 1931) oil operators and speculators in East Texas were indulging in unrestrained production. They turned the chaos that had characterized the Texas oil industry during the spring into anarchy by August. By then East Texas was producing about 1 million barrels a day, enough to meet one-third of all the crude petroleum requirements in the U.S. Crude at ten cents a barrel became common -- if there were takers. Much talk of violence was in the air, talk of dynamiting wells and pipelines to stop the production spree. The breakdown of the economy and of law enforcement in Texas seemed at hand amid the general gloom and hopelessness of the Depression.[10]

Secretary of Commerce, R. P. Lament, was in close touch with the situation but could offer no constructive suggestions. Similarly, Secretary of the Interior, Ray L. Wilbur, kept himself informed, but took no action despite many frantic appeals from oil producers. The breakdown of law and order in the oil fields and the collapse of the industry, evidenced no energetic response from President Hoover, who maintained a sphinxlike pose. In fact, he even refused to make recommendations to Congress for exploration of ways and means to aid the oil industry. This responsibility lay solely with the legislators, he believed. As for the Federal Oil Conservation Board (FOCB), he reiterated his conviction that it had no legal powers to control oil production, in East Texas or anywhere else in the U.S. And he emphasized repeatedly the administration's opposition to a tariff or an embargo against foreign oil.[11]

Thus the State Government of Texas itself had to take the drastic steps to meet the unprecedented crisis within its borders. Governor Sterling, in a mood of desperation, on 17 August 1931, declared East Texas in a state of insurrection. Dramatically, he placed the area under martial law. He appointed General Jacob Walters as head of the state militia and ordered him to enforce a temporary shutdown of all oil wells in the East Texas field. The Governor then sent approximately

4,000 troops into the oil fields to police the closing of the wells, and to arrest all violators.[12]

Perhaps these episodes throughout the course of the Great Depression, better illustrate the breakdown of the national economy than the collapse of the oil industry in the Southwest. And few situations better reveal the ineptitude of the Hoover Administration in dealing with Depression problems. In late August 1931, the drills were silenced as the militia poured into the region. A strange quiet settled over East Texas, a striking climax to the frantic production spree that had characterized the previous six months.

Meanwhile, late in August, the Railroad Commission began hearings on the possible imposition of production controls under the terms of the new Conservation Act. At these sessions most oil producers agreed that a total output of about 400,000 barrels a day in East Texas was compatible with good conservation practices. Thus, on 2 September 1931, the Railroad Commission issued an order limiting statewide production to this amount. In turn, Governor Sterling promised to supply troops needed to enforce the quota. Therefore, the state militia did not leave the oil fields.[13] In fact, during the next fourteen months the Railroad Commission issued monthly prorationing orders, which the Governor enforced through martial law. Despite some violations, military control proved effective in limiting production. By July 1932 the price of crude oil rose to 85 cents a barrel, comparing favorably with the low point of 10 cents a barrel in the preceding August.[14] The resolute action of the state had at least prevented total anarchy.

Once again, however, the federal courts intervened to thwart the efforts of the state to deal with the economic crisis. With a singular lack of realism, in May 1932, the Federal District Court for East Texas issued injunctions against state martial law on the grounds that the Governor had no authority to control oil production. Nevertheless, state troops remained in the oil fields in defiance of the injunction while the case was pending on appeal, and they succeeded in holding production down to 400,000 barrels a day. Meanwhile, the Texas state courts upheld the Railroad Commission's prorationing orders.

This conflict between state and federal jurisdiction did not ease what was already a highly critical situation. Tension heightened while the appeal slowly found its way from the Federal District Court to the U.S. Supreme Court. The fate of the oil industry in Texas and throughout the nation was at stake.

On 16 May 1932, the U.S. Supreme Court handed down its long-awaited decision. The particular case, involving the Champlin Oil Co., concerned the legality of the Oklahoma prorationing statue. In a six to three decision the judges upheld the Oklahoma Conservation Act. In reasoning that this act resembled that of the one in front of the Texas Supreme Court, the Court declared the limitation of production to a reasonable market demand to be a proper method for preventing physical waste, and that if it had an effect on prices, this was merely incidental. The ruling of the East Texas Federal Court was reversed.[15]

Unfortunately, the U.S. Supreme Court's decision had little immediate effect in improving conditions in Texas. Unlike Oklahoma's law, the Texas Conservation Act of 1931 specifically prohibited the Commission from restricting production to market demand. Texas operators still filed suits against the Railroad Commission, charging that under the Act of 1931 it did not have the power to allocate production allowables in relation to market demand. While many of these suits were pending in state courts, a large number of oil producers again went ahead to indulge in an unrestrained production spree. They were encouraged by the Federal District Court for East Texas, which on 24 October 1932, in the Peoples Case, enjoined the Texas Railroad Commission from enforcing its limitation of production.[16] It seemed that unless the Texas Legislature enacted a new law specifically authorizing the Railroad Commission to restrict oil production to market demand in Texas any control the state attempted to impose on the industry was destined for failure.

Consequently, in November 1932, the lawmakers passed a Market Demand Act, which specifically allowed the Railroad Commission to limit production to available market demand; the act defined waste as any oil production in excess of what transportation or market facilities could absorb. Memories of the past year's chaos led Governor Sterling to abandon his earlier fears of possible price regulation by the industry. He signed the bill willingly.[17]

Endowed with its new legal powers, the Railroad Commission in December 1932 began to issue new orders for curbing the flow of Texas oil. The Commission's engineers were able to show quite clearly at various hearings that scientific reasons alone dictated limitations of production, especially the conservation of reservoir energy and the prevention of premature encroachment of water into oil wells. Economic reasons -- the need to maintain a measure of stability in the industry, and to prevent its collapse -- were no less pressing.[18]

The failure of the Hoover administration to provide guidance for stabilization of the oil industry left the problem squarely to producers themselves. With voluntary efforts increasingly ineffective, and with the White House's refusal to concern itself with oil problems, petroleum producers prevailed upon state governments to undertake the close regulation of the petroleum industry.

In fact, the controls applied by the Texas Railroad Commission to restrict the amount of oil produced were far more rigorous than would have been possible under federal jurisdiction. Even in the depths of the Depression, public authorities rarely assumed the right to determine production quotas for private industries.

The economic crisis called forth a revival of state mercantilism to maintain a semblance of economic and social order in the face of an obstinate lack of realism on the part of the President and the federal judiciary.

Much future regulation both on the federal level in the United States and in the United Kingdom, among others, was modelled after the pattern set in Texas and other oil states in this time period. Therefore, even though such state regulation might be considered quasi-municipal law, its ultimate effect on the international legal regime warrants consideration.

Notes to Chapter 5

[1]See Robert Hardwiche, Legal History of Gas and Oil, (Chicago, 1938), pp. 214-220; James P. Hart, "Oil, the Courts, and the Railroad Commission," Southwestern Historical Quarterly 44 (January 1941): 303-311; 1919 Texas Statutes 228,285; and Robert W. Conrad, "State Regulation of the Oil and Gas Industry in Texas" (MA thesis, University of Texas, 1931), pp. 24-106.

[2]See Kenneth C. Davis and York Willbern, "Administrative Control of Oil Production in Texas," Texas Law Review 22 (1944): 149-153; Earl Oliver, "Stabilizing Influences," and H.C. Hardison, "Proration of Yates Pools, Pecos County, Texas," American Institute of Mining and Metallurgical Engineers, Transactions 1931, Petroleum Division, (New York 1931), pp. 9-10, 74-79; and Ft. Worth Star Telegram, 29 April 1929.

[3]See Hardwiche, p. 229; New York Times, 19 July 1931.

[4]See Hardwiche, pp. 222-224.

[5]See Hardwiche, p. 228; and New York Times, 28 January 1931.

[6]See Harold F. Williamson, et al., The American Petroleum Industry, 2 vols. (Evanston, 1959-1963), vol 2: Age of Energy, pp. 543-545, 554-555; and New York Times, 15, 31 March and 13, 27 April 1931.

[7]See Houston Post, 4 April 1931; New York Times, 4, 5, 12, 26 April, 7 June, and 19 July 1931.

[8]See New York Times, 6 June and 10, 15, 17 July 1931; Dallas Morning News, 15 July 1931; Oklahoma City News, 22 July 1931; Christian Science Monitor, 25 July 1931.

[9]See 51 F (2d) 400; Denver Post, 25 July 1931; Houston Post, 13 August 1931; Dallas Morning News, 13 August 1931; Baltimore Sun, 13 August 1931; and 1931 General and Special Laws of the State of Texas, First Called Session, (Austin, 1931) pp. 46-56.

[10]See New York Times, 5, 21 July 1931; "East Texas Drowns in Oil," Review of Reviews 84 (August 1931) 78-79.

[11]See R.B. Brown to R.P. Lament, 24 July 1931; R.W. Mercer to R.P. Lament, 29 July 1931; U.S., Department of Interior, Records of the Department of the Interior, Administrative Files, Correspondence of the Secretary, (hereafter cited as D.I. Records), Washington, D.C.: National Archives. See also Wilbur's letters to R.P. Lament, 10 April 1931; to E.W. Sterling, 1 June 1931; and Herbert Hoover to R.P. Lament, 2 June 1931 in D.I. Records.

[12]See Dallas Morning News, 18 August 1931; Houston Post, 18 August 1931; New York Times, 16, 18 August 1931; and New York Herald Tribune, 16, 18 August 1931.

[13]See Dallas Morning News, 3 September 1931; New York Times, 11, 14, 17, 26 August, 2, 5, 6, 12 September, 26 October, and 14 November 1932.

[14]See Oil and Gas Journal, 14, 28 July and 29 September 1932; and New York Times, 23 July 1932.

[15]See 287 U.S. 378, Champlin Oil Co. v The State of Oklahoma, as Chief Justice Hughes for the U.S. Supreme Court affirmed the Decree, 12 December 1931, which led to the withdrawal of Texas troops from the oil fields.

[16]60 F (2d) 1041.

[17]See Texas, 1932 General And Special Laws of the State of Texas, Fourth Called Session (Austin, 1932), p. 3. See also Dallas Morning News, 13 November 1932; New York Times, 3, 14 November 1932.

[18]See Oil and Gas Journal, 5, 12, 19, 26 January 1933, for discussions of the Texas Railroad Commission hearings; see also Hardwiche, pp. 240-242.

CHAPTER 6

THE ROOSEVELT ERA: IMPLEMENTATION OF SYNERGISM

> States and international institutions can act only through individuals.
>
> Georg Schwarzenberger

> ... affected governments have not always been unwitting accomplices. Indeed, in many instances governmental policies have been lodged in the hands of officials who had themselves been involved either directly or indirectly with these same corporations.
>
> David I. Haberman

Before Roosevelt was even inaugurated a delegation of oilmen approached him in December 1932 to explain their problems and to present various alternative proposals as solutions. Roosevelt, anxious to gain support for his administration's New Deal, promised early attention to these problems.

C. B. Ames of Texaco, and president of the powerful American Petroleum Institute, publicly identified strong federal control to curb production as an immediate need.[1] On that same day the API Executive Committee appointed a special board to negotiate an agreement with the governors of Oklahoma, Texas, and Kansas. The board, which consisted of such prominent men as C. B. Ames (Texaco), J. Howard Pew (Sun Oil), W. F. Teagle (Standard, N.J.), Harry F. Sinclair (Consolidated Oil), among others, believed that if existing state laws were rigidly enforced, the glut of oil might be substantially reduced.[2]

In keeping with his promise to the oilmen, Roosevelt -- on the very day of his inauguration, 8 March 1933 -- asked his Secretary of Interior, Harold Ickes, to call a meeting of the governors of oil-producing states to meet in Washington later that month to consider ways and means of stabilizing the industry. Ickes also invited the API and other leaders of the industry to attend. Roosevelt, meanwhile, had made public statements indicating his inclination to reinstate emergency measures similar to those used in World War I.[3]

Secreatry Ickes welcomed the delegates on 6 March with a warning to "put [their] house in order," backed by the implied threat of his personal preference for nationalization of the industry, and a committee of fifteen was appointed to work out a stabilization program.[4] Most independent oil producers opposed any limitation of oil production, and asked Roosevelt during those first few days of April to require the majors to divest themselves of pipelines instead.[5] J. A. Moffet, one of Roosevelt's closest advisors and a vice-president of Standard, N.J., urged the creation of an oil czar. Alfred Langdon, Governor of Kansas, acting as spokesman for the governors, strongly favored appointment of federal quotas.

U.S. Senator Arthur Capper, introduced a hot oil bill, written by Nathan Margold, Solicitor of the Department of the Interior, to authorize federal enforcement of prohibition of shipment of petroleum in violation of state regulatory laws. Capper also demanded a Department of Interior investigation into conditions in the oil industry. Simultaneously, Oklahoma Representative E. W. Marland, an important oil producer himself, introduced a similar hot oil bill in the House. His bill had been written in consultation with Secretary Ickes at President Roosevelt's suggestion.

In keeping with the tempo set by Roosevelt in the First Hundred Days,[6] Oklahoma Governor Murray no sooner signed a new proration law for his state than he went to Amarillo, Texas, to discuss cooperation with other state governors. Leading oilmen supported the bill by testifying before the hearings on the bill.[7] Throughout April the major companies bombarded the government with a steady volley of lobbying techniques in favor of strict federal controls. C. B. Ames, API President, made several statements to the press, and R. C. Holmes, President of Texaco, wrote an emphatic letter directly to Roosevelt stating that overproduction could be remedied only by effective federal enforcement of restrictions on output.[8] Concerned for their own interests, the Mid-Continent Oil Producers' conference in Oklahoma City appointed a committee on 4 May to convey their views to the President.

Thus, support for the issues of federal enforcement of state production quotas and greater restrictions on oil imports was not always so neatly divided into governors and major companies versus independents. Many factors effect a man's position such as the nature of his personal investments: whether or not his firm was engaged in interstate commerce or was producing oil outside the U.S. Splits began to emerge among the various pressure groups. Representatives of integrated companies seemed divided at an API meeting of 8 May at which directors deferred a decision on a specific course of policy since some favored centralization of authority in Ickes while others opposed it. Thus by 12 May the API adopted a wait-and-see attitude until the Administration's general policy toward business became clearer. Meanwhile, Governor Alred of Texas demurred on his stand with other Governors.[9]

As overproduction grew worse throughout April and May, and East Texas continued to demoralize the entire country, the President received more and more support for his idea of reviving the World War I emergency commissions. Mark Requa, wartime head of the Fuel Administration's Oil Division, wrote a letter to Roosevelt urging just that.[10] Lewis Douglas, in discussing industrial mobilization before the House Ways and Means Committee suggested re-establishment of the U.S. Food and Fuel Administrations as models for congressional action.[11]

Being an astute politician, sensitive to the conflicting attitudes within the industry and recognizing the need for immediate action, Roosevelt thus changed his position which was reflected in a letter to Vice-President Garner and Speaker Rainey noting that two year emergency measures for federal limitation of oil production were imperative, although such measures could be incorporated in more general legislation if necessary. No sooner had Senator Capper and Representative Marland introduced appropriate hot oil bills in Congress, than Roosevelt instructed Congress to abandon these bills for fear they would delay action on his general industrial recovery measure, then being prepared by Raymond Moley.[12]

Congressional dissention became evident. The Senate Committee Hearings on Finance reflected this confusion with Secreatry of Interior Ickes urging adoption of the Capper Bill separately from the General Recovery Measures in order to insure him the powers he needed.[13] The House Rules Committee was deadlocked five to five on the Marland Bill and Chairman Doughton flatly refused to include it in the General Recovery Act until he received direct word from the President.[14]

Congress eventually compromised by including a brief general statement to extend the National Industrial Recovery Act to cover the special problems of the petroleum industry, although Ickes had favored a lengthy ammendment detailing the powers he hoped to exercise. At the

President's direction, Senator Tom Connally's ammendment to prohibit shipment of hot oil was included as Section 9 (c) of the National Industrial Recovery Act of 16 June 1933.[15]

Thus after careful consideration of all the various demands and inputs, a balanced, cost-feasible piece of regulation was selected to remedy the market failures. It also crystalized important trends in government-industry relationships which had been developing for at least a decade. Donald Richberg, who drafted that part of the NIRA concerning industrial cooperation, clearly indicated that the act was designed to achieve stabilization of competition by integration and rationalization of the industry.[16] No longer need businessmen worry about the legality of cooperative activities under antitrust laws. Senator Robert Waggoner suscinctly outlined the objectives of the bill in his testimony before the House Ways and Means Committee:

> The purpose of the present bill is not to abolish competition, but to lift its standards and to raise its plane so as to eliminate destructive practices. In other words, efficiency, rather than the ability to save at labor and undermine living standards, will be the determining factor in business success. Through the cooperative action made possible and lawful under this bill, industry may ... provide for market research and analysis, cooperative marketing and sales promotion ... simplification and standardization.[17]

Shortly after the passage of the National Industrial Recovery Act, NRA Administrator Hugh S. Johnson told trade associations to draft a code of fair competition to be used by the NRA. The API acted quickly, inviting virtually every oil producer organization to attend a meeting in Chicago to draft an industry-wide code to present to the NRA. Many of the names on the drafting committee were well known by this time: J. Howard Pew (Sun Oil), Harry Sinclair (Consolidated Oil), C. B. Ames (Texaco), and A. L. Beaty and W. R. Kingsbury (Standard Oil of

California). The new API President Axtell J. Byles threatened congressional nationalization of the industry unless a unified industry code could be presented quickly. Concurrently, the API-proposed draft code was distributed among the delegates.[18] Nearly everyone agreed to enable the federal government to issue permits to allow drilling and to fix production quotas. However, the government right to fix minimum prices was another matter. Many of the independents as well as Ames of Texaco, Pew of Sun Oil, and Van Derwoude of Shell, strongly objected to price fixing.[19] Before adjournment in mid-June a draft for a code was adopted which closely resembled the API model.[20] By 1 July the oil marketers had approved the same code -- despite the fact that independents dominated their drafting committee -- with one minor exception to change the retail distributing system for gasoline.[21] Price fixing remained in the draft despite Hugh Johnson's known opposition to it.[22]

Labor leaders objected to the conspicuous omission of provisions concerning wages and hours of labor in the code, so Johnson returned the Chicago Code to the API on 5 July for suitable revision.[23]

On 12 July Roosevelt issued an executive order under the NIRA, prohibiting interstate shipment of hot oil -- to be enforced by the Interior Department.[24] Previous legislation providing congressional sanction for the President's action had been introduced by Oklahoma Representative Marland.[29]

By Mid-July the API submitted the revised code to Johnson including a maximum 40-hour week for labor and a minimum wage of 40 to 47 cents an hour. Administration of the code was based on Requa's World War I Oil Division of the Fuel Administration. A general planning and coordinating committee composed 26 producers and 28 refiners (no representatives of labor) was selected from representatives in Chicago with Roosevelt's approval.[26] No sooner had this committee been selected than conflict again broke out on every possible issue. Harry Sinclair, Chairman of the Labor Subcommittee which had drafted the code, favored a 40-hour week. On 25 July Johnson appointed a five-member committee (representing the API, the independents, and two labor representatives) to work out a compromise. The Independent Petroleum Association, attempting to cut their labor costs, came out for 30 hours. Harvey Fremming, President of the International Association of Oil Field, Gas Well, and Refinery Workers, urged a 30-hour week with a guaranteed daily wage of $4.75 for a 6-hour day.[27]

The issue of price fixing elicited much more serious rifts.[28] Johnson, as has been noted, opposed federal price fixing as did Teagle, President of Standard, N.J. -- one of the architects of the Red Line Agreement, along with Deterding of Shell and Cadman of BP -- who would be adversely effected if U.S. prices were allowed to be set below the world price agreed upon by the oligopoly. Consenting with Teagle and Johnson were Standard, Ind., Shell, Texaco, and Gulf. Teagle, in fact, forced the resignation of one of his vice-presidents over the issue -- J. A. Moffet, a son of one of John D. Rockefeller's early partners, a Democrat, a personal friend and close advisor to Roosevelt. Similar conflicts prevailed in other companies. W. R. Kingsbury of Standard, Calif., and Harry Sinclair of Consolidated Oil agreed with Moffet. The API in general and Wirt Franklin of the Independent Petroleum Association also favored federal price fixing. This bitter disagreement almost totally disrupted the preliminary hearings on the code after just three days. Since the oil code was the first to be drawn up under the NRA, the controversy cast a foreboding shadow over the entire industrial self-regulating experiment.

Johnson was forced to draw up the code himself as he had threatened earlier. With Moffet's help he outlined a plan to consolidate some of the big producers, omitting price fixing. He proposed a 40-hour week for producers and 36 hours for marketers. Johnson failed in uniting the industry. Most independents demanded total exclusion of all imported oil. Some of the major producers favored some limitations on oil imports. The larger companies wanted unitization. The independents, bent on breaking up the major integrated companies, still insisted on separation of pipelines and refineries. The independents insisted on administration of industry codes by the Department of Commerce. And finally, as the ultimate split in the seemingly hopeless cavern -- the majors favored administration of industry codes by the NRA.[29]

Secreatry of Interior Ickes, still eager for the power of authority, approached Roosevelt for permission to present a code draft himself, including rigid price regulations, a stand for which he found support from oil magnates like Sinclair, Kingbury, and Wirt Franklin. Meanwhile, Johnson presented his version of the code to Roosevelt, unaware of Ickes' actions. Support from the majors -- his natural allies at this point -- was not forthcoming due to their inability to agree on Johnson's proposal which inadvertently strengthened Ickes' hand. Roosevelt, who frequently played one side against the other, on 19 August 1933 ordered Johnson and Ickes to work out a compromise.[30]

Ickes won a decisive victory by persuading Roosevelt to appoint him as administrator of the oil code, rather than Johnson, as had been widely expected.[31] On 30 August Roosevelt named Ickes to direct execution of the code, thus withdrawing jurisdiction from the NRA. To aid Ickes in the administration of controls, Roosevelt also appointed an industry advisory group, the Production and Coordination Committee, composed of fifteen individuals nominated by the API, independents, and trade associations -- carefully selecting a majority who favored price fixing.

The members of the Production and Coordination (P&C) Committee, most of whom represented smaller companies, not wishing to alienate those who, like Ames of Texaco, Sinclair of Consolidated, and Van Derwoude of Shell, supported the code but opposed price fixing, took no immediate action on this controversial issue, but left it to the President.[32]

Thus the petroleum code was finally promulgated on the basis of a tenuous consensus in industry and government. It granted the petroleum industry administrator power to determine monthly production quotas upon recommendations made by the P&C Committee. He also received authority to restrict oil imports to an amount equal to that of the last six months of 1932. At the same time the administrator could issue regulations for the marketing of refined products, and if necessary for price regulation, also under his jurisdiction was the administration of labor provisions, including Section 7 (a) of the NIRA as it applied to the oil industry. In functions and in structure, the oil administration greatly resembled the oil division of World War I's U.S. Fuel Administration (Refer to Figure 1).[33]

Ickes, as head of the Oil Administration, was primarily concerned with limiting production. In addition to the Production and Coordination Committee, he also created a Petroleum Administrative Board to provide expert technical advice. Ickes set monthly oil quotas -- based on the P&C Committee's recommendations -- for each state, reducing production nationally by about 300,000 barrels a day. He ordered oil imports limited to that amount imported during the second half of 1932. Ickes stated -- after consultation with Roosevelt -- that price fixing would be a last resort.[34]

Labor groups were becoming discontent, largely because they had been ignored. Harvey Fremming, head of the oil workers' union, had suggested joint industry-labor representation on a standing committee.[35] Amid continuous protests from labor the P&C Committee suggested the creation of a Petroleum Labor Policy Board to be composed of one impartial member, three from labor and three from industry. After complaints over representation, the impartial membership was raised to three, but the labor board never represented labor as the P&C Committee represented industry.[36]

Roosevelt and Ickes both rejected labor's demands for representation and ignored the issue of skilled and semi-skilled wage differentials. It was assumed that Section 7 (a) of the NIRA would encourage collective bargaining, thus allowing labor a voice. Ickes approved the Labor Policy Board and began making appointments to such men as Professor George W. Stocking and Charles C. Jones, a company man from Bayonne, N.J., with whom Fremming refused to be seated. At the annual API meeting Ickes and the oil code were hailed as a fantastic success, despite warnings by Ickes.

> By the end of the year many oilmen were still hailing the success of the operation of the Code. C.B. Ames of Texaco, considered it a major step in achieving many of the oil industry's objectives. Similar views were expressed by Teagle, who noted that his company's position had improved greatly as a result of federal efforts to prevent shipment of hot oil. A.J. Byles of the API heartily agreed.[37]

Ickes had warned that more stringent regulation was sure to follow if code violations were not halted.[38]

Early in October Ickes appeared to have converted Roosevelt on the use of price fixing. Yet without a clear mandate from industry, the President was unwilling to commit himself.[39] Ickes actually announced on 16 October that, with the President's approval, he was preparing a price fixing order; within a few days his projected price schedules were circulating.[40]

Hearings on Ickes' price fixing order exposed total disunity on the issue among majors and independents.[41] Ickes conceded and recinded his price fixing order until 1 February 1934 on the condition that industry agree to maintain price levels.[42] In order to avoid federal price fixing the companies created a money pool -- established with contributions of about $10 million, primarily by large corporations -- to buy up distress stocks, thus stabilizing prices.[43]

As the Petroleum Labor Policy Board's functions were never made explicit, they concentrated on accrediting authorized labor bargaining groups, then, as a conciliatory agency mediating strikes and other disputes over working conditions. One such controversy concerned wages which -- as an issue -- had been ignored until the P&C Committee recommended a specific minimum wage schedule to Ickes. At the public hearings on the schedule, the Labor Board members countered by revising the schedule upwards.[44] Ickes approved the Labor Policy Board's revised schedule to be effective retroactively from September 1933. Nonetheless both industry and labor leaders were expressing dissatisfaction with Ickes' iron-fisted rule -- yet, he ultimately got his way.

Ickes continued to campaign for centralization of his powers over production and distribution of petroleum. In the spring of 1934 he had promoted congressional legislation which would make him the virtual arbiter of the industry. On 1 May 1934 Senator Thomas introduced a bill to expand Ickes' existing powers. Representative W. M. Disney Introduced a measure to allow Ickes direct enforcement over hot oil quotas in the states. The Petroleum Administrative Board supported Ickes' congressional bid for power and lobbied Congress to that end in hopes of stymieing the federal district courts in Texas which were increasingly issuing injunctions, curbing federal orders to curtail the flow of hot oil.[45]

However, during Congressional hearings on the bills, opposition from Texas was so strong, that Senator Tom Connally and Congressman Sam Rayburn (later to become Speaker of the House as well as LBJ's mentor) successfully blocked any extention of federal power, thus limiting Secretary Ickes.[46] Instead, Pennsylvania Representative William P. Cole headed the most exhaustive congressional investigation of the oil industry ever undertaken till then. The subcommittee report urged an interstate compact to control production rather than favoring additional power to Ickes as in the Thomas-Disney Bill.[47] When Congress failed to enact federal production regulation, many oilmen again turned to the states. Soon afterwards, the P&C Committee passed a resolution in favor of an interstate compact.

Although failing to acquire congressional powers for enforcement of hot oil infringements, Ickes managed an executive order creating a federal tender board which he set up in the disreputable East Texas field for the express purpose of issuing permits (tenders) to producers for transporting oil out of the state. This measure effectively brought a much needed stability to the industry -- for a while.[48]

By mid-November API directors voted to support the interstate compact under the conditions that it be accompanied by federal regulation of imports to balance production with demand, as well as with an effective hot oil bill. This was a reaction to Ickes.[49] Addressing the API convention in Dallas November 1934, Ickes called for legislation transforming the industry into a public utility, subjected to rigid federal regulation.[50] The changing attitude of the API was mirrored in the states as Oklahoma Governor-elect E. J. Marland, former congressman who had sponsored many regulation bills for Roosevelt, invited state governors from oil-producing states to meet at his home in Ponca City 3 December 1934 to discuss possibilities of a compact and to sound his views for coordination among state governments in arriving at uniform state laws regulating production in relation to market demand by manipulating prices -- to be administered by a joint state-federal committee. Governor James Allred of Texas, however, refused any federal intervention in the soveriegn state of Texas and would only support federal participation in restriction of foreign oil imports and in the form of a hot oil law.[51] Since any agreement without Texas was meaningless, the final compromise, arrived at in Dallas, closely followed Governor Allred's plan but the Texans conceded in allowing a permanent interstate compact board oversee the execution of future interstate agreements. They also dropped objections to a provision that encouraged states to coordinate policies for the attainment of maximum recovery from oil reserves, which actually allowed the compact commission to recommend allowable production quotas to those states that desired them.[52]

The United States Supreme Court in the "Panama" Decision, on 7 January 1935 declared Section 9 (c) of the NIRA invalid, deciding that federal officials lacked the power to enforce production quotas determined by state agencies.[53] The following day, Ickes sought legislation which would continue to outlaw the shipment of hot ôil: within a month the Connally Hot Oil Bill was rushed through both Houses, giving the President the power to suspend its operation whenever he felt it would result in an imbalance in supply and demand. Enacted for a two-year period, the Act was renewed until in 1942 Congress extended the Connally Hot Oil Act indefinitely.[54]

The API wasted no time in protecting their interests after the "Panama" Decision by advocating (1) the 1931 voluntary marketing rules for the industry, developed under the aegis of the Federal Trade Commission; (2) the incorporation of federal, state, and local committees of the NRA's P&C Committee into its own organization, becoming organs of the API's division of marketing; and (3) the continuation of the wage-and-hour provisions of the NRA's Oil Code.[55] Roosevelt re-established the Federal Tender Board by executive order; he also felt voluntary codes were in violation of antitrust laws. Ickes, however, endorsed the API's resolutions.

The U.S. Supreme Court again disrupted the petroleum industry by declaring the entire National Industrial Recovery Act unconstitutional.[56]

The NRA experiment in federal regulation illustrated; (1) that cooperation among the states could be reasonably effective to restrict oil production, especially if supplemented by federal provisions over oil transported across state boundaries; (2) that state or federal laws to enforce conservation measures -- unit agreements, drilling and pressure laws -- were generally welcomed by responsible producers; and (3) that the NRA code selected the most workable features of public oil policies from the vast number of initial proposals although centralization of federal regulatory powers was strongly opposed by some sectors of the industry -- especially in Texas. It was the Supreme Court's reactionary mood in 1935 that ended the NRA.

Immediately after the Supreme Court ruled the NRA unconstitutional, Ickes approved the continuation of the companies' money pool agreement, thus avoiding the need for federal price fixing.[57] Roosevelt favored the Interstate Compact and sent the Downing Committee's draft-- now in the form of the Interstate Compact to conserve oil and gas -- to Congress for approval. In his characteristic manner, Roosevelt convinced whomever he was talking to that he supported his particular cause. Representative W. H. Disney, sponsor of the federal oil bill, had begged for clear Presidential support on the bill. In deference to Texan Sam Rayburn, Speaker of the House, whom President Roosevelt had asked for his suggestions concerning desirable legislation when he so violently opposed the federal oil bill, the President refused Disney direct support and merely encouraged Ickes to push for the Bill's passage. He soon sent a message to the Independent Petroleum Association urging cooperation and self-regulation in the oil industry to obviate federal action.[58] In response to a small group of Brandeisians propounding federal antitrust actions as a means of solving problems in the oligopolist industries, Roosevelt initiated a revival of antitrust policies. This move on Roosevelt's part was strictly political rather than economic in motivation since the oil industry's problems of overproduction and stabilization were not necessarily directly related to collusion among major oil producers; in fact, quite the opposite was true to a large extent.

In mid-June a group of disgruntled oil jobbers, including representatives of the National Association of Petroleum Retailers, complained to the U.S. Attorney General of collusion among large companies in fixing jobber margins,[59] while Ickes continued to oppose the Interstate Oil Compact, subbornly favoring the Thomas Bill in order to gain the power necessary for him to control the industry by changing it into a public utility.[60]

On 1 August Attorney General Robert H. Jackson announced initiation of antitrust investigation of the oil companies. FBI agents helped collect data on the relationship between major companies and jobbers. Since the federal courts in Madison, Wis., were less crowded than elsewhere, and since it was the home of progressive anti-monopoly sentiment, it was in this town that the Justice Department impaneled a Grand Jury to conduct the investigation April 1936. By July the grand jury issued criminal rather than civil indictments against 23 oil companies and 58 individuals who allegedly conspired to fix prices. The trial on the first indictment began in October 1937.[61]

The Cole Subcommittee of the House Committee on Interstate and Foreign Commerce preferred the Thomas-Disney Bill granting Ickes implementation powers. However, without Roosevelt's direct support for such a controversial issue -- not to mention the fierce opposition of Ickes' enemies from Texas -- the Cole Committee dropped the Thomas-Disney Bill.[62] At a White House Conference of 6 August 1935, Roosevelt had sided with Rayburn against Ickes and, together with Cole, Disney and

Charles Fahy (PAB) had drafted a new bill to continue the Connally Hot Oil Act for another two years, as well as to continue import restrictions on imported oil. With Presidential support, Cole offered House Joint Resolution (No. 407), ratifying the Interstate Oil Compact, renewable bi-annually.[63]

In April 1938 Senator Guy Gillette (Iowa) introduced a bill to compel separation of marketing from other lines of the petroleum business; a bill designed to break up the integrated companies which never passed. Senator Borah also urged that pipelines be divorced from oil-producing companies.[64]

The Temporary National Economic Committee, headed by Senator Joseph C. O'Mahoney, and including representatives from the Justice Department, the Securities and Exchange Commission (SEC), the Federal Trade Commission (FTC), and the Departments of Labor, Commerce, and the Treasury, was created by Roosevelt in June 1938. It began hearings on 1 December 1938 investigating many industries, and lasted until April 1941, filling 37 volumes with testimony alone. Oil industry representatives testified on 25 September and 20 October 1939, discussing virtually every phase of their operations.[65] The TNEC sponsored a monograph by Roy Cook, a member of Thurmond Arnold's staff on the extent of monopoly and economic concentration in the oil industry. Cook's paper emphasized the dominant role of the large integrated companies in the production, refining, transportation, and marketing of petroleum, stressing the importance of the oil industry to national defence. His conclusion indicated the petroleum industry as prime for treatment as a public utility.[66]

The oil companies, who needed Ickes' testimony at these hearings concerning his sanctioning of their arrangement, were afraid to supoena

Ickes for fear of just what he might feel inclined to say: Ickes did not wish to appear as a voluntary witness for fear of embarrassing Roosevelt.[67]

After hearing testimony at which Ickes did not appear, the Madison Court adjudged the defendents' guilty of a misdemeanor under the Sherman Act in September 1938, a decision upheld by the U.S. Supreme Court two years later.[68]

The ultimate antitrust suit -- dubbed the "Mother Hubbard Case" because of its scope -- charged 22 major oil companies and some independents with 69 violations of the Sherman Act. The Attorney General had merely begun when World War II forced him to suspend the case. It was briefly revived in 1946, but federal lawyers asked for its dismissal in 1951.

While Roosevelt's New Deal offered little in the realm of policy innovation, it did serve to consolidate government and industry attitudes on a national oil policy. Roosevelt's primary contribution, however, was in fashioning the administrative means of implementation. After the NRA's demise, leaders in both industry and government insisted on maintaining the most pragmatic features: (1) the continuation of monthly production forecasts by the U.S. Bureau of Mines; (2) the Interstate Oil Compact; (3) the Connally Hot Oil Act; (4) an oil tariff; and (5) an emphasis on voluntary cooperation. These features remain operative today. Roosevelt's political astuteness enabled him to develop all his options simultaneously, ever ready to employ his Machiavellian tactics to arrive at a workable solution. Thus it was that despite Roosevelt's reputation as a "socialist", it was the states who ultimately gained in regulatory power. His antitrust phase proved incongruent with the mainstream of national regulation since it emphasized the dissolution -- rather than regulation -- of large integrated companies; it was thus unrealistic in light of petroleum problems confronting both government and industry, and was consequently dropped after World War II.

An examination of the Roosevelt Era illustrates the degree to which government and industry interact in the diplomatic process of piloting an issue through the system to its conclusion. It also graphically shows the differentiation of activities and the simultaneous coordination of these activities into an integrated policy. The degree of sophistication to which both industry and government have developed is evidenced not only on a federal, state, and local level, but in their ability to negotiate several issues on various levels -- ranging from intra-company and intra-government conflicts to global ones -- at the same time. Thus, a strong bond of mutual dependence and manipulation had developed between the American industry and the American government.

These quasi-diplomatic activities of the 1930s established a modus operandi for affecting regulation which the Seven Sisters utilize today on a municipal level in every country in which they operate, which considered cumulatively must ultimately affect any international regulation.

Notes of Chapter 6

[1]Oil and Gas Journal, 12 January and 16 March 1933.

[2]New York Times, 8 March 1933; Harold Ickes, Secret Diary 3 vols. (New York, 1953-1954), 1: 9-16; American Petroleum Institute, Proceedings, 14th Annual Meeting 1933, (New York, 1933), pp. 16-17.

[3]New York Times, 16, 17, 19 March 1933; Transcript of FDR Press Conferences, 1: 69, in Franklin D. Roosevelt Papers (hereafter cited as FDR Mss.), Franklin D. Roosevelt Library, Hyde Park, N.Y.

[4]New York Times, 2, 3, 4, 5 April 1933; a copy of Resolution (29 March 1933) is in FDR Mss.

[5]New York Times, 2, 3, 4, 5 April 1933.

[6]Most New Deal legislation was passed in the first hundred days of Roosevelt's administration.

[7]Oil and Gas Journal, 20 April 1933; New York Times, 7, 8, 11, 15 April 1933; E.W. Marland to Louis Howe, 22 April 1933, in FDR Mss.

[8]New York Times, 3, 5, 6, 22 April 1933; R.C. Holmes to FDR, 17 April 1933, in FDR Mss.

[9]Oil and Gas Journal, 4, 11 May 1933; New York Times, 1, 2, 3, 4, 7 May 1933.

[10]New York Times, 4, 7, 9, 12, 15 May 1933; Mark Requa to FDR, 9 May 1933, in FDR Mss.

[11]Lewis Douglas in U.S. House, Committee on Ways and Means, Hearings on National Industrial Recovery, 73rd Cong., 1st Sess. (hereafter cited as NIRA Hearings), 1933, pp. 17-21.

[12]FDR to Speaker Henry T. Rainey 20 May 1933 in FDR Mss.

[13]New York Times, 23, 24 May 1933.

[14]E.L. Doherty to FDR, 21 May 1933, in FDR Mss.

[15]New York Times, 2, 3, 6, 9 June 1933; Ickes, Secret Diary, 1: 36-47; Ickes Memo for Marvin MacIntire, 1 June 1933, in FDR Mss.

[16]See Richberg's comments in NIRA Hearings, pp. 66-68, 80.

[17]See Waggoner's comments in NIRA Hearings, pp. 95-96.

[18]Oil and Gas Journal, 8, 15, 22 June 1933; New York Times, 9 June 1933. For Ickes views see New York Times, 11, 18, 21, 23, 24, 25 June 1933.

[19]New York Times, 18, 21 June 1933.

[20]"Washington Oil Well: Progress of Oil Control," Business Week 17 June 1933, pp. 8-9.

[21]New York Times, 22, 23, 25 June 1933.

[22]Oil and Gas Journal, 29 June 1933.

[23]New York Times, 2, 4, 6, 7, 11 July 1933; Oil and Gas Journal, 6, 13 July 1933; Hugh S. Johnson, The Blue Eagle, From Egg to Earth, (Garden City, 1935) pp. 216, 235.

[24]New York Times, 12, 13 July 1933: Ickes, Secret Dairy, 1: 49-50, 65.

[25]U.S., Congress, House, Congressional Record 73rd Congress., 1st Sess., 19 May 1933, p. 3776, and 20 May 1933, p. 3843; E.W. Màrland to Louis M. Howe, 22 April 1933, in FDR Mss.

[26]New York Times, 16, 17, 18 July 1933; Oil and Gas Journal, 13, 20 July 1933.

[27]New York Times, 16, 18, 23 July, 1933.

[28]U.S., National Recovery Administration, Hearings on Proposed Oil Code (No. 10), National Archives (Microfilm), Washington, D.C., pp. 3-12; New York Times, 24, 25, 26, 27, 29, 30 July and 1, 2 August 1933; Oil and Gas Journal, 27 July and 3 August 1933; Ickes, Secret Diary, 1: 72-73, 85-86.

[29]New York Times, 3, 4, 5, 6 August 1933; U.S. President, Transcript of FDR Press Conferences, 2: 219-220, FDR Mss.

[30]New York Times, 18, 19, 20 August 1933; Ickes, Secret Diary, 1: 81-82; Oil and Gas Journal, 24 August 1933; FDR to Harold Ickes, 19 August 1933, U.S. National Recovery Administration Records, National Archives, Washington, D.C., Microfilm Document Series of National Recovery Administration, Petroleum (hereafter cited as NRA Records); Henry L. Doherty to FDR, 14 August 1933, in FDR Mss; FDR to Hugh Johnson, 19 August 1933, in FDR Mss.

[31]Ickes, Secret Diary, 1: 82-84.

[32]New York Times, 22, 24, 27, 30, 31 August and 2 September 1933.

[33]U.S. National Recovery Administration, Codes of Fair Competition, Petroleum, (Washington, 1933); successive drafts can be found in NRA Records.

[34]U.S., President, Transcript of FDR Press Conferences, vol. 2, FDR Mss. 16 September 1933 and 13 October 1933; New York Times, 3, 6, 8, 10, 12 September and 4, 8 October 1933.

[35]New York Times, 23 June and 31 August 1933; Richberg in NIRA Hearings, p. 26. Fremming in Hearings on Proposed Oil Code, NRA Records, p. 97.

[36]New York Times, 24 November 1933; U.S., Petroleum Administrative Board, Press Release No. 8398 in National Archives, Washington, D.C.; Renee de Visme Williamson, The Politics of Planning in the Oil Industry Under the Code, (New York, 1936), pp. 54-57.

[37]API, Proceedings of 14th Annual Meeting 1933, pp. 20-26; New York Times, 27, 28 October 1933; Oil and Gas Journal, 26 October and 2 November 1933. See also New York Times, 9, 15, December 1933 and 2, 3 January 1934; Oil and Gas Journal, 22, 29 December 1933.

[38]API, Proceedings of 14th Annual Meeting 1933, pp. 20-26.

[39]New York Times, 4, 8, 13 October 1933; Ickes, Secret Diary, 1: 97-99, 106-107.

[40]New York Times, 16, 20, 22, 25, 26 October 1933.

[41]New York Times, 1, 3, 5, 14, 15 November 1933; Oil and Gas Journal, 16, 23 November 1933.

[42]New York Times, 20, 21, 22, 26 November 1933; Oil and Gas Journal, 22, 29, December 1933.

[43]New York Times, 5,. 8, 31 December 1933.

[44]New York Times, 14, 15, 20 April, 30 August 1934; U.S., Petroleum Labor Policies Board, Report, Washington, 1935, (mimeo), pp. 3-37, summarizes work of Board. Extensive records of the agency are in the National Archives, Washington, D.C.

[45]New York Times, 21, 23 February and 29 April 1934.

[46]New York Times, 29 April 1, 6, 18 May 1934; FDR to Sam Rayburn, 22 May 1934, in FDR Mss.

[47]U.S., Congress, House, House Committee on Interstate and Foreign Commerce, Sub-committee on Petroleum Investigation, Hearings on House Resolution 441, 5 parts, [hereafter cited as Cole Committee Hearings] 73rd Cong., 1st Sess., House Report No. 2, (Washington, 1935), pp. 3-12.

[48]Ickes, Secret Diary, 1: 218; New York Times, 12, 18, 20, 25, 26, 27, 28 October and 11 November 1934; FDR to Sam Rayburn, 22 May 1934, in FDR Mss.

[49]API, Proceedings of 15th Annual Meeting 1934, (New York, 1934), pp. 27-30; See Oil and Gas Journal, 3 January 1935 for Mark L. Requa's analysis of the compact; New York Times, 14, 16 November 1934.

[50]API, Proceedings of 15th Annual Meeting 1934.

[51]73rd Cong. 1st Sess., Cole Committee Hearings, pp. 2884 ff.; The Compact's Formative Years, 1931-1935. (Oklahoma City, 1954) pp. 1-3; Oil and Gas Journal, 7 December 1934; See also Second Report of the Attorney-General Pursuant to Section 2 of the Joint Resolution of July 28, 1955, Consenting to an Interstate Compact to Conserve Oil and Gas (Washington, 1958) pp. 36-42.

[52]New York Times, 2, 4 January and 5, 16, 17 February 1935; Oil and Gas Journal, 10 January 1935 discusses conference in detail; see also Oil and Gas Journal, 24 January and 14, 21 February 1935; minutes of this meeting can be found in Cole Committee Hearings, pp. 2886 ff.; Transcript of Proceedings, Oil States Compact (Dallas, 1935), pp. 1-8.

[53]Panama Refining Co. v. Ryan, 293 U.S. 388 (1935); U.S. Congress, Senate, Senate Document No. 10, the opinion is also found in 74th Cong., 1st Sess., see also New York Times, 8, 9, 10, 11, 12 January 1935; Ickes, Secret Diary, 1: 273.

[54]U.S. Congress, Congressional Record, 74th Cong., 1st Sess. (10, 18 January 1935), pp. 635, 2521; New York Times, 10 January and 10, 23, 24 February 1935.

[55]Oil and Gas Journal, 6, 13, 27 June 1935; API, Proceedings of 16th Annual Meeting 1935 (New York, 1935) pp. 14 ff.

[56]A. L. A. Schechter Poultry Corp. v. United States, 295 US 553.

[57]Ellis W. Hawley, The New Deal and the Problem of Monopoly (Princeton, 1966), pp. 374-375.

[58]Andrew Fahy to Harold Ickes, 15 May 1935, FDR to Sam Rayburn, 23 May 1935, Harold Ickes to FDR, 21 May 1935, in FDR Mss.; Transcript of FDR Press Conferences, 5: 42-46, 344, 349; Oil and Gas Journal, 10 January and 17 November 1935.

[59]New York Times, 31 October 1935.

[60]Oil and Gas Journal, 14, 28 February, 20 June [text of Thomas Bill], and 4 July 1935.

[61]U.S., Attorney-General, Annual Report 1935 (Washington, 1935), pp. 41-48, 307-310; New York Times, 10, 16 April, 28 October 1936; "Mamma Spank: 18 Major Oil Companies Indicted," Time, 18 October 1937, p. 63.

[62]U.S., Congress, Congressional Record, 74th Cong., 1st Sess. (24 August 1935), pp. 14583-14593, (26 August 1935), p. 14768; Oil and Gas Journal, 29 August 1935; U.S., Congress, Senate, Senate Document No. 118, 74th Cong., 1st Sess., (Washington, 1935).

[63]New York Times, 7 August 1935; Oil and Gas Journal, 15 August 1935; U.S., President, Transcript of FDR Press Conferences, 6: 91, FDR Mss.

[64]U.S., Congress, Congressional Record, 75th Cong., 3rd Sess., (30 March 1938), p. 4344, 76th Cong., 1st Sess., (17 April 1939), p. 4282.

[65]U.S., Congress, Temporary National Economic Committee, Hearings before TNEC [September 25, 30, 1939], Part 14, Sect. I, pp. 7097-7110, 213, Part 16, Sect. 3 [9, 13, 16 October 1939], Part 17, 17-25 October 1939, (Washington, 1940).

[66]Roy Cook, Control of the Petroleum Industry by Major Oil Companies, TNEC Monograph No. 39, (Washington, 1941).

[67]Ickes, Secret Diary, 2: 341, 347, 3: 337.

[68]Oil and Gas Journal, 18, 25 November and 2, 9 December 1937; "Oil Trial Tremors," Business Week, 16 October 1937, p. 18; Blakely Murphy (ed.), Conservation of Oil and Gas, A Legal History, 1948, (Chicago, 1949), pp. 630-636.

CHAPTER 7

WORLD WAR II: DICHOTOMY OF AMERICAN POLICY -- DOMESTIC AND FOREIGN

> In an unorganized international society based on entities that tend to put their own interest before the commonweal, the scope of a law of coordination or community law, in which the common interest overrides any incompatible sectional interests, is limited.
>
> Georg Schwarzenberger

> In their exercise of virtually sovereign power, this bloc of companies has consistently promoted and exploited national economic needs and international differences, government ignorance, and the gaping lacunae in the fabric of international regulatory control mechanisms ... in pursuit of their private commercial goals.
>
> David I. Haberman

If municipal law is considered a prerequisite for the development of international customary law, then the role of limited cooperation during World War II and the following years played by the American Government and the American oil companies -- each subject to her own respective interests -- set precedents later inculcated into the international legal regime.

The German invasion of Poland signalled a sudden shift in the American regulatory policy from peacetime production limitation to wartime production maximization. Both government and industry were united in this goal throughout World War II as they had been in World War I. Although the industry-government experience of cooperation in the First World War was recalled as a precedent, the unheralded demands for oil proposed new pressing problems.

Between December 1941 and August 1945 Allied requirements totalled 7 billion barrels of crude petroleum, of which the United States provided 80 percent. The logistics of transportation in the equitable distribution of oil also presented tremendous conflicts to be solved.

More efficient technology for drilling and exploiting new wells was suddenly a top priority again. But by grants of subsidies and favorable tax provisions, and by shrewd allocation of scarce machinery and drilling supplies, federal and state authorities were able to boost the nation's total oil output. Once again the maximum efficiency of government-industry cooperation -- achievable only through wartime emergency measures -- was in operation.

The shift in demand was reflected in new configurations of quasi-diplomatic alliances most vividly evidenced in the hitherto unlikely alliance of Secretary of Interior Ickes and the integrated companies. The major conflicts, then, centered on the degree and method of government-industry cooperation, and the long-term implications of the consequences.

Examples of these conflicts include the financing and regulation of pipelines, sovereignty over the tidelands and offshore drilling rights, and the oil companies' demands for a share of the mid-East market reflective of America's new post-war economic and military strength.

Only a few months after the outbreak of hostilities in Europe, German submarines had effectively disrupted Allied tanker traffic in the Atlantic, causing serious fuel oil and gasoline shortages in New England, who received 90 percent of her supply by sea.[1]

On 6 June 1941 Mark Requa's widow wrote Roosevelt to remind him of her husband's World War I experience in mobilizing the Oil Division of the U.S. Fuel Administration. The President asked Congress to enact legislation conferring broad powers to the Secretary of Interior to control production and distribution of oil. However, private pipeline operators feared Ickes' proposal for a national pipeline. Meanwhile, eleven major companies formed a National Defense Pipelines and Emergency Pipelines Corporation to finance a privately-owned system.

With no cooperation from Congress, Roosevelt evolked his executive powers to delegate authority in oil matters to Ickes.[2] Ickes -- through Presidential order -- now had the authority to establish voluntary rationing and arrange temporary transportation. In December 1940 Ickes warned Roosevelt that government-financed construction of a New England pipeline was necessary. Yet, Congress still was wary of granting Ickes such powers and stalled indefinitely on the issue.[3]

Finally, the House Committee on Interstate and Foreign Commerce initiated -- at Presidential instigation -- an investigation of the entire Southeastern oil transportation system.[4]

On 28 May 1941 the loan of fifty American tankers to the British under Roosevelt's Lend-Lease plan further reduced supply to the Northeast by 250,000 barrels a day. The need for new pipelines was obvious; however, the building of private pipelines was stymied in some states over rights-of-way. When the Georgia Senate refused to offend railways and railroad unions by granting rights-of-way to pipeline companies -- despite Roosevelt's personal endorsement of the bill -- deferring to federal legislation. Thus, in May 1941 Roosevelt turned to Congressman Sam Rayburn for federal legislation solving the rights-of-way issue.

The antitrust issue also needed to be resolved. Based on Mark Requa's World War I experience, Ickes planned for close government-industry cooperation. In early June 1941 Ickes asked Attorney-General Francis Biddle to suspend antitrust suits during the defense emergency.

However, it took a lively correspondence with Ickes -- and then only after White House pressure -- did Attorney-General Biddle acquiese on the antitrust issue.[5]

Next, Roosevelt appointed Ickes as Petroleum Coordinator for National Defense (PCND) which gave him federal advisory committees, and to coordinate petroleum policies of various federal agencies.[6] As usual, Ickes was widely criticized; he was accused by The Nation and other liberal critics of packing his committees with executives, to which Ickes replied that he selected the best man available regardless of their affiliations.[7]

Ickes, thinking it would increase domestic supplies if oil exports were curtailed, ordered Secretary of State Cordell Hull and Administrator of Export Controls Russel Maxwell to stop American oil exports to Japan, and in so doing infuriated both Hull and Maxwell. President Roosevelt himself wrote Ickes that only he himself and the Secretary of State had the power to suspend exports and that this was primarily a matter of foreign policy over which the Department of Interior had no jurisdiction.[8] At the same time, Ickes asked major oil companies to run a campaign urging voluntary reduction of public consumption; failing this the companies were urged to increase tanker loads and scheduled sailings.[9] The major companies had embarked dutifully on publicity to reduce public consumption (as directed by Ickes), but the effort was to no avail.

However, the companies objected to Ickes' other directive to utilize railway tank cars for two reasons: (1) transport by rail cost ten times that by sea; and (2) reliance on rail carriers implied construction of new and expensive facilities, since all existing facilities were geared to water transport. Anticipating these objections, Ickes acquired "special case" dispensation for the petroleum industry from Interstate Commerce Commission Chairman Joseph P. Eastman regarding lower freight rates and from the Department of Justice regarding antitrust in relation to pooling reserves and shipments and to sharing increased transportation costs. The Petroleum Industry War Council (PIWC) and the Association of American Railroads worked out details which increased New England's supply by 142,000 barrels a day -- a thirty-fold increase of shipments by rail.[10]

Finally, by the end of July, Congress enacted the Cole Bill which contained the authority to grant rights-of-way to private pipeline companies engaged in construction vital to national defense. By mid-1941 German sinkings of Allied tankers in the Atlantic portended the need for a long-term solution to the supply problem. At a conference called by Ickes of leading pipeline operators in Tulsa, Okla., 23 March 1942, a detailed plan of construction for a pipeline to be privately financed was drawn up, but it still would not meet New England's needs.

Ickes began campaigning for construction of the Big and Little Inch Pipelines to the Northeast as the most feasible alternatives to seagoing tankers. Due to the wartime scarcity of railway cars and tanker trucks, transport by rail and trucks was eliminated as a viable solution.[11] By June 1942 Ickes begged the House Committee on Interstate and Foreign Commerce for steel allocations vital to the construction of the Big Inch. Although the Petroleum War Industries Committee (PWIC) strongly supported the Big Inch Project, Donald Nelson of the War Production Board (WPB) and the Supply Priorities and Allocations Board refused requests from Ickes for necessary building materials on three separate occasions. He finally relented after worsening shortages in fall 1942.[12] Thus, amid much controversy, the Big and Little Inch Pipelines were constructed at the expense of the Defense Plant Corporation: together they supplied 800,000 barrels of crude to the Northeast from Texas between 1943-1945.[13]

In July 1942 President Roosevelt agreed to let Ickes draw up tentative plans for the consolidation of forty separate federal agencies concerned with oil which were circulated among Cabinet members and industry leaders. Under the plan, Ickes would secure centralized controls over: (1) oil production; (2) domestic and foreign oil distribution; (3) oil prices; and (4) scarce war materials needed for drilling and manufacturing equipment.[14] The Cabinet responded in unanimous opposition: Stimson, Hull, and Knox were particularly infuriated over Ickes' infringements over their departments, as was Donald Nelson, director of the WPG.[15] Industry leaders could not agree: Senator Henry Cabot Lodge introduced a bill on 19 August 1942 to create a National Petroleum Administrator; Senator Harry Byrd (Va.) urged national gasoline rationing;[16] and Deputy Administrator Davies was distressed over public apathy in practicing conservation.[17]

In a series of conferences between August and December 1942 Ickes was directed by Roosevelt to work out a suitable compromise between industry leaders, cabinet members and agency administrators. The result was the creation of the Petroleum Administration for War (PAW) by executive order, giving Ickes, as administrator, autority to develop necessary policies to increase production by fostering improved conservation practices, encouraging drilling, or changing consumption patterns. The WPB retained control over the allocation of scarce resources, and the office of price administration (OPA) retained the power to regulate prices for petroleum products.[18]

The PAW sought to procure allocations from the WPB for scarce oil exploration tools and machinery. The discovery of wildcat and stripper wells was encouraged by publicizing potential locations and offering financial incentives for their exploitation.[19] Unitization agreements and secondary recovery methods were enforced by the PAW's distribution of scarce machinery.[20] Ickes finally succumbed to subsidies as a means of encouraging production instead of higher prices. The RFC at PAW prodding, ammended long-term contracts for 100-octane gasoline; it also encouraged the development of a major new synthetic rubber industry by an RFC subsidiary, the Rubber Reserve Corporation.[21]

Despite a 25 percent increase in drilling in 1942, only four new big producing wells had been discovered. Five industry committees representing the geographical divisions made by the PAW began planning construction of new facilities for large scale production of 100-octane gasoline using Ickes' 1941 survey.[22]

Oklahoma ammended its unitization laws in 1943 at Ickes' instigation; Texas passed a resolution in 1943 urging the OPA to raise prices; and O. E. Thompson of the Texas Railroad Commission wrote Roosevelt for his support in raising prices.[23] The API strongly supported Ickes' attempts to raise prices while Representative Disney introduced a bill to raise oil price ceilings.

However, the OPA steadfastly refused to authorize a price hike, deferring to a Presidential order to maintain the status quo on prices, suggesting subsidies as an alternative. After much heated discussion, James F. Byrnes, director of economic stabilization, authorized the PAW to pay subsidies as a solution to the price conflict on 24 June 1944.[24]

The building of a pipeline to increase availability of supply to New England came to be accepted as a priority by all parties concerned; yet the issue of public versus private funding of that pipeline was hotly disputed, concerning its long-term effect on the market place. As a last resort the industry reluctantly agreed to public financing as the only pragmatic solution to the supply-and-demand problem. Similarly the issue of higher prices for oil was not in question; all factions of the system agreed that higher prices would result in greater production. The conflict lay in the use of subsidies as a temporary war measure as opposed to a government dictated price hike which could bridge the wartime-peacetime operations gap and thereby affect the peacetime market as well. In this instance long-term policy maintained its priority.

The wartime emergency cooperation between American industry and government during World War II had been limited as much as was pragmatic at the time to temporary measures which could be abandoned in peacetime in favor of a return to the pre-war status quo. The industry's fear of direct government involvement, which would shift the advantage of influence over petroleum affairs from the companies to the government, instigated a strong movement to quickly dismantle the war machinery. Unlike the post World War I period, many industry leaders opposed continuation of peacetime counterparts to various emergency commissions for fear of antitrust violations which could conceivably be used against them in a nationalization rationale. Nationalization of oil industries was being utilized by most countries throughout the world as the colonial system ended, and was, therefore, a realistic threat.

Truman, however, in implementing his demobilization program, instructed Secretary of Interior Krug to create some advisory agency to replace PAW in coordinating the petroleum policies of more than thirty federal agencies. This was accomplished by establishing the Oil and Gas Division of the Department of the Interior. (Truman's demobilization program allowed for a relatively smooth transition from war to peace which constrasted most favorably with Woodrow Wilson's post World War I handling of similar problems.) Krug also revitalized the Petroleum Industry War Council, after first checking with Attorney General Tom Clark on the status of such an industry advisory board under antitrust and other municipal laws.

Over the next twenty years, a quiet period existed of re-evaluating existing regulation, making minor adjustments, adding new or more detailed regulation for such issues as secondary drilling, intangible drilling, etc., and considering the possibilities of deregulation.

After the whirlwind years of FDR a relative calm was necessary to reinforce the apparent consensus between government and industry. Committees investigated, made policy suggestions, and recommended legislation, but the end result was satisfaction with the status quo with the noteable exception of three issues -- the tidelands ownership, percentage depletion allowance, and foreign imports.

Harry Truman was primarily concerned with national security and he had hoped to secure direct access to petroleum resources for the federal government, but Congress ruled this out. For similar reasons the President favored retainment of federal title to offshore tidelands. The issue had been debated in Congress since FDR's second Administration when it became technologically possible to tap subsea resources.

The Truman Proclamation, 28 September 1945, stated that the U.S. Government regarded natural resources of the seabed of the continental shelf as federal property. The President vetoed a Congressional resolution surrendering tidelands to the states, and instituted direct legal action to secure explicit recognition of national control. Congress was unable to reach a compromise throughout Truman's Administration over the tidelands issue which had come to the forefront of public opinion.

The controversy over a bill before Congress granting federal tidelands to the states was potentiated by Truman's nomination of Edwin Pauley to be Under-Secreatry of Interior, Ickes, in testimony before the usual Senate hearings on a Presidential nomination, accused Pauley, a prominent California oil operator and treasurer of the Democratic National Committee, of offering a campaign contribution of several hundred thousand dollars to the Democrats if the Justice Department would drop the pending federal suit against California, Texas, and several other states to secure title of the offshore tidelands. This proposal allegedly took place on the Presidential train returning from FDR's funeral. Truman was furious that Ickes had ruined the chances of Senate approval of his nomination, and amidst much publicity Ickes resigned. A few weeks later after it became clear that public opinion had caused the Senate to block the nomination, Truman was forced to withdraw Pauley's name.

Thus, title over the tidelands became a major issue in the 1952 election. With Ike in the White House, Congress quickly passed the Submerged Lands Act of 22 May 1953 which deeded title to the tidelands (within the three mile continental limit) to the states. A few months later on 7 August 1953 Congress enacted the Outer Continental Shelf Act, which designated the area outside the three mile limit as federal property which could be leased by competitive bidding to private enterprises. Thus a political compromise had been worked out giving rise to a unique situation in which the coastal states held title to the first three miles of tidelands and the federal government held title to the outer continental shelf beyond the three mile limit.

The Korean War presented a brief interruption to the relative quiet of the period in which the wartime emergency machinery was quickly installed and operated efficiently according to the precedents established during World Wars I and II, and then almost as quickly dissolved as business returned to its normal peacetime role.

Although Truman's various committees had supported retention of a percentage depletion allowance, he had hoped to at least reduce the percentage from 27.5 percent to 15 percent of gross income. However, despite vociferous support from a minority of Senators including Paul Douglas (Ill.), Hubert Humphrey (Minn.), William Proxmire (Wis.), and John Williams (Del.), Truman failed to achieve the percentage cut. Senator Lyndon B. Johnson (Tx.), in advocating the 27.5 percent figure had expanded the debate to include the needs of national security, promoting the idea of maintaining a reserve supply of 15 percent annual production. Johnson also pointed to the cycle of reduced dividend payments which would lead to the necessity to obtain more outside financing, thus reducing production, and federal tax payments. In short, a reduction in the percentage depletion allowance could undermine the economic stability of the entire nation. Irregardless of the economic arguments for and against the issue, Johnson managed to muster a seventy-one to nine vote defeating Humphrey's amendment to lower the percentage rate of the depletion allowance. The same men rehashed the the same arguments every four years, and each vote retained the status quo by large majorities.

Ike avoided involvement whenever possible and when forced to take action, followed Hoover's model, creating a committee to study the problem and then hoping that Congress, the states, or the companies would take care of the situation, whatever it may be.

Therefore, when the independents cried for import quotas to protect them from the cheap competition, rather than face the political implications -- both domestic and foreign -- Ike created a Cabinet committee to investigate, and then never commented on their proposals. Congress finally took action by passing the Reciprocal Trades Agreement Act of 1955 with a compromise clause giving the President power to impose import quotas if such imports constituted a threat to the national economy or security. Ike preferred to rely on industry cooperation to limit imports voluntarily, which, in accordance with precedents, were about as effective as they had been under Hoover.

By 1959, after delaying as long as possible, Eisenhower was literally forced to use his powers to license oil imports and establish quotas.

During the 1960s such pressing problems as domestic unrest and Vietnam preoccupied all levels of government while the oil companies began to investigate the potentialities of Alaska.

Concurrent with these domestic developments was the expansion of the American oil companies in the Middle East, where wartime government-industry cooperation was utilized to assure their position. Yet the industry remained adamant that the nature of this cooperation remain temporary: a war emergency measure -- not a permanent union.

Market entry into the Middle East and the method of that entry became the key issues. While both American industry and government agreed on the former -- indeed, cooperated toward achievement of the goal, the latter became the point of conflict. British industry and government presented a united negative front to both issues, hoping to maintain status quo in this area, until the shift in world political leadership from Great Britain to the U.S. made compromise the only remaining viable option -- in effect, negating the Red Line Agreement which had served well since 1928.

Although the Red Line Agreement had allowed American entrants to purchase the Persian Gulf concessions on the Island of Barhein, it took direct State Department intervention to convince the British Foreign Office that Standard Oil of California (SOCAL) should be permitted to operate the Bahrein Concession without political interference. When SOCAL first raised the problem, the State Department instructed the charge d'affairs in London to approach the British Government on the subject.

> You are desired by the Department to discuss this case informally at an early date with the appropriate authorities of the British Government. You should point out in your conversation that existing legislation is extremely liberal in the United States; and you should add that the Department of State would be glad to obtain a statement of the British Government's policy respecting the holding and operating by foreigners of petroleum concessions in territories such as Bahrein.[25]

Throughout the 1930s the consortium of American major oil companies (ARAMCO) was unable to convince President Roosevelt of the tactical importance of Saudi Arabia.

In his attempt to conserve American domestic reserves, Ickes in December 1941 appointed nine major executives to the Foreign Oil Committee to investigate the feasibility of foreign oil imports. He maintained contact with the petroleum representatives of the U.K. and the Netherlands who were stationed in Washington, and he secured the appointment of a petroleum attache in London. Between 1941 and 1943 Ickes also continually urged Roosevelt to establish U.S. Government-owned producing and refining facilities in Mexico.[26] Cordell Hull, Donald Nelson, and others objected to Ickes' plan which could have embroiled the U.S. in the nationalization of Mexican oil. Instead, attention was focused on the Middle East.[27]

Roosevelt, although sympathetic to the needs of both ARAMCO and Saudi Arabia, informed the cartel that direct aid would be in violation of Lend Lease. The U.S. Congress had passed the Lend-Lease Act 11 March 1941 to enable "the government of any country whose defense the President deems vital to the defense of the United States" to obtain raw materials in the United States without cash payment. The bill was designed to continue supplying Great Britain with aircraft, guns, and munitions, as set out in the Atlantic Charter between Roosevelt and Churchill, although Britain had exhausted her dollar resources (including all British private investments in the United States which had been taken over by the British government and paid for in sterling), and could no longer afford to pay for the supplies she so desperately needed.[28]

The Roosevelt Administration insisted that primary responsibility for Saudi Arabia belonged to Great Britain in her role as the most dominant influence in the Middle East. As war drew closer the

Administration realized Saudi Arabia's immense strategic value. FDR contived a bazaar solution: Britain could divert part of her $400 million of U.S. Lend Lease to King Saud, which she did between 1941 and 1943 totalling almost $34 million.[29]

Not until the devastating effects of World War II when King Saud's revenues plummeted and he asked ARAMCO for aid, was Saudi Arabia's position recognized as strategic to the U.S. Government. By June 1941 Ibn Saud approached Washington directly, asking for $10 million.

As a result of ARAMCO's pressure, the State Department, in the Rogers' Memorandum, emphasized the great importance of the ARAMCO concession in the American long-range petroleum needs.

In 1941 ARAMCO was asked by King Saud for $6 million; unable to supply the amount, ARAMCO referred the problem to the American Government, calling for direct Lend Lease to King Saud. ARAMCO perceived the U.K. Government as attempting to consolidate her gains in Saudi Arabia by portraying herself as the real benefactor, while in reality, she was merely acting as a conduit of U.S. assistance throug the mirrage of Lend Lease -- a result of the American joint venture's own lobbying to get assistance for her interests in Saudi Arabia. ARAMCO feared this deception might eventually jeopardize her future role in the concession, and called for direct Lend Lease to King Saud as the only way to keep the Arabian Concession out of British hands.

> The officials of both the Standard Oil of California and the Texas Company are much disturbed about the future security of their concession not only because of the normal insecurity in Arabia but also because they feel that the British may be able to lead either Ibn Saud or his successors to diddle them out of the concession and the British into it. American experts on Saudia Arabia are inclined to agree with this estimate of the situation. They point out that the Anglo-Iranian Oil Company had every opportunity to get this concession and, after examination, rejected it on the ground that there was no oil

> in Saudia Arabia -- and have been regarding the concession with covetous eyes ever since the Americans struck oil. The recent British move to set up a bank of issue for Ibn Saud, and the more recent act of the British Charge d'Affaires in Jeddah -- who just after our minister, Mr. Kirk, had visited Ibn Saud, and promised him Lend-Lease aid, informed Ibn Saud that he could get further American Lend-Lease only by applying to the British authorities either in Jeddah or London -- seem to indicate a desire to strengthen British influence, in a manner not quite healthy for the oil concession.[30]

In February 1943 Roosevelt, after increasing pressure from the American oilmen,[31] gave the go-ahead to the Lend Lease Administrator: "... in order to enable you to arrange Lend Lease aid to the Government of Saudi Arabia, I hereby find that the defense of Saudi Arabia is vital to the defense of the United States."[32] The Saudis received $99 million from Lend Lease either directly or indirectly which bolstered ARAMCO's stature in Saudi Arabia; however, access to Persian crude was still controlled by Britain.

In 1943 the U.K. -- through British Petroleum -- controlled 81 percent of all Middle East oil production, compared to 14 percent American control; this same dominance was exhibited in refinery capacity and other down-stream activities.

Roosevelt avoided wartime projects which could conceivably benefit the British position regarding Persian Gulf oil, and helped to increase production in Saudi Arabia by supplying American companies with scarce construction materials.

> A successful attempt to arrange for maximum possible withdrawals of petroleum for use from British-owned reserves would probably be quite adverse to American interests, because it would entail building up British-controlled refining facilities beyond the present proportions. These are already much greater than the American-controlled refining facilities in the Middle East, with the result that American-held concessions are jeopardized by the dissatisfaction of the proprietary governments with the relatively small amount of oil production (and resulting revenue realized by these governments)

from American-operated concessions, as compared to British-operated concessions.[33]

By mid-1943 many industry leaders, as well as government officials, feared an oil shortage.[34]

On 14 July 1943 President Roosevelt called a Cabinet conference to plan U.S. global oil policy.[35] A systematic analysis of the major companies' position was published entitled "A Foreign Oil Policy for the United States." Briefly, it recommended that the government should not enter into competition with domestic oil interests. But instead, the government should act in coordination with the companies in securing concessions, especially when in competition with British houses. This policy was an early successful attempt of the companies to have a dual system of laws; i.e., that they should be exempt from antitrust laws if their foreign competitive position vis-a-vis alien multinational was at stake, and that the government would not participate directly or indirectly in the ownership of overseas oil operations.[36]

On 8 June 1943 the Joint Chiefs of Staff reported their alarm to the President over the dangerous depletion of domestic reserves, suggesting foreign exploitation. On 12 June 1943 James F. Byrnes, Office of War Mobilization Director, presided over a White House meeting at which Stimson, Knox, Ickes, and Herbert Feis agreed that the federal government itself must acquire new oil reserves. For ten days an interdepartmental committee representing the Departments of War, State, Navy, and Interior worked out plans for the proposed Petroleum Reserves Corporation (PRC) -- first suggested by Ickes -- which was approved and established by 30 June 1943.[37] The idea failed to gain widespread acceptance even among government agencies. By December 1943 the PWC itself went on record protesting the PRC and established its own committee to outline a foreign oil policy.[38]

In line with his previous attempts to involve government in industry, Ickes advocated federal exploitation of Saudi oil reserves by creating a Petroleum Reserves Corporation -- under the RFC -- which would acquire and develop foreign oil reserves. He detailed functions of his proposed government corporation which included conserving domestic oil and counteracting British influence. With Cabinet agreement the RFC created the Petroleum Reserves Corporation which lost no time in trying to buy all of ARAMCO's lucrative Saudi properties. Opposition to joint private and public exploitation of Arabian oil reserves was not limited to the major oil firms: the Foreign Oil Committee of PAW omitted any mention of direct government involvement in its Proposal for a Foreign Oil Policy. Despite the growing negative feelings, the PRC sent an exploratory mission to Saudi Arabia in November 1943, composed of E. L. Degolier, a well-known geologist; W. E. Wirtner, Director of the U.S. Geological Survey; and C. S. Snodgrass, Director of the Foreign Refining Division of the PAW; whose report in January 1944 confirmed that the center of global oil production had shifted to the Middle East. The PRC then proposed a joint venture with Gulf and ARAMCO.

Collier and Rodgers of ARAMCO furiously refused Ickes initial bid for the PRC to buy their Saudi properties. Ickes' next proposal was government stock acquisition of 70 percent, or 50 percent, or even a mere 33.3 percent. Negotiations broke off in October 1944 after Rommel's threat to Mid-East oil supply routes had diminished somewhat.[39] To emphasize her objection to federal involvement in foreign oil, the

API adopted a resolution condemning it: Ickes had spoken at the annual meeting in defense of the PRC.

Meanwhile Admiral Andrew Carter, Petroleum Administrator of the U.S. Navy, proposed a U.S.-built pipeline from the Saudi oilfields to the Eastern Mediterranean Coast. By February 1944 the PWC advocated the PRC's abolition. By 6 February 1944, after Admiral Carter's call for a government-owned pipeline, Gulf and ARAMCO signed an agreement with the PRC to build and operate such a pipeline. Under the agreement ARAMCO was to build a privately owned and operated refinery at Bahrein to Produce oil for the U.S. The companies were to repay the $160 million cost to the government who would retain ownership; the U.S. would be entitled to buy one billion barrels of crude from the companies' reserves at a 25 percent discount of the American market price.[40]

Emphasizing the necessity to conserve rapidly depleting domestic reserves, the strategic importance of Middle East oil not only to the war effort but also to future U.S. national security, the importance of U.S. Government support for private American investments abroad, and the potential profitability of the pipeline, the President, Ickes, Knox, and the Joint Chiefs of Staff strongly supported the PRC-Gulf-ARAMCO Agreement.[41] Opposition to the Agreement was strong: Senator E. H. Moore (Okla.) called the pipeline imperialistic and demanded a review of U.S. oil policy; the PIWC again condemned it as did the Independent Petroleum Association President Ralph T. Zook who feared the collapse of domestic operators because of cheap foreign competition; and the Truman Committee urged a U.S. policy stressing private enterprise.[42]

When it became evident that implementation of the U.S. Government's joint venture in the Middle East would cause serious rifts in the

U.S.-British alliance as well as in the government's relations with the American majors, ARAMCO began construction of the pipeline on her own and the American Government never said a word.[43] The PWC began pushing for a formal commitment on the part of the federal government to extend diplomatic support to American oil interests wherever needed. President Roosevelt in response to the demand for diplomatic intervention on behalf of industry interests, and in attempt to reconcile British and American Governmental policy on the issue, called an Anglo-American Conference on the matter.

Hull and Ickes served as Chairman and Vice-Chairman, respectively, of the Anglo-American Conference with ten important oil executives -- appointed by the State Department -- as advisors. Charles Bryner, the State Department's Petroleum Advisor, began technical discussions with British representatives, led by Sir William Brown.[44] In essence, the U.S. was asking the Government of Britain to relinquish her exercise of colonial prerogatives which prevented American oil companies from competing on an equal basis with the empire.

Prime Minister Churchill cabled President Roosevelt that Britain was worried over American attempts to oust the British from Saudi Arabia, and agreed to begin discussions on Roosevelt's proposed treaty. Members of Parliament were particularly critical, not having been previously consulted, and feared that the U.S. was trying to force the hand of the British Government. Even Foreign Minister Anthony Eden was forced to confess that he had received no formal notice of any related meetings by April 1944. It was not until after it became clear that ARAMCO -- without government assistance -- would build the Bahrein

Pipeline that Lord Beaverbrook added Cabinet-level prestige to the Washington delegation.[45]

On 8 August 1944 after difficult negotiations,[46] a vaguely worded Anglo-American Agreement was initialed.

> We go on record against the tying of hands and the closing of doors which have cramped the normal operation of trade in the past .... There will be no more nobbling of American nationals with such devices as the Red Line Agreement. This Red Line Agreement ... was the price that American companies had to pay in order to participate in the development of the Iraq fields. It provided ... that no participating company would go after oil within a territory roughly comprising the Old Ottoman Empire. Or, if any such company did go in there and find oil, then it had to share the concession with the certain favored others. Now, whatever else this Red Line Agreement may be, it certainly is not competitive. I say, therefore, that there is no place for it in the new scheme of things which our Anglo-American oil treaty contemplates. Neither is there a place for a certain type of marketing restriction ... in which a company promises -- as the price of a concession -- that it will not market in places which another company has staked out as its own. I mention these as just a couple of cartel practices which we hope, and expect, to consign to oblivion through the operation of the Anglo-American Agreement.[47]

This Agreement went to the U.S. Senate as a treaty, but action was never taken, due in part to heavy political pressure against it from the American petroleum industry. The treaty was renegotiated,[48] revised,[49] and resubmitted by President Truman in 1947 -- this time with the backing of the PIWC and the API -- but Texas producers, with Senator Tom Connally and Speaker Sam Rayburn as their representatives, stalled again and the treaty was never ratified.[50]

The Anglo-American Conference from its inception angered those executives not consulted in the treaty's preparation like J. Howard Pew of Sun Oil. Others feared the creation of a cartel. James Moffet, among others, saw the agreement as a first step toward nationalization of the American industry. Senator Tom Connally of Texas, Chairman of the

Senate Committee on Foreign Relations, spoke for many independent producers in voicing his fear that large-scale imports of foreign petroleum would seriously depress the American market.

An example of one of the more controversial aspects of the agreement was an international petroleum commission, whose function was:

> ... to analyze such short-term problems of joint interest as may arise in connection with production, processing transportation, and disposition of petroleum on a world-wide basis, wherever the nationals of either country have a significant interest, and to recommend to both governments such action as may appear appropriate.[51]

During World War II both the U.K. - U.S. Government relationship and the U.K. - U.S. industry relationship were strained. Although strong political allies, the Americans challenged British economic authority in the Middle East regarding oil. It was that part of American policy -- led by Ickes -- that attempted to gain governmental entry into the petroleum market which alienated the other participants and caused them to unite in the prevention of it. When confronted with such a formidable mutual competitor as the United States Government, BP and the American majors quickly and quietly began to look for alternatives in correcting the apparent regulatory failure of the Red Line Agreement -- now inefficient as a voluntary regulation of the global oligopoly.

As has been shown, the end of World War II created considerable alteration in the balance of power between Great Britain and the United States, not only politically and militarily, but also commercially: The American majors expanded their presence in the Middle East as well as in the European and Japanese markets. The primary factor restricting

American expansion was the Red Line Agreement, the legal negation of which was actively sought by Exxon and Mobil.

The companies' legal framework came from three English barristers who advised the two majors that the Red Line Agreement had been terminated on the technicality that two of their partners in the Iraq Petroleum Co. -- Compagnie Francaise de Petrole and Gulbenkian -- had become "enemies" as a result of Hitler's occupation of France.

Mobile Vice-President Harrold Sheets informally raised the subject with State Department petroleum advisor Charles Rayner before notifying the Department officially that they would leave for England to invite their European partners to formulate a new agreement, enabling them to keep their existing arrangements in Iraq while eliminating the provisions that would obligate them to share their new participation with ARAMCO.

> I took Charlie Rayner into my confidence Thursday P.M., June 27th. C.R. came to my apartment in New York, spent the evening with me, and I disclosed to him the nature, extent and present status of our negotiations with ARAMCO, with particular emphasis on the Red Line problem .... I urged Rayner to get Byrne's and Acheson's support for asking British Government to join with U.S.A. in bringing about the elimination of the Red Line restrictions and Kuwait restrictions as soon as possible. The British and Americans should be mutually interest in cleaning up, as between themselves, any unpleasant situations such as those resulting from the restraint of international trade resulting from Red Line and Kuwait agreements.[52]

Having obtained State Department approval,[53] Mobil and Exxon undertook to enlist support for their scheme from BP and Shell.

The English were rather uneasy at the prospect of changing the structure of their relationship with the two American majors.

> Sir William [Fraser, BP's chief executive officer], ... considered the maintenance of the Agreement ... important under [the day's] political conditions when the dangers of government intervention were so great -- so much so that if he couldn't <u>secure</u> a revised Group Agreement with his partners,

> he personally would be prepared to carry on with the old one rather than rock the boat, as he felt that the undisturbed continuity of the partnership was infinitely more important as a defense against the governmental and other international dangers which might otherwise threaten us than anything else.[54]

Like BP, Royal Dutch Shell was apprehensive: She feared that the French and Gulbenkian would "drag the ugly question into the public arena" -- an eventuality which all parties wished to avoid.

Not by coincidence, Shell and BP received similar legal counsel to the Americans regarding the technical invalidity of the Red Line Agreement. British Petroleum was reluctant, however, to change her position on the agreement until Exxon and Mobil consented to purchase large volumes of crude from BP's concession in either Iran or Kuwait for a twenty-year span at BP's option.

It seems paradoxical that the American companies insisted that U.S. antitrust would prohibit them from signing a new IPC agreement containing many of the old restrictions, although they could and did sign the long-term supply contracts with BP, specifying marketing restrictions.[55]

The State Department welcomed the long-term arrangements made between the British and American companies, announcing that the companies had informed them in advance.

The political stability of the early post-war period in the Middle East soon gave way to grave instability arising from the growth of nationalist feeling, the decline of Britain's influence, and the conflict over the establishment of Israel. There had been little interference either from the countries in which production happened to be concentrated or from consuming countries, most of which used oil simply as a fuel to supplement the indigenous coal or hydroelectricity on which most of them then depended. The international companies, moreover, effectively organized their activities around the world behind the guarantee of security offered by the political and/or military presences of the United States and the United Kingdom, which between them provided the home base for six and a half of the Seven Sisters (with the remaining half -- the Royal Dutch part of Shell -- domiciled in the Netherlands).

> Instability in this apparently stable system, however, first appeared, paradoxically, when the United States took action to ensure that its tough domestic line against cartels and monopolies, through the medium of its anti-trust legislation, also affected the foreign operations of American companies. This action, moreover, more or less coincided with another which further undermined the traditional organization of the oil industry by the oil companies. This was the insistence by the administrators of the Marshall Plan that the oil companies would cease to charge for the oil they sold to Europe (which was to be paid for out of Marshall Plan Funds) as though it came out of expensive fields in the United States and as though it were transported from the Gulf of Mexico. Thus, a posted price system orientated towards non-U.S. points of oil production and freight rates related to actual, rather than to hypothetical, movements of oil around the world was introduced.[56]

This in conjunction with the inevitable rise of nationalism on the part of host countries forced the oil companies to restrict their production and development efforts, or pursue measures which made it impossible for the companies to continue to operate as they had been.

The nature of concessions changed dramatically. Pre-World War II concessions

> ... were specially negotiated, covered large areas, were of very long duration, and vested the development of a country's oil resources in one or a few oil companies with established marketing organizations. Concessionaires were given wide latitude to explore for, develop, produce, and market petroleum, in return for these privileges, the companies paid royalties and taxes to the host governments.[57]

After World War II, however, these conditions no longer existed:

> General petroleum laws were enacted by most countries to renegotiate the terms of all exploration and development

> concessions: Areas conceded to any one firm were sharply limited to both in space and in time. The duration of new concessions was reduced and local partners were often required.[58]

Consequently, the number of concessionaires rose in nearly every oil-producing country.

Under these general petroleum laws, separate grants of rights to oil companies were often required for the successive stages of operation: (1) a reconnaissance permit authorized preliminary exploration, often on a non-exclusive basis; (2) an exploration license limited exploration rights to a defined area; and (3) a development lease granted the privilege to develop all or part of an area previously explored, with the state retaining either a percentage of the area or "checker-boarded" blocks of land within the area.

In addition, the holder of the concession was frequently obligated to fulfill one or more of the following requirements: to refine specified amounts of crude oil domestically; to deliver to a government company a pro rata share of oil for domestic consumption; to acquire local partners; to begin operation within a specified number of months and to expend specified amounts; or to cooperate in unitized development.

In order to further encourage a larger number of firms to participate in the rapid development of a country's resources, and thereby speed the flow of revenues to the public treasury, maximum limits were set for areas granted to foreign concessionaires.

> Relinquishment of concession areas to the state has been pressed even beyond the requirements of law. Thus government pressure caused 'voluntary' relinquishments of half the entire area of their Kuwait concession by Gulf and BP, one-third of the Quatar concession by the IPC group, and three-quarters of ARAMCO's original concession in Saudi Arabia.[59]

American municipal developments during and immediately after World War II exemplify the limited cooperation for a common goal between entities who stubbornly retain their sectional interests. The precedents set in dealing with the issues of public versus private financing of pipelines, sovereignty over offshore activities, and the development of a foreign policy to accommodate the newly emerging geographic and economic post World War II realities, are still being applied today in the formulation of international customary law.

While these entities -- the American Government and the American petroleum industry -- may not both hold full international personality, and therefore their resulting cooperative efforts may lack the status of international customary laws, these municipal developments do ultimately effect international customary law.

Notes to Chapter 7

[1]FDR to William P. Cole, 4, 26 March and 29 November 1940; William P. Cole to FDR, 7 March 1945, Harold Ickes to FDR, 1 August 1940, in FDR Mss.

[2]FDR to Mrs. Mark Requa, 6 June 1941, in FDR Mss.

[3]U.S., Congress, House, Committee on Interstate and Foreign Commerce, Hearings Before Subcommittee on H.R. 7372 and H. Resolution 290, 5 Vols., 76th Cong., 1st Sess., 6, 7 December 1940.

[4]FDR to H.C. Lea [Chairman, House Committee on Interstate Commerce], 23 January 1941, FDR to William P. Cole, 22 March 1941, FDR to Dawson Kea, 12 May 1941, in D.I. Records; New York Times, 12 January, 7 February, 20, 28 March, 21 May, 1, 6 June 1941.

[5]Robert H. Jackson to Ickes, 3 June 1941, Ickes to Attorney General Robert H. Jackson, 16 June 1941, Francis Biddle to Ickes, 18 June 1941, in D.I. Records; Rosenman Memo for FDR, 14 March 1942, in FDR Mss. outlines the President's position in giving priority to the war effort before antitrust prosecutions.

[6]New York Times, 29 May, 1, 3 June 1941; FDR to Ickes, 28 May 1941, in D.I. Records.

[7]New York Times, 10, 15 June 1941; FDR to H.D. Collier, 4 June 1941, in D.I. Records, Ickes to FDR, 4 June 1941, in FDR Mss.; For details of Ickes defense, see Ickes to editors of The Nation, 11 October 1941, in D.I. Records; New York Times, 30 November 1941; Oil and Gas Journal, 18 December 1941.

[8]Ickes to Cordell Hull, 11 June 1941, Ickes to General Russell Maxwell, 11 June 1941, FDR to Ickes, 18 June 1941, Ickes to FDR, 20 June 1941, Sumner Welles to FDR, 24 June 1941, FDR to Ickes, 25 June 1941, in FDR Mss.

[9]New York Times, 30 January, 31 July 1942; Harold L. Ickes, Fightin' Oil (New York, 1943); Ickes, Secret Diary, 3: 529-531; Ickes to Sinclair Oil Co., 24 June 1941, in U.S., Petroleum Administration for War, Records of the Petroleum Administration for War, (hereafter cited as PAW Records), National Archives, Washington, D.C.; Ickes sent similar letters to other oil companies.

[10]J.S. Grover, "15 Hours Ahead of Schedule: How Railroads Rush Oil Across the Continent," Nation's Business, November 1942, pp. 30-32; "Wartime Revolution in Oil Transportation," Business Week, 17 April 1943, p. 57.

[11]Ickes to Smith W. Brookhart, 27 June 1941, in D.I. Records; New York Times, 23 July 1941; Harold Williamson 2: 763-766.

[12]Ickes to Donald M. Nelson, 20 February 1942, Ickes to Carl Vinson, 20 April 1942, Ickes to FDR, 21 April 1942, Ickes to Donald M. Nelson, 25 May and 29 September 1942, in D.I. Records.

[13]For a good summary on these pipelines, with bibliography, see F.B. Dow, "The Role of Petroleum Pipelines in the War," Annals of the American Academy of Political and Social Science, November 1943, 230: 93-100; "Oil Rechannelled: Vast New Pipeline Pattern Evolved by Industry," Business Week, 9 May 1942, pp. 17-18. New York Times, 12 June 19 July, 29 October 1942.

[14]Ickes to Donald M. Nelson, 2 July 1942, Ickes to FDR, 19 August 1942, in D.I. Records; Ickes to FDR, 19 September 1942, Harold Smith memo for FDR, 1 October 1942, in FDR Mss.

[15]Harold D. Smith to FDR, 22 October 1942, Ickes to FDR, 18 November 1942, in FDR Mss.

[16]New York Times, 9, 14, 16 August 1942.

[17]New York Times, 18 February, 6 March, 11 May, 12 June 1942; Oil and Gas Journal, 28 January 1943.

[18]New York Times, 3, 6 December 1942; Oil and Gas Journal, 17 September 1942.

[19]John W. Frey and H. Chandler Ide, History of Petroleum Administration for War, (Washington: 1946), pp. 177-187.

[20]Frey and Ide, pp. 162-168, 178-189.

[21]Frey and Ide, pp. 191-226.

[22]Ickes to FDR, 19 January 1942, Ickes to Donald M. Nelson, 6 March 1942, Ickes to FDR, 19 January 1942, in FDR Mss.

[23]Ickes to Oklahoma Corporation Commission, 27 February 1942, in D.I. Records; Oil and Gas Journal, 11 December 1941. E.O. Thompson to FDR, 16 February 1943, M.H. McIntire to E.O. Thompson, 22 February 1943, in FDR Mss.

[24]Ickes to FDR, 7 April 1943, FDR Memo for Prentice Brown, 8 April 1943, FDR to Ickes, 15 April 1943, Prentice Brown to Ickes, 15 April 1943, Fred Vinson to FDR, 29 October 1943, Jesse Jones to Fred Vinson, 22 June 1944, Jesse Jones to H. A. Mulligan, 29 June 1944, FDR Memo for James F. Byrnes, 30 June 1944, Copy of Vinson's decision in FDR Mss.; Ickes to Prentice Brown, 10 June and 16 August 1943, Ickes to James F. Byrnes, 14 August and 25 October 1943, Ickes to Fred Vinson, 9 August and 4 November 1943, 18 March and 25 May 1944 in D.I. Records; New York Times, 4, 6 March, 6, 13, 23, 28 August, 24, 30 October 1943; Oil and Gas Journal, 1 July, 4 November, 9 December 1943; U.S., Congress, Congressional Record, 78th Cong., 1st Sess., 7 June 1943, p. 5455, 7 July 1943, pp. 7412 - 13, 15 November 1943, p. 9527.

[25]MNC Hearings, Part 8.

[26]Frey and Ide, pp. 250-274; Ickes to FDR, 3 December 1941, 28 February 1942, 17 April 1942, FDR to Ickes, 4 May 1942, in D.I. Records.

[27]Ickes to Cordell Hull, 24 June 1941, 4 August 1942, Ickes to H.D. Collier [President, Standard Oil of California], 27 June 1941, Ickes to Frank Knox, 30 June 1941, in D.I. Records; James F. Byrnes Memo for FDR [on foreign oil situation], 4 October 1943, Ickes to FDR, 9 July 1941, 4 February 1944, in FDR Mss.

[28]See Goldwin Smith, A History of England, (New York: Charles Scribner's Sons, 1957), p. 774.

[29]MNC Hearings, Part 7, p. 81.

[30]U.S., Congress, Senate, Committee on Foreign Relations, Sub-committee on Multinational Corporation; A Documentary History of the Petroleum Reserves Corporation, A Sub-committee Print [hereafter cited as MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943 - 44], 93rd Cong., 2nd Sess., pp. 4-5.

[31]New York Times, 7 February 1943; Oil and Gas Journal, 14 October 1943; U.S., Senate, Special Committee Investigating the National Defense Program, Hearings, Petroleum Arrangements with Saudi Arabia [hereafter cited as Saudi Hearings] 80th Cong., 1st Sess., (Washington, 1948), Part 41, p. 25232; Benjamin Shwadran, The Middle East, Oil and the Great Powers (New York, 1955), pp. 308-312.

[32]MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943-44, p. 5.

[33]From MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943-44, p. 60.

[34]Saudi Hearings, Part 24, p. 861; U.S., Congress, Congressional Record, Sess. (28 April 1948), P. 4948; Shwadran, p. 310; Cordell Hull to FDR, 30 March 1943, in FDR Mass.; Cordell Hull, The Memoirs of Cordell Hull, 2 Vols., (New York, 1948), 2: 1511-12.

[35]New York Times, 11, 15, 29 July 1943.

[36]See MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943-44, p. 60.

[37]Saudi Hearings, Part 25, pp. 237-238; U.S., Congress, Congressional Record, 80th Cong., 1st Sess. (28 April 1948), pp. 4961-62; FDR to Ickes, 30 July 1943, in FDR Mss.; PRC Charter in Records of the Petroleum Reserves Corporation in National Archives, Washington, D.C.; Federal Register, 2 July 1943, p. 9044; New York Times, 2 July 1943; Oil and Gas Journal, 26 August 1943; Shwadran, pp. 311-14.

[38]See U.S., Petroleum Industry War Council, United States Foreign Policy and the Petroleum Reserves Corporation (Washington, 1944); U.S., Petroleum Administration, A Foreign Oil Policy for the United States (Washington, 1944); New York Times, 12 November 1943; Memo for FDR, 5 February 1944, in FDR Mss.

[39]Saudi Hearings, Part 25, pp. 220-225, 242; James F. Byrnes to FDR, 17 January 1944, in FDR Mss.; Herbert Feis, Petroleum and American Foreign Policy (Stanford, 1944) pp. 36-39; Shwadran, pp. 314-315.

[40]New York Times, 4, 6 February 1944; Saudi Hearings, pp. 25387-25388; U.S., Congress, Congressional Record, 78th Cong., 2nd Sess. (9 February 1944), pp. 1466-71, 80th Cong., 2nd Sess. (28 April 1948), p. 4962; Feis, pp. 40-50; Shwadran, pp. 318-322.

[41]New York Times, 10, 11, 14 February 1944.

[42]New York Times, 17 February and 3, 4, 5, 7 March 1944; U.S., Congress, Congressional Record, 78th Cong., 1st Sess. (3 February 1944), pp. 1135-1138, 9 February 1944, pp. 1466-71; Shwadran pp. 322-324.

[43]U.S., Federal Trade Commission, The International Petroleum Cartel, 82nd Cong., 2nd Sess. (Washington, 1952), p. 125. Shwadran, pp. 331-337; New York Times, 12, 14, 17, 22 March 1944.

[44]Hull, 2: 1522-23; New York Times, 8 March 1944; Oil and Gas Journal, 3 June 1944.

[45]Great Britain, Parliament, Parliamentary Debates, House of Commons, (9 February 1944), p. 396, col. 1744, and p. 399, col. 786 (26 April 1944).

[46]Saudi Hearings, Part 25, pp. 243-44; Hull, 2: 1517-27; Edward R. Stettinius Memo for FDR, 12 February 1944, FDR to Cordell Hull, 5 April 1944, Cordell Hull to FDR, 7 April 1944, in FDR Mss.; Ickes to FDR, 7 August 1944, in D.I. Records; Shwadran, pp. 327-329; Oil and Gas Journal, 9 March 1944; New York Times, 9, 25 August 1944.

[47]From MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943-44, p. 60.

[48]New York Times, 17, 18 September, 2 November 1945; text in U.S., Congress, Congressional Record, 79th Cong., 1st Sess. (2 November 1945), pp. 10323-24, and in New York Times, 25 September 1945.

[49]U.S., Congress, Congressional Record, 79th Cong., 1st Sess. (10 January 1945), pp. 179-180; text in Oil and Gas Journal, 16 December 1944; New York Times, 11, 12, 16 January and 23, 27 February 1945.

[50]New York Times, 2, 4, 15 November 1945; U.S., Senate, Committee on Foreign Relations, Hearings on Petroleum Agreement with Great Britain and Northern Ireland [2-25 June 1947] 80th Cong., 1st Sess., (Washington, 1947); U.S., Senate, Committee on Foreign Relations, Report on Anglo-American Oil Agreement, 79th Cong., 1st Sess. (Washington, 1947).

[51]From MNC Sub-committee Print, A Doc. His. of the Pet. Res. Corp., 1943-44, p. 60; New York Times, 3 December 1944, 20 March and 18, 22 May 1945; Oil and Gas Journal, 25 November and 23, 30 December 1944.

[52]From MNC Hearings, Part 8.

[53]MNC Hearings, Part 8.

[54]MNC Hearings, Part 8.

[55]MNC Hearings, Part 8.

[56]Peter R. Odell, Oil and World Power: Background to the Oil Crisis, 3rd. ed. (Middlesex, England: Penguin Books Ltd., made and printed in Great Britain by Hazell Watson and Viney Ltd., Aylesbury, Bucks, 1974), p. 190.

[57]Stephen Hemsley Longrigg, Oil in the Middle East: Its Discovery and Development, (Oxford: Oxford University Press, 1961).

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CHAPTER 8

THE MIDDLE EAST: EMERGENCE OF A NEW INTERNATIONAL ECONOMIC ORDER

> The sphere of freedom of action for subjects of international law -- what, in relation to typical international persons may also be termed unlimited state jurisdiction -- is governed primarily by the rules on sovereignty. Limitations of this jurisdiction come about as the result of the interplay of the rules underlying some of the other fundamental principles with those on sovereignty.
>
> Georg Schwarzenberger

> ... a kind of private supranational government, an intricate system which has grown up through close to a half century of closely co-ordinated and co-operating joint ventures and arrangements around the world among these seven international companies ... a private United Nations ... its members severally and collectively possess massive wealth and resources, including an exchequer, shipping fleets, production facilities, pipelines, refineries, etc., which exceed by far the resources available to many nations of the world. Furthermore, these companies have shared for many years a broad community of interest and a functional unity of policies and actions in the dispositions of such wealth and resources.
>
> David I. Haberman

Iran is an example of developing international customary law based on municipal law in America. The concession which had been held by BP since its formation in 1901, was the major source of non-Arab oil production; its oil was sold not only in Great Britain and to the Royal Navy -- its first and biggest customer -- but also to European markets. By 1939 Iran was already producing about 10 million tons per year -- twice as much as all other Middle Eastern countries combined.[1]

By 1951 there were strong anti-British feelings: BP's labor policy precluded Iranian nationals from rising above the level of laborers; high profits were inflamatory -- with annual oil exports valued at $360 million, Iran was getting $35 million in royalties and $65 million through the company's local expenditures; Great Britain was receiving more in taxes from the profits than was Iran. Based on a comprehensive study by outside experts who maintained Iran had the necessary resources, a seven-year national development program for the economy and welfare needs had been begun in 1949. A politically inept bureaucracy coupled with a selfish and corrupt ruling class, however, helped dissipate the oil revenues.

Of the 20 million population, 90 percent were illiterate; the infant mortality rate was 500 deaths for every 1,000 live births; 70 percent of the land was held by 2 percent of the people, although farming was the major occupation.[2]

The major conflict between BP and Iran as the host government over the issue of nationalization soon expanded to include the U.K. Government as BP's home government, and the U.S. Government in her role as arbitrator, which was soon over-shadowed by her role as home government to the American majors who were -- by this time -- in conflict with BP over market entry in Iran.

BP had accepted a new supplemental oil agreement in 1949, providing for an increase in the royalty from 22¢ to 33¢ a barrel, but she flatly refused to accept the 50-50 profit sharing arrangement conceded by American firms to the governments of Saudi Arabia and Venezuela. Thus the British Government found herself in the position of rejecting the option of brute force in deference to the changing world power structure, particularly the danger of Soviet intervention, while at the same time unwilling to simply accept Iran's offers for compensation in other countries, and also because any reasonable settlement for the physical properties of the company would be inadequate to compensate the British economy. Stressing the importance of Iran for strategic reasons, Richard Funkhouser, U.S. State Department Petroleum Attache, urged the British to accept Mossadeq's request for the immediate initiation of payments under the higher royalty schedule.

> Both the U.S. and U.K. Governments believe it important that AIOC comply with this request because of the economic, political and strategic considerations involved [i.e., the Russian threat]. AIOC, however, refuses to pay until the agreement is ratified; progress is nil, the Prime Minister had threatened concession cancellation.[3]

Faced with Iran's nationalization of BP, the major companies unilaterally favored BP's position, refusing to operate the Iranian Concession themselves. A Department of State press release of 15 May 1951 stated that "U.S. oil companies ... have indicated ... that they would not, in the face of unilateral action by Iran against the British company, be willing to undertake operations in that country."[4]

The Truman Administration quickly attempted to mediate a settlement of the dispute between BP and Iran -- for more than oil was at stake: merely a month after Mossadeq's nationalization actions, on 27 June 1951 President Truman created the National Security Countil (NSC) which made an attempt to define U.S. policy. The National Security Council consists of top ranking cabinet officers and the joint chiefs of staff.

> Bring (U.S.) influence to bear in an effort to effect an early settlement of the oil controversy between Iran and the United Kingdom, making clear both our recognition of the rights of sovereign states to control their natural resources and the importance we attach to international relationships.[5]

Although Britain had just gone through nationalization of several of her own basic industries, the leadership found it difficult to accept such acts in Iran. Winston Churchill dramatized the negative effects of the nationalization on Britain's balance of payments.

> Now that Abadan refinery has passed out of our hands we have to buy oil in dollars instead of sterling. This means that at least 300 million dollars have to be found every year by other forms of exports and services. The working people of this country must make and export at a rate of 1 million dollars more for every working day in a year. This is a dead loss which will affect our purchasing power abroad and the cost of living at home.[6]

Great Britain first took her case to the International Court which held that it did not have any jurisdiction in the case; next, she applied to the Security Council which also took no effective action. BP then decided to employ economic retaliations on Iran, the most important of which was the boycott of the export of Iranian oil. Prospective buyers were warned of legal action on the grounds that without a compensation agreement between Iran and BP, the oil was still the property of BP.

The U.S. Ambassador to Iran at that time described the British line of reasoning:

> The concept that financial pressures would bring the Iranians into line and solve the oil problem in Iran was from the beginning the key to the British blunders which proved so costly. This notion springs from a colonial state of mind which was fashionable and perhaps ever supportable in Queen Victoria's time, but is not only wrong and impractical today but positively disastrous. It is an attitude which seems to persist in spite of the British experiences in India, Burma, Ceylon and Egypt. In Iran, it was expressed in variations of this theme: "Just wait until the beggars need the money badly enough -- that will bring them to their knees." I heard that vapid statement so often that it began to sound like a phonograph record.[7]

On 4 July 1952 Secretary of State Acheson, British Ambassador Oliver Franks, George McGhee, and Averell Harriman met at Harriman's Washington office to discuss the Iranian question. According to Acheson: "Sir Oliver left no doubt how seriously and angrily both the British government and public viewed what they regarded as the insolent defiance of decency, legality and reason by a group of wild men in Iran who proposed to despoil Britain."[8]

The events of the boycott were described by Noori as follows:

> The British oil tanker fleet was withdrawn from Abadan so that Iranian oil could not be transported to foreign ports. Public warnings were issued that legal proceedings would be instituted against any and all purchasers of Iranian crude or refined products. In fact British charge d'Affaires in Iran reportedly averred that the British government would pursue the matter all the way to the North Pole if necessary in search of a court that would adjudicate such a dispute. Diplomatic pressures were also brought to bear upon foreign governments to discourage or prohibit sales of Iranian petroleum products. As a result of these and other embargo measures only an independent Japanese oil distributor and two independent Japanese oil distributor and two independent Italian companies exported any significant quantities of oil from Iran during the more than three-year span between nationalization and Mossadeq's fall.[9]

The American companies cooperated with BP in the boycott, thus adding to its effectiveness. In his testimony before the MNC Hearings, Howard Page, then Middle East coordinator for Exxon, described the role of the major oil companies in refusing to purchase and market Iranian oil:

Senator CHURCH.	Mossadeq nationalized the oil.
Mr. PAGE.	He had nationalized the oil.
Senator CHURCH.	And the reason Iran was in such trouble was, as you say, it couldn't sell the oil.
Mr. PAGE.	Yes.
Senator CHURCH.	Because the companies had boycotted Iranian oil, isn't that true?
Mr. PAGE.	We didn't boycott it.
Senator CHURCH.	You didn't boycott it?
Mr. PAGE.	Of course not. Why should we buy it? ... we weren't buying it before, and we weren't buying it afterwards.
Senator CHURCH.	And since you had such a very large measure of control over the market, this meant that Iran wasn't able to sell its oil or enough of it to prevent economic chaos in Iran, isn't that correct?
Mr. PAGE.	Well, that is not only that. Remember that they could bring lawsuits and did bring successful lawsuits against buyers for purchasing stolen property ....

> Because it was their property and it had been stolen from them. They had a right of action, no question about that. We don't deal with stolen property and people who do sometimes get lawsuits and sometimes they win them too.[10]

On the surface Page's assertions are correct: as stated previously, Exxon in 1947 entered into a long-term contract with British Petroleum which committed Exxon to purchasing large quantities of crude oil from BP's concessions in Iran or Kuwait over a period of twenty years at BP's disgression. The contract, although negotiated in 1947, was not scheduled to take effect until 1952; so, in fact, Exxon was preparing in 1951 to begin purchasing Iranian crude.

Page is also correct when he stated that BP threatened to sue any company which lifted "hot" oil out of Iran -- a claim she substantiated by placing notices in the world's major newspapers, and even more vividly, by successfully prosecuting the Rose Mary case, in which a British court, sitting in Aden, found that crude from the BP Concession, purchased from NIOC, which had come within the court's providence, remained the property of BP ([1953] W.L.R. 246).

Exxon's refusal to purchase Iranian oil goes much deeper: she was unlikely to purchase oil from the nationalized concession of another company for fear of setting a very dangerous precedent. The embargo was effective due to the cooperation of the major oil companies.

> There was one thwarted attempt to break the boycott. Mossadeq sought the assistance of W. Alton Jones, Chairman of the Cities Service Corporation of New York, with the hope of renewing oil operations in Iran. This was the most serious move of all, because Jones was believed capable not only of setting up an adequate marketing organization, but also of providing a fleet of tankers to carry Iranian oil to foreign ports. On August 16, 1952, Jones arrived at Teheran. After a tour of works, including the refinery of Abadan, he was brimming with enthusiasm. "The free world knows the Iranians can manage their own oil industry and operate the refinery," he was

prompt to declaim. He found the refinery at Abadan upon inspection to be in good repair and estimated that full scale production could be resumed with a minimum expenditure of some $10,000,000. Jones also volunteered the services of Cities Service in enlisting European and American technicians to assist in starting up the industry again, and indicated that tankers could be secured within a matter of months to make resumption of full scale production in Iran. Upon leaving Iran, he publicly announced that "there was interest in buying Iranian oil" and indicated strongly, although he would not enlarge upon it, that "his company shared this interest." As for the blocked [sic] and the possibility of extended litigation over oil purchases, Jones proclaimed that "he might buy oil from Iran ... irrespective of whether Britain or the Anglo-Iranian Oil Co. would take legal action against his Company for handling Iranian oil products."[11]

With these auspicious beginnings, the ultimate failure of the Jones mission to revive the Iranian oil industry is a matter for major conjecture ....

It is known that two concerns with which Jones was affiliated, Cities Service and Sinclair, each received handsome long-term contracts for Middle Eastern crude at substantial discounts from the posted price of the international cartel. It has been publicly charged that one of these contracts was offered to Cities Service by cartel members in order to dissuade it from executing its reported agreement to market Iranian oil. We at least know that companies with which Jones was identified were subsequently given a share in the consortium arrangement which ultimately comprised the Iranian controversy.[12]

Iran's oil exports dropped from over $400 million in 1950 to less than $2 million in the two-year period from July 1951 to August 1953. "If between 1951 and 1955 Iranian production had held at its 1950 level, the net loss (after deducting some 300 million barrels actually produced) would have totaled approximately 900 million barrels."[13]

At the same time, neither BP nor Great Britain suffered the losses that might have been feared, owing to the company's ability to draw upon its fabulous oil reserves in Kuwait. "Oil was available -- even to AIOC -- in abundance in neighboring countries, and world surplus production capacity of crude oil was estimated then at about 1.5 million barrels per day pressing for outlets."[14]

Yet the financial effect of the boycott was not so pronounced as was expected on Iran, since oil revenues accounted for only about 12 percent of total government revenues, and only 120,000 workers had been involved in the local petroleum industry.

However, as it became obvious that a reconstruction of the original concession would be impossible, the Administration turned to the American oil companies asking them to enter into a joint venture agreement with BP. On 8 October 1952, Secretary of State Acheson submitted a plan to the NSC which stated that "no-one other than the majors and ... [BP] had sufficient tankers to move large volumes of Iranian oil," and raised the question whether the majors should be asked to move Iranian oil.[15]

This would, however, conflict with American antitrust policy and the government herself -- after much deliberation -- re-evaluated her priorities in favor of an American-BP joint venture in Iran by relaxing her stand on antitrust. Attorney General McGranery's reaction was that Acheson had "presented a most formidable legal meal. It would be most difficult to work out a program involving the majors and at the same time maintain the present antitrust action" (MNC Hearings, Part 8). He concluded, however, that the basic problem was whether the national interest in finding a solution to the Iranian crisis was more important than the principles involved in the suit.

Despite the Attorney General's qualms, Secretary of Defense Robert Lovett also argued that the possibility of using the five major companies to move Iran's oil should be explored. "This would involve some action to get around the present obstacle of the government suit against those companies. However, there is no doubt in my mind that the interests of the U.S. in connection with the present Iranian crisis requires (sic) some such action" (MNC Hearings, Part 8).

In his reply, Secretary Acheson agreed that: "One of the concrete problems in securing a resumption of the flow of Iranian oil is to determine whom it is we can call on, and who is able in fact to move Iranian oil in the volume which is required to save Iran. The independents are not in a position to give us any real help" (MNC Hearings, Part 8).

On 26 November 1952 President Truman requested the Secretary of State to "... engage urgently in exploratory discussion with representatives of United States oil companies and with the Anglo-Iranian Oil Company ... in order that I may determine what type of agreement and program would be most likely to contribute to the national defense by leading to a solution of this (Iranian oil) situation."[16]

The oil companies saw this opportunity to assist the British and American Governments as a matter of patriotism. The same companies that were being enlisted by the State Department to solve the Iranian conflict were, incongruously, the same companies that were being investigated by a Justice Department Grand Jury for possible criminal violation of antitrust laws -- a matter soon remedied by the State Department.

The position paper presented to the NSC on 9 January 1953 recommended that the grand jury investigation be terminated. (The following discussion is based on this report as discussed in MNC Hearings, Part 8.)

The argument began by noting the critical importance of petroleum in the modern world. "With the increase in demand that will occur under war conditions, the successful conduct of a major war by the United States and its allies will be dependent upon continuing availability of foreign petroleum supplies." Even in peace-time, "major sources of foreign oil are now indispensable to the economy of the United States."

The only areas which could supply Great Britain and America with their oil needs were Venezuela and the Middle East. Venezuela was to American domestic oil supply in time of war as the Middle East was to the supply of Europe in peace-time. "Since Venezuela and the Middle East are the only sources from which the free world's import requirement can be supplied ... nothing can be allowed to interfere substantially with the availability of oil from these sources to the free world."

It was vitally important that these two remaining areas of available free world imports not fall under communist control. Yet, turning to the Middle East, this danger seemed real and present. "Because," the position paper continued, the oil producing states of the Middle East "are on or near the borders of the Soviet Union," and because of certain local conditions, "the Middle East comprises one of the most explosive areas of the world." Since oil is "the principle source of wealth and income in the Middle Eastern countries in which the deposits exist," the "economic and political existence" of these countries "depends upon the rate and terms on which oil is produced." Since the rate and terms in question are to a large extent under the control of the oil companies operating in the area, the "American oil operations are, for all practical purposes, instruments of our foreign policy toward these countries .... We cannot afford to leave unchallenged the assertations that these companies are engaged in a criminal conspiracy for the purposes of predatory exploration." To do so, would leave the companies at the mercy of their critics in the producing countries, the report stated; hence the "entire situation," i.e., criminal prosecution, is "... fraught with great potential danger to the U.S. ... in both Venezuela and the Middle East a wave of economic nationalism which might endanger American interests is entirely possible...."

> In many fields no legal or formal control over the action of American private interests abroad is exercised by this Government. This is in accord with the view that a minimum of regulation and control is an accepted American principle. On the other hand, this means that if Government and industry are to act together to promote foreign policy and security objectives in petroleum there must be a basis of mutual confidence between them. Criminal proceedings are not likely to produce such confidence between the two parties in this disupte .... A trial might well be avoided and hence the great reduction in the number of possible sensational disclosures brought about.

The report further recommended the formation of a Presidential Commission composed of the Secretaries of State, Defense, Interior and Commerce to "give careful attention to the inter-relationships of antitrust, security and foreign policies in petroleum."

The Department of Justice opposed the recommendations to abandon the criminal investigations, because it felt that the cartel was to be attacked effectively.

> The cartel arrangements are in effect private treaties negotiated by private companies to whom the profit incentive is paramount. The national security should rest instead upon decisions made by the Government with primary concern for the national interst .... The discovery process in a civil suit is a great deal more cumbersome and could be drawn out over an extended period of time by an infinite variety of legal motions designed to delay and wear down the Department. The grand jury investigation, on the other hand, would permit the Department to uncover all of the relevant facts in a substantially shorter time .... The facts presently available strongly suggest that the high policy represented by the Sherman Act has been consciously and persistently violated by activities long since determined by the Supreme Court to be illegal. The cartel should be prosecuted criminally if there is to be equal justice under the law and if respect for the law and its even-handed administration is to be maintained.

Enforcement of national competition was the Justice Department's primary concern: the companies contravened antitrust which directly and substantially effected the domestic economy; the companies were and have been acting in a manner contrary to U.S. national interests and to the laws in which the U.S. Justice Department was sworn by oath to enforce.

On 9 January 1953 President Truman, on the advice of the recommendation, and over the objections of the Justice Department, announced that the grand jury investigation would be terminated. It was "... with great reluctance ... that he was constrained to take that decision not on the advice of those Cabinet members who attended the Security Council meetings, but solely on the assurance of General Omar Bradley that the national security called for that action" (MNC Hearings, Part 7, p. 103).

On 12 January President Truman wrote the Attorney General formally of his decision, which resulted in the Department of Justice's termination of the grand jury investigation and the filing of a civil suit in the District of Columbia.

Iran, who had become dissatisfied with the amount of revenues she was receiving from BP, called for renegotiations of the 1933 Concession Agreement, the result of which was signed 17 July 1949, providing Iran with better financial remuneration than any other producing country in the Middle East. A year later the Iranian Majlis (Parliament) set up an oil commission, chaired by Dr. Muhammed Mossadeq, who recommended rejection of the supplemental oil agreement.

When no agreement with BP was forthcoming, the Iranian Parliament -- at the instigation of Mossadeq -- passed a nationalization bill in March 1950. BP's resulting embargo had less of a financial effect than had been expected, since oil revenues accounted for only about 12 percent of total government revenues, and only 120,000 workers had been involved in the local petroleum industry. Yet the boycott had helped to undermine Mossadeq's leadership by forcing him to take measures which contributed to internal political discontent, particularly on the part of the Iranian upper class.

> Needing money desperately, on August 21, 1952, the Premier decreed the creation of a commission to collect the immense arrears of unpaid taxes of the rich for the last ten years. The commissioners were empowered to throw the wealthy Iranians' so called 'thousand families' in jail and confiscate their property if they did not pay. An additional blow to them was Mossadeq's decree that they cut feudal dues received from sharecroppers and return 10 percent of the profits derived from the land they worked ....[17]

Iran had been the first country to receive Point Four Aid. The limited assistance of $1 million for the fiscal year 1951 had been increased to $23 million in 1952 and 1953. Requests to the United States by Mossadeq for additional loans to meet budgetary needs aggravated by the complete loss of oil revenues were turned down by President Eisenhower.

> There is a strong feeling in the United States ... that it would not be fair for the United States Government to extend any considerable amount of economic aid to Iran so long as Iran could have access to funds derived from the sale of its oil and oil products if a reasonable agreement were reached with regard to compensation whereby the large-scale marketing of Iranian oil would be resumed. Similarly, many American citizens would be deeply opposed to the purchase by the United States Government of Iranian oil in the absence of an oil settlement.[18]

By 1953 a power struggle ensued between Mossadeq and the army, and a series of interrelated events led to the eventual overthrow of Mossadeq.

> In an effort to minimize the power of the King and to ease the country's financial woes, Dr. Mossadeq decided to cut into the Shah's $720,000 a year government allotment and his $2,000,000 a year income from other sources. The tension between the Shah and Mossadeq was intensified ... A chain of ominous events followed one after another....[19]

The State Department did not appreciate Mossadeq's laxity in dealing with the domestic communist party, whose position was strengthened by the economic squeeze play engineered by the anti-communist West. It was primarily America's fear of communism that motivated her to actively assist in the overthrow of Mossadeq.

> When the Parliament refused to grant Mossadeq's demand that it extend for one year his right to govern by decree, a wave of demonstrations swept the country. Mossadeq directly challenged the Shah, ordered a plebiscite to dissolve Parliament and won more than 99 percent of the votes cast and counted. In a swiftly moving series of events, the Shah attempted to oust Mossadeq by decree, failed, and fled the country as Mossadeq's supporters demonstrated in the streets smashing the statues of the Shah and his father. The military moved in, and in bloody street fighting deposed Mossadeq and restored the Shah to his Throne, a move which was assisted clandestinely by the U.S. Central Intelligence Agency.[20]

British secret agents had devised a plan early in the crisis to help bring about the fall of Mossadeq which London passed on to the American CIA. In April 1953 Churchill sanctioned the plan and the Americans actively pursued it.

> Behind the scenes mysterious forces were at work in Iran, who were waiting for their moment. Early in the crisis, British secret agents had reported to London that there were many anti-Mossadeq elements in Iran who with encouragement, including cash, from Britain, could halp bring Mossadeq down. The coup, and the project was passed on to the CIA in Washington, who were in turn hesitant to act without British support. Eventually the plan was sanctioned, not by Eden, but by Churchill, who happened to be in temporary command of the Foreign Office during Eden's illness in April 1953. The conspirators were duly assisted, master-minded by Kermit Roosevelt, and their chance soon came. Mossadeq took control over the army; the Shah tried to oust him, failed, and fled the country in August. Three days later the Shah's supporters, led by paid agents, took to the streets to fight Mossadeq's troops.[21]

> Kermit "Kim" Roosevelt, [grandson of President Theodore Roosevelt], also a seventh cousin of President Franklin D. Roosevelt, is still known as "Mr. Iran" around the CIA for his spectacular operation in Teheran more than a decade ago ....

> One legend that grew up inside the CIA had it that Roosevelt, in the grand Rough Rider tradition, led the revolt against the weeping Mossadeq with a gun at the head of an Iranian tank commander as the column rolled into Teheran.
>
> A CIA man familiar with the Iran story characterized this as "a bit romantic" but said: "Kim did run the operation from a basement in Teheran -- not from our embassy." He added admiringly: "It was a real James Bond operation."[22]

Kim Roosevelt later left the CIA and joined the Gulf Oil Corporation as "government relations" director in its Washington office. Gulf named him a vice-president in 1960.

> Mossadeq was forced out of office, the Shah's man General Zahedi took over the government, and the Shah returned to his capital in qualified triumph -- conscious that it was more the CIA's victory than his, though he did not care to admit it. The cost of the covert operation, according to one source, was about $700,000.[23]

> ... when this crisis came on and the thing was about to collapse, we violated our normal criteria and among other things we did, we provided the army immediately on an emergency basis blankets, boots, uniforms, electric generators, and medical supplies that permitted and created an atmosphere in which they could support the Shah .... The guns that they had in their hands, the trucks that they rode in, the armored cars that they drove through the streets, and the radio communications that permitted their control, were all furnished through the military defense assistance program .... Had it not been for this program, a government unfriendly to the United States probably would now be in power.[24]

In November 1953 Herbert Hoover, Jr., Special Representative of the U.S. Government, visited Teheran and London where he urged BP's Chairman of the Board William Fraser to include American companies in a consortium which would enter into an equitable agreement with the Shah of Iran for the production and marketing of Iranian oil.

Fraser duly sent a letter dated 3 December 1953 inviting the chief executive officers of the five American Sisters to London to discuss the tentative formation of a consortium of the seven major oil companies of the world to form what was later to become known as the Iranian

Consortium. As Fraser wrote:

> Mr. Hoover has informed me that the ideal solution, in his opinion, would be for the Anglo Iranian Company to return to Persia alone, a view which is, of course, held by me and is, I think, shared by you. He has, however, said that he doubts whether it is possible to achieve this and his conversations in Tehran led him to the view that a solution might be found through the medium of a group of companies rather than through a single company ....
>
> He has suggested to me that valuable time could well be saved if discussions could be opened with representatives of companies able to make some contribution to a solution of the problem who might, in the interests of progress and stability in the countries of the Middle East, be ready to participate in such a group.
>
> I have felt that the companies which could make a constructive contribution to a solution are those who are now engaged in the production of oil in the Middle East and in the marketing of it on a large scale internationally.[25]

Orville Hardin, a vice-president of Exxon, wrote a letter to Secretary of State Dulles referring to the Fraser invitation, asking for the Department's view as to the propriety of accepting the invitation and noting that Exxon's motivation in entering the consortium was strictly patriotic. Hardin wrote, "from the strictly commercial viewpoint, our company has no particular interest in entering such a group but we are very conscious of the large national security interests involved."[26]

Exxon's conception of the "large national security interests involved" seemed somewhat at variance with that of the State Department: while the Department was primarily concerned with security of supply -- that Iranian oil might be lost to the West, Exxon was apparently more concerned that Iranian oil might be "dumped" on the world market below prevailing prices. "We recognized the dangers if Russia got in, we had a real interest in seeing to it that the problem was solved. We didn't balk at participation. Had the Russians gotten Iranian oil, and dumped it on world markets, that would have been serious."27

The State Department, without exploring her motivational differences with the majors, gave them her unconditional approval for meeting with the BP chiefs. Negotiations began in London on 8 January 1954 where the American majors made rapid progress, recognizing the strength of their bargaining leverage. They informed Hoover, however, that there was one impediment blocking further progress -- that of antitrust.

Herman Phleger, Legal Advisor to the Department of State, summarized a cable from Herbert Hoover, Jr., reporting rapid progress in the London talks:

> ... he points out that our Government has been putting pressure on the United Kingdom and its highest officials over a long period to solve the Iranian problem in aid of our highest security interests and that in this connection our Government has undertaken obligations to the new government of Iran for the same purposes; that if our Government was now to determine that it could not proceed at this time because of antitrust considerations and as a result, negotiations were suspended, the consequences might well be of the gravest kind.[28]

The National Security Council decided on 21 January that it was in the interest of U.S. security for the American companies to participate in the consortium -- thus, once again relaxing her stand on antitrust when it became an impediment to national security. Congressional leaders were informed of the NSC decision the following day. On 22 January 1954 Vice-President Nixon, the Secretaries of Defense and Navy, the Joint Chiefs of Staff, members of the State Department, and Herbert Hoover, Jr., met with a group of nine leaders of Congress:

> Recent National Security Council decisions in connection with the proposed oil consortium were frankly discussed according to the State Department's record. The Attorney General's opinion was made clear. No objection was raised by any Member of Congress concerning the decision and the course of action contemplated. Substantial interest was expressed in the matter of possible imports to the Western Hemisphere from Iranian sources. Secretary Anderson pointed out emphatically that the production developed in Iran would replace other

Eastern Hemisphere production and the sale of oil and petroleum products from Iran would be in the Eastern Hemisphere.[29]

In letters dated 28 January 1954, the heads of the five major American oil companies informed the British that:

> ... the National Security Council has determined that it is in the security interests of the United States that United States petroleum companies participate in an international consortium to contract with the Government of Iran, within the area of the former concession of the Anglo-Iranian Oil Company Ltd., for the production, refining and acquisition of petroleum and petroleum products, in order to permit the friendly government of Iran substantial revenues on terms which will protect the interests of the Western World in the petroleum resources of the Middle East.[30]

The British and American Governments held talks in August 1954 on Iran and the increasing dependence of Western Europe on Middle Eastern oil. The British pointed out that "these problems [were], therefore, highly strategic and political, not just economic in nature and scope."[31] They wished to establish a framework within which the British Government, the American Government, the British oil companies, and the American oil companies could coordinate their efforts to settle the Iranian oil enigma in such a cohesive alliance so as to avoid possible future repercussions in the area. They specifically noted that the U.K. was not "primarily concerned in protecting the profit position of the British companies."[32] The British stated flatly that they were more interested in improving relations and stabilizing conditions in countries concerned in order to insure the smooth flow of oil.

The Foreign Office suggested several modes of coordination which ranged from strategy planning among the major oil companies to an International Petroleum Council, consisting of consuming and producing countries. Biannual coordination meetings between America and Britain were also advocated. The Americans raised several objections: the type of consultations between companies involved antitrust problems; the formation of an International Petroleum Council could be encouraging producer-consumer conflict and accelerate coordination among oil producing countries, especially in the Arab nations; and officially the Government was cool to direct involvement.

An agreement was finally signed on 29 October 1954 between the Iranian Government, the National Iranian Oil Company, and a consortium of British and American companies.

A summary of the agreement follows:

> 1. On the one hand, there was the NOIC, a state company, who owned the assets (oilfields and installations). The principle of nationalization was not brought into the agreement.
>
> 2. On the other hand, there was a consortium (Iranian Oil Participants) composed of BP (40 per-cent.), Shell (14 per-cent.), Gulf Oil (7 per-cent.), Mobil Oil (7 per-cent.), SOCAL (7 per-cent.), Standard Oil of New Jersey (7 per-cent.), CFP (6 per-cent.) and Iricon (5 per-cent.). This consortium held the capital of two operating companies: an exploration and production company and a refining company. These two companies made neither profits nor losses, their expenses being covered by the members of the consortium (at a minimal rate of $1 per ton, bearing in mind the expenditure to be made). These two companies produced for the account of the NIOC.
>
> 3. Each member of the consortium set up its own trading company, who would announce each year how much oil it would off-lift. It was on the basis of these announcements (and the internal requirements of the NIOC) that the production volume would be fixed. The oil was purchased by the trading companies at a price equal to 12.5 per-cent. of its posted price. They would be taxed on the OPEC basis.
>
> 4. Iran undertook to pay Anglo-Iranian compensation of 25 million pounds, payable in ten years.
>
> 5. The consortium's assets were valued at 1,000 million dollars and the new participants paid BP 600 million dollars for their share of the old rights. Of this sum, 15 per-cent. was paid in eighteen months and the remainder at a rate of 75¢ per ton of oil (this so-called BP royalty was terminated in 1970).[33]

According to Petroleum Week, the deal was a sweet one all around. Each 1/12 share cost $625,000 paid to the American members of the Consortium. From the posted price of $1.90 a barrel the companies paid the costs of production, 20 cents, a dime to British Petroleum, and 80 cents to the Iranian Government, leaving a profit of 80 cents each barrel. As the income ranged, according to estimates, from $416,000 to $730,000 a year on each 1/12 share, it was a rather neat investment. One company which staked a claim to a share and later withdrew was able to sell its "rights' for a good sum, without ever having ventured a penny.

In 1958 the country gained more revenue than it had in the entire half century of Anglo-Iranian's sway. The principle of nationalization had been upheld even if direct control had been evaded."[34]

The American independents were perturbed at the manner in which participants in the consortium were selected. The independent oil companies had been interested from the beginning in Iranian oil operations and had only refrained from entering Persia because of the Iranian-BP dispute. When it became known that the independents were to be excluded from the consortium Ralph Davies, president of the American Independent Oil Company (AMINOIL), wrote Secretary of State Dulles reminding him of the government's obligation to them as well as to the majors.

> Suffice it to say that we cannot accept the proposition that the benefits to be derived from a proposed consortium be limited to the five major companies that are parties to it. Our government has no less an obligation to independent enterprise than to the integrated giants of the industry whose practices, both at home and abroad, have made them a target for widespread criticism and, indeed, investigations.[35]

Hoover's response to the independents' complaint persuaded the majors to relinquish 5 percent -- 1 percent each -- to be made available to the American independent companies.

Page again explained the reasons to Senator Church for including the independents:

Mr. PAGE.	Now they, -- I don't know their reasons for it -- but they had a feeling, well "Because people were always yacking about it we had better put some independents in there."
Senator CHURCH.	Put a few independents in?
Mr. PAGE.	Yes.
Senator CHURCH.	Window dressing?
Mr. PAGE.	That's right.[37]

As of 4 March 1955 Price Waterhouse certified eleven independents as reliable applicants, rejecting AMINOIL because of what they alleged to be a lack of financial capacity. Financial capacity of companies was not certified by any governmental institution, but by the public accounting firm of Price, Waterhouse and Co., which at this time was under retainer to three of the five major producers, and at one time or another, represented all seven of the major international oil companies. Their power was so great that inter-cartel disputes between the Seven Sisters were sorted out and settled by Price Waterhouse, acting as a court of last resort in binding arbitration. The firm also set up a single corporation to represent all new participants and divide the total 5 percent participation among thenselves. The eleven companies were appalled and as a unit demanded a 36 percent share, which they never got.

Page of Exxon was later questioned by Senator Church as to why they were not allowed the 36 percent share they were asking:

Senator CHURCH.	Why couldn't they handle up to 36%, because they didn't have the outlets?
Mr. PAGE.	Of course, these were American independents who didn't have any outlets abroad, they only had outlets here and you had the problem of disposing of all kinds of

products and it was almost an impossible task unless you had certain outlets for it.

Senator CHURCH. And the majors had those outlets but the independents did not have access to them?

Mr. PAGE. That's right.[36]

Iran illustrates the abilities of the multinational companies and their Western governments to maintain an equilibrium in the face of a changing world, until one country emerged with the leadership necessary to alter the entire petroleum industry and the established international legal regime; Libya, for a country with such a unique history -- transformed by World War II from an obscure Italian colony to a protectorate under joint Anglo-French military rule until King Idris was restored to his throne in 1951 -- was a late starter in the international petroleum game. Yet she was to have a tremendous influence on the international legal regime during the 1960s and early 1970s.

In return for direct American financial aid, Idris invited the United States Air Force to build Wheelus Air Force Base in an attempt to dilute the British presence in the area. Like the Saudis, in dealing with the all pervasive issue of developing his country's oil resources, Idris decided to encourage American groups over the British. This conflicted sharply with HMG's claim that her companies (BP and Shell) had prior rights to most of Idris' prime drilling sites. The Libyan Government, however, invited all interested companies in order to avoid a situation similar to that in Iran of single company domination.

To further secure their position, the Libyans drafted a law under which all oil production would be regulated, giving bidding preference to independents. The American companies controlled the drafting panel with seven firms represented; the British had only two panel members, and France had one. The American contingent included new entrants to the Middle East fraternity of oil developers -- such independent participants as Nelson Bunker Hunt of Dallas, and Marathon Oil of Finley, Ohio. Of course, Exxon, Mobil and Caltex were also represented. The British companies tried in vain to receive preferential treatment in the Libyan concession bids.

In his disposition Faud Kabazi admits, "I didn't want my country to be in the hands of one oil company."[37] The 1955 Petroleum Law established a highly fragmented concessionary pattern. In the first round of bidding, for example, seventeen companies received eighty-four separate concession areas. This system of bidding gave independent companies an opportunity to secure reserves which otherwise had been unattainable.

The Libyan bidding regime was designed to facilitate rapid development -- a pattern followed by the British in the North Sea over twenty years later. The constituent part of the bids consisted of committing the companies, in terms of both time and financing, to exploration and development rather than the older system of cash bonus payments to the Idris regime. When overlapping bids took place, a special petroleum council awarded the concessions to the companies who seemed most likely to produce the most oil in the shortest period of time.

The companies were encouraged to explore their allotted concession area quickly by the so-called "5-3-3" clause. This clause in the concession agreements gave the Libyan Government the right to repossess one-quarter of each company's exploration concession after five years, another quarter three years later, and a third quarter three years thereafter. These areas could then be reassigned to other companies. Since in practice, the companies were permitted to designate that portion of their concession area which they would relinquish, they had an incentive to explore the whole area quickly in order to make an intelligent determination.

In deciding who should receive a bid, considerable weight was placed on whether or not the company was a major or an independent.

> Well, if in an acreage I found an independent who had spent more energy and discovered oil, this would permit me to talk to his neighbor and tell him, "Look here; your neighbor has discovered oil. You are almost on the same structure. Come on, now: try to drill."[39]

Exxon, first to strike oil in commercial quantities, had finished pipeline and port facilities and was exporting oil by 1961. The Oasis Group (Continental, Marathon, and Amerada) were supplying Europe with Libyan crude by the end of 1962. What made the Libyan situation unique was that the independents produced nearly 46 percent of the 1.2 million barrels per day production. Due to the oil import quota, Libyan crude was marketed almost entirely in Western Europe, causing a quick drop in the price of oil in that market. For example, gasoline on the Rotterdam Spot market fell 22 percent between 1961 and 1965 while Libyan crude soared.

In 1966 Libya initiated a new round of concessions, many of which were awarded to Occidental Petroleum Company, a novice in the international oil game. Occidental's chairman, Dr. Armand Hammer, was unconventional, to say the least. His enticements, bound with ribbons of red, green and black (the Libyan national colors), included the construction of a fertilizer plant.

To compound matters, Occidental was sweetening the Libyans' take just after the international oil companies' capitulation to the new Libyan tax strucccture. "Occidental was a relatively new and very rapidly rising company that was using new techniques, and also offering apparently new arrangements that were a little more favorable to the host government," Ambassador Newsome testified.

> I think it is safe to say that the advent of Occidental on the scene was not warmly welcomed by all of the other companies. There was some concern over the precedent-shattering character of the Occidental management. This view was perhaps stronger with the majors but not entirely confined to them.[40]

Occidental had tremendous success in her exploitation of Libyan oil wealth: by May 1967 she had already drilled nine successful wells and had begun commercial production. By late 1969 the small American independent was the largest producer in Libya. To give some idea of Libya's tremendous speed in increasing production capacity, it surpassed Saudi Arabian output during one quarter of 1969 -- even though Libya's reserves were miniscule compared with the Saudis'. In addition, the closure in 1967 of the Suez Canal helped Libya increase her share of the European market.

"By 1968 the increase in Libyan output had become a cause for alarm, posing a real threat to the majors continued control of the market," Dr. John Blair testified. "Not only had its growth rate been vastly underestimated, but the independents were proving to be far more important than had been anticipated."[41]

This gave companies like British Petroleum and Exxon a tremendous problem as was pointed out in a 1968 SOCAL document:

> Some companies such as Occidental, Continental and others, without large interests in the Middle East, will be under heavy pressure to expand production rapidly and therefore are not likely to limit their Libyan liftings. Their Libyan oil

will be competing vigorously with the majors' oil from the Middle East and Africa.[42]

As George Piercy of Exxon explained the dilemma that the demand-limited market posed for the majors during the 1960s:

> Well, I think that if some capacity was brought on anywhere else in the world, as Mr. Page has said, it is like a balloon and if you bring it in on one place, something has to give somewhere else, because the fact that oil was brought on here or there does not in any way mean there is any more consumption. The consumption is fixed by what customers want to buy.[43]

By the mid-1960s, Iran, having watched the Libyan developments carefully, demanded a 17 percent increase in the consortium's 1966 production commitments, which the Shah desperately needed for his development plans. The consortium insisted that 9 percent was a more reasonable production rate. The Iranian Government, fearing that the majors would be adamant in their denial of production increments, sent representatives to the British and American Governments. The Foreign Office, having listened to the representatives, took Iran's case to the State Department, charging that it was the U.S. major oil companies' fault for the consortium's inability to go above the 1966 export targets. The British accused the American Sisters of not taking anywhere near their allowable share of consortium upliftings. They went on to state that the terms of the agreements for taking quantities of crude above company-set allowables (overlifting) were more favorable to American partners in ARAMCO than the terms of inner-company agreements in Iran. The Foreign Office thus urged the Department of State to give the Iranians a percentage increase through their major multinational oil companies.[44]

Under intense pressure from the British and Iranian Governments, Deputy Assistant Secretary of State Roger Davis met with Exxon's

Vice-President Howard Page and Mobil Vice-President Henry Moses on 19 April 1966 and informed them of the diplomatic representatives' request. Both men denied unequivocally that American majors were holding down the 1966 production levels, arguing that British Petroleum and Shell were not lifting enough crude, thus resulting in a smaller percentage increase than that of the American oil companies. They also stated that neither the consortium nor their inner-company arrangements in ARAMCO favored Saudi Arabia over Iran. The two men emphasized that they and their partners were making an effort to expand 1966 liftings from Iran so as to keep the consortium's increase on par with the Middle East average.

The State Department relayed ARAMCO's argument to the British Government along with their conclusion that the international oil companies were doing their best to increase the consortium's production. The State Department went on to urge that the British Government in future encourage the consortium's members to keep their differences among themselves, and, above all, to stress that unity must prevail in their dealings with the Iranian Government. This presupposed secrecy of inter-company agreements.

Acting Secretary of State George Ball instructed the embassy in Teheran that "this sensitive subject should not become part of the argument with the Iranians."[45] The State Department refused to intervene when the companies might not appropriate percentage increases in the consortium taking the view that Iranian exports were a matter agreed upon within the Iranian consortium after each company analyzed her market demands and other production obligations. The State Department formally told the British that the production dispute was for the consortium to negotiate with the Iranians and that the U.S. Government was in no position to even suggest that the companies change their methods of allocation.

The Shah, disappointed that his production demands were shunned, summoned the top executives of the consortium to Teheran in August 1966, but to no avail. In the fall of 1966, the Shah, noting that without U.S. Government support production increases would not be adequate, attempted to get more capital out of the consortium's present assets. He made two more demands: (1) to relinquish part of the concession to the government which would attempt through a competitive bid to get more outside development in the form of countries other than the United Kingdom and the United States and to attract independent companies -- as the Libyans had done; (2) to relinquish a percentage of the consortium's crude to the NIOC so they could market the oil and sell it at a profit.

Concerned about the new Iranian governmental demands, the five American majors went to Washington in October 1966 to seek help from the State Department, to whom they always turned in time of crisis. It should be noted that BP's perspective was also explained to the U.S. Government because she was still the single largest producer in Iran. The companies vehemently attacked the Shah's new terms, and the State Department, while mindful of Iran's long-term economic development, agreed with the companies that the Shah's budget deficits resulted from his spending too much on military hardware: "... (the Shah) is blaming us for high prices, even though it is not our idea that he should have all the most expensive equipment."[46]

The Secretary of State for Near East Affairs had been concerned by the Shah's negotiation to modernize his military, and by his pressure for more oil revenue which was related to the purchase of modern weapons. He noted that Iran was receiving military aid from the U.S. plus AID development loans and export-import bank loans.

The recommendations of the five American majors (with a great deal of quasi-official input by their partners BP and Shell) was, as Piercy of Exxon summed up: "The companies will appreciate anything Ambassador Meyer (U.S.) and Sir Denis Wright (British) can do to keep the lid on and they hope it might be possible for them to find out more about what is really going on in Teheran." Assistant Secretary Hare declared that the U.S. Ambassador in Teheran would continue to do what he could to "keep the lid on" Iran's demands. "As the visitors started to leave," the State Department record notes,

> Hare asked if his understanding was correct that the companies did not wish the U.S. Government to become involved in the substance of this problem at this time. He was assured that the companies desired only that the U.S. Government do its best to dissuade the Iranians from rash action and discretely probe Iranian intentions.

In early November the British Government, which seemed at this point to take a much more independent line from British Petroleum (as contrasted with the State Department), requested a meeting concerning the Shah's demands with the State Department. The Foreign Office considered a solution vital, directing the consortium to respond with counter-proposals. They stated that they would put pressure on BP and Shell to be as forthcoming as possible and hoped that the State Department would do the same with her nationals in the consortium.

The British, armed with statistics, reitereated that the U.S. majors were not overlifiting as pursuant to their agreements, thus failing to deliver an annual increase in Iran which would satisfy the Shah. In response the U.S. Government insisted that her figures did not agree, and defended the consortium, saying that the companies were giving the Iranians adequate annual growth. The Department's position concluded: "We are convinced that this has been the case solely because the companies could not fit that volume of Iranian oil into their global crude oil requirement."[47]

Hence, the U.S. Government viewed herself as merely a good broker in urging the companies and the Iranians to reach a solution. While she strongly disapproved of acquiescing to the Shah by giving the NIOC a greater say in the production and disposition of oil, she insisted that oil concession contracts should be respected by foreign governments. In effect, then, the State Department was at the oil companies disposal in this matter.

The consortium secretly agreed to an 11 percent annual increment and the relinquishment of 25 percent of its concessions, allowing NIOC to buy "oil in kind".

An international oil consultant privately advised the Under Secretary of State to encourage the U.S. companies to eliminate the secret agreement immediately. The Department discussed the problem with the U.S. companies but decided against making a specific recommendation since the consortium had already begun to consider a relaxation of its overlifiting arrangement. "The overlifting arrangement is a highly sensitive, intercompany commercial policy matter with implications for the competitive situation among the major and independent companies and of the companies in other countries versus Iran," the State Department concluded in December 1966. "These sensitive aspects make it desirable for the U.S. Government to limit its involvement in this problem unless urgent reasons arise for doing so."[48] The Department restricted itself to monitoring the situation while the consortium moved in mid-1967 toward lowering its overlift price from the posted price to a half-way price.

In 1967 the Iranians somehow secured a copy of the secret participants' agreement, and the companies immediately suspected each other of leaking the tightly held information. The State Department tried to minimize the damage by suggesting that "it would be to the consortium's advantage if it could see its way clear to giving the Iranians the same advantage as the Saudis now enjoyed."[49]

Although OPEC had been founded in 1960, it had lacked the leadership needed to unify the organization, allowing it to reach its potential as a force limiting the exploitation of its oil by the British and American companies.

With the Libyan revolution, however, that leadership emerged, and the effect was devastating. The OPEC countries learned the game quickly and by using many of the techniques perfected by the oil companies themselves, managed to shift the advantage away from the firms, into their own laps.

On 1 September 1969 Libyan Colonel Muamer Qaddafi deposed King Idris. Qaddafi's first priority was the removal of British and American military bases from Libyan soil. Meanwhile, on 26 October 1969 the Shah of Iran said that if the United States increased its imports of Iranian oil, Iran would spend the money earned from the sale on American goods. On 1 December 1969 OPEC ended its three-day meeting in Qatar at which discussions centered on participation, Algerian negotiations with France, and member control over production programs. Algeria became an OPEC member. By 7 January the National Oil Companies of Algeria, Libya, Iraq, and Egypt ended a three-day meeting on their policies toward foreign monopolies operating in their countries. Iraq announced the cancellation of Article 3 of Law No. 80 of 1961, which allowed the government to allocate other lands to the IPC in lieu of the concession areas expropriated under the law. This announcement came on 12 February 1970.

By January 1970 Qaddafi's regime had started its campaign against the oil companies for unprecedented increases in oil revenue: the revolutionary government, through Qaddafi, made it a matter of public record that the American oil companies should pay handsomely for their government's pro-Israel stance.

What made this argument so persuasive was the fact that Libya's small population -- even with its recent oil wealth, upon which it was not dependent -- and its leaders boasted that they lived 5000 years without petroleum and could do so again.

Neither the oil companies nor the embassies in Tripoli had anticipated the 1969 revolution, nor were they familiar with the members of the Revolutionary Command Council (RCC). They could not, therefore, anticipate the revolutionary changes that the radical government would make concerning Middle Eastern oil.

The American Government believed wrongly that Oaddafi's regime had a firm domestic political base and that Libya's strong nationalistic and religious fanatics would be compatible with the foreign policy objective of maintaining American investment coupled with sphere of influence in Libya. So when the Libyans demanded the closing of Wheelus Air Force Base and the removal of any British military presence, the Americans acquiesced. Again in 1970 when there was domestic resistance to the

Qaddafi regime, the American embassy learned of the attempted expedition and informed the Libyan Government. The rationalle for this extraordinary act was the safety of American nationals in Libya, i.e., the oil companies' employees, and that the U.S. did not want the Qaddafi regime to think that she was in any way or form associated with the anti-Qaddafi movement.[50]

From the first days of his regime, Qaddafi made it quite clear that one of his main objectives was to exact better terms from the oil companies for the express purpose of discrediting the Idris regime. Early in 1970 Qaddafi started negotiations with two diverse American companies -- Exxon, the largest oil company in the world, and the maveric independent, Occidental. The Revolutionary Command Council (RCC) promptly admonished the multinational companies for stalling the negotiations, and warned the U.S. that her petroleum interests in the Middle East were balanced on a razor's edge due to her support for Israel.

At this point oil can no longer be classified in terms of commodity, but must be considered in relation to the greater geopolitical aims of the Qaddafi regime. For the regime now threw open its door to every foreign firm that had a proposal regarding Libyan oil. Officials of governments and companies from Russia, Hungary, Germany, France and Japan as well as many of Libya's OPEC partners, met in Tripoli.

The companies were shocked at the Libyan demands. As the negotiations continued throughout the Spring, Exxon publicly announced that she did not believe Libya's demands were justified, or that Libya would expropriate her operations. However, on 15 March 1970 the RCC formed the Libyan National Oil Corporation (LINOCO) which took over all oil and gas distribution in Libya on 5 July 1970, announcing that companies would be paid compensation for their nationalized holdings. To compound matters, the Trans-American Pipeline was ruptured and the Syrians refused to allow any repairs -- a situation which aided Libya's position immensely, making Qaddafi's low sulphur oil, along with her geographical location on the right side of the canal, the most attractive oil to the European market.

Thus when the Libyans posted their prices upwards, it not only effected rates in Libya, but those in the entire Persian Gulf. This gave rise to the operative word of the Libyan experience -- leapfrog. The Libyan Government simply ignored Exxon by breaking off all negotiations and concentrating on Occidental, renewing her nationalization threats against the independent as the first anniversary of the revolution approached.

It was rumored that Occidental was damaging the oil fields through overproduction. Thus Occidental had unique and peculiar vulnerabilities to the Libyans, and in a matter of months her production was cut from 2 million barrels a day to 500,000 on 12 June. Since her crude oil and profits were largely concentrated in Libya her negotiating position with Qaddafi was precarious.

When Shell refused to accept similar demands to those made to the independents, she was promptly refused permission to produce any more oil. Exxon was similarly denied the right to export light natural gas (LNG) from its new plant.

James Aikins, U.S. Under Secretary of State for Petroleum Matters, speculated that an Iranian-type boycott in the face of Libyan nationalization would fail due to Europe's total dependence on Libyan oil.

> It was also to our interest, I thought, that the companies have a reasonable working relationship with the Libyans and

> with other producers. If the Libyans concluded they were being cheated, this I thought guaranteed a breakdown in relations with the companies and all sorts of subsequent problems .... If Libya moves in and takes over the companies, Europe, one way or another, is going to get Libyan oil, and if the companies then try to block the sale of Libyan oil, as they said they would, through controlling their tankers or people that bought the Libyan oil, in this case, they would find themselves nationalized in Europe as well.[51]

The international majors were thus confronted with fundamental strategy. If they refused the regime, they would probably lose their concessions; if they acquiesed, Libya would not be the only country to receive better terms, but the idea would soon "leapfrog" to the rest of the Persian Gulf. Thus the oil companies' situation was of crisis proportions, and they turned for help to their home governments, i.e., the U.S. State Department and selected bureaucrats from Whitehall's upper echelons.

Exxon felt she could stand up to Libya. Thinking the independents were responsible for the European price war by dumping excess Libyan crude, the majors refused to support Occidental. Occidental knew that the only way she could withstand the Libyan pressures was to secure guarantees of crude supply from one of the Seven Sisters in the eventuality of a Libyan shut-in. Having received no help from the majors, Hammer of Occidental went to Tripoli to make the best deal he could with the Libyan Government under the circumstances. The resulting agreement contained the most radical increases in revenue for the producing countries since 1950.

The agreement with Occidental set a precedent giving the Libyan Government tremendous leverage in coersing the other independents to follow suit. Libya was now to move into battle with some of the largest organizations in the world -- Exxon, Texaco, Mobil, and SOCAL from the

American side, and British Petroleum and Shell representing Western Europe. On 22 September the Libyans gave these companies five days to accept their demands or the alternative of a production shut-down. The ultimate success of Quaddafi in achieving an incredible 30 percent increase in the posted price as well as an increase in the entire tax-rate structure presented a new situation.

Elsewhere, the NIOC and the Iranian consortium had met on 12, 13, and 14 March but failed to reach an agreement. A second meeting ended on 20 April -- still without agreement. By 6 May an Iranian Ministry of Finance communique announced that negotiations had been successfully concluded. The Shah of Iran stated on 8 June that the present system of exploiting companies must disappear, noting that profits are not made at the well head but downstream. The Iranian consortium agreed on 9 September to raise crude production by 200,000 barrels a day. However, by 6 October the Shah warned the consortium either to increase production again or face the consequences.

An American firm, Distrigas Corporation, a subsidiary of the Cabot Corporation, signed a long-term contract for Algerian LNG on 16 March 1970. By 20 May the 1965 Kuwait-Saudi Arabian agreement to divide the neutral zone between their two countries went into effect. Oil ministers from Libya, Algeria, and Iraq issued a communique dated 23 May stating that the limits on company negotiations would be set, realizing their demands by unilateral action if necessary, and establishing a joint fund in case of a confrontation with the companies. Algeria nationalized the holdings of Royal Dutch Shell, Elwerath, and Phillips on 15 June. Algerian President Boumedienne suggested bypassing companies by direct contracts between producing and consuming countries at the

OPEC meeting on 24 June. Algeria had raised the reference price of CFP crude retroactively to January 1969 just three days prior to this, an act which France rejected, requesting arbitration under the 1965 Franco-Algerian Agreement. By 30 August Iraq signed an agreement with Soviet Techno-Expert for the development of the North Rumaylah Field -- similar to the 1967 Franco-Iraqi Agreement. By the end of September the companies raised the posted price of Iraqi crude by 20¢ a barrel.

The governments and their oil companies knew that the entire pattern of concession agreements worked out since the 1920s would be shattered. Under Secretary of State Johnson convened a meeting of the major and independent companies plus BP and Shell on 25 September 1970, the main purpose of which was the discussion of the Libyan shut-down of production.

Sir David Barran, then Chief Executive Officer of Shell, urged that ...

> the dangers to our own and the consumers' interests lay much more in yielding than in resisting the demands then being made upon us ... our conclusion was that sooner or later we, both oil company and consumer, would have to face an avalanche of escalating demands from the producer governments and that we should at least try to stem the avalanche. [Barran, however, was] left with the impression that the U.S. Government officials were not at all convinced by it.[52]

John J. McCloy, attorney at one time or another for twenty-nine oil companies, including all seven Sisters, who attended the meeting thought that the Under Secretary offered little hope for help from the government, for now she had little or no influence in Tripoli and such intervention would be "ineffective at best". It would be superfluous to offer economic aid to proportionately one of the richest countries in the world, thus rendering the State Department ineffective.

By 30 September the remaining companies involved agreed to Libya's demands for increases in the posted price and a 5 percent tax hike. The oil companies' worst scenario was becoming a reality: the effect of the Libyan leapfrog was swift and dramatic. Kuwait demanded that British Petroleum was paying too low of a posted price and the same pattern was followed throughout the Persian Gulf, from where it jumped into Nigeria, and by early December of that year, into Venezuela. No country or company now had impunity from oil prices or supply fluctuations after Libya.

Against this backdrop of rapid price increases, OPEC sensing victory met in Caracus in December 1970. John J. McCloy summarized OPEC's demands from the companies' point of view:

> The companies were thus faced with the threat of repeated "leapfrogging" on pain of seisure of oil producing properties or serious stoppages with consequent disruption of the supply of oil to the consuming countries. In the circumstances, it was clear that the only hope of achieving stability of supply was for the companies to join together and negotiate with all members of OPEC as a group. Unified action by the governments required unified action by the companies. This was not only in their own interests but in the interests of economic stability in Western Europe, Japan and Australia, which were heavily dependent on the Middle East as a source of energy supply. Confronted with the mounting demands of foreign governments acting in concert, the companies resolved to attempt to devise a mechanism which would tend to equalize to the extent possible, the bargaining powers of the two sides.[53]

On 9 October 1970 Hammer of Occidental met with Sir David Barron of Shell in London and advised him of his earlier unsuccessful efforts to secure assurances from the major oil companies about stubstitute oil to replace production that his company might lose in Libya, as a result of resisting Libyan demands. In late 1970, Hammer again contacted Sir David. He asked him "whether Shell would be prepared to make oil available to so-called 'independent' companies producing in Libya in order to strengthen their negotiating position vis-a-vis the Libyan Government." Sir David replied that his company would cooperate in any industry-wide agreement that could be arranged to replace production cost by independents in the course of resisting Libyan demands.

> ... my initial doubts about the feasibility of the oil industry putting together such an arrangement, since I was uncertain about the legal and practical issues involved in it, but assured him that, if suitable arrangements could be devised by the industry, Shell would participate in them.[54]

> Our Shell view was that the avalanche had begun and that our best hope of withstanding the pressures being exerted by the members of OPEC would lie in the companies' refusing to be picked off one by one in any country and by declining to deal with the Producers except on a total, global basis.[55]

Thus, a quasi-international legal agreement, the Libyan Producers Agreement (also known as the Safety Net Agreement), came about which was a sophisticated form of insurance that provided, in essence, that if one company was forced to cut production by the Libyans while resisting Qaddafi's demands, the other producers in Libya would replace the shut in production with crude oil at near cost. This broke several domestic U.S. laws but when the companies turned to their friends in the State Department, clearance was granted to circumvent the law.

The oil titans thus sent the message to OPEC that under no circumstances would piecemeal negotiations with individual OPEC countries be tolerated.

> We have concluded that we cannot further negotiate the development of claims by member countries of OPEC on any other basis than one which reaches a settlement simultaneously with all producing governments concerned. It is therefore our proposal that an all-embracing negotiation should be commenced between representatives of ourselves ... on the one hand, and OPEC as representing all its Member Countries on the other hand, under which an overall and durable settlement could be achieved.[56]

The companies also approached the U.S. State Department for assistance in persuading the OPEC countries to moderate their demands and engage in fair bargaining practices. McCloy explained before the Senate Hearings:

> We thought that in addition to what we were endeavoring to do in the way of the OPEC message and the other arrangements that we were making with respect to Libya that it would be wise if the Government could enter into this thing and get the heads of the countries involved to moderate their demands, to persuade them at least to engage in fair bargaining practices, and we, without specifying any individual, just felt we would like to have the assistance of the State Department, whatever assistance the State Department could give.
>
> As a result of that, Mr. Irwin -- we were told that Mr. Irwin would be prepared to make a tour through those producing countries, and he did go off on that, and that was the object of his mission.

Senator CHURCH	:	Did you, yourself, suggest that Mr. Irwin be the one?
Mr. McCLOY	:	No. As long as it was a person of dignity, with clout, to use that expression.
Senator CHURCH	:	With clout, high-ranking.
Mr. McCLOY	:	That is right.
Senator CHURCH	:	At the meeting or those meetings with the State Department, did you emphasize the reasons for and the importance of a united front?
Mr. McCLOY	:	Yes, I thought it was important that we have some form of collective bargaining here. Otherwise, the weakest in the chain would be taken off and the pressures would be duplicated by reason of that.
Senator CHURCH	:	Did you explain the experience that the industry previously had with the ratcheting effect of Libyan prices going up and then Persian Gulf prices going up?
Mr. McCLOY	:	Yes.
Senator CHURCH	:	And your desire to avoid that in the future?
Mr. McCLOY	:	As far as possible, yes.[57]

President Nixon personally authorized Ambassador Irwin to travel to Teheran and Tripoli to place the power and prestige of the U.S. Government and the West at the disposal of the oil companies.

As Irwin understood it, the general objectives of his mission were: (1) To prevent an imminent impasse in discussions between the oil-producing countries and oil companies from resulting in an interruption of oil supplies; (2) To explain the reasons why the U.S. Government had taken steps to make it possible under American antitrust laws for the oil companies to negotiate jointly; and (3) To seek assurances from the Gulf producers to continue to supply oil at reasonable prices to the free world.[58]

Irwin arrived in Teheran on 17 January where he told the Shah that the U.S. Government was not in the oil business, and further, that they did not intend to get involved in the details of the producing countries' negotiations with MNCs.[59] Irwin, impressed by the Shah's arguments accepted his assurances that the Gulf countries would not be influenced by whatever deal was concluded with Libya, regardless of the terms, and recommended that the State Department "encourage the companies to negotiate with the Gulf countries separately unless the companies had good reasons to the contrary."[60] The Shah informed Irwin that any attempt by the companies to say that they would not sign the agreement unless other OPEC members signed it would be taken by them and OPEC as a whole as a sign of bad faith. On the other hand, if the oil companies dealt with the Gulf producers as a separate group, the latter "were prepared to sign an agreement, even though producers in other areas obtained better terms from the companies.

Finally the London Policy Group (LPG) was formed: all the participating companies were invited to send their most senior executives to London (they would also have a counterpart based in New York) to unify their negotiating position with OPEC members. McCloy summarized the organizational functions of the LPG as follows:

> The principal function of the London Policy Group was to establish the terms of reference for the negotiating teams in Teheran and Libya: to assist chief executives in selecting the team members as well as the members of the groups of technical experts to accompany the teams to Teheran and Tripoli. The principal function of the New York group was to review and comment on policy decisions proposed in London and to provide technical expertise and information to London for use in connection with the negotiations.[61]

In New York the logistics of the entire operation were amazingly well run and organized: backup committees were formed for public relations, finance, transport data analysis with regards to freight rates, and implementation of the Safety Net Agreement, should the eventuality occur. In London parallel committees were organized. Meetings, held in New York, were held with batteries of company attorneys to consider drafting tax and legal problems in connection with the negotiations. From time to time, as important questions regarding policy arose, the chief executive officers of the companies met in New York and London. These meetings must have been of immense proportions since neither the Departments of Justice or State were allowed to attend. Instead the highest legal office and the chief foreign policy department in the U.S. had to rely upon ex post factor oral reports by company executives. It is not known whether anyone from HMG attended; it would seem likely that no one did.

The governments of the United Kingdom and the United States along with the oil companies thought that they had developed a coherent sound counter-strategy against OPEC. However, this was contingent upon OPEC's compliance with the exact terms of the message that the companies had sent, calling for one global negotiation in order to avoid a Libyan leapfrog eventuality. The precarious situation of the independents was alleviated somewhat by the Libyan Producers Agreement, giving them the needed security to withstand Libya's pressures. They were under no allusions about the magnanimity of charity on the part of the majors. Because it now suited them to support the independents, the majors were prepared if necessary to supply crude to the independents from their backup Persian Gulf concessions. (This was the same assurance Hammer had sought from Exxon but was denied in July 1970).

The LPG selected quite logically George Piercy of Exxon and Lord Strathalmond of BP to speak as a single voice for all of them. They arrived in Teheran on 19 January and were briefed like heads of state by the British, American, Dutch, and French ambassadors. They were told of the Irwin mission and of the U.S. Government's changed policy position. Ambassador MacArthur reported that both the Shah and Amozegar insisted that a one-table OPEC negotiation was a "most monumental error." Since the "moderates" could not restrain Venezuela and Libya and the resulting settlement would be at the highest common denominator.

> Mr. Piercy pointed out to Ambassador MacArthur that pursuing the Gulf negotiations by itself without any agreement on a comprehensive approach was in violation of the document (Message to OPEC) that we had submitted on Saturday. He questioned whether there was anything in the record from dealings in this area that would give us any confidence that these Gulf countries would be able to keep an agreement if we subsequently made a preposterous settlement in Libya. The Ambassador went on to urge in the strongest terms that we go ahead and settle with the Gulf. We were afraid that we did not get across to him the complexity of our agreements with all the companies involved, both the majors and the independents. The essence of the combined strategy did not seem to be appreciated. The Dutch Ambassador seemed to promptly grasp the

situation, and volunteered that what was being suggested was in violation of the statement submitted on Saturday.[62]

Piercy had thought that the message to OPEC which committed the companies to global negotiations had been approved by their home governments. Amouzegar declared: "If you think you have a problem with your Governments, I am quite confident that they will agree to a regional or Gulf approach."[63]

McCloy was not convinced by the Shah's assurances that the Gulf countries would adhere to a new price structure if the terms were less advantageous than the ones accorded Libya or other OPEC countries. As he sarcastically referred to the State Department's decision for the companies to split the negotiations: "We weren't too much impressed, if I may say so, by the attitude of the U.S. Government."[64]

Thus the grand battleplan with its elaborate apparatus of the Western oil companies and "tacid approval from their home governments" had been totally undermined by Irwin's Mission to the Middle East and the resulting adaptation of Irwin's recommendations. The OPEC nations, through their Gulf Committee, had illustrated vividly that they could split the industry negotiators from their governments -- something the oil companies used to do with sovereign states. OPEC had devised a coordinated strategy and maintained it, whereas the governments of the West and the industry seemed totally uncoordinated. Henry Schuler, Bunker Hunt's chief representative in the LPG, summed up quite succinctly the position they now faced: "The momentum had shifted to OPEC."[65]

From this time onward, OPEC would succeed in the 1970s much in the same way as the British and American companies succeeded for decades. The negotiations that followed showed the industry retreating with OPEC demands escalating.

In talking with Strathalmond and Piercy, Amouzegar insisted that the companies must change their position in the negotiations rather than the governments since OPEC was an intergovernmental, not a supranational organization. OPEC's Gulf Committee would have nothing to do with East Mediterranian postings to act as a hinge to link the Gulf settlements with later agreements in Libya. On 22 September 1971 the OPEC meeting in Beruit passed Resolution 139 calling for effective OPEC participation in the companies' assets on an individual, country, or group basis. Next they passed Resolution 140, calling for "necessary action and/or negotiations" to avoid what they felt was the adverse effect of the floating dollar.

After the briefing, Strathalmond and Piercy met with Amouzegar, Saudi Arabia's Amani, and Iraqi Oil Minister Hamadi. Strathalmond sought in vain to convince the "moderates" of the need for global negotiations. When the global approach had been abandoned, the companies adopted a "separate but necessarily connected formula."

In reality this meant that discussions were to be held in "groups comprising fewer than all OPEC members, but with the understanding that it be realized that any negotiated settlement must be acceptable overall and would not lead to further leapfrogging."[66]

The precept was to present one all-encompassing proposal simultaneously in two separate cities -- Teheran and Tripoli. This necessitated the diplomats of the oil industry to split into two sections; a Libyan team, led by Exxon's Piercy, and a Persian team led by BP's Lord Strathalmond. "Neither half of the team should be prepared to negotiate on the proposals or counter-proposals. The line to be taken would be the team as a whole may consider what new terms are presented to both groups to insure that there was no doubt as to what we are intending."[67]

Nonetheless, as with their strategy of global negotiation, so this "separate but necessarily connected" scheme was also abandoned almost from the outset. The Gulf Committee demanded immediate substantive negotiations and in a letter from the Iranian finance minister proposed this to Lord Strathalmond, who by instruction should have rejected the letter for the LPG, instead accepted the letter and, supported by the British and American embassies, returned to London to receive instructions for new terms.

When this also failed, the LPG attempted to make the two regional settlements "hinge" together. In essence, they were trying to tie the terms of sale of the world's oil to the Persian Gulf in the hope that they could thus impose on Western Mediterranean supplies, and isolate the wild-eyed Libyans. The companies believed that the independents, secure in the Safety Net Agreement, could now withstand Libyan pressures.

Meeting total resistance on this policy as well, the LPG and the New York heads accepted Strathalmond's assessment about East Mediterranean postings and recognized their hinge was nonnegotiable, and instead tried to get Gulf assurances against embargoes and price ricocheting. On 14 February 1971 the Teheran Agreement was signed between the companies and the Gulf Committee to bring about security of supply and stability of financial arrangements, which was intended to last through 31 December 1975.

An important aspect was an anti-leapfrogging amendment that simply stated that the Gulf countries would not seek to obtain advantageous terms which might be negotiated by other Gulf states. In addition, there was a 30¢ a barrel increase in price. McCloy felt that from the financial aspect the costs were extremely high, but went on to comfort the U.S. and Britain on the grounds that in return for the increase, the companies had security of supply and price stability for a five year period.

The supposition that the Teheran agreement would last five years was preposterous. Even before the agreement was concluded, Piercy was told by Yamani in Teheran "that he was not so sure that we would obtain the five year stability that we were seeking."[68]

Yamani knew that the companies had no spare capacity outside OPEC and thus the oil companies had lost their advantages in negotiating with the Gulf countries. To compound matters, reserves in the U.S. had declined to virtually zero.[69] Yamani had thus observed to Piercy, "George, you know the supply situation better than I. You know you cannot take a shutdown."[70]

The Libyans stated that they would not even begin negotiations until those with Teheran were concluded, making it obvious that Libya would seek to better whatever terms the Gulf states reached. After the Teheran Agreement the Libyans settled with the companies on 20 March for a 65¢ a barrel increase over their agreement of September-October 1970. Thus, once again Libya forged ahead of the Gulf-producing countries, who reacted swiftly despite their earlier claims.

> Despite earlier insistence on the conduct of Gulf negotiations independently from negotiations covering Mediterranean exports, and professed lack of concern for the outcome of the Mediterranean discussions, Iranian officials expressed with increasing vigor the resentment of Iran at the outcome of Libyan negotiations.[71]

Before a solution between the Gulf countries and the LPG could be reached in Geneva, on 7 December 1971 Libya nationalized all of BP's rights and assets in Libya following Iranian occupation of three tiny islands in the Persian Gulf. The Iranian occupation was blamed on the British Government since the islands were nominally under British protection until a day after the occupation.

The oil weapon was now a potent political tool; Qaddafi's nationalization transformed him into the champion of Arab political causes. Shortly afterwards on 1 June 1972 Iraq Petroleum Company followed suit.

After the signing of the general agreement, Libya, who now had a classic pattern of expropriation and nationalization, tried to demonstrate that she could obtain better participation terms than those of what Qaddafi perceived as his weaker, politically moderate bretheren in the Persian Gulf. In her usual role of attacking individual oil companies one by one, Libya trained her sights on the independent Bunker Hunt, BP's partner, who was now unabashedly vulnerable. Libya demanded 50 percent of the Texas company's assets.

Hunt, feeling some security in the Producers' Agreement, rejected Qaddafi's demands for 50 percent participation and instead, offered to negotiate on the basis of the Persian Gulf's terms agreed with Sheik Yamani, only to have all her Libyan assets nationalized on 11 June 1973. In August 1973 Occidental Petroleum had no choice but to accept Libyan participation demands of 51 percent at new book value compensation. As in September 1970, the independent companies -- as a domino column -- capitulated to Libyan demands.

Soon after the fall of the independents to Libyan participation, the remaining companies -- Exxon, Mobil, Texaco, Shell, and ARCO -- were also decreed to have 51 percent participation with the Tripoli Government.

The U.S. Government reacted swiftly but totally ineffectively by suggesting an Iranian style embargo. In a Presidential news conference, the following exchange took place:

> Question. What exactly are you doing to meet these threats from the Arab countries to use oil as a club to force a change in our Middle East policy?
>
> Answer. The radical elements that presently seem to be on ascendancy in various countries in the Mid-East, like Libya. Those elements, of course, we are not in a position to influence them, influence them for this reason: oil without a market, as Mr. Mossadegh learned many, many years ago, does not do a country much good.
>
> We and Europe are the Market and I think that the responsible Arab leaders will see to it that if they continue to expropriate, if they do expropriate without fair compensation, the inevitable result is that they will lose their markets, and other sources will be developed.[72]

Nonetheless, the New England Petroleum Company, the third largest purchaser of Libyan crude, began purchasing her supplies directly from the Libyan Government, circumventing Standard Oil of California. Her pattern was soon followed by other companies purchasing nationalized oil from the Libyan regime -- no matter what the legal consequence.

The OPEC meeting in September made new negotiations with the Gulf states inevitable. Thus, on 20 January 1973 the LPG's opening offer in Geneva, which was based on the IMF index of export data was quickly dismissed and the companies were forced to accept OPEC's unequivocal demand that gold be the point of reference and that posting be increased by 8.9 percent. Once the currency parity question was resolved, participation came to the forefront in the Geneva talks. OPEC's initial suggestion of 20 percent ownership quickly escalated to 51 percent participation, for which the OPEC countries would pay only net value. The companies could buy back the shares at a considerably inflated price. By 5 October 1971 the companies and five producing governments in the Gulf reached an agreement in New York providing for government participation in the producing concessions. It would start with an immediate 25 percent government share and progress until 51 percent ownership, management structure, and exact role of host governments to each of the parties involved, which proved to be its undoing. The Kuwait National Assembly refused to ratify the settlement and reopened negotiations.

The Libyans were also instrumental indirectly in other negotiations in the Middle East. From December 1972 to December 1973 the ARAMCO consortium negotiated with the Saudis, ending in a stalemate as it became obvious that the Saudis were watching developments in Libya and Iran. Finally in August 1973 Yamani told the companies what the new arrangements would be: the Teheran Agreement was certain to be renegotiated before 1975; the next change would be a very large one; it would be imposed rather than negotiated; and -- like the "wild ones" in OPEC would insist on very high prices leaving the companies no real choice. Yamani then began a discussion of the stability of the participation agreement, reviewing the developments country by country and finally saying, "You will have to improve on the Kuwaiti deal if you are to avoid nationalization and then I'll have something even better than Kuwait."[73]

As the negotiations reopened on 13 September, Yamani and Taher told the company team that the developments of the last few weeks had drastically altered the participation issue. Yamani said that Kuwait would not accept the 51 percent that Libya had taken in August; it would have to press for more. Observing that the European governments, in need of sweet crude would not support the major companies in their efforts to stand off Libyan nationalization, Yamani added that the deal in Iran which enabled the Shah to say he had full control required Saudi Arabia to react forcefully. Throughout he told the companies that there were political problems the companies did not understand, that participation was being described as a sham in which ownership is given with one hand and taken back with another. After making demands that the companies immediately accept a buyback price set at 93 percent of posted price, Yamani told the companies he would meet with them again in ten days in the United States.

On 17 September 1973 in San Francisco the company negotiators surrendered to Yamani's terms of 93 percent buyback price with an escalation clause for increases resulting from changes in the posted price from the agreement in Geneva. From this time on, buyback prices were set by the average sale of third party customers. Before the agreement could be signed Yamani left the country, and in the interim the October war in Israel started and the rapid moving events of oil were thrown into chaos.

While the Libyan leapfrog had taught OPEC members to play against one another effectively in dealing with the oil companies, the organization still lacked any single unified motivation. What advantages the OPEC members had gained before the Israeli War of 1973, could probably have been acquired without any formal organization. They had been functioning in much the same way as the world oligopoly members had been operating for years without any formal unification.

The Israeli War presented a temporary unifying factor. Each leader was safe in assuming that his people would favor action against Israel based on historical enmity. Each leader also knew that increased oil revenues meant rapid development and was therefore the key to obtaining all the other objectives of his particular government. By using Western support of Israel as an excuse to evaporate the existing surplus and raise prices, the Middle East leaders of OPEC stood only to gain in the short-term.

Without deliberating in any great detail over the long-term effects, and without much anticipation of success, the boycott was called. It was immediately successful beyond OPEC's wildest imaginations: The price of oil quintupled and although Israel was effected only superficially, propaganda gains were sufficient to satisfy the domestic goals of the OPEC leaders. As the boycott faded from view, so did the warlike emergency cooperation between OPEC members.

In effect then, struggle over sovereignty was a key issue in the Middle East between home governments, host governments and MNCs. Iran in the 1950s illustrates the international application of principles established on a municipal level in Texas in the 1930s. Iran, like the independents in Texas, wanted more upliftings; whereas, the majors preferred not to rely so heavily on any one source. After nationalization, British Petroleum declared Iranian oil "hot" and applied that concept on a global basis. The effectiveness of the boycott was due primarily to voluntary cooperation on the part of the majors. The independents, on the other hand, were viewed by the majors as a disruptive force until they could be neutralized by appeasement. The use of clandestine activities to affect favorable results, while following the example set in the East Texas oil fields, would never again be so blatant as was the CIA action in Iran.

The changing relationships in the Middle East reflect the general alterations in the international legal regime. With the decline of Britain's military strength at the close of World War II, her political strength was also diminished which therefore effected BP's long-standing association with Iran. The American Government's involvement illustrates her management of her new role as the world's policeman with her traditionally strong protectionist attitude toward her oil companies operating abroad.

Refusal by the Seven Sisters to sell oil directly to the American and British fleets during the 1973 Middle Eastern Crisis, in effect, marked a shift in policy promoting company interest above patriotism on the list of company priorities. This action shocked the Americans into convening the famous MNC Congressional Hearings, investigating the companies' improprieties and reviewing the threat of nationalization. Britain's position with BP was even more paradoxical because of her partial ownership. Heath used the threat of a government veto but to no avail.

BP's relationship with the American companies survived the competitive struggle and reinforced her allignment with her Sisters in order to minimize the independents' involvement in the Middle East. Since 1973 these major companies have illustrated near-sovereignty in their global actions.

As we have seen, Qadaffi created a new model in his concession agreements which favored independents. He utilized the divide-and-conquer methods of the oil companies to his own advantage in regulating the development of his own fields, irrespective of global supply imbalances. His leapfrog concept was essentially applied in order to exact unprecedented prices; however, in so doing, previously uneconomical sources of crude became viable. Sanctity of contract, good faith, etc., were interpreted differently in the Middle East than in the West, negating any long-term security of supply and price stability. Therefore, the U.K. and U.S. Governments, spurred by the Arab boycott into encouraging development of their own indigenous oil in the North Sea and Alaska, respectively, have strengthened the hands of the oil companies by diminishing their dependence on Middle East crude.

Notes to Chapter 8

[1]Odell, p. 75.

[2]U.S., Congress, House, Committee on Government Operations, United States Aid Operations in Iran, Hearings before the Sub-Committee, 84th Cong., 2nd Sess.

[3]From MNC Hearings, "Background Paper," 10 September 1950, Part 7, pp. 122-134.

[4]From MNC Hearings, "State Department: Summary of U.S. Governmental Actions to secure the cooperation of American oil companies in a settlement of the Iranian Oil dispute," Part 8.

[5]From U.S., National Security Council, NSC 107/2.

[6]Winston Churchill in The Times (London), 7 October 1951.

[7]From Henry F. Grady, "What Went Wrong in Iran?" Saturday Evening Post, 5 January 1952, p. 57.

[8]From Dean Acheson, Present at the Creation, (New York: Signet, 1969).

[9]From Hossein Sheikh-Hosseini Noori, "A Study of the Nationalization of the Oil Industry in Iran," Ph.D. Thesis, University of Colorado, Boulder.

[10]From MNC Hearings, Part 7, p. 298.

[11]From Noori, pp. 249-250.

[12]From Jerrold L. Walden, "The International Petroleum Cartel in Iran -- Private Power and the Public Interest," Journal of Public Law. 2: (Spring 1962) 17.

[13]From Mikdashi, p. 167.

[14]From Mikdashi, pp. 158-159.

[15]From U.S., State Department, Summary of U.S. Government Actions to Secure the Cooperation of American Oil Companies in a Settlement of the Iranian Oil Dispute, MNC Hearings, Part 8.

[16]From U.S., Congress, Senate, Select Committee on Small Business, Monopoly Sub-committee Print, International Petroleum Cartel Case, [hereafter cited as Monopoly Sub-committee Print, International Petroleum Cartel Case] (21 February 1974), p. 26.

[17]From Noori, pp. 248-253.

[18]New York Times, 10 July 1953.

[19]From Noori, pp. 248-253.

[20]U.S., Congress, Senate, Report of the Federal Trade Commission, 1973, p. 11.

[21]From Sampson, p. 141.

[22]From David Wise and Thomas B. Ross, The Invisible Government, (New York, 1957), p. 110.

[23]Sampson, p. 141.

[24]U.S., House, Committee on Foreign Affairs, Hearings on the Mutual Securities Act of 1954, 83rd Cong. 2nd Sess., pp. 503, 569-570.

[25]From Monopoly Sub-committee Print, International Petroleum Cartel Case, p. 57.

[26]Monopoly Sub-committee Print, International Petroleum Cartel Case, p. 58.

[27]Myra Wilkins, The Making of a Multinational Enterprise, (New York, 1973), p. 322.

[28]Monopoly Sub-committee Print, International Petroleum Cartel Case, pp. 60-61.

[29]From MNC Hearings, Part 8.

[30]Monopoly Sub-committee Print, International Petroleum Cartel Case, p. 76.

[31]MNC Hearings, Part 8.

[32]MNC Hearings, Part 8.

[33]From Jean-Marie Chevalier, The New Oil Stakes, trans. by Ian Rock, (London: Allen Lane, Penguin Books Ltd., printed by Western Printing Services Ltd., Bristol 1975), p. 28.

[34]O'Connor, p. 295.

[35]MNC Hearings, Part 8.

[36]MNC Hearings, Part 7, p. 298.

[37]Allen 1. Occidental, 67 Civ. 4011 (S.D.N.Y.) Deposition of Faud Kabazi.

[38]MNC Hearings, Part 5, p. 105.

[39]Allen 1. Occidental, 67 Civ. 4011 (S.D.N.Y.) Deposition of Faud Kabazi.

[40]Statement of Ambassador Newsome before the Sub-committee on Multinational Corporations, 24 January 1974, MNC Hearings, Part 9.

[41]MNC Hearings, Part 9.

[42]MNC Hearings, Part 7, p. 362.

[43]MNC Hearings, Part 7, p. 308.

[44]MNC Hearings, Part 8.

[45]MNC Hearings, Part 8.

[46]"State Department Memorandum of Conversion," MNC Hearings, Part 8.

[47]"State Department Memorandum of Conversion," MNC Hearings, Part 8.

[48]MNC Hearings, Part 7, p. 288.

[49]MNC Hearings, Part 7, p. 288.

[50]See testimony of Ambassador David Newsome retained in Sub-committee files, MNC Hearings, Part 5.

[51]MNC Hearings, Part 5, pp. 6-7.

[52]From MNC Hearings, Part 9.

[53]Report of J. McCloy to Hon. Richard W. McLaren, 23 July 1971, MNC Hearings, Part 6, p. 234.

[54]MNC Hearings, Part 5, p. 256.

[55]From Barron's testimony in MNC Hearings, Part 9.

[56]MNC Hearings, Part 9.

[57]MNC Hearings, Part 5, p. 263.

[58]See MNC Hearings, Part 5, p. 147.

[59]MNC Hearings, Part 6, p. 148.

[60]MNC Hearings, Part 6, p. 149.

[61]Report of J. McCloy to Hon. Richard W. McLaren, 23 July 1971, MNC Hearings, Part 6.

[62]MNC Hearings, Part 6, p. 64.

[63]MNC Hearings, Part 5, pp. 220-221.

[64]MNC Hearings, Part 5, p. 265.

[65]MNC Hearings, Part 5, p. 123.

[66]MNC Hearings, Part 5.

[67]MNC Hearings, Part 5.

[68]MNC Hearings, Part 5, pp. 226-227.

[69]MNC Hearings, Part 5, p. 77.

[70]MNC Hearings, Part 6, p. 70.

[71]Described by McCloy, MNC Hearings, Part 5.

[72]MNC Hearings, Part 5.

[73]MNC Hearings, Part 5.

CHAPTER 9

ALASKA: THE AMERICAN LEGAL REGIME

> In any mature legal system, the law of property counts among the most technical branches of the law. It needs the change of but one word, and a more formidable subject emerges: law and property. Now, we no longer think of the writers of standard textbooks on personal or real property, but of revolutionaries in the field of property relations: William the Conqueror, Henry VIII, Pizarro, Cortez, Lenin, Stalin, Mao Tse-tung and, perhaps, even tragicomic figures such as Hitler, Musaddiq and Sukarno.
>
> Behind the technicalities of the more sophisticated systems of property law lie, shrewdly hidden, the fundamental political, social and economic decisions on which these legal rules are based. Once they are laid bare, we have uncovered one of the deepest roots of this law. It then becomes easier to understand why a subject that, on the surface, is merely technical is inextricably bound up with the most crucial decisions any social group has to make.
>
> Georg Schwarzenberger

> This [community of interest] has been facilitated by the highly developed technical and diplomatic capabilities which these companies have frequently and effectively exercised *en bloc* in sophisticated high-level dealings with the governments of the world.
>
> David I. Haberman

The synergistic relationship between the American legal regime and the petroleum industry has evolved with its recurring pattern of oligopoly, cooperation, and continuity affecting the development of petroleum law. This pattern has been traced through the establishment of Rockefeller's model of monopoly, the ambivalence toward antitrust enforcement, the effectiveness of government-industry cooperation during World War I, participation in the quasi-diplomatic activities of the 1920s, the advent of the Texas Railroad Commission during the trauma of the

Great Depression, and as a result of World War II, the emergence of America as the pre-eminent world power.

After the post-war era which lessened BP's prior predominance in the Middle East, she began looking for alternative sources of secure oil supplies. America became a likely choice of location for investment for three reasons: (1) As her Sisters had already demonstrated, companies operating in America were somewhat protected by government import quotas from European price-cutting created by forced increases in Middle Eastern oil production; (2) Alaska was believed to have the largest undeveloped oil reserves in the world; and (3) the United States Government was the least likely of host governments to nationalize her oil industry. Disadvantages of investing in America included: (1) entering a highly developed competitive system on a grassroots level; (2) incurring the extremely high cost of extracting Alaskan crude; and (3) dealing with the sophisticated and technical municipal system of the U.S. Government.

> Petroleum exploration on the Arctic Slope of Alaska began in the early 1900s after oil seeps were discovered near Cape Simpson, east of Barrow. Early exploration work by the U.S. Geological Survey confirmed the petroleum potential of the area and led to the establishment of the 23-million acre Naval Petroleum Reserve No. 4 (NPR-4) by order of President Harding in 1923 ....
>
> Between 1944 and 1953, the U.S. Navy spent about $60 million in exploration work in [NPR-4] drilling a total of eighty wells. One small oil field and two small gas fields were found during this period of exploration. Only two of the wells drilled in NPR-4, however, reached the stratigraphic equivalent of the main reservoir at Prudhoe Bay.[1]

Having evaluated the factors, BP decided the advantages -- although they would incur short-term losses -- would eventually out-weigh the disadvantages. Thus when the opportunity arose to enter the U.S. market through Sinclair in 1958, BP jumped at the chance despite the fact that a mere thousand, generally run-down Northeastern service stations could hardly satisfy BP's need for a major outlet for her Middle-East crude surplusses.[2] In fact when the U.S. Government shortly thereafter suddenly reimposed a mandatory imports policy, BP's justification for her Sinclair association would have seemed negligible had it not been for the continuing exploration agreements in Alaska.[3]

Early in this association -- still 1958 -- a team of BP geophysicists, utilizing specially developed cold-weather seismic techniques, underwent preliminary exploration in Alaska and their report of February 1959 stated that the sedimentary basins on the Arctic Slope were larger than the company's entire Iranian concessions, containing a wealth of drillable anticlines on the Iranian scale with lengths of up to 20 miles.[4] These techniques were later to win BP the coveted European engineering prize -- the MacRobert Award.

On the basis of this feasibility report, along with its modest expenditure estimate, BP proceeded to acquire leases, or options to lease, for 150,000 acres around the North Slope. Most other oil companies, while acquiring a few protective land holdings in the North, concentrated their prospecting activities in the South, and merely watched with interest as BP and Sinclair began drilling dry hole after dry hole in the remote, inaccessible and climatically hostile North. Their interest may have turned to amusement as BP arranged in 1963 to have a drilling rig floated 2000 miles down the Mackenzie River from Canada to the North Slope.[5]

Thus, when Alaska held its first lease of lands near the mouth of the Colville River on the North Slope in 1964, BP and Sinclair secured 317,934 acres -- almost all the acreage covering the delta area.

Sinclair dropped out of further bidding since subsequent drilling had still been unproductive so that in 1965, BP's acquisition of thirty-five additional blocks in the Prudhoe Bay area was without Sinclair. In cooperation with Union Oil of California she began drilling again in the Colville Delta -- again unsuccessfully. By 1967 BP decided to sit on her acreage (including six off-shore blocks acquired that year) until further exploration by the ARCO-Exxon partnership on adjacent land had been completed.

In February 1968 ARCO hit the largest deposit ever found in the U.S. (and a hundred times that of any other Alaskan deposit) as she was completing exploration in the Prudhoe Bay State No. 1.[6] BP resumed drilling immediately and on 20 November 1968 finally struck oil -- just three miles from ARCO's original discovery well. Drilling continued throughout the winter and by March 1969 BP announced that she had discovered oil in the porous sandstone below 8,000 feet. Due to her stubborn acquisition of leases over the last ten years, she held claim to about half of the entire Prudhoe Bay field.[7]

BP now desperately needed management and marketing outlets in the U.S. Not having the time nor the expertise to build up a grass-roots marketing organization, she opted for a compatible partnership with some existing company already proficient in marketing and management practices.

Meanwhile Sinclair, avoiding a take-over bid by Gulf and Western, chose to go in with ARCO, which meant divesting herself of certain properties in compliance with antitrust restrictions.[8] BP Oil Corp. was quickly set up in New York and an agreement was struck whereby BP Oil Corp. would buy Sinclair's marketing assets in eleven eastern states and the District of Columbia, the Atlantic-Richfield refinery at Port Arthur, Texas, the Sinclair refinery at Marcus Hook, Pennsylvania, and interests in the Colonial Pipeline and other systems -- all for about $400 million.[9]

Although the Sinclair acquisition established a marketing presence, it failed to meet all of BP's objectives: She was still in the market for a suitable partner. In the Spring of 1969, therefore, she began amalgamation discussions with Standard Oil of Ohio (SOHIO) even before the Sinclair deal was completed, and entered into a consent decree with the Ohio company in March 1969.

SOHIO was incorporated in Ohio on 10 January 1870; prior to December 1911 the company was a subsidiary of Standard Oil Company of New Jersey which subsequently distributed the stock to its own shareholders in accordance with U.S. Supreme Court dissolution decree. Their Chairman of the Board Charlie Spahr described the more recent history of his company before the MNC Hearings in 1973 as follows:

> ... we were a regional refiner-marketer with domestic production amounting to 16% of our refinery runs. By the early 1960s we had made some fundamental decisions. We would seek to acquire petroleum reserves by acquisition since our finding efforts were not too successful; we would expand our marketing into states surrounding Ohio; we would expand our chemical activities, acquire a fabricated plastics business and enter the vending, motor inn and restaurant business. As the figures show, we were successful in the petroleum business in the environment that existed in the second half of the 1960s. There were ample supplies of low cost crude oil and the product price wars of the early 1960s were ending. Our non-petroleum investments slipped into a loss position as we broadened our investments and the agricultural chemicals began to run into problems.
>
> By the mid-1960s we recognized that our program of acquiring oil reserves was not progressing as fast as the oncoming crude oil shortage. We attempted mergers with several companies who owned large oil reserves but we were not successful. We acquired oil shale properties and have done developmental research in oil shale which is continuing. We identified the

> potential for coal at a time when many investors thought coal would have no future due to its environmental problems and the anticipated conversion of electric generation to nuclear fuel, and in 1968 we acquired Old Ben Coal Company. Old Ben is a profitable operation. It has expanded its production 15% since we acquired it and it has a new mine under development. Old Ben's capital investments have equalled its cash generation since we acquired it.
>
> With the crude oil shortage clearly in sight, we were anxious to acquire a major source of crude. When the North Slope of Alaska reserves were discovered we sought ways to participate. When The British Petroleum Company Limited approached us in late 1968 regarding a possible merger, we were receptive.[10]

Again before MNC Hearings, Spahr further explains his company's motivation for the BP merger:

> We have tried every way that we could to increase production. We have tried to change our exploratory program. We tried to arrange for mergers, absorbing companies that might like to exchange stock on a tax-free basis, particularly if the heads of those companies were getting older and they were privately held.[11]
>
> When the opportunity to acquire British Petroleum's interest in the newly discovered reserves in Prudhoe Bay on the North Slope of Alaska presented itself, we seized it believing that it offered a never to be paralleled chance to cover our future requirements for raw material for a substantial period of time.[12]

Any history of SOHIO is incomplete without mention of the contribution of Charles Spahr.

> [He] ... grew up in Missouri, where his father was a stillman at a refinery, and had long harbored ambitions of being a builder. Young Charlie Spahr put himself through the University of Kansas, earning a degree in civil engineering and went on to Harvard Business School -- until his money ran out during the Depression. For a while it seemed as if his biggest job of building would be overseeing construction of a fuel pipeline in India during World War II. Soon afterward he headed back to SOHIO, where he had been an engineer before the war. A prodigious worker, Spahr rose rapidly, and in 1959 -- when he was just forty-five -- he became chief executive. It is fair to say, as one vice president does, that "for the past eighteen years, Charlie Spahr has dominated this company."
>
> Informal but strong willed, Spahr quickly proved himself a decisive executive. For decades, SOHIO had consistently made money in refining and marketing when others hadn't, mostly by

concentrating its retail outlets in Ohio and supplying them through a pipeline distribution system that cut down on trucking costs. But the company's return on investment was running a slim 8.1 percent when Spahr took over; he thought that he could do better than that through diversification. Soon he ventured into plastics, acquired Old Ben Coal Co., and built chains of motor inns and restaurants. By the late sixties, the refining and marketing operation, which still contributed some three-quarters of SOHIO's revenues, had improved and the new businesses were paying off. The total return on investment climbed to a handsome 12.5 percent.

But as time went on, Spahr became increasingly worried about SOHIO's supply of crude. The company purchased three-quarters of the crude it refined and with overall domestic reserves showing signs of decline, he figured that less would be available on the open market. Unless SOHIO could buy or find its own reserves, it might fall victim to a takeover.

Spahr was fully aware of that possibility, and determined to make the best of it. "Through diversification," he says, "we had become more attractive to someone who might want to acquire us and pay a substantial premium, which would enhance our stockholders' investment." To have a job title to give away to an acquiring company, he left the position of chairman unfilled throughout the Sixties.[13]

BP's 1969 consent decree with SOHIO was challenged by the U.S. Justice Department on antitrust grounds and not allowed to go through until 1 January 1970 with certain divestiture requirements in compliance with antitrust regulations. BP now had her marketing organization and SOHIO had crude sources, and together they set out to develop their Alaskan holdings.

On 1 January 1970 Standard Oil of Ohio acquired all outstanding capital stock of British Petroleum (Holdings) Inc. in exchange for 1,000 shares of SOHIO special stock which were received by British Petroleum (Overzee) N.V., a wholly-owned subsidiary of British Petroleum Co. Ltd.. These 1,000 shares of SOHIO special stock were equivalent to a 25 percent common interest in the company. Her percentage ownership of SOHIO was to reach approximately 54 percent by the time 600,000 barrels a day were produced by SOHIO from the Prudhoe Bay leases acquired by SOHIO in the deal, prior to 1 January 1978 (this date was amended in 1973 to extend the deadline until 1984, due to delays in building TAPS).

British Petroleum would retain 75 percent net profit interest in production from Prudhoe Bay in excess of 600,000 barrels a day. Each share of special stock had rights equivalent to those of a holder of 8,932 shares of common stock, except that until 1 January 1975 such special stock was not entitled to dividends. After that date if a dividend was declared on the common stock, a dividend would also be declared on the special stock in an amount commensurate with the number of shares of common stock to which the special stock was then equivalent. The number of common shares to which each special stock would be equivalent was based on achievement of sustainable net production from the Prudhoe Bay properties, at any time prior to 1 January 1984 (the amended deadline), as follows:

Rate of Sustained Net Production (b/d)	Shares of Common Stock to which each share of special stock is equivalent
200,000	13,806
250,000	15,740
300,000	17,866
350,000	20,218
400,000	22,830
450,000	27,894
500,000	29,034
550,000	30,222
600,000	31,460

Special stock included provisions restricting, among other things, changes in its terms, disposition of the Prudhoe Bay or other properties, mergers, and issuance of senior shares. It also placed limitations on cash dividends and other capital stock transactions, and contained antidilution provisions. Production of 600,000 barrels a day was reached by July 1977.[14]

No sooner had BP overcome one of the disadvantages of investing in America -- that of entering a highly developed competitive system on a grass-roots level -- by combining forces with the established integrated firm of SOHIO, than she encountered the U.S. Government municipal system. BP's acquisition of Sinclair's previous holdings only hurt SOHIO's overall plans; she inherited two refineries which she didn't need at the time, and was forced to rid herself of quite a few service stations in Ohio.

> When Spahr took over BP's Sinclair properties, the Justice Department forced SOHIO to divest itself of about a thousand service stations in Ohio within four years, to encourage competition. But after the embargo, the federal government instituted an allocation program for petroleum products, guaranteeing each existing station only as much product as it has been selling during a base period in 1972. Prospective buyers of the SOHIO stations were interested only if they could increase volume -- and in this case, they had no assurance of getting more product. Spahr practically had to give the stations away. Making matters worse, the divestiture requirement meant that SOHIO would lose market share, just when Spahr was eager to beef up sales by switching to high-volume stations.
>
> Yet another restriction, limiting the amount of higher crude-oil costs that companies could pass through, sent SOHIO's profits from petroleum products into a nose dive. Though that business still contributed more than four-fifths of the company's overall revenues in 1974, it produced only 18 percent of pretax profits (down from 75 percent in 1970). After taxes and interest, it was in the red.[15]

> On May 12, 1970, [SOHIO] announced that a subsidiary, BP Oil Corp., had asked the Federal Court at Cleveland for a declaratory judgment cutting [the] price paid for properties purchased from Sinclair Oil Corp. by about $36,000,000.
>
> BP Oil, then a subsidiary of British Petroleum, Ltd., agreed last year to buy the properties for about $400,000,000 from Atlantic Richfield Co. [The] purchase price was [to be] subject to audit and certain other conditions. SOHIO acquired BP Oil in a merger and has assumed obligations of that [company]. "The audit has been completed," SOHIO said, "but there remain differences of opinion on certain items."
>
> A spokesman for Atlantic Richfield said the [company] had been holding some discussions with SOHIO about [the] price to be paid for Sinclair and Atlantic Richfield properties acquired

by BP Oil. However, he said, the [company] had not received a copy of the BP Oil court action and could not comment on it at this time.

[The] largest single disagreement is SOHIO's contention that [the] purchase price should be reduced because [the] number of service stations owned or leased by Sinclair was far fewer than [that] provided in [the] purchase agreement, which called for 814 Sinclair-owned stations or stations where the [company] owned improvements on property, 2,037 stations with initial leases of at least 10 years and 1,550 stations with one-year leases. [The] purchase price was to be reduced by $100,000 for each owned station less than [the] number specified, by $50,000 for each 10-year lease station short of [the] agreement and by $10,000 for each one-year lease station under the specified number.

An audit showed there were only 782 owned stations, 1,561 stations with leases of 10 years or more and 613 stations with one-year leases, according to [the] suit. Atlantic Richfield contends there was a "mutual mistake of fact resulting from a misunderstanding of Sinclair Oil Corp. records before [the] agreement to sell the properties," the suit said. It also said Atlantic Richfield asserts that any reduction in purchase price resulting from shortages in service stations so transferred do not exceed $15,100,000.[16]

No one could have foreseen the magnitude of the project at hand -- that of marketing Alaskan crude. While exploration and production costs have outranked transportation costs, the sheer jump in the latter, due primarily to the complexities involved in building the Trans-Alaskan Pipeline System (TAPS), warrants a close examination. Prior to 1974 capital expenditures for pieplines in the U.S. had never exceeded $550 million in a single year. In 1975 capital expenditures for pipelines in the U.S. was $3,500 million; in 1976 this figure rose to $3,625 million. The extraordinary high levels of spending have been due to the huge cost of constructing TAPS.[17]

The building of TAPS would escalate the original $900 million expenditure estimate to a completion bill of well over $14 billion. The preliminary cost estimate for construction to initial capacity of 600,000 barrels a day was $900 million. This budgetary figure was based on general information available at the time. By March 1970 Alyeska reported that TAPS would cost $1.3 billion. Preliminary estimates revised in March 1971 indicated that the requirements set out in the initial draft of the environmental schedule and technical stipulations would increase the cost to $2.2 billion. The March 1972 estimate included expansion of the line to a 1.2 million barrels a day capacity at an estimated cost of $2.45 billion. This figure had risen to $2.86 billion by March 1973.

The October 1974 estimate which placed the figure at $5.982 billion was due -- according to Alyeska press releases and material provided by SOHIO -- to three major factors: (1) increased costs of materials; (2) increased costs of labor; and (3) more sophisticated design and engineering. By June 1975 the forecast cost of TAPS reached $6.375 billion. Increases in the estimate resulted from construction experience, improved definition of construction and support requirements, and compression of the construction schedule to meet the 1977 startup date.

The June 1976 forecast figure of $7.7 billion reflected the effects of lower productivity, additional materials and associated freight and transportation, and additional construction equipment. Anticipated reinspection or repair costs for resolution of the welding and x-ray problems were included; however, as the GAO notes, none of the documents reviewed by them (primarily Alyeska press releases and material from SOHIO) ascribed a specific part of the expected total cost to negligence, mis-management, illegal, or improper activities.

David P. Goodman, managing director of Morgan Stanley and Co., Inc., investment bankers to SOHIO, Exxon, Mobil, and BP, also a member of the Energy Financial Advisory Committee to the Federal Energy Administration, made the following statement on 21 March 1977:

> The companies which own the Prudhoe Bay reserves will likely spend $14 to $15 billion to develop the 9.6 billion barrels of oil reserves and transportation facilities needed to bring the oil to market. Expenditures of similar magnitude will be required to bring Prudhoe Bay gas reserves to market. Probably in excess of $9 billion of financing for the oil project has been arranged since the Pipeline Right of Way Act was passed in January 1974 ....[19]

The $9 billion figure is greater than the assets of all but three of TAPS eight owners.[20]

No less than 70,000 people from all over the world would work on the pipeline, creating managerial and technical problems never before tackled. However, it would be the legislative process which would turn the largest modern-day industrial enterprise ever attempted into a nightmare.

Experts would be recruited in the thousands. Engineers from all manner of disciplines would construct a 48-inch diameter pipeline across a wilderness (much of which was permanently frozen), across three mountain ranges and at least 800 rivers and streams. Experts in weather patterns would be required since temperatures dropped to -75 degrees Fareinheit; experts in natural science, ecology, and the environment would contribute so that everything could be built to withstand 90-pound snow loads, 90-mile-an-hour winds, and earthquakes registering 8.5 on the Richter scale. More than 800 animal crossings would be built to allow caribou and moose migrations across Alaska.

Some of the abandoned ideas would include ice-breaking oil carriers and submarine tankers. Creating a tanker harbor by means of a nuclear explosion would also be suggested, as would oil-carrying airships and tractor trains carrying oil in drums through an 800 mile subway tube.

At one point aluminum-foil containers to be floated through the line would be considered, as well as air-propelled canisters. But perhaps the most novel idea would be the use of trained sea-gulls to detect leaks.

Certain illegalities would arise as in the case of the falsified welding x-rays which included the mysterious death by syanide of the engineer in charge.[21]

In selecting TAPS as a viable option, the companies involved first identified probable markets: at that time it was expected that all the Alaskan oil could be consumed on the West Coast, although the Midwest and Northeast also desperately needed supplies. This assumption still appeared valid when Congress was debating the TAPS Authorization Act in 1973.[22]

However, after the Middle East Oil Crisis two changes affected this evaluation: (1) Japan became considered by the oil companies as an important possible market (although this would incur negative public opinion as well as legislation); and (2) with changes in consumption patterns it became evident that there would be a surplus of oil on the West Coast (opinions and forecasts differ as to the estimated duration of this glut).

Thus, after the Crisis the oil companies put forward a plan to sell Alaskan crude to Japan, displacing her allotted supply of Middle Eastern crude directly to the Northeastern United States. The TAPS Authorization Act, however, requires that "before any crude oil ... may be exported ... the President must make and publish an express finding that such exports will not diminish the total quantity or quality of petroleum available to the U.S."

The Act also provides for congressional veto power over a President's decision to export any oil. There has been some discussion in recent newspaper and trade journal articles regarding exchanges with Japan, but it has been limited to discussion because of the problems foreseen in getting approval from the President and the Congress. An exchange with Japan would involve shipping Alaskan oil southwest to Tokyo, Japan. An equivalent amount of Persian Gulf oil, originally intended for Japan, would be shipped around Africa and into the U.S. gulf or east coast. Standard Oil Company of California officials have stated that in the shortrun, exchanges with Japan probably would be the most efficient and least costly means of moving Prudhoe Bay oil to market.

A more likely possibility, according to a recent trade journal article, is that of short-term exchanges involving Canada (permitted by the TAPS Authorization Act). Some congressional leaders, who are opposed to exports to Japan, have urged the Federal Energy Administration to arrange for such an exchange with Canada. The problems with any direct exchange, according to the article, are that western Canada refineries are equipped to process only low-sulfur crude, not North Slope high-sulfur crude, and tankering Prudhoe Bay oil around Cape Horn to eastern Canada refineries which do process high-sulfur crude would be costly.

Another option that has been discussed in a recent trade journal would involve a three-way trade involving both Canada and Japan. Under such a system, Canada would deliver oil to the U.S. northern tier and Puget Sound; an equal amount of Prudhoe Bay oil would go to Japan; and an equal amount of Middle East oil, otherwise destined for Japan, would go to eastern Canada. However, this option would require specific Presidential and congressional approvel.[23]

Having identified the market, various transportation alternatives were considered, and by process of elimination were narrowed to the following.

The most obvious was an alternative to TAPS -- a Trans-Canadian pipeline directly connecting the North Slope with the Midwest. While this would appear at first glance to be an appropriate choice, further study indicated that completion of such a pipeline would take nine or ten years.

The nine to ten year estimate for completion of a Trans-Canadian pipeline is based upon the following (From GAO Alaskan Markets Report, pp. 6-7):

(1) Ownership and operating agreements must be negotiated and a corporate entity must be formed to undertake all the responsibilities associated with financing, designing and constructing a project of this magnitude.

(2) The Canadian Native Claims issue must be resolved and negotiations might take several years. The fact that the proper mechanism for settlement is unclear would add to, rather than shorten, the time required.

(3) The detailed route analysis through Canada to determine the most desirable location and appropriate mode of construction would take at least as much time, and probably more, than was spent on TAPS because the Canadian route is approximately four times longer. Since Alyeska will have taken three years to complete its route analysis and its mile-by-mile design, a longer period of time will be required to write the revised project description, prepare and review the environmental impact statement for the new route through Alaska to the Canadian border, hold public hearings, solicit the views of the various U.S. federal agencies and secure U.S. and Canadian permits for the Trans-Canadian system. This time period would, of course, run concurrently with the Canadian Native Claims negotiations.

(4) TAPS construction plans, barring major interruptions, call for three years from start to commissioning. It is inconceivable that a line four times as long and travelling through twice the length of difficult construction terrain could be built in the same time, particularly when there is a shortage of massive equipment to outfit more than a few construction spreads. The best estimate available indicates more

clearly five to six years would be required for constructing the Trans-Canadian alternative. This time period would not run concurrently with the above since all permits, native claims settlements, labor agreements and other issues would have to be identified, understood and settled before such a massive undertaking could be started.

The total of nine to ten years required to accomplish route analysis, design and construction of the Trans-Canadian line does not envision any prolonged delay for either Canadian or United States governmental actions or approvals. Nevertheless, it would be understandable if the Canadian federal and provincial governments wanted the same opportunity that the United States Government had, to carefully review proposals, to consider alternatives, and to determine appropriate stipulations. Negotiations between the U.S. and Canadian Governments on energy-related matters of mutual concern that could be triggered by consideration of a Trans-Canadian line would delay the start of production from Prudhoe Bay beyond the nine to ten years referred to above.

The prolonged delay in production of North Slope crude oil, which would be the inevitable result of a decision to build a pipeline through Canada, would have the following undesirable effects:

(1) North Slope crude oil will displace imported foreign crude regardless of whether it moves to the West Coast or the Midwest. A delay in production will, in turn, delay the reduction of our dependence upon imported oil. While the North Slope will not eliminate our need for oil imports, it is an important means of reducing them by a significant amount.

(2) North Slope gas deliveries will be delayed until after production of North Slope crude begins because: (a) Conservation practices

prohibit production of gas prior to production of oil (Gas will be produced in a manner that will maintain sufficient reservoir pressures to insure maximum recovery of oil); (b) Physical restrictions due to limited availability of the massive construction equipment, qualified pipeline contractors, skilled workers and governmental inspectors will make it practically impossible to begin construction of the gas pipeline prior to completion of the oil pipeline without significantly extending the time required for construction of both lines.

The remaining alternatives to TAPS would each employ a Trans-Alaskan pipeline to Valdez and then branch out in different directions; however, it should be noted that a Trans-Alaskan pipeline would not preclude a Trans-Canadian pipeline for the second leg of the journey.

The trans-provincial pipeline proposal calls for constructing a new port at Kitimat, British Columbia, and constructing a new 30-inch, 780-mile pipeline extending from Kitimat to Edmonton, Alberta. The pipeline would transport some Canadian as well as Alaskan oil. At Edmonton, the new pipeline would connect with existing lines and would serve about a dozen refineries in Washington, Montana, Minnesota, and North Dakota that currently depend on Canadian oil. The sponsors, which are refiners in the northern tier plus two major Canadian pipeline companies, claim the pipeline could be initially operational with a capacity of 300,000 barrels a day within 16 to 22 months after receipt of permits to start construction. The sponsors estimate that the eventual capacity of the pipeline could be 600,000 barrels a day, of which 420,000 barrels a day could be Alaskan oil. The sponsors estimate that the line will cost $418 million and capacity will be achieved 2 years after startup.

A Federal Energy Administration official stated that this line could be built faster than some of the other proposed lines because it has few environmental problems and would require fewer permits. However, according to the Federal Energy Administration official, the northern tier refineries are not currently equipped to process oil with the high sulphur content of Alaskan oil.[24]

Two Trans-American pipelines were suggested: the northern tier and the mid-continent pipelines, the latter of which was proposed by SOHIO with the backing of other major companies.

The northern tier pipeline proposal calls for construction of a new 40/42-inch, 1,500-mile pipeline from Port Angeles, Washington, to Clearbrook, Minnesota. At this point, it would connect to the Minnesota pipeline and the Lakehead pipeline. This line would serve basically the same region as the trans-provincial pipeline. The sponsors, which are two railroads, three consulting firms, and two small oil companies, claim the pipeline system could be initially operational, with a capacity of 600,000 barrels a day, 24 months after receipt of permits to start construction. The eventual capacity could be 800,000 barrels to 1.2 million barrels a day, of which 600,000 barrels a day could be Alaskan oil. The sponsors estimate that the line will cost about $868 million.

A problem with this proposal, according to a Federal Energy Administration official, is that 1,500 miles of new pipeline would have to be constructed which would require many government permits. Also, citizens of Port Angeles, Washington, voted against construction of a proposed Port Angeles tanker port that would have to be built as part of the project. City officials said they would abide by the vote in future dealings with northern tier officials.

Another problem is a recently enacted Washington State law which limits the size of tankers entering Puget Sound to 125,000 deadweight tons. This law also mandates that a tug escort all tankers larger than 40,000 deadweight tons through the Sound. Although ARCO has successfully challenged the constitutionality of the law in Seattle Federal district court, the state government intends to continue to enforce the law and appeal the court's decision.[25]

The SOHIO mid-continent pipeline proposal calls for a 100-mile pipeline system extending from Long Beach, California, to Midland, Texas. This proposal involves reversing the flow in an existing 800-mile natural gas pipeline and converting it to an oil carrier, which according to SOHIO is a relatively simple and inexpensive operation. This would be connected to about 200 miles of new pipeline. At Midland [Texas] the system would connect with existing oil lines which serve the Midwest. SOHIO stated that initial capacity will be 500,000 barrels a day, with potential for expansion up to 1 million barrels a day. SOHIO believes that the pipeline would be able to handle most, if not all of the surplus Alaskan oil and estimates that it would be completed 12 to 14 months after receiving permits to start construction. SOHIO estimated the cost of this system at $500 million.

The California Air Resources Board has expressed concern about this proposal because it contends that the emissions resulting from the unloading of oil tankers in Long Beach harbor and escaping from the storage tanks would violate state and federal air-quality standards. SOHIO has stated that it is willing to guarantee an equivalent reduction in emission by paying for pollution controls at other companies' plants in the Long Beach area. In this way, SOHIO said, there would be no overall deterioration of air quality.[26]

Although SOHIO has received rights of way for her proposal (Dallas Morning News, 26 July 1978), she has now cancelled the PACTEX line in a dramatic objection to government bureaucracy.[27]

A short term solution would be to ship tankers from Valdez, through the Panama Canal, to the Gulf or Eastern Coasts.

Since the canal is only capable of handling tankers of 58,000 to 60,000 deadweight tons (dwt), the following three methods have been proposed to move Alaskan oil through the canal:

(1) Transport the oil on small (60,000 dwt) tankers, fully loaded, for the entire route.

(2) Use medium-size tankers (60,000 to 90,000 dwt) from Valdez to the canal's Pacific side. Both would then transit the canal to the Gulf Coast.

(3) Use large tankers (greater than 100,000 dwt) from Valdez to the canal's Pacific side and off-load to smaller vessels for the final leg through the canal to the Gulf Coast.

SOHIO estimated that the marine transportation cost for a Panama route will range from $2.10 to $2.55 a barrel regardless of which method may be used. This cost is $1.50 to $1.75 a barrel more than the marine transportation cost from Valdez to California markets, which SOHIO estimates would range from $0.60 to $0.80 a barrel. Standard Oil Company of California estimated that the marine transportation cost for the Panama Canal route would be $2.72 a barrel. A recent trade journal article stated that the higher transportation cost of this proposal might be absorbed by the producers to make the oil competitive with foreign oil delivered to the Gulf Coast.[28]

After careful consideration, then, those companies with the largest stake in Alaska (See Figure 2) decided to develop TAPS as a first step in transporting their oil to market, leaving their future options open as to a long-term selection of a trans-continental pipeline.[29]

FIGURE 2

ESTIMATED OWNERSHIP OF PRUDHOE BAY FIELD

Owner Companies	Estimated Recoverable Reserves (billion barrels)	Percent Ownership
SOHIO	5.100	51.0
ARCO	1.970	19.7
Exxon	1.970	19.7
Mobil	.325	3.3
Phillips	.290	2.9
Others*	.345	3.4
Total	10.000	100.0

*Primarily Amerada Hess, Louisiana Land, and Getty. From GAO Alaskan Markets Report, Appendix I, p. 3.

Thus the Alyeska Pipeline Service Company was formed in 1970 as a non-profit contracting firm by the permitee companies as their common agent for the express purpose of designing, constructing, operating, and maintaining TAPS, a 48-inch diameter, 800-mile pipeline with initial capacity of 1.2 million barrels a day which can be increased to 2 million barrels a day (See Figure 3).

Once formed, Alyeska began the design stage by compiling a detailed feasibility report including an environmental impact statement to be

FIGURE 3

OWNERSHIP OF ALYESKA*

Companies	Percentage Ownership
SOHIO Pipeline Co.	33.34
BP Pipeline Co.	15.84
ARCO Pipeline Co.	21.00
Exxon Pipeline Co.	20.00
Mobil Alaska Pipeline Co.	5.00
Phillips Petroleum Co.	1.66
Union Alaska Pipeline Co.	1.66
Amerada Hess Corp.	1.50
Total	100.00

*These owners are either major oil companies or subsidiaries of major oil companies. The assets are owned in common; each of the owners is an individual common carrier and will file for its own tariff rate in accordance with state and federal laws and regulations covering its share of the capacity in TAPS. The owners will each collect their own revenues payable by shippers under such tariffs. Information compiled from Moody, Moody's Transportation Manual.

approved by the Interior Department, while each member company was actively arranging for its part of the financing. Obviously, the completion of each of these two steps is mutually dependent on the other. These activities are further hindered by Justice Department investigations of antitrust violations and environmental interest groups concern for strict adherance to the 1920 Mineral Leasing Act and the 1971 National Environmental Protection Act.

The companies involved must, therefore, not only set out to systematically attack the complex job of planning, financing, and executing the pipeline design, they must also anticipate any possible obstructions with workable alternatives. As can be seen by the numerous delays, this was not a simple matter.

The American policy on oil imports was finally defined after many years of debate by the 1958 oil tarrif which charged $1 a barrel on imported oil in order to protect domestic producers from the glut of cheap Middle Eastern oil. As has already been discussed, BP originally had hoped to enter the U.S. market to unload some of her Middle Eastern surplusses. However, this was only the short-term motivation for her desire to enter the American market; her long-term motivation was to enjoy the position of security which her American Sisters had already established by spreading their investment risks.

> British Petroleum's entry into the U.S. Market in 1969 seems to have been motivated by [several] considerations. Lacking a U.S. base, B.P. was at a clear disadvantage vis-a-vis American majors, who were well established in both European and Commonwealth markets. During the Sixties, oil was in oversupply throughout Europe, and the U.S. companies cut prices sharply. At the same time, the U.S. market was relatively insulated from price competition because of our import quotas. By buying Sinclair Oil, some of ARCO's service stations, and then a piece of SOHIO, BP sought to restore a semblance of competitive balance.[30]

This decision to enter the U.S. market was based on two well-known axiomatic principles of the business: (1) the greater the quantity and quality of oil supply sources acquired by a company, the greater her position of confidence will be both in her home country and in the global sphere; (2) the greater the stability of both the home and host governments and the stronger the political friendship between the two, the more secure the company's sources of oil supply will be.

Thus, the 1958 oil tariff, while seemingly spoiling BP's short-term motivation for entering the American market, actually strengthened her long-term motivation, so that twenty years later, by functioning as a home company through the SOHIO merger -- even though BP still remains a foreign investor -- the oil tariff serves as a protection for BP's extensive investments in America.

After the drastic price rises of Middle East oil resulting from the growing power of OPEC and the 1973 Crisis, justification for the oil tariff became invalid. Both the U.S. Government and her oil companies were now more concerned with limiting increases in the price of oil. With Middle Eastern oil finding a more realistic world price -- and thus insuring profitability for the more expensive production of domestic oil -- the $1 a barrel import tariff had lost its meaning, and was duly eliminated.

After assuring her own entry into the American market by securing over 50 percent of the Prudhoe Bay reserves, and by combining with various established companies -- primarily SOHIO and other Alyeska partners -- to carry out downstream activities, BP's position on market entry inevitably changed in order to protect her newly gained position. It should be remembered that including BP's original 25 percent share of SOHIO, BP's actual share of Alyeska was 24.175 percent initially; however, after the 600,000 barrels a day production from Prudhoe Bay fulfilled the conditions of the SOHIO merger and BP's share of the Ohio company reached 54 percent, BP's actual share of Alyeska proportionately increased to 33.84 percent.

It was now in her interest to limit market entry of potential competitors and encourage market exit of existing competitors. While the Alyeska cooperation was necessary for each member to market her previously acquired and proven Alaskan reserves, fierce competition remained between the companies as to specific conditions leading to favorable advantages.

Thus the very structure of Alyeska as a condominium pipeline in which each member was responsible for the use of the pipeline according to her percentage share of Alyeska, meant that those companies outside the organization must arrange transportation rights for use of TAPS with some Alyeska member before even bidding for leases in Alaska.

> The scheduling of pipeline input is very complex and must be worked out in advance of the shipment. Because of this process, an independent crude producer may have great difficulty in securing a place in the flow, especially if he does not have storage tanks at the trunkline station and ships a relatively small amount of crude .... Furthermore, pipeline owners may employ a variety of harassing or delaying tactics to cut off or limit use of their pipeline by independents, including irregular shipping dates and limited storage facilities.[31]

In this way BP and SOHIO had an active role in limiting potential competitors. This practice was not without its restraint of trade complications which were first brought to the Justice Department's attention in the 1969 litigation between Alyeska members over details of their arrangement.

The litigation itself exemplifies the degree of competition among Alyeska members for personal advantages. Exxon was, by all accounts, the least cooperative of the Alyeska partners since she could best afford to delay the operation of TAPS.

> ... Interior Department officials who had to deal with TAPS and the parent companies regularly during this period generally agree that Humble was the least cooperative of the companies involved .... Exxon, with access to plenty of petroleum even in 1973, had always felt ambivalent about the pipeline and the potential competition of a BP-SOHIO combination with ready domestic crude.[32]

Exxon was especially wary of the formidable new competitive threat of BP-SOHIO and was none too anxious to expedite her progress. "None of the eight owners, except perhaps Exxon, has the financial capability to build the line alone."[33]

These, then, are a few examples of BP's involvement and motivation regarding the issues of market entry and exit.

The government, for her part, has demonstrated her continued insistence on strict antitrust enforcement in line with her political-economic program of advancing her macro-economic policy objectives, the basis of which is the projected flourishing of the free-enterprise system and, thus, competition. However, exceptions to this occur, as has been historically proven, whenever some other government policy gains temporary predominance.

Therefore, when the need to implement TAPS was heightened by the rise of OPEC, Attorney General John Mitchell pointedly instructed the Justice Department to drop its sure antitrust prosecution in August 1971, saying, "In view of what is going on, this is not the time."[34] With national conventions that same summer, and Mitchell preparing to resign as Attorney General in order to head the Committee to Re-elect the President (CREEP), he was fully cognizant of the need for cooperation with the oil companies and of the Watergate implications inherent in campaign financing.

As a company progresses through the various stages of exploring and producing, transporting, refining, and marketing, she must deal with the various forms of regulation which apply. Generally speaking, the company must exhibit the necessary technical expertise in meeting established standards before she is granted the various rights needed to proceed. She must also demonstrate her financial reliability in meeting these obligations.

In the exploring and producing stage, for example, the company must first obtain exploration rights:

> Preliminary studies of surface conditions that may be indicative of potentially oil-bearing or gas-bearing strata are frequently made on public lands, such as the public highways, or are made from water and airways. If the preliminary surveys indicate the possible existence of petroleum, more intensive surveys become necessary or desirable. In order to make these intensive surveys, it is often necessary to obtain permission to enter property for purposes of conducting geological or geophysical surveys from the landowners to enter private or public lands. Permission is frequently obtained without cost. In some instances such rights are secured by paying the landowner a nominal amount for exploration rights, either with or without an allowance for crop or other surface damages. Frequently an oil and gas lease is acquired before beginning the survey, since such a lease usually grants the right to make geological surveys as well as the right to develop the mineral deposits, if any are found. An acreage selection clause in the lease permits a large area to be surveyed geologically, with an option on the part of the lessee to select, within a limited period of time, only a portion of the acreage for leasing. Under such an arrangement the lessee usually pays a relatively small amount for the survey rights and a larger amount for the acreage which is ultimately selected.
>
> Inherent in the ownership of minerals is the right to extract them. This right is frequently granted to another person by means of an oil and gas lease. Extraction of the mineral is then made possible by the drilling, equipping, and operation of one or more wells.
>
> Under the ordinary oil and gas lease, the lessee is given the right to enter upon a property, to survey it and locate a well site, to perform drilling operations, and to remove any minerals found. The lessee is also given, expressly or by implication, the right to perform all acts necessary and incident to this ultimate objective. The term of the lease is most often for a specified number of years, called the primary term, and for as long thereafter as production is obtained from the property. Usually lessee may terminate the lease without penalty.
>
> In consideration of the granting of the lease, the lessee ordinarily (1) pays the mineral owner a bonus in cash, which is usually equal to a specified amount per acre under lease, (2) promises to pay a specified amount per acre in delay rentals, usually annually, until production commences or until the lessee terminates the lease, and (3) promises to deliver to the mineral owner, at no cost to him a fraction of all oil and gas produced and saved from the property or, at the lessor's option, to pay him the cash value at the wellhead of a

fraction of all oil and gas produced and saved from the property. The lessor's share of production is known as the landowner's royalty or fee royalty, and the interest acquired by the lessee is known as the working interest.

The most commonly accepted fraction of production designated as the landowner's royalty in the southwestern United States has, through custom, come to be one-eighth. In other parts of the United States, one-sixth or one-fifth of the production has been specified as the landowner's royalty. The size of the fractional interest representing the landowner's royalty may depend in part upon the relative bargaining positions of the landowner and the prospective lessee.

It might appear, from the relatively small fraction accruing to the landowner's royalty, whether it be one-eighth, one-sixth or one-fifth, that the landowner is not obtaining an equitable share of the production from the part of the development or operating costs of the property, all of which are borne by the lessee, it becomes apparent that the landowner's royalty may be worth as much as, and in some cases more than, the lessee's working interest. There is nothing to prevent a person who desires to acquire a mineral property from purchasing the entire mineral interest, so that he owns both royalty and working interest. However, the financial burdens and risks are so great that it is more common to separate these two interests, and it often occurs that the owner of the working interest will induce others to share part of the burdens and risks by transferring to them certain portions of his interest, such transfer commonly referred to as a farmout.[35]

Before any exploration and production may take place, capital expenditure must be anticipated and financing arranged. Preliminary exploration establishes the probability of the existence of a certain quantity and quality of oil. This becomes known as proven reserves and once mineral rights are established these reserves are considered assets of the company for financing purposes, so that private loans may be arranged to cover exploration and production costs until the oil is actually sold on the market enabling the company to repay the loan as well as the accrued interest.

In the case of Alyeska, each member company was responsible for her share of the financing, so that SOHIO had to finance 33.34 percent of TAPS. Since her loans totaled six times her assets and nearly fifty times her debt in the late 1960s at one point,[36] private financing was only possible by delaying repayment until returns on the investment began to pay off. BP for her part in the merger with SOHIO was initially responsible for arranging 25 percent of SOHIO's financing as well as 15.84 percent of BP's direct ownership of Alyeska. Her financial liability only increased in direct proportion to production, an advantageous position illustrating BP's leverage in the arrangement.

Federal income taxes apply to every phase of the industry and will be discussed in their most general terms.[37]

> In general, all of the costs incurred by the party making geological surveys are to be capitalized as a part of the leasehold costs of the property or properties acquired or retained as a result of the surveys. In addition, payments made to landowners in the form of damages or bonuses for the acquisition of a lease must also be capitalized as a part of the cost of the properties acquired. If the landowner receives a cash consideration for the granting of a lease on the property, such cash is a lease bonus, which is treated as ordinary income subject to depletion because it is considered to be an advance royalty ....
>
> The costs of drilling and completing an oil and gas well are divisible for tax purposes into two classes, intangible drilling costs and equipment costs. The equipment costs must be capitalized and recovered through depreciation. As to intangible drilling costs, the lessee has the option to expense or capitalize such costs; however, an election once made in the first taxable year in which such costs are incurred is binding upon that taxpayer as to treatment of such expenditures on all properties for all future years.
>
> The landowner is not considered to have derived any taxable income by reason of the fact that a well has been drilled upon his property. Although there is an enhancement in value of his property, such enhancement is not recognized as taxable income because it has not been realized ....
>
> Assuming that oil has been found and that the well has been completed as a producer, the income from the well is divided between the landowner, who owns the royalty, and the lessee, who may be referred to as the operator or owner of the working interest. Each of them is entitled to recover by depletion allowance his capital investment, if any, in the property. A taxpayer is entitled to claim the higher amount of depletion computed by two methods. The first method is cost depletion,

> which is computed by dividing the depletable cost of the property by the estimated recoverable reserves to arrive at a unit cost. Such unit cost is then multiplied by current unit sales to arrive at cost depletion for the taxable year. The second method is percentage depletion, which is computed at 22 percent of the gross income from the property. Allowable depletion is not limited in amount to taxpayer's basis in the property. Thus, he may continue to claim percentage depletion after his full depletable capital investment in the property has been recovered ....
>
> Production or severance taxes levied by the various states on the production of oil or gas are deducted by the purchaser of production from the well, in making remittance to the various owners of interests in the property. This expense is borne by the royalty owner proportionately with the owner of the working interest; the cost of treating the oil on the lease to make it marketable may also be shared by the royalty owner. All other expenses incurred in connection with the operation of the well are borne entirely by the lessee or owner of the working interest in the property ....[38]

Problems in relation to bidding, leasing, and royalties arose in Alaska. First of all, land ownership was questioned by the natives and required a federal law to settle the issue.[39] Secondly, the government's lack of expertise in exploratory techniques put her at a disadvantage when it came to bidding for leases. The 1969 bidding round should have brought in more revenue than $900 million. The American Government is presently studying the British system of license allocation as developed through the North Sea experience.

In addition to taxation regulating bidding for leases, permits, licenses, and certification, other regulatory standards exist and must also be complied with such as production quotas and unitization agreements.

Production quotas are most useful in limiting production, and since it is to the government's advantage at this point in history to encourage production -- not to limit it -- mandatory production quotas would be inappropriate, with the exception of regulating conservation standards. Instead, tax incentives are used by the government to encourage production. These incentives cover many facets of the industry, and the minimization of taxation is effected by the method of accounting employed.[40]

Without actually embarking on this technical subject, a short discussion of the depletion allowance is necessary since it has recieved so much attention in recent years.

> The removal of a mineral from its natural reservoir diminishes the quantity remaining in the reservoir until eventually the recoverable supply is exhausted. The exhaustion of supply of a wasting asset is called physical depletion. As the supply of the mineral diminishes, the value of the mineral deposit also undergoes a gradual reduction, which is known as economic depletion ....
>
> Although physical and economic depletion depend upon the units produced, the Federal income tax concept makes depletion depend not upon units produced but upon the income derived from that production. In other words, depletion, for Federal tax purposes, depends not upon production of a mineral but upon its sale ....
>
> On March 29, 1975, the "Tax Reduction Act of 1975" ... became law. Among other things, the Act provides substantial changes with respect to the percentage depletion deduction for domestic and foreign oil and gas production. The principle change is the repeal of percentage depletion for all domestic and foreign oil and gas production effective January 1, 1975, with limited exceptions. These exceptions include retention of percentage depletion at the rate of 22 percent for ... a per-day barrel ... exemption for oil....[41]

Thus, the depletion allowance continues to be one of the most effective tax incentives the government can use to encourage production.

Although mandatory production quotas -- those imposed by government for the purpose of limiting production -- are inappropriate at this time, voluntary inter-company production quotas are a necessary managerial method of effectively using TAPS. Since each member of Alyeska is allotted a percentage use of TAPS, then only that amount permitted to be transported should be produced in order to avoid massive storage problems.

Unitization agreements for the purpose of more economic development and operation have been used since the development of the East Texas field, and have generally been encouraged by the government. Such an agreement is one

> ... under which two or more persons owning operating mineral interests agree to have the interests operated on a unified basis and further agree to share in production on a stipulated percentage or fractional basis regardless of from which interest or interests the oil or gas is produced.[42]

Because of the sheer size and number of leases involved in the unitization agreement between Alyeska members, the government has shown considerable concern over the regulation of future unitization agreements.

Once oil is extracted from the ground, the wellhead price is fixed by the federal government. In setting the price, the government directly effects the ultimate profit of the companies, and must consider the projected rate of return of the companies investments.

Certain large lenders were not willing to participate in the Prudhoe Bay-TAPS project because of uncertainty as to government policy on the pricing of Alaskan North Slope crude oil, and companies undertaking projects involving significant risk are unwilling to accept a rate of return of less than 14 to 16 percent as the projections for TAPS showed.[43] The American oil companies, then, are highly motivated towards the deregulation of price-fixing, so that the price of domestic oil will be allowed to float and find its own place, competitive with the current world price of oil.

While the government is considering such deregulation, she is aware that as a result, not only would prices rise significantly, but so would the profits of the oil companies. Thus the windfall profits tax has been suggested as a means to achieve a certain parity.

These, then, compile a general survey of the municipal isssues involved in the exploration and production stage of the oil industry.

In the transportation stage the company may choose one or any combination of various transportation methods: via land the oil may be transported by rail, truck, or pipeline (the latter being accepted today as the most cost feasible); by sea the oil may be transported by tanker or sub-sea pipelines; by air the oil may be transported by air tankers, although as yet, this choice remains cost-infeasible.

Irregardless of the method of transportation chosen, the procedure of progressing through this stage is similar. Rights of way, be they on land, sea, or air, must be acquired. This generally entails submission of detailed plans illustrating the company's proposal for compliance with established standards. The list of standards is numerous and range from ecological considerations to physical safety. Construction and operation permits or licenses must be obtained by the company from the appropriate regulatory body (international, federal, state, local, and/or permission from private individuals).

Regulation of interstate transportation has been in the hands of the Interstate Commerce Commission since 1888, who has the right to set rates and insure their use as common carriers. However, the use of private tankers or those not sailing under the American flag raises a few jurisdicial questions for the ICC.[44]

Antitrust implications of Alyeska's structure and functions have already been discussed regarding restraint of trade in acquiring leases as well as in use of TAPS as a common carrier.

As in the production stage, financing is based on the expectation of marketing proven reserves, and must have been arranged originally to cover all stages of the business.

The pattern remains constant throughout the refining and marketing stages, in that the company must exhibit the necessary technical expertise in meeting established standards before she is granted the necessary rights to proceed. Her financial reliability will have been met prior to this time, assuming she can maintain interest payments and service her debt.

Having defined the various positions on municipal issues, a brief description of SOHIO's relationships will exemplify the complexity of the business environment in which petroleum companies operate in America.

To influence government policy SOHIO employed one official lobbyist as of 1974, and in 1972 she had twelve representatives on federal advisory committees.[45] In addition to these direct influences, Spahr, as president of the API in 1973 gained an additional position of influence -- not only with the government, but also with fellow companies.

Relationships between companies take various forms, many of which become difficult to measure when scrutinized from the level of interpersonal relationships between men who happen to work for different companies.

> Directors are not likely to be scoundrels, they are likely to be gentlemen. And gentlemen respect other gentlemen with whom they are closely associated. And that is far more profound a problem than scoundrelism. The problem is that if gentlemen

associate on boards, they are not likely to be something really hostile to the interests of the other gentlemen with whom they are associated.[46]

A study of interlocking directorates becomes a game of trading influence and is generally played on several levels simultaneously. To qualitatively measure the influence generated by SOHIO or exerted over her in this game would be impossible. Suffice it to say that such conflicts of interests have been discussed in Congress throughout the history of the petroleum industry.

> A Congressional Committee in 1912 said, "When we find common directorships in banks and other businesses located in the same city and representing the same class of interests, all further pretense of competition is useless" ....
>
> In the past, Congress has paid particular attention to bank interlocks since credit, bank loans and terms of financing are crucial to the success of a business. A bank director is prohibited from being the director of another bank. Bank directors or a director of any other business will consciously or unconsciously favor those corporations with which he has connections.
>
> Oil company directors who are directors of banks and other corporations form a cozy and exclusive club where it is convenient for them to reach understandings and agreements which result in common, if not conspiratorial, action. Oil company interests in large banks, particularly where a relatively large number of oil men are bank directors, could generate a multitude of potential conflicts of interests.[47]

Closely related to the question of interlocking directorates is the situation of subsidiaries and joint ventures. This again involves a complex web of changing relationships between companies. While mergers and joint ventures may be convenient -- or even necessary -- for a small company's operation or existence the scale tips when major companies engage in these activities, and the sheer magnitude of the venture inevitably straddles the antitrust violation tightrope.

BP has experienced -- through her merger with SOHIO and their operations both in Alaska and the lower forty-eight states -- a new role in her relationship with the U.S. Government. Not only is the U.S. Government now a host country to BP, she is the home country to SOHIO, and thus, indirectly also to BP. BP gained the advantages she aimed for in investing in America and in so doing strengthened her competitive position with her American Sisters. By selecting Alaska as her first major challenge, BP's initiation into the American legal regime only illustrates the sophistication of the company's adaptable ingenuity.

American municipal law regulating petroleum has been studied meticulously by virtually every oil producing and consuming state. Therefore, the analogy may be made that as British law has dominated the international maritime legal regime, so American law has dominated the international petroleum legal regime.

Notes to Chapter 9

[1]From Southwestern Legal Foundation, Exploration and Economics of Petroleum Industry, vol. 16: New Ideas and Methods of Development, ed. by Martha L. Landwehr, (New York: Mathew Bender and Co., 1978), 16:72.

[2]BP Shield, May 1978, p. 14.

[3]BP Shield, May 1978, p. 14.

[4]BP Shield, May 1978, p. 14.

[5]BP Shield, May 1978, p. 14.

[6]BP Shield, May 1978, p. 14; Southwestern Legal Foundation, Exploration and Economics of the Petroleum Industry, 16:72.

[7]BP Shield, May 1978, p. 14.

[8]BP Shield, May 1978, p. 14.

[9]BP Shield, May 1978, p. 14.

[10]MNC Hearings, Part 7, p. 51.

[11]MNC Hearings, Part I.

[12]Oil and Gas Journal, 8 May 1978, p. 185.

[13]Aimee L. Morner, "Alaskan Oil - Or Bust," Fortune, August 1977, pp. 173-174.

[14]Information compiled from Moody, Moody's Transportation Manual, (New York: Moody's 1977), pp. 2882, 2884, 2888; U.S., Department of Interior, Trans-Alaska Oil Pipeline: Information on Construction, Technical, and Environmental Matters through Spring 1977, written by the Government Accounting Office for the Department of Interior (Hereafter cited as GAO TAPS Report), p. 5.

[15]Morner, p. 174.

[16]Moody's, Moody's Industrial Manual, (New York: Moody's, 1970).

[17]See Chase-Manhattan Bank, N.A., "Capital Investments of the World Petroleum Industry - 1976," Comp. by Richard S. Dobias, Norma J. Anderson, Richard C. Sparling, The Energy Economics Division, Chase Manhattan Bank, N.A., 1 Chase Manhattan Plaza, New York, N.Y., 10015, December 1977, pp. 5-8.

[18]This information was collated by the GAO in U.S., Department of Interior, U.S. Development and Delivery of Alaskan Oil to Market, January 1977, written by the Government Accounting Affice for the Department of Interior (hereafter cited as GAO Alaskan Markets Report), Appendix II, pp. 13-14.

[19]U.S., Federal Energy Administration, Hearings on Alaskan North Slope Pricing and Entitlement Issues (hereafter cited as FEA Hearings), p. 216.

[20]See James P. Roscow, 800 Miles to Valdez: The Building of the Alaskan Pipeline, (New York: Prentice-Hall 1977).

[21]See Roscow.

[22]See GAO Alaskan Markets Report, Appendix III, p. 16.

[23]GAO Alaskan Markets Reports, Appendix III, pp. 19-20.

[24]GAO Alaskan Markets Report, Appendix III, pp. 17-18.

[25]GAO Alaskan Markets Report, Appendix III, p. 18.

[26]GAO Alaska Markets Report, Appendix III, p. 17.

[27]See Wood Gundy, Ltd., Basic Report: International Oil Strategy, (hereafter cited as Gundy, Basic Report), "U.S. Energy Muddle," 13 March 1979, prepared by Wood Grundy Ltd., Royal Trust Tower, P. O. Box 274, Toronto, Ontario, MSK 1MF, pp. 27-28.

[28]GAO Alaskan Markets Report, Appendix III, pp. 18-19.

[29]For a thorough analysis of SOHIO's comparison of the feasibility of TAPS with that of the Trans-Canadian pipeline, see U.S., Senate, Committees of Interior and Insular Affairs and Commerce, Potential Problems Associated with the Delivery of Crude Oil from Alaska's North Slope, "Responses by Standard Oil Company of Ohio to the Joint Committee Questionnaire of 23 August 1976."

[30]Morner, pp. 175-292.

[31]U.S., Federal Trade Commission, Preliminary Staff Report on Investigation of Petroleum Companies, 1973.

[32]Mary Clay Berry, The Alaska Pipeline, (Don Mills, Ontario: Fitzhenry and Whiteside Limited, 1975), pp. 123, 275.

[33]MNC Hearings, Part 5, p. 307.

[34]Berry, p. 266.

[35]Clark W. Breeding, Frank M. Burke, Jr., A. Gordon Burton, et al., Income Taxation of Natural Resources, Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1977, ¶¶ 1.05-1.07, pp. 105-107.

[36]Morner, p. 173.

[37]For a detailed description and explanation of the income tax rules of the united States as they relate to the development and production of oil, see Breeding, Burke, and Burton.

[38]Breeding, Burke, and Burton, ¶¶ 1.12-1.14, pp. 112-114.

[39]Native Claims Settlement Act 1971.

[40]For a detailed report see Peat, Marwick, Mitchell and Co., "Accounting Practices for Oil and Gas Producers: Securities and Exchange Commission Rules and Proposals," (31 August 1978), Printed for P.M.M. and Co. by The Bureau of National Affairs, Inc., Washington, D.C. Available in P.M.M. and Co. Corporate Library.

[41]Breeding, Burke, and Burton, ¶¶ 8.01, 8.14, pp. 801-802, 816.

[42]U.S. Treas. Reg. Section 1.614-8(b)(6).

[43]See FEA Hearings.

[44]See GAO Alaskan Markets Report, Appendix IV, V, pp. 27-28.

[45]See U.S., Federal Advisory Committees, First Annual Report, March 1973, (Washington, D.C.: Government Printing Office, 1974); See also Business Week Magazine, 2 April 1974.

[46]U.S., House, Committee on Banking and Currency, Oil Imports and Energy Security, An Analysis of the Current Situation and Future Prospects, 93rd. Cong., 2nd Sess., September 1974.

[47]U.S., House, Committee on Banking and Currency, Oil Imports and Energy Security, An Analysis of the Current Situation and Future Prospects, 93rd. Cong., 2nd Sess., September 1974.

CHAPTER 10

THE NORTH SEA: THE BRITISH LEGAL REGIME

> As the cradle of Anglo-American law and in its position on the Atlantic fringe of Western Europe, the United Kingdom continues to form a bridge between the legal systems of the transatlantic and Continental capital-exporting States as well as between the Anglo-American legal systems and those of a considerable number of new independent States.
>
> Georg Schwarzenberger

> ... several nations sought in various ways over the years to regulate these companies for their respective national interests ... the resulting general patchwork of country-by-country regulation has fallen far short of the comprehensive system required for effective control of international cartel activities operating far beyond national boundaries.
>
> David I. Haberman

The development of British Petroleum's relationship with her home government developed along different lines than those of her American Sisters with their home government primarily because of the U.K.'s lack of indigenous oil. There had never been a need for specific regulatory legislation, nor for a domestic policy statement.

Government ownership of over 50 percent of BP's stocks has actually been considered a handicap in her foreign operations since many developing countries viewed state enterprises as a suspicious new form of colonialism. Consequentially, the government role in BP was minimized as she developed into a fully integrated company engaging in all phases of industry and thus functioning as a private enterprise.

Recently the company declared that the right of veto held by the government's "ex officio" directors had never been exercised. In testimony given to a Commons Committee in 1974, BP's Chairman stated that "our policies are normally those of a commercial company which have been agreed for 60 years or more with Government and have, I think, suited successive governments. This has never been a controversial matter ... we take our decisions commercially and without influence from Ministers."

After the Iranian fiasco of the early 1950s which marked the decline of British influence in the Middle East, developing the off-shore oil fields of the North Sea took on new meaning for both the government and the oil company. What better way to satisfy supply needs than to develop ones own indigenous oil fields. For BP it meant gaining a new and powerful source of supply potentiating her established positions throughout the world.

Technological and cost limitations had delayed serious exploration in the North Sea until the late 1950s, as was the case in Alaska, although knowledge of the existence of oil in the area had been prevalent since 1920.[2] By 1958, however, with at least twenty firms undergoing initial exploration in the area, the neighboring countries were spurred into negotiating the legal territorial ownership of the waters at the UN Geneva Continental Shelf Convention (Also known as the Law of the Sea Conference).

In 1959 a giant onshore gasfield was discovered at Gronigan, the Netherlands, giving a definite urgency to the Geneva Conference, since many firms were interested in exploring the southern waters of the North Sea where it was believed that additional substantial reserves of gas were located.

However, not until 1964 did the U.K. ratify the UN Convention, bringing the number of signatories to the level required for international adoption.

> The Convention had the effect of extending the sovereign rights of the North Sea coastal countries to include the exploration and exploitation of the natural resources of the seabed on the Continental Shelf. Boundaries were to be negotiated by any set of principles. However, the Convention stipulated that when mutual agreements between countries could not be reached, in the absence of special circumstances, boundary lines would be determined by the principle of equidistance (measuring the width of the North Sea at the widest point between two countries and giving half of the area to each country).
>
> The line demarcating the U.K. sector of the North Sea was established by five separate agreements with each of the coastal countries.[3]

Having obtained the authority to regulate the exploration activities occurring on the U.K. Continental Shelf, the government quickly embarked on the job of defining such regulation in more specific terms by legislation.

In preparing such legislation the government first had to crystalize a general petroleum policy, by considering both her long-term and short-term needs, arranging them according to priority, and reviewing any existing legislation for guidelines as to the most effective way to implement these policy objectives.

Having given top priority to balancing her growing trade deficit, Britain needed rapid development. From the beginning it was recognized that North Sea oil would bring only temporary relief in this area, but it was hoped that the interval would be sufficient -- in conjunction with other domestic economic policies -- to allow Britain to reverse her down-hill trend.

With this aim in mind, the U.K. Government prepared the Continental Shelf Act of 1964, vesting in the Crown those rights to explore and exploit the seabed and subsoil of the North Sea as outlined in the Geneva Conference and extending the relevant provisions of the 1934 Petroleum (Production) Act to apply to offshore activities, primarily the right of the Secretary of State for Energy to grant licences for such exploration and exploitation.

Other previous legislation relied upon to form the framework of the 1964 Act included the Coal Industry Nationalization Act of 1946, the Ministry of Fuel and Power Act 1945, the Coast Protection Act of 1949, the Oil in Navigable Waters Act 1955, the Wireless Telegraphy Act 1949, the Radioactive Substances Act 1960, the Submarine Telegraph Act 1885, the Gas Act 1948, the Companies Act 1948, and the National Insurance (Industrial Injuries) Acts 1946 to 1963.

Under the terms of the 1964 Act the Energy Secretary also has the power to make orders specifying safety zones around offshore installations employed in the exploitation of the U.K. Continental Shelf as well as to execute various ecological and safety standards.

Not only had the government to consider her own aims in developing the North Sea, but she also had to consider the needs of the other members of the petroleum community. The 1964 Act was formulated at a time when

> the North Sea was completely unproven as an area in which petroleum existed. The considerable interest of the companies pointed to the existence of structures that might contain petroleum. Whether or not they did could only be determined by deep drilling, a risky and expensive operation, much more so offshore than on land and in offshore conditions never before met by the oil industry.[4]

Thus the policymakers needed to find ways of enticing the oil companies to commit large amounts of capital to a risky and expensive venture when massive reserves were readily available elsewhere, particularly in OPEC countries. It was feared that "if the U.K. were to impose onerous financial term it might have incited OPEC countries to follow suit, to the detriment of our [the U.K's] overseas oil interest and balance of payments."[5]

H.M. Government was also in effectual competition with the U.S. Government in attracting large scale industry investments, since Alaska was developing during the same time period. Obviously, the firms would be shopping for the deal which would best maximize their profits.

The 1964 Act's treatment of such specific issues as bidding, licensing, royalties and taxes were thought to be workable compromises which would invite investors and accomplish British aims simultaneously without instigating unwanted reprisals in British foreign investments.[6]

The discretionary method of allocating licences was retained as outlined in the 1934 Petroleum (Production) Act and exercised by most countries -- with the notable exception of the United States who relies on competitive bidding. Under the discretionary method, a government simply grants licences according to her own estimate of companies' abilities and willingness to do the work; under the competitive bidding method companies submit cash bids for exclusive rights to the licence area.

> It was judged in 1964 that, in the unproven North Sea, competitive bidding would be unlikely to lead to full and thorough exploration, and it was thought that bids might well have been small, and confined to strictly limited areas, and that British participation might well have been less than was possible to achieve under a discretionary system .... Under a discretionary system, the Department felt that they would be able to insist, as a condition of a production licence, that

the licensee carry out an effective work programme and also to persuade him to buy British goods and services where they were readily available.[7]

Thus with a single experimental exception in 1971, the discretionary system has been retained in U.K. bidding rounds.[8]

In addition to the method of licence allocation, the other major decision that had to be made by the framers of the Continental Shelf Act was on the type of licence to offer. Exploration licences were granted that were non-exclusive, valid for three years, and entitled the licensee to carry out geological probes in any area not covered by an exclusive production licence.[9] An exploration licence did not provide any claim on suspected oil or gas areas.

A production licence gave the holder exclusive rights to search for and extract oil or gas in a specific area. Blocks generally were sectioned in 100-square-mile areas. This licence lasted for an initial period of six years, after which at least half the area had to be surrendered. The holder was then entitled to continue operations in the remainder for a further forty years. The surrendered area could be relicensed by the government.[10]

The licensee made initial payment of £6,250 for the first 6 years of a licence, per average block, a payment of £10,000 per block in the seventh year, followed by annual increments thereafter of £6,250, to a maximum of £72,500.[11]

Taxes consisted of a royalty rate of 12.5 percent of the value of oil produced, and a company taxation rate of 53.75 percent.[12]

Government control over the disposal of oil and gas was incorporated in the licence by requiring the Energy Secretary of State's written consent for the delivery of petroleum elsewhere than onshore in the

United Kingdom. The Minister was given the further power to impose conditions on the place of delivery and the price to be obtained.[13]

Work programs could be imposed upon licensees by the Secretary of State for Energy. These could have included general drilling obligations, such as requiring that one well be drilled in each block, but it was decided to leave such specifics to the discretion of the Energy Minister.

In the First Round of oil licensing, April 1964, 394 blocks were applied for and 53 licences were awarded covering 348 of the blocks. The Conservative Government of that year required "that the applicant for a licence ... be incorporated in the United Kingdom" and stated that it would "look at the contribution the applicant has already made or is making towards the development of resources of our Continental Shelf and the development of our fuel economy generally."[14]

The British firms of BP, Burmah, Shell, and one public sector energy company, the Gas Council (later the British Gas Corp. -- BGC), who joined with AMOCO, Amerada, and Texas Eastern to receive four licences, were given 30 percent of the total area. The remaining 70 percent went mostly to foreign companies although some British firms participated as investors. Most of the blocks offered in this First Round were in the southern region and although a few natural gas fields were discovered, no commercial quantities of oil were found in this sector until 1969 when the British Gas Corp. consortium struck oil in the northernmost block released in that First Round -- block 22/17.

The Second Round took place in August 1965 and the consideration of licences include the newly elected Labour Party's philosophy of encouraging participation of public enterprise. The immediate result was a 6 percent share of the blocks going to the BGC (as opposed to a 3 percent share of the First Round). In order to increase the public enterprise share, the Labour Government passed the National Coal Board (Additional Powers) Act of 1966, giving the National Coal Board (NCB) the right to participate in offshore activities. The NCB quickly accepted a previously arranged offer to buy a 50 percent interest in all of Conoco's licences, a 40 percent interest in some of Gulf's licences, and a carried interest in the Allied Chemical licences, which brought the public sector share of the Second Round from 6 percent to 10 percent. These subsequent NCB assets would play an important part in the development of BNOC.

In October 1965 BP announced the first major gas discovery, the West Sole field, which necessitated the formulation of a government gas policy as to its disposal. The BGC's monopolistic position enabled the government to control all the activities of this industry, from the wellhead to the market.

Consideration of the BGC's position gave rise to a government policy review in which a reassessment of state participation took place encouraging the suggestion of establishing a National Hydrocarbons Corporation to "assume sole responsibility for exploration and development in all the offshore areas not retained by existing licences."[15] The proposal was not adopted at the time since (1) oil reserves had still to be proven, (2) the establishment of a state company might discourage private investment, and (3) such action might have adverse effects on British oil interests abroad.

Thus the Third Round in 1969 was to be conducted under the existing terms except that more weight was to be given to those bids including public sector participation, and a retroactive provision for all blocks in the Irish Sea, not yet seriously explored to include an option for either the BGC or the NCB to share the existing licence.

While the government was considering the 34 bids it received, covering 117 of the 157 blocks on offer, AMOCO announced the discovery of the Montrose oil field -- the first major North Sea oil find. During the next year BP discovered the Forties field and the Ekofisk field in the Norwegian sector was also discovered.

The new enthusiasm generated by these discoveries combined with the drop in exploration apparently due to inadequate acreage under lease and the series of events occurring in the Middle East -- specifically Lybia's increased participation -- led to a much larger Fourth Round in 1971-1972, which concentrated on the more promising areas of the northern section.

The Conservatives, who had returned to power by this time, decided to place 15 of the 436 blocks open in this round up for auction as an experiment in the competitive bidding method of allocating licences:

> Looking to future policy, Ministers also decided ... to carry out a limited sample tendering exercise to gain experience in this method for later rounds and to test the market by offering 15 blocks which, though all in areas where hydrocarbons had been discovered, ranged from blocks which appeared very attractive to others which appeared indifferent.[16]

The result was that those 15 blocks brought in £37.2 million as opposed to the figure of less than £3 million collected from the remaining 185 blocks applied for, giving rise to public concern over the government's take as opposed to the companies' profits.

The government retained her preference for discretionary bidding; as one Minister testified:

> The exploration programmes which have been insisted on as part of the discretionary licensing system would be very difficult to apply in auction, and absolutely impossible in the early days of exploration of a province, because not enough knowledge exists about the province to discuss and lay down an exploration programme or a work programme, such as is part of every licence agreement under the discretionary system.[17]

Yet, the public debate over method of bidding led to an investigation by the House of Commons' Committee of Public Accounts. The inquiry delved into the method of allocation, the terms of the licences, and the corporate income tax situation in Britain. The latter was particularly important. Britain had a corporate tax, applicable to the entire set of operations of the integrated oil companies, but not a petroleum tax, applicable only to revenues earned from production of North Sea oil. In 1972, British tax laws provided companies to earn double relief on their U.K. corporate income taxes: one relief by means of free depreciation on capital expenditures, including exploration expenditures; the other by means of the provision whereby "the tax take, in the oil production country, takes the form of a local tax which is set against United Kingdom tax and not against the profits of the company."[18] Free depreciation allows expenditures to be written off against the first year's profits, at the company's discretion. The second provision extinguished the U.K. tax oblication of Shell and BP before North Sea oil started flowing, but the real concern was that "losses" on overseas operations that exceeded the U.K. tax obligations in any one year could be accumulated and carried forward to offset U.K. tax obligations in future years. This cumulative loss had reached the order of £1,500 million for nine of the major companies, and under the tax laws, could be used to offset some of the potential profits from U.K. Continental Shelf operations.[19]

The Committee regarded it as "unsatisfactory that U.K. tax revenue from Continental Shelf operations should be pre-empted by the tax demands of administrations elsewhere in the world," and recommended that "the Government should take action substantially to improve the effective tax yield from operations on the continental shelf; and should consider among other methods the possibility of imposing a system of quantity taxation," such as a tax on each barrel of oil produced in the North Sea.[20]

Meanwhile government regulation of standards continued to develop. The Mineral Workings (Offshore Installations) Act 1971 was enacted which introduced a comprehensive code of safety regulations which covers the following: registration of all installations with the Department of Energy; appointment of installation managers to be responsible for overall installation safety; keeping of logbooks, and the registration of deaths of persons on installations; functions and powers of the Department's Inspectors, and the notification of accidents; surveying of offshore structures and the issuing of Certificates of Fitness by appointed certifying authorities; safety of diving operations from or in connection with installations; extension of the Employers' Liability (Compulsory Insurance) Act 1969 to require that employers of persons working on offshore installations obtain insurance coverage against employee claims for injuries; day-to-day personnel safety, the safety of equipment and working procedures, and the provision of medical facilities; life-saving appliances; and emerging procedures and the holding of regular drills and practice musters. Enforcement of these regulations lies with the Department of Energy's Petroleum Engineering Inspectorate. Further regulations were to be prepared which would cover the provision of fire-fighting systems and equipment.

In addition, the Merchant Shipping (Oil Pollution) Act 1971 was enacted which places a liability on the owner of a tanker from which oil escapes and requires him to carry insurance against the liability.

The Prevention of Oil Pollution Act 1971 makes it an offence for ships of any nationality to discharge any oil into U.K. waters, and additionally for U.K. - registered ships to discharge any persistent oil anywhere at sea, except in accordance with very strigent regulations. The act also controls discharge of oil or oily water from installations on land into U.K. waters and from offshore platforms or pipelines on the U.K. Continental Shelf into the sea. The prevention of accidental pollution from offshore installations is essentially a matter of using safe working practices which, while aimed primarily at the safety of men and installations, undoubtedly reduces the risks of pollution from oil spills.

The Town and Country Planning (Scotland) Act 1972 provides local government with the authority to plan for land development. It requires that each proposal for development be the subject of a planning application to the planning authority for review and decision.

The Merchant Shipping Act 1974 provides that oil importers contribute to an international fund that will compensate for pollution damage in the U.K. where persons suffering the damage are unable to obtain full compensation under the Merchant Shipping (Oil Pollution) Act 1971. The act also enables the Secretary of State for Energy to regulate the design and construction of British oil tankers and the admission of foreign tankers to British ports.

The Dumping at Sea Act 1974 provides legislative support in the United Kingdom for control of dumping at sea and replaces a previous voluntary control scheme. It provides that before any materials can be disposed of at sea by "dumping" (excluding discharge through pipelines) a certificate must be obtained. The determining factor in deciding whether to grant a licence is the need to protect the marine environment and its living resources.

By this time the loss of oil supplies due to the 1973 Arab embargo had threatened Britain, as well as other countries, with economic disaster. The Heath Government had taken certain steps including bilateral oil supply agreements with Iran and Saudi Arabia, to assure that the country would receive adequate amounts of oil; yet, in spite of these agreements, Britain lost a proportion of her supply similar to other European countries.

BP could not be persuaded to give her home country favored treatment regarding oil allocations, even though that home country held over 50 percent of her shares. She assumed the attitude that all nations must be treated equally stating that British "laws and the contracts written under those took priority over instructions from their shareholders." Robert Stobaugh reports the Heath Government ordered BP to give British customers priority, but was refused.[21]

The incident serves to further exemplify BP's independent role as a private firm as opposed to a state company, which contributed to the Labour Party's later demand for the creation of a state oil company. Had BP functioned in the country's interest at this time, there may have been no need for establishing BNOC; however, had she condescended to operating strictly in the interest of the government, she would have lost her status as an independent, private firm -- something she refused to do. The government, for her part, asked, begged, and finally ordered BP to deviate from her established pattern of behavior in terms of their relationship. It was the decision of BP -- not that of the government -- that the company maintain the distance as established by precedence between herself and her government-shareholders.

> The government traditionally does not interfere with the commercial running of the company. This policy started back in 1914, when the assurance was given by the then government. Successive governments have observed that practice.
>
> When the combined government and Bank of England shareholding in BP was 70 per-cent. it was difficult to make this credible. Many people were saying, how can you still be running as a commercial and independent company when the government and the Bank of England have 70 per-cent.?
>
> Viewed in this light, 51 per-cent. (which is about what the government percentage has been for many years) is not significant in terms of control, and, as I say, the main thing is that we continue in our relationships and carry on and run our own business.[22]

The issue raised questions over the government's power to control the rate of production and ultimate destination of North Sea oil in time of crisis since the Continental Shelf Act had only vaguely touched these questions. Domestic political events -- namely the 1973 coalminers' strike leading to the 3-day work-week -- took precedence temporarily until after the 1974 General Election when the new Wilson Government quickly instituted a review of oil policy that produced an important White Paper[23] setting forth a new set of conditions for the regulation of North Sea oil development. It established two principal government objectives: "To secure a fairer share of profits for the nation and to maximise the gain to the balance of payments to assert greater public control."[24]

To achieve these objectives, the White Paper proposed the following measures:

> Legislation will be proposed in an early Finance Bill to impose an additional tax on the companies' profits from the Continental Shelf ....
>
> It will be made a condition of future licences that the licensees shall, if the Government so require, grant majority participation to the State in all fields discovered under those licences ....
>
> 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 ....
>
> A British National Oil Corporation (BNOC) will be set up, through which the Government will exercise their participation rights. This Corporation will represent the Government in the present consortia ... and also build up a powerful and expert supervisory staff that will enable it to play an active part in the future development, exploration and exploitation of the Continental Shelf. It will also have powers to extend its activities ultimately to the refining and distribution of oil.
>
> The Government will extend their powers to control physical production and pipelines .... They will also take powers ... to require licensees to provide more information about their activities than is now obligatory.[25]

The general principles as outlined in the White Paper had broad bipartizan support; e.g., maximizing national revenue from North Sea oil, improving government access to information, and implementing effective governmental powers over the rate of oilfield development.

The 1973 Crisis was the impetus, then, for the abrupt change in U.K. Government policy. Where she had wanted rapid development of North Sea potential to aid her balance of payments, she now favored conservation rather than depletion of supply. The role of inflation -- irregardless of its origins -- was that of defeating the original purpose of rapid development. No matter how speedily production took place, inflation was spoiling the intended benefits to balance of payments. Therefore, a shift in priorities of government demands was effected. The reallocation of scarce resources in favor of the government, with the inherent alteration to income needed to provide uneconomical services -- especially those related to Britain's unemployment problem -- took precedence over rapid realization of North Sea profits.

The Labour Government viewed BNOC as a tool for achieving these objectives, but the Conservatives insisted consideration of alternatives. The Conservative Party argued that the profits of a state-owned oil company would not enlarge the public's direct share of North Sea oil wealth for several reasons. First, BNOC would not be an efficient oil company: "There may now descend on British oil operations the same dead hand of political control as is afflicting the steel industry, the Post Office, and other sad examples in the public sector."[26] Second, BNOC would find it difficult to attract a competent staff because the private companies could offer salary levels and a range of worldwide opportunities that the state company could not easily match. Third, the increase in government participation via BNOC in oil investments, if made with government funds, would decrease the amount of government revenues usable for other pressing purposes. If BNOC sought funds on the private money market, the public would ultimately lose out because the big private corporations could get such funds at a lower rate of interest than BNOC, and indeed than the British Government itself.

Banks were so hesitant to finance projects developing small, unproductive fields during 1974, due primarily to the failure of the British Government to quantify the return which they would allow companies to earn, and to the weak position of international money markets, that only one partially financed project was announced.

Republic National Bank of Dallas (now RepublicBank Dallas) and International Energy Bank co-managed the syndication of $250 million of financing for the Piper field, consummated in October 1974, the only project financed that year.

Occidental Petroleum Corporation, Allied Chemical Corporation, Getty Oil Company, and Thomson Scottish Associates Limited (through their respective subsidiaries) made a significant discovery in Block 15/17 on Licence P 220 in the U.K. sector of the North Sea. The field was discovered in January 1973, and was defined by drilling eight expendable wells. DeGolyer and MacNaughton, one of the world's most imminent firms of petroleum geologists, acclaimed for the accuracy of their reserve estimates, reported recoverable reserves of the Piper Field at 642 million barrels of oil, and Occidental's engineers project a maximum production rate of 250,000 barrels per day. Occidental and Thomson Scottish own 36.5 percent and 20 percent, respectively, in the licence. Both Occidental and Thomson desired separate credit facilities for their respective development costs, to construct and install a 36-slot platform in 480 feet of water, lay 127 miles of 30-inch pipeline to a loading terminal in the Orkney Islands, and construct the terminal and shore facilities.

A credit facility of $150 million was consummated for Occidental of Britain, Inc. in October 1974, secured by a first charge on Occidental's interest in the Piper field facilities and licence. Occidental agreed to provide the facilities and field development in accordance with a specified development plan, and guaranteed repayment of the facility if construction was not completed by a specified date.

After completion of development, production of a specified amount of Piper crude, and verification of the reserves, Occidental has the option to convert all but $30 million of the financing to a production payment. Repayment of the financing is from a variable percentage of the proceeds from the sale of Occidental's share of Piper crude. This variable percentage is designed to accomplish repayment within nine years from the closing date, and to maintain minimum ratios of present worth of future net revenue to the outstanding loan balance.

The Thomson Scottish Petroleum financing involved a $100 million credit facility for development of the Piper field. Obligations of Thomson were limited to providing $20 million before drawing under the facility and an additional $30 million, if required, after the facility was fully drawn. Repayment was contractually limited to gross proceeds from the sale of Piper crude and also provided a variable dedication of gross proceeds to accomplish repayment nine years from the closing date and to maintain minimum ratios of present worth of future net revenues to the outstanding loan balance. In addition to a normal interest rate, the banks receive a 2.5 percent royalty interest on the Thomson interest on the first 642 million barrels produced to compensate for the additional risk of the limited recourse facility.

Both of the Piper credit facilities required the consent of all the consortia partners and the consent of the U.K. Government to the security provisions contained in the charge against the licence and the Piper field facilities. In addition, of course, agreements on the part of the Bank of England regarding convertibility of funds for repayment and certain tax rulings by the Inland Revenue were required.

In order to insulate the bank's security from defaults that might occur outside the Piper field area, Licence P 220 was restricted to the Piper field area, and the residual area of P 220 was cancelled by the Department of Energy and reissued as Licence P. 247.[28]

On the issues of Governmental access to information and control over North Sea oil development and disposal, the Conservatives proposed a small regulatory body -- the United Kingdom Oil Conservation Authority (UKOCA) -- inspired by the Texas Railroad Commission and the Energy Resources Board of Alberta.[29]

After a year's debate the Petroleum and Submarine Pipelines Act of 1975 (P&SPA) was passed, over the objections of the Conservatives, and became law on 12 November 1975. Its main provisions include: (1) The setting up of the British National Oil Corporation with powers to explore for and produce petroleum; transport and refine petroleum; store, distribute, and buy and sell petroleum and products; take over the Government's participation interest in U.K. licences; carry out consultancy, research, and training in petroleum matters; build, hire, or operate refineries, pipelines, and tankers. Certain activities (.e.g., exploration and production abroad, "downstream" activities such as refining and trading in products, setting up or acquiring subsidiaries, giving loans and guarantees) can be carried out by BNOC only with the consent of the Secretary of State for Energy. (2) The introduction of additional controls over exploration and exploitation of the U.K. Continental Shelf to assure its orderly development; this includes Government powers to control future rates of oil depletion. (3) The introduction of controls over the construction and operation of submarine pipelines, including the use of third parties of both proposed and existing pipelines. The

Act also empowers the Secretary of State for Energy to assure the safety of pipelines and the safety and health of people working on them. (4) Powers to control the construction of new refineries and the expansion of existing refineries. (5) The setting up of the National Oil Account.

Other legislation of this time period relating to oil include the Oil Taxation Act 1975 which established the current taxation and royalty system used in the United Kingdom sector of the North Sea. Its main features include the petroleum revenue tax of 45 percent, a corporation tax of 52 percent, and a 12.5 percent royalty. Also included are tax incentives for developing marginal fields, and provisions which prohibit losses and allowances for activities outside the North Sea to be used to reduce a company's tax liability for activities there.

The Offshore Petroleum Development (Scotland) Act 1975 gave the government control of certain types of oil-related developments in the public interest. The Act provides for the acquisition and reinstatement of oil sites in Scotland and for the control of certain oil-related operations within territorial waters. The Secretary of State for Scotland is given the power to acquire land either by agreement or compulsorily if it is required for one of a number of defined oil-related purposes. Where such land is urgently required (and planning permission has been given) the Secretary of State may acquire it by an expedited acquisition order. A statutory instrument containing such an order cannot be made unless a draft of it has been laid before, and approved by resolution of, each House of Parliament. The Act stresses the rehabilitation of oil sites after use, and local authorities are empowered to make financial arrangements with developers to assure that money is available for restoration.

The Submarine Pipelines (Diving Operations) Regulations 1976, which came into force on 10 July 1976 relates to diving operations carried out in respect to submarine pipelines and associated works. They closely follow the Offshore Installations (Diving Operations) Regulations 1974 and the Merchant Shipping (Diving Operations) 1975.

The most important of these, of course, is the P&SPA which created BNOC; however the Act failed to outline in any detail the ways in which the company is to resolve the conflicts inherent in her nature as a government-owned company.

The P&SPA attempted to ease the dilemma by making BNOC more accountable to government than most other State enterprises, and yet, on the other hand, endowing her with sufficient quantities of oil to become the leader in the North Sea and a large, oil-rich company even by international standards. BNOC's inheritance included holdings of Burmah, BGC, NCB, as well as options in 51 percent of all existing leases and 51 percent participation in all future leases.

The question of attracting suitable leadership is interlaced in the same paradox. The more dynamic the personality of the leader, the more concerned he will be with creating a dynamic and successful enterprise, and the less satisfied he will be with governmental accountability limitations. It remains to be seen whether the leadership selected will be able to fill both roles satisfactorily.

> BNOC's first employee was its Chairman and Chief Executive, Lord Kearton. Kearton had retired as Chairman of Couraulds, which during his tenure grew to be the second largest chemicals conglomerate in Britain. By all accounts, he is an aggressive businessman and a forceful personality, although it is unlikely that he will be with the Corporation beyond 1980

-- he is presently 65 years old. BNOC's other Board Members include Lord Ballogh, formerly a Labour Minister of State for Energy and an early advocate for a State oil company; two civil servants, one from Treasury and the other from the Energy Department; two bankers; two industrialists, including the Chairman of the British Gas Corporation; and two trade union executives. One board member, Mr. W.H.A. Camp, previously had served as a political advisor to an oil company. Aside from Lords Kearton and Balogh and Mr. Camp, the Board has little direct experience in the oil industry.[30]

Participation agreements with companies holding leases prior to the Fifth Round in which 51 percent participation with BNOC was mandatory, created other problems for the state company. Initial participation agreements were secured by making the degree to which a company exhibited her willingness to concede to the state a majority (51 percent) share in existing leases a prime consideration in awarding leases in the Fifth Round. Conditional awards were given to 65 companies in respect to 44 of the 51 blocks applied for (71 blocks had been offered).

Ideally, of course, according to Labour Party conception, BNOC would have liked to buy her 51 percent share of the existing leases. Due to limited government funds, however, this was impossible, so BNOC had to settle for an option to buy 51 percent of oil produced on the leased property with the further stipulation in most cases that she be obliged to resell the oil to the original owner at the same price at which she bought it. The Financial Times editorialized that the Shell/Esso agreement with BNOC, the first of these arrangements, was an "unnecessary oil deal .... Only in a politician's eye does it come anywhere near to the spirit of the original intention." (6 January 1977).

The details were worked out in individually negotiated contracts between licensees, BNOC, and the government and were concerned with the conditions under which BNOC must resell the oil. While the companies were willing to grant negation on national emergency terms, BNOC -- at the government's insistence -- demanded broader, less confining terms.

BP's participation agreement, signed 1 June 1977, while granting BNOC the right to purhcase up to 51 percent of BP's light North Sea crude (as well as some of its heavy crude -- primarily from the Middle East) at current market prices, stipulated that in the first 18 months, all the oil BNOC bought was to be resold to BP at the original selling price. Between 1979 and 1981 BNOC was to retain only 12 to 16 percent of production. During 1982-1989 BNOC and BP would operate under a fixed contract with BNOC retaining 16 percent of output in 1982 and 12.75 percent in the remaining years.

Article 12 of the participation agreement outlined the downstream cooperation set out in a separate document, effective to 31 December 1981, in which BNOC is to have training and a non-voting presence in BP Oil's (BP's U.K. refining and marketing subsidiary's) internal counsels dealing with refining, distribution, and marketing, as well as the manufacture of chemical feedstocks, on the condition that she not enter into competition with BP in these areas during the time period. However, the document stated that BP Oil and BNOC were to establish a long term basis for cooperation in U.K. refining and marketing, "which would indicate that joint ventures may well be possible after 1981 when ostensibly the training aspect ceases."[31]

Article 13 provided for consultation between BP and the Secretary of State for Energy on BP's U.K. offshore activities and her U.K. petroleum supply, refining, exports, and imports.

Public opinion mocked the agreement depicting BP sitting BNOC on her knees teaching her the business.[32]

Perhaps the government had previously been unable to persuade or even order BP to act as her tool, yet as a condition of discretionary leasing, she managed to coerce BP into imparting her expertise to the government's (now tightly controlled) state company, with insinuations of a future partnership on at least a limited scale.

Did BP, however, submit any of her freedom as an independent firm? Since BP has always been a crude-rich company with more crude than she can refine, competition from BNOC in this area was unlikely to cut in on her sphere. Acting as a purely private enterprise, however, BP was careful to prepare for BNOC's eventual venture into the refining and marketing aspects of the oil business by assuring a future partnership between the two and thereby gaining for herself a much larger percentage of the market than she would be allowed under unrestricted competitive practices. She had arranged a remarkably favorable buy-back agreement with BNOC; she had assured herself a partnership in the possible future monopoly of the marketing and refining aspects of the business; she had positioned herself as the teacher of her probable future partner; and she had acquired the enviable position of funneling information to the government on which the government was likely to make any future policy decisions -- all the while maintaining the secrecy of her independent operations elsewhere in the world, particularly those in America and the Middle East.

Her fellow Sisters were not so lucky, as the Shell/Exxon Participation agreement illustrates; although they, too, retained certain privileges. BNOC was granted the option to purchase up to 51 percent of production, "on a basis which recognizes the company's need for crude oil to support its U.K. refining and marketing commitments and which therefore provides for the sale back of oil at the same market price." In the event of short-fall between the companies' U.K. production and their U.K. oil requirements, the participation arrangements provide for the sale back by BNOC to the companies of up to 100 percent of its participation oil entitlement. In return, the companies declared their intention to use their U.K. North Sea oil "from existing licences" to feed their U.K. refineries, to "optimize" the use of U.K. oil and to "trade at fair market prices using their best endeavors to safeguard U.K. Government petroleum revenues and maximize the benefit to the U.K. balance of payments."

Clause No. 5 in the Agreement stated specifically that the Secretary of State for Energy could order BNOC not to sell back to a company crude acquired under the terms of the Agreements. The government need only give thirty days' notice that BNOC will not sell back. This clause applied to all other participation agreements that include buy-back arrangements, including the BP Agreement. The circumstances under which the clause would be applied deal, in part, with how a company disposes of oil it buys back. The clause would allow the U.K. Government to stop selling back crude if a company sold the crude contrary to government policy.

The threat of withholding buy-back crude might be used to force compliance with government guidelines limiting exports of North Sea crude to one-third of production. The government in 1977 started meeting with producers to discuss the fact that exports had been exceeding these guidelines, averaging about 40 percent of output. It indicated it would be flexible in applying the rule but was calling on producers to conform.[33]

The agreement made BNOC a joint licence-holder in all present and future commercial finds made under existing licences. The companies retained their beneficial interest in the oil and remained responsible for all costs, including royalties and taxes. BNOC received rights to information customarily provided to co-licensees, as well as an effective voice and a vote, but no veto, in the development and operation of the fields. The companies provided a defined program of training for BNOC employees in crude supply, transportation and refining operations.

An additional area provided for consultation between BNOC and the companies on, but not limited to, historical and planned production levels, U.K. refinery throughput and output, use of U.K. oil in their refineries, arrangements for securing other crudes needed for refineries, crude and products import-and-export balances, plans for construction of refineries, upgrading or modification of existing refineries and pertinent information about relevant prices.

In May 1978 invitations for Sixth Round licence bids went out whereby the U.K. Government notified companies they must offer BNOC more than a 51 percent equity in Sixth Round bidding for licences. Other terms to be imposed on companies included the carried interest formula, in which BNOC would maintain its equity rights as a licensee but would not pay "for any costs or be liable for any obligations which would otherwise be attributable to the share for which it is being carried, except and to the extent that it elects to participate in any development program." If BNOC opts into a commercial development, it will then reimburse the companies for its share of the exploration and appraisal costs and will pay its share of the development costs.

The companies were also asked to grant BNOC options to buy, at market prices, their "shares of oil and natural gas liquids" and to state what portion of their shares they would so sell. In attition, the companies were asked to grant BNOC options to sell to them at market prices BNOC's share of oil and gas liquids and to state what portion they would buy back.

If BNOC should decide not to take part in any development, it would still hold a 51 percent equity interest and be represented at meetings concerning development. It would not be entitled to a share in the oil or in the ownership of assets, nor have a vote on development matters.

Of forty blocks offered in the Sixth Round, the government wanted BNOC to be operator in the exploration phase for six blocks; selection of such blocks were to be made after all applications for the forty blocks received.

Companies were judged on their Fifth Round performance in agreeing to government participation and their implementation of any agreements. The government also looked at a company's performance in providing access to offshore installations for trade union representatives and in providing offshore training.

The government proposed to hike the licence application fee to £1,000 as well as all rentals by 25 percent. Another financial change was a requirement that applicants produce their annual audited accounts.

The development of North Sea oil placed the U.K. Government in new positions; indigenous oil had provided the opportunity to stimulate her domestic industry and the regulation of that industry, and in so doing she created and nourished her own state company -- BNOC.

However, she now found herself as a host government as well, and adapted accordingly: her previous affinity towards American companies became a direct relationship on terms differing totally from the past. Thus her connection with the U.S. Government was also slightly altered.

BP maintained her peculiar association with the U.K. Government amidst stress to revise it, and emerged even stronger as a commercially independent company. She continued the unofficial alliance with the American majors while taking advantage of her new ties with BNOC.

If one only considers BP's contribution of her technical expertise to the municipal law creating process of her home government, that in itself would be a significant contribution to future international regulation. But compounded with her alliance in the Sisterhood, her voice in unorganized international society is more powerful than any single state; and, in organized international society, than any confederation of states.

As has been shown BP successfully boycotted Iran, exemplified by the Rose Mary case; she also refused a direct order from her home government to supply fuel to the Navy during the 1973 Crisis; but perhaps the best example is that of Rhodesia, where she not only defied her home government, but mocked the U.N. and, indeed, the entire international legal community as well.

Notes to Chapter 10

[1]From U.K., Select Committee on Nationalized Industries, Nationalized Industries and the Exploitation of North Sea Oil and Gas, First Report, Session 1974/75 [hereafter cited as Select Committee Report], (London: H.M. Stationery Office, 1975), p. 116, p. 234.

[2]Southwestern Legal Foundation, Exploration and Economics of the Petroleum Industry, Vol. 16: Subsea Production Systems, (New York: Matthew Bender and Co., 1977), 16: 102.

[3]U.S., Departments of State and the Interior, The United Kingdom's Development of its North Sea Oil and Gas Reserves, Report of the Government Accounting Office, 1977 [hereafter cited as GAO Report on U.K. Reserves] pp. 7-8.

[4]U.K., Department of Trade and Industry, First Report from the Committee of Public Accounts: North Sea Oil and Gas, Session 1972-73 [hereafter cited as Public Accounts Committee Report], (London: H.M. Stationery Office, 1973), p. 24.

[5]Public Accounts Committee Report, p. x.

[6]For a comparative assessment of licence terms in various countries, see Public Accounts Committee Report, pp. 36-42.

[7]Public Accounts Committee Report, p. xi.

[8]For a thorough comparison of the two systems with applications to the North Sea, refer to Kenneth W. Dam, Oil Resources: Who Gets What How? (Chicago: University of Chicago Press, 1976).

[9]Public Accounts Committee Report, p. 43.

[10]Public Accounts Committee Report, p. 43.

[11]Public Accounts Committee Report, p. 24-25.

[12]Public Accounts Committee Report, p. 24-25.

[13]Public Accounts Committee Report, p. 44.

[14]Select Committee Report, p. 26.

[15]Public Accounts Committee Report, p. 28.

[16]Public Accounts Committee Report, p. 32.

[17]Public Accounts Committee Report, pp. 3-4.

[18]Public Accounts Committee Report, p. 101.

[19]Public Accounts Committee Report, p. xxi.

[20]*Public Accounts Committee Report*, p. xxxii.

[21]See *The Oil Companies in Crisis* (Daedulus, 1975) p. 189.

[22]From an interview with Sir David Steel, Chairman of the Board of British Petroleum, *BP Shield*, January 1978, p. 1.

[23]"United Kingdom Offshore Oil and Gas Policy" [hereafter cited as "U.K. Oil and Gas Policy"], Cmnd. 5696 (London: H.M. Stationery Office, July 1974).

[24]"U.K. Offshore Oil and Gas Policy," p. 4.

[25]"U.K. Offshore Oil and Gas Policy," pp. 4-6.

[26]Statement by Parliamentary Under-Secretary for Energy; John Smith in the House of Commons in April 1975, *Hansard*, Vol. 891, No. 115. Cols. 602-603.

[27]See Ewan Brown, "Finance for the North Sea," in *The Political Implications of North Sea Oil and Gas*, (Oslo: Universitetsforlaget, and Guildford, U.K.: IPC Science and Technology Press Ltd., 1975), Edited by Martin Saeter and Ian Smart under the auspices of the Norwegian Institute of International Affairs, Oslo, and the Royal Institute of International Affairs, London, p. 119.

[28]Information acquired from T.K. Matthews, Senior Vice President, RepublicBank Dallas, Dallas, Texas.

[29]*Hansard*, Vol. 891, No. 115, Cols. 1305-1310.

[30]U.S., Senate, Committee on Energy and Natural Resources, *Controlling Oil: British Oil Policy and the British National Oil Corporation*, by Edward N. Krapels, Committee Print, Publication No. 95-59, 95th Cong., 1st Sess., October 1977, pp. 27-28.

[31]*Petroleum Taxation Legislation Report*, p. 84.

[32]*Financial Times*, 3 June 1977.

[33]Refer to *Petroleum Taxation Legislation Report*, p. 86.

CHAPTER 11

RHODESIA: FAILURE OF ORGANIZED INTERNATIONAL SOCIETY

> Global multipurpose institutions such as the League of Nations and the United Nations are best understood as organizational superstructures of international customary law on a consensual and confederate basis. Their impact on international law is threefold: modification by express consent of the rules underlying the fundamental principles of international law, indirect modification of these rules by acquiescence on the part of member states in the action of organs not actually authorized to exercise lawmaking functions, and initiation of the further codification and development of international law.
>
> Georg Schwarzenberger

> ...(the U.S. [and U.K.]) government has, to date, shared the general failure to regulate those companies effectively ... the signal shortcoming of national policy and, indeed, that of the Western European nations on this issue, has been our collective failure to recognize, at least since the end of World War II, the central proposition that the orderly disposition of world petroleum resources between the producing and consuming nations must ultimately be resolved internationally on a sovereign level, i.e., as between governments, through multilateral treaties, international arbitration and enforcement, etc.
>
> David I. Haberman

In examining a company's relationship with both home and host governments it has been illustrated that in most cases the objectives of home companies and governments have been parallel and thus little discord has arisen between them; in fact, mutual support has nourished this alignment for years.

Rhodesia, however, exemplifies some of the conflicts inherent in a situation where objectives of home companies and governments are in direct opposition. As has been illustrated, a large oil firm is motivated by profit and is generally apolitical, in that politics which could limit profits are shunned; politics which could enhance profits are adopted. The home government, as a general rule, benefits from a successful home oil company so that the established pattern is one of cooperation. However, in a case where a home government's political priorities inhibit the company's profit incentive, the relationship between the two bodies is stressed. While this contradiction of objectives and behavior may damage the relationship on one level, it need not adversely effect all the aspects of the relationship.

Thus while a serious rift may have divided BP and the U.K. Government over Rhodesian sanctions, no indication of this rift was evident over BP's activities in the Middle East, America or Britain.

BP, for her part, acted in accordance with her general philosophy of business practices. Her financial interest in the area was specified in the Red Line Agreement of 1928 when it was determined by the emerging world oligopoly members that the "area between Cyprus, South Africa and Ceylon" would be divided fifty-fifty between Shell and BP for supply and distribution purposes.

Shell had previously begun developing the area for herself and had already gained brand-name recognition in the area; so it was decided to capitalize on this and allow Shell's established management in the area to continue. The 1931 Management Agreement spelled out the details of the arrangement whereby Shell (then the Asiatic Petroleum Co. Ltd.) would manage the operations of the Consolidated Petroleum Co. Ltd., the company established by Shell and BP to service the Cyprus-South Africa-Ceylon triangle.[1]

This was a logical progression following the established pattern of efficient scientific management in order to best maximize profits. BP was always a crude-rich company, while Shell specialized in refining and marketing. It mattered little to BP that the products would be marketed under a Shell label so long as BP received her 50 percent share of the profits.

This arrangement worked well for close to fifty years, and was, then, in existence when on 11 November 1965 Ian Smith and the "Government of the British colony of Southern Rhodesia illegally and unilaterally announced its independence of the United Kingdom" (UDI), and when the resultant sanctions took effect.

> On the 16th November the British Parliament enacted The Southern Rhodesia Act 1965, declaring that Southern Rhodesia continued to be part of Her Majesty's dominions and giving power by Order in Council to impose economic and other sanctions against Southern Rhodesia .... Then, on the 17th December 1965, sanctions were imposed in respect of petroleum and petroleum products.[2]

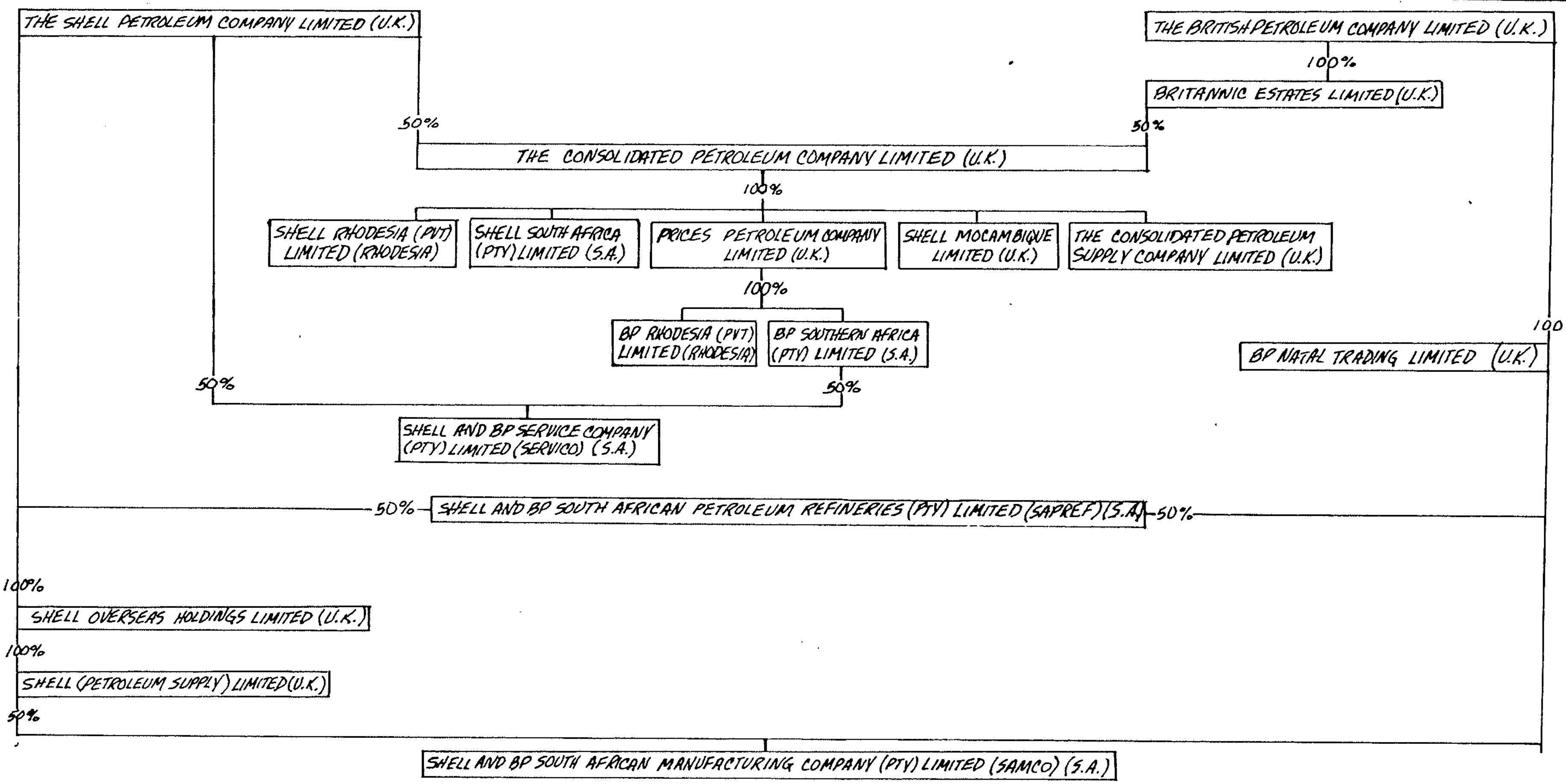
On 29 May 1968 the Security Council of the United Nations adopted Resolution No. 253 which prevented the sale or supply of commodities or products to Rhodesia.[3]

> Her Majesty's Government responded by making The Southern Rhodesia (United Nations Sanctions) Order 1968 (S.I. 1968/885) ("the 1968 Sanctions Order") which became effective on the 14th June 1968. The 1968 Sanctions Order obtained the necessary approval of the House of Commons but not of the House of Lords. A further Order was therefore made: The Southern Rhodesia (United National Sanctions) (No. 2) Order 1968 (S.I. 1968/1020) ("the Sanctions Order") which became effective on the 3rd July 1968 and was duly approved by both Houses of Parliament .... [The 1968 Sanctions Order] revoked a number of earlier Sanctions Orders, including the Southern Rhodesia (Petroleum) Order 1965 (S.I. 1965/2140) ("the 1965 Sanctions Order") but contained transitional provisions and provisions concerning the liability of Directors and company officers ....[4]

Since the U.N. has never been endowed with enforcement powers, its Resolutions serve as a model which may be incorporated into members' separate domestic laws and thus enforced by individual members only when offences fall within that members' jurisdiction. Therefore, the U.K. Government's power of enforcement of the sanctions she imposed on Rhodesia were limited to

> (i) ... companies incorporated in the United Kingdom and also, under both the 1968 Orders, by companies incorporated in any other country or place to which the Southern Rhodesia Act 1965 extends: such countries or places include Southern Rhodesia, Colonies and Protectorates within the meaning of the British Nationality Act 1948 and foreign countries and territories in which Her Majesty has jurisdiction. (ii) ... British citizens and subjects (although only, under the 1965 Sanctions Order, if ordinarily resident in the United Kingdom). (iii) citizens of Southern Rhodesia (but only in respect of exports to Rhodesia, under the two 1968 Orders).[5]

It becomes important to examine the corporate home of the companies operating in the area (See Figure 4). Prior to UDI five companies marketed petroleum products in Rhodesia, a land-locked country with no indigenous source of crude: Shell Rhodesia (Pvt) Ltd. enjoyed a 39.1 percent share of the market; BP Rhodesia (Pvt) Ltd., held 12.9 percent; Mobil Oil Southern Rhodesia (Pvt) Ltd. and Caltex Oil Rhodesia (Pvt) Ltd. each had 20.0 percent; and Total Rhodesia (Pvt) Ltd. constituted the remaining 8.0 percent of the market. All of these companies, incorporated in Rhodesia, were obtaining their supplies in 1965 from the newly opened Feruka Refinery in Umtali, Rhodesia, which was owned by Central African Petroleum Refineries (Pvt) Ltd. (CAPREF), also incorporated in Rhodesia. CAPREF was established in 1963 for the purpose of constructing and operating the refinery by the following companies in accordance with their respective share-holding percentages: Shell Petroleum Co. Ltd. (20.75 percent), British Petroleum Co. Ltd. (20.75 percent), Mobil Petroleum Co. Inc. (17.75 percent), Caltex U.K. Ltd. (15.75 percent), American Independent Oil Co. (15.00 percent), and Kuwait National Petroleum Co. (5.00 percent).



ADAPTED FROM BINGHAM AND GRAY, PP. 13, 225.

FIGURE 4

CORPORATE REGISTRATION IN THE RHODESIAN CHAIN OF SUPPLY (1965-NOVEMBER 1967)

The sophisticated and modern refinery, intended to serve the needs of Rhodesia, Zambia and Malawi, was supplied from the Mozambique port of Beira by a pipeline owned by Lonrho Ltd. (U.K. incorporation) and Companhis do Pipeline Mozambique Rhodesia SARL (CPMR), a company controlled by Lonrho. Those products not supplied by CAPREF came from South Africa primarily by sea from Durban to Lourenco Marques (now Maputo), Mozambique, and then continued by rail to Rhodesia, although some were routed by rail from Durban through Botswana to Rhodesia. Any remaining products unavailable from South African sources would be shipped from the Persian Gulf or elsewhere to Beira, Mozambique, and forwarded by rail to Rhodesia.

Since South Africa supplied such a large proportion of products to pre-UDI Rhodesia, a look at the South African market is indicated. Marketing of petroleum goods was proportionately shared as follows: Shell South Africa (Pty) Ltd. (27 percent), BP Southern Africa (Pty) Ltd. (13 percent), Mobil Oil Southern Africa (Pty) Ltd. (26 percent), Caltex Oil (S.A.) (Pty) Ltd. (18 percent), Total South Africa (Pty) Ltd. (8 percent), South African Coal, Oil and Gas Corp. Ltd. (SASOL) (5 percent), Esso (1 percent), and others (2 percent). In 1965 there were two major refineries in South Africa -- South African Petroleum Refineries (Pty) Ltd. (SAPREF) owned by Shell and B.P., and Mobil Refining Company Southern Africa (Pty) Ltd., owned by her American parent company.

> Market shares of Mozambique are hard to establish, but Shell/BP and SONAP, a local marketing company in which the Mozambique Government had a majority interest, enjoyed about one third of the trade each; the remaining third was split between Caltex and Mobil, roughly equally but probably with Caltex enjoying a slight advantage. The business of Shell and BP was carried on by Shell Mozambique Ltd. and by a Mozambique branch of BP Southern Africa (Pty) Ltd. Caltex and Mobil also conducted business in Mozambique through branches of their South African marketing companies.[6]

A single refinery situated at Matola near Lourenco Marques was owned by the Sociedade National de Refinacao de Petroleos (SONAREP). The majority interest was held by Manuel Boullosa, and CPF held a substantial minority interest with a supply agreement for crude. SONAREP was protected by a Portuguese Government requirement for all marketers to obtain from the refinery volumes of certain products equal to the amount sold in 1961 plus 80 percent yearly growth demand. A series of international agreements secured by the Portuguese insured the use of Mozambique's ports and railways for supplying the inland areas so that both before and after UDI the quantities of oil products carried from or through Lourenco Marques exceeded the entire domestic consumption of Mozambique and that of Rhodesia.

Following the United Nations Security Council Resolution of 7 April 1966, the Royal Navy at the express invitation of the Council, undertook the patrol of the port of Beira to enforce the sanctions. As Lord George Wigg pointed out in a letter to the Times (London) on 3 March 1971, had the Navy not accepted the commission, little could have been done to stop the Council from inviting the Soviet Union to do the job with all the consequences inherent in such a decision. From March 1966 no attempt by tankers was made to use the port of Beira. However, no such patrol guarded the port of Lourenco Marques, which was well known as a base from which oil travelled to Rhodesia.

> The British Embassy in Pretoria had made excellent arrangements to ascertain with great accuracy what oil was being taken from Lourenco Marques into Southern Rhodesia and, therefore, there can be no doubt this information was well known to the Foreign Office.[7]

An entry in Richard Crossman's diary, dated 10 September 1966, records a meeting with Lord Wigg, who was then Paymaster-General and security advisor to Prime Minister Harold Wilson:

> I found him entirely absorbed in ... sanctions. He busily set about proving to me that the military intelligence at his disposal confirmed the view that petrol moved by rail can only go one way and could be cut off as it passed through Lourenco Marques.
>
> Early that morning [September 8, 1966] I had just had time to read the JIC [Joint Intelligence Committee]. I'd seen the stuff George was talking about but I'd also read the end of the staff paper, which said that petrol could also be taken through by road and at a not much greater price. So even if Portugal did cut off supplies it would not be the end of Rhodesia.

Mr. Crossman's note of a meeting of the Cabinet's Rhodesia Committee the same day records Lord George Brown, then Foreign Secretary, as saying: "I must make my views clear and I must tell you that I am not speaking for my department, because my department want no sanctions."[8]

From this evidence alone it seems likely that the U.K. Government was cognizant of the possible and probable supply routes to Rhodesia, which would be congruent with her general practice of keeping informed. It is also clear that the government position was not popular in all departments. What remains unproven is the degree to which the government was informed at various stages and why comprehensive action (such as patrolling Lourenco Marques and other notable points of entry) failed to materialize.

During 1965-1966 the chain of supply operated in three ways. The SAPREF connection in South Africa accounts for a large percentage of Rhodesia's supplies at this time. The South African marketing subsidiaries of BP and Shell, Shell South Africa and BP Southern Africa, would submit estimates of their needs to the Consolidated operation who forwarded the figures to SAPREF. SAPREF, in turn, would submit an order to the parent companies for various quantities and types of crude necessary for filling the order. The Shell (SIMC) and BP Trading companies would sell the allotted crude to the Shell and BP South African trading companies on cif. terms with property passing with the exchange of documents on the high seas. The crude was then processed by SAPREF (SAPREF never owned any goods; she only processed them for a fee). Upon departure from SAPREF title transferred to the South African marketing subsidiaries, who later sold the goods to Freight Services. Freight Services oversaw the connection with GENTA in Rhodesia. Processed products followed the same chain of supply, omitting the unnecessary refining stage with SAPREF.

Shell Mozambique, under direct orders from the South African trading subsidiaries, loaded 500 rail tank wagons per annum at Lorenco Marques which had then been railed direct to Rhodesia.

> At first the trains had been sent into South Africa and then shunted back over the Mozambique frontier to Moamba and thence north into Rhodesia. When this movement had been stopped by South African Railways in 1966, the trains had instead proceeded direct to Rhodesia.[9]

In 1967 SERVICO came into existence and added an additional link to the chain -- at the refinery fence title passed not to the marketing companies but to SERVICO, which owned the local storage and distribution facilities. Title remained in SERVICO until the time of delivery to the customer, when a rapid transfer of title to the local marketing company and then to the customer occurred. SERVICO also handled previously processed products acquired from CPF.

According to BP she only learned of Shell Mozambique's direct involvement on 23 January 1968, and immediately worked out steps to arrange a swap agreement with the French company Total, an option discussed before UDI.[10] According to a BP file note, in a discussion of the swap arrangement at Shell Centre in London, 19 February 1968, BP's then managing director William Fraser (later Lord Strathalmond) took "the stand that a full disclosure of the facts should now be made to the Commonwealth Secretary [George Thomson], and Shell that a quite different approach was called for. Shell resisted point by point....[11]

Two days later the government was told something of what happened:

> Among those present were Mr. William Fraser the late Lord Strathalmond of BP, Sir Frank McFadzean, of Shell, Mr. George (now Lord) Thomson of Monifieth, then Commonwealth Secretary, Sir Leslie Monson of the Foreign Office, Mr. (now Sir) James Bottomly, of the Commonwealth Office, and Mr. Barry Powell from the Ministry of Power.
>
> Mr. McFadzean, as he then was, has a note of the meeting which made it clear that Mr. Thomson correctly understood that although he had recently told the African countries that "no British company was supplying oil to Rhodesia" it was now apparent that "this probably was not correct."
>
> A more detailed version of events, however was given to Mr. Alan Gregory a civil servant at the Ministry of Power [on 15 May 1968].
>
> Mr. Gregory, [later to become a BP employee], accepted that the effect of the change (that is to the swap arrangements) would "be a purely cosmetic one, in the sense that the same amount of oil would reach Rhodesia by the same route but would appear to have originated from a French instead of an English one."
> BP says that the Shell representative at the meeting agreed the information could be passed to the responsible desk office at the Foreign Office "on a purely personal basis."
>
> BP says that "by one route or another, therefore, all the relevant facts regarding the 1968 arrangements were fully and clearly communicated to the Government."[12]

The oil companies had told the government shortly after the imposition of sanctions that it would be impossible to prevent oil from reaching Rhodesia without blockading South Africa. "At no stage were the Government prepared to do this," according to Sir Frank McFadzean, then chairman of the Shell Petroleum Company.

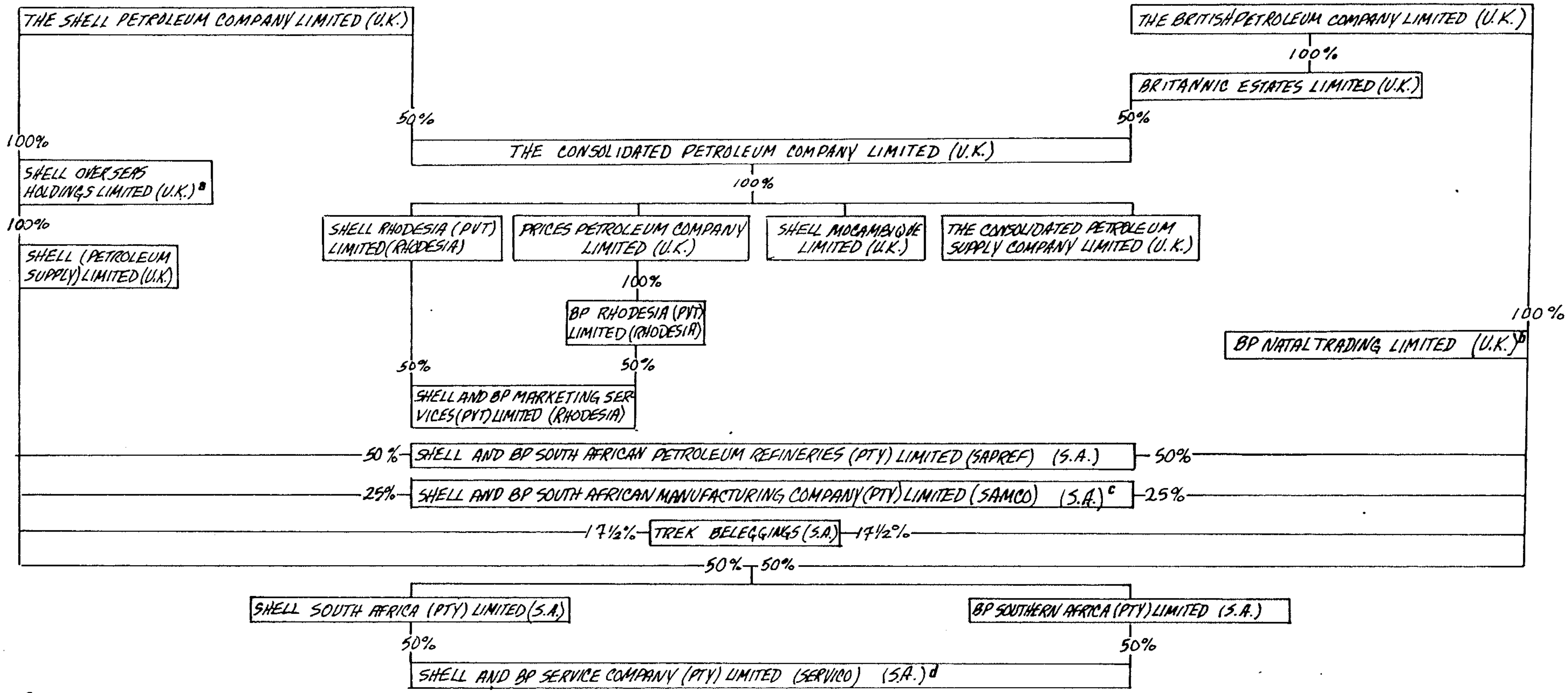
Lord Thomson, Commonwealth Secretary 1968-1969, had admitted that a prosecution of Shell Mozambique was considered at this time but rejected.

> If there had been a prosecution, the disclosure that British companies had been supplying oil would have boosted Rhodesian morale, provided ammunition for critics of Britain at the United Nations; and would not have stopped oil flowing in from other countries.
>
> So in 1968, the Government concentrated on ensuring that British oil companies were observing British law, while the efforts went on from a negotiated settlement in Rhodesia on the basis of majority rule.[13]

The question of government knowledge at this time has been hotly debated and until such time as government records are made public the issue may remain blurred. However, according to Jorge Jardim, Mozambique representative of the Portuguese dictator Dr. Salazar, Mozambican Railways documents show that even in 1969-1970 Shell Mozambique was still handling large quantities of oil which were knowingly being sent to Rhodesia.[14] A long silence ensued between government and the oil companies over the question of sanctions breaking which BP interpreted as government approval of existing arrangements.

Early in 1968 Shell wished to separate her U.K marketing operation (which had been jointly owned and operated with BP); and, according to the pattern of barter in inter-company negotiations, BP agreed to the split under the condition that a similar division be made in South Africa. The exercise of splitting Consolidated South Africa was not completed until 25 June 1975 (See Figures 5 and 6). In the interim, however, management was gradually transferred to the subsidiaries.

The Operating Agreement of 1969 stipulated that Shell would maintain operating and managing control of Consolidated and Consolidated Supply but would act only as advisor to the remaining subsidiaries. It

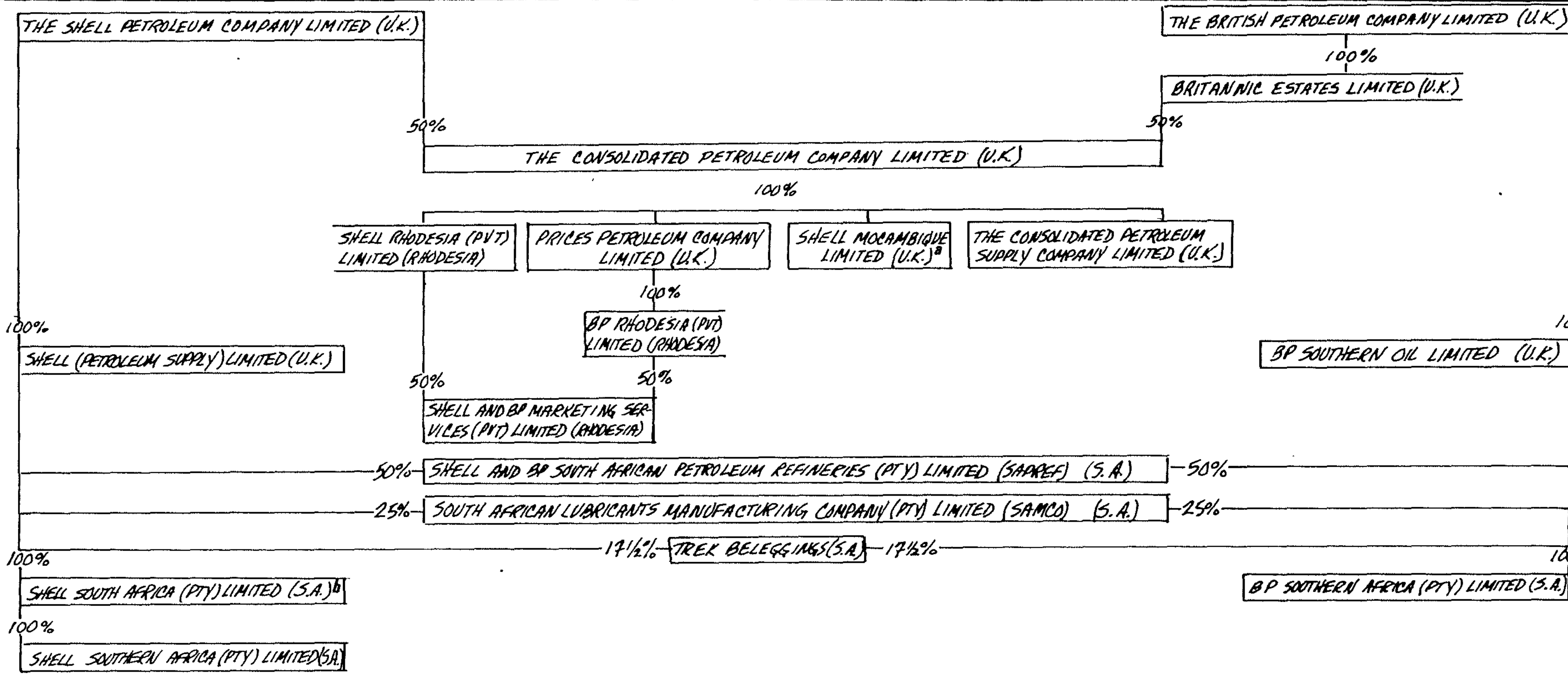


a REMOVED FROM THE CHAIN IN 1969.
b IN APRIL 1973 THE NAME WAS CHANGED TO BP SOUTHERN OIL LIMITED.
c TREK BELEGGINGS WAS GRANTED A 50% INTEREST: THE NAME WAS CHANGED IN FEBRUARY 1974 TO SOUTH AFRICAN LUBRICANTS MANUFACTURING COMPANY (PTY) LIMITED.
d BECAME DORMANT IN JUNE 1975.

ADAPTED FROM BINGHAM AND GRAY, PP. 14, 226.

FIGURE 5

CORPORATE REGISTRATION IN THE RHODESIAN CHAIN OF SUPPLY (NOVEMBER 1967-25 JUNE 1975)



[a] IN 1975 BP MOCAMBIQUE (PTY) LIMITED, A SOUTH AFRICAN COMPANY OWNED 50/50 BY SHELL (PETROLEUM SUPPLY) LIMITED AND BP SOUTHERN OIL LIMITED, WAS FORMED TO ACQUIRE THE BUSINESS AND ASSETS OF BP SOUTHERN AFRICA (PTY) LIMITED. THIS COMPANY IS NOW IN LIQUIDATION. ITS ASSETS WERE TRANSFERRED TO SHELL MOCAMBIQUE LIMITED, TO WHICH ADVICE AND ASSISTANCE HAS SINCE SEPTEMBER 1975 BEEN GIVEN BY BP, AND WAS CHANGED TO BP AND SHELL MOCAMBIQUE LIMITED.

[b] FOR A PERIOD THIS COMPANY WAS CALLED SHELL OIL SOUTH AFRICA (PTY) LIMITED; IT RESUMED THE NAME SHOWN IN JANUARY 1978.

ADAPTED FROM BINGHAM AND GRAY, PP. 15, 226.

FIGURE 6

CORPORATE REGISTRATION IN THE RHODESIAN CHAIN OF SUPPLY (SINCE 25 JUNE 1975)

has been intended that a similar division of the groups' interests in the Consolidated companies in Mozambique should be effected. This plan was at a late stage given up, but the provision of services and advice to the jointly owned Consolidated marketing company in Mozambique, now called BP and Shell Mozambique Ltd., has since September 1975 been undertaken by BP and not by Shell.

No formal change has been made in the Consolidated Agreements so far as they affect Rhodesia although Rhodesian legislation has so operated as to oust both Consolidated and the parent groups from effective control of the Rhodesian marketing companies.[15]

In May 1971 Denys Milne, then chairman of BP Southern Oil Ltd., was sent to Cape Town to oversee the Consolidated split. Shortly thereafter, he commissioned John Rounce, one of his assistants, to investigate the Freight Services operation. The resulting "Rounce Memorandum" of February 1974 described in great detail BP and Shell's arrangements to supply 51 percent of the Rhodesian market, pointing out that the swap agreement with Total had not been operative since early 1973. He illustrated how business continued as normal with Exxon vying for the entire market in 1970 by offering to supply 100 percent of GENTA volumes at heavily discounted prices only to be refused in deference to the "continued relationship with the established marketers."

The report was forwarded to London and to Ian McCutcheon, a British director of Shell Mozambique, with whom Milne conspired to cover up the facts.[15] Milne is now managing director and chief executive of BP Oil Ltd. in London; McCutcheon is now financial controller of the Royal Dutch Shell Group.

The BP London office did not seem to be concerned over the memorandum, and in 1975 the Central Planning Department made references to the loss of Rhodesian trade with its Durban refinery should a settlement be reached.[16]

In 1976 when newly independent Mozambique closed its borders with Rhodesia, reports were reaching BP London about sales to Freight Services drying up and the need for an alternative supply route.

But it was not until June 1977 -- a month after Bingham's appointment to conduct the investigation -- that a team from BP was sent to South Africa "to discover, if it could, whether BP's marketing subsidiary was still selling petroleum or petroleum supplies to Freight Services and, if so, what steps, if any could be taken to end such sales." BP explains that assurance of the subsidiary's non-involvement entailed approval of the South African Minister of Economic Affairs. Not being satisfied with "the wording" of the first letter of assurance received, on 12 July the company withheld "all products which they thought might be the subject of sales to Freight Services until a clear assurance had been given." Nine days later BP received the properly worded letter of assurance she had wanted. Shortly thereafter rumors of a new swap deal emerged linking Shell/BP with the "South African state oil group Sasol, whereby Sasol supplies Rhodesia and Shell/BP supply Sasol's customers in South Africa. As Sasol's refinery, Natref, in which Sasol has a controlling interest, has a capacity equal to Rhodesia's needs, this is seen as a neat arrangement.[17]

According to BP's established pattern of behavior, at the first sign of a problem -- be it legal, political, technical, or whatever -- she would enlist expert advice (she has done this in America by being the first to employ an Alaskan expert). She made gestures to the government early in the series of events about possible sanctions breaking via South Africa to secure some indication as to how strictly the rules were to be enforced.

Reassured by inaction and silence on the part of the government, BP continued her business practices as usual. For this reason -- that she continued her business practices as usual -- her statement that she was unaware of Shell Mozambique's activities prior to 1968 and that she could not exercise much control over her subsidiaries must be challenged. For it was her business practices that would have held a tight rein on her subsidiaries, studying every report.

However, with the single exception of how much the London office knew at any given time, there is nothing in BP's report to Bingham that contradicts her philosophy. She has taken care to stay within the letter of the law, changing her arrangements to comply with successive interpretations of that law. At the same time she has used the protection of South African law to claim ignorance on certain issues. This practice of adhering to the letter while skirting the spirit of the law has been evident in dealing with U.S. antitrust laws in the past.

An interesting question arises concerning the amount of knowledge of the two government-appointed BP board members. Without minutes of board meetings, only speculation can be conjectured as to what they knew. Answers to this question might shed illumination as to the nature of BP's relationship with her government share-holders.

> The position of Lord Greenhill is especially intriguing. From 1969 to 1973 he was head of the Foreign Office, and intimately involved with Government policy towards Rhodesia. On his retirement in 1973 the Heath government appointed him to the BP board.

Whether or not he knew of BP's sanctions-busting activities, he continued to take a close interest in Rhodesia. In February 1976 James Callaghan, then Foreign Secretary, sent him as a personal emissary for talks with Ian Smith.[18]

It would appear that Sir Frank McFadzean's appraisal of the Rhodesian situation as one in which "there was a conflict of law and political objectives between the United Kingdom and South Africa"[19] is correct.

As has been shown, BP continued to operate in Rhodesia after UDI for various political, social, and economic reasons, defying her home government's resolve in the matter, and, more specifically, ignoring U.N. sanctions. It should be noted, however, that Rhodesia is not necessarily an exception to the rule. MNCs have frequently operated in their own best interests, even when this contradicts their home government's policy.

Just as Iran was boycotted under Mossadeq, so Rhodesia could have been, had BP so wished. Such is the continuity of the cooperation of the oligopoly.

Notes to Chapter 11

[1]See T.H. Bingham and S.M. Gray, Report on the Supply of Petroleum and Petroleum Products to Rhodesia, written for David Owen, Secretary of State for Foreign and Commonwealth Affairs, (London: H.M. Stationery Office, 1978), p. 8.

[2]Bingham and Gray, p. 1.

[3]United Nations, Security Council, U.N. Res. No. 253.

[4]Bingham and Gray, pp. 24-26.

[5]See Bingham and Gray, pp. 9, 12.

[6]Bingham and Gray, pp. 5-6.

[7]George Wigg in letter to the Times (London), 20 November 1978.

[8]Richard Crossman, The Diaries of a Cabinet Minister, (London: H. Hamilton, 1975).

[9]Crossman.

[10]See Times (London), 5 November 1978, for copies of cables to this effect.

[11]Times (London), 27 August 1978. See also Times (London) 5 November 1978.

[12]Times (London), 29 August 1978.

[13]Times (London), 7 September 1978.

[14]Times (London), 27 August 1978.

[15]Times (London), 27 August 1978.

[16]Times (London), 27 August 1978.

[17]Times (London), 11 September 1978.

[18]Times (London), 27 August 1978.

[19]Times (London), 7 September 1978.

CHAPTER 12

CONCLUSION

The example of Rhodesia serves well to illustrate not only the failure of municipal law -- even that of a strong home government -- but more importantly, the failure of law in organized international society to effectively regulate and control multinational corporations.

The rapid growth of MNCs since World War II in conjunction with the global dependency on oil has rendered multinational petroleum corporations virtually as powerful as sovereign states. If international law prescribes standards of conduct for a society, it must be reflective of any major changes in this society. Yet, it is these very changes which the international legal regime has been so slow to address.

The regime has digressed over such technical discussions as attempts to outline the problems inherent in both structural and functional definitions of MNCs; as well as attempts to categorize the transactions of MNCs in an effort to determine whether they should be subject to public or private international law, or whether a new field of international economic law is indicated.

Both the OECD and the UN Commission on TNCs have stated that it is possible to progress in the writing of guidelines for the conduct of multinational corporations without ever agreeing on a particular definition. In fact, they have done just that. Perhaps this is something that will be interpreted by future international judicial bodies.

This work utilizes an interdisciplinary approach to international law in respect to multinational corporations and their various symbionic relationships with states. The actual functioning of MNCs in unorganized world society has been traced from social, historical and ethical perspectives, the result of which indicates that MNCs already exhibit a degree of at least quasi-sovereignty in their dealings in the international arena. Since recognition of subjects of international law is a matter of evidence, the organized world society should recognize MNCs as limited international legal personalities in their own right and commence the process of defining what limits are inherent in their nature.

One of the more obvious definitional problems involves the concept of sovereignty with its traditional implication of territory. The issue of sovereignty over a state's own natural resources becomes inextricably muddled when -- in practice -- MNCs exercise quasi-sovereignty over the lands they own, lease, or for which they contract for mineral extraction rights. In fact, the entire history of concession agreements -- usually with states or state-owned corporations formed for the express purpose of contracting with multinational corporations -- indicates that such sovereignty is in effect, negotiable, and bound by contract as an implement of international law.

Advantages of recognizing MNCs as limited international legal personalities include the rights and duties of states. MNCs would be entitled to utilize international courts and judicial bodies for third party binding arbitration and contribute to the law creating process as well. On the other hand, they would be obligated under international law to either abide by any applicable international agreements or to make reparation, as are sovereign states.

The two best examples of the results of the call for a New International Economic Order include the OECD Guidelines and the U.N.

Commission's Code of Conduct. While the results and implications of these conflicting behaviour guidelines for MNCs have been widely debated, suffice it to say that the OECD Guidelines reflect the Western bias of its Group of Experts, while the Commission mirrors the Third World cries for NIEO. Thus, while the OECD has developed an entire set of Competition Guidelines in respect to restraint of trade based on the precedents set in the U.S. Sherman Antitrust Act and the EEC Treaty of Rome, the concept of competition is anathema to many of the LDCs and host government participation -- if not nationalization -- is called for.

While municipal law of more sophisticated countries who have developed their own municipal regulation from the dual perspective of both a home and a host country is so advanced as to serve as precedents for international law, the Guidelines and Codes will probably serve as models for national legislation for less developed countries whose municipal regulation of MNCs is not yet highly developed. Therefore, the importance of American municipal petroleum law is emphasized and has been closely examined.

As was outlined in the introduction, British Petroleum was selected as the ideal vehicle through which to examine the overall developments of the industry. BP remains as one of the few great remnants of the British Empire in that she still operates in over 130 countries today. Not only was she the first great oil company outside America, almost as old as Exxon herself, her global rank with Exxon and Shell today is unquestioned. When she did enter the American market, in which she controls 11 percent of the proven indigenous oil and gas reserves, she chose to do so through the auspices of the Standard Oil Company of Ohio

(SOHIO), a direct offspring of Rockebeller's great monopoly. Steeped in the tradition of both common and international law, her contributions to the industry in general, and specifically her influence on American municipal law -- especially that of antitrust -- was apparent long before she actually entered the American market. BP's close history of working relationships with the biggest of the American majors, particularly in view of her British nationality, would appear to render her a more objective observer, offering a slightly different slant in her relationship with the U.S. Government as well.

It is her paradoxical relationship with her own part-owner home government, however, which allows for exploration of the implications inherent in a mixed economy such as Britain's.

These various relationships have been examined over an extended period of time under diverse circumstances in order to fully analyze their synergistic nature.

Several theories have been proposed regarding the future of multinational corporations and their relationships with governments.[1] Raymond Vernon in Sovereignty at Bay[2] suggests that the nation-state has become obsolete with the technological advances in communication and transportation which have increased economic interdependence; that the multinational corporation is better equipped to meet the needs of the international system than the nation-state and will, therefore, assume responsibility for maintaining the new world economic order of interdependency.

A second model, "dependency",[3] portrays a Marxist concept of a hierarchical and exploitative world order, in which the multinational corporation produces affluence for some nations and dependent underdevelopment for others.

The "mercantilist"[4] view sees the nation-state as the dominating factor manipulating economic arrangements to suit their particular national interests. According to this theory a new political order is developing in which American power is declining and taking with it the influence of the multinational corporation.

While it may be true that the efficiency of scientific management employed by companies better equips them to handle economic arrangements, the fact that they are less directly responsible to public opinion than governments suggests that they will be less efficient in meeting the wide range of public needs. Therefore, the nation-state will not be so quickly replaced as the "beyond sovereignty" theory suggests.

According to the symbionic nature of industry and government relationships, the hierarchical and exploitative world order as described in the "dependency" model appears to be valid; however, the way in which this order develops is seldom left simply to the discretion of multinational corporations. Instead, a combination of social, historical, ethical, economic, and legal factors affecting home-host relationships determine the priority of affluence. In this way a country such as Britain, through her strength as a dominant cultural influence combined with her position of home country to one of the most powerful multinational petroleum corporations, guarantees her place in the world order, compensating for her physical or economic deficiencies. A country such as Japan on the other hand, who qualifies neither as a host nor a home country in the petroleum industry will never attain a position of leverage in this industry, although in another field such as electronics, the picture may be altered dramatically.

Similarly while the strength of a nation-state plays an important role in forming economic arrangements, this role is but one of a series of factors and thus cannot be simply viewed as a single dominant manipulative force. Instead, a combination of factors in a definitive pattern of mutual manipulation forms a synergenic approach to establishing and maintaining a world hierarchical and exploitative order in which each Actor plays the Role he performs most efficiently.

The relationship between multinational corporations and governments has been analyzed in terms of the inter-related functions performed by the two entities, reflecting the resolution of inherent conflicts between their structural natures which materialize in agreements, laws, and customary practices. Over a period of time these customs establish a pattern from which future projections may be deduced.

One of the key elements of this synergistic relationship is the congruent goals of home states and companies regarding security of supply -- whether the implication is one of national security or pure profit motivation. This commonality of interest can be expanded to include, to a lesser degree, Western alliances and cartel members.

It should be noted that figures on crude reserves fluctuate since they are effected by technological improvements which determine cost-feasibility of extraction. Validity of such data becomes complicated by the incorporation of propaganda, which may or may not be intentional on the part of the compilers, so that the same information may be interpreted in several ways. Since the oil companies are the recognized experts in this area of estimating reserves and it is from them we receive such information, it is likely that their conclusions are conservative, that supplies of crude may last longer than present conjectures suggest, assuming the consumer is willing to pay increased premiums for the addition of technological innovations. It is inconceivable that the needs of the world for supplies of energy will diminish; thus it is plausible that the petroleum industry will flourish proportionately to these needs, and that security of supply will remain a predominant issue.

Security of supply was one of John D. Rockefeller's primary concerns in developing the Standard into the prototype of a monopoly, and World War I brought security of supply to the top of all priority lists. Churchill had emphasized profit motivation in his House of Commons argument for investing in British Petroleum in 1914, but without indigenous oil at the time, security of supply for national defense was probably a more persuasive factor. American companies began looking for foreign sources of oil to alleviate depletion of her own reserves; while BP's position outside America was seemingly impregnable at the time.

When overproduction in Texas threatened to further deplete proven American reserves, security of supply took on a new implication in that overproduction could debase the entire competitive nature of the American industry by bankrupting the independents. World War II renewed the call for secure supplies with a slightly different twist: America very carefully avoided any projects which might conceivably aid the British after the war; she diverted Lend Lease Aid to King Saud, and allocated scarce machinery for construction in Saudi Arabia. In fact, the Gulf-ARAMCO Agreement for U.S. Government financing of the Bahrein pipeline was considered such an overt threat to the U.S.-British Alliance that it took a series of Anglo-American conferences to work out a treaty

-- never to be ratified -- in which Britain was to relinquish her colonial perogative which had so far prevented American companies from competing on an equal basis with the empire. During all the commotion ARAMCO began construction on her own and the issue was subdued.

Post World War II political shifts marked the entry of American-based MNCs into the Middle East Market in an attempt to utilize cheap foreign oil, reserving her more expensive indigenous supply. Britain, on the other hand, was forced to begin looking for more secure sources of crude to develop after nationalization in Iran, especially in light of this new American competition in the area. In fact, the OPEC experience, culminating in the 1973 Oil Embargo, was the primary impetus for the timely development of Alaska and the North Sea.

Thus, as has been traced throughout the paper, security of supply -- whether for profit or national security -- is a key element of the synergistic nature of home government-industry relationships.

Since the actions of multinationals reflect the desires of their stockholders, it has been suggested that were governments to nationalize the companies, the rationale for existence of these companies would change so that their performance would then mirror the needs of government, eliminating conflict between the two.

If the assumption that nationalization of oil companies would eliminate contention over government-industry conflicts were proven, then such action would potentially negate the existing relationships. However, as House of Commons debates over the creation of BNOC exemplified, the characteristic antipathy would still exist so that a government-controlled company might still function as a private firm, as in the case of BP, or its loss of profit motivation in favor of such governmental policies as job creation to eliminate unemployment or providing uneconomical services would create an impediment of inefficiency.

The pattern of interactions between companies also reflects symbiotic relationships between private enterprise in that there is a pluralistic competitive force pitting companies against one another. In the early stages of development these internal struggles can be quite vicious, as has been illustrated from the perspective of the American independent during the monopoly of Standard Oil, or amongst the wildcatters in the East Texas field. During such unstable times market entry and exit tend to transpire overnight. Alliances first develop between companies in the course of self-defense or preservation in opposition to another company or coalition whose actions either threaten the existence or profit of the first. Successful associations may be repeated in similar future conflicts.

Organizations with common structural bonds naturally tend to unite and this federation is more likely to survive over a period of time than any without such a liaison. Common experience such as language, nationality, and cultural background are contributing factors to the strength of an affiliation but cannot be its sole determining factor.

It is only natural that a certain affinity exists between BP and the U.K. Government; between BP and the other Sisters; and to a lesser degree between BP and the American Government. Yet this affinity does not eliminate conflict between organizations; it tends to materialize when confronted with a mutual opponent.

Relationships are clearly defined on different levels; for instance, both the American majors and the U.S. Government would benefit by expanding their influence to Saudi Arabia during World War II in a nationalistic bid, challenging the established British dominance. However, when the government proposed entering the oil business there, the American majors immediately called upon their alliance with BP as a major company to check the common threat.

When a company engages in business with a host country, the natural coalition between that company and her home government is usually roused by mutual potential benefit in opposition to the host. The U.K.'s endorsement of BP in her commercial transaction with Iran exemplifies this concept, in that not only did the government obtain secure supplies for herself, she became BP's most consequential client, providing both diplomatic and military protection for the company.

When nationalism replaced colonialism after World War II, and BP's holdings in Iran were seized, condemnation was evoked in both the company and the home country. To enlist support in the ensuing boycott, BP appealed to her Sisters, while Whitehall approached the American Government. The coalition produced a resounding defeat for Mossadeq, but the cost of this assistance was American participation in a previously all-British sphere of influence.

By arranging for the Shah to return to the throne, all parties concerned could comfortably rely on Iran's solid commitment to them -- a commitment which lasted for twenty-five years. Khomeni's Revolution deposed the Shah and with him, Iran's obligation. The present chaos reflects a period of instability which will eventually correct itself. While similarities exist between the Khomeni Regime and that of Mossadeq, the difference is that today no firm or country is totally dependent on Iranian crude. While impositions may occur, no such drastic action as a boycott is likely to recur. This time, a period of readjustment will be allowed until a certain political stability is recovered when the companies will once again negotiate terms.

When a company engages in business within her home country, the natural coalition between companies as free enterprises is sparked by mutual potential benefit in opposition to government regulation. The situation becomes slightly more complex when divisions within the companies obstruct the basic drives of other firms for maintaining their own existence or maximizing their own profits.

Such divisions occur along nationalistic lines of domestic versus foreign investors in which instances the domestic investors will generally affiliate -- at least partially -- with their home government to protect their spheres of influence.

With the U.K. Government employing a discretionary form of bidding, BP is assured of the advantage inherent in British citizenship. At the same time, she is careful not to allow this privilege to be used as leverage by the government or by the foreign investors who may invoke the principle of reciprocity against her operations in their country.

Another division which may exist is between independents and the majors with each group vying for support from the home government. Governments tend to reward those groups which consistently generate the most qualitative support for them. Therefore, since the majors not only have more resources on the domestic level but also on the foreign plane (where industry usually supports home government), it is the majors who consistently generate the most qualitative support for the government and thus are most frequently rewarded.

The pattern for this dissent between independents and majors was set by the 1911 Dissolution decree, which used antitrust legislation to ensure the survival of independents. This in effect, has frozen the proportionate distribution of the market, limiting any future aspirations of independents. No independent has since bridged the gap of transformation into a major company. Note that SOHIO was bought by BP and infused with her Alaskan holdings and the technology to achieve this end -- which is, actually, the expansion of a major, not the transformation of an independent. This situation is limited by antitrust legislation so that it can never be repeated; it was only allowed originally because BP had no major prior holdings in America.

Conversely, on a broader scope, since the home government consistently generates qualitative support for the majors, the companies, in turn, reward the government in such ways as volunteering information, creating jobs, developing technology, investing capital, and establishing a tremendous tax base as well as prestige and power, supplying the resources with which the government may satisfy its demands. Ultimately, the American Government is rewarded by the implied power to regulate the world-wide activities (through municipal control) of each of the Seven Sisters since each operates under American domestic law. This power has recently been employed by the U.S., offering a $5 subsidy to oil companies for every barrel of Western Hemisphere oil imported in order to perpeturate her secure supply of cheap oil. She was limited by the principle of reciprocity to proposing this incentive only in the Western Hemisphere which she can justify by referring to the precedents established in the Roosevelt Correlary to the Monroe Doctrine.

On still another level, cartel members will compete feverishly amongst themselves, forming partnerships with whoever is convenient for the purpose, until such time as a mutual opponent presents a threat provoking the cartel fraternity into unified action.

OPEC is the obvious example. From the early part of this century the Seven Sisters played one Middle Eastern country against the other for personal competitive advantage. With the Libyan Revolution came resistance to the exploitative practices of the companies, who immediately called on all the -- by now -- traditional alliances to counter this adversity. The inefficiency of the London Policy Group was due to a breach in home government-industry strategy, weakening the coalition. This shifted the temporary advantage of leverage to OPEC members, each of whom utilized Machiavellian tactics to realize his terms.

Unification of OPEC failed to materialize until the Israeli War of 1973 provided the impetus necessary for integrated action. However, since this conjuncture was based on a political goal totally unrelated to oil policy, the unity of OPEC was superficial. By failing to maintain cohesion, the Arab coalition has become impotent. The companies, having armed themselves with new supplies of oil in order to minimize the Arab leverage, have enhanced their position so that the prevailing pattern of multinational corporation dominance has return.

Relationships in the international petroleum industry follow the precedent of set alliances to meet given circumstances. This practice can be illustrated from the perspective of British Petroleum.

In her relationship with her home government she will continue to enjoy diplomatic and cultural strength in her dealings with host governments, unless -- as in the case of Rhodesia -- either the company or the government adopts a policy which is inconsistent with her primary goals and objectives. Continuity of leadership and the efficiency of scientific management inherent in company structure is less likely to allow the development of such an inconsistent policy than is the fluctuating political nature of governments.

Domestically, they will cooperate to a certain degree to ensure nationalistic development of a large portion of the North Sea; but as the British regulatory system develops, BP is likely to identify with other companies to attain more favorable results.

In order to encourage North Sea development, the Conservatives have lowered corporate taxes and allowed the industry freedom to engage in voluntary cooperation for their own benefit. According to the pattern, however, voluntary intra-company cooperation is seldom so practical as it appears on paper and the traditional dominance of the majors in such agreements will eventually lead to a call for government imposed regulation by the companies themselves.

The U.K. Government is still bidding against the U.S. for industry investments and unless certain incentives are offered to industry, she is unlikely to attract the momentum of development she so desperately needs to accomplish her broad national goals. The advantage of leverage clearly lies with the companies who will reward whichever government makes the best offer, allowing the greater return on the companies' investments.

In BP's relationships with her other Sisters the established mode of competition will continue so that in the American market BP, through SOHIO, will continue to be a leading competitor; BP, in a possible joint venture with BNOC will enhance her already powerful North Sea investments; and in the rest of the world she will compete as she has for her fair share of the market. Together the majors will contend with the independents and face such adversaries as OPEC and other host governments.

Her relationship with the U.S. Government, through SOHIO, will become more direct and influential as her men participate more in the established federal, state, and local levels of American Government.

Since the U.S. Government has already made overtures towards industry's demands for profit maximization by allowing the domestic price to float and gradually find its competitive place in the world market and by offering a five dollar subsidy for every barrel imported from the Western Hemisphere, the government has assured herself of supplies of cheap oil to meet her national goals and at the same time to foster her relationship with the companies.

With the exception of supplying Israel's oil needs from Alaska for at least fifteen years in a special case to underwrite the Middle East peace, American oil will be consumed on her own soil while she continues to import ever increasing amounts. Rates, prices, and profits, have been partially deregulated although a windfall profits tax was passed to limit the inevitable boost in profits.

Antitrust enforcement will continue to be an important issue on the American domestic scene, although according to precedent, it will be waived at the discretion of the government whenever it is deemed an impediment to some other more pressing need. Likewise, the procedure for bidding for leases, permits, and certification is well established and there is no apparent need for radical change.

The traditional American attitude of abhorence toward public finance will encourage private arrangements to continue to develop as the projects become more costly, and interlocking directorates will become even more prevalent between oil companies and financial institutions. However, public finance will always remain an option which may at least be partially employed, although such a move would require industry backing and will, according to history, be reserved as a last resort, as in the case of the Big Inch pipeline.

Since the nationalistic nature of governments dictates that the stronger a nation is, the more resources she will have available to enhance her position, the American Government will continue to encourage cooperation with her companies. BP has assured herself a large share of this market.

So long as the need for supplies of cheap energy outweigh the need to alter income distribution, the companies will maintain a slight edge in leverage over the U.S. Government, allowing them to achieve most of their goals. This advantage need not work to the detriment of the government however; in fact, so long as each continues to meet the major needs of the other, the natural home industry-government alliance will fourish.

In operating with OPEC members and other host governments, BP will continue in her synergenic role with the U.K. and U.S. Governments and the American majors to extract the most rewarding terms possible.

The alliance will benefit from the inevitable price rises since Alaskan and North Sea oil become progressively more attractive as the margin of price differential narrows. Conversely, the narrower the margin becomes, the more leverage the alliance gains over the Middle Eastern producers. The company will function from company oriented goals, thus opposing any attempts at regulation on the part of host governments. So long as it is in the interest of the home governments for the companies to thrive unfettered in host situations, the nationalistic selfish interests of the home country will support the companies rather than limit them. In fact they are likely to cater their home regulation as it affects foreign operations to the needs of the companies, waiving antitrust enforcement, for instance, if need be, as has been done on several occasions in the past. On non-industry related issues home governments will follow the pattern of supplying any needs of hosts which might strengthen dependency on Western trade, thus enhancing their leverage.

Ultimately, under the present system of municipal regulation, it is the public opinion of the home country population which dictates the limits on multinational corporations.

In short, BP will continue as she has in the past to participate in the pluralistic balance of power.

The interdisciplinary approach to the study of international law, illustrates the complexities of the global order: it indicates patterns of behavior which reflect the motivational nature of the participants; demonstrates the interaction and mutual manipulation involved in the functioning of conflict management; and defines alternatives to current legislation on both domestic and international levels. The practical application of this approach enables an active participation in the law creating process of effecting appropriate international legislation, which may be expanded effectively from precedents of municipal laws only when similar needs and proportionate support exist between the two situations. Since the evolution of multinational corporations -- and thus the need to regulate them -- is relatively recent, case studies must be fortified with some basis for projecting the suitability of specific international law, considering the practicality of enacting and enforcing such a law.

One such contribution from American municipal law is the issue of antitrust or restraint of trade. While examination of the Sherman Act and various related court cases is important, perhaps equally important is a survey of America's officially ambivalent attitude toward antitrust enforcement, especially in relation to foreign investments. Merely by tracing official government investigations of the oil industry and noting the types of situations in which the Justice Department was stifled in its attempts to "enforce the laws of the land," a definite pattern emerges in which antitrust is pragmatically used as a coersive negotiating tool.

The Sherman Act (1890) was passed primarily with the Standard Oil Co. in mind. A 1903 Bureau of Corporations investigation under the auspices of the Department of Commerce and Labor reviewed affairs of corporations involved in interstate commerce. Two important developments can be traced to this investigation: (1) The Hepburn Act (1906) defined pipelines as "common carriers" and, as such, interstate commerce to be regulated by the Interstate Commerce Commission; and (2) the U.S. Supreme Court ultimately issued the 1911 Dissolution Decree against Standard.

A few years later the Federal Trade Commission investigation of 1915 (the results of which were published in 1918) charged Standard Oil of Indiana with violating both the FTC and Clayton Acts (the latter being part of the Sherman Act). This was intended as a direct challenge to Mark Requa's World War I regulatory commissions as evidenced by the negotiated settlement of the issues in a signed agreement between Requa and the FTC in which Standard Oil of Indiana, in effect, plea bargained for the lesser charges of false advertising, etc., in exchange for an industry promise not to raise prices. It was Bedford of Standard who was selected by Requa to convince the industry to cooperate.

The Red Line Agreement by its very nature as an intra-company agreement intended to restrain the trade of independents, indeed, of any petroleum company who was not a signatory. Perhaps because it was a "secret" agreement, but more likely because it was in the interest of American national security under the security of supply rationalle, no antitrust objections were raised.

Roosevelt in his New Deal attempted to renew antitrust policies more from political motivation than economic concerns since the oil industry's problems during this recovery period were not so much reflective of restraint of trade as they were of unrestrained overproduction.

Nevertheless, the Cole Sub-Committee of the House committee on Interstate and Foreign Commerce held the most exhaustive herings till then, investigating antitrust allegations regarding, among other things, the entire Southeast oil transportation system.

Attorney General Robert Jackson initiated a grand jury investigation in Madison, Wis., which returned a guilty verdict to a misdemeanor charge rather than to the criminal charges of price fixing. An even more extensive investigation was that of the Temporary National Economic Committee between 1938-1941, filling 37 volumes with testimony alone. Soon to follow was the ultimate antitrust suit dubbed the Mother-Hubbard case which was suspended during World War II and dropped in 1951.

One further issue under the Roosevelt Era with antitrust complications was the voluntary nature of the industry code of fair competition -- not unlike the OECD Guidelines.

World War II renewed the wartime emergency commissions with its accompanying special case antitrust dispensations from the Interstate Commerce Commission, allowing lower freight rates; and from the Department of Justice, allowing the pooling of reserves and shipments, and the sharing of increased transportation costs.

At the conclusion of the War, industry favored rapid dismantlement of the domestic wartime machinery in order to avoid charges of antitrust as an excuse to nationalize the industry. The majors also asked for exemption from antitrust considerations, in effect, when competing with BP for Middle Eastern concessions after the War.

In the post war renegotiations of the Iraq Petroleum Co. Agreement in which Mobil and Exxon had sought for and acquired the legal negation of the Red Line Agreement in order to acquire a bigger share of the spoils of war, State Department approval was granted concerning antitrust implications in participating in the new IPC Agreement. Later, in the midst of dealing with the leapfrog effect of Libya's spiraling demands, the State Department refused a U.K. Foreign Office request to ask U.S.-based members of the Iranian concession to grant a participation percentage increase to Iran similar to that already agreed with Libya. The State Department insisted that the companies should work out their own differences to the exclusion of the home governments which presupposes secrecy of intra-company agreements, in direct conflict with antitrust principles. Similar disregard for antitrust principles is evident in the Libyan Producers' Agreement, not to mention the obvious example of the London Policy Group.

The BP-SOHIO merger was delayed by the Justice Department as a matter of standard practice until the proposed holdings were brought into line with current antitrust guidelines.

Attorney General John Mitchell recommended dropping antitrust charges in 1971. But after the 1973 Oil Embargo during which several of the MNCs had refused to sell oil to the Mediterranean Fleet, the much publicized MNC Hearings, as they came to be known, were held which again became the most extensive investigation to date. The hearings covered many issues but among the most frequently heard complaint was that of restraint of trade.

Many of the other issues being addressed by OECD and the UN Commission also have precedents in the American as well as the British municipal legal regimes.

Such issues as allocation of leases, permits, licenses, and certification, royalties, methods of disclosure, accounting procedures and taxes -- both domestic and foreign -- including depletion and depreciation allowances, import tariffs, and foreign tax credits, are also traced from the inception of the industry.

Balance of payments, rates, profits, and prices, are also recurring issues. But perhaps second only to antitrust are the complex isuses of financing with the implications of joint ventures and interlocking directorates in the private sector; of direct government control through participation or nationalization; of indirect government control through subsidies or public utility status -- all of which have received a great deal of attention on the municipal level.

While every industry can probably caricature its leaders, it only follows that the oilmen have developed a mystique surrounding their entrepreneur image equal in economies of scale to the size and importance of the industry itself. Such giants as John D. Rockefeller, William Knox D'Arcy, Gulbenkian, Admiral Lord Fisher, Civil Lord of the Admiralty E. G. Prettyman, Lord Strathcona, Winston Churchill, and Theodore Roosevelt are only the beginning of a long list of industry and government personalities.

Many of the same names appear time and time again, e.g., A. C. Bedford (Standard), Mark Requa (World War I regulatory commissions), Deterding (Shell), Ames (Texaco), Teagle (Standard, N.J.). In fact the chapter describing the chaotic Roosevelt Era reads as a Who's Who of the industry, as does the description of the London Policy Group with Fraser and Peircy leading the negotiations. Other colorful industry leaders as Sam Rayburn (Speaker of the House from Texas), Kim Roosevelt (Mr. Iran), Secretary of Interior Ickes, not to mention Libya's Quaddafi or Iran's Mossadeq -- while not oilmen, per se -- have certainly left their mark on the development of petroleum law. It seems quite fitting that such an industrious, dynamic personality as Charlie Spahr is responsible for so successfully maneuvering BP's American investment through the maze of U.S. municipal law dealing with many of the same issues as did the forefather of his company -- John D. Rockefeller.

Thus the functions of the Seven Sisters, and particularly those of British Petroleum, have been traced from the virtual birth of the industry through the complex global operations which provide the evidence necessary for recognition of these multinational petroleum corporations as limited international legal personalities.

As was discussed in the Introduction, a recent provision made by the World Bank-sponsored Convention on the Settlement of Investment Disputes for a conciliation and arbitration procedure between governmental and private participants in investment transactions on a level of equality is the first overture by an international organization toward recognition of MNCs. as -- at least in this instance -- equal to sovereign states. The EEC has made a similar concession by establishing a procedural standing for MNCs equal to that of governments in the right to appeal against decisions and recommendations of the High Authority on the grounds of legal violations of the EEC Treaty. And the UN General Assembly Resolution calling for the study of treaties concluded between two or more international organizations is yet another indication of recognition oby organized international society of multinational corporations as subjeccts of international law.

Although this paper concentrates on the relationships of British Petroleum, the method of investigation should be applicable to any multinational corporation regardless of the industry or countries in which the company operates.

The validity of this synergenic theory may be further tested by application to industries other than petroleum. A multinational corporation such as IBM, for instance, may not be geographically limited to producing areas as in the petroleum industry, yet her relationships with home and host countries follows the same general outline as described for the oil industry.

The regulatory process remains constant in any industry with only a few differences in special-case treatment of specific issues due to the nature of the industry under inspection. For instance, product safety is heavily regulated in the automobile industry, whereas in the communications field regulation covers the more abstract areas of privacy and ethics. However, it would be an interesting study to trace the development of regulation for several industries to see if the pattern of development remains the same.

The international legal regime regards the call for a New International Economic Order as reflective of the growing insurrection of the Third World against the traditional forms of Western domination: Post War nationalism of newly emerging states has successfully curtailed expansion of Empire, while much clammor over economic imperialism as a more subtle threat to LDC sovereignty has been made.

There are approximately 200 major multinational corporations operating in the world today, most of which reflect the Western values of their home countries. Having already saturated the markets in Japan and the West, MNCs are becoming more and more dependent on LDCs -- not only for the development of new markets, but also for new resources as well.

Keeping in mind the motivation of MNCs, they must now be regarded from a global perspective, divorced from their so-called home countries. For instance, Exxon, like the majority of American-based MNCs, makes a higher percentage of profits outside the U.S. than she does at home; the same is true of BP's profits in the U.K.

Thus it now becomes not merely advantageous but almost compulsory for MNCs to expand their operations in LDCs.

It should be possible, then, for countries to enforce an appropriate code of conduct by means of economic sanctions or fines. For instance, if an appropriate code of conduct for MNCs were agreed upon by international agreement or treaty among countries with an accompanying schedule of fines to be imposed on a percentage of net profits per country basis, an offense in one country -- no matter how trivial -- could be punishable by fine in all signatory countries. While a fine of 1 percent (arbitrarily selected for the sake of argument) of BP's total net profits in Ghana, for example, may not be enough to dissuade the company from committing such an offense, that mypothetical 1 percent of total net profits in Venezuela or Mexico, on the other hand, begins to alter the cost feasibility of committing the offense. The cumulative effect of paying multiple fines for the same offense in probably over 100 countries should be enough to insure compliance.

Enforcement of any code of conduct is obviously the key to its success. And administration of sanctions and/or fines on a municipal level raises the inevitable question of how to persuade all signatories of such an agreement to consistently enforce the code. By allowing the signatory countries to spend the revenues collected from such fines as they see fit, reserving a minimal amount to cover the international coordination of administration costs -- it would be to the advantage of each country to collect on every charge. If this were not forthcoming automatically, the principle of reciprocity could be applied to assure uniform enforcement of sanctions or collection of fines. In reality, however, most MNCs will have throughly evaluated the expected cost to be incurred by committing a given offense, and would most likely curb their conduct to conform to the code.

While strong Western home countries may not support such international regulation, it would appear to be irrelevant since application and enforcement on the basis of LDCs alone would be sufficient to render such a plan operative.

In this manner a confederacy of LDCs could conceivably initiate some of the goals of NIEO into international practice without totally eliminating the existing world economic order.

Another practical aspect of such a plan is that as an international treaty or agreement between countries, effective regulation of multinational corporations could conceivably be made operational without ever addressing the abstract philosophical debate about the degree to which MNCs may be said to have international legal personality or sovereignty. While such a debate may still need to be resolved, a confederacy of LDCs could enact and enforce international law regulating MNCs in such a way as to simultaneously aid in their own development, impact on MNCs, and ultimately affect the direction of the development of multinational corporation law in the international legal regime.

In such a light it would be advantageous for Western countries to participate in such a plan -- especially in the formulation of the code in order to infuse some of the already well established principles from Western municipal experience into the codes or at least to act as a nulifying counterbalance to some of the more radical demands which are likely to be made.

Irregardless of the outcome, the fact remains -- as evidenced by the extent of the current international dialogue concerning the regulation of multinational corporations -- that the synergistic relationship between MNCs and governments has had an impact on international law. The question remains as to the extent and direction of that impact.

Notes to Chapter 12

[1]See Robert Gilpin, "Three Models of the Future," World Politics and International Economics, ed. by C. Fred Bergsten and Lawrence B. Krause, International Organization, (Winter, 1975), pp. 37-60.

[2]Raymond Vernon, Sovereignty at Bay, (New York: Basic Books, Inc., 1971), p. 326.

[3]Osvaldo Sunkel, "Big Business and 'Dependencia': A Latin American View," Foreign Affairs, (April, 1972), pp. 517-531.

[4]David Calleo and Benjamin Rowland, America and the World Political Economy, (Bloomington, Indiana: Indiana University Press, 1973).

APPENDIX A

A GLOSSARY OF INTERNATIONAL ORGANIZATIONS IMPACTING MNCs (JANUARY 1981)
(From International Organizations Monitoring Service)

BIRPI - United International Bureau for the Protection of Intellectual Property: BIRPI, which was established in 1893, oversees the Paris Convention for the Protection of Industrial Property and the Berne Copyright Convention for those states which are members of the Paris or Berne Unions but which have not yet become members of WIPO. In practice, it is indistinguishable from WIPO.

CIEC - Conference on International Economic Cooperation: a group of 27 nations (8 industrial and 19 developing) organized in December 1974 to help resolve the NIEO confrontations. The Conference, co-chaired by Allan MacEachen of Canada and Manuel Perez-Guerrero of Venezuela, met monthly in Paris during 1976 in the framework of commissions on energy, raw materials, development and finance, to study and negotiate proposals in these issue areas. The Conference ended up with little accomplished in May 1977.

Council of Europe: inter-governmental organization of 18 European countries which studies problems, makes recommendations to other international bodies and even works on multilateral treaties itself, usually in social areas such as human rights. The Council, which was created in 1949, has been more and more involved in international issues, especially national policy towards MNCs.

EEC - European Economic Community: an association of ten (originally six) European countries founded as a "Common Market" by the Rome Treaty in 1957. Its institutions have legal status and its decision-making process is based on a dual executive: the Commission which proposes and supervises the execution of laws and policies, and the Council of Ministers which enacts laws and programs, based on Commission proposals.

ECA - Economic Commission for Africa: a UN regional commission of ECOSOC based in Addis Ababa, Ethiopia, which studies the economic and social problems of its African member countries and which authorizes financial, technical and other assistance to help solve these problems.

EEC Commission: the executive arm of the European Economic Community, comprised of a staff of almost 10,000 and a board of 14 commissioners. The Commission administers Common Market programs and drafts policy directives to send to the Council of Ministers for approval.

ECE - Economic Commission for Europe: a UN regional commission of ECOSOC headquartered in Geneva which studies the economic problems of the European member governments and authorizes assistance if needed.

ECLA - Economic Commission for Latin America: a UN regional commission of ECOSOC based in Santiago, Chile, which studies the economic and social development of the Latin American region and authorizes financial and technical assistance where and when needed.

ECOSOC - Economic and Social Council: one of the six principal organs of the UN. It coordinates the work of the UN in the economic, social and human rights fields. It oversees the UN Commission and Centre on TNCs and is responsible for most MNC issues.

ECWA - Economic Commission for Western Asia: a UN regional commission of ECOSOC presently headquartered in Beirut which studies the economic problems of its member countries (all Middle Eastern nations with the exception of Israel) and authorizes the required financial and technical assistance to solve these problems.

ESCAP - Economic and Social Commission for Asia and the Pacific: a UN regional commission of ECOSOC headquartered in Bangkok, Thailand, which studies the economic and social problems of its Asian member countries and authorizes assistance, if needed.

European Parliament: the legislative arm of the European Community, now elected directly by the people in the EEC, is mainly a consultative body, but it must pass on most EC legislation, and its legislative power will slowly increase in the coming years.

FAO - Food and Agriculture Organization: a specialized agency of the United Nations, whose mission is to raise the levels of nutrition and living standards as well as to improve the efficiency of food production and distribution in all UN member countries.

GATT - General Agreement on Tariffs and Trade: a multilateral treaty applied to trading nations which seeks to reduce barriers to trade. The Tokyo Round of the GATT negotiations, completed in 1979 in Geneva, is designed to lower tariffs and eliminate non-tariff barriers. It is now being implemented by member nations.

Group of 77 - The bloc of less-developed countries, now numbering about 113, which comprise the so-called Third World. Since 1972 this bloc of nations has campaigned for the "New Order" both within the United Nations system and in other international organizations.

IBRD - International Bank for Reconstruction and Development: the official name of the World Bank, which now helps developing countries finance development through loans and technical assistance.

ICC - International Chamber of Commerce: the international organization of world business which seeks to improve business conditions around the world by supporting and defending the free enterprise system.

ICFTU - International Confederation of Free Trade Unions: a group of international trade unions which seeks to promote the interests of the worker, and which has been very critical of many of the practices of the MNC. The United Mine Workers is the only U.S. member of this organization which also serves as a loose coordinator of several large multinational unions.

ILO - International Labor Organization: a specialized agency of the UN arranged in a tripartite framework which brings together government, employer and worker representatives to discuss working conditions, collective bargaining and other issues and which sometimes acts through its ILO Conventions and Codes as a first stage for national legislation on labor and industrial relations.

NIEO - New International Economic Order: the program advocated by the developing nations to promote their economic growth through rapid economic change and based on the premise that governments must play a preeminent role in this process.

Non-Aligned Nations Centre on TNCs: an "Information Centre on TNCs" being planned by a group of 86 developing countries in Havana, Cuba, designed to coordinate their regulatory policies toward MNCs and to monitor the activities of these companies.

OAS - Organization of American States: an association of Western Hemisphere, mostly Latin American, countries which seeks to promote more economic and social cooperation between member countries, including the granting of preferential treatment to the developing countries in the areas of technology transfer and trade.

OECD - Organization for Economic Cooperation and Development: an association of 24 developed nations which seeks to promote economic growth in member countries through private international investment channeled under guidelines for both companies and governments. The OECD also serves to coordinate the member countries' economic policies before and during bargaining sessions with the developing world.

RBP - Abbreviation for restrictive business practice.

SELA - Sistema Economico Latino Americano: the 23-member Latin American Economic System, which includes only Latin American and Caribbean countries including Cuba, established in 1975 to unite the economic power of the Latin American nations in negotiations in international organizations, to coordinate national programs to regulate MNCs and even to grant assistance to joint member country efforts to establish Latin American MNCs to compete with those from the industrialized world.

UN Centre on TNCs: a New York-based research center, headed by Finland's Klaus Sahlgren, which was created to assist the UN Commission on TNCs in drafting an MNC Code of Conduct, gathering data on MNCs, writing studies on the impact of MNCs on host countries and providing technical assistance to these countries.

UN Commission on TNCs: a committee of 48 member countries established under the aegis of ECOSOC to study the MNC phenomenon and recommend a policy approach for host governments, especially those of developing nations. The Commission has begun to draft a UN Code of Conduct for MNCs.

UNCSTD - United Nations Conference on Science and Technology for Development: the latest in a series of UN "mega-conferences". This one, held in Vienna, Austria, from August 20-31, 1979, was designed to help UN member states, especially the developing nations, to harness science and technology to achieve national socio-economic goals, with as few negative side-effects as possible. Its resolutions will be implemented by a new centre and committee at the UN in New York.

UNCTAD - United Nations Conference on Trade and Development: the permanent organ of the UN which promotes trade between developed and developing countries and which serves as a base for the developing world's demands for NIEO and as a battleground for debates over such issues as technology transfer, restrictive business practices and MNC production-sourcing.

UNIDO - United Nations Industrial Development Organization: the UN organ which assists developing countries in fostering industrialization efforts through technical assistance as part of its program to achieve NIEO.

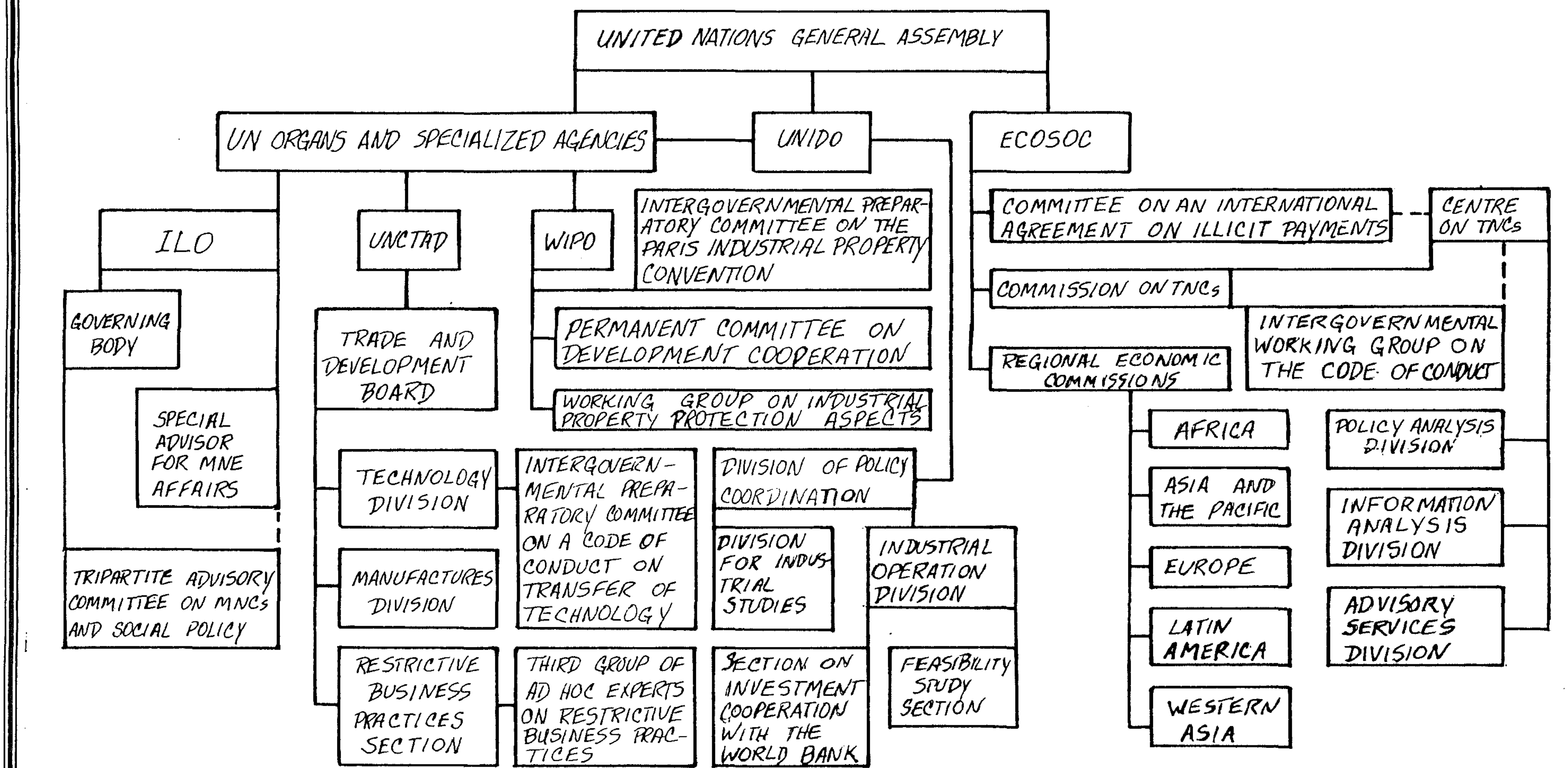
UNDP - United Nations Development Programme: the UN organ which coordinates technical and pre-investment assistance to developing countries and which is the outlet for all UN financial development aid.

UNCITRAL - United Nations Commission on International Trade Law: a subsidiary organ of the UN General Assembly which promotes the harmonization of international trade law.

UNEP - United Nations Environment Programme: the UN organ which promotes environmentally sound economic and social development in both urban and rural areas.

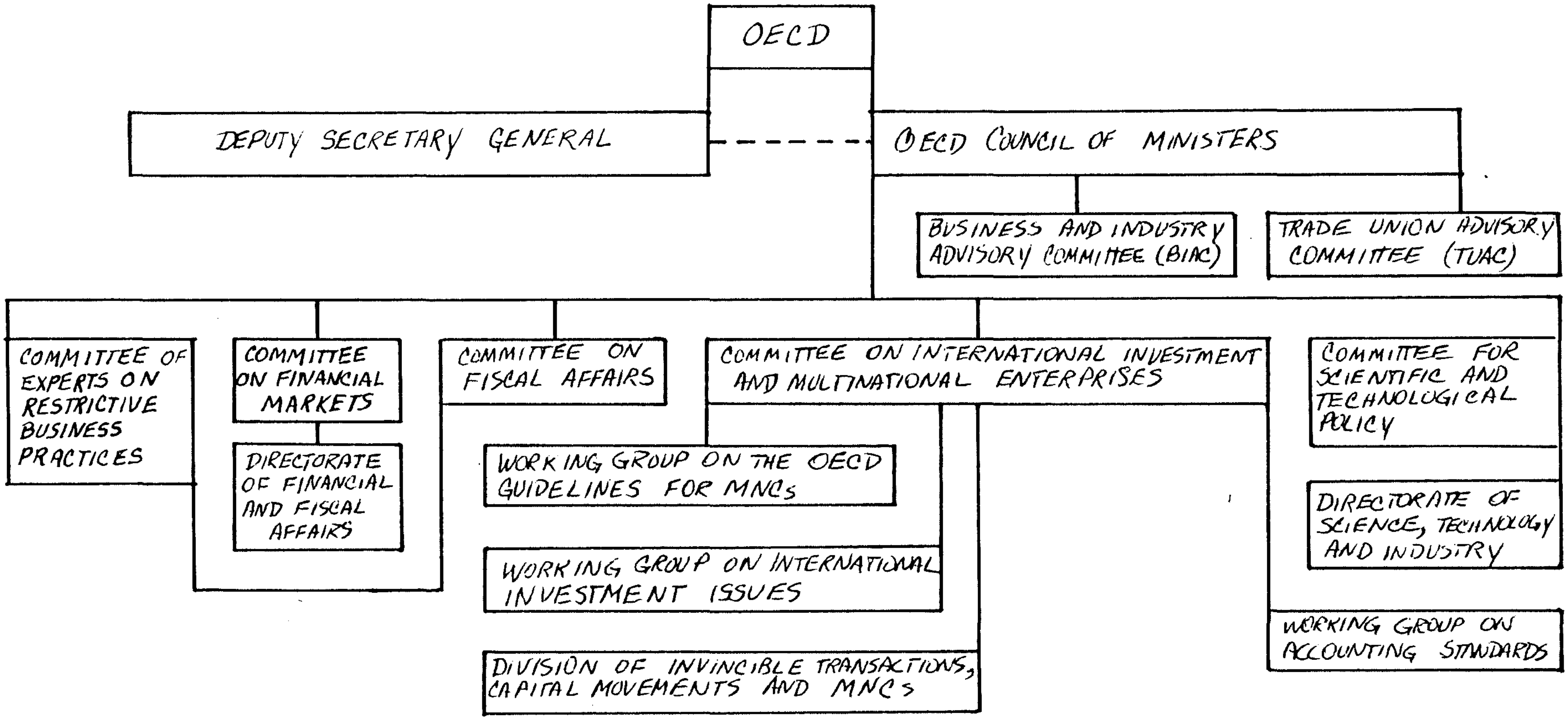
WHO - World Health Organization: the specialized agency of the UN which promotes global health care programs, especially for developing countries.

WIPO - World Intellectual Property Organization: the specialized agency of the UN which promotes the protection of inventions, scientific works, trademarks, copyrights and other rights as part of its oversight of the Paris Industrial Property Convention and the Berne Copyright Convention. The organization is also the focus of developing country efforts to revise the international patent and trademark system.



APPENDIX B

SCHEMATIC OF INTERNATIONAL ORGANIZATIONS IMPACTING MNCS (UN)



APPENDIX C

SCHEMATIC OF INTERNATIONAL ORGANIZATIONS IMPACTING MNCS (OECD)

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