PETROLEUM LICENCES/CONTRACTS -
FORCE MAJEURE AND RENEGOTIATION ISSUES
IN RELATION TO THE RECENT OIL PRICE COLLAPSE

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SUMMARY

The purpose of this paper is to consider the legal ramifications which are thrown up once there is a contract in place between the host state and an oil company for the exploration and exploitation of its oil resources and a massive change in the pricing structure occurs.

The specific area of concern is the contractual obligations in relation to the drilling of exploratory wells in the work programme which in most cases constitute a basic term of the contract and which under the United Kingdom petroleum regime is considered a precondition to the grant of a licence to explore and exploit the oil resources. The discussion is centred around the U.K. petroleum arrangements mainly because former British Colonies including Trinidad and Tobago which are oil producers have relied upon the U.K. regime as a working model.

It is being argued that the petroleum "contract" has undergone changes overtime unlike a contract in classical terms, moving away from the concept of a grant of a "concession" or "licence" to the foreign oil companies, who held the balance of the power because of their massive capital and technology, to the notion of the modern day governmental contract where, although its legal nature is controversial, its effect is essentially a mutual economic arrangement under which the foreign oil companies' profit expectations are balanced by the host states' interest in achieving maximum economic benefits for its oil resources in the national interest. In addition, the agreement is being concluded against a very complex background of

inter alia emerging international legal norms and principles respecting permanent sovereignty over natural resources and a new international economic order, an unregulated international oil market as well as diverse political and social factors.

The central issue is whether in the changed economic conditions brought on by the recent oil price collapse the oil companies can claim a right to renegotiate the contract in relation to the work obligations in the work programme in order to secue their profit expectations whether or not a stipulation for renegotiation exists in the contract. Related issues concern the general nature and legal nature of the petroleum contract concluded between a state party and private companies and the general nature and legal nature of the concept of force majeure and whether such a concept is applicable in the case where some oil companies have claimed that the drilling obligations have become too onerous because of the drastic price fall.

Finally, it is being contended that in the complex oil industry the future would reveal shifts in the balance of power with the foreign investors claiming increased rights inter alia the right to renegotiate the work programme when economic conditions have changed and which would most certainly impact upon the British law and practice that at present, in certain respects, operate contrary to international practice in the oil industry.

Chapter 1

The Changing Contractual Patterns of Petroleum Agreements

The blame for the oil price collapse in 1986 has been placed squarely on the policy of the Saudi Arabian faction of the Organisation of Petroleum Exporting Countries (OPEC) which aimed at engaging itself in a search for new ways for increasing their bargaining strength and share in the world market by overproduction and the consequent driving down of the oil price.[1] The result was a dramatic change in the price of oil which fell from its peak price of over $40 a barrel in 1980-81 to a very low $10 a barrel and even lower in what has been described as "the price cut that went too far".[2] This event has brought into focus contractual issues regarding the binding nature of those agreements which the oil companies have entered into under the terms of the licence to exploit the oil resources in a producer country. The contraction of the cash flow brought on by the fall in oil prices has caused some companies to embark on programmes that were contrary to the terms of the licence. Some companies in the U.K. were reported to have sought relief from drilling "obligation wells" that is, those wells to which they were committed under the terms of the licence and the report claimed, while some of the requests were entertained, the Department of Energy would not encourage such practice.[3] In as much as the nature of petroleum agreements is based essentially on profit-oriented undertakings by oil companies and governments as parties events such as the recent oil price collapse illustrate the changing nature of relationships between contract law in the classical sense, based on the notion that parties are assumed to have equal bargainaing strength and are endowed with complete freedom of decision, and its political and economic environment.

The heart of the contract between a state and an oil company for the exploration and exploitation of its oil resources lies in the idea of an agreement. The notion of equal bargaining strength of the parties to such an agreement needs to be questioned. Initially, the state is the weaker party and in most instances has no real option but to agree because it lacks either technology, expertise or capital which the transnational oil companies can provide. Once an agreement is made, however, a shift of bargaining strength occurs and the state becomes the stronger partner because concepts such as sovereignty and national interests, for example, come to its assistance.

The idea that the parties to a petroleum contract intend to create binding relationships in the strict classical sense is misplaced. One important consideration is that the main oil exporters outside the Soviet Union and Britain are developing countries whose recent claims to a new international economic order in which concepts of permanent sovereignty over their natural resources[4] assume _inter alia_ that the state may radically alter its contractual commitments with foreign private enterprises. The United Nations General Assembly Resolution No. 2158(XXI) on Permanent Sovereignty over natural resources (1966) at paragraph 5 recognizes the right of producing countries "to have a greater share in the advantages and profits" derived from their natural resources "on an equitable basis". One writer[5] has viewed this paragraph as an indirect endorsement of the concept of mutual equivalence of contractual advantages. The effort, however, to reestablish the "equitable basis" for relations between producing countries and foreign concessionary companies admits that petroleum contracts are subject to change and evidently the classical notion of strict binding relationships in the petroleum agreement from the view of the developing country oil exporter is contrary to its interests. Developing countries argue that petroleum contracts are concluded with governments and involve the exploitation of a major natural resource which is bound up with the strategies of the country therefore there is need to expand contract law beyond its technical features in order to include a more general concern with the development needs of the country.[6] Both the U.K. and Norwegian legislations governing oil production have emphasised that oil exploitation must coincide with the national interests. Nevertheless, developed countries have always opposed the developing countries' idea of a new international economic order. In the Texaco Overseas Petroleum Co. and California Asiatic Oil Co. v. the Government of the Libyan Arab Republic (Texaco)[7] the arbitrator, Dupuy, analyzed the voting pattern of U.N. General Assembly Resolutions

- 3171(XXVIII) 1973, Permanent Sovereignty over Natural Resources (PSNR)[8];
- 3201 (S-VI) 1974, Declaration on the Establishment of a New International Economic Order (NIEO)[9];
- 3281 (XXIX) 1974, Charter of Economic Rights and Duties of States (CERDS)[10]

and concluded that 3171 (PSNR) and 3281 (CERDS) lacked support from the overwhelming majority of Western countries while 3201 (NIEO), although adopted by formal 'consensus' was challenged in its 'legal validity' by a number of substantial reservations stipulated by these countries. The developed countries' argument is that the principles underlying the new international economic order suppose on break from traditional legal concepts inter alia the concept of pacta sunt servanda therefore they claim that such principles do not form part of customary international law. Developing countries on the other hand were vigorously challenging the old order with concepts of equity and the principle of rebus sic stantibus (changed circumstances).

Quite apart from the legal issues, however, reference must also be made to political and economic factors which serve to undermine the principle of binding relations in any strict sense. A brief look at some of the claims and interests nationally as well as internationally would illustrate this point. The interests of the producer-state revolve around policies concerning the regulation and conservation of its resources; a share of oil revenues, the supply of oil for domestic market and the employment for domestic industry. There is also the consumer state's interest in the stability of supply at prices it can afford. The international community's interest may lie in freedom of trade and navigation and freedom of pollution.[11] A common feature of petroleum legal arrangements is that they provide for changes albeit through negotiations so that to regard petroleum arrangements as being legally binding in nature strictly speaking may be quite misleading.[12]

The petroleum agreement therefore must be considered in conjunction with several claims and interests which are essentially political and economic factors and which result in changes in its terms throughout the life of the agreement itself. These factors have always influenced the shape that these agreements take since the William Knox D'Arcy Concession in Persia (Islamic Republic of Iran) in 1901. Some description is being made of the changes that have taken place over time and which have culminated in the modern legal frameworks, such as the "licence", which to all intents and purposes are regarded as a contract between the producer state and the oil company for the exploration and exploitation of oil.

Traditionally the substantial capital that is a prerequisite for petroleum development was provided by the multinational oil companies within a legal framework known as the "concession" which was generally recorded in simple documents and included terms and conditions which resulted in effective control by the companies of the entire range of petroleum activities. Some principal conditions were:

a) Large areas with no relinquishment provisions;

b) Long concession periods up to 99 years;

c) No state participation in management;

d) Royalty paid on production tonnage;

e) Exclusive rights granted to the company to all facets of petroleum activities;

f) contractual provisions guaranteed for the duration of the concession.[13]

In the past the oil companies were assured of uninhibited exploitation of massive oil reserves until in some cases the early twenty-first century without having to renegotiate the contract. Where the host state attempted to renegotiate or unilaterally altered applicable laws the oil companies would claim that the host state had acted illegally by 'breach' of the contract and would demand immediate restitution of any resulting loss of bargain by resorting to public international legal rules in the field of 'state contracts'.

Asante[14] is of the view that on an ideological level this regime represented the classical nineteenth century doctrine of 'freedom of contract' by which the parties to a contract would be regarded as possessing equal bargaining power and that once they had made their bargain the law should not upset it because it would upset the most efficient principle of resource allocation, namely, the free market. While this philosophy was a useful device for legitimating the extremely favourable terms that the oil companies had gained under the old oil concessions, it is undeniable that in real terms any notion of equal bargaining power with regard to the parties in petroleum agreements with developing countries then, as now, is completely misplaced. The state therefore exercised no real voice in either the management or the conduct of petroleum operations and could not participate in profits, either inside or outside the country, apart from royalty payment based on the tonnage of the crude oil produced rather than on its value. Inevitably disputes arose and the state began to assert its legislative and executive powers.[15] By 1957 the dominance of the oil companies was being threatened - Mexico had expropriated the domestic assets of foreign oil companies in 1938 and created PERMEX, a national oil company. In 1948 Venezeula enacted legislation taxing companies' profits at the rate of 50 per cent. Saudi Arabia, in 1950, took advantage of U.S. tax laws which allowed foreign income tax payments to be creditable against U.S. tax liabilities and imposed its own 50 per cent tax and as a consequence doubled company payments to itself. The shift from royalty to income tax had begun to take place. Further, the massive expansion of world-wide petroleum exploration resulted in the emergence of hundreds of new companies and entities and rapid development of new countractual arrangements to replace traditional concession agreements. These had been modified to include royalty (generally 12½ per cent of gross production and which was either credited or expensed against a net income tax of 50 per cent), a shorter exploration period of 25 to 30 years, a minimum exploration expenditure, stricter relinquishment provisions and the training and employment of national personnel.[16]

The period 1957 to 1966 marked the beginning of the first joint-venture agreements and production-sharing contracts and was characterised by an increasingly active state role in the conduct of oil operations based on its right to intervene founded upon the notion of sovereignty. The profound discontent with the inequitable situation that existed between oil producing countries and the concessionaires showed itself in the Iranian nationalisation of the oil industry in 1951 (though later forced to be reversed by an oil embargo) so that continued foreign operations had to be permitted under a concession regime. The result was the joint-venture agreement between the National Iranian Oil Company (NIOC) and the Italian State Company (AGIP SpA) 1957. Some principal features were:

a) NIOC and AGIP were both represented on the Board of Directors;
b) The duration of the agreement was limited to 25 years;
c) AGIP obligated itself to a firm spending commitment during the exploration period, with reimbursement only in the event of a commercial discovery;
d) Development and exploitation costs would be borne equally by NIOC and AGIP;
e) AGIP was subject to a royalty of 12 per cent calculated on the posted price and a 50 per cent tax on net income after deducation of the royalty paid.[17]

Two points are worth mentioning. First, the state company became an important instrument in increasing the host country's equity position in the joint-venture agreements. Secondly, although income tax became a main source of revenue royalties have not disappeared but the shift away from royalties to some form of income taxation allowed the host government to collect two types of levy. Royalties in practice have seldom represented any significant portion of actual company profits.

A significant development during this period was the formation of OPEC in 1961 by Venezeula, Saudi Arabia, Kuwait, Iran and Iraq.[18] The immediate cause of the formation of OPEC was not to obtain an advantage but rather to use the oil weapon in furtherance of a political aim, namely to ensure that the unilateral action of the oil companies in price-setting would not be repeated. Therefore some of the main goals were to maintain prices in a falling market and to change the margins of surplus and shortage by controlling the rates of production, in part through the imposition of royalties and taxation.[19] Whether OPEC can be classified as a classic cartel is an academic exercise outside the scope of this work but it undoubtedly represented a collective effort by powerful producer states determined to maximise their economic advantages and in the past had been largely successful in securing higher prices and more favourable contract conditions.

The first petroleum production-sharing contract dates from the Independent Indonesian American Petroleum Company (Iiapco) 1966. The Indonesian government's position was that it would retain ownership of the oil and be responsible for the overall management of operations. Secondly, it was felt that a division of production would replace the pricing basis of profit-sharing. This development has had a great impact on the structure of transnational petroleum arrangements since a large number of oil producing countries has adopted this form.

The legal structure of the Indonesian production-sharing arrangements, however, was altered after the 1976 U.S. tax ruling which stated that the share of production retained by the Indonesian government via Pertamina (its state oil company) was in effect a royalty and could not qualify as a foreign tax credit applicable to income tax of U.S. corporations. Additionally, since the contractor (the U.S. corporation) did not have a legal title to the production it could not claim foreign tax liability on production it did not own. Therefore, in attempting to comply, the modern contracts stipulate that "both partners" (Pertamina and the foreign company) are to carry out all operations as a "Joint Operation" with obligation jointly to participate in the costs and rights under the contract, each holding 50 per cent participatory interest share in the contract and for that purpose an additional "Operating Agreement" was signed.[20]

Some features of interest are:

a) The Foreign Company (contractor) shall be the Operator;

b) Operations shall be approved by the Operating Committee comprised of one representative of each party and decisions are binding;

c) Exploration efforts must have been conducted by the Foreign Company in the Contract Area at an agreed cost prior to the effective date of the contract;

d) Development of fields can be undertaken jointly or singly but where undertaken jointly each party shall be entitled to production in proportion to its Participating Interest in the production-sharing contract;

e) The contract period is 30 years but if no petroleum is discovered within 6 years in the Contract Area, the contract shall be terminated in its entirety.

f) The Foreign Company pays compensation and Production Bonus as well as stipulated sums calculated on daily production from the Contract Area.[21]

It should be mentioned that the production-sharing contract allows many variations, for example the "production split". This can be a 50 per cent government and oil company split as used in Peru. The variation is not as striking as it may seem for the oil company is subject to income tax on its share and regardless of the split the rate of return to the oil company can be controlled by varying tax rates. There is also the "cost recovery" variety as used in Indonesia where the first 40 per cent of production would go to the contractor to cover costs but the percentage varies in other countries. Since each nation has its own special needs the form of production-sharing contracts has important variations around the world."[22]

Another significant type of contractual development is the service contract which can be either risk service contract or non-risk service contract. The risk service contract came into being in the 1970's. It contains all the usual elements, such as duration, work obligations, with production-sharing contracts but its basic distinctive feature is that it pays the oil company in cash, not in crude oil although it may provide permission for the oil company to buy back an amount of crude at international prices from established production. The contractor undertakes all risk and investment and provides capital for exploration and production. If discovery is made the contractor places it on stream but thereafter it is operated by the state or the contractor. Capital is reimbursed with interest and a risk fee. Taxes are paid by the contractor on his earnings. Brazil uses this type of contract.[23]

The non-risk type is a pure service contract of work where the contractor is paid a flat fee for his services e.g. Aramco in Saudi Arabia (1980) where the net fee is 15 cents a barrel (plus inflation) after tax. Exploration is also carried out and the risk is rewarded with additional crude from reserves found plus an additional 6 cents per barrel on new oil. This type of contract is subject to general corporate taxation but not to higher special petroleum taxes. Further, there are two categories of service contracts that is, those which run parallel but contractually unconnected with a purchase contract for part of the oil produced in the contract area, and secondly, those not accompanied by any access to the oil being produced under the contract.[24]

Although the pattern of contractual development cannot be assigned to precise periods the period 1966 to 1980 was marked by the emergence of the fully active controlling role played by the oil producing states. The principal device through which such control has been exercised is the service contract but even where other forms of contracts were used the period since 1966 has seen a marked advance in the extent to which the host government can control the petroleum sector and in the revenues accruing to the host country from petroleum production.[25] One writer has thus summed up the situation:

"The last twenty years have been a major upheaval in the oil industry ... dramatic changes in the commercial and legal relationships between producer states and major or independent oil companies have transformed the position of these companies from one of apparently secure access to ample long-term supplies of crude to one of scrambling for exiguous supplies from the national oil company of producer states on short-term contracts."[26]

The full significance of the legal transformation from concession to contract has been recently questioned on the ground that despite the world-wide trend toward contractual arrangements the concession system is still widely used under different names such as "licence" in the United Kingdom, Norway, Australia and Trinidad and Tobago to name a few countries. The distinction of "traditional" concession and "modern" concession has been suggested as being more appropriate.[27] It is nevertheless agreed that the modern type was mainly influenced by the increased state participation in the ownership of the enterprise and the insistence by producing states on a greater role in managing the extractive operation.

Some writers argue that the concession should be seen as a "process in which the bargaining powers and interests change over time".[28] Yet another is of the view that it is impossible to draw any distinction between concession and contract because whatever terms and conditions provide "the ultimate success of the venture will depend upon the ability of its managers to dispose of oil in the international markets."[29] He notes:

> "Both concenssions and contracts result from agreements between governments and foreign investors. In both cases, the essential purpose is the same - to regulate the terms upon which a foreign investor is to operate in the territory that is under the jurisdiction of the government party. Both result in the granting of rights to the foreign investor by the government and in the assumption by the foreign investor of obligations towards the govenment."[30]

The legal debate over the evolution of the concession may continue but clearly it will be fallacious to dispute that political and economic factors gave rise to changes in the attitudes of the producer states which were in turn reflected in the agreements that they concluded with the oil companies. It has been observed:

> "The former legal security of the companies, based on the device of the long-term concession, has not withstood the weapons of renegotiation and unilateral variation (whether of the concession itself or of its surrounding legal framework) deployed by producer governments in their struggle to derive greater advantage from the exploitation of the crude oil resources."[31]

The modern petroleum contract must necessarily be viewed in a global context which has also been extremely complex over time. Petroleum development is important both for governments who are either importers or producers/exporters and who have constantly to identify the role of law and seek to prevent and resolve the conflicts that are bound to arise. For the producer states the main actors are the multinational oil companies and for such governments the law and policy are tied up with:

> "... rapid and thorough exploration of prospective areas, the effective development of, and maximum ultimate recovery from, reservoirs which are discovered and maximisation of benefit to the national economy from such developments."[32]

The multinational's principal objective of maximisation of its long-run earnings from its overall global operations determines its global exploration strategy. When a multinational engages in a petroleum contract with a producer state it, no doubt, has an interest in exploration and making a commercial discovery. But there could be basic divergencies between the government and the companies on a whole range of issues. Therefore the legal arrangements usually provide for consulations to take place before decisions are taken on the various stages of operations, namely, exploration, development, production and marketing.[33]

The divergence of interests between producer states and oil companies has been recently demonstrated in the British petroleum sector when at the company's annual general meeting the Chairman of British Petroleum (BP) urged the government to consider a tax cut on the companies' production profits to prevent North Sea oilfields developments from drying up as a result of the recent fall in the oil prices. He stressed that "if a more appropriate tax system" was not arrived at new investment in the North Sea will be prevented. The government, on the other hand, while expressing concern about a possible slump in new North Sea developments, initially stated that it was not prepared to cut Petroleum Tax (currently at 75%) on the argument that a cut would reduce its own take but would not necessarily lead to a greater North Sea investment because the "oil companies could direct the extra cash to any of their operations worldwide."[34]

The majors or the long-established oil companies like BP tend to be concerned with their long-term position in the oil industry and are primarily interested in the discovery of oilfields that are capable of making a significant contribution to the companies' worldwide needs for supplying their own downstream operations. Consequently, their main interest is in the export of petroleum produced. On the other hand the large independent oil companies such as Phillips, Occidental or Conoco, for example, tend to have less fully integrated worldwide operations and would thus be less concerned than the majors with assuring their own crude oil supplies and as such would be more amenable to accommodate the concerns of developing countries while at the same time challenge the majors' traditional control over the world's main oil producing areas. In 1970, for example, Occidental agreed to terms with Libya which were significantly more favourable than those applying in the major's concession in the Middle East. The smaller independents have tended to concentrate their foreign operations in a few countries and are more willing to explore in areas where only small or medium sized fields are likely to be found.[35]

It is against such background of varied conflicts of interests added to the proliferation of agreements and legislations that one has to seek and assess the role of law in which international economic relations in the petroleum sector fall to be regulated.

Notes for Chapter 1

1. Rees and Odell: The International Oil Industry. Macmillan Press (1987) p.7. The authors have claimed that the tendency to blame OPEC members exclusively for the price decline is naive since it is based on an outdated view of OPEC's present market power.

2. Financial Times. 11 April, 1986. p. 20

3. Financial Times. 13 March, 1986. p. 11

4. UNGA Resolution 1952 - No. 626 (VII)

   1966 - No. 2158 (XXI)

   1973 - No. 3171 (XXVIII)

   1974 - No. 3201 (S-VI)

   1974 - No. 3281 (XXIX)

5. Mughraby, M.A.: Permanent Sovereignty Over Oil Resources, published 1966. Middle East Research and Publishing Centre: See also article on Recent Developments in Permanent Sovereignty MEES 3 Feb 1967. Vol. X no. 14

6. Asante, S.K.B. : the Concept of Stability of Contractual Relations in the Transnational Investment Process. K. Hosain (ed.) Legal Aspects of The New International Economic Order: London Frances Pinter, 1980

7. 19 January 1979 in International Legal Materials (ILM) 1978

8. UN Doc. A/9030 (1973) and 13 ILM (1974) p. 238

9. UN Doc. A/9559 (1974) and 13 ILM (1974) p. 715

10. UN Doc. A/9631 (1974) and 14 ILM (1975) p. 251

11. Rees and Odell op. cit. - D. Bentham at p.57-8

12. U.K. Model Cl. 14 Sl - 1982 No. 1000 for e.g.

13. UN Doc. ST/CTC/29 - Main Features and Trends in Petroleum and Mining Agreements 1983, p. 1

14. The Concept of Stability in Contractual Relations. op. cit. (Note 6).

15. For example note the attempted nationalisation by Iran in 1951 of the Anglo-Iranian Oil Company

16. UN Doc. ST/CTC/29 op. cit. at p. 2 and UN Doc. ST/CTC/43 - Alternative Arrangements for Petroleum Development - 1982 pp. 3-6

17. UN Doc. ST/CTC/29 op. cit. p. 2

18. Qutar joined in 1961, Indonesia and Libya in 1962, Abu Dhabi in 1967, Algeria in 1969, Nigeria in 1971, Ecuador in 1973 and Gabon in 1975.

19. Fawcett and Parry: Law and International Resource Conflicts (Clarendon Press Oxford 1981) at p. 6

20. Fisher - Collection of International Concessions and Related Instruments Vol. IV - (Oceana Publications Inc. London 1985) p.137

21. Ibid., p. 100 and 237-270

22. Barrows - World Petroleum Arrangements 1980, P.O. Box 1591, Grand Central Station, N.Y. New York 10017, Vol. 1, p. 47-49

23. Ibid., p. 57-67

24. Ibid., p. 57-67

25. UN Doc. ST/CTC/29 op. cit. p. 2-4

26. Daintith, T. : The Legal Character of Petroleum Licences: A Comparative Study - (University of Dundee 1981) p. 1

27. Cameron, P. : Property Rights and Sovereign Rights - The Case for North Sea Oil (Academic Press Inc. (London) Ltd.) 1983 p. 11-12

28. Smith and Wells: Negotiating Third World Mineral Agreements (Ballinger Publishing Company Cambridge USA) 1975 p. 23

29. See George Glass: Contract Verus Concession: Middle East Economic Survey Supplement to Vol. XII No. 3, 15 November 1968, p. 1

30. Ibid.

31. Daintith, T.: op. cit. p. 1

32. Hosain, K.: Law and Policy in Petroleum Development (Frances Pinter (Publishers) Ltd. London 1979), p. 32

33. Ibid., p. 43. See also: U.K. Model Clauses S1 1982 No. 1000 esp. Model Clauses 14 and 15.

34. Financial Times: 2 May 1986, p. 48. But the Gov't succumbed to tax cuts: See HOC Debates on the Advance Petroleum Revenue Tax Bill

Vol 106 Col 637-66 where the Financial Secretary to the Treasury in moving the Bill aimed at helping the Industry to adjust to the sharp deterioration in its financial position consequent upon the fall in oil prices, has stated that the Government's position was that some measures were necessary to help only those companies which suffered cash flow problems. The legislation therefore provides inter alia for repayment early in 1987 for APRT credits, up to a ceiling due to oil companies which have not yet reached their net profit or payback period. For details see Advance Petroleum Revenue Tax Act 1986 (1986 c. 68).

35. UN Doc. ST/CTC/43 op. cit. p. 9.

Chapter 2

The Legal Nature of the Petroleum Contract: The Issue of the Collapse in the Oil Prices

The Third World claim of a right of permanent sovereignty over their natural resources whether oil or any other resource is intended to establish political control over exploitation in order to ensure maximum benefits for the host country from use of a non-renewable asset. Therefore the state's wish is to have freedom to vary the contractual terms of petroleum agreements when it considers that the public interest demands variation. Co-existing with this ideology is the aim of the foreign corporation to protect not only the investments it has made in the host country but also to secure its profit expectations based on the contract. A fundamental and recurring problem is how to reconcile two legitimate needs namely, flexibility and stability, in the contractual arrangements. The consequences of this problem have in the past produced the well known confrontations between the producer states and the transnational companies and the subsequent changes in the substance and structure of the petroleum agreement. The recent collapse in the oil price may again produce tensions leading to changes in the agreement only this time the signal for change would come from the oil companies rather than the producer states. Interestingly, the policy of strict governmental control over its oil resources is not restricted to the Third World. Such policy objective conforms with the policies adopted by some developed country producers. The U.K. legislation[1], for example, has its base in the philosophy that exploration and exploitation of the oil must be in the national interest and asserted for the U.K. "greater public control" by the setting up of the British National Oil Corporation (BNOC). The objective is to ensure state presence as a basic feature of the arrangements with the private oil companies in a venture from which a considerable amount of the state's revenue would be derived. In this sense the petroleum agreement comprises certain characteristics which do not strictly correspond with the classical contract for it is a government contract with international dimensions under which complex issues arise and any attempt at solving such issues would demonstrate the inadequacy of classical contractual solutions.

Looking briefly at the legal nature of a petroleum contract it is to be noted that the legal status of the parties is a peculiar one. Generally the transnational oil company will enter into the agreement through an affiliate incorporated in the host country but the "foreign" status of the investor and the transnational character of the agreement are usually preserved inter alia in relation to questions of applicable law.[2] One writer[3] is of the view that in practice this peculiarity could present difficulties of identification of the investor whether foreign or local for particular purposes. Identification of the investor's contractual counterpart the "state" can also be uncertain in cases where a state uses an indirect means and contract through enterprises which are incorporated under public or private law, with their capital held by the state or other entities. Wolfgang Peter[4] has made the point that while the state may be identified through its state enterprise by using various criteria (appearance of representation, public power prerogatives, control, etc.) the many different ways in which a state may be present in a contract still make the formal identification of the state as a contract partner a difficult undertaking. He therefore supports the view that identification of the contract partner as "state" should not be made in general terms but rather with regard to every particular legal question that arises.

Important legal implications follow the identification of the state's presence in the contractual relationship e.g. the rules of law applicable to the contract or the problems of power prerogatives, immunities and responsibility. These implications vary depending upon whether the state is a direct partner to the contract or whether this role is assumed by the state enterprise. A state is subject to international law while a state enterprise is a corporation created by the state and usually governed by the state's public law. A state enterprise as a contract partner may create problems such as the question of separation between the state and its enterprise where a state enterprise claims force majeure in case of the state's intervention with the contract performance. An example is the Bangladesh case[5] where the People's Republic of Bangladesh dissolved the state enterprise which resulted in the disappearance of its debts causing huge losses to the foreign investors.

State enterprises are a feature of both developing and developed countries in the petroleum sector. Both U.K. and Norway have used state enterprises for North Sea oil exploitation. In the U.K. the state remains the direct partner to the contract. State enterprises were created as instruments to achieve control over foreign investment, albeit graduallly, with the intention of reducing the dependence on foreign economic actors. One writer has noted that:

> "National oil companies around the world have been created to ensure the service of domestic objectives on an international industry dominated by firms headquartered abroad".[6]

However, where governments by their national oil companies sought to formulate policies in order to compete with existing 'majors' and thus operate as a source for gathering information about the workings of the market sucess has been limited, for, according to Daintith[7] governments quickly found themselves presented with a dilemma: in order to compete on the international scene these state companies had themselves to become fully integrated organizations thereby restricting the potential for government access and influence.

The complexity of the legal nature of the state enterprise, however, is beyond the scope of this work nevertheless it may be useful to note the formulation put forward by W. Peter[8] thus:

> "Generally a state enterprise is a public corporation based on a statute that describes its administrative and commerical autonomy as well as the extent and form of control exercisable over it by the state which has created it and which usually owns its entire capital."

A common difficulty with petroleum agreements is that of classification. The development of the petroleum industry in any particular country is done over an extended period and in different phases or stages. The basic elements of a petroleum grant whether labelled "concession" or "contract" may be divided up into three major phases, namely reconnaisance, exploration and exploitation[9], the latter being more frequently referred to as the production phase. This classification is not strict because in the myriad systems found around the world governments interested in makaing the best use of petroleum resources may embark on diverse petroleum resource policies[10]. Whatever arrangement is chosen to govern petroleum activities has, as noticed, been characterised as contractual and there exists abundant literature regarding the legal nature of such contracts[11]. Henry Cattan for example sees the oil concession as:

> "... on the one hand ... a commercial agreement which defines the rights and obligations of the parties and regulates their relationships much in the same way as any other contract. On the other hand ... [it] possesses elements of public law which are inexistent in private contracts."[12]

However, he concludes that the combination of features of private law and public law reflects

> "a new orientation in the contractual relationships between a state and a corporation ... made necessary by the need of cooperation between the state and private commercial interests for the promotion of the oil industry and the exploitation of petroleum resources in a manner which serves the interest of the state and at the same time secures the rights of the concessionaire."[13]

The complexity of defining the legal status of petroleum contracts is not made any simpler by the diversity of the many operations and interests involved in petroleum activities and which encompass the notion that each state possesses a sovereign and permanent right to freely dispose its natural wealth and resources in accordance with its national interest[14] and to enjoy respect for its economic independence[15]. The UN General Assembly Resolution (1966) placed great emphasis on the right of all countries to secure and increase their share in the administration of enterprises which are fully or partly operated on their soil by foreign capital and to have a greater share in the benefits deriving from them on an equitable basis.[16]

The foreign companies, on the other hand, anxious to secure their own interests and expectations, insist on inclusion in the contract various legal techniques which tend to reinforce the general principle of sanctity of contract. Stabilization clauses are one of the methods frequently used. These aim at preventing the host state from altering the terms of the concession contract and generally provide for international arbitration. They are provisions stating simply that the investor's rights will remain unaffected by subsequent enactments. An example is the Aminoil Concession with the Shaikh of Kuwait[17] which provided inter alia that alteration will only be made by agreement of both parties. Not only contractual rights are protected by such device in one known case even nationalization is excluded.[18]

Stabilization clauses may refer to the property in which case compensation is provided for but they may also refer to the fiscal régime in which case the host country would agree that the taxes, rates, royalties and related matters will remain invariable during the term of the contract. The tax system is one of the important factors which determine decisions by oil companies whether or not to operate in any particular area and since developing countries are usually in a weak bargaining position initially, they agree to stabilize their fiscal regimes in order to attract much needed investment. However, when prospects improve as a result of discoveries and developments the tax system becomes an important device for maximising government revenues and these governments then seek to tighten up the generous regimes. This is customary and the U.K. is no exception. In 1974 both Britain and Norway unilaterally altered their fiscal regimes for North Sea oil following the escalation of oil prices.

However, stabilisation of the fiscal regime is a feature of petroleum agreements involving developing countries and oil companies.[19] Developed countries by contrast enter into no such agreement. In the case of the U.K. the notion of parliamentary supremacy makes any agreement to stabilise its fiscal regime pointless. The British position is that under its constitutional arrangements tax raising is a fundamental sovereign power and therefore the government cannot, by contract, fetter its future executive action which must necessarily be determined by the needs of the community. In other words, the British view is that in matters which concern the welfare of the state the government cannot contract to hamper its freedom of action.[20] It follows therefore that oil companies cannot obtain British government contractual guarantees which would operate to bind Parliament for the future in terms of a specific fiscal package. The oil companies must therefore appeal to the British government for downward alteration of the petroleum tax legislation. It has been reported that oil companies in the U.K. and Norway have appealed to the respective govenments to ease the petroleum tax burdens so as to offset the effects of the low oil prices.[21] In Norway the oil companies record that tax levels were raised in 1975 and 1980 to match rising prices and argued that since the recent prices have fallen in real terms below the 1975 level taxes should also be reduced. The Norwegian government responded to the call to reduce taxes. The Canadian government took the initiative and eliminated Federal Revenue tax on oil and gas production until the end of 1986[22]. But even in a state of sharp contraction as development projects were being deferred and drilling rigs taken out of use the British government's initial concern was that a cut in the Petroleum Revenue Tax, while reducing its own take, would not necessarily lead to greater North Sea investment.[23]

By contrast most petroleum agreements concluded with developing countries contain very definite restrictions on their freedom of action.[24] It has been recently noted[25] that when contracting with developing countries the oil companies tend to ensure that once an agreement has been reached on the fiscal regime no scrap of residual power is left to the government to increase its share of any available surplus by new fiscal measures not contemplated by the agreement.[26] As a consequence when circumstances change developing countries are accused of violating agreements while developed countries, with stronger bargaining positions who do not have to accept restrictions on their freedom of action, are not.

It could be argued that oil agreements which stabilise the fiscal regimes of developing countries may, strictly speaking, constitute a constitutional limitation on their powers to deal with their natural resources and that such agreements do cut across rights of permanent sovereignty over their natural resources that these countries are claiming in their call for a new international economic order despite the vigorous defensive arguments put forward by some Third World lawyers that such agreements are in effect exercises in sovereignty.[27]

Kamal Hossain[28] has reasoned that by affirming a legal policy a state does not intend to restrict its own freedom to contract which is also part of its fundamental sovereign rights. The counter argument could be that oil companies do not intend to dispute sovereign power rather their insistence on stabilising the fiscal regime must be understood as an indication that the contract depends on mutual expectations of profits thus making it quite clear that if they do not achieve their expectations they would not wish to continue to work.

Muchlinski[29] observes that in the contemporary period the relationship between the oil companies and the producer state is characterised by an uneasy balance of power. The oil companies have lost their previously total control over production by the partial displacement of the old one-sided concession regime and the cautious acceptance of the state's sovereign rights to economic development while the producing states have lost their grip over world oil prices due to factors such as a glut in supplies, the development of spot markets and new sources of oil so that they continue to depend on the oil companies for distribution and sales outlets, for revenues from oil purchases and for co-operation over new exploration investments. The effect of these changes argues Muchlinski[30] has been to claw back the apparent gains of the producing states through their recognition of the legitimate expectations of the company and as a consequence the nature of the legal issues involved has changed. He notes that the most important questions relate not to ownership but to the division of revenues between the company and the state and these involve the non-legal question of negotiating a level of revenue that will ensure economic efficiency for both parties.[31]

The scenario in the oil market is one of 'chaos' and it has been pointed out[32] that the central problem is that the oil agreement has to be made against a background of an unstable market which is not regulated along the lines of neo-classical economics that assume inter alia that buyers and sellers meet in markets that clear and operate in equilibrium, or that politics has little place in the market and that governments intrude only to overcome limited market imperfections. Although the strengths of this approach are inter alia that it assumes market logic, that is, the desire to maximise returns will in the long run dominate the behaviour of those involved and insists on the complementarity of producers and consumers, buyers and sellers, thereby implying that despite major political or commercial conflicts a basis exists for accommodation, a basic weakness of the neo-classical approach, however, is that it does not capture the key aspect of the market, that is politics interactions.[33]

According to M.A. Adelman[34] in a recent work on the Economics of the International Oil Industry, the instability of the oil market in the past as well as at the present time is a direct result of the fact that the oil market is in the grip of a clumsy group monopoly, the cartel of the OPEC nations, which, he claims, is unable to make even changes that would benefit the group as a whole because it must conciliate conflicting interests within the group. Ernest J. Wilson[35] has analysed three economic models which describe the interactions of the oil markets and politics namely, the neo-classical economic paradigm, regime paradigm and public policy paradigm. He also discussed the strengths and weaknesses of each model and concluded that as yet no adequate model is developed and felt that it would be disastrous not to design an appropriate model which would be more historically rooted and more politically sensitive.[36]

At this point it is perhaps appropriate to look briefly at the political issues surrounding the recent crisis in the market which mainly concerned the confrontation between Saudi Arabia and the large non-OPEC oil producers especially Britain. The oil market has been flooded by new sources of oil from developed as well as developing countries which operated to displace the high demand for OPEC oil. As a result Saudi Arabia lost markets because it had assumed the role within OPEC of swing producer - adjusting its production level up and down to balance supply and demand in order to protect the price - under the OPEC celing system where each member was restricted to its "quota" of production. In practice, however, many of the poorer oil producing OPEC members found it necessary to undermine quota agreements because of their own individual financial demands, for example, the war between Iran and Iraq.

Saudi Arabia took decisions in the summer and fall of 1985 which resulted in a change of its traditional conservative approach to pricing, that is, official sales pricing, to a new approach called 'netback pricing' which assured its buyers of profits on each barrel of crude bought. This led to overproduction, a strategy which it is felt[37] aimed at recapturing its lost markets though the Saudis' stated aim was that it wished to scure and defend for OPEC a fair share in the world oil markets by limiting production on a global basis. By overproduction the Saudis hoped to drive prices downwards so as to force non-OPEC producers, particularly the U.K., to cut production[38]. The U.K., on the other hand, repeatedly refused to support any OPEC policy of production control and was not prepared to agree to full cooperation with OPEC because, according to Mr A. Buchanan-Smith,[39] it seemed difficult to envisage how that policy would be applied on the U.K. side of the North Sea and furthermore if production were cut jobs would be lost. Depressed oil prices followed the overproduction[40] but the changes brought about by netback pricing allowed the Saudis to recapture the downstream end of the European oil market in which they had lost most market share. In the process they had directed 1.7 million barrels a day of crude to refiners displacing North European spot priced crude and caused North Sea spot prices to plummet[41]. Whether the Saudi Arabian decision to overproduce was motivated by a desire to punish those OPEC membes who found it necessary to undermine quota agreements, or an attempt to force non-OPEC producer countries, especially Britain, to adopt production quotas, or to recapture markets it lost while acting as swing producer remains a matter for conjecture. Clearly, however, much of the blame for the fall in prices was attributed to the Saudis' decision to overproduce.

It is clear that the oil market has in recent times been characterised by an atmosphere of complex policies added to which it is not regulated along any predictable lines. Consequently the recent confrontation by Saudi Arabia and some large non-OPEC producers, especially the U.K., would certainly lead to further instability but it is doubtful whether the extremely low price fall was anticipated or even contemplated. In such a setting some of the oil companies claim that they are experiencing undue hardship because of the unprecedented low oil price fall. Undoubtedly, the price collapse would have affected the entire petroleum industry but the area of most concern is the legal arrangements governing the exploration and production phases. Depressed oil prices have led to high cost of exploration and production especially in the North Sea. This economic situation, the oil companies claim, is less than favourable to them and as a result have responded to the 'chaotic conditions' in the oil markets by scaling down expenditure. In the U.S.,[42] for example, two of the larger oil companies, Exxon and Chevron, are reported to have undertaken drastic policies of reduction of capital spending in 1986 by a combined $4.3bn. Exxon planned to cut capital explortion expenditure by 26% in which expenditures for oil and gas exploration and production would be reduced by $2bn and spending on downstream refining and marketing operations by 21%. Chevron, Texaco and AMOCO have all announced major cuts to capital spending. In the U.K. British Petroleum has stated that capital expenditure will be revised downwards in 1986[43] while Britoil's cut in exploration expenditure will be 40% with future exploration under constant review and capital expenditure will be reduced by £40m.[44] Burmah Oil, U.K.'s oldest oil exploration company, is to cease its activities as an offshore operation by selling some of its assets to Britoil and to cut its exploration budget by 50%.[45] In Norway exploration planned for 1986 has been postponed[46] while Canadian oil producers have decided to cut spending by more than a third[47] and it has been reported in Hamiltonm that worldwide exploration and production cuts could be as much as by 50%.[48]

While the majors and those companies who have diversified earnings are able to survive the immediate contraction of their cash flow brought on by the fall in the oil prices and can look ahead to higher prices in the long term, the smaller companies without such economic prosperity will find it more difficult to fund future drilling programmes.[49]

As mentioned earlier, some oil companies operating in the U.K. sought to be relieved from drilling their "obligation wells". By making such a request they are in effect seeking renegotiation of the terms which were the bases upon which the licences, contracts were granted. To adopt the strict legal approach that the contract is binding without regard to the economic and political factors that combined to trigger the collapse in the price of oil could have some undesirable effects in the industry which may, to some extent, operate to defeat the very purpose of generating revenues for the host state. Bearing in mind that the petroleum contract depends on mutual benefits it is being argued that renegotiation of the contract to accommodate those companies which are most in need should form part of the contracting policies of the oil producer governments. In the following chapter issues relating to the recent trend of renegotiation of contracts generally and the U.K. law and practice specifically would be looked at.

Notes for Chapter 2

1. See Part 1, Schedule I of the Petroleum and Submarine Pipelines Act, 1975; Department of Energy United Kingdom Offshore Oil and Gas Policy Cmnd 5696 (1974); Department of Energy, UK Offshore Petroleum Production Licencing, Fifth Round, A Consultative Document (1976). However, BNOC was later abolished see HOC Deb 13 Mar (Hansard Vol. 75, No. 72 Cols. 305-6) Mr Alick Buchanan-Smith stating inter alia that the changes in the oil market had shifted the balance of advantage against the retention of BNOC in its present form. See commentary on the Abolition of BNOC in Survey of Current Affairs Vol 15 No 4 April 1985 HMSO London p. 129.

2. Wolfgang, Peter: Arbitration and Renegotiation of International Investment Agreements: Martinus Nijhoff Publishers (1986) p. 27.

3. Ibid.

4. Ibid.

5. Societe des Grands Travaux de Marseille v East Pakistan Industrial Development Corporation discussed in W. Peter op. cit. at p. 197.

6. J.B. Bell: The Need for National Oil Companies and Their Relationship to Government and Industry 10th IBA (1981) Vol 1, p. 29, quoted in W. Peter op. cit. at p. 29.

7. Daintith, T. and Hancher, L.: Energy Strategy in Europe: The Legal Framework. Walter de Gruyter Publishers, Berlin, New York 1986, p. 92.

8. Peter, W.: op. cit. at p. 29.

9. Barrows: World Petroleum Arrangements 1980 Vol 1, p. 26.

10. In the UK at last five phases are identified for which five forms of licences are necessary. See UK Petroleum (Production) Regulations 1982-S1-1982 No 1000 paras. 5-139 to 5-223.

11. See for e.g. Barraz, Pierre: The Legal Status of Oil Concessions: Journal of World Trade Law (1971) p. 609; Skeete, T.H.H.: International Oil Industry: Journal of World Trade Law (1967) pp.46-48; Daintith, T.: The Legal Characters of Petroleum Licences (1981) University of Dundee.

12. Cattan, Henry: The Law of Oil Concessions in the Middle East and North Africa: Oceana Publications, Inc., N.Y. 1967 at p. 26.

13. Ibid. p. 30.

14. UN General Assembly Resolution 1952 No. 626 (VII).

15. UN General Assembly Resolution 1962 No. 1803 (XVII) Paragraphs 1 and 5 provide as follows:

> "1. The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the state concerned."

and at paragraph

> "5. The free and beneficial exercise of the sovereignty of peoples and nations over their natural resources must be furthered by the mutual respect of States based

on their sovereign equality."

16. UN General Assembly Resolution 1966 No. 2158 (XXI) Operative paragraph 5.

17. Article 17 of the Oil Concession Agreement between Shaikh of Kuwait and Aminoil of June 28, 1948 discussed in W. Peter op. cit. at p. 136.

18. In the Ertsberg Agreement between Indonesia and Freeport Indonesia 1967 the Indonesian Government agreed not to take any action inconsistent with the enterprise including without limitation any action of nationalisation. (Article 14(c)) discussed in Peter, W: op. cit. at p. 137.

19. Peter, W. op. cit. at p. 146.

20. See Rederiaktiebolaget Amphitrite v R. (1921) 3 K.B. 500.

21. Financial Times 2 May, 1986, p. 48 (UK) and Financial Times 22 April, 1986, p. 2 (Norway).

22. Financial Times 1 May, 1986, p. 4.

23. See Financial Times 2 May, 1986, p. 48. Note however the Advance Petroleum Tax Act 1986 C 68 and the HOC Debates preceding the passing of the Act referred to in Chapter I (Note 33).

24. Faber, M. and Brown, R. Changing the Rules of the Game: Practical Risk, Instability and Fair Play in Mineral Concession Contracts. 2 Third World Quarterly (1980), p. 101.

25. Peter, W. op. cit. at pp. 145-146 quoting Faber and Brown op. cit.

26. Ibid.

27. Subrata Roy Chowdhary in Hosain, K. and Chowdhary, S.R.: Permanent Sovereignty and its impact on Stabilization Clauses in Permanent Sovereignty Over Natural Resources in International Law: Frances Pinter (Publishers) London, 1984, p. 42 at p. 47.

28. Kamal Hosain in Hosain K. and Chowdhary, S.R.: Permanent Sovereignty over Natural Resources in International Law. op. cit. at p. xiv.

29. Rees, J. and Odell, P.: The International Oil Industry: An Inter-disciplinary Perspective: Macmillan Press (1987) p. 151. Paper by P.T. Muchlinski: Law and the Analysis of the International Oil Industry. p. 151.

30. Ibid., p. 151.

31. Ibid.

32. Ernest J. Wilson: International Energy Markets: International Organisation. Winter 1987. Vol. 41 No. 1 p. 125.

33. Ibid.

34. Rees, J. and Odell P.: The International Oil Industry: An Inter-disciplinary Perspective. op. cit. p. 30.

35. Ernest J. Wilson: International Energy Markets: op. cit. at pp. 130-136.

36. Ibid.

37. Chris Cragg: Harder for the Middleman. Press Digest - Financial Times February 11, 1986.

38. Financial Times 14 March, 1986, p. 6 and Financial Times 15 March, 1986, p. 20 for e.g. and Edward L. Morse's article: After the Fall. The Politics of Oil: Foreign Affairs Spring 1986. Journal p. 792 at pp. 794-796.

39. House of Commons Debates 28 November, 1986, (Vol. 106) Col. 384 (Written Answers).

40. See Hasan S. Zakariya: Rees, J. and Odell, P.: The International Oil Industry. op. cit. at p. 117. He makes the point that since 1982 the price in the world market had been on the decline and this was due to factors such as world economic recession, conservation efforts, substitution, market manipulation by large-scale draw-down of stocks and lack of discipline and short-sightedness on the part of some exporters both OPEC and non-OPEC.

41. Chris Cragg: Harder for the Middleman. See note 37 supra.

42. Financial Times, 14 March, 1986, p. 32.

43. Financial Times, 21 February, 1986, p. 44.

44. Financial Times, 21 March, 1986, p. 24.

45. Financial Times, 11 April, 1986, p. 44. Note that the decision to sell Burmah Oil's largest assets was on account of its inability to finance developments even before the recent fall in prices.

46. Financial Times, 3 April, 1986, p. 11.

47. Financial Times, 1 April, 1986, p. 2.

48. Financial Times, 29 April, 1986, p. 10.

49. Financial Times, 13 April, 1986, p. 11.

Chapter 3

Force Majeure Concepts - Renegotiation Issues - U.K. Law and Practice

The recent oil price collapse, according to some oil companies operating in the North Sea, has resulted in changed economic conditions causing undue hardships sufficient to admit changes in the contractual terms of the petroleum licences regarding drilling of wells in the exploration and production phase. In almost all agreements between host states and oil companies the obligation to drill exploratory wells within a specified period is a basic term of the contract. In the U.K. such obligation is a precondition to the grant of a licence to explore and exploit the oil[1], that is, it forms part of a work programme agreed between the licensee and the Department of Energy prior to the award of the production licence which contains no provision for change regarding such obligation. Generally petroleum contracts are subject to the law of the host state in keeping with the theory of absolute sovereignty of states which contain elements of permanent sovereignty over natural resources and the New International Economic order. Therefore any legal issues regarding changed economic circumstances, <u>force majeure</u>, would have to be decided in the context of the law of the host state. It must be pointed out, however, that at present there exists no uniform set of rules regarding <u>force majeure</u> in changed economic circumstances in national legal systems nor in international practice thus the entire area is one of uncertainty. As a result the economic and legal consequences would vary in the different legal systems but in cases where a legal system recognises the concept of <u>force majeure</u> the courts may revise the contract.

In civil law systems the concept of <u>rebus sic stantibus</u> (changed circumstances) gives the injured party a right to seek changes in the contract where circumstances change to render performance more burdensome so that continued contractual liability appear an unfair hardship.[2] However, this rule was later opposed by the rule that the will of the parties must prevail and must not be changed by the courts therefore legal thinking regarding the concept of force majeure vary from country to country.[3] The remedy for non-performance in civil law systems is that the aggrieved party is entitled to specific performance. In French law force majeure is a feature of transnational contracts. The concept of contrats administratifs gives the government the freedom to alter contracts in the public interest but at the same time this feature of mutabilité is balanced by a requirement that such other changes be made in the contract as necessary to restore the original financial equilibrium between the parties. Under the doctrine of imprévision the state is required to help shoulder the burdens where unforeseen changes of circumstances (not necessarily brought about by governmental action) affect performance of the contract.[4] In German law the concept of force majeure has no counterpart but overtime a formulation of a general principle on contract revision was accepted under the formula of a 'collapse in the foundation of the transaction', which provides that an uncontrollable change in the circumstances surrounding the contract that leads to a fundamental disequilibrium in the contract and puts an undue burden on the party who had not anticipated and accepted the risk in the contract would justify an adaptation or termination of that contract.[5] However, this principle is counterbalanced by the principle of binding force of the contract[6] thus it is debatable whether circumstances such as the collapse in the oil price would justify changes in the terms of the work obligations under the German system.

The English position, on the other hand, is that liability to perform a contract is absolute and even if non-performance is not as a result of the fault on the part of the defaulting party he is liable for breach of contract.[7] However, in limited cases the courts hold that a fundamental or radical change in circumstances may 'frustrate' the contract bringing it to an end[8] but where performance becomes economically burdensome as in the Suez Canal cases[9] the Courts maintain that so long as performance remains possible, though possibly more difficult or expensive than originally anticipated the parties will be held to their bargain. When frustration occurs the contract ends and the remedy is monetary compensation and damages. Further, the Libyan nationalisation cases[10] which concerned the complex dispute regarding revocation of concessions by Libya makes it quite clear that English courts have no power to adjust the contract to unforeseen fundamental changes. The parties must agree to renegotiate.[11]

In international law the concept of _force majeure_ in changed economic circumstances is less clear. The French law of _contrats administratifs_ with its doctrine of _imprevision_ has influenced many legal systems[12] examples are Belgium, Italy, Poland, Spain, Latin America. Additionally, the civil codes of some Arab countries, such as Iraq, Libya and Kuwait which contain explicit provisions enabling the courts to modify the contractual obligation to adapt it to new and unforeseen circumstances,[13] have undoubtedly been influenced by the French law of _contrats administratifs_. However, the French approach cannot plausibly be said to be the basis of a law of contract between states and foreign nationals simply because its tenets have not been proved to be among those "general principles of law recognised by civilized nations"[14]. International tribunals have peristently refused to count the French law of contrats administratifs as among the principles of law recognised by civil nations as recently the decision in the Texaco Overseas Petroleum Co/California Asiatic Oil v Government of the Libyan Arab Republic.[15]

If it is agreed, however, that in the final analysis the petroleum contract is little more than a mutual economic arrangement then modification of the contract with respect to drilling obligations in certain cases would not only be fair but in the long term would also serve to promote the desired goals of the host state by virtue of the continuation of the project. Modern international practice support the view that cooperation could combine stability with mechanisms for renegotiation, even of the drilling obligations in work programmes, when economic conditions change. It is being submitted that the British position that changed economic conditions rendering the contract regarding the work programmes more difficult and expensive than originally anticipated can only result in revocation of the licence, is not in accord with international oil industry practice. Such a position is an endorsement of the classical notion of the sanctity of contract which seems awkward in the context of legal arrangements in the dynamic petroleum industry.

Since the oil industry is one of economic importance to the host state as well as the oil companies both parties seek to clarify their positions in the contractual terms in the agreement by use of various types of clauses and these impact upon the performance of the contract. Stabilization clauses, as noted in the previous chapter, aim at ensuring the principle of the sanctity of contract but in view of the principle of permanent sovereignty over natural resources the juridicial effect of such clauses is doubtful thus modern practice has responded by the use of additional devices such as renegotiation clauses in which the parties agree, for various reasons, to a substantial material change in the contract. Situations constituting force mejeure, used in its wider meaning to include events such as economic fluctuations, may either be ground for renegotiation of the contract or be ground for termination depending on the particular legal system. In the context of the oil price collapse the term force majeure would imply that the drastic price fall was unforeseen and outside of the control of the oil companies thus rendering the drilling obligations more onerous and expensive causing undue hardships. It should be noted that hardship clauses are also employed in some petroleum agreements. These are basically the same as force mejeure regarding the events which may apply to them even though, according to W. Peter[16] a theoretic difference is that the aim of hardship clauses is the adaptation of the contract to the changed situation whereas force majeure clauses do not describe in detail the procedure to be followed and the type of adjustment to be reached. This proposition seems doubtful, however, in the light of the following extract of a force majeure clause contained in a 1977 agreement.[17] It states:

"23. Force Majeure.

> The obligations of each of the Parties ... other than the obligations to pay money, shall be suspended while such party is prevented ... from complying therewith by any cause beyond the reasonable control of such Party ... such Party

shall give notice of suspension ... stating the date and extent of such suspension and the cause thereof. [And] ... shall resume the performance of such obligations as soon as reasonably possible after the removal of the cause ..."

The idea behind the obligatory work programme is to accelerate the benefits of production when a potential petroleum field is to be explored therefore the host state would wish to discourage the oil companies from delaying the work and using the licensed area for speculative purposes which would obviously delay the state's expected economic benefits. This is not to assume that the international practice is that once agreed upon the work programme and drilling obligations may not be reviewed and/or changed neither is it true that the overall control of the state over the exploitation of its natural resources is being undermined if provisions are included in the agreement to revise the drilling obligations. In an exploration and production sharing agreement between the Government of Qatar and Wintershall Aktiengesellschaft and others (1976)[18] by Article 5 work obligations provided inter alia for exploration within the contract area during a specified period for the purpose of assessing the prospects of the area and the drilling of obligatory wells during a specific time. However, Article 10(2) gives the contractor a discretion to revise the exploration work programme "as may be required by the circumstances" and to notify the government without delay even though "any major change" shall require the approval of both parties. The important features of this agreement is that it contains provisions for both revision and governmental supervision at the same time.

Problems may arise, however, if the state party is not convinced that the economic situation merits a change in circumstances sufficient to alter the contract and also if the renegotiation clause incorporates an undetermined trigger such as the use of the words 'profound change in the circumstances' as appeared in the 1974 Supplemental LAMCO Iron Ore Agreement in Liberia[19] where the parties may consult together for the purposes of considering changes in the agreement as they see fit. However, W. Peter[20] observes that in practice renegotiation has a wide scope so that market conditions could possibly give cause for renegotiation of the contract despite the existence of an undetermined trigger.

In the recent market crisis the oil companies' argument for renegotiation of the work programme can be based on the fact that recession and depressed prices have resulted in fundamental changes in the economic environment which affected the equilibrium of the agreement. Renegotiation provisions may well anticipate changes in the work obligations since these are basic terms of the agreement. A recent petroleum agreement between Ghana and Shell (1974)[21] has made provision for renegotiation in situations not unlike the recent oil price collapse. It states in part:

> "[If] ... there should occur such changes in the financial and economic circumstances relating to the petroleum industry, operating in conditions in Ghana and marketing conditions generally as to materially affect the fundamental economic and financial basis of the Agreement then provisions

... may be reviewed ... making such adjustments and modifications as may be reasonable having regard to the Operator's capital employed and the risks incurred by him ..."

Renegotiation clauses drafted as above are supportive of Thomas Walde's view[22] that the notion of "sanctity of contract", a feature of the liberal economy of the last century, as a rigid distribution of risks of future unforeseen developments is giving way to a more fluid, less predictable notion of the agreement as an institutional and procedural framework of long-term cooperation. Such clauses represent an important indication of the practice regarding international contracts which recognise that the financial equilibrium must be preserved. In commenting on the effects of the recent price collapse on the international oil scene, Michel Pecquer, President of Elf Aquitaine[23] explained that exploration budgets must be cut and "governments are usually very understanding" and that the companies' object was to "maintain a proper financial balance".

According to the British law and practice amendment of the licence terms is not allowed once agreement has been reached. The drilling obligations in the work programme, according to general practice in the industry, represent an important consideration in awarding a contract and this is similar in the U.K. law and practice where the Department of Energy considers the work programme proposed, which is expressed in terms of the surveys to be carried out, and the exploration wells to be drilled in the initial period of the licence. The exceptions are cases where the production licence has been the result of a cash tender (for example, where certain blocks licenced in the fourth and eight rounds) where it is the practice not to specify any particular work programme. Once agreed with the Department of Energy this work programme becomes a part of the licensee's obligations. The Amending Regulations (1982)[24] stipulate that production licences are to be awarded for an initial term of six years with an option subsequently to continue the licence in respect of "the continuing part" for a further term of thirty years.

Exercise of the option is subject to due performance of the work programme so that exploration drilling is a precondition to the petroleum production licence.[25] Recent trends indicate that many developing countries' contracts contain some equivalent stipulations as principal terms of their contracts with oil companies. While primary exploration periods may vary[26] the work programmes invariably consist either of a firm commitment to drill a certain number of wells before the end of the exploration period[27] or a firm commitment of an agreed expenditure.[28]

The policy adopted by governments, no doubt reflective of the development of the right of permanent sovereignty over natural resources, has seen the exercise of as much control as possible over the drilling programmes with heavy and concentrated work programmes and this seems true of most of the modern contracts whatever name is given to them. The Indonesian production-sharing contract of 1977 with Pertamina/Conoco is an example. Among the principal provisions the exploration period was for 6 years plus 2 years., plus 2 years with the exploitation period being 30 years from the effective date of the contract; the expenditure for the work programme was $40.6 million over 10 years with a firm commitment of $15 million for the first three years.[29]

Different petroleum arrangements have their distinctive advantages and drawbacks and most co-exist with laws in which guidelines are present but basically the governments try to find the arrangement most suitable to their national picture. Therefore most producer governments have sought to make binding contracts for exploration and exploitation of their petroleum resources inter alia either by stipulating that a certain amount of wells be drilled, or, a firm commitment of cash to be spent at some defined stage of oil production. The question then is can the oil price collapse destabilize such contracts? Changes due to fluctuation of the market price of oil have often been negotiated or achieved outside the contractual framework, such as taxation, and most petroleum contracts reflect some form of accommodation in their tax regimes[30]. Therefore when the market collapsed it was not surprising that oil companies successfully appealed for adjustment in the tax regime.

Generally revenues accrue to the host state from the oil industry by way of royalties and tax. While the former is usually a fixed charge the latter has taken many forms and is variable since it operates as a charge on profits. In the U.K. this two-tier system of industry transfers to the government has been described[31] as "complex in its conception as it is arbitrary in its effect as a charge on profits". While the complexities of the British taxation system is beyond the scope of this work an observation by Anthony Carty[32] is well worth noting. He contends[33] that if taxation is based upon a supposed fair return upon capital invested it is possible to argue that the tax system is part of the contractual regime of mutual profit and if this is accepted then the further argument could be that the

U.K. has merely entered into a contract with the oil companies to extract oil at a very great speed in return for a very high level of profit in order to satisfy the U.K.'s balance of payment difficulties. This line of argument has been recently echoed by Peter Kellner[34] who explained that for decades the British economic growth has been held back by balance of payment constraints which the oil revenues removed for a 'brief, golden period' but he lamented the fact that the Tories did not implement aggressive expansionist policies designed, for example, to re-equip British industry which he claimed would have resulted in a stronger economy. This appears to be a restatement of the Labour position with respect to North Sea oil.[35]

The U.K. licence controls over development and production are to be found in clauses 14 and 15 of the present model clauses[36] and these date back to 1976. It is from these clauses that the obligation to drill wells would emanate since the contract for work programmes would follow the guidelines laid down in these clauses. Model Clause 13(1) provides that the licensee should carry out his working obligations referred to as a "work programme" before the expiry of the initial term of the licence and by Section (6) where the licensee commits any breach or non-observance the Minister has power to revoke the licence by virtue of Model Clause 39(1). It has however been accepted that:

> "the development and production decisions of the companies could not be assumed always to coincide with the depletion policy which might be dictated by the public interest."[37]

The practice became significantly different from the legal stipulations if only because the government, though wishing to exert as much control of the extractive process, also recognised that its depletion policy must be sufficiently predictable in its operation so as not to undermine the bases on which the oil companies and the banks to which they look for finance, made their plans and entered into commitments.

Two elements of depletion policy, namely, development delay and production cut-backs, have always been of concern to the government and while initially the policy was strict in that no delay on development of fields was allowed under existing licences (namely licences granted under the first four rounds) later policy statements stresed the need for flexibility[38] and in 1982 the government indicated that it saw no case in the foreseeable future for delaying any new field developments. Production cut policies were more precise with statements that no cuts would be made in production from fields found after 1975 under an existing licence until 150 per cent of the investment in the field had been recovered and that cuts would generally be limited to 20 per cent.[39] It is submitted that these shifting policies of the government result in greatly increased burdens on the licensee and raise the question whether the extensive regulatory powers the govenment retains under the licence would not serve to undermine the notion that the licence is a contract in any strict legal sense. From an economic point of view it could be argued that such extensive powers may serve to undermine the profit expectations of the oil companies.

The licence terms according to Model Clauses 14 and 15 stipulate that neither development nor production of petroleum can be carried out except with the consent of the Secretary of State in accordance with a development programme which he has approved. By Model Clause 14(4) the Minister has a discretion to approve it, unconditionally or conditionally, or reject it. When he uses his discretion to reject it in the national interest there could be no arbitration (Model C. 14(4)(c)(ii)).

Once the Minister exercises his discretion and approves the development programme under Model Clauses 14 and 15 and its procedures if the licensee fails to carry out the work programme it would be considered a breach and ground for revocation of the licence provided he has had reasonable time to carry out such works.

One writer[40] has pointed out that the current practice relating to development programmes differs from what was intended by the 1975 Petroleum and Submarine Pipelines Act (U.K.). Model Clauses 14 and 15 set out a procedure for approving a development programme and for regulating rates of production through the use of limitation notices. The initial intention of the Department was to control production through "approvals" which would presumably cover production from a field during its entire life and the procedures for "consenting" to operations under Model Clause 14(1) was intended as a "temporary expedient" prior to the approval of a definitive programme. However, the original intention was found by the Department of Energy to be too inflexible and certain practical solutions were employed. For example, in 1976, the Department decided to base production control on a system of permitted field production rates within a range of plus or minus 5 per cent of the anticipated production forecast submitted by the licensee and approved by the Department.[41]

Arguably, the effect of such an agreement is a whittling down of the force of the law because even a minor shortfall in the agreed rates of production contained in the work programme as agreed could lead to a breach and consequent revocation of the licence. In reality accurate forecasting levels of production for the whole life of the field is extremely difficult in the initial stages. However, the fact is that such a decision is a unilateral variation of the licence terms which is contrary to contractual principles.

The view[42] has been put forward that the wording of Model Clauses 14 and 15 allowed a construction that approvals can be granted with conditions attaching thus giving the Department of Energy ample room to manouvre and thus was able, with the consent of the offshore operators, to devise a procedure of "staged approvals". The first and second stages are normally of short duration covering the development up until full production is achieved at which time the field would have repaid its investors and made the substantive part of its profit.[43] The third stage approval covers the remainder of the field's life and normally will be left open in order to preserve maximum flexibility without fettering away the discretion of the Secretary of State to approve or disapprove proposals which are contrary to the intents and purposes of the petroleum legislation.[44] At each stage of the approvals the Department is able to review the progress of the field by examining the information supplied by the licensee in the procedure of Annex A and Annex B forms.[45] The Minister, by Model Clause 39, has a discretion to revoke the licence because Model Clause 40 excludes from arbitration

> "... things to be determined, decided, directed, approved or consented to by the Minister ..."

The foregoing brief comments on the licence regarding the contractual requirements for the development programme which includes drilling obligatory wells illustrate that, apart from emphasising its regulatory aspects, it does show some variation between what is stated in the law and what obtains in practice. This flexibility has been achieved in the U.K. not only in giving much discretionary powers to the Minister to alter the agreed terms of the licence but also in the use of legal terminology which is malleable enough to afford choices to be made in interpretation of the legislation. These characteristics, it is submitted, operate to expose the arbitrariness of the British licensing regime which seems most unusual in the context of British legal standards as well as its stance regarding the economic concepts to which it is committed.

With regard to the Minister's power to revoke the licence for breach of the work programme Daintith[46] is of the opinion that the government would be cautious regarding its use of the power because such a course would throw wide open the legality of those agreements which the government has made with third parties, that is, those financing major developments under licences. Since the licensee lacked title to the oil in situ lenders tried to secure a charge or mortgage on the licence interests in the field under development. According to Daintith[47], to facilitate financings the Minister may agree, under seal, with the lenders to certain limiations on the exercise of his powers under the licence, most obviously, the power of revocation. In such a case the Minister would appear to have agreed to fetter statutory powers set out in Schedule 2 of the 1975 Petroleum and Submarine Pipelines Act. On the basis of the Amphitrite case[48], it is doubtful whether the courts would allow, under the petroleum production licence, any restraint on the exercise of governmental public policy that public bodies should not fetter the discretionary powers conferred upon them to exercise in the public interest.[49] However, Section 18(5)(b) of the 1975 Act declares:

> "(b) any model clauses as incorporated in a licence by virtue of those provisions may be altered or deleted by an instrument under seal executed by the Secretary of State and the licensee."

Daintith[50] argues that if by the above-quoted section the Minister is explicitly empowered to derrogate from his licence powers by agreement with the licensees, he may also do so by agreement with a third party, that is, the financers. Whether or not the question of fettering public powers arises any assertion by the present government that its carefully drawn agreements were invalidated by a legal flaw would severely damage its credit with the banking community in Daintith's opinion. The government would be prudent to avoid taking measures which could drive the companies to bankruptcy since insolvency of the licence holder may lead to revocation of the licence (Model Clause 39(2)(c)) which would in turn affect its security and raise questions concerning the legal status of the agreements made between the government and the licencee's lenders. It would seem therefore that it may be both in the government's and the banks' commercial interest to keep the licence going so as to preserve the security.

By way of conclusion it must be stressed, however, that governments are not motivated always by the same private sector criteria and therefore if it is to encourage a policy of, for example, technology transfer, regional employment or defence industry base, they may act in a way that would be considered "inefficient" by the private sector. In other words, national interest can override and government can revoke the licence for failure to comply with the drilling obligations. The companies could then sue for damages if they can show damages in theory but it must be pointed out that some contracts may contain a limitation of liability clause so that the damages the companies may claim would be limited to the extent provided for in the contract.

Notes for Chapter 3

1. See Model Clause 13-S1-1982 No. 1000 Schedule 5.

2. Horn, N.: Adaptation and Renegotiation of International Commercial Contracts: Klewer Publications (198), p. 17.

3. Ibid.

4. International Contracts (Ed.) Hans Smit and others: Parker School of Foreign and Coamparative Law: (1981) published by Matthew Bender & Company, pp. 196-197.

5. Horn, N.: op. cit. p. 18.

6. Ibid.

7. Delaume, Georges: Transnational Contracts Law and Practice 1984 Oceana Publications Booklet 7 July 1983, pp. 1-47; Cheshire, Fifoot & Furmston's Law of Contract (11th Edn.) London, Butterworths 1986, Chapter 20.

8. Ibid., and see Davis Contractors Ltd. v Fareham 1956 AC 729.

9. Tsakirogolou & Co. Ltd. v Noblee G.m.b.H. (1962) AC 93.

10. B.P. Exploration Co. Ltd. v Hunt (1976) WLR 788, BP Exploration Co. (Libya) Ltd. v Hunt (1979) IWLR 783.

11. Delaume, Georges: Transnational Contracts Law and Practice. op. cit. at note 7.

12. International Contracts op. cit. at note 4 supra at pp. 197-198.

13. See Art 146 of the Civil Codes of Iraq and Libya and Art 146 of the Law of Commerce of Kuwait discussed in Hasan S. Zakariya's work: Impact of Changing Circumstances on the Revision of Petroleum Contracts. Published in Middle East Economic Survey Supplement to Vol XII No 37 of 11 July, 1969. pp. 9-12.

14. International Contracts. op. cit. at pp. 197-198.

15. 17 Int'l Leg. Mat. 1 (1978). The claim was also rejected in Government of Saudi Arabia v Aramco 27 Int'l L. Rep. 117 (1963).

16. Wolfgang, Peter: Arbitration and Renegotiation of International Investment Agreements. op. cit. at p. 148

17. Operating Agreement December 20, 1977 between British National Oil Company (BNOC) and Texas North Sea U.K. Ltd. quoted in Delaume: Transnational Contracts: Law and Practice: Oceana Publications 1984 Ch. 2.

18. Quoted in Fisher: A Collection of International Concessions and Related Instruments: Contemporary Series: Oceana Publications Inc. (1983) Vol. III at p. 375.

19. See extract quoted in W. Peter op. cit. p. 155.

20. W. Peter op. cit. p. 153.

21. Petroleum Production Agreement between the Government of Ghana and Shell Exploration and Production Co. of Ghana Ltd. of 1974 (Clause 47.6) quoted in Wolfgang Peter op. cit. at p. 158.

22. Thomas Walde: Journal of World Trade Law Vol 19(1985) p.3 at p.26.

23. Petroleum Economist, May 1986, p. 175 at 176.

24. S1-1982 No. 1000 See Model Clauses 3 and 4.

25. S1-1982 No. 1000 paras 5-39 to 5-222.

26. For example: In Trinidad and Tobago the period is 6 years - See: Unpublished Exploration and Production (Public Petroleum Rights) Licence No. 18271 of 1481 Registrar General's Department, Port of Spain para 1.

In Guatemala and Tunisia the period is 4 years. See: Main Features and Trends in Petroleum Mining Agreements: UN Centre on Transnational Corporations: UN NY ST/CTC/29 p. 37.

27. See for example: In Trinidad and Tobago - two wells must be drilled during the exploratory period according to the Government of Trinidad and Tobago Production Sharing Contract signed in 1975 with Mobil and Deminex - Published in Central America and Caribbean - Basic Oil Laws and Concession Contracts. Supplement 19.

Guatemala - one or two wells to be drilled reaching at least 300-400 metres. See: UN Doc. ST/CTC/29 op. cit. p. 37.

28. For example: Sudan - $4 million to be spent over the first two years; Indonesia - $15 million over the first three years. See: UN Doc. ST/CTC/29 op. cit. at p. 29.

29. UN Doc. ST/CTC/29 op. cit. at p. 29.

30. The UK Oil Taxation Act 1975 by its Special Petroleum Revenue Tax

has allowed the government the flexibility to skim off "windfall" profits by increases in oil prices especially in 1979 and 1980. Varying tax rates are also found in some types of production-sharing contracts. See for e.g. Indonesia Pertamina/Conoco Contract (22 October 1977) cited in UN Doc. ST/CTC/29 at p. 29.

Service Contracts (Non-Risk) do not, however, provide for fluctuation in the tax rates but are subject to general taxation. They are commonly used in the Middle East, Venezeula and more recently used by US Government in Alaska with the Husky Oil Company. See: Barrows op. cit. Vol. 1 pp. 65-67.

31. See Daintith, T. and Willoughby, G.: Manual of United Kingdom Oil and Gas Law: Sweet and Maxwell (London) 1984, p. 24.

32. Power and Manoeuvrability: The international implications of an independent Scotland: Tony Carty and A. McC. Smith: Edinburgh Press (1978), p. 103.

33. Ibid.

34. New Statesman 17 July 1987 Vol. 114 No. 2938, p. 9.

35. See House of Commons Debates of 13 February, 1986, Vol. 91 Col. 1083 where Mr Campbell-Savours remarked that Labour's position is that too much reliance is being placed on development of North Sea oil while too little attention is paid to the development of the manufacturing industry within the U.K.

36. Petroleum (Production) Regulations 1982, S1-1982 No. 1000 Schedule 5.

37. Daintith, T.: Manual of United Kingdom Oil and Gas Law: op. cit. p. 115.

38. Ibid., p. 115.

39. Ibid., p. 116.

40. See Daintith: Manual of United Kingdom Oil and Gas Law op. cit. pp. 114-120.

41. Ibid.

42. Ibid.

43. Ibid., pp. 118-120.

44. Ibid.

45. Ibid., see p. 120 - for details. Generally: Annex A - Field Development and Production Programme - outlines the form of the programme giving details of the various field installations and the schedules for production and construction of the relevant works. Annex B - Background Information - a more detailed document requiring for e.g. history and status of the discovery; details of licensees, operators, manpower resources; detailed reservoir data; the feasible development options considered; descriptions of field installations etc.

46. Daintith, T.: The Legal Character of Petroleum Licences. op. cit. p. 223.

47. Ibid.

48. Rederiaktiebolaget Amphitrite v R (1921) 3 KB 500.

49. Daintith, T.: The Legal Character of Petroleum Licences. op. cit. p. 200.

50. Ibid., p. 224.

Chapter 4

Conclusions

The recent oil price collapse has again raised questions concerning the nature of the oil company/host state relationship. The balance of power from the companies in the early concession regime shifted to the host states against a background of claims to permanent sovereignty over natural resources and a new international economic order which resulted in changes in the legal regime between them. One writer[1] has commented thus:

> "... In particular, international minimum standards of protection, with their emphasis on the interests of foreign investors, have given way, in part to norms of the national law of the host state, which emphasise the interests of the state subject to some protection of the legitimate expectations of the foreign investor."

It is being contended that the recent oil price collapse has demonstrated that in the complex and murky international oil industry another shift in the balance of power may occur giving increased rights to the foreign investors <u>inter alia</u> rights to renegotiate the work programmes in changed economic conditions so as to enable them to fully realise their profit expectations. The basis of this argument is that the petroleum agreement depends on the mutual economic benefits of both producer-states and oil companies. Changing circumstances in the oil industry brought on by economic or political considerations have always impacted on the legal regimes in the past. However, governments have generally been the beneficiaries of the theory of changed circumstances by claiming special governmental prerogatives as contracting parties and affirming rights to alter petroleum agreements in the public interest. It must be noted, however, that the petroleum agreement suffered alteration for even broader political objectives which at times can be unrelated to the purpose of the contract. By way of illustration one may recall the tense political situation in the Middle East in 1973 following the Israeli-Arab conflict in which the United States government support of the Israeli policies was the cause of much resentment in the Arab world. They were moved then to act unilaterally and _inter alia_ to take over ownership of the operating oil companies.[2]

That changed circumstances should impact upon contractual commitments is generally accepted although the legal effect in the U.K. and common law systems would be termination of contractual obligations whereas in systems that follow the French law of _contrats administratifs_ the legal effect is normally revision of the contractual obligations rather than termination.

Further, petroleum agreements are concluded against an extremely complex background where politics and economics and even social factors interact; where the oil market is unregulated; where the structure and organisation of the oil companies are constantly changing; and, where the policies of the major non-OPEC oil producers such as Norway and U.K. and those of the powerful OPEC countries impact as evidenced by the recent Saudi Arabian policy of overproduction which led to chaos in the industry. In such circumstances it is too simplistic to regard petroleum agreement as 'contracts' in the strict classical legal sense - the complex nature of the industry has effectively rendered certain classical notions obsolete. For example, the concept of equal bargaining strengths of the parties has never been applicable in the context of the petroleum-concession, more realistically the agreements were always characterised by shifts in bargaining power from the company to the host states. The recent oil price collapse may well see the reverse in so far as the companies may validly claim that international practice recognises that there should always be renegotiation of the contracts when economic circumstances change. Additionally, the idea of state participation has influenced the establishment of state enterprises as "the most appropriate vehicle for the implementation of state participation" according to one writer[3], but apart from the obvious changes in the contract which this idea brought with it, the identity of the state as a party to the contract could at times be obscure and in addition pose many legal questions both at national and international levels.

In the wake of the recent oil price collapse it was widely reported[4] that oil companies were responding to the situation by cutting expenditure on exploration. It is assumed that such cuts may have been in excess of what was agreed to in the work programmes therefore some companies operating in the North Sea, as reported[5] could "drill only those well they have to drill". However, many companies were reportedly asking[6] the Department of Energy to be relieved of the obligation to drill "obligation wells" and while the Department of Energy agreed in some cases it did not wish to encourage such practice. The companies in question would most likely be those without a solid stream of diversified earnings who would suffer a cash flow problem. The Energy Minister initially doubted[7] whether the price fall would impact upon exploration contracts but later admitted[8] that a number of companies had raised issues with respect to Advance Petroleum Revenue Tax and its effects on their cash flow and ability to fund existing and new developments in the U.K. continental shelf. However, he avoided[9] making statements or discussing government policy towards development of North Sea oil. In November 1986, nevertheless, legislation was passed to provide for early repayments of Advance Petroleum Revenue Tax credits in 1987 with a view to assisting only those companies that suffered cash flow problems as a result of the collapse in prices. When the Minister refuses to allow the companies the opportunity to renegotiate the drilling obligation he is acting within the dictates of the British administrative legal practice and since the British legal system does not recognise that force majeure situations (used even in the context of changed economic circumstances) merit changes in the contractual obligations unless the parties have agreed to renegotiate, the companies do not have any legal rights because the work programmes cannot be renegotiated according to British petroleum law.

It seems therefore that the British government has no interest in agreeing in principle to renegotiate the work programmes to reduce exploration. It is submitted that if the British government accepts a legal right of the oil companies to renegotiate it would be held against them at a later date. This approach, however, is contrary to recent trends in the industry which tend to renegotiation when economic circumstances change in order to maintain the equilibrium of the contract. Companies are of the view that if economic circumstances change then they too should require a revision of existing agreements, in other words, renegotiation should work both ways.

There is evidence to support that in international practice the work programmes in a petroleum contract can be renegotiated in situations of changed economic conditions. While it is admitted that such practice does not have any legal force to restrict governments it does constitute evidence of what governments are prepared to accept which is that basically the petroleum contract depends upon mutual economic benefits. It is therefore being submitted that the British government should consider that it has a duty to renegotiate the work programmes in the same way as Third World governments and that the negative approach to renegotiation of the work programmes in changed economic situations is, to say the least, arbitrary and unsuited to the British capitalistic situation.

Finally, an approach recommended by one writer with regard to mineral contracts may well be relevant in the context of the recent oil price collapse. She states:[12]

> "Solutions in the vast and complex field of international economic relations - if they are to last and to be successful - require the common support of all parties involved. The overall goal therefore must be to reach reasonable arrangements in each individual case for host country and foreign parties alike - securing the legitimate political, social and economic goals of the host country without frustrating reasonable expectations of the foreign partner."

Notes to Chapter 4

1. Muchlinski, P.T., Rees, J. and Odell, P.: The International Oil Industry. Macmillan Press Ltd. (1987), p. 144.

2. Rees, J. and Odell, P.: op cit. paper by Edith Penrose p. 10 at p. 14.

3. Zakariya, Hasan S.: Sovereignty, State Participation and the Ned to Restructure of the Existing Petroleum Concession Regime: Middle East Economic Survey Supplement to Vol XV No 3 12th November 1971, p. 12.

4. Financial Times, March 13, 1986, p. 11.

5. Ibid.

6. Ibid.

7. HOC Debates Vol 93, 10 March, 1986.

8. HOC Debates Vol 103, Col 284, 23 July 1986.

9. See HOC Debates Vol 93, 6 March, 1986, Col 210; HOC Debates Vol 12, 24 July, 1986.

10. Advance Petroleum Tax Act 1986 C.68. (U.K.).

11. Ria Kemper: The concept of permanent sovereignty and its impact on mineral contracts: Legal and Institutional Arrangements in Minerals Development, Mining Journal Books Ltd. 1982. p. 29.

12. Ibid. p. 34.

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