



## A CRITICAL EXAMINATION OF THE MAIN PROVISIONS OF MODERN CONCESSION AGREEMENTS

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### ABSTRACT

*With the passing of time and political evolution of the world, the concession system came to be viewed as incompatible with the sovereignty of the Nation State. As a result, there came into being new forms of contractual systems such as the joint venture and production sharing contracts. It has been suggested that condemning the concession system on those grounds confuses the effect with the cause: it is not the legal system per se which made for inequality, but the state of affairs then prevailing. It must be remembered that in those days, sovereigns granted concessions, occasionally with little authority, often under foreign political supremacy. Also, the countries concerned were backward, at times wandering and in no case possessed a legal framework competent of leading such complex endeavours as petroleum operations. This article critically examines provisions of modern concession agreements.*

*Keywords:* Petroleum, Concession, Revenue, Inequality, Nigeria.

### 1. INTRODUCTION

Under traditional concessions, agreements arrived at between particular investors and host countries were to be kept secret and were not truly accessible. The multinational foreign companies, however, were in a position to have knowledge of the terms of agreement used in various countries and to make use of this knowledge to guide their negotiations and to conclude similar agreements with other governments. The feature of secrecy thus handicapped the host countries in their negotiations whilst benefiting the transnational because negotiators from newly independent countries had difficulty obtaining information on questions of law, technology, economics and other important issues related to concession agreements. Therefore, they had difficulty evaluating the proposals of the foreign companies, which had at their disposal all the information contained in agreements concluded elsewhere. But with time, this situation changed when copies of concession agreements became increasingly accessible to host governments that were not parties to the particular agreement. Only then could host governments compare the terms of their agreements with those of other developing countries. Members of the Organisation of Petroleum Exporting Countries (OPEC) who publicised their

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negotiating positions and the terms of their agreements deserve the credit for breaking the tradition of secrecy

## 2. FINANCIAL IMPROVEMENT THROUGH MODERN CONCESSIONS

### 2.1 Introduction of government share

At the end of the Second World War, petroleum became apparent as the world's foremost fuel<sup>3</sup> and the Arab world as the world's most abundant<sup>4</sup> and cheapest<sup>5</sup> source of petroleum supplies.<sup>6</sup> The fact is that oil was found in huge deposits in the Arab world and the usual risks formerly associated with oil exploration activities were on the wane. With the exit of the colonial powers from the Middle East and the new wave of nationalist feeling amongst these developing countries, there was now a general resentment at the idea of continued control of their natural resources being left in the hands of the major transnational, which was now being seen as an affront to the new independent status of the host countries. Various new approaches to the negotiation of agreements ensued, including different forms of equity and profit sharing.

### 2.2 Equity Sharing Agreements

#### (a) State participation:

In the late 1960s, the governments of most of the oil producing countries started agitating for a better share of the oil revenue. This led to an increase in the number of agreements that provided for some sort of local participation. It has been argued that equity sharing or participation may or may not bring the government an effective voice in management decisions within the operating company, and invariably it does also mean that the government needs to take on an active role and certain obligations in respect of other activities. However, the concept of participation as it has been developed in the oil industry has been characterised as "pseudo participation" because it does not assume that the host country produces or sells the oil, or transfers it downstream for refining and sale. Popular viewers, however have criticised this position. The better view is that the drive towards increasing participation is simply an ingenious way of further increasing the tax per barrel without touching either posted prices or nominal tax rates.<sup>7</sup>

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<sup>3</sup> R A Daring, consumption of oil and natural gas constituted about two-thirds of the total world primary energy consumption, with consumption of oil alone accounting for almost half of all energy consumption, according to the BP Statistical Review of the World Oil Industry 16 (1972).

<sup>4</sup> As of January 1, 1972, total estimated proved reserves of the Middle East alone totalled nearly 356 billion barrels, and, adding the reserves of the major North African producers, Algeria, Libya and Nigeria, nearly 448 billion as compared with total estimated world reserves of about 17 million barrels. Production in 1972 from the Middle East alone averaged about 17 million barrels per day (b/d), and together with production from the major North African producers, about 22 million b/d, as compared to total world production of about 50 million b/d. See *Oil & Gas J*, Dec 25 1972, at 82-83. Of the 30 billion b/d movement of crude in international markets in 1972, nearly 22 billion b/d came from Middle Eastern and North African producers, according to the BP Statistical Review of the World Oil Industry 16 (1972).

<sup>5</sup> M Adelman. *The World Petroleum Market*, pp. 76-77 (1972).

<sup>6</sup> P. Grimm. 'From Concession to Participation: Restructuring the Middle East Oil Industry' *New York University Law Review* (1973) Vol. 48, 776 at 778.

<sup>7</sup> M. Adelman. 'Is the Oil Shortage Real?' *Foreign policy* vol. 9, (1972)

(b) Equity interest without payment in exchange for tax allowances:

There are also instances where, under equity-sharing agreements, the government not only obtains equity interest without financial contribution, but in exchange for all or part of its right to levy an income tax, the government obtains half the payments, as well as dividend payments in the equity-sharing arrangement. It is fair to say that the government assumes a share in the capital expenditure. Under a tax arrangement, the government takes its funds before the deduction of such expenditures. However, in rare cases, net cash flow from which dividends are paid may be greater than taxable profits. It is a common practice in equity sharing agreements for the government to buy back shares of equity and to retain all its rights to tax corporate profits. In most of the cases, the government contribution has been made only after the existence of a commercially viable source has been proven. This is usually done after a substantial portion of the uncertainty has been done away with. An example would be the action of Papua New Guinea which bought equity in the Bougainvillea mine while imposing a gradually rising rate of income tax.

(c) *Combined Ownership and Production Sharing:*

It is fairly reasonable to suggest that when there is a substantial shift in a particular project from a traditional arrangement to one that provides for sharing of ownership, the steps may be complex and demanding. There are usually a number of technical problems that should be dealt with in the negotiation of equity sharing arrangements. The first relates to the rights of one partner to purchase shares offered by another and the method by which an expansion of the project may be financed. There are many variations on the equity-sharing theme. A good example of this is the arrangement between the Libyan National Oil Company and Shell Exploration (Libya) Ltd, which combines some of the features of ownership sharing with those of production sharing.

(d) *Workers' Rights of Participation:*

Host countries and investor relationship that allow workers rights of participation could also be considered as variations of equity sharing.

(e) *Other Equity Sharing Arrangements:*

There were also instances of direct equity sharing between Governments, for instance in 1974, Nigeria decided to take a five percent view to establishing a Nigerian iron and steel industry, which would stimulate demand for cooking coal which Nigeria has in huge deposits.

### 3. EARLY GROWTH IN PROFIT SHARING AGREEMENTS

(a) Equal Profit sharing:

It has been commented that the most remarkable development in the evolution of concession in the Middle East in the last century was the emergence of new contractual patterns in oil concession agreements. The development and the adoption of the fifty-fifty principle was aimed at achieving the equivalence of the oil production benefits between the oil producing countries and the foreign oil companies.<sup>8</sup>

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<sup>8</sup> H Cattan, *op. cit.*, (n. **Error! Bookmark not defined.**), p.119.

The success of governments of Latin American and Central African countries in obtaining equity in copper operations influenced other countries and other industries. The first battle between governments and companies in the contest for oil was opened in Venezuela. They, however, took the lead in imposing taxes in addition to royalties on foreign companies.<sup>9</sup>

As a result of this new development, in 1950, Saudi Arabia and Aramco concluded new agreements to modify the financial arrangements between them and implemented a 50% 50% profit sharing scheme. Consequent on that agreement, oil concessions in Kuwait, Qatar, Iraq and Bahrain were also revised to give effect to the new concept.<sup>10</sup> Since that time, the equal profit sharing principle had been incorporated into most oil concession agreements.<sup>11</sup> Despite all these new changes the international oil companies retained complete control of both the conduct of operations and the pricing of petroleum and most especially, the control of production remained their exclusive prerogative.

(b) The Iranian Exception:

By 1952, the 50/50 profit sharing principle was being applied in most host countries, except in Iran where a more radical decision was taken with the nationalisation of the oil industry in 1951 by the Mossadegh government. As a result of this unfortunate incident, the transnational companies succeeded in imposing an embargo on Iranian oil. This eventually led to the downfall of the Mossadegh government and the enthronement of Shah Mohammad Reza Pahlavi. For our purposes, the fact remains that nationalisation of the oil industry was achieved and the Anglo-Iranian concession replaced by an agreement between the National Iranian oil company and an international consortium predominantly made up of US companies.

The adoption of the fifty-fifty principles was a step of economic consequence,<sup>12</sup> for it involved a transition from the traditional royalty sharing of four shilling gold<sup>13</sup> per ton of crude oil to equal profit sharing.<sup>14</sup>

#### 4. PRICES AND THE SHIFT FROM ROYALTIES TO INCOME TAX

With the passage of time, the major oil companies' (Big Oil's) oligopolistic control over the supply of crude oil, especially that of the Arab states in reaching a reasonable price, had succeeded during and after World War II in keeping up the market price. In the sixties, with the falling prices of crude oil on the international market, the majors were forced to cut their prices and the cumulative effect was a serious loss in their revenue. Further, the so-called independents, who had concessions especially in the Middle East, had to resort to price cutting to secure market for their expanding output. To match these threats to their revenue, oil producing countries established the organisation of petroleum exporting countries (OPEC).

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<sup>9</sup> 'The Venezuelan Law of Hydrocarbons and its Regulations of 1943' (1967) in Barrows Company, ed. *South America: Basic Oil Laws and Concession Contracts, vol.2* (New York, Petroleum Legislation, Inc.) pp. Venezuela A22-32. In 1948, the country passed a new income tax law which taxed the profit of foreign companies at the rate of 50 percent.

<sup>10</sup> It was only in Iran that the parties failed to reach a consensus on the new concept and the other matters then pending between them and as a result the Anglo-Iranian concession came to a premature end as a result of the Iranian nationalisation of the industry in 1951.

<sup>11</sup> H Cattan, *op. cit.*, p. 119. He commented that the principle has since been applied in all new oil concessions except in a few cases where a share higher than 50% of profits was reserved in favour of the producing country.

<sup>12</sup> For recent changes and deviations in the equal sharing concept, see Cattan, H. *Ibid.*

<sup>13</sup> On the basis of the price of gold at U.S. \$35.00 an ounce, four shillings in gold are worth U.S. \$1.65.

<sup>14</sup> It is estimated that in terms of income to Governments, the implementation of the equal profit sharing concept in oil concessions has resulted in a threefold to a fourfold increase in the revenue previously derived from the standard royalty of four shillings of gold per ton of crude oil.

During the same period, a new form of royalty payment was also introduced. For instance, Iran revised their concession agreement to reflect the equal sharing principle. In addition, bonuses became more substantial in amount and more sophisticated in form. The next measure taken by host governments to increase their financial gain from their natural resources was the use of taxation. The shift from royalties to income taxation – a form of participation in the company’s profits – occurred in stages.

In the LMC example, the government started by receiving twenty-five per cent of profits, later increased its tax to thirty five per cent, and finally taxed at fifty per cent of profits. When this “fifty-fifty” profit sharing formula was established, royalties were abandoned. The pioneering agreements that adopted fifty-fifty profit sharing were the oil concessions in the Middle East and North Africa.<sup>15</sup>

The old income tax system was changed. For instance, Saudi Arabia in 1950 passed legislation to impose an income tax on the companies at the rate of 20 percent. This spread like wildfire to other oil producing countries, who began to enact petroleum legislation or make provisions in their new agreements to tax foreign oil companies. This ultimately led to the incorporation of an income tax of 85 percent and a royalty of 20 percent, which is now known as the “OPEC formula”.<sup>16</sup>

## 5. WHY THE ISSUE OF PRICING WAS SO CRUCIAL

The issue of price was traditionally at the sole discretion of the international companies. But with time and with the new wave of changes in the oil sector, this incongruity began to change. In addition to the introductions of royalties, posted prices were also introduced for the purpose of calculating income taxes and royalties based on the value of output. The issue of pricing was seen by producing countries as a *sine qua non* upon which to base their relationship with the oil companies and they could not afford to gamble with it. The issue of pricing was so vital, and caused so many rifts between developing countries and foreign companies the parties, because the development and well-being of their countries depended on oil, due to the fact that most of them were Neo-countries. This eventually had a cumulative effect, giving rise to the formation of OPEC.

## 6. PARTICIPATION, REVENUE MAXIMISATION, CONTROL AND NATIONAL OIL COMPANIES

With the passage of time, the accessibility of the OPEC agreements increased the opportunities for developing host countries to learn from each other and to adjust the relevant provisions of the publicised agreements to each country’s local situations and needs. Changes which OPEC introduced led to the development of new approaches in modern agreements, including active State participation in the operation of the mining company, maximisation of government revenues through carefully negotiated financial obligations, stricter control of the activities of the foreign companies, and the creation of national oil companies when appropriate.

## 7. RELINQUISHMENT OF AREAS NOT UNDER DEVELOPMENT

In addition to the rights and obligations of traditional concessions, many agreements, for instance the Aramco concession, incorporated a program of relinquishment of offshore

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<sup>15</sup> For a review of the evolution of the financial consideration in oil concessions, see Cattan, *op. cit.*, (n. **Error! Bookmark not defined.**).

<sup>16</sup> D A Suleiman. ‘The Oil Experience of the United Arab Emirates and its Legal Framework’, 6 JENRL 3 (1988).

areas. Accordingly, the oil company was expected to surrender large portions of the concession area it did not wish to develop. The principles of compulsory and progressive relinquishment by the concessionaires of unexploited area of the concession now feature in most concession agreements as a matter of course.<sup>17</sup> With time, there was also the introduction of the concept of exploration obligations. The foreign Oil Company was required to commit a minimum and guaranteed expenditure on drilling or exploration during a certain period of time.

## 8. HOST GOVERNMENT PARTICIPATION

From 1955, developing countries began to see tremendous improvement in the financial sector, and started agitating for state participation, that is ownership and management of petroleum operations. Participation was championed by most OPEC countries as one of their main cardinal objectives. In 1957, for instance, the National Iranian Oil Company entered into a joint venture agreement with Agip, the Italian National Oil Company, which saw an arrangement being made between the national oil companies of the host and prospecting governments respectively. This key Agip contract can be said to have signalled the introduction of State participation and came to be followed by many developing countries. State participation produced a partial recognition of the Host countries' sovereignty over their petroleum resources whilst maintaining some of the functional virtues of the concession system. It can be argued that to a great extent, it restructured traditional concession relations.<sup>18</sup> By 1971, a resolution was passed calling upon OPEC members to take immediate steps towards the effective implementation of the principle of participation in existing oil concessions.<sup>19</sup>

## 9. FACTORS THAT LED TO THE CHANGE IN THE STRUCTURE OF PETROLEUM AGREEMENT CONTRACTS

Even a cursory review of the widespread and extensive nature of the rights exercised by the oil companies under traditional concessions would indicate that discontent was bound to arise. These original agreements were so one-sided because they were negotiated in the colonial era with the weight of puppet home government thrown behind their domestically based companies.<sup>20</sup> It has been commented that in bidding for concessions the oil companies were united and had the common characteristics of a conglomerate in limiting exploration agreements whilst on the other hand the Middle Eastern states had to bargain as separate entities.<sup>21</sup> Some of the principal factors which have contributed to the changes in the concession system which we have been discussing will now be examined.

### 9.1 *The United Nations*

First and foremost, the contribution of the United Nations has played a notable role in influencing effective changes in terms of the content and improvement of such contracts. The United Nations, by a number of historical resolutions passed by an overwhelming majority in the General Assembly, declared that every State enjoys full permanent sovereignty over its

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<sup>17</sup>Z Gao, *op. cit.* (n. **Error! Bookmark not defined.**), p. 16.

<sup>18</sup>Grimm *op. cit.* (n. 6), p. 774.

<sup>19</sup>OPEC Res. XV 190, June 1968 and OPEC Res. XXIV 135, July 1971 in Barrows Company, *Middle East Contracts*, see also the Convention of March 14, 1925 as revised by the Principal Agreement of March 24 1931, in Barrows Company, ed. *Middle East; Basic Oil Laws and Concession Contracts*, Vol. 2 (New York: Petroleum Legislation Co. 1959) pp. 31-37 (hereinafter *Middle East Contracts*, see pp. 31, 1971, OPEC C 1-2 and K.1.)

<sup>20</sup>'From Concession to Participation', *op. cit.* (n. 6) p. 777.

<sup>21</sup>*Ibid.*

natural resources and all its economic activities.<sup>22</sup> It seems axiomatic to observe that the legal binding force of UN resolutions still remains a controversial issue, but the fact remains that it cannot be denied that these resolutions constituted the political and the legal basis by which developing countries effectively improved the terms and conditions of their concessions. These resolutions placed great importance on the rights of all countries to secure and increase their share in the administration of enterprises operating in their territories by foreign capital and expertise, as well as the right to acquire a greater share in the benefit to be derived from them.

### *9.2 The Emergence of OPEC and Collective Action*

A third factor that played a remarkable role in the demise of the traditional concession, without any doubt, is the advent of the Organisation of Petroleum Exporting Countries (OPEC) and the discovery by the OPEC countries of the tremendous benefits of coordinated action. The industry, within a framework of overall surplus producing capacity could, by shifting lifting from one country to another, bargain effectively with an individual country, particularly on the vital questions of volume, expressed as lifting obligations, and prices and profit sharing expressed in terms of rent, royalty and taxes. There is no doubt that cooperative action by OPEC has very substantially reduced the ability of the industry to effectively bargain in this way and the organisation has played a vital role in refashioning the legal relationship between the host country and the foreign oil company.

### *9.3 The Independent Operator*

The active and the aggressive entry into international operations of the so-called independent that emerged in the later fifties and sixties destroyed a great deal of the uniformity of response which the community of interest exercised on the part of the majors<sup>23</sup> tended to engender. With no vested interest in the traditional concession regime, these independents were willing to conclude terms more favourable to host governments than the terms in the old concession agreements.

Prior to 1954, with the exclusion of the Gulbenkian 5% holding in the IPC, all the concessions in use in the Middle East were ultimately owned by the majors. In 1955, each American major in the Iranian conglomerate forfeited 1/8 of its holding to permit the division of the resulting 5% between groups of nine American independents.<sup>24</sup> These formed the IRICON agency. This break-in by non-majors began a process whereby American, European and Japanese independents began to contend successfully for acreage in the Middle East.<sup>25</sup> Commentators have argued that the entry of these newcomers had two effects. First, they created a demand for new acreage which the host countries were unable to develop fully themselves. An important aspect of this was that the independents were regarded as a welcome counter-balance to the majors. To have allowed the majors to develop the acreage “would

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<sup>22</sup> E.g. UN G.A. Res. 1803 (XVII) and Res. 2158 (XXI) Permanent Sovereignty over Natural Resources, December 14, 1962 and November 25, 1966, in D.J. Djonorich, ed. *United Nations Resolutions*, Series I, Vol. XI, 1962-63 (Dobbs Ferry, N.Y.: Oceana Publications, 1973), pp. 107-108, and *ibid.* Vol. XI, 1966-68, pp. 145-46.

<sup>23</sup> “The seven international ‘majors’ ranked by their crude oil production in 1966 are: Standard Oil Company (New Jersey), Royal Dutch/Shell Group, British Petroleum Company, Gulf Oil Corporation, Texaco, Standard Oil of California and Mobil Oil Corporation (formerly Socony Mobil). Compagnie Françaises des Pétroles is much smaller than any of these, as well as smaller than a number of other US companies, but it very early had a share in Middle East oil and is for this reason often referred to as an eighth ‘international major’.” Penrose, E.T. (1968) *The Large International Firm in Developing Countries*. George Allen and Unwin Ltd. p. 89.

<sup>24</sup> S L Longrigg, *Oil in the Middle East*, third edition, (1968) p. 278.

<sup>25</sup> Penrose, *op. cit.* (n. 23), pp. 59-62.

strengthen the walls of the prison.”<sup>26</sup> Second, because bids for the acreage were on a gung-ho basis and demand was strong, a seller’s market for the new acreage was created. When Kuwait opened territory for bids in 1961, there were 13 potential bidders.<sup>27</sup> By 1963, when Iran also invited bids for territory, 30 companies applied.<sup>28</sup> This, without doubt, meant that the host countries would be able to secure more favourable terms in any agreement signed. The majors were not ready to compromise their positions since they feared that their concessions would be adversely affected. This tense atmosphere and the competition brought about by the independents for sources of oil in the producing states played an increasing role to help reduce the official bargaining power of the major oil companies. Notwithstanding these new developments, the new governments were persuaded by their former metropolitan powers as well as the oil companies themselves to preserve the concessions themselves on the grounds of sanctity of contract.

#### *9.4 The National or State Oil Companies*

The establishment of National State oil companies by developing countries played an outstanding role in the advancement of this notable course. The first of this kind of company was Yacimientos Petroliferos Fiscales (YPF) founded by Argentina in 1922. By the mid 1970s nearly all developing countries engaged in oil production had established their own State oil companies and most of them had a monopoly over the whole range of petroleum operations.<sup>29</sup>

#### *9.5 Increase in Petroleum Prices*

In addition to the above, the substantial increase in petroleum prices on the world market strengthened the hands of the developing countries to bargain for more control over, and a greater share of the profits from, petroleum development. The worldwide development of off shore areas provided developing countries with more acreage for new foreign participation. With the passage of time, and the rising wave of independence, new patterns and perceptions emerged. Substantial additional oil reserves were discovered in the Middle East and demand for oil as a source of energy by the industrialised countries of Europe and United States greatly increased.

#### *9.6 The Influence of Latin America*

Developing countries striving to obtain a better deal for their petroleum resources were greatly influenced by the pioneering role of some of the Latin American countries. It is well documented that the early Latin American experience has been a considerable source of inspiration and influence in the shaping of new petroleum policies in other parts of the world both within and outside the OPEC community. Several factors can be discerned. In the first place, most of these countries have been politically independent for well over a century. This placed them in an advantageous position to adopt and implement nationally-determined policies vis-à-vis the international oil companies even as early as the 1920s and 1930s. Such Latin American countries such as Argentina, Brazil, Mexico and Venezuela were already involved in

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<sup>26</sup> Abdallah Tariki quoted in Mikdashi, Z. (1966) *A Financial Analysis of Middle East Oil Concessions (1901-1965)*, New York: Frederick A. Praeger, p. 236. see also Stevens, P. J. ‘Joint Ventures in Middle East Oil 1957-76’ Ph.D. Thesis University of London, 1975, Typeset and printed by PRJ Offset Ltd., London. p. 8.

<sup>27</sup> Penrose, *op. cit.* (n. 23), p. 74.

<sup>28</sup> Petroleum Press Services (PPS), September 1964, p. 331.

<sup>29</sup> UN Centre for Natural Resources, Energy and Transport (1980), *State Petroleum Enterprises in Developing Countries*. New York: Pergamon Press.



sharp controversy with the foreign oil companies by then. They were consequently compelled to take legal measures designed to establish State control and to set up National oil companies. For instance, Brazil in 1938 declared the petroleum industry a public utility and placed it under the direction of a national petroleum council. Venezuela followed suit and in 1943 was able to renegotiate its concession agreements and to obtain more favourable terms which other developing countries were not able to do until the 1950s and 1960s. Mexico was so dissatisfied with the foreign oil companies that it proceeded to wholly nationalise their former concession, an action which has had an enduring effect on subsequent development within Latin America in particular and the world in general. It has been observed that the nationalisation of Mexico's oil provides Latin America's and possibly the world's outstanding example of action by a poor, undeveloped Nation against what in 1938 was termed the international petroleum cartel. Politically, it showed that the power of this cartel could be contained by resolute action in which, in the final analysis, the companies would have to acquiesce unless they could persuade the US and Britain to intervene with physical force.<sup>30</sup>

### *9.7 Adoption of Legislation*

During the last five decades many oil producing countries began to feel urgent need to re-examine the existing patterns for the development of their natural resources. One can argue that it is this which has led to the adoption of petroleum legislation, which clearly defined the new policy to be pursued and served as a fresh point of departure.<sup>31</sup> This tends to be done in combination with the creation of a State-owned oil company to serve as an effective instrument for the implementation of the new policy.

In addition, and notable as a development within the metropolitan as opposed to the producing countries, one must point to the spread of antitrust legislation as having a significant effect in further weakening the bargaining position of the industry. Even though specific dispensation from the anti-trust laws has often been obtained, the fact remains that the number of parties and their diversity of interest has tended to restrict the effectiveness of cooperative action.

### *9.8 Growing Economic Awareness in Developing Countries*

A number of exporting countries, it has been suggested, benefit from a relatively small population and have managed to accumulate large enough gold and foreign currency reserves to give them a financial cushion. With growing economic awareness, there arose a realisation that their oil deposits are not infinite and a consciousness of the fact that the extraction industries constitute their economic mainstay. It is safe for one to say that it became imperative for them to agitate for a better deal in the exploitation of such resources. The scramble for revenue of the colonial days was fast being replaced by a willingness to let the oil stay in the ground unless it could be seen to be bringing in the highest possible price. Developing countries were now prepared to wait for the highest bidder. These collective effects led to the eventual withdrawal of the British, French and American companies' presences, especially in the Middle East and North Africa. These vicissitudes undoubtedly played a significant role in the changes which were imminent to unfold in years to come.

The view that is favoured, however, is that in many producing countries, especially those which have previously been colonies, there is desperation to make a change and a desire

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<sup>30</sup> P.R. Odell. *The Oil Industry in Latin America*. London: Allen & Unwin (1968).

<sup>31</sup> Hassan Zachariah 'New directions in the search for development of petroleum resources in the developing countries'. *Vanderbilt Journal of Transnational Law*, (1976) p. 553.

not only to avoid what might be thought of as economic colonialism, but perhaps even a desire to turn the tables and do a bit of exploiting themselves.<sup>32</sup>

### *9.9 Arab-Israeli Conflict, Artificial Oil Shortage*

Finally the Arab-Israeli conflict and the Arab boycotts have had the tremendous effect of producing an artificial shortage of oil. The non-Arab countries have been swift to take advantage of the situation and demand better terms for their existing agreements. There have been significant changes, especially in 1969, after Colonel Muammar el Qaddafi in Libya demanded a substantial increase in the posted prices<sup>33</sup> of petroleum.<sup>34</sup> The majors were quick to perceive the implications of this leap and the resulting effect it would have on the companies' large-scale production in the Gulf. Iran followed suit as this new wave spread like wildfire through the producing countries. The other Mediterranean suppliers, including Algeria, formed a united front with Libya<sup>35</sup> and Algeria in particular coordinated her policies to intensify the impact of Libya's campaign.<sup>36</sup> These new developments, consequently, resulted in a substantial increase in the "government take" and clearly weakened and eventually destroyed the 50/50 principle.

In addition, the whole structure of profit sharing was eventually destroyed after the 1973 oil embargo imposed by the Middle East producers and the drastic rise in oil prices in that decade. The Iranian revolution of 1979 led to a serious loss of power by most of the metropolitan producing and consuming countries which further strengthened the hands of the host countries, especially the OPEC countries. This situation concomitantly gave rise to the new forms of agreements such as the joint venture and production sharing contracts constituted under the so-called OPEC terms.

## 10. OPEC ASSUMES PROACTIVE ROLE ON PRICING SUPPORT

The active intervention into the market of the organisation of petroleum exporting countries (OPEC) also facilitated the demise of the concession agreements. The main purpose for the formation of this organisation was actually to checkmate or prevent a drop in crude oil price. This basic role came under challenge with the discovery of huge oil deposits by newcomers lacking in marketing skills. Although the oil was located, the failure of the newcomers to actively extract and market it effectively resulted in a reduction in the incomes of host countries. This turn of events led OPEC to expand its role and to move into a whole new area of support for member OPEC countries. Through its organisation, OPEC member countries started challenging the oil companies on such matters as production levels and the ever-

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<sup>32</sup> Rene P. Lavenant Jr. (A Houston Texas Gas and Oil Lawyer). Prior to joining the firm of Fulbright & Jaworski as a partner in 1973, Mr. Lavenant was a senior attorney and Regional General Counsel for Mobil Oil Corporation-Europe.

<sup>33</sup> "The concept of 'posted price' was first developed in the U.S. oil industry. It simply means that any refiner or agent wanting crude oil posted a price at which he is willing to buy oil from a specified field... In the Middle East, the first to start posting prices were the parents of Aramco which announced their postings at the end of 1950. Other companies followed suit. Their purpose was to provide a basis (acceptable to governments) for calculating taxable profits." Z. Mikdashi, *op. cit.* (n. 26), p. 169.

<sup>34</sup> 'The Libyan expropriation: further development on the remedy of invalidation of title.' (1974) *Houston L. Rev.* 924.

<sup>35</sup> See, e.g. PONS, June 30, 1970, at 3, col. 1 (tripartite agreement between Algeria, Iraq and Libya to establish joint fund to finance any Arab country facing financial trouble arising from an oil dispute); PONS, April 15 1970, at 1, col. 2. (talks between Algeria and Libya to establish joint oil front).

<sup>36</sup> On June 15, 1970, Algeria nationalised five foreign oil interests. PONS, June 17, 1970, at 1, col.2. In July, Algeria announced to French companies that posted prices would be raised \$79 per barrel. Algeria also coordinated her natural gas policies so as to deprive Exxon (then Esso) of the option to shift natural gas offtake from Libya to Algeria. PONS, Sept. 21, 1970 at 4, col. 2; PONS, July 29, 1970, at 1, col. 1.

problematic issue of control. The Declaration of Sovereigns and Chiefs of State of OPEC Countries in Algiers supported this tactic on March 6 1975.

*The sovereigns and Heads of state reaffirm the solidarity which unites their countries in safe-guarding the legitimate rights and interests of their peoples, reasserting the sovereign and inalienable right of their countries to the ownership, exploitation and pricing of their national resources and rejecting any idea or thought that challenges these fundamental rights and thereby, the sovereignty of their countries.*<sup>37</sup>

With this OPEC leverage, OPEC countries now enjoy a near monopoly on external supplies to the industrialised world.

## 11. CONCESSIONS HAVE A BAD PRESS

Despite all the criticism that might be levied against the traditional concession agreement, and although the old concession agreements are not acceptable by any present day standards, the terms of these agreements are best viewed in their historical context. Oil exploration in the early days involved such considerable risks that the developing countries could not have done it alone. The early concession system has been beset for the last quarter of last century with sharp criticisms, mainly from third world producing countries. Although the concession system is now considered as outdated, a large number of countries still adopt variations of concessions in their dealings with oil companies. One could argue that the characteristic features under the concession regime were clearly inequitable and lopsided in favour of the companies, and that therefore such arrangements were unable to survive decolonisation and the new international economic order. The concession was therefore regarded as a discredited form of contract, and the very word concession had a bad connotation in many countries.

## 12. INCENTIVISING ROLE IN THE PRESENCE OF HIGH RISK

Nonetheless, the principal advantage of the concession system is that it is a tried and true system that works. It could be enacted as a corpus of legislation, as is the case in United Kingdom, France, the United States and Austria. It has also been noted that it can be negotiated directly to incorporate the same requirements and achieve the same goals as now feature in the more modern agreements. Although the concession agreements had serious shortcomings, there are cases in which they may meet the immediate needs of certain host countries, arguably, for instance, in countries with unproved potential, geographically isolated exploration areas and little local expertise and capital. In such situations, a concession type agreement may be a useful device for attracting foreign oil companies to undertake exploration operations. In addition, the traditional concession did play a notable role in the provision of incentive and capital for undertaking the particularly risky and expensive business of petroleum exploration in what were, in those early days, remote areas of the world. It cannot be termed an overstatement

## 13. CONCLUSION

This article examined the traditional concession agreement between the developing countries and the international oil companies. At the beginning of last century, there was really in existence only the traditional concession. At that time, the developing countries were mostly

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<sup>37</sup> Blinn *et. al. op. cit.* (n. **Error! Bookmark not defined.**), p. 50.

under colonial rule or, even if formally independent, weak in actuality and easily subjected to foreign influence. With time, they came to realise that they had not been given a fair deal and, once that realisation had been arrived at, the glaring inequities of the concession system could no longer be tolerated.

The traditional concession accorded the major oil companies nearly complete freedom to conduct petroleum operations in the territories of the subject states. Governments had little or no control over either their resources or the companies operating within their territories. The notion of mutuality of interest did not even arise under the concession regime. Because of these shortcomings, the concession system came under increasing pressure by host country governments who were pressing for more equitable sharing, and the concession eventually underwent phases of renegotiation including revision, nationalisation and eventual termination. The tendency has been towards the reassertion of state sovereignty over natural resources by abolishing completely or phasing out the concession agreement. The main factors that facilitated these changes was the invaluable work of UN in the field of sovereignty over natural resources, the pioneering role of Latin American countries such as Mexico, Colombia, Argentina etc. and finally, the growing trend amongst states to nationalise their petroleum industry to speed up the process of readjustment to new facts of life.

Traditional concessions generally failed to develop a broadly balanced, persistent, stable and mutually beneficial relationship between the contracting parties. During the stage of development in which concession agreements were the norm, concerns for natural resource conservation and sustainable development were not expressed at all.

The transition from traditional concession agreements to modern petroleum contracts has been viewed by some developing countries as a revolutionary process, which would totally reshape the legal relationships between governments and companies in the years to come. One major shortcoming of the traditional concession was that it did not enable the host country to participate in the ownership of the petroleum produced, but left the Host country with no more than a mere passive role. Sovereignty is now acknowledged to be meaningless without economic power, so ownership has little significance in economic terms unless translated into effective control and concrete financial benefits reinforced by sound managerial and technical skills.

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