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New Directions in the Search for and Development of Petroleum Resources in the Developing Countries

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I. INTRODUCTION

The developing countries have several things in common. They share, to a large extent, similar political and socio-economic backgrounds, strive to overcome similar problems, and aspire to achieve the same goals of social progress and economic welfare. Hence, the importance of coordination of their efforts towards their common objectives can hardly be overemphasized.

In order to avoid the mistakes of the past and emulate the positive gains of the present, the developing countries, in searching for and developing their petroleum resources, can and must learn a great deal from each other. The experience of some of them has been long, rich, and varied, albeit painful and agonizing at times; that of others has been either fledgling or virtually non-existent. The gap between the two extreme categories can span as much as three-quarters of a century or more. The latter can obviously benefit from the experience of the former, adapting whatever is relevant to their own particular local conditions and current needs. This paper is an attempt to review certain aspects of that experience and to deduce its lessons in order to promote the exchange and dissemination of information, which is a prerequisite for effective cooperation among the developing countries.

Within the developing countries, exchanging information and learning from each other's experience in the field of petroleum is, of course, not entirely new. The process has been evolving for a long time. It antedates formal institutionalization in such intergovernmental bodies as the Organization of Petroleum Exporting Countries (OPEC), or such strictly regional groups as the Organi-

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zation of Arab Petroleum Exporting Countries (OAPEC) and the Asistencia Reciproca Petrolera Estatal Latinoamericana ("Mutual Assistance Between the Lation American State-Owned Oil Companies") (ARPEL). The United Nations, through its Secretariat in New York and its Regional Commissions, has also rendered valuable service in this regard by sponsoring seminars and symposia to facilitate the exchange of information and the coordination of petroleum policy among the developing countries.

More recently, some of the more developed industrialized countries of the West appear to have been learning lessons from the achievements of the oil producers among the developing countries. Norway, the United Kingdom, Canada, Australia, New Zealand, and others have been introducing into their own petroleum industry, to the profound dismay and chagrin of concesson-holding companies, new concepts and practices advocated by the OPEC countries in recent years, such as state participation, maximization of government revenues, stricter control over the activities of foreign operators, and the setting up of national oil companies. It is small wonder that leading "trade journals" have been trying to discredit these attempts for some time by projecting them under such colorful and rather amusing titles as "Norway Takes a Leaf From OPEC's Book," "OPEC Spirit in the North Sea," "The Blue-Eyed Arabs," "The Sheikhs of the North Sea," and so forth.[1]

It is to be remembered that what has greatly contributed to the process of instant and world-wide dissemination of petroleum information is the unique and crucial position petroleum enjoys as the most important commodity, both in value and volume, traded in the international market. For as long as we can remember, its vicissitudes have been unfolding dramatically on the world stage for everyone to see and ponder.

1. See, for example, *Petroleum Press Service*, January, 1973; *The Economist*, July 13, 1975; *The Petroleum Economist*, January, 1975. Commenting on a statement by the British Secretary of State for Energy on the North Sea oil, *The Economist* of London, for example, had this to say: ". . . it reads mostly like a piece of Labour dogma, heavily influenced by what the Norwegians have done recently with their national oil company, what the Latins did a few years ago and what the Arabs are continuing to do. If the Norwegians had not already earned the nickname of the Arabs of the North, Labour would like to be a strong candidate for it." *The Economist*, July 13, 1974, at 67.

II. Background and Scope of Petroleum Experience in Some of the Developing Countries

A. *The Concession Regime*

It is presumed that most readers are familiar by now with at least the broad outline of the general past experience of those developing countries which have become major producers/exporters of petroleum. Nevertheless, a brief account of the early aspects of the story is indispensable to the discussion which will follow.

Until very recently, a long and bitter controversy marked the relationship between those countries and the major oil companies operating in their territory. That controversy centered around the old concession regime. In some countries, such as Iran, that regime was adopted at the turn of the present century. In others, such as Indonesia, it appeared even earlier. It was introduced in the remaining countries during the years between the two world wars. These countries were, at the time, either under direct colonial rule or, if formally independent, actually weak and easy prey for foreign influence. With the passage of time, they came to realize that they had not been given a fair deal initially and that the glaring inequities of the concession regime could not be tolerated much longer.

This discontent with the concession regime can only be fully understood by recalling some of its main features.

1. The area of the concession was enormous. While not comprising the whole territory of the country, it covered the largest and most promising part of it. In spite of this anomaly, no effective area relinquishment program was stipulated under the concessions.
2. The duration of the concessions was exceptionally long, generally ranging from sixty to seventy-five years. In one particular case, that of Kuwait, the duration was ninety-two years.
3. The financial benefits which were to accrue to the countries were very limited and meager. They consisted mainly of modest royalty payments. The equal division of profits, the so-called fifty-fifty formula, was not adopted until the middle of this century.
4. More significantly, the concessionaires retained complete freedom of action in such vital matters as the determination of production levels and the fixing of prices. Equity state participation was either denied altogether or meagerly provided for under certain concessions, but deliberately never carried out. Participation in management was restricted to symbolic minority representation on the boards of a few concession-holding companies, but entailed no real influence whatsoever in substantial matters and policy decisions.

These were only some of the strange anomalies of the early oil concession agreements with which the developing countries had to contend or endure. No wonder that a fair-minded American author remarked, "Never in modern times have governments granted so much to so few for so long."[2]

Change was inevitable. The inequities of the past were gradually, albeit belatedly, tempered or eliminated. Some governments were compelled to nationalize their petroleum industry to speed up the process of readjustment to the new facts of life. Others did not go that far. Instead, they demanded and obtained partial nationalization in the form of effective state participation in the ownership and management of the concessions. This was achieved amicably through the patient process of negotiation with the concession-holding companies. In both cases, the result has been the reassertion by the governments of their lawful right to exercise full or at least partial control over such vital matters as the fixing of the price of crude oil and the setting of allowable levels of production. This has also resulted in increased financial benefits. By retaining as much as possible of the so-called "economic rent" the governments leave the foreign companies with only what is their due, a fair and reasonable return on their investments. This process of equitably readjusting existing arrangements and the initiation of new forms and patterns, which has been going on for some time now, has not exhausted all its dynamic potential. What we are witnessing now, however, is a far cry from what was the case at the outset.

B. *The Influence of the United Nations*

It is imperative at this juncture to point out that in their desperate effort to achieve a new deal, these developing countries have been enormously encouraged and sustained by the invaluable work of the United Nations in the field of sovereignty over natural resources, and by several resolutions that the General Assembly has adopted by overwhelming majorities over the last two decades on this theme. Particularly notable were the landmark resolutions of December 14, 1962, and of November 28, 1966. These resolutions placed great emphasis on the right of all countries to secure and increase their share in the administration of enterprises that are operated within their territory by foreign capital and expertise, as

2. G. STOCKING, MIDDLE EAST OIL, A STUDY IN POLITICAL AND ECONOMIC CONTROVERSY 130 (1971).

well as the right to acquire a greater share in the benefits to be derived from them.

C. *The Pioneering Role of Latin America*

No review of the half-century process during which the developing countries strove to obtain a better deal for their petroleum resources can be complete without mentioning the pioneering efforts of some of the Latin American countries. It is perhaps rather widely known that the early experience of Latin America has been a considerable source of inspiration and has influenced the shaping of new petroleum policies in other parts of the globe, both within the OPEC community and elsewhere. Several factors have enabled certain Latin American countries to play a pioneering role. Undoubtedly, the most important fact is that most of these countries have been politically independent for well over a century. This placed them in a position to adopt and implement nationally-determined policies vis-á-vis the international oil companies. By the 1920's and 1930's countries such as Argentina, Brazil, Mexico, and Venezuela were already involved in a sharp controversy with their foreign operators. Consequently, they were compelled to take legal measures designed to establish state control and set up national oil companies. Thus, in 1938, Brazil declared the petroleum industry a public utility and placed it under the direction of a National Petroleum Council. After the 1950 presidential election, which was fought under the slogan *O Petróleo e nosso* ("Petroleum is ours"), more comprehensive oil legislation was enacted forming *Petróleo Brasiliero* (Petróbas), a state-owned company with monopoly rights for exploration, production, and all new refining developments.

Venezuela, although epitomizing the gradualistic approach of successive revision and readjustment instead of drastic and swift change, has persistently endeavored, with no small measure of success, to regulate and control the activities of its concession-holding companies and to maximize oil benefits. Thus, as early as 1943, Venezuela was able to renegotiate its concession agreements and to obtain more favorable terms, which other developing countries were not able to do until the 1950's and 1960's.

In 1938, Mexico was so dissatisfied with the attitude of the foreign oil companies that it decided to nationalize their concessions altogether, a major step which has had an enduring effect on subsequent developments both within Latin America and elsewhere. As was rightly observed:

> The nationalization of Mexican 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 U.S. and Britain to intervene with physical force. Technically, it has demonstrated that a State oil enterprise, responsible for all aspects of oil operations from exploration through to final sales can, in the long run, operate an oil industry. And economically it has indicated how a nationally owned company can be organized and controlled by the State to meet what are considered to be required national objectives—which in Mexico's case have been increasing supplies of energy at low prices to the consumer.[3]

III. State Participation in the Petroleum Industry

State participation has been brought about in some developing countries which were unable or unwilling to establish full national control either through the restructuring of existing concessions, or by providing for it *ab initio* in new oil agreements covering areas previously not assigned or handed back to the government by virtue of the application of a relinquishment clause. As will be shown later, this latter process, which began in the late 1950's, has assumed two main forms.

Why State Participation?

Under the traditional concession system, the concessionaire virtually assigned to himself the role of an "autocrat," leaving the host government as a mere spectator with little or no say in running the enterprise. Perhaps this imbalance was inevitable at the outset when most of the developing countries were quite unfamiliar with the mechanics and intricacies of this highly technical industry. But with the passage of time, local expertise began to grow and develop through training programs and academic learning, and the role of indigenous personnel in running the day-to-day phases of operations continually widened and expanded. However, the management of the enterprise as a whole and the policy directions it

3. Odell, *The Oil Industry in Latin America*, in THE LARGE INTERNATIONAL FIRM IN DEVELOPING COUNTRIES—THE INTERNATIONAL PETROLEUM INDUSTRY 274, 289 (E. Penrose ed. 1968). For further discussion of the subject *see generally* A. BERMUDEZ, THE MEXICAN NATIONAL PETROLEUM INDUSTRY—A CASE STUDY IN NATIONALIZATION (1963); Odell, *Oil and State in Latin America*, in 40 INT. AFF. 659-73 (1964).

assumed continued to be the sole prerogative of the concessionaire. In due course this led the host governments to demand that, due to changed circumstances, original agreements be modified to allow for state participation in the industry.[4]

State participation of course should not be viewed merely as a matter of prestige and national pride. It is much more than that. Except for direct and full national control over natural resources, which should indisputably be the rule, state participation is the second best option and is designed to fulfill some of the aims of the general rule, albeit in an incomplete way. Its tangible and intangible benefits are many, but the following would seem to be among the most important.

1. *Additional Revenues.*—This is the tangible benefit *par excellence.* There is no doubt that equity participation will increase the revenue of the state. By becoming a partner, the state will receive not only the royalty, income tax, and other ancillary payments which accrue to it in any case as a "granting authority," but also an additional share of the profits by virtue of its new capacity as a co-owner of the enterprise. This share will mean either dividends in cash in accordance with normal business practice, or a share of the crude oil produced, corresponding to the rate of participation. This crude oil can be marketed by the state either directly or through the established channels of its private partner.

2. *Control From Within.*—It is submitted that the increase in revenue should of itself be more than sufficient inducement for the state to seek participation. But that is not the whole picture. There are other vital considerations which commend state participation. Complete national control of natural resources is, of course, the ultimate goal. In certain places and at certain times, especially at the outset, this might not prove possible or advisable. State participation, initial or subsequent, is a big step on the way to the ultimate goal, a pragmatic and effective compromise between what is possible and what is desirable. It is true, of course, that even without equity participation the state usually retains a certain degree

4. Such demand was first indicated in the OPEC Declaratory Statement of Policy of 1968 (Resolution XVI. 90). One of its ten principles reads as follows:

> Where provision for Governmental participation in the ownership of the concession holding company under any of the present petroleum contracts has not been made, the Government may acquire a reasonable participation, on the ground of the principle of changing circumstances. If such a provision has actually been made but avoided by the operators concerned, the rate provided for shall serve as a minimum basis for the participation to be acquired.

of supervision and regulatory power from without as a granting authority. No petroleum concession or license can contract away this sovereign prerogative. The degree of control might, of course, vary from one country to another, or from one time to another. But no matter how stringently or extensively it is applied, this control from *without* is not enough. Control from *within* is likewise essential. State participation can provide that control in a spontaneous and uninterrupted manner. It entitles the state to have greater representation on the board of management of the operating company, enabling it to play a more effective role in directing the general course of the enterprise and in shaping its policy decisions in both the short and long-term. Such control would have a far-reaching influence on such vital issues as the volume of production, pricing policies, the rate of investment for further exploration and development, the role the oil industry should play in the national economy, conservation policies, and many other related matters which directly affect public order and welfare.

3. *Acquisition of Technical and Managerial Skills.*—It is clear that if the developing country is to achieve its ultimate objective of being able to produce, refine, and market its own oil, it is essential that its nationals should, through actual hard experience, acquire and develop the highly sophisticated skills which are so essential for running the various phases of this industry. Thus, by the time the entire industry reverts back to the state, the cadre required for its continued effective functioning will already be there.

4. *Direct Access to the World Market.*—Under state participation, the government or one of its agencies will be entitled to a share of the oil produced at the same cost at which it is available to the foreign concessionaire. This will no doubt enable the government to enter the world market and gradually establish secure and profitable channels for the disposal of its oil. This will also provide her with direct knowledge of the true conditions in the market and more adequate means of influencing them, particularly with regard to the vital issue of the pricing of crude oil.[5]

5. For further discussion of the subject *see generally* Zakariya, *Sovereignty, State Participation and the Need to Restructure the Existing Petroleum Concession Regime*, X ALBERTA L. REV. 218 (1972); *State Participation in the Petroleum Industry—The Recent Experience of the OPEC Community*, March 22, 1973 (paper presented to the Seminar organized by the Canadian Arctic Resources Committee in Ottawa).

IV. Petroleum Legislation as a Vehicle for Change

At one time or another, particularly during the last three decades, many developing countries began to feel the urgent need to reexamine the existing patterns for the development of their petroleum resources. In most cases, this process resulted in the adoption of petroleum legislation which defined the new policy to be pursued and served as a fresh point of departure. This was usually combined with the creation of a state-owned oil company to serve as an effective instrument for the implementation of the new policy in accordance with the general guidelines laid down in the legislation. Sometimes a model petroleum agreement was also adopted.

Reference has already been made to the pioneering efforts of certain Latin American countries in this regard. One of the earliest and best known petroleum laws in Latin America was enacted in Venezuela on March 3, 1943. Although it fell short of nationalizing existing concessions, it nevertheless represented a substantial reform. It unified and improved terms and set the legal pattern for the future relationship between the Government and the concession companies.[6]

In Iran, the Petroleum Act of 1957 was issued as a policy guideline to be followed by the National Iranian Oil Company (NIOC) in carrying out the tasks delegated to it by the State to search for and extract petroleum throughout the country and the Continental Shelf, excluding the area assigned to the International Consortium under the Agreement of 1954. The Act authorized NIOC to negotiate and conclude non-concessionary oil agreements in which it should retain no less than 30 per cent of the ownership. It also provided that NIOC must ensure that at least one-third of the total exploitable areas under any particular agreement, including agreements pertaining to the Continental Shelf, would be conserved at all times as national reserve.

In August of 1974, a new Petroleum Act was issued in Iran, repealing that of 1957. The new Act lays down more comprehensive guidelines for NIOC, by taking into account the important developments which have occurred during the last two decades, in Iran and elsewhere. While confirming NIOC's exclusive jurisdiction over all aspects of the petroleum industry in Iran, the Act stipulates, however, that the "service contract" is the only type of oil agreement NIOC is permitted to enter into with outsiders. This

6. For further details, see E. Lieuwen, Petroleum in Venezuela, A History (1954).

means that the "joint venture" type of agreement, which was authorized under the old Act, is excluded altogether. This preference for the "service contract" no doubt reflects the recent prevailing trend in both Iran and other major producing countries.

Algeria enacted a new Petroleum Code (No. 71-22 of April 12, 1971) two months after introducing State participation by partial nationalization of the concessions held by French companies. The main features of this important law can be summarized as follows:

1. No foreign person or company may engage in the exploration for and development of hydrocarbons in Algeria without the participation of the national oil company, Sonatrach. Sonatrach *alone* can obtain exploration and production permits from the State (art. 1);
2. If a foreign company is permitted to act as a partner of Sonatrach, then an Algerian company, which is at least 51 per cent owned by Sonatrach, and headquartered in Algiers, must be set up in accordance with Algerian law. Sonatrach will have a voting majority on the board of this joint company (art. 4);
3. With certain exceptions, Sonatrach will act as operator (art. 5);
4. The crude oil produced is to be distributed in the field among the partners in accordance with their share of the venture (art. 6); and
5. Natural gas discovered under any such partnership is *wholly* owned by the State and is not covered by the above arrangements. The foreign partner is not entitled to any share in the gas (art. 7).

More recently, several other developing countries throughout the world have also effected radical changes in their relationships with foreign oil companies or chartered new paths for the future by promulgating new petroleum laws and regulations. By way of illustration one can cite the examples of Colombia, Guatemala, Malaysia, and Uruguay.

V. Some Forms of State Participation in the Search for and Development of Petroleum Resources

A. *Background*

Generally speaking, a joint venture in the petroleum industry is a partnership which, like all other business partnerships, is entered into to pool resources, share burdens, and spread risks. Since its early days over a century ago, the petroleum industry in the United States has witnessed the formation of several types of joint venture, including drilling partnerships, farm-outs, and unitized operations. These joint ventures, motivated mainly by economic and financial considerations, were designed to achieve one or more of the following objectives:

1. To raise sufficient capital;
2. To spread the risks inherent in oil activities over several projects, enabling each partner to undertake several separate ventures;
3. To develop and/or exploit an oil field jointly as a unit rather than individually, thereby decreasing costs and improving efficiency for the benefit of all participants;
4. To avoid unnecessary capital outlay in the provision of downstream facilities such as crude oil pipelines, tanker-loading facilities, refineries, product storage, product handling, and distribution facilities; and
5. To enable companies with existing down-stream facilities to acquire a guaranteed supply of crude oil by buying into fields developed by other companies which either do not have down-stream facilities or a need for all of the crude discovered.[7]

In their world-wide search for new petroleum reserves after the turn of the century, the major oil companies first tried to establish themselves alone, guarding jealously what they deemed to be their exclusive sphere of influence. Subsequently, for reasons that must be well-known by now, they began to give way and to allow others to join them in their operations. This development marked the beginning of the formation of international petroleum consortia. Until the advent of the national oil companies of the oil producing (developing) countries, these consortia took two forms. The first was an international grouping coalition of two or more oil companies with a different home base, such as the Iraq Petroleum Company (IPC), the Kuwait Oil Company (KOC), and the Iran Consortium of 1954. While the motives for setting up this type of consortium were initially political, reflecting the well-known rivalry existing at the time for a share in potential riches of these areas, the economic advantages inherent in such a concerted action can hardly be overestimated. The second form embodied the cooperation of two or more petroleum companies with the same home base, such as the four American majors which set up the Arabian/American Oil Company (ARAMCO) of Saudi Arabia. It is safe to say that purely economic considerations were predominant in the formation of this type of consortium.

The historical and political circumstances under which the great international oil consortia came into being during the years be-

7. Stevens, *Joint Ventures in the International Industry*, 1973 PETROLEUM REVIEW 395.

tween the two world wars have become somewhat muted in recent years. It is now common practice for international oil companies, regardless of their home base, to operate together under the same agreement for purely economic and financial considerations. Of course, one of the best examples of this general trend is found in the North Sea operations.

B. *Joint Ventures Between National and Foreign Oil Companies*

What concerns us here is the recent and more specific type of joint venture, which consists of a partnership between a national oil company and a foreign one with a view to exploring for and exploiting the petroleum resources in the host country. This type represents a practical compromise which has emerged in the post-World War II era to meet two basic needs: that of the host country to exert greater control over its petroleum resources and to obtain greater revenues; and that of some of the non-major companies, the so-called "Late-Comers"—whether state-owned like the Italian ENI or privately owned like the American and Japanese independents—to secure their own crude supply.

As far as the developing countries are concerned, the joint venture system was first introduced into the Middle East in February 1957, in an agreement concluded between the Italian ENI and two Egyptian State companies. A few months later, in August, the national oil company of Iran (NIOC) entered into similar arrangements with ENI. Since that time, several other agreements of the same type have been concluded with companies representing various North American, European, and Japanese interests, not only in Iran and Egypt, but also in other producing countries in the Middle East and Africa.

The advent of the joint venture agreement was an "innovation, if not a revolution" in the pattern of petroleum relationships in the developing countries. Small wonder its emergence met with heated debate and aroused the fierce suspicions of the major concession-holding companies, which saw in it a threat to the traditional balance of relations between themselves and the countries where they were operating. This explains why these major companies, with only one or two minor exceptions, were most reluctant to enter into such a joint venture agreement until very recently, fearing a precedent that might endanger their lucrative concession holdings in the developing countries. It was the relatively smaller companies who actually pioneered this new form of oil agreement. However, after the majors were forced by changed circumstances to concede during recent years to the demands of their host governments for state participation, their old apathy vanished and they joined the band wagon with their smaller competitors in accepting, and even at times proposing, new agreements of a non-concessionary nature.

1. *Percentage of National Participation in the Joint Venture.*—The national share in the joint venture may assume one of three forms. In the first form, minority participation, the national company holds less than 50 per cent of the venture with the rest allocated to the foreign partner. Into this category falls, for example, the Petromin/Auxirap Agreement of 1965 in Saudi Arabia in which the national company owns only a 40 per cent share. It is to be noted that although they provide initially for minority participation, some agreements have given the option to increase the national share up to 50 per cent when production reaches a certain considerable level. This is exemplified by the Petromin/ENI Agreement of 1967 in Saudi Arabia, the Lipetco/Auxirap Agreement of 1968 in Libya, and other agreements which Lipetco concluded later with ENI, Ashland, and Shell. Secondly, the joint venture may assume parity participation. This exists in most agreements concluded so far in the Middle East where the national and the foreign companies own equal shares (50 per cent each) of the venture. Thirdly, the national company may own a major share of the joint venture. Examples of this situation are found in the Sonatrach/Getty Agreement (as renegotiated in 1968) in Algeria, and the KNOC/Hispanoil Agreement of 1967 in Kuwait, in both of which the national company owns 51 per cent of the joint venture as opposed to 49 per cent held by the foreign company. With regard to management control, the joint venture is managed by a board of directors, the composition of which normally reflects the equity holdings of each party. Usually the office of chairman of the board is assigned to a director appointed by the national partner, and that of the managing director is filled by the foreign partner.

The measure of control exercised over the enterprise by the various partners is usually determined by their voting power in the management. This may not be the case under joint ventures involving entities of developing countries. Here the degree of control exercised by each partner in practice may or may not reflect the actual size of his voting power. While the allocation of management seats is no doubt important, in many cases the question of majority or minority representation is essentially symbolic, rather than a reflection of the actual degree of control exercised over the enterprise.[8]

2. *Main Features of the Joint Venture.*—While the objectives of each joint venture are basically the same, the terms and conditions vary somewhat from one agreement to another. What should concern us here is, of course, the general, easily recognizable theme running through all of these terms and conditions, regardless of the percentage of national participation. The main features of this general theme can be seen in the following summary.

Exploration Work.—Exploration plans are to be prepared and implemented either directly by the foreign partner or through the agency of an operating company. Exploration should be to the maximum possible extent and in conformity with good oil field practice, and periodic progress reports should be submitted to the national company. The foreign partner provides the capital at his own risk and is committed to spending an agreed minimum amount of money within a certain number of years, according to a definite work program prescribed in the agreement. If exploration does *not* result in the commercial discovery of oil within a certain period of time, the agreement becomes null and void. The foreign partner is not reimbursed for his expenses. If exploration *does* result in commercial discovery, the national company will have to reimburse the foreign partner for his share of the exploration expenses in accordance with a predetermined procedure. However, under some agreements, such as the EGPC/Philips Agreement of 1963 (Egypt) and the Lipetco/Auxirap Agreement of 1968 (Libya), the national company is actually exempted from bearing any part of the exploration expenses, even in the event of commercial discovery.

Equipment and Technical Expertise.—As already indicated, the rationale behind having a foreign partner in the joint venture is that he has the necessary financial resources and technical expertise. Accordingly, the foreign partner must provide, initially at least, both of these requirements. This explains why the technical management of the joint venture at the outset is normally entrusted to experts appointed by the foreign partner.

Marketing Obligations.—In addition to marketing his own share of the oil, the foreign partner also undertakes to market part or all of the share of the national entity, if the latter so wishes. Prefera-

8. W. FRIEDMAN & J. BEGUIN, JOINT INTERNATIONAL BUSINESS VENTURES IN DEVELOPING COUNTRIES, CASE STUDIES AND ANALYSIS OF RECENT TRENDS 15 (1971) [hereinafter cited as FRIEDMAN & BEGUIN].

bly, this is accomplished through the partner's own marketing channels, if any, in either his own home country or elsewhere.

Duration.—The joint venture normally runs for a period of twenty-five to thirty years, renewable for a further period of about half of the original duration. This is substantially shorter than under the traditional concession regime. The effective date of the joint venture can either be the date of the beginning of commercial production, which tends to make the term of the agreement run separately for each field in which commercial oil has been found (as in Iran), or the date on which the agreement was signed, or the Law of Authorization published in the Official Gazette, which would make the duration the same for all fields regardless of the date of commercial discovery (as in Egypt). In renewing the agreement, a stipulation has sometimes been made (as in Iran) for the amendment of the original contract to incorporate the improved terms that the national oil company might subsequently obtain under similar agreements with other partners.

Relinquishment of Area.—The joint venture is subject to a relinquishment program so that after a predetermined period of time the joint venture will be left only with areas where commercially exploitable deposits have been discovered.

Profit Sharing and Royalty.—The fifty-fifty formula for splitting the profit, which was already in operation under the concession regime when these joint venture agreements were first introduced in the late 1950's, applies also under the joint venture system. The total revenue accruing to the host country, however, rises to at least 75 per cent of the total profits (50 per cent of the profits going to the national oil company as an equal partner, plus 50 per cent income tax on the foreign partner's share). Although the principle of equal profit sharing has remained the same in theory, it applies twice in practice. In addition, some of the agreements have also provided for the payment of royalty, which may be between 12.5 per cent and 20 per cent of oil produced, in cash or in kind. Some agreements have provided also for the payment of rent. A special feature to which attention should be drawn here is the one stipulated under the renogotiated Getty Agreement of 1968 in Algeria, whereby Getty undertook to reinvest 75 per cent of the profits of the sale of oil under the agreement in Algeria.

3. *Legal Structuring of the Joint Venture.*—Once the exploration carried out by the foreign company results in commercial discovery, the joint venture becomes effective and the subsequent phases of the development and production cease to be the sole responsibility of the foreign partner, becoming instead the responsibility of the joint venture. Within this general framework, the

form and purpose of each individual joint venture differs under the various agreements. Generally speaking, there are two basic kinds of association. One is that adopted in the joint venture agreements concluded with ENI in both Iran and Egypt. This might be termed the Italian approach. The other is that adopted in the Sonatrach/ Getty Agreement of 1968 in Algeria and also in the agreements concluded with the American companies PAN AM and Philips in both Iran and Egypt. This might be termed the American approach.

The Italian Approach: The Equity Joint Venture.—Under this approach,[9] which is characterized by closer partnership ties, the joint venture is a separate legal entity in the form of a joint stock company established under the local laws of the host country to conduct, as a corporate body, all aspects of the operations, including the marketing of oil. This joint stock company, such as SIRIP created in Iran under the NIOC/AGIP Agreement of August 8, 1957, is owned equally by the national and foreign companies and is charged with the duties of exploration, production, and marketing. At times its activities may even extend to the refining and petrochemical industry. It is essentially a profit-making company, paying taxes and royalties directly to the government, owning its own equipment, machinery, and other material assets. It draws up its own policy independently, and it is not a mere agent of the two partners together or separately. The composition of its board is likewise equally divided, with the chairman named by the national company and the vice-chairman or general manager naned by the foreign company. At the end of the exploration stage, during which the foreign company is alone financially responsible, and after the commercial discovery of oil, the joint stock company enjoys financial independence and it is free to borrow whatever additional funds are needed for its operations. As already indicated, the net profit of the joint stock company is shared, after the payment of income tax, by the national and foreign partners in equal parts, or according to their share in the equity of the enterprise in the case of non-parity partnership.

The American Approach: The Contractual Joint Venture.—Under this approach, the joint venture does not assume a separate legal identity. Instead, an operating company, which is non-profit making in nature and registered under the local laws of

9. This is also known as "mixed organizations," a term used, for example, in the Iranian Petroleum Act of 1957.

the host country, is created to act as an agent for both the foreign and national oil companies. Its capital is contributed on an equal basis. This company is solely responsible for production and the oil produced is handed over in kind to each of the partners in equal shares. As to the management, half of the members of the board of the operating company, including the chairman, are nominated by the national company and the other half, including the vice-chairman, are nominated by the foreign partner. The operating company is created mainly to take care of management and accounting, and it does not own any equipment, machinery, or other property obtained for the production, and makes no decisions independently. All funds required for the operations are supplied by the foreign and national companies on an equal basis. However, under certain agreements, NIOC/PAN AM for example, if a partner is unable to provide these funds, the operating company may seek an alternative source by raising a loan or by any other method agreed upon by the two partners. The relationship between the foreign and national companies has come to be known as a "joint structure" with no separate legal personality. Because it lacks legal personality, the two partners have a common right and undivided interest, in accordance with their share in the venture, in all property, equipment, machinery, and other assets obtained for the joint venture. The oil produced is not owned by the joint structure but by the partners directly. Consequently, the joint structure does not entail any tax obligation. The national and foreign partners are separately subjected to taxation and have to draw up separate balance sheets.

The provisions regarding the date for setting up the operating company under this arrangement and for defining the nature of its activities are, however, not uniform. Under certain agreements, in Iran for example, the company is to be organized and registered, to act first as an agent of the foreign company alone for the purpose of carrying out the exploration work, which is its sole responsibility. After the commercial discovery of oil, the operating company naturally assumes the role of agent for both the national and foreign companies. Under other agreements, the operating company is to be established only upon commercial discovery of oil and within thirty days thereof. Under this arrangement, the foreign company assumes the exploration work directly, since the operating company will not come into being unless oil is discovered in commercial quantities.

The reason this form of business cooperation has been preferred by the American oil companies is that under United States tax laws, American companies investing abroad may obtain considerable fiscal advantages if they can prove to the tax authorities that they have direct ownership of their part of the production. When proof of direct ownership is established, the American company is entitled to deduct certain intangible expenses from the taxable account in the year of occurrence. Moreover, the company is also entitled to the depletion allowance, which supposedly is a form of fiscal compensation for the depletion of deposits each year. The depletion allowance represents a deduction of 27.5 per cent (reduced a few years ago to 22 per cent) from the gross income of the company in the United States, provided such deduction does not exceed 50 per cent of net income.[10]

C. *The Service Contract Agreements*

1. *Introduction.*—Under this system, the state retains, normally through its national oil company, ownership of the oil discovered and jurisdiction over its subsequent exploitation. However, the state entrusts the actual search for, development, and at times even the marketing of, the oil to a foreign firm capable of providing the needed risk capital and technical expertise. The service contract may assume, rather confusingly at times, different forms for petroleum exploration and development. Not only do they have different names, such as the service contract, work contract, operations contract, association contract, production-sharing contract, etc., but they may also differ somewhat in their underlying concepts and procedures, as will be shown below.

Normally, the service contract covers a wide range of various stages of the industry, from the geophysical survey all the way to the refining and marketing of crude oil. However, the service contract can also be utilized on a restricted basis to accomplish one particular task, such as geophysical work, drilling operations, or any other individual work which the national oil company may deem advisable to entrust to a well-qualified outside firm. This type of *ad hoc* work contract may be entered into even when there is a complete state monopoly over petroleum resources.

As a result of their deep dissatisfaction with the concession regime and their concern for establishing more effective control, several developing countries have recently opted for this type of petro-

10. FRIEDMAN & BEGUIN, *supra* note 8, at 42. It is to be recalled that early this year, the United States Congress abolished the depletion allowance as far as the major oil companies are concerned.

leum agreement. Indonesia, for example, pioneered the agreement in the mid 1960's after she had abolished the concession regime a few years earlier. In Latin America, Venezuela has made it clear for many years that it will not grant any new petroleum rights to outsiders except in the form of a service contract. Peru, after nationalizing its major concession-holding company in 1969, declared its willingness to conclude petroleum agreements with newcomers on the basis of the production sharing contract, and has since concluded several such contracts with numerous oil companies. Colombia recently cancelled the existing concessions and declared its readiness to convert the abolished concessions into association or service contracts.[11] Last June, Uruguay concluded its first service contract for offshore exploration in the Atlantic with Standard of California (SOCAL).[12] Presently, several other Latin American countries, Costa Rica, Guatemala, and the Dominican Republic among them, are actively contemplating the adoption of the service contract for their new and more serious drive to search for petroleum deposits within their territories. Elsewhere in the Middle East, North Africa, and Southeast Asia, the service contract system has been widely used in recent years (*e.g.*, Iran, Iraq, Egypt, Libya, Syria, Malaysia, the Philippines, Bangladesh, and others).

2. *The Common Main Features of the Service Contract.*—The main features of the service contract which distinguish it from the concession system and from other forms of state participation, such as the joint venture, are summarized below. As already indicated, the service contract agreements, while containing basically the same principles, differ in practice in some respects. The main difference, however, lies in the manner in which the foreign contractor obtains his reward under the contract. If the reward is the guaranteed purchase by him of a certain percentage of the annual production at a special favorable price (and treating the costs as a loan to be repaid by the national oil company with or without interest), the arrangement is usually known by the general term "service contract." If the reward consists of allowing the contractor a certain free share of the annual production (after recovery of costs), the arrangement is usually known as a "production-sharing contract." The following is a brief review of the main features of both variations.

11. OIL AND GAS JOURNAL, May 5, 1975 [hereinafter cited as JOURNAL].

12. PETROLEUM INTELLIGENCE WEEKLY, Sept. 1, 1975, at 8 [hereinafter cited as P.I.W.].

The Service Contract: Guaranteed Purchase of Crude Oil.—The review here is primarily based on the twin agreements concluded by the French State-owned company (ERAP) with the national oil companies of Iran (NIOC) and Iraq (INOC) in 1966 and 1968 respectively. Although the general theme of both agreements is virtually identical, there are in fact certain variations which will be indicated at the appropriate place.

The national oil company is by law the sole titular holder of the area under agreement. All petroleum deposits and oil and/or gas produced are the property of the national oil company at the well head. The foreign company, either directly or through a subsidiary, acts as general contractor for the national oil company, and as such carries out, in the name and on behalf of the latter, all operations necessary for the exploration and development of oil deposits. Thus, the contractor is not a concession holder or partner, but merely a hired agent. The foreign contractor is solely responsible for providing all the necessary funds at his own risk. In practice, this means that unless oil is found in commercial quantities, the foreign contractor will not be reimbursed for the expenses he has incurred in his unsuccessful search for oil. However, if oil is found, the cost incurred up to the time of discovery will be considered as a loan to be debited to the national oil company's account. The loan will be repaid in the form of crude oil, after the start of the commercial production. The terms of the loan are fifteen years, *without* interest. Thereafter, the development expenses will also be considered as a loan, but *with* interest to be repaid to the contractor over a shorter period. Once oil is produced, the contractor undertakes to act as an agent for the national company and markets its oil abroad if the latter so wishes in return for a certain nominal commission. The contractor has the right to retain a certain percentage of the sale proceeds in repayment of the loans that he advanced during the exploration and development stages. Fifty per cent of the oil discovered by the contractor is to be set aside as a national reserve. The contractor is entitled, as a reward for his services, to a guaranteed purchase of a certain amount of the oil produced under the contract (35-40 per cent in Iran and 30 per cent in Iraq) at an agreed "discounted" price. The contractor is not subject to any income tax in the producing country since his activities are regarded as nonprofit. Under the Iraqi Agreement, however, the contractor has to pay a royalty of 13.5 per cent based on the posted price, and undertakes to pay, within a prescribed time after the commercial discovery of oil, a bonus totaling U.S. $15 million. Five years after the start of production, the entire management of the venture may be taken over by the national oil company. The duration of the contract is eight to nine years in Iran and six years in Iraq for exploration, and twenty-five years in Iran and twenty years in Iraq for production. In addition to the above, comprehensive provisions regarding relinquishment of the assigned area, minimum work and investment programs, rate of production, and many others are included in both contracts.

Production-Sharing Contract.—Since the mid-sixties, Indonesia has pioneered this type of oil agreement. Petroleum activities were previously carried out under the conventional concession regime. In 1960, Indonesia decided to abolish that regime and to replace it with a new arrangement under which the foreign operator would act merely as a contractor for the national oil company, Petramina. Within a few years, this new arrangement evolved into what has become known as the "production-sharing agreement." Under this agreement, the foreign operator acts as a contractor and risk bearing investor, but the management of the enterprise, in principle at least, is in the hands of the national oil company. In the event of commercial discovery, the foreign contractor recovers his exploration and running costs and amortizes his capital expenditure (the capital equipment then becoming Petramina's property) against a maximum of 40 per cent of the crude output in any one year, handed over to him and freely exportable. This 40 per cent is, however, strictly a maximum; not only is the foreign contractor limited in cost recovery to the value of this amount in any one year (though he can carry forward excess cost in the succeeding year(s)), but once the capital costs of exploration and development have been fully recovered he will receive less than the 40 per cent. The remaining 60 per cent (or possibly more) of the crude output is usually divided at the rate of 65-67.5 per cent to Petramina and 35-32.5 per cent to the contractor, the latter allotment being in effect the fee or reward. Normally, the contractor will market not only his own share but also Petramina's, if the latter so wishes. While the contractor is usually made subject to the income tax laws of Indonesia, Petramina undertakes to pay such taxes on his behalf. Title to equipment purchased by the contractor vests in Petramina when the equipment is landed in Indonesia. Title to the contractor's share of oil (including the portion to be sold to recover costs) passes to the contractor at the point of export.[13]

13. For further details, see the text of the typical Indonesian production-sharing contract published in O.P.E.C.: SELECTED DOCUMENTS OF THE INTERNATIONAL PETROLEUM INDUSTRY 81-105 (1968).

3. *Recent Readjustments of the Terms of the Service Contract.*—The foregoing review represents the highlights of the service contract regime as it prevailed until 1973. The recent sudden and substantial increase in the price of crude oil, however, led some of the producing countries to reexamine some of the premises upon which their relationship with foreign contractors had been determined. On the one hand, there was a need to curtail the excessively high profits some contractors were reaping due to the new situation. On the other hand, this new situation enabled those developing countries to demand stiffer terms from prospective new contractors.

Some producers introduced special measures to restore the balance of benefits to the realistic and equitable level which had been radically undermined as a result of the unforeseen price increase. For example, in 1974 Indonesia enacted a special excess profit tax by which it was able to recoup most of the unforeseen excessive profits which the foreign contractors of Petramina were making. In negotiating a new service contract (including, of course, the production-sharing variant), some developing countries seized the opportunity presented to them by the new circumstances to demand and obtain more favorable terms from newcomers. In early 1974, Iran set certain tough terms for foreign companies which were invited to bid for open onshore and offshore acreage in that country. Two agreements were concluded, with CFP of France and Deminex of Germany, under which the two companies agreed to pay a signature bonus ($6 million by CFP and $32 million by Deminex) and undertook to spend a minimum of $40 million and $65 million respectively on exploration over a five year period. They both also agreed to pay production bonuses. What should be of particular significance in these two contracts is the reward assigned to the two European contracting companies. In return for their services and risks, the only reward they can aspire to is the privilege of purchasing a certain amount of annual production (between 35-40 per cent) for a fifteen year period at a certain discount (ranging only between 3 to 5 per cent off "market price"). In both agreements the exploration expenditures are entirely the sole risk of the contractors. But after the discovery of oil, they can recover their exploration and development expenditures over an agreed period of time.[14]

14. THE MIDDLE EAST ECONOMIC SURVEY, Aug. 2, 1974, at 4 [hereinafter cited as M.E.E.S.].

Recently, in Libya, several new production-sharing contracts with both major and independent oil companies were concluded. Under the agreement with Mobil, for example, an important innovation was introduced; exploration expenditure is not only borne by the foreign company alone, but is nonrecoverable even if petroleum is discovered in commercial quantities. In the event of such a discovery, production will be divided 85 per cent to the government and 15 per cent to Mobil in the onshore area (the ratio will change to 81-19 for the offshore area). Mobil, of course, is not liable to pay any royalty or income tax. Another important innovation was that regarding the treatment of development expenditure. As to commercial discoveries on the onshore blocks, the Libyan government will advance Mobil 85 per cent of the development costs. This advance is to be paid back to the government with interest in twenty annual installments, either from the time 80 million/bbl have been produced and exported or three years after production has commenced, whichever is sooner. As to commercial discoveries, on the offshore blocks, the government will advance Mobil 30 per cent of the development costs, interest free, and a further 20 per cent with interest, to be repaid under the same terms that are applicable to the onshore area.[15]

Since early 1974, Indonesia has concluded several new production-sharing contracts with such foreign companies as Cartex, Katey Industries of Illinois, Phillips-Tenneco, and others. Under the Phillips-Tenneco contract, for example, the cost recovery will be allowed from only 35 per cent of production instead of the usual 40 per cent. The remaining output will be split 72.5-27.5 per cent in favor of Petramina up to 50,000 b/d, 77.5-22.5 per cent between 50,000 and 150,000 b/d, and 80-20 per cent for output over 150,000 b/d. The contract includes a stipulation for the recovery of excess profit already negotiated with existing operators in Indonesia. Phillips-Tenneco agreed to pay Petramina a percentage, which escalates with the production of all revenues from their share of production over a current base of $5.83/bbl. Petramina is to get 85 per cent of the excess revenue of the first 150,000 b/d of shared crude, 90 per cent on the next 100,000 b/d, and 95 per cent over 250,000 b/d.[16]

4. *Epilogue.*—Before concluding this review of the non-concessionary agreements, it is both interesting and revealing to

15. M.E.E.S., April 26, 1974, at 4; April 19, 1974, at 7.
16. P.I.W., March 31, 1975. 10; JOURNAL, March 31, 1975.

note that cooperation among the developing countries themselves in the field of exploration for, and development of, petroleum resources has assumed in most cases one of the forms just discussed. This further attests to both the adequacy and fairness of these new arrangements. Initially, certain developing countries, which were in a position to engage in this type of activity, acted together with international oil companies as joint partners with the national oil companies of other developing countries. This is illustrated, for example, by the offshore joint venture agreement concluded in 1965 between the Iranian National Oil Company (NIOC) and the Indian Oil and Natural Gas Commission (ONGC) in collaboration with AGIP of Italy and Phillips of the United States.

More recently, the national agencies of developing countries have been able to make direct and exclusive deals on their own. Thus Braspetro, the international arm of the Brazilian Petrobras, has entered into a service contract agreement with the Iraqi National Oil Company (INOC) covering three different areas in Iraq. At about the same time, Braspetro concluded a joint venture agreement with the State-owned Egyptian petroleum organization. The Indian Oil and Natural Gas Commission also entered into a service contract agreement in April 1973 with the Iraqi National Oil Company with regard to searching for and developing petroleum deposits in southern Iraq. In Latin America, the most recent example has been the joint venture agreement concluded early this year between Uruguay's State-owned ANCAP and its Argentinian counterpart, YPF, for the exploration and development of petroleum in the Rio Santa Cecilia sedimentary basin onshore.

VI. More Recent Developments

A. *Complete Liquidation of the Concession Regime—Nationalization by Mutual Consent*

The drive for state participation in existing petroleum concessions that became a reality in the early seventies has continued unabated, gathered momentum, and lately assumed wider dimensions, culminating on occasion in complete national control. As a result, the role of the international oil companies, which was that of an "autocrat" under the traditional concessions and subsequently was transformed to that of a "partner" under state participation, has finally been reduced to the more modest and realistic one of a mere provider of technical services and of a long-term buyer of crude oil. In some countries, this was accomplished by circumventing the stage of partial acquisition and opting directly for complete take over, either through a unilateral act of nationalization, as in the case of Algeria in 1971 and Iraq in 1972 and 1975, or by negotiation with the concessionaires, as in Iran and Venezuela. In others, state participation was first obtained, but the process evolved much faster than was initially envisaged, and also brought about, through mutual agreement, complete national control over the industry. This was the case in Kuwait, and also the case in Saudi Arabia, which declared early in 1974 its intention to take over the remaining 40 per cent of ARAMCO.[17]

Because of the relative novelty of this process of "negotiated nationalization," which lacks the often dramatic or dramatized overtones normally associated with traditional nationalization as a unilateral exercise of a sovereign right, the matter merits discussion in some detail. First of all, one must highlight the fact that without the considerable improvement in the bargaining position of the producer governments in the last few years and the ensuing shift of the balance of power, such a step would have been almost inconceivable. The concession-holding companies would have predictably invoked the "sound and fury" of the sanctity of contracts, refusing to yield to the demands of their host governments without at least exacting an enormous and perhaps prohibitive price. But the recent shift in the balance of power has made the traditional position of the international oil companies untenable, and undoubtedly explains the realism, docility, and cooperative spirit which they have displayed of late. Clearly, they have had no other choice. Besides, the new deals have not been totally negative as far as the companies are concerned. They have not only been offered fair compensation benefits, but more importantly, have also been guaranteed a continuing, albeit much reduced, role as providers of technical services and purchasers of a secure supply of crude oil. Thus a positive and more realistic relationship has emerged to the mutual benefit of the two parties.

1. *Venezuela and Kuwait.*—By way of illustration, let us review the two most recent cases of "negotiated nationalization," those of Venezuela and Kuwait. Both of these took effect toward the end of 1975. As is perhaps well-known, most of the oil concessions in Venezuela were destined to expire in the early 1980's. Probably for that reason, she never showed much interest in state

17. M.E.E.S., Jan. 30, 1976, at 1 (quoting the Saudi Deputy Minister of Petroleum and Mineral Resources, reporting that the Saudi takeover of ARAMCO is imminent).

participation, unlike several other OPEC countries whose concessions were destined to expire many years later. In fact, Venezuela seemed at first reconciled to the idea of leaving the existing structure undisturbed until the concessions reached their predetermined end. This is evidenced, for example, by the fact that she actually enacted a new law, the Petroleum Reversion Act of July 1971, which was designed to regulate the eventual takeover of the concessions in an orderly and fruitful manner. Under the impact of recent unforeseen circumstances, however, Venezuela began to have second thoughts about the continued wisdom of that policy. Eventually, she decided to accelerate the process and advance the date of full take over by nearly a decade. After prolonged negotiations with the concession-holding companies and after lengthy debate, both within the Venezuelan Congress and without, a law effecting complete take over of the oil industry was enacted and signed on August 29, 1975. It is interesting to note that article V of this law reserves the right to the State, directly or through one of its entities, to enter into association agreements with private companies should it prove necessary to carry out one or more of the oil activities in the nationalized fields. But in order to do so, prior authorization by both congressional houses, acting in joint sessions, is required.[18]

In Kuwait, the concession granted to the Kuwait Oil Company (British Petroleum and Gulf Oil Corporation) back in 1934 was not destined to expire until the year 2023, some ninety years later. Along with several other OPEC countries, Kuwait sought first to acquire a measure of state participation in its sole major concession. However, the Kuwait National Assembly refused to ratify the minority participation (25 per cent) reached under the New York Agreement of October 1972,[19] not only because the majority

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18. The original text of this article which allowed foreign oil companies to work under contract was subject to a serious controversy. The Government argued that Venezuela did not yet have sufficient expertise to handle its mammoth industry or market all its crude. The opposition party argued that the original text tended to give foreign operators too much leeway and that it would contradict the principle of national control. Although the ruling party had enough votes to pass the original text of article V, it preferred not to make it law on a straight party line vote. Consequently, a compromise was reached to the satisfaction of all concerned.

19. This was the agreement reached between the representative of the five Arab states bordering on the Gulf seeking equity participation and the team of three top executives representing the major concession-holding companies in the Middle East.

thought that the rate was inadequate, but also because of the objection to the compensation criterion adopted in that Agreement. Eventually, the Government succeeded in obtaining and ratifying 60 per cent participation with payment based on the "net book value" of existing assets, instead of the so-called "updated book value" which figured in the New York Agreement. Again due to changed circumstances, Kuwait announced early in 1975 its intention to accelerate the process and establish full control much sooner than originally envisaged. After prolonged negotiations, which almost collapsed in October, 1975, an agreement was signed on December 1, 1975, by which BP and Gulf Oil agreed to surrender to the State their remaining 40 per cent share in the original concession.

It is of course beyond the limited scope of this general review to deal in detail with all the various aspects of these two important developments.[20] A brief survey of the common main features is, however, in order. A state-owned national entity (an existing one, KNPC, in the case of Kuwait, and a newly created one, Petrovin, in the case of Venezuela) will henceforth direct all oil operations within each country and be responsible for all new investments. However, technical services of the "divested" foreign companies may be sought to assure smooth transition in return for specified commercial fees. Most of the oil produced under the new regime will continue to flow through the previously established channels, since the companies undertook in both cases to purchase during the coming few years a substantial amount of the annual output. These sale contracts may be extended for a further period of time.[21]

20. For the full text (in English) of the Venezuelan law, and a commentary thereon, *see* P.I.W., Sept. 8, 1975, Special Supp. For the full text of the Kuwait/BR Gulf Agreement and a commentary thereon, *see* M.E.E.S., Dec. 5, 1975, Supp.

21. In Kuwait, for example, the two divested companies undertook to buy 950,000 b/d of Kuwait oil at a rate of 500,000 b/d for Gulf and 450,000 b/d for BP over a five-year period ending in 1980 with the possibility of extension for a further 5 years at a minimum of 800,000 b/d (400,000 b/d each). It is to be remembered that the guaranteed oil supply to the companies is pragmatically aimed at satisfying two complementary needs: (1) that of the producing countries whose national oil companies are still facing difficulties in their marketing operations and consequently might not be able, in the near future, to dispose of all their oil directly in the world market; and, (2) that of the international companies to continue to meet their well-established commitments as world refiners and marketers, through their own integrated operations and/or long-term sales to others.

The price of oil to be purchased will be determined periodically by the government. Thus, in Kuwait the companies will have to pay the so-called "notified price," which means the f.o.b. price per barrel established by the Government and communicated to would-be purchasers—less 15 cents a barrel.[22] The divested companies are compensated for their property on the basis of "net book value," which usually means the acquisition value less accumulated depreciation and amortization as shown on the books for income tax purposes. In Kuwait, the compensation was fixed in the agreement at a one-time payment of $50.5 million. In Venezuela, the law of August 1975 provided for an elaborate legal procedure and timetable for the payment of compensation (articles 12-17). The law also provided that compensation can be deferred for a specified period of time not exceeding ten years, or it can be made in Government bonds at no more than 6 per cent annual interest. It is interesting to note that, with only one exception (Occidental Oil Company), all the divested companies decided to accept the amounts offered by the Government as compensation and did not contest the awards before the Venezuelan Supreme Court, which by law they were entitled to do.

2. *Scope of Take Over—Non-Concessionary Agreement Not Affected.*—It is worth noting here that the trend toward complete national control and the recent measures taken to that effect have been uniformly confined to the major concessions only.[23] None of these measures has affected in any way the several existing non-concessionary agreements (*i.e.* joint venture or service contracts) that have been concluded in Algeria, Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela. The reason for this can be readily understood. First of all, the main concessions were not only the oldest, but commanded by far the largest reserves from which over 90 per cent of the annual output in each of these countries is still derived. The nonconcessionary agreements, concluded much later, have existed merely as small satellites on the periphery of the main concessions. Secondly, in these latter agreements, particularly those of the service contract type wherein the foreign contractor acts merely as an agent of the national oil company, the state has already established, in theory at least, its unimpeded sovereign

22. This compares with a margin of about 22 cents before the takeover agreement, with the now standard 60 days credit. M.E.E.S., Dec. 5, 1975, Supp.

23. In Kuwait, however, there are still two smaller concessions—that of Aminoil Co. and Arab Oil Co. of Japan—which have been left alone. No action appears to be contemplated for their immediate takeover.

control. It can be said safely, therefore, that the continuation of these nonconcessionary agreements does not essentially contradict the overall national aims, but fits comfortably within the new scheme. This is so notwithstanding the state's occasional dissatisfaction with the application of one or more of the terms (especially the fiscal ones) of any such agreement because of changed circumstances. But, as shown above, this can easily be rectified through mutually agreed revisions or by state action without affecting the general structure, which is basically sensible and sound.

B. *Relaxation of State Monopoly*

It is evident from the preceding discussion that the general trend among the oil producers of the developing world, particularly those within OPEC, has been toward the increasing assertion of national control over the petroleum industry. Meanwhile, a new move among certain other developing countries has emerged—a move toward the relaxation of the rule of state monopoly, with its underlying injunction against foreign private capital, which these countries managed to establish sometime ago. On the face of it, this move might seem to the uninitiated as heading in the opposite direction from the main trend. It is erroneous, however, to interpret it as a retreat from, or relinquishment of, effective state control, or a turning back of the clock to the old concession regime. In fact, it is nothing more than an attempt, under the impact of recent world-wide events, to supplement the national effort in the search for and development of whatever further petroleum deposits might exist, particularly in far more challenging and costly areas such as the deep seabed. After the recent sharp increase in the price of oil, it is only natural that those who have been negatively affected should try to cope with mounting balance-of-payment deficits by desperately trying to intensify and accelerate the pace of exploration.[24] Countries like Brazil, India, Burma, Syria, and Sri Lanka have come to realize, through their own bitter experience, that it does not detract from the principle of sovereignty over natural resources to engage the services of outsiders and to utilize their enormous financial risk capital and sophisticated technologies. Outside services will be engaged provided, of course, that they are strictly on a "contractual" basis, to be carried out within the confines of a national plan in collaboration with, and under the direc-

24. At present, Brazil, for example, produces about 200,000 b/d and consumed 835,000 b/d in 1975. JOURNAL, Nov. 3, 1975.

tion of, state agencies.

As indicated previously, some of the developing countries, both within OPEC and without, not only did this in the past, but seem intent on continuing the practice in spite of their unmistaken quest for full national control. Even a socialist nation like the Soviet Union, the biggest oil producer in the world, found no wrong or embarrassment in engaging Japanese financial and technical assistance to develop some of her petroleum resources in the eastern part of Siberia.[25]

One can give a few examples to illustrate this new move. Brazil, which established a state oil monopoly as far back as 1938, decided last October to allow foreign participation in exploration activities for the first time, under risk-bearing contracts with the State oil entity, Petrobras. Petrobras was set up in 1953 to exercise the monopoly in every aspect in which private companies have been engaged except marketing. Although Petrobras has had several work contracts with foreign companies for drilling and equipment, it has never permitted foreigners to explore for, or develop and produce oil. The new exploration contracts announced in January 1976 will cover areas that are beyond Petrobras' own technical reach, such as offshore areas over 400 feet deep or the flood waters of the Amazon. The contracts will be modeled after the Indonesian/Peruvian production-sharing formula, with exploration costs recoverable in oil or cash if commercial production is established. Contractors will be required to sell their share of production locally until domestic demand is met. They may then export any available excess.[26]

Syria is yet another developing country which decided a year ago to relax its injunction against the participation of foreign private capital in the development of its petroleum resources. According

25. It is reported that the Japanese consortium Sakhalin Oil Development Corporation Co. (SODECO), signed a deal with the Soviet Government to provide $152.5 million ($100 million of which is a risk credit, 70% of which is to be provided by the Export-Import Bank of Japan), for exploration offshore Sakhalin Island over a five-year period. Japan is to get 50% of any oil produced at a certain discount from prevailing prices during repayment of the loan. A U.S. seismic ship will be used, manned by a Soviet exploration crew, with five to seven non-Soviet personnel to be permitted on the ship as consultants when necessary. Gulf Oil, which will acquire a 10% interest in SODECO, (and will also be liable for 10% of the outstanding $30 million on the risk credit), is likely to provide the ship. JOURNAL, Nov. 3, 1975. PETROLEUM TIMES, Oct. 31, 1975, at 3; P.I.W., Oct. 27, 1975, at 8.

26. For further details, *see* P.I.W., Oct. 20, 1975, at 6; THE PETROLEUM ECONOMIST, Nov. 1975; JOURNAL, Oct. 20, 1975; Nov. 3, 1975; Jan. 19, 1976.

to a recent authoritative report, Syria has some 75,000 sq. kms. of promising oil acreage of which only 500 sq. kms. have been covered, with the help of Soviet and Algerian experts and French research organizations, by the state-owned Syrian oil company during the past ten years. In view of the urgent need for oil revenues for economic development, Syria has decided to pursue a "dual approach" to speed up the development of its oil resources. It has set aside 25,000 sq. kms. in which the national oil company will concentrate its maximum efforts during the coming five year period. It has opened the remaining 50,000 sq. kms. to offers for service contracts from international firms. The latter approach has already resulted in the conclusion of agreements with Rompetrol of Romania, Chemokomplex of Hungary, and the American TRIPCO group. Talks are still being conducted with others on similar agreements.[27]

Likewise India, whose Oil and Natural Gas Commission (ONGC) has had a virtual monopoly over exploration activities,[28] decided late in 1973 to allow foreign companies to obtain service contracts for offshore areas. In mid 1974, ONGC concluded two production-sharing contracts with two groups of foreign companies.[29] Under these contracts, which basically contain the same terms as those of the Indonesian type, a novel and more favorable feature was introduced. The contractor is obligated to turn over to India 75 per cent of his equity oil or the proceeds therefrom once he has recovered his exploration and development costs three times over.[30] Most recently, Sri Lanka, where the state-owned Ceylon Petroleum Company (CPC) has had a monopoly over oil exploration since 1970, decided to open all of its continental shelf for production-sharing contracts. The first contract was recently awarded,[31] and others are being negotiated.

27. M.E.E.S., Nov. 28, 1975, at 12 (citing a news agency interview with the Syrian Deputy Premier for Economic Affairs).

28. O.N.G.S.'s activities have recently led to some important discoveries, notably the offshore "Bombay High" discovery in 1974.

29. The first group was headed by Natomas Company and the other by Reading and Rates.

30. P.I.W., June 3, 1974, at 10; May 20, 1974, at 9.

31. Under this contract which went to Ceyoil Corp., a subsidiary of Pexamin Pacific Inc. of Houston, the contractor would recover costs from 30% of annual output and split the remainder 80-20 in Sri Lanka's favor on the first 75,000 b/d of production. The split would rise to 92.5% for Sri Lanka on production over 300,000 b/d. JOURNAL, Jan. 26, 1976.

VII. CONCLUSION

In the preceding pages, an attempt was made to review the fundamental change that has occurred in the legal relationship between some of the developing countries and the international oil companies, and the new directions this relationship has assumed in recent years. While the general tendency has been toward the reassertion of state sovereignty over petroleum resources by abolishing or phasing out the traditional concession regime, the door has nevertheless been kept open for further cooperation on a more equitable and harmonious basis. One of the factors which helped bring this transformation to a fruitful, albeit belated, conclusion was the example of the new type of oil agreements pioneered since the mid 1950's primarily by the European state-owned companies and some of the American independents, in collaboration with the national oil companies of some developing countries. These new types of agreement, which basically involve a true partnership, represent a satisfactory compromise between two fundamental needs: that of the developing countries to exercise full control over their resources, both from within and from without, and that of the developing countries to attract outside assistance in the form of large risk capital and sophisticated technical expertise and equipment, which are necessary in the search for and development of these resources.

Even though the terms of these new types of agreement were, at the outset, more favorable both in their tangible and intangible aspects to the developing countries concerned, they have not remained static. Because of changed circumstances and the improved bargaining position of the oil producers among the developing countries, these producers have been able to require and receive not only better terms from new operators, but also rectification of disparities as they arise whenever unforeseen conditions disrupt the old balance envisaged under the original agreements. Once again, this confirms in practice the validity of the doctrine that contractual arrangements can be revised and readjusted in the light of changed circumstances.[32]

Until very recently, the major oil companies were, by and large, adamantly opposed to entering into any agreements except those

32. *See* Zakariya, *Impact of Changing Circumstances on the Revision of Petroleum Contracts*, in INTERNATIONAL OIL AND ENERGY POLICIES OF THE PRODUCING AND CONSUMING COUNTRIES 299-316 (a collection of papers presented at the OPEC Seminar in Vienna, July 1969). *See also* Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT'L & COMP. L.Q. 73 (1974).

of a purely concessionary nature. The reason for their refusal has all but disappeared as their large concessions have been recently abolished altogether or phased out through the application of state participation. The majors now appear to be just as prepared, indeed as eager, as their minor colleagues on the international scene to operate as business partners, contractors, or mere providers of technical services to (and long-term buyers of oil from) the national oil companies of the developing countries. Needless to say, this augurs well for all concerned. There is no doubt that genuine cooperation between the developing countries and those who have the professional expertise and financial means to assist these countries in the exploration for and development of petroleum resources is not only in their mutual enlightened interest, but is also to the advantage of the entire world community.