Recent Evolutions of Legal Techniques in oil Exploration agreements

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Oil was known to mankind since immemorial times. as Books of history recalls that the Babylonians used oil as mortar, the Bysantines as Greek fire, and the Red Indians as war paints. By the eighteenth century the French began using oil as a lubricant, and by the middle of the nineteenth it became the main source of fuel for oil lamps which lightened the streets of the main cities in Europe and the U.S. But oil wasn't explored in a scientific commercial way until 1854 when a pioneer called Edwin L. Drake working on behalf of George H. Bissel bought a farm near Titusville in Pennsylvania and started a well which led to the discovery of the world's first major field (1).

Drake's success led to oil-rush fever similar to the old rush fever of the west. The production raised to economic scale and exportations to Europe were executed: By 1865 Britain, France and Germany were substantial oil buyers, and for most of the century exports accounted for over a Third of the United States annual production.

The huge investments in the oil business resulted in the creation of big oil corporations who formed powerful cartels in the U.S and Europe which affected and played the major role to the future of the world economy, and later known as the seven sisters (2).

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(1) Christopher Tugendhat, Oil the Biggest Business, London 1968 page 9; Le Petrole, Etienne DALMONT, PUF, PARIS 1975 P.3.

(2) Anthony Sampson, The Seven Sisters, stated by Prof Conine, Readings In International Energy Transactions 1989 P.3-1; Durand Daniel, La Politique Petroliere, P.U.F. P.16.

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On the other hand many of original companies were forced out of business.

Throughout the oil industry's history men have been afraid of what will happen when their supplies are exhausted or they become dependent on somebody else. This fact le the strategists of the oil corporations in the U.S. and Europe to think about expanding their activities and explorations to overseas territories.

The two world wars transformed oil from being a source of revenue for speculators and Tycoons into a vital industrial and strategic raw material. Its importance was demonstrated in the words of Lord Curzon " Truly Posterity will say that the allies floated to victory on a wave of oil ". Another expansion in the overseas territories took place to include IRAN (EX. PERSIA), The Soviet Union, The Middle Eastern countries, Central and South American countries Notably Mexico, Venezuela and Brazil. Other importan discoveries later took place in Africa i.e Algeria, Egy Libya, Nigeria and GABON, and in the Far East i. China and Indonesia.

The diversity of Legal systems in the oil producing countries led to another diversity in the exploration techniques depending on the nature of the ownership concept (1) and the economico - legal systems in every country.

The revision of the aforementioned legal systems and the terms governing the relationships between a foreign investor in minerals (2) development and the government of a developing country are usually formulated in ad hoc

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(1) Richard Hemingway, The Law of Oil And Gas, 2nd ed., Wes Publishing, Minn.1983, P.32 and seg.

(2) For the definition of minerals, Hemingway op.cit, P.I

agreements. With the exception of the advanced (developed) countries i.e U.S.A, FRANCE and BRITAIN who have general mining codes applicable on all mineral operations, other mineral producing countries, although usually having general mining codes besides foreign investment laws , often allow government officials considerable powers in shaping individual ad hoc agreements . Early ad hoc agreements took the forme of Tradititonal concessions in which the terms were primarily financial (1). Later the pattern took frequent shift to forms in which the government reserves to itself substantial participation in and control over the venture.

Usually such ad hoc agreements are sophisticated, they include such matters as taxation, export and import regulations, employment conditions, management structure, exchange control, company and state rights and obligations and infrastructure etc.. . Some of these agreements virtually includes all the laws and regulations that will govern the operations of the company in the country.(2) Both kinds of ad hoc agreements - traditional and the most sophisticated - were the most acceptable forms for the hosting states in Petroleum Business. Consequently the governments have had considerable experience to draw upon the terms of such agreements untill they became standard with less flexibility in negotiations than other hard minerals agreement.

But by the time and due to political and economical

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(1) i.e contracts made with Saudia Arabia (ARAMCO), with PERSIA (TRAW) NIOC ETC.

(2) GEORGE HAZBOUN, LEGAL NATURE OF STATE CONTRACTS CONCLUDED WITH FOREIGN PERSONS , ALEXANDRIA 1988 P.7 & SEQ.

reasons the trend was to accept other kinds of agreements which took the form of three main instruments i.e Equity sharing ; joint ventures and management agreements.

On the other hand, in advanced countries one rarely finds comprehensive agreements similar the type found in other countries. Mining activities , including Petroleum , are usually subject to special Acts (1) within the general law of the land; But in their activities in the hosting countries (underdeveloped) multinational corporations prefer entering in ad hoc agreements than being subject to local legal systems. The special nature of the multinational companies and their role in the economy of the hosting countries brings a bundle of problems that are usually inadequately covered by the domestic legal systems. The structure of the legal instruments and their convenience depends on the Nature, components and scope of ownership in the domestic law. For the purposes of this paper we will divide the subject into two sections. The first one will deal with actual ownership regimes on Natural resources. The second section will contain different types of legal structures in oil business.

Section I Ownership Regimes And their effects.

The main rule of ownership can be derived from the United Nations resolution (2) on permanent sovereignty

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(1) DAVID GODWIN SARRE AND AYHAN UNLER, MODERN OIL LAWS, Journal of Business Law, 1960 P.163.

(2) Dec. 14, 1962, UNGA Res. 1803 (XVII), 17 U.N. GAOR, SUPP (No 17) 15, U.N. Doc A/5217 (1963), reprinted in 2 International Legal Materials 223 (1963).

over Natural resourses. But if we go further into details we discover three types of ownership regimes which have been developed under traditional Jurisprudential and international law concept.

A) The first type of ownership regime is based upon the legal concept, common to both civil and common law systems, that the owner of the land owns everything beneath the soil including mineral deposits and ownership rights expand to the space over the land. This traditional view of private ownership of all types of natural resources is today possible only in the United States, Canada, Australia and another very few countries. Even in those main countries most of mineral reserves are outside private sectors and owned by the governments of the States.

The U.S. government owns such reserves by virtue of its rights on the continental shelf (1) and its ownership over vast tracts of the rich land in ALASKA besides many of the southern and western States. Even in the United Kingdom, which originated the common law concept of that owners of the soil owns aud ad coelum ad infierno, has vested title to all petroleum and natural gas in the sovereign (2).

B) The second type of ownership regime is derived from international treaties. Those treaties usually provide methods for adjusting competing claims of national domain over disputed areas and thus provide for what amounts to many cases national sovereignty of the area where

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(1) Scelle Georges, Plateau continental et Droit International, Paris, 1955 P.57-58. The author advocates the idea of considering the continental shelf international ownership.

(2) Smith and Dzienkowski, International Business Transactions, Texas 1989.

mineral deposits are located is in dispute between two or more different countries, as where countries disagree over how their boundaries extend either into an adjacent continental shelf or disputed piece of land located between the two countries or which has the better claim to an island(1) or any other dry land area. The most elucid example of this latter case of disputes is that of Antarctica. This continent is disputed by at least seven different countries, which claim various shares of it. But none of the disputing countries has established a clear claim cognizable in international law.

In other cases petroleum reservoirs expand beneath national boundaries, as is the case with several North sea fields shared between Norway and the United Kingdom, also Roumaila field between Iraq and Kuwait (2). Also the neutral Zone between Kuwait and Saudia Arabia.

Treaties between claimant countries establishing rights in such areas range from provisions for joint development of the whole area by the treaty parties, to a simple agreements for adjusting shares of production in accordance with fixed proportions of ownership. Those agreements may cover all minerals in the area or only specific minerals. It is to be noted that this special kind of agreements created a kind of co-ownership which has it source in international law and their parties are international sovereigns.

C) The third type of ownership which is the most important , and the most common global regime(1). This type places ownership of minerals in the governments hands.

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(1) Such as the Island of Fisht Al DIBL disputed between Qatar and Bahrain.

(2) Which was one of the elements causing military hostilities between the two countries.

This is the case of the countries in the socialist bloc were this regime is applied to every mineral substance. Also, in much of the oil producing countries in the third world , Oil and minerals are considered a governmental property owned and administered by government establishments. i.e. IRAN, IRAQ, Eqypt, SAUDIA ARABIA, Kuwait, Etc. In some countries there are minor exceptions such as the provisions in the mineral codes of latin American countries which place ownership of sand and gravel in the hands of the owner of the land. However, Energy resources, considered as a strategic materials, are subject to government ownership in nearly all the countries outside the northern American States. Consequenlty we can confirm that the bulk of the world reserves of petroleum and natural gas are government owned property.

All three traditional regimes agree on a common legal principle based on the theory of state sovereignty. This principle include the undisputed right of every sovereign state to develop its own legal system for the ownership and development of minerals. The permanence of such sovereinty over natural resources which was recorded by the U.N. General assembly resolution (2) noted that even Nationalization, expropriations or requisitions for public utility, security or national interest are recognized in international doctrine to be the exclusive right of the sovereign state. Any compensation to the owner shall be paid in accordance with the rules in force in the state taking such measures in the exercise of its sovereignty and in

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(1) This type goes with the U.N. Resolution..

(2) Art. 4 of the resolution op.cit.; Ralf Folsom, Michael Gordon and John spanogle, International Business trans. actions, west publishing Co. P.858

accordance with international law(1). On the other hand the resolution provides that any controversy concerning the question of compensation must be subject to the national jurisdiction of the state taking such measures which shall be exhausted . Consequently, as the rights of ownership and development of mineral resources are permanent , they cannot be alienated. This version of permanent sovereignty of the state over its natural resources implys two main legal results, the first is that a country does not violate international law if its repudate an agreement with a foreign corporation to develop and market mineral resources in its territory, and the second is that a country cannot enter into an agreement binding itself to relinquish its sovereign rights over its natural resources . This fact leads to discuss the validity of stabilisation clauses in sub-section I and Binding character of arbitiation clauses subsection II .

Subjection I Stabilization Clauses and right of ownership

Stablization clauses are those in which a sovereign agrees to give up the right to exercise its sovereign rights over specified natural resources for the duration of agreements concerning oil and mineral exploration and administration or management including joint ventures.

The stabilization clause was one of the most debatable matters in the law of international contracts . The most acceptable agreement is that which gives the country the exclusive right of non-respect of such clauses (2), provided

(1) Domke, Foreign Nationalizations, 55 AM J. Int. Law 585 (1961).

(2) TESON, State Contracts and oil expropreations: The Aminoil - Kuwait Arbitration. 24VA. J. International Law 323 (1984).

that the hosting state offers equitable compensation. Therefore the effect of stabilization clauses inserted in a concession agreement depends on the substantive law which controls the contract. And according to the prevailing version in international law, which goes in line with the U.N. General assembly Resolution No.1803 on the permanent sovereignty over natural resources, a nationalization may amount to legislative termination of the contract, thereby lawfully cancel its provisions including stabilization clauses(1); but this version was not adopted in full by the tribunal in the aminoil case. The tibunal loosely asserted that even if recent U.N. resolutions could be interpreted as codifying customary international law, it was not possible to go one step further and deduce the existence of a rule prohibiting a state from promissing not to proceed to a nationalization, including expropriation for public utility, within a limited period. The arbitrators concluded that under international law a state can obligate it self not to nationalize VIS-A-VIS a private investor, provided that the duration of this under-taking is limited. But finally the tribunal took a decision in contradiction with this argument, and which goes in line with the U.N. general assembly resolution, by finding that the stabilization clauses did not prevent the government of Kuwait from legitimately nationalizing Aminoils property. To reach such a conclusion the tribunal based its decision on the intention of the parties who inserted the stabilization clause in order to prevent

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(1) Stabilization clauses were severely attacked by Kuwait in the Aminoil case. Kuwait argued that the stabilization clauses had a colonial character and werefore that reason devoid of value. This argument was rejected due to the fact that the Kuwait government confirmed these clauses in 1961 and 1973after the independance.

confiscatory measures which is not the case of Nationalization. On the other hand the tribunal argued that nationalizations were not expressly covered by the stabilization clause(1).

Sub-Section II Binding Character of Arbitration Clauses

In the absence of an agreement in connection with the waiving of immunity vis-a-vis contracts concludes between a State or State agency with foreign corporation, questions arises whether submission to arbitration should be regarded as an implicit waiver of immunity and whether there is a binding character of the arbitration agreement .

In response to the first answer, the overwhelming weight of authority calls for an affirmative answer. Many arbitral tribunal and domestic court decisions concur that state party to arbitration is precluded from asserting its immunity in order to frustrate the purpose of the agreement. On the other hand part of the writers (2) saw real difficulties in connection with state contracts that purport to be delocalized in order to avoid host states law. This was treated (3) by Article 42 of the ICSID convention which clearly and positively answered to the question whether disputed matters between states and private law persons can be submitted to

(1) In Texaco case the arbitrator included Nationalizations under the stability clause guarantee.

(2) DELAUME GEORGE, State Contracts And Transnational Arbitration, American Journal of International Law, 1981 P. 786 and Seq.

(3) Hazboun Georges, Autonomy in choice of Law, Journal of Law, Kuwait 1985, P.25 and Seq.

transnational law, which part of the doctrine consider it part of the Public international law.

In the international cases literature related to arbitration clauses the arbitrators were influenced by different considerations i.e. In both Sapphire (1) and BP (2) awards the arbitrators were influenced by the following considerations.

1) The fact that " the arbitration should be governed by a law procedure, and that it should be subject to the supervision of a state authority, such as the judicial sovereignty of a state " and 2) The need to facilitate the enforcement of the award.

By providing for arbitration as an exclusive mechanism for resolving contractual disputes, the parties to an agreement, even if one of them is a state, must however, be presumed to have intended to create an effective remedy. The effectiveness of an arbitral award that lacks nationality- which it may if the law of the arbitrator is international law- generally is smaller than that of an award founded on the procedural law of a specific legal system and partaking of its nationality(3).

In the ARAMCO case the arbitrators took part for the opposit view. Under the arbitration agreement between Saudi Arabia and the Arabian American oil company (ARAMCO), the arbitration tribunal was required to decide

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(1) SAPPHIRE International Petroleum LTD. V. National Iranian oil Co. 35 ILR 136 (1967) here in after cited as SAPPHIRE case.

(2) BP Exploration Co. (LIBYA) Ltd. V. LIBYAN ARAB REPUBLIC 53 ILR 297 (1979) (BP. Case).

(3) BP award, 53 id, at 169, Delaume, op.cit, State contracts and transnational Arbitration, AJIL 1981 P.791.

a dispute over their concession agreement in accordance with Saudi Arabian law, in so far as matters within the jurisdiction with Saudi Arabia were concerned, and in accordance with the law deemed by the tribunal to be applicable in so far as matters beyond the jurisdiction of Saudi Arabia were concerned. The arbitrators held that the arbitration was directly governed by international law on the following grounds :

1) That the juridictional immunity of states excludes the possibility for the judicial authorities of the country of the seat, of exercising their right of supervision and interference in the arbitral proceedings which they have in certain cases(1) also that 2) " Considering the jurisdictional immunity of foreign states, recognized by international law in a spirit of respect for the essential dignity of sovereign power, the tribunal is unable to hold that arbitral proceedings to which a sovereign State is a party could be subject to the law of another state. Any interference by the latter state would constitute an infringement of the prerogatives of the State which is a party to the arbitration. This would render illusory the award given in such circumstances ". The arbitrators concluded that the arbitration, as such, can only be governed by international. The main criticism to this thesis is that it places excessive emphasis on considerations of sovereign immunity as a factor of determination, by holding that procedural rules should be internationalized in order to waive jurisdictionnal immunity.. This result will ignore the fact that submission to arbitration is in itself an indication of the states will to waive immunity. From our part we agree with the doctrine which accept the principle that by agreeing to refer disputes to arbitration, states

(1) ARAMCO case, 27 I.L.R. at 155-56.

wave right to invoke immunity of jurisdiction but still preserves the right to invoke immunity of execution after the issuance of the award.

After having dealt with the problems of ownership of oil and minerals and their effects in the first section we will analyse the legal structures of Traditional and Contemporan oil agreements.

Section II: Legal structures of Traditional and Contemporan oil agreements.

This part of our paper will be devoted to the traditional concessions which governed the legal and economic relationship between hosting states and the development in this field.

Sub-Section I: Traditional Concessions

Agreements between foreign companies and hosting countries during the first half of this century were recoded in a simple documents giving for the exploring corporation, usualy multinationaly owned, extensive unrestricted rights in exploring one or more of the minerals covering large areas of the land for very long periods of terms. Royalties-Financial Obligations -, based on the tonnage of crude oil produced, were the main source of financial obligations, but few countries sought additional financial benefits like collecting income tax (1) although a normal land tax was also usually imposed on the area subject to the concession agreement. The few attempts to impose income tax were aborted.

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(1) The 1920 agreement between the Persian government and the Anglo-Persian Oil company called for an income Tax on the world wide incomė of the enterprise , excluding only profits from transprotation of the oil, similar provision was imposed by article 22 of the agreement signed between Auxirap and Saudia Arabia. In the contrary article 21 of the agreement signed between the government of Saudia Arabia and standard oil company of California In 1933 Exempted the company from all direct and indirect taxes.

At a later stage many agreements abandoned the fixed cash royalties in favor of royalties based on a percentage of the export price of the resource .

Compared to later and more recent agreements , the early concession agreements have two main advantages First, The Royalty payment is an easy type of Tax to be administered secondly, it guarantees a certain payment to the government irrespective of the company's profits or of the International market prices. Consequently as long as there is production or sales, the government should receive revenue. But on the other hand by this type of agreements. The technology of exploration and the know how remain the exclusive monopoly of the foreign company, who works independantly of any active intervention of the hosting state in the technical aspect of the production .

By the late 1960 s new financial factors were added to the most of the traditional agreements . There was a shift from royalty to income tax. Tax on income was implemented either through a direct income tax (1), or in a later stage through a sharing - of profits arranged in a way that made it roughly equivalent to income tax (2).

In oil agreements the shift from royalty to income tax has taken place in Two ways First, the amendment of traditional existing agreements, to substitute income taxation for royalty payments or by supplementing royalties with tax on income. Second, new agreements were negotiated in the same period resulted in the incorparaton of income tax or profit-sharing principles as the main source of government revenues.

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(1) Frequently at a rate of 50% , this rate later led to another version of sharing of profits - attenuated version of income tax.

(2) Henry cattan , the evolution of oil concessions in the Middle East and North Africa, Dobbs Ferry : Published by Oceana, 1967 p.44 .

Although the inclusion of income tax in oil agreements made of this type of tax the principle source of government revenues, royalties never disappeared , because it served the aim of assuring a minimum resource to the hosting state when there is little or no income .

The executions of income tax clauses besides the complexity of oil exploration agreements, imposed a significant increase in the burden on the financial administrations of the hosting states (1). In federal governments , Royalties were sometimes retained as payments to States or provinces while income tax goes to the federal government (2) .

The shift from royalties to income tax system was some times more encouraging to oil corporations, as the firms were Reluctant to take on heavy royalties especialy in the begining of explorations. A commitment to a large royalty , particularly in the first years of operations, is potentially dangerous for the companies.

The investor company faces uncertainty about the profitability of the exploration operations . The royalties represent additional costs which will be collected whether the project was profitable or not : On the other hand income tax is linked to profits which is more suitable to the company in particular when the income tax is collected only if the profits are high.

Income tax arrangements in oil contracts agreement

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(1) Including additional expenses and wider administrative organ to be able to verify the sales prices of the resource and the calculation of deductions for expenses that are changed in minerals against gross income with the exception of petroleum where posted price is used.

(2) Smith and Wells, Negotiating Third world Mineral agerrments Am.Jornal of International law 59(july 1975) 560-590 .

where negotiated with prosted price used for calculation, tax arrangements had reverted to similar to royalty arrangements. But by 1973 as oil producing countries began to tie the posted price to the market price with an additional increase, the move was again to the other direction, the company's position became similar to service contractor rather than indepedant Royalty or tax payer.

Another shift in the traditional agreement led to a narrow linkage between oil exploration project and the National economy. Foreign corporations were required to contribute in the development of the local economy, by establishing the infrastructure of the area covered by the agreement, this include building main roads, hospitals, operating schools, offering houses to local workers Etc...

But the most important of all was the training of local workers, which later led to the trasfer of the know-how to the host countries, this latest evolution encouraged the hosting governments to push for negotiations in order to obtain better conditions and other type of agreements.

Sub-Section II: Modern Agreements

During the 1960s and 1970 the political and popular pressure led to the intervention of the hosting governments and the renegotiation of the agreements concluded with foreign corporation.

The result of the renegotiations was a rapid increase in the number of agreements that provided for local participation in the ownership of the corporations. Some oil producing countries sought for an Equity-sharing exceeding the 51% (fifty one percent) of the shares,others pressed for bigger share. But the participation structures were in many cases unusual. It does not assume that the host country

produces, refines and sells oil, also it may not bring the government to be effective in major management dicisions within the company or playing an active role in the disposal of the resources(1).

This early form of participation include sometimes the obtaining of equity interest in exchange for all or part of the government rights. This structure is not always in favor of the government financial position (2). Dividends results from the funds after deducting expenditures, where as in many cases by tax arragements the government takes its funds before deducting such expenditures.

In the more recent participation agreements, governments sought to buy shares of equity and retain all rights to tax corporation profits. Usualy this pattern is refered to after the uncertainty of the profitability of the project was diminished.

This form of participation in sharing the ownership of the corparation by the host government led to more complicated simular pattern encouraged by the oil production countries. Governments of those countries reached the conclusion that they may obtain a interest in a contractual joint-venture rather than having shares in an incorporated entity (3). We think that this formula is the best to adopt, because it retaines the right to tax and preserves all the gurarantee to foreign firms to encourage

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(1) Also it does not always include governmental financial contrbution for the obtained equity interest.

(2) Smith and Wells, op.Cit. P.38.

(3) I.e The case of the National Iranian Co. Which in 1965 provided 50% of the capital for off shore oil parnership with the other half opened to a consortium of foreign corporations. By this arrangement the government retained rights to tax.

update transfer of technology in the field (1). Some of the oil producing countries managed to structure their agreements with the foreign oil corporation in more combined terms, taking in mind that their participation will result in minimum expenses in the first stages of explorations and maximum profits in later stages, for example the agreement between the libyan National Oil company and shell exploration (libya) L.T.D. included a combined clauses between production and ownership sharing. The Libyan farty will have 25% percent sharing in the first stage with exploration expenses to be borne by shell. By the time the production increases to certain ceiling, (260,000 barrels per day), the share of the Libyan party will be increase untill reaching 50% percent when out put reaches 500,000 barrel per day. This structure will avoid the libyan party of being liable for big expenses in case the results of explorations were not economically fruitful. On the other hand it will garantee a maximum revenue in case the foreign corporation obtained, positive results. Besides this advantage, other facilities were predicted concerning the reimbursement of expenses which will be borne by Shell but will be reimbursed, by the state company to Shell out of the state company's share. Evidence of direct equity sharing contractual structure between governments were rare untill mid 1970s , although some state owned companies from developed countries had participated in the exploitation of minerals in the under developed countries (2). The trend for equity sharing and joint venture legal structures in the minerals

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(1) Under condition that the government obtain 51 percent of the joint venture to keep dicision powers under State control.

(2) Smith and Wells,op.cit.p.41,Tarzian, op.cit.p.132 and seq.

and oil explorations bussiness is hesitant (1) but certainly continue to grow in importance in spite of its complexity. Recently Algeria sought to sell parts of its shares in the oil and gas exploration corporations monopoly to some foreign investors to cover part of its international debts. This new policy of the Algerian government will lead to a more effective economic structure in the Algerian mineral fields (2) .The foreign participation by means of equity sharing (3) or a direct joint ventures will facilitate the task of obtaining modern technology and know how, besides finding some parties to participate in exploration and marketing expenses.

On the other hand , newly created legal structures were adopted by the oil producing countries ranging from management control and service and work contracts.

* Mangement control and other forms of contemporary contracts :

For political reasons governments often seek to obtain management control over the petroleum explorations. For

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(1) Due to the fact that decision makers are coerced by the political aspect of their decision rather than the legal economic feasibility .

(2) This step was recently adopted after extended practice of nationalised administration and operations .

(3) The participation phenomena is not a newly created structure ,due to the fact that some participation provissions dated back to Persion d'Arcy agreement of 1901 also the British-French San-Remo agreement of 1920 concerning the IRAQI minerals contains similar provisions and Saudi Arabian agreement with standard oil of California 1933 provided for similar clauses, Tarzian Pierre, Petroleum Prices, Royalties and contracts, Arabic Version, Beirut 1982 P.84.

this purpose governments acquire equity assuming that more equity means more ownership and more ownership gives more control. So by increasing control over the operations of the foreign firm the government seek to obtain political benefits in addition to the financial ones.

But in real terms the extent of the governments shares does not always correspond to the real control over the foreign firms operations. On the one hand,the technical decisions necessitates real sophisticated decision makers well aware of the know how and the marketing of the products within a market dominated by big competitors. On the other hand the governmental bureaucracy does not correspond to the necessities of modern management flexibility. But still governments press for control management either by obtaining the majority share of equity or by other means. One of the usual adopted structures is to dissociate equity ownership from control and the assignment of different classes of shares to the different parties.

Every class of shares may have different rights than others i.e no voting rights. Some times those classes are designated to give holders rights to specified number of members in the board of directors, other classes are empowered to different number regardless of the proportionate share of ownership. This kind of arrangements may be in favor of the froeign firm or the hosting state(1). But some times governments may wisely

(1) Smith and Wells op.cit. p.42 gives an example infered from the 1960 LAMCO agreement in Liberia which with 50% shares for the government and 50% shares for the other share holders gave the right to class A share holders to designate five representatives and six representatives to calss B share holders regardless of their number of share equities.

prefer not to interfer in the day to day operation decisions, but preserve certain rights linked to the more important decisions. In this case the government seeks to have the right to veto some decisions, by providing that such kind of dicisions requires the unanimous voting of the board of directors or sometimes three-fourth of all the board before certain steps of management could be taken (1).

Consequenlty a single governmental vote by government appointed representative - can block such decisions. This technique was also used to protect the interests of the foreign corporation(2) as this right to block certain decisions can be used by the corporation representative to make a balance with the government representation.

But even with this measure, government negotiators continue to be worried that their representatives in the board are not sufficiently informed and trained to take sophisticated technical decisions . So in order to overcome these difficulties government negotiators seek to introduce special provisions in the agreement for the creation of a technical committee, composed primarily of local citizens,

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(1) The two main targets which a government aims to fulfil in structuring its representation on a board of directors of an extractive operation are: A)Defining vital issues of concerne . B) Assuming the necessary technical skills in their representatives.

(2) For example the Kuwait agreement with Hispan oil and the ABU DHABI agreement with the French Petroleum co. Which provided for 51/49 share for the distribution of expenses, production and profits, but the overwhelming share in favor of the national corporation does not give any advantages for any party due to the fact that the agreement provides for a unanimous decision voting in some matters and percentage exceeding 51% percent for other decisions, TARZIAN , op. cit. p.160 .

whose main task is to insure the adequate training of local citizens and to give the government the opportunity to be appraised of any past or future decisions by operator that would affect it's interest . The necessity of having an autonomous staff of technical specialists to assist outside directors of the board is largely recognized and called for by United States authors(1). This recognition is due to the fact that outside directors are rarely well equipped to take right decisions to sophisticated matters and to exert suitable control over day-to-day management.

In fact the equity sharing arrangements, with the high rate limits of voting in important matters, can help in reducing some of the political popular fears associated with foreign activities in the oil and minerals fields resulting from the old powerful type of concessions.

The increase of control in the hands of the government is a clear evidence that the government guards the national sovereignty over the natural resourses. On the other hand the actual and effective government participation in management of sophisticated project will provide the host country with the necessary experience to furnish the national enterprises with equitable management.

Besides those kinds of agreements which consist of having participation in the ownership of the enterprise, there are other kinds of contracts more simple and less sophisticated.

In fact the pure necessity forced the oil producing countries who sought to nationalize foreign corporations assets , to seek some kind of cooperation with foreign corporations in vue of securing adequate management for

(1) Robert Townsed, "Lets install public Directors" Business and Society Review, No 1, Spring 72 P.P.69-70.

sophisticated project and convenient help in marketing the local oil production in the international markets. The legal cooperation in those fields took the form of management and service contracts according to each single case. But no standard terms have been developed for management agreements. The renumerations vary from one contract to another , sometimes they are based on sales volume and expenses incurred(1) and some other times the parties have turned to base it on a share of profits, with a hope that the managing firm would have an incentive to increase efficiency. In practice the foreign corporations showed little interest in management contracts.

On the other hand some sovereign countries leaned to the use of work contract agreements to describe those arrangements with the essential features that the title to the oil or minerals remains with the host government until it was pumped or extracted .

The term service or work contracts implies different relationship than those included under traditional concession arrangements. In the service and work contracts cases foreign firms usualy act as contractors for the host government. This form of agreements gives the host country the privilege of preserving the sovereignty of the state in the eyes of the people.

The foreigners's services may be paid for in cash or kind, and it could be based on an annual fixed fee. In general the foreign firm receives reimbursement for actual costs plus a payment based on profits . By the 1966 agreement, concluded between the National Iranian Oil co. and the French State Agency (ERAP) and its subsidiary (SOFIRAN) parties intended to provide typical model

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(1) Smith and Wells, Negotiating Third world mineral agreements p.46 Aslo , TARZIAN, op. cit. p.172 and seq.

of a service and work contracts (1). The parties avoided any use of the term grant of concession and described the foreign firms as contractors. Consequently, the oil produced was to belong to the national corporation (NIOC), but an agreed percentage of the produced oil is to be sold to (ERAP) at a fixed price.

On the other hand (ERAP) agreed to act, on the world market, as a broker to sell certain quantities of crude oil on behalf of (NIOC). And funds advanced by the foreign corporation (ERAP) for exploration purposes are to be refunded once oil was produced in commercial quantities. Similar provisions were emphasized in many oil exploration agreements in the Gulf States, Iraq, Saudi Arabia, Venezuela, Indonesia and Bolivia. In fact some agreements treated exploration expenditures as an interest-bearing loan from the foreign corporation to the host government which could be repaid in cash and sometimes in kind. Other agreements provided that the corporation will bear these expenditures entirely on its own account. In this last case the only incentive to the company - the contractor- would be the promise to obtain certain amount of production to cover costs and profits.

As with the case of equity-sharing agreements the government supervision, exercised directly or through its agencies, varies from one case to another. In some cases the government supervision has been theoretical rather than actual, In other cases it is real which is the case in the venezuela agreement with Shell where the parties agreed to have joint operating committees and the state firm could exercise strong influence by taking up an option to purchase 20 percent of the equity in the contracting firm.

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(1) Smith and Wells, op. cit. p.47 .

Another example for the wide supervision cases can be infered from the Bolivian general law of 1972 related to Hydrocarbons which provided, in the case of operating services contract, for a control committee. The task of the committee is to approve all budgets, programs of work, and methods of operation. Also the committee is to perform audits among other more sophisticated operations.

Finaly, another method of agreements along with service contracts have become popular. The so called production sharing agreements served to describe the arrangements whereby the foreign firm and the government share the out put of the operation in predetermined proportions.

In fact this kind of agreements is very popular in countries with hard currency problems like the Eastern European countries where the western corporations provide machinery, licences and know how assistance. Both the government and the firm agree to receive their benefits in kind rather than in cash. It is not surprising that the most successful production-sharing agreements have been in the oil industry (1).

The Indonesian agreements during the early sixty's proved to be typical examples of such agreements (2).

By these agreements the foreign corporation offers the government the so-called redeemable fixed interest loans. The loan is subject to repayment by the government within a stipulated period in the form of agreed percentage of the product. According to these agreements the foreign

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(1) Smith and Wells, op. cit p.51 .

(2) Joyce Gibson, " Production - sharing " Bulletin of Indonesian studies, February 1966 - PART I and June 1966 PART 2,75, See Also Smith and Wells ibidem.

investor was generally regarded as a creditor even though he was responsible for certain services.

In the indonesian case, agreements were arranged between the state oil company - "Pertamina" and many international corporations such as BP. ,Gulf, Mobil, Shell and Phillips petroleum companies. This latter is significant in characterizing the production-sharing contracts. Under the terms of the agreement the national oil agency was responsible for the management of operations and Phillips was responsible for the execution of the operations and for providing every financial and technical assistance for the operations. By this Phillips carried the risk of the operation costs including exploration, development and marketing. In fact the most important provisions are those related to oil pricing which give the government an important protection aganist the firm's underpricing of oil sold to affiliates or non ... filiates, in this case the government could take payment in crude oil and sell it for higher prices.

These typical production sharing agreements were later on developed to include other provisions requiring the contractor to offer a stated percentage of his contractual rights and obligations to a local participant - public or private entity - as soon as commercial sales were made . Usualy the proposed participation ranges between five and ten percent.

In fact the difference between production - sharing contracts and simple service and work contracts became very light. The two major elements that distinguish production sharing from service agreements are that (A) th oil corporation is usualy entitled to recover, in the form ot oil operating costs up to a predetermined amount per calender year of the produced crue oil and (B) Besides the balance of oil shared between the parties, the government or

it's agency and the foreign firm, the oil corporation, is subject to the income tax. The require ments of such laws include all the financial provisions. In this latter case the evaluation of the pricing for accountant purposes and taxation etc remain s under the government control in order to avoid any misuse of the possibility of pricing to affiliates and third parties.

By this we end a flash, review of the traditional standard concessions and the main development in the oil business contracts.

CONSLUSION

During the last thirty years the oil business flourished and resulted in revolutionary changes in the legal techniques linking the host countries with the foreign corporations.

The raising of the national spirit in the third world countries during the post war era coloured oil exploration agreements with political aspects. The issuance of U.N resolutions confirming the countries sovereignty over their natural resourses led to the revision of the concessions which were the typical tool for organizing the relationship between the hosting states and the corporations. This was followed by another step including the reference to different kinds of arrangements such as Equity-sharing, Management, Production-Sharig , Service and Work contracts ETC.. The preference between a kind of agreement or another is difficult to establish from a general rule and many states have shifted from one contract on another i.e recently the Algerian government offered to sell shares of its oil enterprises to help its national economy, after having resisted such foreign intervention in the oil business for a long period. For the hosting state, the government must study the benefits from having foreign reliable partner in order ot take the right decision. Those advantages can be summarized in two main topics (A) such partnership allows having updated technology from the foreign corporation. (B) Such partnership gives the government the possibility of using the marketing facilities of the foreign corporation, including it's refinaries and distribution network. This last result necessitates the verification of the corporations size .

To be sure of the reliability of the corporation it is advisable to seek arrangements with one of the major ones.

On the other hand, foreign firms seek a kind of protection and stability to big amounts of money devoted for the investment in the oil business and this can be realized by a partial ownership of the enterprise.

The equity - sharing may be the best legal technique to preserve the rights of both parties and guarantees acceptable incentives for the development of the business.

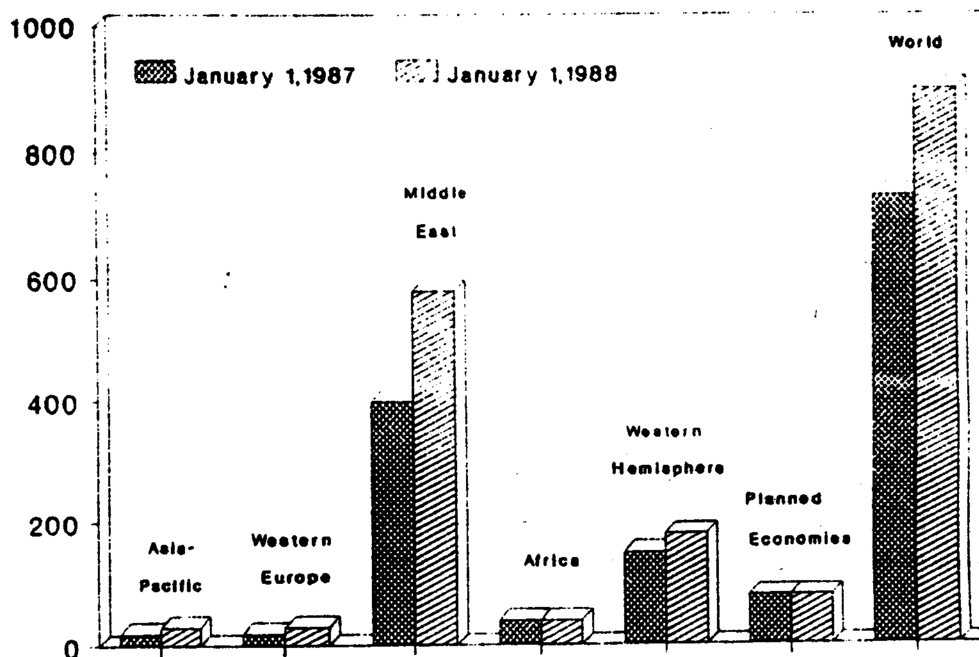
FIGURE 1 Map of the Middle East. Major oil pipelines are shown as brokes lines. Major oil fields are indicated by small black spots of irregular shape.

Figure 2

WORLD OIL RESERVES BY REGION AS OF JANUARY 1,1987

AND JANUARY 1,1988

(in billions fo barrels)



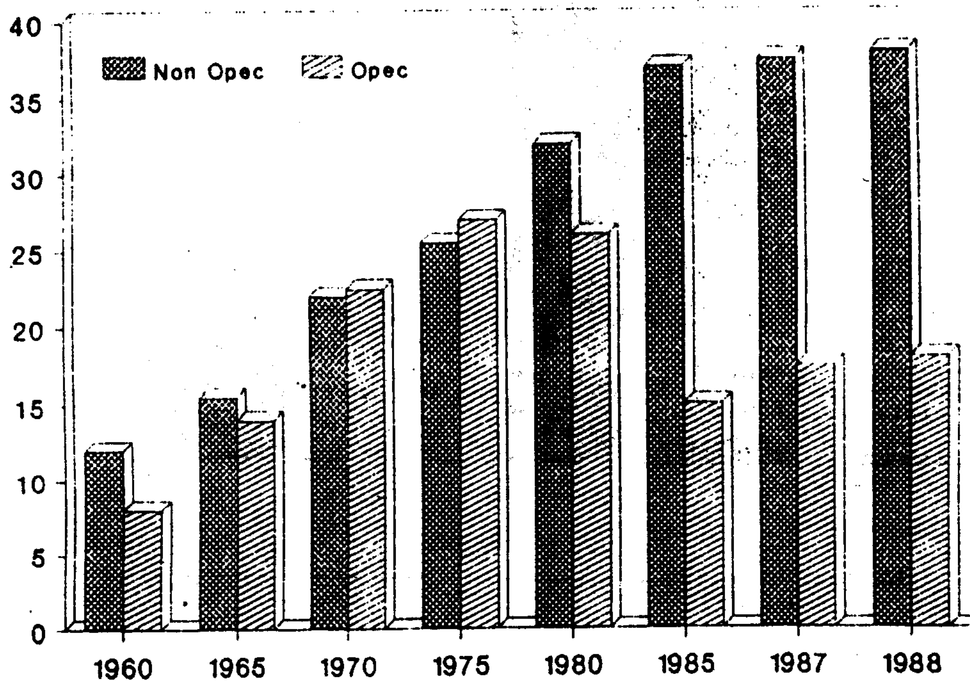
Source : Oil and Gas Journal, December 28,1987.

Figure 3

NON-OPEC PRODUCTION

Oil production by non-OPEC producing contries has begun to level off in the last few years. Several non-OPEC nations agreed to cut or freeze oil exports during the second quarter of 1986.

Millions of barrels per day



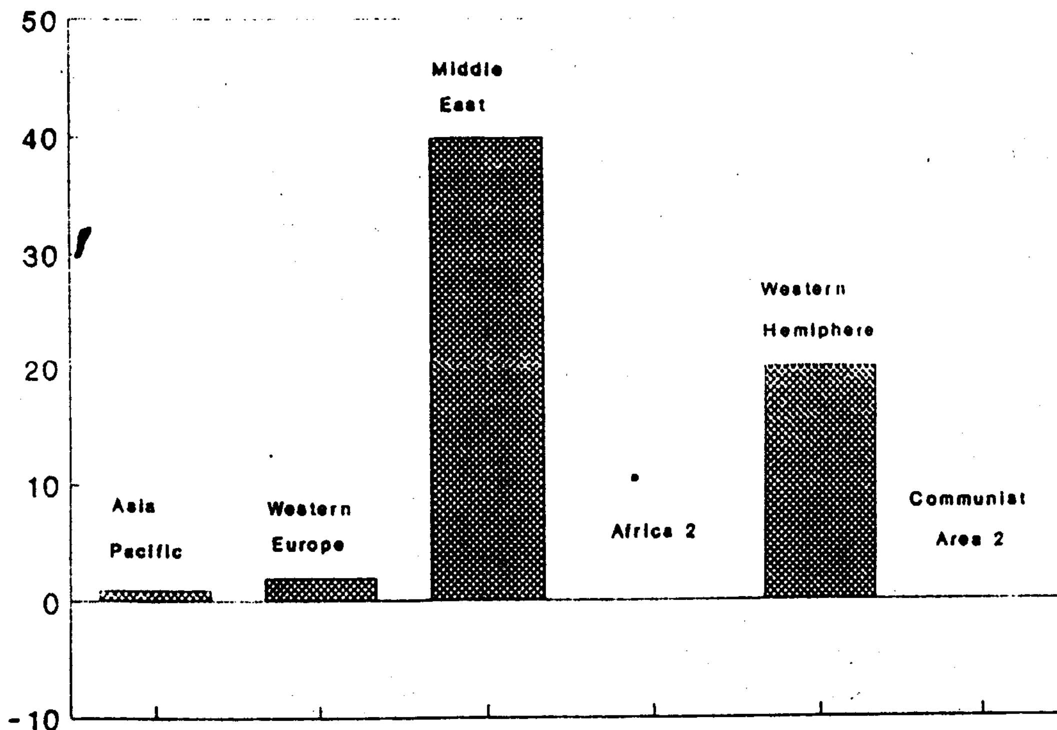
* 1986 figures for non-OPEC are actual. OPEC. is estimated.

Source: Petroconsultants inc. OPEC Annual Statistical Bulletn

Figure 4

PERCENTAGE INCREASE IN WORLD OIL RESERVES BETWEEN

JANUARY 1,1987 AND JANUARY 1,1988 BY REGION

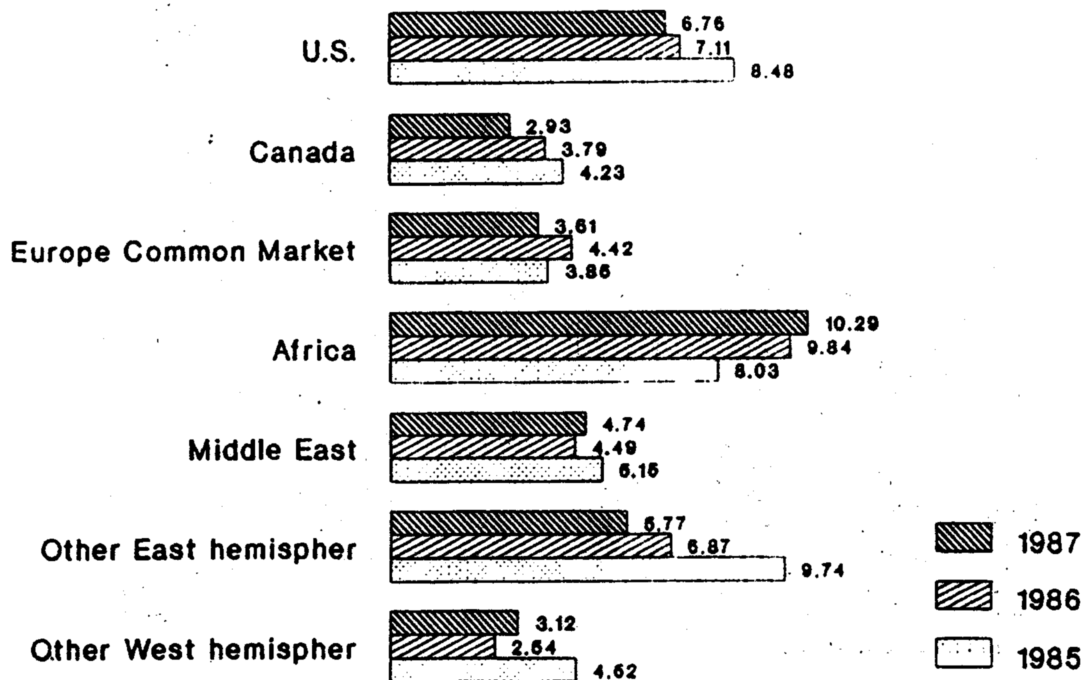


* Change for Africa and communist area are insignificant.
Source: Oil and Gas Journal and The Wall Street Journal, Feb 9,1988 .

Figure 5

COST OF FINDING OIL AND GAS

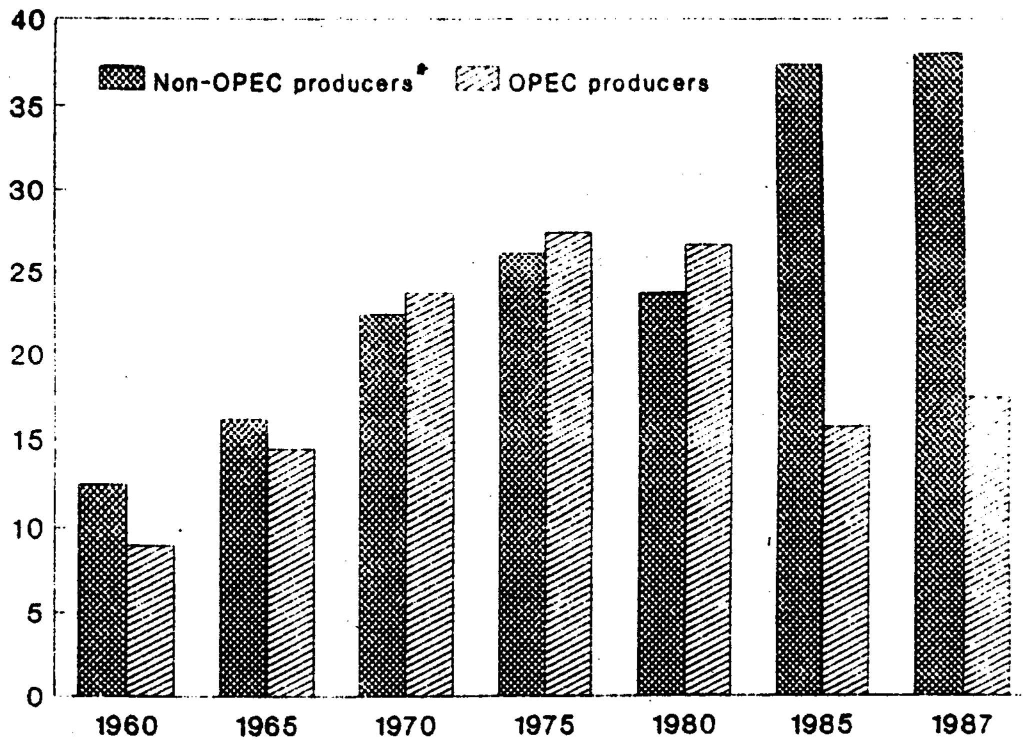
The cost of finding oil and gas in the United States is higher than in most areas overseas, prompting many firms to shift their focus to international exploration.



* Cost reflects extensive on going exploration that has not yet paid .

Source : U.S Energy Information Administration .

NON - OPEC producers have increased their share of the oil - export market.



*Includes communist countries production

Table 1

OIL EXPORT REVENUES OF THE GULF COOPERATION COUNCIL
1985 - 1987(a)
(in million of U.S dollars)

Country	1985	1986	1987
Saudia Arabia	26,665	20,131	21,499
Kuwait	7,251	4,928	5,391
Neutral Zone(b)	3,424	1,700	2,347
United Arab Emirates	10,661	6,074	8,810
Qatar	2,981	1,571	1,873
TotalG OPEC(c)	50,982	34,403	39,739
Total OPEC(d)	126,720	72,279	90,568
GOPEC's share of OPEC(e)(%)	40.23	47.59	43.87

(a) Except Oman.
(b) The Neutral Zone is jointly administered by Kuwait and Saudia Arabia; its production is shared by both counties.
(c) This acronym stands for Gulf Organization ofPetroleum Exporting Conutries, composed of the states given in this table.
(d) Organzization of the Petroleum Exporting Countries.
(e) If the share of Iran and Iraq is included, the total Middle East share in OPEC production jumps to 61.01 percent, 64.94 percent, and 67.05 percent for 1985, 1986 and 1987, respectively.
Source: Adapted from the petroleum Finance company, Washington,D.C., December 1987, Middle East Economic Digest, January 2, 1987, p.7.

TABLE 2 : Total World Crude Oil Reserves by Region in 1975 and 1984, in Billions of Barrels of Proved Reserves.

	1975	1984
OPEC areas:	152	169
Saudi Arabia	208	201
Other Middle East	90	81
Other OPEC		
TOTAL OPEC	450	451
North America	40	82
Western Europe	25	23
Rest of Non communist World	40	29
TOTAL NON-OPEC	105	134
Total, All Noncommunist Area	555	585
Communist Area	103	85
Total World	658	670

SOURCE: Oil and Gas Journal, Year-end Summary Issues, 1975 and 1984.

TABLE 3 Percenttage of Government Owned Oil Production for Selected Years in OPEC Countries.

Country	1970	1972	1974	1976	1976	1980
Saudi Arabia	.9	.7	58.7	58.7	58.7	97.7
Iran	4.5	5.0	96.2	96.2	94.6	100
Kuwait	1.2	1.2	55.1	90.6	94.1	90.6
Iraq	0	53.8	77.2	100	100	100
Libya	0	3.6	60.7	64.2	65.7	67.7
U.A.E	0	0	49.5	62.1	64.4	64.4
Venezuela	1.2	1.9	2.5	100	100	100
Qatar	0	0	60.0	78.5	99.4	100
Nigeria	0	0	54.9	55.1	54.9	71.1
Indonesia	11.7	16.2	30.5	36.6	44.6	45.7
Algeria	14.6	76.9	88.2	90.5	89.1	93.7
Ecuador	--	1.3	25.4	25.5	62.9	62.7
Gabon	0	0	0	0	0	0

SOURCE: OPEC Annual Statistical Yearbook.

Table 4

CRUDE-OIL PRODUCTION IN THE NON-COMMUNIST WORLD, 1985-2000
(in percent)

Porducer	Annual Change		Share	
	1990-1985	2000-1990	1985	2000
United States	-2.4	-2.4	23	13
Western Europe	0.4	-3.0	10	6
Mexico	0.9	3.9	7	9
Other	1.7	-0.6	18	16
OPEC(a)	2.4	3.8	42	56
Total	0.9	1.5	100	100

(a) Organization of the Petroleum Exporting Countries.

Source: Chevron Corporation, World Energy Outlook (San Francisco: Chevron Corporation 1986), p. 10.

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