Contracting and regulatory issues in the oil and gas and metallic minerals industries

Michael Likosky*

This article looks at key regulatory and contractual issues in the oil and gas and also metal minerals industries. It provides an overview of contract types and discusses several state-of-the-art issues. In discussing contract types, it first provides a brief historical backdrop. It then turns to the major contract types. Both the history of traditional concessions and the enumerated present-day contract types are common to oil and gas and also metal mineral extraction. For this reason, they will be discussed together. Among state-of-the-art issues, the article considers (1) contract renegotiations, mainly with regard to Bolivia, Ecuador and the Venezuela; (2) the proposed Iraqi oil law; and (3) the handling of human rights and environmental issues by projects.

Key words: extractive industries, contracts, Bolivia, Ecuador, Iraq, Venezuela

1. Introduction

This article looks at key regulatory and contractual issues in the oil and gas and also metal minerals industries. It provides an overview of contract types and discusses several state-of-the-art issues. In discussing contract types, it first provides a brief historical backdrop. It then turns to the major contract types: (1) modern concessions; (2) production-sharing agreements (PSAs); (3) joint ventures; and (4) service contracts, including risk service contracts, pure service contracts and technical assistance contracts.¹ Both the history of traditional concessions and the enumerated present-day contract types

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¹ This taxonomy borrows from the three basic works in this area: Barberis, 1999; Omorogbe, 1997; Smith et al., 2000).
are common to oil and gas and also metal mineral extraction. For this reason, they will be discussed together. Among state-of-the-art issues, the article considers (1) contract renegotiations, mainly with regard to Bolivia, Ecuador and Venezuela; (2) the proposed Iraqi oil law; and (3) the handling of human rights and environmental issues by projects.

2. Historical background

Historically, the principal contractual form in the extractive industry was the concession. A concession essentially grants a private company the exclusive right to explore, produce and market natural resources. This contractual form has survived to this day, albeit in a vastly different form. Our understanding of the modern concession and other contractual forms for exploiting natural resources may be understood as a reaction against some of the excesses of the traditional concession. For this reason, it is useful to recount some of the basic features which sound repugnant to modern ears.

Importantly, the financial bargain struck between the host government and the foreign company was highly uneven, at times teetering on the verge of the unconscionable. Companies paid small sums to the host government for the rights over its natural resources. Typically, the compensation was not tied to the value of the resource itself. It was, however, tied to volume produced. For example, the Oil Concession of 1934 between the State of Kuwait and the Kuwait Oil Company Limited (United Kingdom) states:

“(d) For the purpose of this Agreement and to define the exact product to which the Royalty stated above refers, it is agreed that the Royalty is payable on each English ton of 2.40 lb. of net crude petroleum won and saved by the Company from within the State of Kuwait-that is after deducting water sand and other foreign substances and the oil required for the customary operations of the Company’s installations in the Sheikh’s territories” (Oil Concession of 1934: Article 3(d)).

Because companies determined the volume of production, this meant that the interests of governments and companies could and often did diverge. That is, it was not always in the interests of companies to exploit resources fully (Smith, 1991-2, p. 495).

In addition, the scope of the traditional concession was broad, particularly with respect to duration and geography. For example,
a foreign company could be granted rights from 40 to 75 years. The Kuwait contract was to run for seventy-five years (Oil Concession of 1934: Article 1. At times, the company secured rights over large tracts of land. This control could extend to the entire country. (Omorogbe, 1997, p. 58). The broad remit meant that the interests of companies in exploiting resources were not always congruent with those of the host government. For instance, a company might not always have a financial interest in comprehensive exploration. Thus, potential sources of revenue for the host government might not be identified and pursued. Moreover, since the contract granted exclusive rights to the foreign company for the period of the concession, the Government could not seek out a different “thirstier” company. Exploration was contractually tied up. At times, certain parameters for exploration were set. This was the case in the Kuwait contract which stated:

“(a) Within nine months from the date of signature of this Agreement the Company shall commence geological exploration.

(b) The Company shall drill for petroleum to the following total aggregate depths and within the following periods of time at such and so many places as the Company may decide:

- 4,000 feet prior to the 4th anniversary of the date of signature of this Agreement.
- 12,000 feet prior to the 10th anniversary of the date of signature of this Agreement.
- 30,000 feet prior to the 20th anniversary of the date of signature of this Agreement.” (Oil Concession of 1934: Article 2(a) and (b)).

Importantly, these parameters allowed the company great freedom in determining the nature, scope and extent of exploration.

These aspects of the concession agreement did not survive decolonization, the New International Economic Order and the creation of the Organization of the Petroleum Exporting Countries (OPEC). Expropriations and renegotiations as well as newly formed contracts saw to this. As we move towards the present-day partnership-based contractual models, there is a concerted effort to rebalance specific contracts so as to remove many of these outmoded features of the traditional concession.
3. Contract types/regulatory models

Today, extraction contracts are premised on transnational public-private partnerships (Likosky, 2006, Chapter 2). Together, a transnational group of governments and companies generally share control over the financing, exploration, production and marketing of natural resources in varying degrees. For example, a foreign government may involve itself in a project through an export credit agency which advances loans to a project company. Through the involvement of export credit agencies, foreign governments may influence project decision-making. This influence may be amplified in situations in which several export credit agencies are involved in a single project and coordinate their activities. At times, intergovernmental organizations may also be involved in a project. The involvement of the export credit agencies and the international financial institutions will carry with it their own respective project documentation, often in the form of loan agreements. The nature and form of the overarching partnership, however, varies according to contract type. Furthermore, the contractual clauses are often even more important in defining the nature of the partnership than the contract type. The basic contract types are (1) modern concessions; (2) production-sharing agreements; (3) joint ventures; and (4) service contracts.

In a field in which nationalism and anti-foreign sentiments are rife, the name attached to an agreement may be more important rhetorically than in practice. The content of contracts is often less dependent on type and more on specific terms. Nonetheless, from a developmental perspective, service contracts arguably afford the most independence to the host State. They are often associated with Middle Eastern countries that have high levels of domestic expertise. Joint ventures are next along the spectrum, because they involve substantial host State participation, sometimes a majority equity stake. Such ventures are common internationally. Thus, it will be important to identify the nature of the venture, i.e. the relative percentages of ownership and control over the overall enterprise. Production-sharing agreements (PSAs) are currently a matter for intense controversy. At the same time, in situations in which a large exploration risk exists, they may be the best way to advance developmental interests.

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2 For example, the Inter-American Development Bank is involved in the Camisea project. Likewise, the International Financial Corporation is involved in the Baku-Tbilisi-Ceyhan and Chad Cameroon pipelines.

3 In the former Soviet Union, there is some dissatisfaction with them in retrospect. Moreover, in the Iraq context, non-governmental organizations argued that they were not an optimal means for achieving development.
Regardless of the contract type chosen, from a developmental perspective, among other issues, it will be important to attend to the levels of taxes and royalties as well as to clauses stipulating technology transfer and local sourcing requirements. Given the fact that contracts are rarely public and that conditions vary from country to country and from project to project, it is difficult to provide an estimate of normal revenue splits.

Furthermore, when assessing the development impact of the different contractual forms and clauses, generalizations are difficult. Not only do countries vary in the quality of their resources and in their level of domestic expertise, but it is possible that, as we shall see in the Iraq case, different projects within a country call for different contractual types. It may be argued, however, that contractual clauses focusing on national content, local training, host government control over key decisions, and participation by State-owned corporations all advance developmental objectives. From a human rights and environmental perspective, it may also be that the involvement of public and private international banks and also certain oil majors with relevant policies influences such practices on a project-specific basis.

The overriding importance of contractual clauses in determining the nature of revenue sharing makes it difficult to generalize about the relationship between contract forms and revenue sharing. Royalty and taxation rates will be contractually determined. This is one reason why caution is important in making generalizations as to which contract type is best for development and financial purposes. At the same time, a qualitative difference exists between concessions, joint ventures and risk-sharing agreements, on the one hand, and service contracts, on the other. Under the former models, the company will have a share in revenue, even though the extent will depend upon contractual clauses and legislation. Under the latter model, however, the company will be compensated generally by the host Government for services carried out. Under such an arrangement, the company may not have any stake in revenue: the company is contracted in to provide a set service and the Government pays it accordingly in cash. As a result, the benefits of the commercial productivity of the project do not accrue to the company.

Importantly, the evolution from the concession contract to the modern participation agreements shows how the types of activities which contracts govern have changed over time. Today, greater emphasis is placed on the development of local capacity. For example, contracts might now stress that the foreign company must, all things being equal, purchase inputs locally. In addition, a host Government is more likely
today to play a role in projects through a State-owned company. Further, human rights and environmental commitments are perhaps the most significant recent development affecting projects. These commitments are nowadays incorporated into project documentation at the impetus of multinationals, private investment banks, or international financial institutions. These areas will receive greater attention in the section below on contractual clauses and, with regard to human rights and the environment, within the section on such inputs below.

Before discussing relevant national and international legal aspects of projects, it is important to underscore that the contract will be the most important instrument by which benefits and responsibilities from projects will be distributed. Importantly, national legislative action may establish the enabling environment in which contracts are negotiated and carried out. National regulatory action may also force the renegotiation of key contractual terms. With regard to international legal action, action by international organizations may impact on the contractual relationships among parties as well as establish new ones. For example, if the International Finance Corporation (IFC) lends money to a project company, then it will be important to ascertain the terms of the loan and the mechanisms for enforcing provisions. Further, if, for example, the Multilateral Investment Guarantee Agency (MIGA) provides political risk insurance for a project, this might influence the allocations of responsibilities among project parties in a material way. Because projects pull on international resources in differing ways and because national legislation varies by country, it is not possible to arrive at ironclad rules regarding the relative importance of different levels of legal action. Nonetheless, the identification of actors involved in specific projects is an important starting point for gauging relative influence.

4. **National level**

At the national level, laws, regulations and contract types are all important. This section, however, focuses mainly on contract types. At the same time, the importance of laws and regulations relative to contracts may vary. For example, laws and regulations may be more significant than contracts in the metal mineral industry of certain countries.4

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4 Notwithstanding, Daniele Barberis, a leading commentator, makes the following point about the mining sector, which is significant for our purposes: “Many governments in developed countries use the unilateral licensing/leasing approach, while many developing countries prefer the consensual approach and use mining agreements which are negotiated with TMC [transnational mining companies]” (Barberis, 1999, p. 13).
Perhaps the difference in this approach lies in the purpose of mining legislation itself, which Barberis argues is to act as a signal of the host Government’s position towards investment in the sector. In developed countries, an investor would assume that a legislative signal amounts to secure investment relatively free of legislative risk. In developing countries, however, investors are keen to contractualize commitments by the Government, arranging a reliable dispute resolution mechanism for instance.\(^5\)

Nonetheless, laws and regulations are important in setting out the general enabling environment in which contracts will be negotiated and executed. Often, a State-owned company or Government ministry acts as the negotiating arm of the Government. In such cases, regulations might explicitly delegate such authority to the public entity, which may itself be created by legislation. Both laws and regulations are important for reinforcing contractual relationships and also, at times, for altering such relations. For example, they may be the instrument guiding contract renegotiations. Legislated changes may be in the form of increases in rates of taxation or outright nationalizations. The contract is important in setting out the primary relationships among parties.

This section looks mainly at the different types of contracts, pointing out their similarities and differences. In addition, attention is paid to how well different contracts are suited to varied economic situations. National laws and regulations will be discussed later in the context of nationalizations and contractual renegotiations. In these situations, a legal or regulatory change may gear itself towards redefining the contractually determined relationship between host government and investor. Nonetheless, although different contract forms will be elaborated below in turn, in practice the types sometimes mix with one another.

### a. Modern concessions

Although the traditional concessionary contract is now a relic, concessions survive and flourish in many parts of the world, albeit sometimes as the less politically charged “license” or “lease” (Omorogbe, 1999, p. 60). Fundamentally, what distinguishes these two generations of concessions is the shift from an unequal bargain-based

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\(^5\) Australia provides an example in which the licensing system predominates. On the other hand, in Papua New Guinea mining agreements are of primary importance. (Barberis, 1999, pp. 29–39)
model to a partnership-based one. As the other main contractual forms are introduced below, the differences between the modern concession and the other forms will be discussed. This section sets out the features of the modern concession that underscore its use as a partnership-based model.

The new generation of concession contracts aims to fulfil national development and welfare goals as well as purely financial ones. For example, the contract between Indonesia and P.T. Stanvac Indonesia (PTSI) provides as follows:

“PTSI will plan and conduct all operations under this Contract in the best manner possible for the sound and progressive development of the petroleum industry in Indonesia, will at all times give consideration to the aspirations and welfare of the people of the Republic of Indonesia and to the economic development of the nation, and will cooperate with the Government in promoting the growth and development of the Indonesian economic and social structure by assisting in making available information and technical data relating to enterprises and developments which would be of mutual benefit to the Government and to the operations being conducted by PTSI as contractor for PN” (Petroleum Working Contract Between Indonesia and P.T. Stanvac Indonesia 1964: Article 15).

Just as with the first generation of concessions, today’s contracts grant companies the right to explore, produce and market resources. However, the latitude afforded to companies is relatively curtailed. Control over projects is premised on partnership, not dominance. Accordingly, leading commentators speak of the move from concession to participation (Smith et al., 2000, pp. 418–425; Note, 1973, p. 774). The actual distance between traditional and modern ones often depends on the natural attributes of the country. The most important set of nations in this regard are those that make up OPEC. Countries such as Saudi Arabia, Islamic Republic of Iran, and Iraq all renegotiated traditional concessions, replacing them with dramatically different profit-sharing regimes (Smith et al., 2000, pp. 418–422). Nonetheless, the locus of control has invariably shifted along the continuum towards partnership. Unlike the production-sharing agreement, the terms of participation are mainly based on a grant for a specified period of time.6

6 By way of contrast, the main aim of the production-sharing agreement is to encourage a company to undertake the exploration risk and, in return, provide a flexible period to recoup sunk costs profits.
In many countries, the transmutation of traditional to modern concessions happened through host Government-initiated renegotiations and nationalizations. These contract amendments were most famously carried out in Latin America and North Africa. The terms of the modern contracts that emerged varied by country and project. Although projects were renegotiated by each Government, in the oil sector, OPEC played a significant role in pooling information on terms of renegotiation among member countries (Smith et al., 2000, p. 419). Most governments sought to modify contracts so as to address the excesses of the traditional concessions discussed above.

If the main criticisms of the concessions related to degree of foreign control, geographical scope and duration and also financial compensation, then it is unsurprising that the new contracts sought to rebalance these terms. Governments might limit the acreage of the concession and the duration of the contract. Thus, no longer would companies be granted rights over an entire country. Further, host governments are now keen to ensure that companies cannot leave areas unexplored for long periods. Hosts now have a say in when a company must hand control of unexplored land back to the Government. An Indonesian contract between Indonesia and P.T. Stanvac Indonesia sets forth a minimum expenditure on explorations by the oil company over a number of years:

“a. PTSI must commence exploratory operations in the New Area under this Contract not later than six (6) months after the date the ratification of this Contract is promulgated. The minimum amounts to be spent by PTSI in conducting operations during the first eight (8) years following the date of ratification of this Contract is promulgated shall in the aggregate, be not less than hereafter specified for each of these eight (8) years as follows:

<table>
<thead>
<tr>
<th>Contract Year</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>First Contract Year</td>
<td>U.S. 1,000,000</td>
</tr>
<tr>
<td>Second Contract Year</td>
<td>U.S. 1,000,000</td>
</tr>
<tr>
<td>Third Contract Year</td>
<td>U.S. 1,500,000</td>
</tr>
<tr>
<td>Fourth Contract Year</td>
<td>U.S. 1,500,000</td>
</tr>
<tr>
<td>Fifth Contract Year</td>
<td>U.S. 1,250,000</td>
</tr>
<tr>
<td>Sixth Contract Year</td>
<td>U.S. 1,250,000</td>
</tr>
<tr>
<td>Seventh Contract Year</td>
<td>U.S. 1,250,000</td>
</tr>
<tr>
<td>Eight Contract Year</td>
<td>U.S. 1,250,000”</td>
</tr>
</tbody>
</table>

(Petroleum Working Contract Between Indonesia and P.T. Stanvac Indonesia 1964: Article 4(a)).
Likewise in an agreement between Egypt, the Egyptian General Petroleum Corporation and Esso Egypt Inc. (United States), the concession provides that: “ESSO shall spend a minimum of forty-eight (48) million U.S. dollars on exploration over a period of twelve (12) years”. It goes on to break down amounts that must be spent on a yearly basis. The literature, as far as I am aware, does not provide evidence of whether countries like Indonesia and Egypt have benefited from these modern concession contracts or whether it has been wise for Indonesia, for instance, to pursue PSAs subsequently. The main clauses found in concessions are set forth below. Of course, contracts pick and choose among such clauses and the specifics vary. With regard to finances, royalties, which had previously been tied to volume of production, might be made sensitive to the market value of the resources. Taxation regimes might be instituted, eclipsing a legacy of either no or minimal taxation.

**b. Production-sharing agreements**

Indonesia was first to employ production-sharing agreements (PSAs) (Fabrikant, 1975, p. 3030; Machmud, 1993, p. 179; Machmud, 2000). They are at the heart of present-day controversies over oil extraction from regrets over their use in post-Soviet Russia (Stoleson, 1996-7; Timokhov, 2001-2) to their proposed employ in post-war Iraq. They are less common in mining (Barberis, 1999, p. 155). This type of agreement grants a company the right to explore for natural resources. If resources are not found, then the company is out of pocket. However, if commercially exploitable resources are discovered, then the company has the right to recoup sunk costs and subsequently to share in profits. This is the incentive for shouldering the risk of non-discovery.

The PSA differs from the concession in two main respects. First, it does not grant the company ownership rights over the resource.

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7 See Egypt-Egyptian General Petroleum Corporation/Esso: Concession Agreement for Petroleum Exploration and Production 12/14/74: Article IV (Egypt-Egyptian General Petroleum Corporation/Esso: Concession Agreement for Petroleum Exploration and Production 12/14/74: Article IV Work Program, Expenditures and Management of Operation (b).]

8 Daniele Barberis argues that they are unusual in mining, “because the Government does not have a major interest in receiving the actual production of mining activities as it does with petroleum” (Barberis, 1999, p. 155). Commentators have not seriously considered whether production-sharing agreements should be used more fully in mining. In Indonesia, it was ultimately decided that a preference of such agreements would have an adverse impact on the ability to secure foreign investment insurance (Barberis, 1999, p. 155).
Accordingly, the Government may take a greater interest in technology transfer, preparing for the eventual turning over of the resources to its hands. Further, unlike the concession, which grants the company rights over the resource for a specified period of time, the PSA grants the company an interest in the resource that is tied to the recouping of sunk costs and, then of course, to the garnering of a profit. It may be useful for a host Government that is keen to encourage a company to undertake the risk of exploration. The company might find it more useful than a modern concession, for instance, in the situation in which a company is uncertain about its ability to recoup its sunk costs within the strictly definite time period provided for by the modern concession. Dzienkowski identifies the three key issues that PSAs must address: “(1) the existence of a work program or minimum dollar contribution towards development; (2) the duration of the exploration and development phase; and (3) the sharing of benefits of production between the multinational and state oil company if production is achieved” (Smith et al., 2000, p. 454).

Importantly, during a successful post-discovery phase of cost recoup and profit garnering, the Government does take a share of the financial largess through taxation and royalty.

Roughly, PSAs have been devised to encourage private investment in untested areas. Host governments appreciate certain attributes of private companies, as can be seen from the Agreement on the Exploration, Development and Production Sharing for the Shakh Deniz Prospective Area in the Azerbaijan Sector of the Caspian Sea:

“Whereas, Contractor has the technical knowledge and experience, the administrative and managerial expertise, and financial resources to efficiently develop and produce the Petroleum resources of the Contract Area, and desires to contract with SOCAR for that purpose” (Final Consolidated Version 3/30/96: Preamble).

As a result, companies are given special financial incentives to invest, but must also shoulder the risk that no resources will be found. Along these lines, the Azerbaijan contract grants the companies the “sole and exclusive right to conduct Petroleum Operations within and

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9 The agreement was signed between the State Oil Company of the Azerbaijan Republic (Azerbaijan), on the one hand, and Socar Commercial Affiliate (Azerbaijan), BP Exploration (Azerbaijan) Limited (United Kingdom), Elf Petroleum Azerbaijan B.V. (France), Lukoil International Limited (the Russian Federation), Oil Industries Engineering and Construction (Islamic Republic of Iran), Statoil Azerbaijan A.S. (Azerbaijan) and Turkish Petroleum Overseas Company Limited (Turkey), on the other hand.
with respect to the Contract Area” (Final Consolidated Version 3/30/96: Article 2, Section 2.1).

To entice companies to seek out resources, the host Government, upon discovery of resources, allows companies to recoup sunk costs and to garner an agreed-upon profit. If the company does not succeed in finding resources, then it is generally out of pocket. The Azerbaijan agreement, for instance, provides:

“2.2. Except as expressly provided elsewhere herein, in the event production resulting from Petroleum Operations, upon completion of commercial production from the Contract Area at the end of the term of this Agreement, inclusive of all extensions provided in Article 4 is insufficient for full recovery of Contractor’s Capital Costs and Operating Costs as provided hereunder, the Contractor shall not be entitled to any reimbursement or compensation for any of its costs not recovered” (Final Consolidated Version 3/30/96: Article 2, Section 2.2).

If a commercial discovery is made, then the company has the right to recoup sunk costs and an agreed-upon profit. For example, the Azerbaijan contract indicates:

“(a) Contractor shall be entitled to the recovery of petroleum costs as follows:

(i) All Operating Costs shall first be recovered from Total Production;

(ii) All Capital Costs shall then be recovered from a maximum of fifty (50) percent of Crude Oil and fifty (50) percent of Non-associated Natural Gas remaining out of Total Production after Crude Oil and Non-associated Natural Gas required to recover Contractor’s Operating Costs (‘Capital Cost Recovery Petroleum’). (Final Consolidated Version 3/30/96: Article 11 Contractor’s Recovery of Petroleum Costs and Production Sharing, 11.2 Cost Recovery (a)(i) and (ii)).” (Final Consolidation Version 3/30/96: Article 11 Contractor’s Recovery of Petroleum Costs and Production Sharing, 11.2 Cost Recovery (a)(j) and (ii)).”

Afterwards, according to this particular agreement, profit sharing between the host Government and the companies kicks in with a profit-sharing formula (Final Consolidated Version 3/30/96: Article 11, 11.5 Profit Petroleum).
Under PSAs, in the partnership forged between governments and companies, the host maintains varying degrees of oversight over decision-making. The life cycle of the project is important here. If a project will eventually shift to Government control once the company has recouped costs and captured a profit, then the host must plan from the start for this eventuality. This means that decisional control is partially reserved to the Government even during the period of robust private involvement.

The Government must also ensure that it has the knowledge and expertise necessary to eventually run the project. The attendant increased micro-level Government participation is also in line with the overarching emphasis on partnership.

c. Joint ventures

Also in line with the partnership-based approach, under the joint venture (JV) arrangement, the foreign company does business with a national State-owned company. The venture may involve creating a jointly controlled project company. Like the concession and the PSA, it is important to look to the specifics of the venture’s legal arrangement in order to ascertain the extent to which the control over the companies rests in foreign or domestic hands. As indicated, contract types often blend into one another. What is important about the JV, in distinction to modern concession and PSAs in the purest forms, is that it provides a corporate-based, structured means for technology transfer and shared decision-making. Of course, such goals may be accomplished through other instruments; however, a corporate partnership may be the most strategically attuned means available.

JV agreements may be found throughout the world. As contracts are not generally public, it is not possible to conclude that they look the same everywhere. Nonetheless, it is fair to assume that the contents of JV contracts are shaped by political exigencies everywhere. Thus, when the host Government is in a strong negotiating position, the local partner may have greater rights than in a situation in which the local strength is limited. The politicized nature of these arrangements is evidenced by the recent controversy over the Russian Government’s intervention in the Sakhalin-2 project, a JV among Shell, Mitsui (Japan) and Mitsubishi (Japan).

Importantly, JVs may be incorporated into other contractual types, such as PSAs. For example, the Azerbaijan contract involves mixed corporate participation. The relevant clause is set out in the next section.
Likewise, the Camisea project discussed in the human rights section below is a JV project. It is important to look to the specific clauses included in the JV agreement. Once again, this may be more a matter of picking and choosing than contract form-specific considerations.

Like the PSA, the JV arrangement puts a premium on technology transfer. The aim is to foster eventual genuine independence by the State-owned company. Inevitably, the prospect of independence runs counter to the interests of foreign companies. As a result, the extent of technology transfer built into the joint venture is negotiated and varies depending upon the bargaining strength of the national government.

d. Service contracts

Often, the Government seeks to exert greater control over the exploration and exploitation of its resources. It may do this through service contracts, whereby private companies are brought in to accomplish carefully delimited tasks. Unlike modern concessions, PSAs and JVs, service contracts are thought of as a device in which the host Government exercises the greatest control over a project. In this case, the host Government is only contracting in the foreign company to perform a carefully delimited service. The company does not generally share in the revenue produced. Thus, the host Government does not yield control of the resource in a meaningful way. Under the service contract, a host Government must have the requisite technological know-how and access to capital. Often, this is not the case when exploration risk capital is required. It is also important to remember that a service contract might be for a minor task and thus preferable to the other contract forms. The three main types of service contracts are the risk service contract, the pure service contract and the technical assistance contract.

Risk service contracts. Like PSAs, risk service contracts address a situation where a host Government is seeking to use private companies to bear the risk of exploration. Two scenarios are envisioned: either commercially exploitable resources are identified or they are not. If they are, then the company receives cash remuneration for its efforts in addition to a possible stake in the subsequent enterprise. If resources are not found, then the company is out of pocket (Omorogbe, 1999, p. 63; Neto, 1985). These types of contracts are generally out of favour. (Smith et al., 2000, p. 511).

Pure service contracts. More straightforward are pure service contracts, whereby a company is brought in to perform a defined service and compensated accordingly. Unlike risk service contracts, the
host Government shoulders all risks. Under this type of contract, the company also acquires an interest in the extracted resource (Omorogbe, 2000, pp. 63–64).

**Technical assistance contracts.** Technical assistance contracts represent the last main type of service contract. Their scope is narrower. As with the other service contracts, the company is brought in to perform a defined task for which it receives a fixed compensation. Unlike the other service contracts, however, the company has no possibility of acquiring an interest in the resource (Omorogbe, 2000, p. 65). Importantly, the technical service contract appears closest to a transnational public-private partnership, in which the host Government is the strongest party. Once again, it is important to recognize that contract choice is tied as much to rhetorical needs as anything else:

“The technical assistance agreement is one of several types of arrangements that can be used to take advantage of the multinationals’ technological and managerial expertise and capital resources while allowing the host country to maintain at least the appearance that its State oil company has control and ownership” (Smith et al., 2000, p. 512).

Often, service contracts are held out as the ideal choice in situations characterized by nationalism. However, the value of a host country’s natural resources may be more determinative of contract form choice. Nonetheless, as indicated above, the meaning of the contract may ultimately lie in the content of the clauses.

**e. Contractual clauses**

As indicated above, the choice of contract type might be less important than the content of particular contract clauses. Dzienkowski argues:

“As stated before, although one can attempt to offer conceptual and theoretical differences among the three [contractual types], in reality it may be difficult to classify petroleum agreements into one category. This difficulty may result from a harmonization of agreements whereby the parties are borrowing the best type of agreement to fit a particular situation” (Smith et al., 2000, p. 472).

In a joint venture arrangement, a contract may specify the percentages held in the enterprise by the various contracting parties. For example, the Azerbaijan contract provides the following breakdown:
1.1 The Rights and Obligations under this Agreement of each of the Contracting Parties shall be held in the following respective percentage of Participating Interests as of the date this Agreement is executed:

<table>
<thead>
<tr>
<th>CONTRACTOR PARTIES</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>SCA</td>
<td>10.0%</td>
</tr>
<tr>
<td>BP</td>
<td>25.5%</td>
</tr>
<tr>
<td>Elf</td>
<td>10.0%</td>
</tr>
<tr>
<td>Lukoil</td>
<td>10.0%</td>
</tr>
<tr>
<td>OIEC</td>
<td>10.0%</td>
</tr>
<tr>
<td>Statoil</td>
<td>25.5%</td>
</tr>
<tr>
<td>TPAO</td>
<td>9.0%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

(Final Consolidation 3/30/96: Article 1 Participating Interests, Section 1.1.).

The number of parties to such an agreement and their according shares will, of course, be project dependent.

Another important clause in a contract is the one setting out reimbursement for sunk exploration costs. In some cases, the project company will shoulder this risk, as under the risk-sharing agreement. In other cases, the host Government may cover all or part of this cost. A clause might indicate the company’s responsibilities during the exploration phase. This might include a commitment to spend a specified amount of money on exploration or to undertake an agreed level of exploration. There may be a provision within the contract indicating the circumstances under which the company may be granted an extension of the time allotted for exploration.

A different set of provisions may govern the discovery phase. For example, the company will be obligated to notify the host Government in the case of a discovery of a commercially exploitable resource. The Azerbaijan contract here provides:

“4.4 Discovery

Before the end of the Exploration Period or if the Contractor enters the Additional Exploration Period then [sic] before the end of the Additional Exploration Period, Contractor shall notify SOCAR in writing of a Discovery and its commerciality, summarising relevant information relating to said Discovery, including but not limited to the following, to the extent same are available: location
plan, geographical maps and interpretations, seismic and other
data, well logs, core sample, lithographical maps and description of formations, drill stem tests, completion reports, production tests including quantities of fluid produced, build-up/draw down tests and pressure analysis, and analyses of oil, gas and water samples and other information consistent with generally accepted Petroleum industry practice” (“Notice of Discovery and its Commerciality”). (Final Consolidation 3/30/96: Article 1, Section 4.4).

Contractual clauses may also set out specific terms governing the production phase. This phase may last a number of years and a clause may set out the conditions upon which it may be extended. It may be important for the host Government to set out specific commitments during this phase, because, as indicated earlier, it is possible that host Government and company interests may diverge, that is, it might not be in the commercial interests of the company to exploit fully reserves within a time frame that the Government desires.

As indicated in the section on PSAs, many of the decisions regarding the strategic exploitation of reserves may be governed by an oversight committee with representatives from the host Government and the companies. A mechanism for decision-sharing may be a useful way of resolving conflicting commercial and political interests.

Contracts may also stipulate certain local content preferences. For example, a contract may include a clause indicating that the company is to employ local workers, as long as they meet certain qualifications. For example, the Azerbaijan contract provides:

“(b) Contractor shall require Operating Company to give preference, as far as is consistent with efficient operations, to employ citizens of the Azerbaijan Republic in the performance of Petroleum Operations to the extent reasonably practicable, provided that such citizens have the required knowledge, qualifications and experience. Such citizens shall be eligible for training in Accordance with Article 6.8” (Final Consolidation 3/30/96: Article 1, Section 6.7(b)).

The host Government might require that the company train locals. Likewise, a company may agree to source goods locally. For example, the agreement between Egypt, the Egyptian General Petroleum Corporation and Esso Egypt Inc. (United States) provides in the relevant part:
“ARTICLE XXIII
LOCAL CONTRACTORS AND
LOCALLY MANUFACTURED EQUIPMENT
(a) The Operator and its contractors shall: –
(1) Give priority to local contractors as long as their prices and performance are comparable with International prices and performance. The Operator shall, however, subject to the preceding sentence, be exempted from the provisions of Presidential Decree No. 1203 of 1961 as amended.
(2) Give preference to locally manufactured materials, equipment, machinery and consumables, however, such material may be imported for operations conducted hereunder if the price of locally manufactured material at Operator’s stores is more than ten (10%) per cent higher than the price of the imported material at Operator’s stores.” (Egypt-Egyptian General Petroleum Corporation/Esso: Concession Agreement for Petroleum Exploration and Production 12/14/74: Article XXIII(a)(1) and (2)).

It is also worth noting that contracts may require the company to keep certain records of its operations. Governments may find such provisions useful in determining taxation and royalty rates. Governments may not always have the expertise or capacity to enforce certain revenue schemes. Thus, such clauses may reduce the burden on the Government.

Moving forward in the project cycle, contracts may provide for the transfer of control away from the company and towards the host Government. For example, a clause may provide that facilities will transfer to the Government as the company leaves the country. The clause may stipulate the condition of the facility, for instance. And, lastly, as indicated in the section on renegotiations below, a contract will typically include a clause indicating how possible disputes will be resolved; both the forum and choice of law may be stipulated in the contract.

In conclusion, it is important to note that one cannot generalize about revenue-sharing and the prevalence of specific contract clauses within agreements. Such information is not publicly available. At the same time, it can be debated whether it would be in the interests of developing countries to have such information published. At present, it is the sort of information that experienced countries and active law firms might hold privately.
5. Bilateral and multilateral agreements

Although this article focuses mainly on different contract types, it is important to point to some key bilateral and multilateral legal issues. Because of space constraints, this section considers a few selected issues rather than providing a cursory survey. It first looks briefly at bilateral investment treaties (BITs) and bilateral subsidy programmes before turning to the multilateral level, looking at the subsidy programmes of international financial institutions.

Parties to an investment agreement generally stipulate the choice of law and forum in which any contractual disputes will be heard. A dispute might be heard in an international arbitration tribunal or else in the national courts. Parties may have to exhaust local courts before turning to the international tribunal. In situations of ambiguity, a relevant BIT between the governments of the respective parties may provide guidance.\(^{10}\)

Many international projects rely on public and private sources of financing, domestic, foreign and international, raising various legal implications. National public banks and insurance agencies play a role in facilitating projects through subsidy programmes. These subsidies range from the political risk insurance provided by the United States Overseas Private Investment Corporation (OPIC) to the loans offered by the United States Export-Import Bank or the French COFACE. These public subsidies are used by project companies to encourage private banks to invest in projects that are otherwise too politically risky. Importantly, developing countries increasingly have their own export banks which play a role in facilitating South–South investment. Public banks may facilitate private investment through finance sweetening insurance policies, loan agreements and feasibility studies. They may also mitigate political risk through informal political intervention. In other words, their involvement may mean that the home State government of the multinational involved might be willing to step in should a conflict arise with the host Government and use diplomacy to smooth the situation out.

\(^{10}\) Otherwise, it is worth noting that legal scholars are currently debating the significance of BITs for development (Elkins et al., 2006; Rose-Ackerman and Tobin, 2005). To date, however, legal studies have not isolated oil and gas or hard mineral extraction for study. Thus, given the early stage of these studies and the lack of relevant sector-specific published data, it is too early to generalize about the relationship between BITs, investment and development in our area.
At the international level, subsidies similar to the bilateral-based ones exist. The Energy Charter Treaty is relevant in this context as it advances sustainable, sovereignty-respecting development. The most important public subsidies are offered by the World Bank Group through the IFC and MIGA. The Oil, Gas, Mining and Chemicals Department of the IFC is particularly relevant. For example, the Baku Tbilisi Ceyhan oil pipeline relies on a diverse set of public agencies. The pipeline part of this project runs through several countries, including Azerbaijan, Georgia and Turkey. Among others, this pipeline is financed by seven export credit agencies, the European Bank for Reconstruction and Development, the IFC and fifteen commercial banks. Each bank, public and private, will have its own set of project documentation. This may mean multiple loan agreements, each with its own set of terms and conditions. At the same time, the actions of multiple public and private banks are often coordinated.

These public agencies may attach certain conditions to their subsidies. For example, both OPIC and the Export-Import Bank often attach environmental and human rights conditions to their loans. Complying with these conditions may mean establishing special entities or else hiring consultants to ensure that wishes are fulfilled. Such conditions will be discussed in detail below. Importantly, they must be understood in tandem with international efforts through the IFC and MIGA. They must also be related to the initiative by the major private investment banks involved in projects, the so-called Equator Principles.

6. Selected state-of-the-art issues

Talk of oil and gas and also metal mineral projects regularly occupies our headlines. This section seeks to focus on three bones of contention: (1) contract renegotiations; (2) the proposed law for governing resources in Iraq; and (3) human rights and environmental contractual issues.

a. Contract renegotiations

Contract renegotiations have recently dominated the public reporting of Bolivia, Ecuador and Venezuela. In each country, the

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Government has justified the renegotiations on development grounds.\textsuperscript{12} This section briefly presents the controversy, discusses legality issues that may emerge and provides some observations on the relationship between the present wave of renegotiations and development.

In Bolivia, the Government passed Hydrocarbon Law 3058 in 2006. This law repealed the 1996 Hydrocarbon Law which had privatized the sector, moving control over resources back to the State. Control over resources was thus transferred to the State agency, Yacimientos Petrolíferos Fiscales Bolivianos. Nonetheless, foreign companies are likely to continue to play a role in the future as well given the lack of national expertise. Accordingly, although the 2006 law cancelled contracts, it also directed the negotiating of new ones but on terms more favourable to the Government, including higher tax and royalty rates. As in Venezuela, the aim is to establish a series of joint venture agreements.\textsuperscript{13}

In Ecuador, the new hydrocarbons law set off a policy of contract renegotiation and increased Government revenue from projects. In a parallel but thematically related action, the Government entered into a dispute with Occidental (Vasquez, 2007). In turn, Occidental brought an action in connection with demands for the payment of value-added taxes.\textsuperscript{14} Investments in Venezuela must now be pursued through the State-owned company, Petroleos de Venezuela, S.A. Both service contracts and joint ventures are possible. In 2001, the Government passed a new hydrocarbons law. In part, it required that future investments be under 51 percent control by the State company (Hydrocarbons Law of 2001:...
Article 22). However, the Government has progressively renegotiated existing contracts to comply with this requirement. A presidential decree in February 2007 expropriated projects in the Orinoco River Belt. In doing so, it formed mixed corporate entities charged with exploiting resources. Petroleos de Venezuela is to hold majority stakes in these entities. Further, the decree provides that any disputes regarding the Orinoco projects will be heard in Venezuelan courts according to Venezuelan law (Dugan and Profaizer, 2007). Also significant, Article 44 of the Hydrocarbons Law raises royalty rates.15

At times, talk of the introduction of new taxes, royalties or price ceilings extended to Algeria, Argentina, Chad, the Russian Federation and others (AFX International Focus, 2006). For example, Chad plans to establish a State-owned oil company and renegotiate certain contracts. Similarly, Equatorial Guinea also aims to renegotiate contracts. Mauritania has sought to sever certain contracts. The Russian Federation has changed positions on the advisability of production-sharing agreements.

No clear evidence in the legal literature exists as to whether the present wave of renegotiations advances developmental goals. A consensus has emerged that previous negotiations had some justification given the need to combat the legacy of colonialism. At the same time, a case might be made that the present wave could promote development goals if the renegotiations guaranteed an equitable redistribution of revenues from resources. Whether this is achievable will depend on the terms of renegotiations, the micropolicies of State-owned companies, legislative action and also the ability of governments to maintain foreign financial and corporate interest in their projects.

Legal arguments for and against renegotiations and nationalizations occur along a spectrum. At one end, detractors argue that contracts should include stabilization clauses, freezing the law governing the contract to the one in force at the time of contract formation. Such arguments are based on the principle of “sanctity of contract”; the position that the wishes of the parties as embodied in the terms of the agreement should govern. An Egyptian contract provides an example of a contract that avoids renegotiations:

“(b) The rights and obligations of EGPC and ESSO under, and for the effective term of, this Agreement (as well as matters relating

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to the Joint Company subject to Article IV hereinabove) shall be governed by and in accordance to the provisions of this Agreement and can only be altered or amended by mutual agreement of the parties.” (Egypt-Egyptian-General Petroleum Corporation/Esso: Concession Agreement for Petroleum Exploration and Production 12/14/74: Article XVI Rules and Regulations (b)).

The Russian law governing PSAs provides investor protections against changes in legislation, while specifying certain exceptions:

“2. In the event that within the duration of the agreement the legislation of the Russian Federation, the legislation of subjects of the Russian Federation and normative acts of self-government set norms deteriorating the commercial results of the investor’s activities within the framework of the agreement, amendments shall be made to the agreement which shall safeguard those commercial results of the investor which he would have obtained if the legislation of the Russian Federation, the legislation of the subjects of the Russian Federation and normative legal acts of local self-government effective as of the conclusion of the agreement would continue to apply. The procedure for the introduction of such amendments shall be specified in the agreement.

The aforesaid provision concerning a change of the terms and conditions of the agreement shall not apply in the event that the amendments are introduced by the legislation of the Russian Federation to the standards (norms, rules) for the safe conduct of works, the protection of the subsoil, the natural environment and the health of the population, including their modification to adapt them to similar standards (norms, rules) which are accepted and generally recognised by international practice.” ([Russian] Federal Law on Production Sharing Agreement 1996: Article 17(2)).

A middle position is that parties may voluntarily incorporate a renegotiation clause into the contract itself. An example of a renegotiation clause occurs in the agreement between Kuwait and Aminoil (United States):

“If, as a result of changes in the terms of concessions now in existence or as a result of the terms of concessions granted hereafter, an increase in benefits to the Governments in the Middle East should come generally to be received by them, the Company shall consult with the Ruler whether in the light
of all relevant circumstances, including the conditions in which operations are carried out, and taking into account all payments made, any alterations in the terms of the agreements between the Ruler and the Company would be equitable to the parties” (quoted in Kroll, 2004).

Renegotiation clauses are inserted in many contracts. Renegotiations generally can be squared with national and international laws, although with some contrary voices. For example, Abba Kolo and Thomas Wälde argue that the spirit of the contract may be more important than the actual written text. They acknowledge that in principle:

“[t]he philosophy behind renegotiation is that the contractual relationship is more important than the formal contract document itself and that parties will make all efforts to let this relationship survive if and to the extent that it is in their interest to let the relationship survive – and sometimes send a signal to the outside world over the ‘reasonableness’ of the government or company in dealing with its partners on a long-term basis of mutual benefit and trust” (Kolo and Wälde, 2004).

Zeyad A. Al Qurashi argues that “a renegotiation clause may play a facilitative role in stabilizing long-term agreements such as international petroleum agreements, whose nature creates a high risk of instability” (Al-Qurashi, 2005, p. 268). As a practical matter, it could be argued that it is within the sovereign’s prerogative to renegotiate contracts, if not de jure then certainly de facto. Generally speaking, as a matter of doctrine, it would be difficult to sustain the position that renegotiations are absolutely contrary to national or international law.

Nonetheless, the conflict in international law is between freedom of contract and sovereign prerogative, on the one hand, and sanctity of contract and stabilization, on the other. Unsurprisingly, the host State might seek to have disputes heard within its own courts applying its own laws. On their side, investors have sought to guard against host State legislation or regulation that modifies the terms of the host State agreement both through choice of law and forum provisions and also the insertion of stabilization clauses (Muchlinski, 1995, p. 494). With regard to the former, the aim is to have disputes resolved in more investor-friendly international tribunals. Furthermore, investors seek to have a law friendly to their interests govern the dispute. The use of a stabilization clause aims to freeze the national law applicable to the contractual relationship to that one in force at the time the contract was entered into.
Tribunals have taken different sides on this debate. On the one hand, in certain cases, international tribunals have sided with contract stabilization and sanctity of contract, most notably in Texaco’s dispute with Libya. The general position has, however, gone the other way, with “fundamental change of circumstances” sometimes cited as justification (Muchlinski, 1995, pp. 493–497). As argued by one scholar: “despite the above-mentioned arguments favouring the strict stability of international investment agreements, international practice in this field has increasingly favoured the periodic renegotiation of such agreements […] In these circumstances the international legality of renegotiation per se can no longer be doubted” (Muchlinski, 1995, p. 497). At the same time, coercive action, duress and discrimination must be guarded against (Muchlinski, 1995, pp. 498–501). Where “a foreign investor is irrevocably deprived of its contractual rights in a joint venture created under an investment agreement, such an interference will give rise to a right of compensation” (Muchlinski, 1995, p. 501). Although it is outside the scope of this article, the appropriate standard for determining compensation is contested and positions taken on it will depend upon the strategic interests of disputants.16

Renegotiations have been triggered by a variety of factors, and tribunals have addressed the fallout. The issue has not been entirely whether changed circumstances justify the renegotiations, but rather a focus on how the renegotiations themselves have been conducted. Generally, a norm has emerged which concentrates on the renegotiation process, taking into account the original agreement, good faith between parties, and the need for a tailored renegotiation period.17 Importantly, a duty to renegotiate in due faith has been established by at least one tribunal. In another important case, the trigger was the Iranian revolution (Al-Qurashi, 2005, pp. 292–299).

The shift from traditional concessions to the modern partnership-based agreements often involved contract renegotiations and sectors

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17 For example, in the AMI-NOIL case, a rise in oil profits in the early 1970s led to an attempt by three Arab States to reformulate the revenue share. Subsequent negotiations failed, and the Government of Kuwait severed its agreement with AMINOIL. The renegotiation had occurred under the auspices of a contractual clause, and the court in part decided on whether the renegotiation had in fact been carried out properly. Thus, the concern was with establishing a new contractual equilibrium. In another case regarding relinquishment, the tribunal took the original contract into consideration when determining the new equilibrium.
mainly during the nationalizations of the 1970s and 1980s and generally occurred in the extractive industries (Muchlinski, 1995, p. 493). In addition to the OPEC renegotiations, as Kolo and Wälde point out, others have taken place in Papua New Guinea (1967), Chile (1967–1971), Jamaica (1974), the Dominican Republic (1987, 1988), Peru (1985) and Colombia (1996).\(^{18}\) Importantly, they have not been limited to developing countries; advanced capitalist economies such as the United Kingdom have pursued renegotiations. Further, they have not just been instigated by governments. At times, companies have pushed for them (Kolo and Wälde, 2004).

Commentators often tie the recurrence of renegotiations to the nature of the underlying contract between host State and foreign corporation. These contracts in the extractive sectors are often long term. As a result, over their lives, the value of the commodity may fluctuate. Perhaps unsurprisingly, as prices rise significantly, governments seek a larger share of profits. Renegotiations generally occur in a “period of increased prosperity, in which the sense of dependence on foreign investors may be reduced and nationalistic sentiments heightened” (Muchlinski, 1995, p. 493). Similarly, writing in an earlier period of recession, another scholar argued that:

“When conditions change, it is reasonable to assume that the developing countries will once again make efforts to assert ‘permanent sovereignty’ over their natural resources in whatever way possible and that since it is their second time around, they will achieve greater success. Any supposed ‘incentives’ or stabilization measures which have come into existence during this period and which appear to run counter to nationalistic ideals are likely to prove problematic in the long run” (Omorogbe, 1997, p. 30).

The present wave of renegotiations may simply mean reallocating profit shares between governments and companies. Accordingly, in a situation of renegotiation, a company will remain in a project so long as the proposed reallocation is financially still in its interests. The Government will accommodate the company in this respect, so long as it still relies upon the company’s expertise. Further, the Government must take care not to upset other potential investors: companies and banks, ratings agencies and insurers.

\(^{18}\) For an overview of these renegotiations see Kolo and Wälde (2004).
Commentators disagree over whether the present wave of contract renegotiations advances development goals. Importantly, literature touching on this issue is sparse. Nonetheless, arguments exist on both sides. A pro-renegotiation law-based position has been advanced by a non-lawyer, Joseph Stiglitz. His argument was put forward in relation to the Bolivia renegotiation in the form of a newspaper piece, not an academic article. Stiglitz argues that the Bolivian renegotiations were justified based on their “attempt to represent the interests of the poor people of [the] country” (Stiglitz, 2006), maintaining that the privatizations which the recent renegotiations sought to overturn were themselves not legally valid, having not passed through Congress as required by law. He thus likens the renegotiations to the return of stolen artwork:

“Moreover, many deals were apparently done in secret by previous Governments – and apparently without the approval of Congress. Indeed, because Bolivia’s Constitution requires the approval of Congress for such sales, it isn’t clear that Morales is nationalizing anything: the assets were never properly sold. When a country is robbed of a national art treasure, we don’t call its return ‘re-nationalisation’, because it belonged to the country all along” (Stiglitz, 2006).

Thus, the Bolivian people, the argument goes, are entitled to a fair share of profits from their natural resources. Whether the argument put forward by Stiglitz can be generalized to renegotiations throughout the region requires further study. Nonetheless, his argument that contracts must be made in an open and transparent manner does seem a prerequisite for any development inducing renegotiation.

A broader point might be made regarding transparency and contracts in this area. The overriding norm is non-disclosure. Nonetheless, important progress has been made by the Extractive Industries Transparency Initiative (EITI) and other initiatives, which crucially do not abrogate the principle of non-disclosure. For example, in Azerbaijan, efforts have been made to publish relevant information in the aggregate so as to assuage confidentiality concerns. Promisingly, these initiatives are leading to the publication of revenue information, and inquiries into how revenues are being directed have on occasion been initiated. At the same time, it is important to move towards the publication of contracts themselves. As the discussion of the contract types and clauses above showed, development issues may be found in many areas of a contract. In Ghana, companies have moved to publish how revenue streams have been directed to areas such as education, health, and infrastructure. Similarly, Nigeria has started to ask related
questions. Effective public oversight requires disclosure of key terms. Arguably, disclosure will depend on the willingness of corporations to support transparency. It has not been proven that so-called Western companies are more likely to participate in transparency initiatives than their developing country counterparts. In an era of multinational joint ventures, it may be that any difference is arguably diminished.

Without the broad publication of contracts, it is difficult to determine the practical significance of renegotiations for development. It may be that determination of the developmental aspects of these renegotiations requires the publishing of contracts, both before and after renegotiation. The focus on making revenue information public by countries such as Kyrgyzstan is promising. Otherwise, it is not obvious where the new revenue is being allocated. It is also not clear whether the structure of the relationships between host governments and firms is itself being reformulated to serve development goals.19

Others argue that the present renegotiations run counter to the interests of developing countries and should only be pursued in exceptional circumstances. They distinguish the OPEC renegotiations from the present wave. In doing so, the argument made is that sanctity of contact is a pillar of development-inducing globalization. Thus, contracts should be respected. If a country goes wayward, it may not be legally sanctioned. However, the logic of the market will reverse any perceived gains. Kolo and Wälde underscore this impact: “loss of reputation and credibility, not the threat of legal sanctions (which does matter a lot) […] The fear of being ostracized, isolated and boycotted by other players may not only have a psychological effect but may influence, in a practical and positive way, respect for contracts” (Kolo and Wälde, 2004, p. 28).

What then are the lessons from the present wave of contract renegotiations? For one, determination of the developmental impact of renegotiations should not turn on questions of legality, not because of jurisprudential uncertainty but instead because of the infrequency of recourse to tribunals to resolve today’s disputes. At the same time, Kolo and Wälde correctly observe that threats of litigation may be important, although this is a difficult variable to measure. From a developmental perspective, however, law is nonetheless important in at least two respects. First, it will be important to look at the actual terms of the renegotiation as embodied in the amended or new contract. For example, does the

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19 Examples here and elsewhere of transparency initiatives may be found in the Extractive Industries Transparency Initiative, Source Book (March 2005).
renegotiated contract place new responsibilities on the multinational when it comes to alleviating poverty? If the contract is simply a reallocation of profits, a second point arises: is the host Government using the revenues itself either through legislative or regulatory action in a manner that advances the interests of development? There is no data on the renegotiations in this regard. However, in situations in which international financial institutions are involved in projects, human rights and environmental conditionalities may be monitored by the hiring of consultancy firms.\(^{20}\)

From a legal perspective, in answering these questions, it will be necessary to monitor the evolution of legislative and contractual provisions aimed at achieving development through renegotiation. The literature on these issues is understandably provisional given the state of knowledge. Furthermore, as we will see in other areas, it is necessary to attend not only to legal pronouncements, but also how laws function in practice.

\textbf{b. Iraq}

This section discusses two issues raised by the proposed Iraqi legislation covering oil and gas. It looks at contract choice and renegotiations. Importantly, the contract types provided in the legislation accord with the general public-private partnership approach, given the importance of commercial interests in providing “technical, managerial and operational skills as well as robust capital resources” (Preamble). At the same time, it favours “substantial national participation” through overarching management as well as through national companies, “Iraqi products and services”, “training and technology transfer”, and also “affiliations, joint ventures and other forms of partnership and or cooperation in order to promote the rapid growth of an Iraqi private sector capable of assisting and enhancing Petroleum Operations to the mutual benefit of the said holders and the nation” (Article 15). It is within this backdrop that the identified issues should be understood.

A few initial words might be said about the Federal Oil and Gas Council. It plays an advisory role to the Council of Ministers. It may propose legislation. It coordinates regions. The Council has the power “to approve major changes in ... plans and policies”. (Article 5(c)), which includes altering contracts. Significantly, it may choose the “appropriate

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\(^{20}\) For example, in the Camisea case discussed next, monthly reports have been filed focusing on compliance with such social development clauses.
contract type”. It may hire consultants, nationals and foreigners, to assist its work. The proposed law sets out the membership of the Council, whose president is the Prime Minister or his/her representative, as comprising:

- Federal Government Ministers from the Ministries of Oil, Treasury, Planning, and Cooperative Development;
- The Director of the Iraqi Central Bank;
- A regional government minister representing each region;
- A representative from each producing province not included in a region;
- Executive managers of from [sic] important related petroleum companies including the national Iraqi oil company and the oil marketing company;
- Three or less experts specialized in petroleum, finance, and economy to be hired for a period not exceeding five years based on a resolution by the Council of Ministers.

The Council shall represent all the different basic components of the Iraqi people (Article 5(c)). It is noteworthy that number 5 above seems to allow for the inclusion of foreign oil companies on the Federal Oil and Gas Council.

In accordance with the dictates of the Iraqi Constitution, the proposed Oil Law recognizes that ownership of the country’s oil and gas lies in the people as a whole. Control over the resources is held by the Federal Government, producing governorates, and regional governments. The proposed law provides some idea of how control will be shared among these entities. As indicated above, representatives from each of these entities sits on the Federal Oil and Gas Council. Generally, the Federal Government seems to wield primary control over resources. Thus, the federal Ministry of Oil is the authority. The Federal Government owns the main pipelines.

The Ministry of Oil consults with the producing provinces and regional authorities in devising policies and plans. The provincial authorities feed into federal decision-making. For example, they make proposals and assist in discussions leading to the finalization of federal plans. They also play a role in licensing exploration and production. Moreover, the authorities monitor operations. The aim is to work with
the Ministry in order “to ensure uniform and consistent implementation throughout the Republic of Iraq” (Article 5(F)). The Ministry must include the producing provinces in every contract negotiation (Article 7 Operation 7). Together they take decisions on exploration (Article 8(E)). While regions have the ability to enter into contracts themselves (Article 9(A)), the Federal Oil and Gas Council may void contracts concluded by regions (Article 10(B)). Municipal and local governments may levy taxes (Article 33(3)).

In the Kurdistan region, the proposed legislation provides a process for reviewing these contracts which are to be judged with the aims of the proposed legislation in mind. The final say over the validity of the contracts lies with the Bureau of Independent Experts (Article 40(A)), which is contracted by the Federal Oil and Gas Council (Article 4(38)). With regard to other pre-existing contracts, the proposed legislation stipulates that the Ministry will review them before the Federal Oil and Gas Council undertakes a review (Article 40(B)). For both the Kurdistan region contracts and the others, the interests of the Iraqi people as a whole are to be a guiding principle.

With regard to contract choice, it is problematic to draw more than tentative observations from the proposed Iraqi legislation. The legislation provides wide latitude to the Government and its agents in designing specific contracts. It aims to choose “the appropriate contract type for the field nature or exploration area that guarantees the maximum benefits for the Iraqi people” (Chapter II, Article 5(C)). The proposed legislation presents a menu of contract types including service contracts, exploration and risk contracts, and exploration and production contracts (Chapter II, Article 9). Caution should be exercised in drawing conclusions about contract choice issues. It will be important to know both the appropriateness of contracts chosen for specific situations and also the clauses used. These decisions will become clear in time.

However, emphasis should be placed on employing contract clauses that reinforce local capacity. For example, attention must be paid to the extent to which the Iraqi National Oil Company is involved in projects. Further, untested areas obviously require ceding greater control to companies than does the exploitation of proven reserves. Political risk should not be confused with exploration risk, although it is possible that international banks may be more willing to finance projects with greater foreign private participation.

Finally, a few words on renegotiations. Legislation leaves open the possibility of honouring, renegotiating or repudiating pre-war contracts.
This flexibility also applies to new contracts that might be subject to future legislative changes. The proposed legislation states in the relevant part that:

“The exploration and production contracts mentioned in Article 10/A must include the following: ‘The contract is valid unless the Federal Oil and Gas Council objects, in accordance to this law (number of 2007). This includes the negotiation and contracting mechanisms, contracting models, and any related future changes in this concern issued by the Federal Oil and Gas Council’” (Article 10(B)).

Thus, in conclusion, the proposed legislation is noteworthy for its flexibility. For this reason, overarching statements regarding its advisability from a development perspective are difficult. It seems to err on the side of host Government discretion. At the same time, if it is in the contract formation that decisions will ultimately be made, it is important to promote transparency so as to mitigate political risk and also to foster a sense of legitimacy. Here, transparency along with public debate over contract choices and clauses could lessen the validity of criticism that decisions over Iraqi resources are made abroad.

c. Human rights and environmental legal challenges

In the legal realm, human right and environmental issues in the extractive industries are often viewed through the lens of litigation under the Alien Torts Claim Act (ATCA). Such cases have been limited recently in certain respects. Similar cases have, however, emerged internationally in the courts of Australia, Canada, Japan, India, and the United Kingdom (Baxi, 1990; Engle, 2005; Joseph, 2004; Muchlinski, 2001). The European Union is also encouraging similar routes into the courts of its Member States. Well-publicized cases that have been written about extensively have been brought against Unocal and Total and also against Chevron and Shell for their alleged roles in perpetrating human rights abuses in Burma and Nigeria respectively. The broader movement of which this litigation is a part is referred to as either “transnational public interest litigation” (Baxi, 1990; Engle, 2005; Joseph, 2004; Muchlinski, 2001) or “plaintiff’s diplomacy” (Slaughter and Bosco, 2002). Essentially, it involves the use of the courts to advance human rights and environmental policies internationally. This human rights litigation appears to be gaining in popularity, despite some jurisprudential setbacks. However, in practice, human rights and environmental issues
are more often addressed by extractive industry projects through non-litigation means, that is, through contracts, voluntary codes, loan agreements and Government regulations (Likosky, 2005, 2006).

It is difficult to generalize about the extent to which projects contractualize human rights and environmental concerns. However, assumedly private international investment banks that have signed on to the Equator Principles incorporate such commitments in their project documentation. Likewise, when international financial institutions such as the IFC, the Inter-American Development Bank and others are involved in financing projects, then similar human rights and environmental documentation will be present. Further, the involvement of export credit agencies may carry with it such commitments in the project documentation. In other words, if all of the major project financiers have made commitments to incorporate these issues in the projects they are funding, then the project documentation assumedly reflects these commitments. As with even the most commercial aspects of agreements, the fact that contracts are not public makes it difficult to authoritatively assert their contents.

To illustrate the importance of non-litigation measures, this section looks at the handling of human rights with the Camisea natural gas pipeline in Peru. Camisea is a transnational public–private partnership involving a multinational mix of public and private actors – domestic, foreign and international. A case-based approach is chosen because of space constraints. Nevertheless, it is possible to generalize lessons learned from the Camisea project to other oil, gas and mineral projects.

The Camisea gas project is representative of human rights and environmental practice more broadly. In this respect, four generalizable features may be identified:

**Mixed transnational financing:** Camisea is financed by private investment bankers, national export credit agencies and an international development bank. The involvement of each type of actor implies certain human rights and environmental conditions. For example, the United States Export-Import Bank’s environmental practices, the private international banks’ Equator Principles and the Inter-American Development Bank’s human rights loan conditionalities are all important. The meaning of legal commitments to human rights and the environment must ultimately be understood by how they are implemented in practice.

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21 In doing so, it draws on Chapter 6 of Likosky (2006).
What we see in most projects is a common set of commitments that are applied differentially.

*Mixed transnational participants:* The project itself is carried out by a group of national and foreign companies. These actors are involved in varying degrees at the different project stages. Significantly, companies may themselves have human rights and environmental policies. As we shall see, Shell’s policies in this regard were important to Camisea in the early stages. They are similarly important in projects internationally.

*Two types of human rights:* In its conception and execution, the project raises what I have classified elsewhere as two types of human rights issues: (a) positive human rights, the promise of public goods; and (b) negative human rights, the possibility that human rights will be infringed upon in the process of production (Likosky, 2006: Chapter 3) Also, consultations and participation by affected communities is emerging as an important norm in projects (Bastida et al., 2005, p. 2; Williams, 2005, p. 49).

*NGO advocacy:* Lastly, a group of local and international non-governmental organizations (NGOs) have chosen to target the project because of perceived environmental and human rights shortcomings. Some of these NGOs play a role in other projects internationally.

Although the relative importance of each of these features varies with country and project, they recur internationally.

The Camisea natural gas pipeline is over 25 years old. Shell and Mobil were originally involved in the project. Despite major discoveries, however, disagreements between Shell and the Government resulted in the company’s withdrawal. Yet during the period of Shell’s involvement in the project, human rights and environmental concerns influenced company policy.

This was mainly as a result of the campaign against Brent Spar in Nigeria that made the company recognize that “We know the eyes of the world are on us” (Watts, 1997) in adopting extensive human rights and environmental-related directives. Shell’s policies ranged from measures to prevent contact with indigenous communities to the vaccination of workers and local communities to biodiversity initiatives. The project involves extraction in the Nahua-Kugapakori Reserve, which is home to a number of indigenous communities including the

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On the Shell policies, see Dabbs and Bateson (2002).
Nahua, Kirineri, Nanti, Marhiguenga and Yine (Grumble, 2003). Shell hired an anthropologist to design policies to safeguard the human rights of indigenous groups through whose communities the project would run (Chaterjee, 1997). It also hired a local NGO.

When Shell and Mobil withdrew from the project, the Peruvian Government began a search for a successor. From an environmental and human rights perspective, it was unclear what the post-Shell period would portend. Peru eventually settled on two consortia of international companies. The first would be responsible for producing the gas, and included Pluspetrol Peru Corporation (Peru), S.A., Hunt Oil Company (United States), SK Corporation (Republic of Korea) and Tecpetrol SA (Argentina). The second was responsible for distribution and was made up of Tecgas N.V. (Brazil), Pluspetrol Resources Corporation (Peru), Hunt Oil Company (United States), SK Corporation (Republic of Korea), Sonatrach Petroleum Corporation B.V.I. (United Kingdom), Tractebel (Belgium) and Grana y Montero S.A. (Peru). Gas was to be produced and then distributed to Lima for consumption and, as available, distributed internationally by Tractebel (Belgium).

Camisea was regulated by the Peruvian Law for the Promotion and Development of the Natural Gas Industry. The Peruvian Energy Tariffs Commission is charged with levying tariffs. The project is carried out through a common public-private partnership contractual scheme, the build-operate-transfer (BOT) arrangement. Legal services were provided for both the upstream and downstream consortia by Sullivan and Cromwell (Sullivan and Cromwell). Clifford Chance represented the Inter-American Development Bank, along with Rodrigo, Elias & Medrano. Peru was also represented by Sullivan and Cromwell, along with Miniz y Associados (Latin American Oil and Gas Deal of the Year 2004 3/05). NGOs sought to influence the post-Shell human rights and environmental practices of Camisea by targeting private international investment banks, the United States Export-Import Bank and the Inter-American Development Bank. Each targeting involved a different set of legal obligations.

23 “Bush, the rainforest and a gas pipeline to enrich his friends”, London Independent, 30 July 2003.
25 Under this scheme, a project company builds the project, operates it long enough to recoup sunk costs and garner a profit and then transfers it ultimately to the Government. Even during the period of nominal private control, the project is premised on a public–private partnership.
Several of the private international investment banks involved in financing the Camisea project had signed on to the Equator Principles – a set of human rights and environmental guidelines. The Equator Principles apply to project finance-initiated projects costing over ten million United States dollars. Together, the banks that have signed on to the Principles represent 80% of the market. In the “Preamble” to the Principles, the banks set out their main purpose:

“The Equator Principles Financial Institutions (EPFIs) have consequently adopted these Principles in order to ensure that the projects we finance are developed in a manner that is socially responsible and reflect sound environmental management practices. By doing so, negative impacts on project-affected ecosystems and communities should be avoided where possible, and if these impacts are unavoidable, they should be reduced, mitigated and/or compensated for appropriately. We believe that adoption of and adherence to these Principles offers significant benefits to ourselves, our borrowers and local stakeholders through our borrowers’ engagement with locally affected communities. We therefore recognise that our role as financiers affords us opportunities to promote responsible environmental stewardship and socially responsible development” (Equator Principles: Preamble).

Although banks sign on to a common set of principles, they implement them in bank-specific ways. The impact and thus significance of the principles will become clear with time. If a project is financed by the IFC and an Equator bank, there will inevitably be some overlap in the commitments imposed by each on the project companies.

It is early to assess the significance of the Equator Principles. In fact, Equator bank projects such as Camisea have been sharply criticized. It may be useful nonetheless to view their significance as groundwork-laying strategies: “It is much more difficult to fight and win battles at project level on issues of broad policy when such general policy is not yet clearly formulated or enacted” (Cernea, 2005, p. 75). Oil projects have increasingly come under the umbrella of the Equator Principles and at times similar IFC commitments. We can expect to see disputes

26 On other private initiatives focusing on mining, see Ostensson (2005).

over IFC projects resolved in inspection panels within the World Bank
Group and regional development banks.

However, it is not yet clear where disputes over the Equator
Principles will be managed. Potential litigants would have to establish
standing to sue, which is difficult since the general public is not a party to
these agreements. The seeming absence of practical justiciability limits
the legal implications of the Equator Principles. Further, the trend towards
greater competition from the Government of China in funding projects
may mean that the international financial institution commitments may
become less significant. It does not seem at present that the Government
of China will attach such human rights and environmental conditions
to the projects it funds. Regardless of the financing institution, the lack
of transparency at the contractual level makes it difficult to challenge
particular clauses on human rights or environmental grounds; if
commitments are not public, then how do we know what clauses are
capable of being breached?

Camisea companies sought financing through the United States
Export-Import Bank, which offers loans and other inducements for
domestic nationals to travel overseas. When the Export-Import Bank
was considering loans, NGOs targeted it, seeking a declination on
environmental and human rights grounds. The Export-Import Bank
takes these considerations into account in its lending. In international
projects involving United States companies, the Bank is a major focus of
human rights and environmental pressure. Other countries have similar
banks. It may be that the Bank places more stringent requirements
on its project lending than other banks. Indeed, this is often assumed
in informal discussions. Such assumptions have not, however, been
subject to rigorous, systematic empirical study. Such an assessment
might be made more difficult by the fact that loan decisions take into
consideration multiple factors and it is difficult to isolate human rights
and environmental considerations. A related issue is the question of
whether China-financed projects are less respectful of human rights and
the environment in practice than World Bank ones. This is a topic that
has received media attention recently. In the case of Camisea, the Export-
Import Bank ultimately declined funding. Although it did not officially
base its denial on human rights or environmental grounds, NGOs saw
it as significant in that respect nonetheless. Camisea companies did
successfully garner financial support from the export credit agencies of
Germany and Italy.
Following the Export-Import denial, the front line quickly shifted to another financier, the Inter-American Development Bank, which ultimately agreed to issue (1) a direct loan for seventy-five million US dollars; and (2) sixty million United States dollars in privately syndicated loans for the project (World Watch, 2003). The United States holds a 30% voting share at the Bank. Its representative abstained from the vote on the project in part on environmental grounds (Ichniowski, 2003). Significantly, the Inter-American Bank attached many human rights and environmental conditions to its loans, financing an implementation programme. In another context, an important contractual dimension to this commitment was explained:

“In an unprecedented move by the IDB, the failure to comply with the human rights [and environmental] conditions is grounds for default on its loans. As well, although the IDB only loaned money to the upstream component, it made its loan with the upstream consortium companies also conditioned upon the implementation of human rights [and environmental] conditions in the downstream component of the project. This condition resulted from the adjustment of several contracts ‘to comply with internationally recognized social and environmental standards.’ In an effort to ensure compliance with the loan conditionalities, over four hundred consultations on the environmental and human rights impact of the project were made during the design phase.” (Likosky, 2005, pp. 126–127).

The ability of Camisea to realize the goals of the Equator Principles and the Inter-American Bank conditions will depend on the success of the implementation programme. It is too early to make a confident assessment. The significance of these and other soft laws in Camisea and other projects lies in both the nature of legal commitments and also in their implementation, often through the execution of contractual clauses.

7. Conclusion

An overall move away from the unequal traditional concession and towards more modern transnational public-private partnership-based contractual arrangements has occurred in the extractive sector. At the same time, the power balances of these present-day partnerships vary according to the natural resource wealth and indigenous expertise of the host state. These factors will determine the choice of contract and also the specific terms governing relationships. When looking at
issues such as contract renegotiation, Iraq’s proposed oil law and also human rights and environmental issues, each of these issues relates to (1) the appropriate allocation of responsibilities and benefits within the partnership agreement; and (2) the correlation between the nature of contractually determined responsibilities and the promotion of development.

Although it is not possible to advocate for a one-size-fits-all contract for any purpose, it seems reasonable to argue that host governments should focus on maximizing revenue. One of the successes of the OPEC renegotiations was that countries were able to share experiences, and this sharing led in turn to more favourable contractual terms for all members. Arguably, the publishing of contracts broadly may serve a similar purpose. It would also perhaps lead to more effective clauses aimed at technology transfer and local training. Such clauses are to be recommended to developing countries to the extent that their negotiating strength allows. Further, in the human rights and environmental context, a need exists for the publishing of best practices. Thus, an overall recommendation might be made for transparency, subject to reasonable disclosure.

References


*EnCana Corporation v. Republic of Ecuador* LCIA Case No. 3481 (2/3/06)


