WORLD GAS CONFERENCE ABSTRACT SUBMISSION

RESOURCE NATIONALISM AND THE LAW

PAUL GRIFFIN

1. INTRODUCTION

The subject of this paper is resource nationalism and this paper addresses the tension over time between States exercising their sovereign control over natural resources and investors seeking access to those natural resources.

2. RESOURCE NATIONALISM

Moves of resource nationalism are generally seen as a State's expression of a determination to optimise the exploitation of its sovereign natural resources. These moves are balanced over time by a greater or lesser participation of foreign investors, typically international oil companies ("IOCs"). The taking of measures towards resource nationalism is often expressed to be in the national interest. What constitutes the national interest will necessarily vary over time and recent experiences have seen populist measures and the disowning of earlier decisions and commitments following changes of government, regardless of public international law.

3. OIL AND GAS CYCLES

The expression of resource nationalism tends to be cyclical and is not a "one-time event". Producer States and foreign investors are mutually dependent and the nature and extent of this dependency changes over time. In the early years of oil and gas development, IOCs were the beneficiaries of State concessions or other grants which constituted ownership and control of petroleum in place. Subsequently, many governments increasingly intervened in what were seen as the strategic sectors of the economy. These steps were enhanced by the treaty declarations during the 1950s and the 1960s concerning the recognition of a State's permanent sovereignty over its natural resources. This recognition and the growing dissatisfaction with the nature of the concessions led to moves against the IOCs. Early moves included the creation of national oil companies ("NOCs") and the revision of fiscal terms. The following twenty years or so saw the re-emergence of the international oil

companies. But from the beginning of this century, the cycle turned again and there has been a growing role for NOCs, both from producer States like Brazil and consumer States like China.

4. PRESENT CIRCUMSTANCES

In the present circumstances, the NOCs from a number of producer States (such as Petrobras and Statoilhydro) are increasingly making their way into the international oil and gas business, while the NOCs from largely consumer States (such as CNPC and ONGC) are increasingly acquiring oil and gas interests and influence in producer States. The inevitable political importance of the hydrocarbon sector results in geopolitical influence and the re-emergence of the economies of the Middle East, Russia's moves towards becoming an energy super power and the opening of African reserves are all contributing to the shifting circumstances in today's oil and gas sector.

5. EXPROPRIATION

Broadly, expropriation consists of a State taking of the property or rights of investors. It is seen to be an exercise of sovereignty and is recognised in international law when carried out for a public purpose, under proper process, in a non-discriminatory way and with prompt, adequate and effective compensation. More sophisticated forms of expropriation include the indirect taking involved in the removal of control of assets or the value of assets without affecting the legal title to those assets. In recent times, State steps have more usually constituted creeping expropriation as a form of indirect expropriation where a series of actions, none of which is itself an expropriation, has the combined effect over time of diminishing or removing the value of the investment to the investor. The management of these risks of expropriation has taken many forms over time, including the making of State-to-State treaties, the making of individual State promises, the enactment of local laws, the entry into stabilisation provisions or the taking of insurance cover.

The former Soviet Union has seen the different examples of Kazakhstan and Russia. Kazakhstan has seen the enactment of new legislation to support the recent assertion of a constitutional right to pre-empt transfers of oil and gas interests. Russia saw the early privatisation of many of its producer companies but the retention by the State of ownership and control over oil and gas pipelines. Recent times have seen the State's reassertion of control over oil and gas production.

South America has diverse jurisdictions and has seen different approaches. New legislation in Venezuela in 2007 saw greater participation for the State company and forced changes to existing contracts together with State control of commercialisation and modifications to the fiscal regime. Bolivia's earlier moves towards liberalisation were reversed by new legislation in 2005 and there

has been a reassertion of State ownership and control and amendments to the fiscal regime. Ecuador offers a different example, where new legislation in 2006 recognised "windfall" profits and introduced a new royalty to share these unexpected profits. South America has also seen parties pursuing remedies under treaties, with Exxon Mobil and ConocoPhillips referring to ICSID arbitration in Venezuela and Occidental in Ecuador. More recently, Bolivia has taken steps to withdraw from ICSID and Ecuador to exclude ICSID jurisdiction in petroleum disputes.

Africa provides yet different examples with its great diversity of jurisdiction and influences. While there are similar themes to what has happened in the former Soviet Union and South America, there are those who see Africa as an example of "opportunistic" expropriation.

But it is not only producer States which take steps to remove the counterparties' value under long-term contracts. The application of the EU's competition rules has resulted in forced changes to long-term petroleum contract terms concerning destination clauses, joint selling and marketing. It is the perception of many producer States that these steps have reduced the value of their long-term contracts for the sale of oil and gas into European markets.

6. TENSIONS IN LONG-TERM CONTRACTS

The oil and gas sector is characterised by long-term contracts for the production and disposal of petroleum and with State participation. At the time these contracts are made there is a consistency of political and regulatory influences, markets and the interests of the parties. But these and other circumstances change over time as do the interests of one of the primary contracting parties – the State. Also, there is an identified trend for the investment bargain to obsolesce in any event. Before the investment is made it is the investor who is often perceived to have a position of negotiating advantage. However, once the investment is made and the capital committed then the advantage tends to move to the State in relation to the management and administration of that investment over time.

The oil and gas sector has been characterised by the restructuring of long-term contracts, sometimes against the background of breach and dispute resolution and sometimes by renegotiation. But with host States and investors being aware of the inevitability of these changes over time, why do their contractual arrangements not contain the flexibility to enable the contractual relationship to adapt to these changing circumstances?

7. PREVAILING LEGAL SCHEME

The prevailing law of the oil and gas production interests will ordinarily be the local law and it is not unusual for this to be a common law. As a rule, common laws will seek to enforce the bargain made in accordance with its terms, notwithstanding changes of circumstances. The certainty required at common law to achieve contractual relations will ordinarily militate against relational flexibility over time. The principle of sanctity of contract (or pacta sunt servanda) is widely accepted and many would say that it is the legal basis on which the IOCs have built their businesses. But this principle is rarely absolute, particularly when the core purpose of a contract no longer exists. For some, a "long-term contract" is a sociological rather than a legal category and it is not the duration of the contract which is the definitive characteristic but the nature and duration of the relationship between the parties.

In the common law circumstances where the courts are reluctant to adjust the bargain between the parties, the source of the power to adjust the contract terms is not the common law but the terms of the contract itself. The oil and gas sector is familiar with a number of contractual mechanisms to this intended effect. These include the "force majeure" clause, the "hardship clause", and the "price reopener". However, in each of these cases the provisions will, under English law, amount to little more than an unenforceable "agreement to agree" in the absence of a reference of that lack of agreement to a third party whose position would be constituted by the terms of the contract to decide on the revised terms.

Paul Griffin

December 2008