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A LEGAL ALTERNATIVE TO INSTABILITY IN INTERNATIONAL OIL

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The instability of international oil concession arrangements caused by the absence of appropriate legal methods to deal with disputes as they arise is the problem treated in this article. A specific proposal for solution of this problem is presented.

I

INTERNATIONAL OIL CONTEXT

Oil is *sui generis*. Recognition of this pervasive fact is a condition precedent to any intelligible discussion of the legal aspects of international oil concession arrangements.

The combination of two sets of factors appears to account for the unique character of oil. First, oil is presently, and for the foreseeable future, the greatest single source of energy relied upon by the Western industrialized ("consuming") countries; such reliance is almost exclusive because of the economic structure of industry fuel requirements. Second, with the qualified exception of the United States, the consuming countries depend on a few developing countries for most of their petroleum requirements; although the possibility exists that this dependence may be reduced in the future, so far this dependence has continued to grow.

Oil is presently the greatest source of energy used by the consuming countries. For example, the foreign oil industry (outside the United States) supplies approximately one-half of the foreign free world's energy requirements.¹ The best available evidence indicates that these consuming countries will use at least as much and probably more oil in relation to total fuel for most of the remainder of this century. For example, if the energy demand grows at a rate parallel to the economic growth projected for these consuming countries, the demand may increase by two and one-half times over the next twenty-five years. It is likely that oil will have to supply the biggest part of that increase.² It may be true that the cost of

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1. G. Burck, *The Boiling World of Oil*, Fortune, Feb. 1965, p. 126.

2. 215 The Economist 1155 (1965).

nuclear energy is approaching a substantially competitive position vis-à-vis that of petroleum. Nevertheless, the dynamic growth of total energy demand should preclude any market gains for nuclear fuel at the expense of petroleum. Further, it is arguable that, apart from price competition, the structural problem of conversion of energy requirements from oil to nuclear fuel may prolong the relative growth of nuclear fuel for some time beyond this century. For example, nuclear fuel seems more structurally adaptable to the generation of electric power than to the production of small vehicular power. Thus, some petroleum user markets, like the automobile and aircraft user markets, may not be affected for some time by the price economies of nuclear fuel. It also appears that the thrust of nuclear fuel replacement is primarily directed at the much more vulnerable coal and water consumption markets rather than the oil consumption markets. Therefore, the enormous growth in energy requirements predicted for the rest of this century and the structural reliance of industries on petroleum assure an increase in the absolute supply of oil and caution against the possibility of a decline in the relative supply of oil to total fuel.

Fortuitous events cause the consuming countries to reach far in terms of both geography and politics for the supply of their oil needs. Their dependence on developing countries for this supply is attributable to the facts that most of the known foreign free-world oil is located within a few developing countries and that alternatives to current oil trade arrangements between the developing and the consuming countries are presently non-existent.

The eight oil producing countries belonging to the Organization of Petroleum Exporting Countries (OPEC)—namely, Venezuela, Kuwait, Saudi Arabia, Iran, Iraq, Qatar, Lybia, and Indonesia—account for three-fourths of the free world's crude-oil production outside the United States and eighty per cent of the total free world reserves.³ In addition, the trend is toward an increase in the concentration of a crude oil supply within these developing countries.

The output of crude from the old-established producing countries has continued to forge ahead—much more rapidly in the Middle East than in the (higher cost) Western hemisphere. Offshore production has been mounting in the Persian Gulf, exports have begun from the Murban field in Abu Dhabi, and substantial discoveries have been confirmed in Oman. Progress is rapid in Lybia, much more

3. Burck, *supra* note 1, at 127.

so than in Algeria, while Argentina is in the process of becoming a major exporter. On the other side of the world, Australia has at last become a commercial producer. Thus, developments in 1964 have helped to sustain the growth of crude reserves . . .⁴

A further trend is in the direction of an increased dependence of consuming countries, especially those belonging to the European Economic Community (EEC), upon petroleum imports.⁵

The unavailability of alternatives is demonstrated by the impossibility of substantial stockpiling of oil and the absence of substantial petroleum reserves within the consuming countries (exclusive of the United States). Particular reference is made here to the North Sea exploration. The insurmountable barrier to large-scale storage of petroleum within the consuming countries is that petroleum is practically conservable only at its locus—that is, where it is discovered in the subsoil.

[O]il, unlike hard fuel, cannot easily be stockpiled for eventualities. For a known date, a special effort can be made; in 1944 the United Kingdom was able to tuck away 23 million tons for D-Day. But large quantities cannot be put by in artificial containers for some time or never, both because containers of the necessary size are so expensive that the capital investment is almost prohibitive, and because the oil deteriorates. The only proven way of hoarding oil is to discover it and close it in till wanted—that is to conserve it in its natural sub-soil.⁶

Location of the oil outside the consuming countries together with the impossibility of stockpiling and the non-existence of a secondary source of supply means that the only practical way to protect the oil supply is to influence the stability of conditions relating to the oil exporting countries. The importance of stabilization of oil conditions is elevated to a critical level when the strategic fact of exclusive reliance on oil by the consuming countries is considered. The impact of a severance of supply of Middle Eastern oil, for example, would surely be severe. An effective cut-off of such oil could quickly bring Britain, Japan, and the Common Market countries to their knees. Where could Britain turn for replacement of the loss of two-thirds of its total oil supply, Japan for three-fourths, and the EEC

4. 31 Petroleum Press Service 444 (1964).

5. *Id.* at 57-58 (1965).

6. E. Monroe, *Britain's Moment in the Middle East 1914-1956*, 97 (Johns Hopkins Press 1963).

for sixty per cent? The Suez crisis demonstrated that the United States can temporarily intervene to suspend the crippling effect of a severance of Middle Eastern oil. However, the enormous costs and drain of oil reserves involved in this American action merely emphasized the stop-gap usefulness of such intervention. The central problem of stability of the individual concession arrangements persists.

These considerations also help to explain the intensity of response by consuming countries to external threats directed at the security of the oil supply. Such a response was the armed action taken by France and Britain in Suez to "protect the oil."⁷ However, a significant distinction lies with respect to internal threats to the oil supply. It appears that the predominant responsibility for securing oil supply arrangements from internal adverse conditions rests with the parties to the arrangements, the international oil companies and exporting governments, and not with any Western government. Therefore, the problem of stabilization of oil concession arrangements may be treated best at the concession agreement stage. The proposal advanced below is based on this approach to the problem.

The lack of stability of present oil concession arrangements is caused by the lack of appropriate legal methods to effectively deal with differences in the first instance. Persuasive evidence that present procedures are inappropriate is the fact that the parties have generally chosen to use other methods to pursue their disputes. An illustration is the OPEC settlement concluded early in 1965.⁸ There, the parties selected the method of negotiation outside the concession arrangements (for two and one-half years) in preference to arbitration or conciliation or other procedures provided in the concessions. Thus, an extra-legal method was selected by the parties to settle the issues which included "royalty expensing" and "posted pricing." The negative inference is that the parties deemed the concession procedures unsuitable for dealing with the causes of their dispute. It may be argued that the OPEC dispute is distinguishable on the ground that it involved several concession arrangements and a strong world oil industry interest. Consequently, the industry negotiation beyond concession procedures was necessary and the selection of such a method does not bear on the appropriateness of concession procedures for treatment of local disputes. However,

7. H. Finer, *Dulles Over Suez: The Theory and Practice of His Diplomacy* 63 (Quadrangle Books 1964).

8. 214 *The Economist* 351 (1965).

the answer to this argument is clear. Although the issues of the dispute were generally common to the parties, the respective interests of the parties in the terms of settlement varied. Moreover, the interests of OPEC governments and some oil companies inevitably differed. This proposition is substantiated by the fact that after the oil companies offered to settle with OPEC and OPEC was willing to accept, nevertheless, OPEC returned the decision to accept or reject the offer to each member government because of the incongruity of member government interests.

Other evidence of the inadequacy of concession procedures for settling disputes is the conspicuous history of general non-use of procedures such as arbitration despite the frequency of concession differences. Of course, the extent of the use of arbitration and other settlement procedures does not bear on the value of concession arbitration clauses for choice of law purposes. It is conceded that the arbitration clause greatly contributes to place the concession agreement in the domain of international law rather than local law. Furthermore, the fact that arbitration has been used successfully on a few occasions does not detract from its general inactivity in the face of recurring dissatisfactions and disputes; nor does it meet the evidence of a pattern of resort to *ad hoc* methods to resolve disputes of the allocative kind, like those involved in the OPEC dispute.

It has been stated that the main reason for the non-use of arbitration and other concession procedures is the preference of government officials for argument in private rather than in front of third parties.⁹ Another reason for the avoidance of arbitration may be the inherent delay in activation of the arbitration machinery.¹⁰ However, it appears that the strongest reason for the avoidance of arbitration and other concession procedures is the tacit recognition by interested parties that adjudication by arbitration would be an inappropriate, and hence an unacceptable determination of allocative issues such as royalty expensing, pricing, and taxing which usually arise within the concession context. This subject is further discussed below.

It could be argued that, even if present concession arrangements do not provide appropriate procedures for dispute settlement, their stability is not thereby impaired. Rather, the argument goes, resort

9. Monroe, *op. cit. supra* note 6, at 108.

10. S. G. Siske, *The Legal Framework for Oil Concessions in the Arab World* 417 (Middle East Research & Publishing Center 1960).

to an external method of settlement may be as effective as an internal method. The short answer is that the concession method is more effective, assuming it is suitable for treatment of the dispute, because it is available as a matter of legal right. An external method, even if suitable for dealing with the dispute, is less effective because its operation depends on the discretion of both parties. Either or both parties may foreclose or terminate resort to the method. Consequently, its application is arbitrary. It is this absence of legal certainty about application of the method which permits the dispute to have such an unsettling effect on concession relationships. Conversely, the presence of a legal guarantee that a suitable settlement method will be applied tends to check the disturbing consequences of a dispute and to stabilize concession relations at the most important stage—that is, at the point when a dispute arises.

Once again, the recent OPEC case is relevant to this discussion. OPEC elected to pursue the method of industry negotiation with the oil companies. Neither the concession nor any other law conferred upon OPEC an enforceable right to secure oil company participation in the negotiation process. Conversely, the oil companies had a “right” *not* to participate. The “right” not to participate, it is suggested, seriously undermined the effectiveness of the negotiations. The absence of legality caused an uncertainty in concession relations and the appearance that the oil companies were granting the discussions as a matter of grace. The latter adversely affected the relative bargaining attitudes and efforts of the parties.

It is arguable that the companies’ “right” not to participate in the negotiations meant very little because non-participation was really not an alternative. The companies had to negotiate because of the power possessed by OPEC governments to terminate concessions. The reply to this objection is twofold. First, it is questionable whether the incentives were strong enough for OPEC governments to terminate concessions in the event of the companies’ refusal to negotiate with OPEC. The member governments have varying economic and political intentions. One or more governments might prefer to negotiate directly with its concession companies rather than threaten termination or actually terminate the concession because of the companies’ failure to participate in industry negotiations with OPEC. Second, even if the termination power and policy might be aligned with the OPEC negotiators, the mere casting of doubt on the legality of OPEC’s action is harmful to the relations between the parties and to the application of the negotiation method. To say that an organization of governments is acting illegally is to politi-

cally embarrass and perhaps insult the member governments. The consequence is that concession relations and actual negotiations tend to become more difficult and less effective.

Another criticism might be that the external negotiations were nevertheless successful because a settlement was finally reached. Such an assertion is based upon the end-justifies-the-means approach. The problems with this assertion are, first, that in a concession dispute settlement, the means of settlement is often more important than the result; second, the settlement reached in the OPEC case was not concerned with the cause of concession instability which accompanied the course of the dispute. In the OPEC case, negotiations were conducted over a period of two and one-half years and it is possible that the damage done to the security of concession relationships over that period is irreparable. In any event, the problem of curing the weakness of such relationships is substantial. The eventual settlement of the OPEC dispute did not even consider the cause of instability which grew out of the handling (or mishandling) of the dispute. The cause was the absence of a legally assured form of participation in the resolution of concession disputes. The uncertainty of future participation in a legal method of dispute settlement remains. The proposal submitted below seeks to eliminate this cause of concession instability.

The irrelevance of most contemporary legal discussion regarding the question of stability of international oil arrangements should be noted. Instead of discussing how concession arrangements may be made to work better and thereby strengthened, prominent international legal writers have preferred to discuss the doctrinal positions outlined by classical international law relevant to the issue of whether a government has the "right" to unilaterally modify its obligation to a private foreign party under certain circumstances—the continuing argument of *pacta sunt servanda* versus *rebus sic stantibus*.¹¹ This doctrinal discussion is irrelevant because, whether or not a government has a "right" to unilaterally revise its concession, as the OPEC settlement demonstrates, governments may view their compliance with concession agreements as increasingly difficult and perhaps impossible without revision. Therefore, the question for the oil companies is not whether governments have the "right" to demand a revision but how to deal with their claims. The latter question relates directly to the stability of concession arrangements. A

11. *Id.* at 49, 55.

more relevant approach to the question is similar to the "middle course" referred to by Professor Fuller:

[I]t is simultaneously desirable that laws should remain stable through time and that they should be such as impose no insurmountable barriers to obedience. Yet rapid changes in circumstances, such as those attending an inflation, may render obedience to a particular law which was once easy, increasingly difficult to the point of approaching impossibility. Here again, it may become necessary to pursue a middle course which involves some impairment of both desiderata.¹²

II

LEGAL ALTERNATIVE OF GOOD FAITH BARGAINING

The proposal recommended herein is addressed primarily to the oil exporting countries and to the major international oil companies. However, many of the suggestions apply to all contemplated concession arrangements. The proposal is directed toward the making of *new* concession agreements. However, it may be used as the basis for changing existing concession arrangements. The differentiation of oil "exporting" countries is made for several reasons. First, the major concession activity is carried on by these countries. Second, the element of uncertainty in the presence of commercial oil is substantially reduced. Third, urging action within a given organizational framework (OPEC) promises more favorable results. Fourth, the oil exporting governments have acquired an important degree of sophistication in negotiation. The differentiation of the international majors is also convenient for the purposes of this paper. The major oil companies—Standard of New Jersey, Royal Dutch/Shell, Gulf, Texaco, British Petroleum, Socony Mobil, and Standard of California—do approximately seventy per cent of the foreign oil business directly and, through such devices as long term contracts with independents, substantially influence the rest of the world market.¹³ It will be seen that this market power is a desirable condition for application of the proposal. However, this does not mean that independents may not find the proposal applicable to their particular situations. The majors form a definable group which is materially interested in the stability of international oil arrange-

12. L. L. Fuller, *The Morality of Law* 45 (Yale Univ. Press 1964).

13. Burck, *supra* note 1, at 126, 221.

ments; consequently, they may be more likely to act on this proposal.

The proposal which is recommended is briefly described at this point; the discussion of it and the various alternatives is postponed temporarily. It is proposed that the legal method of compulsory good faith bargaining be applied within the framework of concession arrangements. The subject matter appropriate for bargaining may be defined as the allocative (or apportionment) issues. The allocative issues arising in the oil concession arrangements are commonly referred to as "financial." This is a convenient term for inclusion of the following classes of allocative sub-issues: pricing, taxing, proration, royalty, and perhaps relinquishment. The nature and extent of the duty to bargain in good faith may be determined by analogy with the American domestic labor law concept of good faith bargaining. The subjective test of good faith will be limited to bargaining conduct that does not bear on the substantive results of the process. The choice is made to favor free substantive negotiation over the extension of legal compulsion to bargaining practice. It is recommended that compulsory bargaining start to operate after the oil concern has recovered its initial capital investment plus a "reasonable" return on the investment. This more than covers the oil companies' reliance interest. Thereafter, it is suggested that compulsory bargaining become operative only periodically. In this way the proper balance between stability and adjustability of the arrangement to material changes in conditions may be achieved. A reasonable period may be from three to five years. If the proposal is relied upon to implement compulsory bargaining in existing arrangements, the capital recovery period seems irrelevant. It is urged that the duty of enforcement of compulsory bargaining be placed with a continuing adjudicative tribunal, whether on a full time or standby basis, established at the industry level by joint authorization of the OPEC and company concession participants. This would be the most desirable arrangement, for it assures the widest application of authoritative determinations and lays the proper foundation for expert and consistent development of the law. However, this adjudicative procedure requires broad industry acceptance. Alternatively, provision would have to be made at the concession level for an *ad hoc* enforcement tribunal. In either case, enforcement power of the tribunal is limited to an authoritative determination on the issue of bad faith. Thus, the remedy lies solely with the willingness of the wrongful party to comply with the authoritative determination. Of course, the failure of a party to comply in the second instance automatically

raises the issue of termination, which is subject to arbitration under most existing concession provisions.

This proposal may be equally applicable to the two major types of concession arrangements presently in force. One is the fifty-fifty profit sharing arrangement and the other is the so-called "partnership" arrangement. Differentiation between the two schemes pivots on investment and profit allocations. The fifty-fifty plan calls for the company alone to provide the needed capital for exploitation and for the government and company to share equally in the net operating profits after a deduction, among others, for royalty payments to the government (until the recent OPEC settlement). The partnership plan calls for the government and company to share the investment burden equally and for the government to obtain a greater portion of net operating profits—for instance, a formula of seventy-five and twenty-five. In both arrangements the parties are expressly committed to a good faith standard of conduct. However, in neither are they required by the terms of the concession to open the allocative terms for redetermination, with the possible exception of the recent Iranian concessions to be discussed below. Further, it seems that good faith may have a different meaning in these types of arrangements (whatever it is) than when it is applied in the legal context to define bargaining conduct as in the present proposal.

III

APPLICATION OF GOOD FAITH BARGAINING METHOD¹⁴

Professor Fuller defines adjudication as "a social process of decision which assures to the affected party a particular form of participation, that of presenting proofs and arguments for a decision in his favor."¹⁵ Similarly, the bargaining technique can be defined as a social process of decision which assures the affected party both substantive participation in and consent to the outcome. Participation and consent are achieved through the discussion of proposals and counterproposals progressing toward a common ground of settlement. Bargaining is not only distinct in the substantive participation

14. In this discussion the terms "bargaining" and "negotiation" are used interchangeably. The terms bargaining "technique," "method," or "process" include both the duty of good faith bargaining and the accompanying adjudicative enforcement.

15. L. L. Fuller, *Collective Bargaining and the Arbitrator*, 1963 Wis. L. Rev. 3, 19.

and consent it guarantees, but also in its compulsion of participation by a recalcitrant party.

On the effectiveness of the bargaining process as applied to labor relations, Professor Fuller has said:

Taking the system as a whole, and viewing it across considerable periods of time, I should say that it works remarkably well. Indeed I believe that our system of industrial self government is one of the finest expressions of the American genius for political arrangements.¹⁶

Professor Cox made this measured evaluation of the success of the bargaining method:

There are undoubtedly labor-relations advisors who have made good the promise to talk a union to death without either signing a contract or involving the employer in unfair labor practice proceedings; but . . . the duty to bargain in good faith seems on the whole to have been remarkably effective . . . Many empty discussions were gradually and unconsciously transformed into a *bona fide* exchange of ideas leading to mutual persuasion . . .¹⁷

Further, Judge Henry J. Friendly, in his Holmes Lectures, commended the National Labor Relations Board for its enforcement work in clearly elaborating the rules defining unfair labor practices.¹⁸

It appears that the effectiveness of the labor bargaining process can be measured by the extent of its accomplishment of the legislative objectives¹⁹ which underly Section 8(a)(5) of the National Labor Relations Act.²⁰ The first objective was industrial peace. This has been realized by the legislation of compulsory union recognition. A second objective was to create economic power for the unions to counterbalance the power of corporations over labor standards. This objective appears to have been substantially accomplished. The third objective was to give the unions some, perhaps equal, participation in the determination of conditions of employment. It is clear that unions participate in the determination of employment conditions but it is not clear how much they participate. It may be said that this objective has been partly, if not substantially, achieved. The

16. *Id.* at 45.

17. A. Cox, *The Duty to Bargain in Good Faith*, 71 Harv. L. Rev. 1401, 1439 (1958).

18. H. J. Friendly, *The Federal Administrative Agencies* 36 (Harvard Univ. Press 1962).

19. Cox, *supra* note 17, at 1401.

20. 49 Stat. 452 (1935), 29 U.S.C. § 158(a)(5) (1964).

fourth objective was to create a process of rational persuasion. It is not clear at all whether and to what extent this goal has been accomplished. Professor Cox points to the paradox which exists in the application of the bargaining technique.

Collective bargaining is curiously ambivalent even today. In one aspect collective bargaining is a brute contest of economic power somewhat masked by polite manners and voluminous statistics. As the relation matures, Lilliputian bonds control the opposing concentrations of economic power; they lack legal sanctions but are nonetheless effective to contain the use of power. Initially it may be only fear of the economic consequences of disagreement that turns the parties to facts, reason, a sense of responsibility, a responsiveness to government and public opinion, and moral principle; but in time these forces generate their own compulsions, and negotiating a contract approaches the ideal of informed persuasion.²¹

The bargaining process would be appropriate and hence effective if applied to concession arrangements because concession arrangements satisfy the conditions relevant to the effectiveness of bargaining in the labor situation and in general. Of the following conditions, the first two are necessary for the application of bargaining and the remainder are conducive to good bargaining practice.

A. Reciprocity of Interests

The concession relationship contains the element of reciprocity of interests necessary to create the subject matter for bargaining, that is, the disputed issue. This condition makes the modest point that the basis of the relationship necessary for application of the bargaining process is that of reciprocity rather than harmony.²² The parties must differ in their relative interests so that each sufficiently values the relationship of the other. The basis of the relationship may be an exchange or collaboration.

In either case, the contribution made by one party is seen by him as less important than the contribution made by the other. The more important contribution made by the other is the benefit of the bargain to the first party. It seems to make no difference whether the form of contribution is a transfer of an object or a performance of a service (or the promise of either). In the final analysis the parties value each other's contribution differently and each seeks to increase

21. Cox, *supra* note 17, at 1409.

22. L. L. Fuller, *The Forms and Limits of Adjudication*, Nov. 1957 (unpublished paper in Harvard Law School Library.)

his benefit of the bargain. It seems to follow that, for the same reasons, they are likely to evaluate differently the terms involved in arranging for the contributions. This is how the subject matter of disputes originates and why the element of reciprocity is a necessary condition precedent to bargaining.²³

Both the labor and concession relationships meet this test. Each involves an ongoing collaboration. Labor and management favorably value the respective contributions of labor resources and capital-management. Likewise, governments and oil companies favorably value the respective contributions of oil resources and capital-management. At the same time, both the unions and governments commonly differ with the companies in the evaluation of the proper apportionment of income earned by the enterprise. One important influence on this evaluation which is common to both governments and unions is the projection of a "collective" interest into the allocative negotiation. This collective interest seems to be somewhat of a consensus of the represented group. It may take the form of nationalism in the government case.

B. Sufficiency of Interests

The oil companies and governments share a sufficient interest in maintaining the concession relationship that the application of bargaining would not be endangered by the possibility of termination of relations. This point is related to point A *supra*. Whereas in point A the parties must have different interests that cause different evaluations of the same object, in point B the parties must have the same interest in maintaining the relationship founded on different interests. The common interest in preserving the relationship must be sufficient to provide appropriate incentives for each party to be willing to seek a settlement through bargaining rather than abandon the relationship. It appears that the extent of interest the parties have in preservation is directly related to the extent of their willingness to bargain and consequently is related to their bargaining positions.

In one respect, the labor and oil situations manifest a similar kind of common interest in continuity of relations. The company's continuity objective in both cases is governed by its profitability notion. In contrast, the union or government has a continuity objective shaped by the potentially competing interests in maximization of income and security of position in the arrangement. The former

23. But cf. F. C. Iklé, *How Nations Negotiate* 2 (Harper & Row 1964).

focuses on the present while the latter looks to the future. For example, in the labor area unions insist on higher current wages while at the same time they press for job security in the face of automation. Similarly, in the concession area governments might demand a larger share of current oil revenue while seeking to protect their market supply position from invasion by old and new rivals.

In another respect, the shared continuity objective in the oil area seems even stronger than in the labor area for two reasons. First, most concessions have proved enormously rewarding to both parties but promise to be increasingly more rewarding for the companies. It appears that most of the companies have fully satisfied their reliance interest through substantial recovery of their total capital investment. It remains for them to reap the profits in satisfaction of their high expectation interests. However, this expectation interest seems compressible when confronted with the possibility of cessation of the arrangement. Second, the governments have frequently built up a substantial reliance on the viability of the concessions by scheduling vital development programs according to concession revenue projections. Consequently, the possibility of disruption is relevant not only to the fear of the government's loss of position in the market, but also to the threat of curtailment of economic development.

These considerations are persuasive that the parties to existing concessions would have strong incentives for making compulsory bargaining work in order to promote the durability of their relations. In addition, these factors are relevant in examining the bargaining positions of the parties in point C *infra*.

C. *Equality of Bargaining Power*

The oil companies and governments possess the relative equality of bargaining power which promises relative equality of participation and consent in the negotiation process, the optimum condition of bargaining. For truly equal participation to be realizable, the bargaining strength of the parties should be truly equal. However, relative equality is sufficient for substantive participation. Of course, substantive participation advances the acceptability and integrity of the bargaining process. It is difficult to see how much less than relative equality would impair the standard of substantive participation. It is clear at the other extreme that disproportionate bargaining power means dictation of the results by one party and participation solely in the motions of bargaining by the other. Evaluation of the relative bargaining positions of the parties should include several factors. One factor is the relative degree of interest in preservation

of the relationship; this may be a limiting factor. Another is the difficulty of calculation of real strength; the result is that the appearance of strength may mean more to a confronted party. A third factor may be the support offered by a third party. A fourth factor is the extent of rational persuasion present in the negotiations; the emphasis on bargaining power declines in the face of this phenomenon. The effect may be equalization of power by deemphasis. A fifth factor is the enforcement of compulsory bargaining; if the bargaining rules affect substantive negotiation, the law has recast the relative balance of strength.

The root of economic power for union and government alike is ultimate control over a resource essential to the productive enterprise. The union has the power to strike and the government has the power of nationalization. Each weapon is ultimate in that it stops production. Both weapons are authorized by the relevant law-applying systems. The NLRA authorizes the strike; international law approves nationalization. That the use of each weapon is qualified does not detract from its contribution to bargaining power. The validity of nationalization is conditioned only upon proper compensation. However, the consequences of the use of these economic weapons are quite different. Nationalization causes termination of the relationship; a strike causes only interruption. It may be said that the sovereign power of nationalization (or expropriation) is a greater economic weapon than the strike. The answer may be that the ultimate destructive characteristic of the weapon severely limits the effectiveness of the threat of its use, a result not unlike the ultimate power of atomic weapons. The NLRA ordered the relations between union and management; this ordering creates the condition of relative equality of economic power. Naturally, no such supra-governmental power is available to recast the relative economic positions of oil companies and governments. However, the answer seems persuasive that no such authority is necessary.

It is contended that the international majors and the OPEC governments possess relatively equal bargaining strength. This may be proved by comparing the economic strengths of the international majors and the OPEC governments. First, the government has ultimate control over the oil. This may be compared to the companies' control over the capital investment in the exploitation of oil and, more importantly, the companies' control over the marketing of oil. Although the majors' market power has theoretically declined in ten years from about ninety per cent to seventy per cent of the

direct foreign oil business, that twenty per cent loss of market control is substantially recaptured through the long term contracts the majors have with independents who account for most of that so-called loss.²⁴ Furthermore, the fact that there now exists an over-supply of crude-oil and the economic prediction that this condition is likely to continue²⁵ reinforce the companies' position in relation to the governments. In a condition of over-supply of crude-oil the government must rely more on the marketing power of the companies to dispose of production. In a condition of under-supply, however, the government may be able to find alternative buyers and place less reliance on the marketing power of the concessionaire. A partial answer to this is that an increasing number of governments are becoming buyers for the refining stage. Approximately 123 refineries are being built in fifty-seven countries, "many by the governments themselves."²⁶ The over-supply condition of the market raises an additional possibility that enhances the oil companies' position; this possibility is the risk of the replacement of part of the concession country's share of the market by other exporting countries or even by Russia. (By 1970 Russia is expected to supply seven per cent of the free-world consumption of oil outside the United States.)²⁷ Rival exporting countries replaced Persia's position in the market when Musaddiq's nationalization program resulted in his virtual inability to deliver oil to buyers. The major oil companies refused to handle Persian oil pending a settlement while the American Government, in mid-1953, suspended aid to Persia. "Never since has Persian output caught up with that of either Saudi Arabia or Kuwait."²⁸ The possibility exists that the American Government would act in support of "wronged" Anglo-American oil companies in the Middle East, for as one historian described American foreign policy during the Suez crisis, "[O]ilmen were the most powerful single influence in American policy in the Middle East: they pressed on the State Department an insistent pro-Arab policy."²⁹ However, this possibility seems remote because it depends upon a serious deterioration in the security of the Middle Eastern oil supply. The American Government's pro-Arab policy in the

24. Burck, *supra* note 1, at 221.

25. Petroleum Press Service, *supra* note 4.

26. Burck, *supra* note 1, at 130.

27. *Id.* at 129.

28. Monroe, *op. cit. supra* note 6, at 109-10.

29. Finer, *op. cit. supra* note 7, at 12.

Middle East calls for a stabilizing influence on relations between governments and oil companies; neutrality is an easier course than discrimination.

It appears after thorough evaluation of these relevant factors that the bargaining positions of the international majors and the OPEC governments are nearly equal. Indeed, a substantial advantage of one party over the other does not appear. Furthermore, this appearance of relative equality of economic power is confirmed by the recent settlement between OPEC and the majors. The terms of the settlement seem to represent a relatively equal compromise on the part of both groups.³⁰

D. Suitability of the Negotiation Process

The negotiation process is especially suited for settling the allocative kind of issues typically raised in oil disputes and, therefore, its effectiveness of application to concession relations seems assured. This proposition is merely the converse of Professor Fuller's view that allocative (or "polycentric") problems are inappropriate for solution by the adjudicative process.³¹ He distinguishes between the functions of economic management and adjudication in operational terms.

To act wisely, the economic manager must take into account every circumstance relevant to his decision and must himself assume the initiative in discovering what circumstances are relevant. His decisions must be subject to reversal or change as conditions alter. The judge, on the other hand, acts upon those facts that are in advance deemed relevant under declared principles of decision. His decision does not simply direct resources and energies; it declares rights, and rights to be meaningful must in some measure stand firm through changing circumstances. When, therefore, we attempt to discharge tasks of economic management through adjudicative forms there is a serious mismatch between the procedure adopted and the problem to be solved.³²

His reasoning may be extended to support the appropriateness of the bargaining method in the case where two or more parties with differing values jointly participate in economic allocation. Here the bargaining method is a particularly useful collaborative tool.

30. The Economist, *supra* note 8, at 353.

31. L. L. Fuller, *Collective Bargaining and the Arbitrator*, 1963 Wis. L. Rev. 3, 30, 33.

32. L. L. Fuller, *The Morality of Law* 172 (Yale Univ. Press 1964).

It possesses the flexibility to treat simultaneously all dimensions of the "polycentric" (many-centered) problem of allocation. Within its framework the parties are able to make a series of adjustments in their positions on the various centers of the problem as they approach a basis of accommodation in which each gives up what he values less in return for what he values more. Professor Fuller has referred to this approach in connection with mediation;³³ it seems equally applicable to negotiation in the oil context.

The nature of the problems in the labor and oil cases is typically polycentric. For example, the labor dispute over a proper wage structure and the oil dispute over the proper price structure are parallel cases presenting the problem of economic allocation. In each of these cases the final determination rests on a pattern of terminal adjustments. In a hypothetical concession dispute over the "financial" provisions (as defined in the proposal) the negotiation process as applied may be concerned with many centers of apportionment such as posted pricing, expensing, proration, relinquishment, and customer discounts. Assuming the parties are seeking settlement, the negotiations will proceed with a continual shifting of the respective positions on the terminal issues. The parties will tend to relax their position where the terminal issue is less important to them and press their position where it is more important. The result of this progression of maneuvers is, ideally, the best possible settlement as seen by both parties. Practically, the process may be seen as approaching the most acceptable overall settlement. The relation between the appropriateness of the method to the problem and the relation of the nature of the problem to the result point to an extraordinary aspect of negotiation in this context. The process of negotiation is particularly suitable for instantaneous treatment of the several dimensions of an apportionment problem. At the same time, the dimensions of the problem facilitate the most acceptable settlement (to the parties) because the dimensions allow each of the parties to receive what he values most after giving up what he values least. This infers that in some cases settlement of a dispute may be made easier by enlarging the dimensions of the problem rather than by isolating the linear sub-issues. It seems, however, that this technique of dimensional enlargement ought to be confined to the cases presenting the allocative-characterized problem. Recognition of this phenomenon cannot help but impress one of the great potential utility that this legal process may have for ordering a variety of economic relations.

33. L. L. Fuller, *Collective Bargaining and the Arbitrator*, 1963 Wis. L. Rev. 3, 23.

E. Rationality of Relations

The rationality of the relations between oil companies and governments is sufficient to infer that the parties will make good use of the bargaining process in settling their differences. Rationality of the parties may mean either or both the willingness to disclose information necessary for intelligent discussion and willingness to be persuaded by reason. These are distinguishable from the willingness to bargain which is discussed below. Willingness to bargain clearly does not require reasonableness of attitude and full disclosure of relevant data. However, rationality in this dual sense greatly contributes to sound bargaining results and sophisticated bargaining relations. Conversely, mature bargaining relationships commonly produce a high level of rationality in practice. Thus, rationality seems to be both the cause and effect of good bargaining.

So far, in the labor relations area, the statutory duty to bargain in good faith has not been interpreted to impose a standard of rationality on the parties in either of the dual senses. The main reason for this result is that either a standard of reasonableness or a standard of disclosure would tend to affect the substantive terms of negotiation. Professor Cox emphasizes the relevance of information to the substance of bargains when he concludes that, "today's negotiations do not turn upon the ascertainment of objective facts but upon the evaluation of the data."³⁴ He comments upon the possibility of imposing a standard of reasonableness upon the parties in respect to major issues by saying that, "passing judgment upon the reasonableness of his proposals . . . would apply pressure to make concessions. . . . The policy of allowing free negotiation upon such matters is too strong to warrant the risk of government interference even when a weak inference might seem justified by experience."³⁵ Instead of compulsion, the voluntary approach to rationality is advocated by Professor Cox and seems to be followed by the National Labor Relations Board and the courts. The voluntary course seems more likely to induce rational persuasion than does compulsion. The foundation for rational persuasion seems to be mutual respect and trust, which are achievable by choice rather than fiat. The possibility of the lack of sophistication of government negotiators is not unlike that which confronted unions a few years ago. This possibility should not detract from the operation of the process for three reasons: first, the OPEC settlement once again im-

34. Cox, *supra* note 17, at 1442.

35. *Id.* at 1419-20.

plies that the government negotiators possess an adequate measure of bargaining skill. Second, most of the OPEC governments have had a great deal of experience in bargaining with the Anglo-American oil companies. Third, the bargaining process makes an independent contribution by giving the government negotiators a training ground; furthermore, the sophistication gap may be crossed in short time. The possibility of a "collective" projection of irrationality into negotiations from the government side may be similar to that which exists in labor relations. Middle Eastern nationalism may represent this kind of collective irrationality. One British historian, in describing the revival of Middle Eastern nationalism in the last decade, notes that "resentment swelled at the uncommon degree of control exercised by companies that managed not only production but the marketing end of operation as well."³⁶ She concludes that, "Middle Eastern nationalism narrowed to vanishing point the gap between the commercial and the diplomatic handling of oil affairs."³⁷ The short answer to this objection that nationalism will project irrationality into concession bargaining is that the nationalist demands for a share in the control of oil are being met by the institution of this process.

F. *Good Faith Standard*

The good faith standard of bargaining presents the best balance between compulsion of bargaining willingness and freedom of substantive bargaining for achieving good bargaining relations within the concession framework. The willingness of the parties to bargain necessarily influences how well the process works. Obviously, unwillingness (refusal) to bargain defeats application of the process. Beyond refusal, the extent of willingness necessary to make negotiation actually meaningful is unclear. The statutory answer in the labor relations field is the good faith standard, a minimum standard of willingness. The choice of the good faith standard is governed by the legislative policy of preserving the private autonomy of substantive decision making, while compelling the parties to have a willing attitude toward settlement through bargaining.

Congress was generally not concerned with the substantive terms on which the parties contracted. . . . Since the Board was not viewed by Congress as an agency which should exercise its powers to arbitrate the parties' substantive solutions of the issues in their bargain-

36. Monroe, *op. cit. supra* note 6, at 114.

37. *Ibid.*

ing, a check on this apprehended trend was provided by writing the good faith test of bargaining into Section 8(d) of the [National Labor Relations] Act.³⁸

The good faith standard seeks to prevent two kinds of objectionable conduct: non-compliance (refusal to bargain) and evasive compliance (bargaining in form only). There may be several reasons why the choice of this minimal standard has worked effectively. First, the voluntary development of bargaining practice is more likely to encourage good bargaining than the regulatory development of such practice. The former is consistent with the voluntary approach parties usually take in determining their own relations; the latter is inconsistent. Regulation restrains conduct and too much regulation could transform bargaining into adversary proceedings. Second, regulation would seem to impair both the procedural flexibility needed to uncover solutions to dimensional problems and the guarantee of substantive participation and consent in the bargaining results. (A questionable psychological factor is that the parties may tend to respond better to the voluntary approach than to the increased regulatory approach.) Third, the quality of adjudicative enforcement by the NLRB has been a factor in the acceptance of the fact of bargaining. Clear elaboration of the rules of good faith bargaining and self-restraint in determination of the reach of good faith have been policies which have carried the day for the good faith concept in labor law. Fourth, compliance with the good faith test is easy because it is a minimum standard of fairness in the relations between parties.

Since it is proposed that compulsory bargaining should be applied in the same way as it is in labor relations, it may be expected that, other things being equal, a similar record will be made in oil relations.

G. Compromise Between Stability and Adjustability

The proposal for operation of compulsory bargaining herein advanced represents the most desirable compromise between the legal desiderata of stability and adjustability of the arrangement. It seems to be a necessary condition for the orderly development of good bargaining practice that an appropriate balance be struck between the policies of stability of substantive terms governing the relationship and the adjustability of these terms to the changing conditions which create changing interests. This proposal chooses

38. NLRB v. Insurance Agents' Int'l Union, AFL-CIO, 361 U.S. 477, 485 (1960).

the "middle course" referred to by Professor Fuller³⁹ in providing that the substance of each negotiated result should remain secure for a reasonable term, such as three to five years. This permits a sufficient degree of certainty for the parties to conduct their affairs, while it retains the substantial guarantee of the opportunity for effecting a change in interests. In the labor area Professor Cox emphasizes the importance of stability:

'Continuous negotiation over the basic terms of employment doesn't contribute to a stable relationship and can seriously interfere with the main job of labor and management—producing goods.' Effective co-operation depends upon the mutual acceptance of basic principles defining the framework within which the parties are to live.⁴⁰

In the concession area relative stability of the substance of the bargain seems equally important. The right to seek a change in "financial" terms is also very important. This is demonstrated once again by the implied motives for the OPEC negotiations. It is further demonstrated by the inclusion in Article 21, Section 6 of the Iranian "Draft Agency," 1964, (the format for the Iranian Concessions to Persian Gulf Rights awarded in 1965) of the provision that "changes . . . in the price structure of Middle East crude-oil" is a ground for revision of the taxing terms.⁴¹ Therefore, it appears that the recommended proposal adequately recognizes these considerations.

In summary, it has been shown that the relevant conditions for the successful application of the bargaining process prevail in the concession context and may be even more favorable in some instances than in the analogous labor-management context.

IV

ALTERNATIVES WITHIN THE ALTERNATIVE

A. Definition of the Subject Matter of Bargaining

There seem to be four important possibilities for defining bargainable subjects: (1) all allocative issues; (2) "financial" issues; (3) specific issues like taxation, pricing, and the like, and (4) any of the

39. L. L. Fuller, *The Morality of Law* 172 (Yale Univ. Press 1964).

40. A. Cox & J. T. Dunlop, *The Duty to Bargain Collectively During the Term of an Existing Agreement*, 63 Harv. L. Rev. 1097, 1115 (1950).

41. Petroleum Legislation, Supp. No. V, Middle East: Basic Oil Laws and Concession Contracts, Iran B-28 (1964).

above three with a limitation on the extent of change permitted to result from bargaining.

For the most consistency with the preceeding analysis of the conditions determinative of good bargaining, alternative (1) should be selected. However, this may be accomplished by broadening the plain meaning of "financial" to include all allocative issues. It may be stipulated that "financial" subjects are bargainable and that this category includes, but is not limited to, the questions of pricing, taxation, proration, relinquishment, royalty, and discounts. Conversely, if it is desired to narrow the "financial" category of subjects, this alternative is available. For example, the parties might want to fix the terms of relinquishment and royalty for the whole life of the concession. This may be expressly stipulated. Whenever a dispute arises concerning either of these issues, the possibility that the nature of the issue is allocative may cause the parties to view its referral to arbitration as unacceptable. If it is referred to arbitration, the nature of the problem will be mismatched with the process of settlement; the result may then be undesirable. The objection to a quantitative limitation on the settlement possible through negotiation (alternative 4) is that the policy of free negotiation is violated. The policy of voluntary development of good bargaining practice is preferable to imposed bargaining practice through control of the substance of the terms. A quantitative limitation on the substance of the terms, such as percentages varying with the period of renegotiation, certainly controls the settlement.

The objection may be made that some non-allocative issues should be put within the scope of bargainable subjects. The reply is two-fold. First, some degree of long term stability of the arrangement is necessary to conduct the kind of venture that depends on long term operation for its success. An oil concession venture is this type. The qualitative distinction between allocative and non-allocative is convenient for dividing the stable from the variable provisions of the arrangement. Second, a reason for making the non-allocative provisions stable is that their nature involves rights which, to be meaningful, ought to stand firm under changing circumstances. Thus, those provisions which require stability are matched with the concession need for stability of some provisions. This is not to say that disputes over non-allocative (justiciable) issues are not to be authoritatively determined. Such disputes are referred to the adjudicative machinery of arbitration which is suited to apply legal principles or standards in deciding relative rights. By contrast, the bargaining machinery is not suited to the non-allocative dispute because

it does not apply law in reaching a settlement. In short, it may be said that there is one "right" answer to non-allocative questions, whereas there are many conceivable "right" answers to allocative questions. Adjudication is designed to determine the "right" answer, while negotiation is designed to hit on any one of numerable accommodations.

Of the possible allocative issues within the scope of bargainable subjects, the ones identified under the "financial" label above have been actual or appear to be foreseeable causes of concession disputes. The list is certainly not all-inclusive. If the "financial" label is chosen, it may be desirable to make amendment of the list of bargainable subjects itself bargainable. Similarly, bargaining may be provided for the determination of the periods between operation of the duty to bargain. In each case some limitations may be practically desirable.

B. Definition of the Duty of Good Faith Bargaining

It is suggested that the subjective test of good faith bargaining be formulated in the negative as proposed by Judge Magruder. He defined "bad faith" bargaining as a "desire not to reach an agreement."⁴² This formulation has the advantages of best describing the actual results of the case law and not compelling a party to put reaching agreement ahead of maintaining a position.⁴³ This distinction may prove important in limiting the enforcement reach of compulsory bargaining to non-substantive terms.

Alternatively, the standard may be formulated in the affirmative: each party has a duty to "engage in negotiations with a sincere desire to reach an agreement and must make an earnest effort to reach a common ground, but it need make no concession and may reject any terms it deems unacceptable."⁴⁴

Labor experiences furnish enforcement guidelines that may be useful in the determination of bad faith bargaining practice in oil relations.⁴⁵ Evidence of bad faith, which must be weighed according to the circumstances, includes but is not limited to: (1) declaration inferring bad faith; (2) stalling negotiations by unexplained delays in answering correspondence and by unnecessary postponement of meetings; (3) sending negotiators without authority to do more than listen; (4) repudiating commitments made by a negotiator after the other party has been led to believe the negotiator had

42. *NLRB v. Reed & Prince Mfg. Co.*, 205 F.2d 131, 134 (1st Cir. 1953).

43. *Cox*, *supra* note 17, at 1416.

44. *Ibid.*

45. *Id.* at 1418-19.

real authority to agree; (5) constantly shifting position or interjecting new demands just as agreement seems imminent; (6) insistence upon verbatim transcript of negotiations; (7) rejecting a standard or trivial provision; (8) refusal to make counter-proposals, and (9) making demands having only the objective of obstruction. Evidence of bad faith, however, may not include evaluation of a party's position relative to a major bargaining issue. The latter clause places a negative limitation on application of the standard; it is a clear statement of the policy of non-interference with bargaining.

It is possible to include rules of bad faith. The disadvantage with this approach is that it tends to convert the substantive standard into objective criteria which regulate bargaining practice. This potential result is contrary to the policies of voluntary development of good bargaining practice and free negotiations.

C. Operation of the Duty To Bargain in Good Faith

There may be several possibilities which contend for selection as the best resolution of the competing policies of stability of the bargain and changeability to new needs. Regarding the initial period of a new concession prior to the operation of compulsory bargaining, it is suggested that this period be determined by: (1) a fixed number of years; (2) a length of time commensurate with the company's recovery of capital investment in addition to a reasonable return on the balance of the investment, or (3) an indefinite length of time until a material change of condition occurs which makes the original apportionment inapplicable.

The clear advantage of (1) is its definiteness. For example, a twenty-five year concession with three five-year renewal periods (as in the Iranian "Consortium" Agreement) may provide for bargaining at the end of ten or fifteen years and at the end of each five-year period thereafter. The definiteness of a fixed number of years reinforces the formal guarantee of the right to participate in the redetermination of financial terms. Furthermore, this provision is easily enforceable.

The advantage of (2) is that it matches the period of concession stability with the reason for the importance of stability; that is, protection of the reliance interest by allowance of compensation for the investment of risk-capital (recovery plus a reasonable profit). Subsequently, the profit expectation interest becomes subject to periodic bargaining. Further, although admittedly a compromise, this alternative seems to provide a sufficiently definite guarantee of the right

to renegotiation as to preclude difficulties in compliance and to induce a faith in the fairness of the procedure. One practical difficulty may be in designing a proper method of accounting for this scheme. However, this is not an insurmountable managerial problem. The right to examine accounting records must be included as a check on the method.

A refinement which may be applied to alternative (2) would be to provide for the transfer of ownership (equity) of the concession assets to the government simultaneously with the recovery of capital. The government would then own the concession assets when compulsory bargaining starts to operate. The purpose of this would be to remove from the arrangement the possibility of nationalization and the political connotations. The threat of nationalization, as an ultimate economic weapon, has a severely limited use; if anything, it confuses concession relations. In turn, confusion detracts from the stability of the arrangement. Furthermore, ownership of the assets does not seem relevant to the bargaining position of either party. Where the oil companies own the assets, the country may at any time expropriate them. Ownership seems only relevant as a seed to nationalistic unrest. One consequence of this proposal may be to neutralize nationalistic resentment of foreign ownership of the oil. Yet the security of the concession contract remains intact. The bargaining positions are unaffected. A potential political explosive is disarmed and stability of the arrangement is advanced a little further.

The advantage of (3) is that it matches the period of stability of the concession arrangement with the stability of material conditions affecting the arrangement. In contrast, alternative (2) relates the period of stability to the duration of the reliance interest of the companies. It is alternatively possible that conditions could change before the reliance interest runs out or that conditions remain stable beyond the end of the reliance interest. Therefore, one disadvantage of (3) to the companies is that it does not protect their reliance interest in the large capital investment made. A practical disadvantage of (3) is the difficulty a party would have in showing a material change in conditions which justifies redetermination of some allocative terms. This difficult burden of proof falls on the affected party, whether government or company. The uncertainties created as to whether or when such a change might occur and whether the burden of proof can be met before the other party or arbitral forum appear to outweigh its theoretical advantage of relating the operation of renegotiation of certain terms to the need for redetermination of

those terms caused by factors outside the control and expectation of the parties.

Of particular interest is a variation of alternative (3) that may be found in the 1964 Iranian "Draft Agency" which apparently served as the format for the recently awarded Persian Gulf concessions. Article 21, Section 6, provides:

In case of changes taking place in the price structure of Middle East crude oil or in the Iranian taxation regulations, the parties to the agreement *will through negotiation settle on new arrangements* which in no circumstances shall be less favorable to Iran.⁴⁶

If this clause survived in the recently awarded concessions, several interesting and far-reaching questions may be raised. First, what kind of changes in the price structure are necessary to invoke negotiations? Any change or substantial change? A change in any increment of pricing? Second, if the proper change takes place, what terms of the arrangement are negotiable? Any or all terms or only allocative or certain allocative (financial) terms? Third, does the obligation to negotiate mean the obligation to negotiate in good faith? If so, by what standard is good faith judged?

Within the context of the Iranian Concession, these questions remain open. However, the third question invites a rather surprising answer that is within the scope of this article. It appears that Article 21, Section 6, may be interpreted to give the Iranian concession the essence of the compulsory good faith bargaining method proposed herein. The concession provides that the parties will adhere to the principle of good faith in their relations under the concession agreement. Article 21, Section 6, states that upon the happening of a certain event the parties "will through negotiation settle on new arrangements."⁴⁷ The language of this phrase purports to impose two duties on the parties upon the occurrence of the event necessary to set the clause into motion. The first is the duty to settle and the second is the duty to settle by the negotiation procedure. The only problem is that the first duty seems unenforceable. If an impasse in the negotiations develops, forcing the parties to settle is involuntary and therefore is contrary to the voluntary way "through negotiations." A more meaningful construction of the phrase is to say that it does not go so far as to force a settlement but does go so far as to force the parties to negotiate with a view to settlement. The

46. Petroleum Legislation, *supra* note 41. (Emphasis added.)

47. *Ibid.*

consequence of this construction is to shift the emphasis from settlement to negotiation. The duty to negotiate is enforceable. In filling-in the content of the duty to negotiate (which is not otherwise elaborated in this clause), the enforcement agency should look initially to the terms of the concession. An important term requires application of the good faith standard of conduct to concession relations. It may be urged that such a standard applies to negotiations required in Article 21, and further that the analogy of the American labor law concept of good faith bargaining may be referred to in defining the good faith standard of Article 21 negotiation. To the extent that the enforcement agency (for example, an arbitral tribunal) accepts that Article 21 negotiations are subject to the good faith standard and that good faith can be defined by reference to the labor law analogy, the substance of the proposal made in this Article could be imported to the Iranian Concession.

The relative degree of stability and changeability allowed in the results of each periodic negotiation raises questions. The labor experience suggests a reasonable period of three to five years. This length of time seems to allow enough certainty for company planning and uninterrupted production of oil. It also is close to the length of time that oil market changes appear predictable. Finally, it also affords sufficient time for the parties to prepare for bargaining. Another possibility would be the alternative of a fixed period (for example four years) or a period as set in the negotiated settlement. In the absence of setting a period, the fixed period could automatically apply. One objection to this method is that it may project the bargaining position into the future and cause an impairment of the legal guarantee of participation in the process by making operation of the right to bargain itself bargainable.

D. Design of the Enforcement Procedure

An enforcement tribunal is an integral element of the bargaining method. It fills in the content of the right to participate in substantive negotiation. The character of enforcement by the administrative tribunal is relevant to the success of the whole process. Thus, the rules for its operation are important.

There are three important alternatives for selection of an administrative tribunal:

(1) The individual concession may provide for an *ad hoc* method for the formation of a tribunal to decide an individual dispute. This method is parallel to the arbitration procedure customarily afforded to concession parties.

(2) The major industry groups (OPEC governments and concession companies) may agree to formally establish a continuing adjudicative tribunal which would have jurisdiction over individual concession disputes. The tribunal may be established for a certain term of years or on a permanent basis.

(3) Such industry groups may agree to a modification of the above suggestion. Instead of putting the continuing industry tribunal on a fulltime basis, they may put it on a standby basis. The members of this standby enforcement commission, although regularly serving in other capacities, would be called to serve on the commission as disputes may arise before it.

One advantage of the *ad hoc* procedure is that its use corresponds more closely with the periodic operation of compulsory bargaining, combined with the possibility of infrequent bad faith allegations. Its disadvantage is identical with that of present arbitration clauses. The apparent delay and dislike of the procedure results in its non-use.

As a practical matter, it seems that the acceptability of the continuing industry-level tribunal depends on the latitude of the acceptability of compulsory bargaining. However, the advantages of a continuing industry-level, law-applying agency are many and significant. The fact of availability of a forum encourages settlement of disputes in the early stages, increases the probability of its use, and makes more meaningful the right and duty of bargaining. The continuing nature and wide international jurisdiction would promote competence and fairness of adjudication. The judges would be able to acquire broad understanding and experience in filling the void of concession law and would be able to bring those authoritative determinations to bear on a broad sector of international relationships in a uniform fashion. The government and company endorsement of and submission to this international agency would seem to insure its prestige and authority and be a significant step toward the peaceful settlement of disputes through law. The costs would be small as compared to the stake the parties have in the great wealth of oil.

It appears that the standby qualification of the continuing agency is especially appropriate because it embraces solely the favorable features of each of the other alternatives. The standby character of its machinery matches the uncertain or periodic enforcement responsibility provided by the proposal. Yet, unlike the *ad hoc* method, there should be no delay or dislike in calling upon the agency. The forum is available on call, by definition, and the con-

tinuing membership of the standby forum should enable the members to develop expertness and consistency in their determinations. Further advantages may be that more qualified and distinguished administrators and judges could serve on such a standby organization and that such an agency may be more politically suited to launch the program. Eventually, if the need justifies a full time agency, the change could be easily effectuated.

A description of the way the administrative tribunal should work, whether in an *ad hoc* or institutional manner, follows. Either party to a concession may invoke the tribunal by the proper allegation of unfair bargaining practice (bad faith). Either the *ad hoc* or the industry tribunal would be constituted by impartial and experienced judges and administrators, as is customarily provided in arbitration clauses. The tribunal would first determine if the issue of bargaining, about which an unfair practice was charged, is a proper subject of bargaining. This means the allocative or "financial" test would be applied. If the issue is determined to be a proper subject, the tribunal would determine the issue of good or bad faith. One should note that the issue of good or bad faith is non-allocative. As a practical matter, the industry tribunal may be used to decide the merits of all non-allocative issues which arise; this includes good faith bargaining and any other issues arising from the execution of the concession. If the tribunal determines that the issue is an improper subject of bargaining, its jurisdiction over the non-allocative issue of good or bad faith is divested. However, it may determine the non-allocative issue itself as a matter of convenience. The remedy available to the parties is limited to the authoritative determination; it should contain an order to cease an unfair practice where it exists. Sanctions have no place or basis in this system. Review may be made obtainable through the invocation of another *ad hoc* body or through the dubious route of petition to the International Court of Justice. However, review seems unnecessary since second-order compliance is so easy and the incentives are many and strong for the parties to get on with the business of their relationship.

V

REASONS FOR CHOICE OF THE ALTERNATIVE

A. Governments Should Find This Proposal Acceptable

The proposal furnishes a real incentive for the governments to comply with the apportionment terms of concession agreements

which was formerly lacking: specifically, the substantive right to participate and consent through negotiation in future decisions concerning potentially unfavorable financial terms; generally, the right of real participation and consent in the decision relating to the apportionment of oil wealth. The rule of law replaces the grace of oil companies in assuring a meaningful collaboration in the control of oil.

The proposal is an instrument through which oil companies are legally compelled to recognize in good faith the exporting governments as equal partners in the production of oil. This forms the basis for the development of mutual confidence and trust among the parties. Governments appear to have nearly equal, if not equal, bargaining power in relation to the oil companies; thus, the governments need not fear that an economic advantage lies with the oil companies.

The good faith standard of bargaining, a minimal standard of conduct, is easy for the governments to comply with. They need not fear that their rights relative to the non-substantive issues will be adjudicated so long as they comply with this easy standard. Furthermore, their rights relative to the substantive issues of bargaining, the apportionment issues, will not be adjudicated at all.

Adoption of this proposal will predictably enhance the position of the leaders of the governments at home by satisfying the nationalist demands for more control of the oil. In addition, adoption of this proposal promises to further enhance the reputation and prestige of the governments and OPEC in the international community, because it is a step in bringing law to bear on international relationships.

The implementation of the proposal may even be a face-saving way out of the dilemma that confronts OPEC and its member governments. This dilemma is the inevitable dissension of members caused by the inherently conflicting interests in oil. This conflict is demonstrated by the views of certain governments toward the issues of proration and relinquishment. For example, Saudi Arabia and Kuwait oppose proration because of their vast oil reserves, whereas, Venezuela favors proration because of its comparatively small reserves. Iraq delayed acceptance of the OPEC settlement because of its special relinquishment problems. On the positive side, OPEC has much to gain in the international community by endorsing this proposal and seeking to establish an industry tribunal for dealing with the financial disputes. After all, acceptance of this proposal

by the oil companies would represent a major triumph for OPEC in obtaining more control of oil for the member governments.

B. Oil Companies Should Find This Proposal Acceptable

Adoption of the proposal should neutralize those OPEC activities which the companies view as disruptive of the business of foreign oil development. This would mean that legal uncertainty and political irrationality, apparent corollaries to the OPEC renegotiations, would be reduced or eliminated by the proposal. The proposal would bring law to bear on the negotiations, which is now absent. It would localize disputes at the concession level, making settlement easier by routine treatment in the early stage before the issues become politically inflated. It is persuasive that there would be much more stability under the proposal than under present circumstances. This view is supported in the Petroleum Press Service, where it is suggested that oil companies would regard a firm commitment not to alter the financial terms for a certain period within the duration of the agreement as worth more than the present unlimited guarantee which is in reality dishonored by OPEC's efforts.⁴⁸

Adoption of the proposal appears to be a way for the oil companies to secure present government compliance, which is not now secured. It lays a foundation for a pattern of government compliance which should provide additional protection in the future.

It has been shown that the marketing power of oil companies within a market structure characterized by an increasing over-supply of crude oil supports the view that the companies have a nearly equal, if not equal, bargaining position in relation to that of the governments. Thus, they should not fear any disadvantage in bargaining participation under the proposal; nor should they fear any drastic action by the governments after adoption of this proposal. Acceptance of the proposal should also neutralize the influence of nationalistic irrationality upon the leaders of the exporting governments. The combination of a substantial reduction in the influence of nationalism on government leaders and the enhancement of their positions for gaining a share of the control of the vital national resource would appear to induce more responsibility on the part of these leaders, along with the greater control of the economic management of oil.

48. 31 Petroleum Press Service 404 (1964).

The proposal appears to accord more with reality than does the present order (or disorder) of oil relations. It seems that the profit expectation interest is dominant with respect to old concessions and, therefore, application of compulsory bargaining to them would subject that expectation interest to redetermination under more certain conditions. That is far better than subjecting the expectation interest to continuous redetermination with OPEC. Furthermore, the reliance interest would still be protected with respect to new concessions under the proposal. The suggestion that the periods of new concessions should be lessened can be persuasively resisted under the proposal and hence the time necessary for payback of the large investment may be protected.

Adoption of the proposal means a probable stabilization of the oil industry for the long-term in exchange for giving up nothing that is not already taken, except without legal restraint, at the present time. By making their international legal arrangements (concession agreements) work better through application of this proposal, the oil companies would be making international law work better, a substantial contribution to the international legal climate for all commercial relations.

VI

REBUTTAL

Some argue that the proposal will result in the reduction or elimination of the oil companies' incentives to risk the large capital investment necessary to undertake concession exploration. Commercial oil might not be found in many cases and consequently, invested capital would be lost. However, as the argument goes, whenever commercial oil is discovered in sufficient quantities to return the capital investment in addition to a profit, the profit would be negotiable under the proposal. Consequently, the total risk on capital investment in oil exploration is not covered by the successful instances.

The answer to this argument rests on the following four propositions: first, the incentive to invest capital in oil exploration is already declining and is expected to decline under present conditions.

[T]he Big Seven have already adjusted to the times by not expanding capital investment, particularly in exploration and production, as much as they may have. . . . At the same time, the incentive to spend a lot of money looking for crude will automatically continue to

decline. (When, if, and as the threat of scarcity becomes evident, it will automatically rise again.) Meantime capital outlays for exploration and production will claim a smaller proportion of revenues.

. . .⁴⁹

Furthermore, it seems clear that the proposal provides more stability for financial provisions than does the current industry practice of renegotiation at the whim of OPEC and the grace of the oil companies.

Second, the uncertainty of the existence of commercial quantities of oil is reduced to the extent that this proposal is limited to oil exporting countries. One oil company executive referred to a concession covering areas in the Persian Gulf as lying within "the world's most prolific oil-producing basin."⁵⁰ This uncertainty in oil exporting countries is less than in producing, but non-exporting, countries and is much less than in non-producing countries.

Third, the proposal provides for the recovery of invested capital plus a reasonable return on the balance of the investment. This covers all of the reliance interest and a reasonable portion of the profit expectation interest before the operation of compulsory bargaining. The reasonableness of the profit expectation portion received along with the recovery of capital is determined by the parties; its determination may be made with reference to the risk foreseen in undertaking the concession. It may be that a reasonable return relevant to one risk is five per cent on the balance of capital investment while relative to another risk it could be fifty per cent.

Fourth, the remainder of the profit expectation interest is bargainable; and the bargaining strength of the oil company will cover some proportion of the remaining expectation. Strength of bargaining is bolstered by a government's reliance on the company for its marketing power in a buyer's market and its fear of replacement of its market supply position by either friendly or unfriendly exporting rivals.

Another objection is directed not at the proposal but at the burden of persuasion. A proponent of the proposal may be asked to cite instances where the dispute might not have culminated in nationalization had the proposal been in force. For example, could the proposal have prevented the Mexican oil expropriation of 1938 or the Persian oil nationalization of 1951?

The short answer appears to be that it is difficult to determine

49. Burck, *supra* note 1, at 222.

50. New York Times, Feb. 18, 1965, p. 47, col. 4.

whether the negotiation method, if applied, could have saved either situation because of the intensities of the revolutionary movements involved. It is more difficult to determine whether the negotiation method could have been applied at all in the Mexican situation because of the absence of a concession system.

The British historian, Elizabeth Monroe, suggests:

Perhaps no scheme short of total foreign capitulation to Persian demands would by 1951 have been acceptable, for the tide of anti-foreign feeling in Persia had been running so high since the Second World War that a succession of Persian governments felt bound to swim with it.⁵¹

Conversely, it is possible that some of the Persian grievances could have been better handled through the negotiation method sometime prior to 1951. The main complaints appeared to center on the financial terms of pricing and taxation. If the Government had been legally assured of the opportunity to renegotiate the financial terms at a certain date, the proposal might have served as an escape valve for nationalist and Anglophobia pressures. Furthermore, the British Government may have refused in bad faith to disclose the price paid by the British Navy for Persian oil and an authoritative determination to that effect might have dampened the rising tension. It seems that the proposal might have been successful in checking the causes of nationalization to the extent that it had been in operation close to the time when they originated. For the reasons stated elsewhere in this paper concerning the likely impact of this legal method upon nationalistic excesses, it appears that the Persian oil dispute could very well have been settled if the proposal had been in force.

The Mexican situation was in a class by itself. There were no concession arrangements between the Government and oil companies within which the proposed negotiation method could have been applied. A concession system pre-supposes that the grantor owns the oil. Ownership of the oil was the central issue of dispute. The Mining Code of 1884 departed from Spanish law by providing that petroleum was, from that date, property of the surface owner.⁵² Minerals remained the property of the Government and mining was administered by a concession system. Although the Mexican Government passed a Petroleum Law in 1928 which provided that

51. Monroe, *op. cit. supra* note 6, at 111.

52. W. C. Gordon, *The Expropriation of Foreign-owned Property in Mexico* 57 (American Council on Public Affairs 1941).

companies' titles to oil which were obtained prior to May 1917 must be exchanged for "confirmatory concessions" of unlimited duration, the legislation was a compromise agreement between Calles and the companies. Thus, the "confirmatory concessions" were no different from the prior fee simple titles.⁵³ Additionally, the "confirmatory concessions" were merely a form of registration and not agreements between the Government and companies. Consequently there did not exist direct legal arrangements such as concession agreements within which the proposed method could have been installed.

Even if a legal standard of good faith negotiation could have been applied in some way to the relations between the Government and oil companies, such a standard would not have been formally applicable to the 1937 dispute which precipitated the expropriation. The formal parties to the dispute were the oil companies and an oil labor syndicate—not the Government. Furthermore, Mexican law governed labor-management disputes and a federal labor board (subject to supreme court review) handled these labor disputes. Even if the substantive good faith of the Government concerning the labor dispute could have been questioned by some procedure, once the 1937 oil strike started the domestic procedure for dealing with labor disputes, government compliance with the good faith determination may have been impossible. From the accounts published by the Standard Oil Company of New Jersey and the Mexican Government, the inference may be drawn that all the parties were probably in very bad faith according to the standard set forth in the proposal.⁵⁴

The foreign mining companies in Mexico were not nationalized for a combination of reasons. First, they were under a concession system and hence were not entrenched like the oil companies because of a strong legal claim of ownership of sub-soil property. Second, they were decentralized and somewhat passive, whereas, the oil companies were very powerful and active in protecting their interests. The consequence may have been that the revolutionary leaders directed their foreign resentment against the big oil corporations rather than the diverse mining concessionaires. These two factors indicate that a rather weak incentive to take over the mining companies existed.

53. *Id.* at 72.

54. Government of Mexico, *The True Facts About the Expropriation of the Oil Companies' Properties in Mexico* 30 (Gov't of Mexico 1940); Standard Oil Company of New Jersey, *The Reply to Mexico* 21-22 (Standard Oil Co. of New Jersey 1940).

Third, government timing was fortunate for the mining companies. The Government did not turn its attention to mining until after it had taken over the oil and railroad industries. Two mounting pressures were brought to bear on the Government at about this time: international political pressures for compensation or restoration of expropriated property and internal financial difficulties partly caused by the losing operations of the seized oil and railroad industries.

Furthermore, the mining industry was the source of the government's largest source of revenue and the United States Government was virtually the sole customer for silver—a major branch of the industry.⁵⁵ In 1938 Mexico agreed to pay at least 1 million dollars a year in settlement of agrarian expropriation claims and it has been suggested that the United States and Mexican Governments "tacitly agreed that most of this sum would come from increased export taxes on the mining industry, which would be principally carried by the silver exports, and therefore indirectly by the United States government."⁵⁶ These circumstances demonstrate that there were rather strong incentives for the Mexican Government to leave the mining industry in peace.

CONCLUSION

Experts on oil concession law have often testified that an alternative to the existing form of concession agreements is vitally needed.

[T]here is much room for new constructive ideas and for flexible development in both the basic structure and the technical details of compacts of this nature.⁵⁷

It seems true that the parties to a concession agreement would each surrender, to a small extent, a prerogative which it formally regards as "sovereign." For the concession company it means relinquishment of some of its formal control over apportionment decisions. For the government it means voluntary submission in a limited manner to international legal processes. In addition, this proposal means that both parties would have to assume more responsi-

55. Gordon, *op. cit. supra* note 52, at 147.

56. *Id.* at 148.

57. J. G. Wetter, *Salient Clauses in International Investment Contracts*, 17 Bus. Law. 967, 971 (1962).

bility. The concession company must become more politically sensitive and the government must become commercially sensible. Yet the reward is disproportionate to the cost of this middle course. The value to the government could eventually be the realization of economic development for the country. The value to the oil companies could be long-term profitability for the oil business. The value to the free world may be a major contribution to peace, both through securing the supply of oil for Western defense and by easing tensions in those areas of the world affected by oil.