PRINCIPLES OF PETROLEUM LEGISLATION

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Graham & Trotman

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The Case of a Developing Country

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To my wife Amal

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FOREWORD

This book was originally prepared and submitted as a Ph.D thesis to the University of London in 1969, and it was intended to publish it soon afterwards. However, the Libyan September Revolution took place in 1969 before arrangements for publication were completed and one of the declared aims of the Revolution was a thorough review of the oil situation in the country. Consequently, it was decided to delay publication in order to take the new developments into account.

More than thirteen years have now passed during which important developments have taken place. Control of the oil industry is now firmly in the hands of the Government through a process of nationalisation and majority shareholding. The price of crude is now decided by a government agency and not by the oil companies. Oil-based industries have been established and most of the original concession holders are now out of the country.

The Libyan experience, and particularly the Petroleum Law which has been the framework of one of the most successful experiences in the history of the oil business, can be of great interest not only to those countries which intend to embark on oil exploration, but also to those which are in the middle of the way. The development of legal thinking as well as the pragmatic approach to problems can be of particular significance. Because of this, the book, without attempting to be unduly legalistic, attempts to follow the stages through which legislation has passed and to refer to practical issues which dictated, inspired or led to the legal development.

The author was fortunate enough to be an active participant in preparing the basic legislation and in dealing with the daily problems of the industry from its beginnings in Libya, first as Chairman of the Libyan Petroleum Commission in charge of the implementation of the Law, and secondly, as a private practitioner in his law office in Tripoli with a number of law companies as his clients, after he resigned from Government service in 1960.

One of the major handicaps faced by the author was the secrecy with which some agreements, particularly joint venture agreements, have been shrouded. No detailed reliable analysis of such agreements was possible. However, officially published material allowed an insight into such developments in the practice of the industry. With the departure from the concession formula, which became limited to dealings between the Government and its national oil corporation, any form of agreement between the national oil corporation and an oil company became possible depending upon the type of service required by the national oil corporation.

One thing this book has intentionally avoided: the politics of the oil industry, which, in the case of Libya as in other countries, can be an instructive book to read. Perhaps someone else will write this book one day.

References in the book are made to the laws and practices of some other countries such as the United Kingdom and the United States. However, it has never been my intention to make a detailed comparative study. References to United States practices were used mainly for interpretation purposes when the Petroleum Law was the sole governing legal instrument, and guidance on its interpretation must be sought in a legal system where oil jurisprudence has reached a stage of high development. The only time the Petroleum Law required judicial interpretation was in connection with nationalisation, and therefore, direct judicial authorities on other aspects of the Law are non-existent. Hence, I had to rely on outside sources, prevailing administrative practice and my own experience in offering any interpretation.

I cannot conclude this foreword without expressing the great debt I owe to my wife, Amal, who was the originator of the idea and the driving force in its implementation. Without her diligent, loving persuasion, neither thesis nor book would have been completed.

Anis Al-Qasem
London

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INTRODUCTION

Interest in prospecting for petroleum in Libya was shown by a number of the major oil companies and independents from the early days of Libyan independence. Some companies, such as Shell and BP, were permitted to carry out limited exploration activities by the British Military Authorities which occupied most of the country after the defeat of Italy in the Second World War. The Military Administration was, however, careful not to grant any rights which would bind the new State when it came into being on December 24, 1951.

After independence, the interested oil companies maintained their contacts with the Libyan Government. Some tried to make the Government recognise rights allegedly granted by the Military Administration. Others worked hard against such an attempt. The Government was not prepared to recognise any alleged rights which, on close consideration, appeared not to have any legal basis. However, it was keenly interested in permitting petroleum exploration. The Government took the first step in the direction of trying to evaluate the oil possibilities of the country. The Minerals Law No. 9 of 1953, was enacted and came into force on September 18, 1953. The Law permitted the grant of exploration permits authorising exploration of the ground, including aerial surveys. All the companies which indicated interest in carrying out petroleum activities applied for and obtained exploration permits under the Minerals Law and Notice 14 issued thereunder.

The clear and stated policy of the Government, however, was not to apply the Minerals Law No. 9 of 1953, with reference to petroleum activities other than the grant of exploration permits. This policy was made public in Notice No. 14, published on September 18, 1953, the same day on which Law No. 9 of 1953, came into force. The Minister of Finance stated expressly that he "will only approve permits to carry out exploration of the ground, including aerial surveys. Concessions to carry out further operations in respect of petroleum *will not be* granted under this (the Minerals) Law . . . Applications

for concessions to carry out further operations will be dealt with under petroleum legislation now under consideration by the Government'.[1]

The Government was indeed studying a Petroleum Law. The Legal Advisor of the Government in consultation with local representatives of some of the oil companies was busy preparing a draft Petroleum law. When the draft was completed, it was circulated to interested oil companies for their comments. Comments were received — diverse, conflicting, appreciative and critical. The Council of Ministers decided that the best way to handle those comments and expedite the finalisation of a draft for presentation to Parliament was to invite those companies which submitted comments to meet in a panel with Government representatives to study the draft law and the comments connected with it. Accordingly, the first meeting of the panel was held in Tripoli on November 1, 1954.

The Panel[3] met throughout November 1954, studying and amending the draft law as originally submitted by the Government. The draft was then submitted to the Council of ministers which established a Ministerial Committee to study and report. The Ministerial Committee suggested certain amendments and, after approval by the Council of Ministers, the draft was submitted to Parliament, approved and promulgated on April 21, 1955, and became effective 30 days after publication in the Official Gazette. Publication took place on June 19, 1955.

In order to establish the administrative machinery for implementation of the Law as well as to set out the regulations governing procedure of application for permits and concessions, a Royal Decree was promulgated on May 21, 1955, putting into force, as of date of publication, Article 2 of the law authorising the establishment of the Petroleum Commission and Article 24 authorising the making of regulations. On the same day, May 21, 1955, a Royal Decree was signed establishing the first Petroleum Commission.[4]

A number of factors were involved in the preparation of the Law. From the geological point of view all that was known about Libya was regional geology. No detailed geological studies were available and not a single well for oil had previously been drilled in the country. Later oil discoveries showed that the oil companies were no better informed regarding oil prospects than the Government. For example, the most sought-after area in the early days, Gerdes

1 *Official Gazette* No. 7, 1953. Emphasis added.

2 The Government representatives were: the author, who was also Chairman of the Panel, Mr Hogenhuis, Mr Pyke and Mr Pitt-Hardacre. Companies present were: Socony represented by Dr A. Sfer, Mr Scott, Mr Toward and Mr Gubbins; Standard of New Jersey represented by Mr Temple and Mr Benett; C.F.P. represented by Mr d'Espaigne and Mr Dupony Canet; Conorada Oil Corporation represented by Mr Braly and Mr Lager; American Overseas Petroleum Company represented by Mr Van Benschoten and Mr Logan; Anglo-Saxon (Shell) represented by Mr Savill and Mr Lush; D'Arcy Exploration Company (BP) represented by Mr Prince, Mr McPherson and Mr Henshaw.

3 The first Commission consisted of: the author; Abu Bakr Ahmad; Mohammed Assifat and Taher al-Bishti — the minimum number established by the Law.

al-Abid, in northern Cyrenaica, still holds the record of having three of the driest and deepest wells in Libya, and, so far, no oil has been found in that area. The prolific Esso Zelten field was not included in any of the original applications, and when, as a result of settling conflicting applications, it was included in concession No. 6 of Esso, no drilling was started there except after five wells in the northern section of the Concession were found to be dry. Concession 59, which became one of the most promising areas, was not applied for in the first round of applications. These examples can be multiplied to indicate how little information was available to both Government and companies, and how misleading even that little information was.

To this should be added that a report prepared by a United Nations expert on mineral possibilities in Libya was negative regarding oil, and encouraging only in so far as it related prospects in Libya to the results of exploration in Tunisia. At the time of the drafting of the Petroleum Law, exploration activities in Tunisia were at a standstill. Ironically, exploration was again activated in Tunisia as a result of discoveries in Libya.

In addition to the above, oil exploration was being stepped up massively in neighbouring Algeria. Conorado was actively drilling in the Egyptian Western desert. Turkey had enacted a new petroleum law. Libya had to compete with all these neighbours, in addition to those already established in the market. It was therefore imperative that concession conditions should be at least as attractive as those prevailing in these other countries.

In addition, the known natural resources of the country were extremely meagre. Foreign aid balanced the budget of the State and was relied on for reconstruction and development projects, which were of a very limited nature. An authority on modern Libya, Professor Majid Khadduri, expressing the great need of the new State to develop new resources, wrote:

> From the time of the achievement of independence, Libyan leaders realised that their country would remain dependent on foreign aid and subsidies unless serious efforts were made to exploit her subsoil resources. Some mineral deposits were already known, but no petroleum exploration had yet been conducted. The Libyan government could not afford to spend large sums to carry out geological exploration in such a vast area as the Libyan desert.[5]

All around there was a great need to find any major income-producing natural resource to meet the needs of a modern State from national sources. The financial situation, the risks involved in petroleum exploration in a virgin country and the absence of any technical and financial basis for the establishment of a local petroleum industry precluded any possibility of the State carrying out, at its own expense, even the preliminary stages of exploration.

[5] Majid Khadduri, *Modern Libya* (The Johns Hopkins Press, Baltimore, 1963), pp. 326–7.

Libya therefore had no choice, when considering the development of its probable petroleum resources, but to deal with established oil companies.

It is not difficult to enact a petroleum law with the most favourable terms on the government's side, and imposing all the most severe conditions on the oil companies. However, such an occasion may arise only, if at all, where one country enjoys complete monopoly of this very important commodity. No country enjoys such a position. That being so, a petroleum law should be formulated in such a way that it may realise its main objective — bringing adequate income to the State as a result of petroleum operations. But, in order to realise such an objective, the work has to be done. Such work, however, cannot be conducted by the mere promulgation of a law, unless the State itself undertakes the work at public expense. If the State is unable or unwilling to do the work itself, the terms of the law should be acceptable to those to whom the law is actually addressed, i.e. to the oil companies.

Essentially, a petroleum law is an offer to do business. This is certainly the case at the beginning of the oil industry in any country where oil companies do not already have vested interests and may accept terms for the protection of these interests, which they might find otherwise unacceptable.

Therefore, at the beginning of oil operations, it is essential that the terms of the petroleum law should be acceptable to the oil companies which are to be induced by the State to conduct petroleum operations.

The difficult question is how far a law can go before it is unacceptable or, at least unattractive. The difficulty becomes greater when the presence of oil is uncertain or discovery possibilities are unknown. This situation can arise where no serious exploration has been conducted prior to the enactment of the law. The difficulty acquires unusual dimensions where previous exploration led to negative or only probable conclusions.

All the above should be taken into account in the evaluation of any petroleum law, including the Libyan Petroleum Law, which has developed rapidly, mainly because of the evolution of the above factors.

In the background of all this was the thought that should results of exploration prove encouraging, and certain concession terms prove unduly favourable to the companies, ways would be found to amend both the law and the concession agreements, in the light of developments and changing circumstances. That attitude is well vindicated by the history of other countries in the field of petroleum. No petroleum law and no concession remained unamended, and any amendment in any part of the world had its repercussions elsewhere. It was not unnatural, therefore, for the Libyan Government to expect that should activities be successful, it would not be particularly difficult to amend the law and the terms of the concessions to fall into line with better terms and conditions prevailing in other parts of the world.

In fact, the tendency to amend concession terms and conditions started even with the first concessions granted under the law. Attention was first directed

towards obtaining more effective working obligations aiming at guaranteeing more intensive prospecting. Drilling obligations were incorporated in some concessions, and pressure was exercised on oil companies to step up their programmes. Other opportunities were seized upon to amend even the financial provisions of certain concessions. The depletion allowance was first limited to actual expenditure, then it was required to be spent partly on actual exploration for the encouragement of which depletion was granted. Finally it was deleted from a number of concessions. The royalty was also increased and, in some instances, the increase treated as a bonus. Deferred cash bonuses were agreed. Marketing obligations were introduced, and the establishment of a refinery was undertaken. Undertakings to establish a petrochemical industry, if the operations of the concession holder were successful, were also concluded. Even participation of the Government in successful operations was secured in respect of the operations of a certain oil company. All these precedents of amending standard concession terms were created by the very first Petroleum Commission which was entrusted with the execution of the Law. These precedents, established in a number of directions, were in preparation and anticipation of the day when it would be possible to re-evaluate the situation. Competition between the oil companies was carefully manipulated to achieve this result even before any major discovery was made. All those additional obligations and amendments were introduced through bilateral agreements without amending the Petroleum Law itself.

The year 1959 witnessed the first major oil discovery in Libya. The important discoveries were made during 1960 and 1961, and the time was ripe for re-evaluation. Law No. 25 of 1955 received its first substantive amendment through Decree Law of July 3, 1961.

The timing of the amendment was made to coincide with the Government's invitation to oil companies to apply for new concessions. Old concession holders were given the opportunity to accept the new terms of the Law. A concession holder who failed to amend his concessions was barred from obtaining any further concessions.

The second incentive to induce old concession holders to adopt the new Law was the undertaking by the Government to extend the duration of concessions whose holders would apply for conversion within six months from the date of the amendment coming into force, by a period equal to the period from the date of the grant of the original concession to the effective date of the amendment. To most concession holders, this would extend the duration of their concessions by about five years. To producing companies, in particular, it meant the hope of five more producing years.

The Decree Law of November 9, 1961, which was promulgated during the six months within which old concession holders were invited to convert to the new Law, carried with it certain financial amendments more acceptable to old concession holders. It gave concession holders who would convert to the new terms the right to relinquish areas, not in one block as required by Decree Law of