International Oil Companies and Petroleum Legal Policy in Iran: Evolution in the Shadow of Resource Nationalism, 1951-1980

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This Article applies legal thought to a critical theory on resource nationalism. The discussion is guided by the question: How did resource nationalism (1951-1980) shape the legal landscape of oil production in Iran? Adopting a historical approach, I explore how resource nationalism shaped the legal policy for oil production, following a series of political and economic changes from 1951 to 1980. The main argument is that the political and economic changes that ensued from resource nationalism affected the legal power of international oil companies and the Iranian state, by shaping the legal framework that governed oil production and ownership. During resource nationalism, legislation is introduced to restrict foreign participation, and when nationalisation recedes, different contractual regimes are used to re-facilitate foreign interest. The discussion is organised under two headings, 'The International Consortium' and 'Resource Nationalism'. An understanding of how the International Consortium achieved its dominance is firstly established. This is followed by an exploration into how resource nationalism influenced the legal structure of the oil industry. Key legal changes fell under three phases of the Iranian framework for petroleum: (1) the traditional concessions phase, (2) the hybrid phase and (3) the general legislative framework. Throughout these phases I examine how the rearrangement of power was achieved through contracts and legislation. Finally, I apply the critical theory of resource nationalism as a cyclical phenomenon, to explain the fluctuating nature of state intervention and legal changes in this context.

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I. INTRODUCTION

Resource nationalism created a structural change in power and ownership of the oil industry. This Article explores how it has shaped the legal landscape of oil production, analysing the phenomenon through the evolution of contractual regimes and legislation. As suggested in the title, the core discussion will focus on Iranian oil production. This is because Iran is an example of a country that has experienced almost all forms of prototypical contractual regimes in the history of oil trade,¹ from traditional concessions to buy-back agreements. Additionally, the advent of resource nationalism in 1951 was the first government intervention of its kind in the Middle East, and despite its initial failure, it sowed the seed for similar political developments throughout the region. Resource nationalism itself is a phenomenon worth examining, not only because it created an irreversible shift in patterns of investment and the operation of the oil industry, but also because it affects the ability of a country or region to mobilise its resources for development (in this sense, growth, employment and poverty alleviation).²

An important consideration is the definition of resource nationalism. There is no single meaning, let alone legal typology of resource nationalism. Thus, it is useful to consider a number of interpretations of the term. The International Energy Forum describes it as ‘nations wanting to make the most of their endowment’,³ by which producer countries create conditions ‘to maximize revenue from present oil and gas production while altering the terms of investment for future output’.⁴ Another is the ‘increasing use of control of natural resources to advance policy goals – both economic and foreign policy’.⁵ Paul Stevens ⁶ simply defines it as ‘limiting the operations of private

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⁴ Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 5.
⁶ Paul Stevens was educated as an economist and specialist in Middle East Studies at the University of Cambridge and SOAS, University of London. Stevens is a distinguished expert in the field of oil and energy research. A number of his works expound on the political economy of the Middle East that pertain to nationalisation in the region. See Paul Stevens, ‘Saudi Aramco: The Jewel in the Crown’ in David G Victor, David R Hults and Mark C Thurber (eds), Oil and Governance: State-Owned Enterprises and the World Energy Supply (CUP 2012).
International oil companies (IOCs) and asserting a greater national control over natural resource development’. For the purpose of this Article, Stevens’ definition will be construed in line with resource protectionism. This expands the meaning, by revealing a core motive behind resource nationalism in Iran, which is protection against ‘Western dominance in the energy sector through their IOCs’. Thus resource nationalism is understood as limiting operations of international oil companies (IOCs) and asserting sovereign control over natural resource development, shielding the national oil industry from foreign influence. Lastly, Stevens’ theory of resource nationalism as a cyclical phenomenon will be interpreted in the core discussion, to offer a critical narrative on the changing legal landscape of Iran’s oil industry.

II. EVOLVING LEGAL LANDSCAPE

2.1 The International Consortium

The hypothesis of this Section is that the oligopolistic structure of the international oil industry from 1945 to the 1960s was a catalyst for resource nationalism, structural change in ownership, and the rise of power over production. As a result, the industry saw an evolution in agreements and legal conditions that reflected the political and economic climate of the time. This will be analysed in terms of how the legal landscape of oil production evolved during the period of nationalisation in Iran. Adaptation of rules were implemented by governments during resource nationalism, and by IOCs in response to it; but in order to understand how the landscape of ownership and production changed, it is necessary to look at the state from which it evolved. Prior to the shift, the world’s oil supply was in the hands of seven major corporations, otherwise informally known as the Seven Sisters. These seven companies were the major powers of the Oil World: Shell, British Petroleum (the Anglo-Persian Oil Company), Esso (Exxon), Gulf, Texaco, Mobil and Chevron (Socal). During the time when they ruled as de facto supranational governments, their fleets of oil tankers were comparable to navies; controlling whole cities in the desert, and their citizens, Western consumers. Their map was defined by oil fields; and in the Middle East, regions were divided along the gulf coast marked with the consortia of oil companies: Saudi Arabia was ARAMCO’s turf, Kuwait was Gulf’s and BP’s, and all seven operated as the

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7 Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 5.
9 Anthony Sampson, Seven Sisters: The Great Oil Companies & the World they Shaped (Bantam Books 1974).
Consortium for Iran. By the 1960s, these companies controlled 85% of the world’s oil reserves. In essence, it was the reincarnation of Rockefeller’s Standard Oil monopoly in the United States, as a global cartel.\textsuperscript{10}

The International Petroleum Cartel commanded the Oil World, operating as an oligopolistic closed system. How it achieved its dominance can be categorised as two key systems: (1) through a system of petroleum concessions, and (2) a system of inter-company arrangements.\textsuperscript{11} Petroleum concessions were the key legal tool that granted exploration and production rights to IOCs, who held major concessions in the Middle East, where they had almost full autonomy over oil resources. An example is the D’Arcy Concession, issued to William D’Arcy, a founder of the Anglo-Persian Oil Company – later known as the Anglo-Iranian Oil Company (now BP). It was the first ever concession for oil in the Middle East that covered almost all regions of Iran, granting rights for a 60-year term.\textsuperscript{12} For governments and rulers of emerging Arab oil states, the IOCs were a beacon for technology, expertise and market knowledge; in this sense the IOCs were able to decide where to allocate economic growth.\textsuperscript{13} This was a subcontract of their national sovereignty:\textsuperscript{14} meaning that the host country could not interfere in production activities (e.g., \textit{inter alia}, exploration plans, development of oil fields) because traditional concessions gave exclusive rights to the holder (the oil company) in all upstream phases and made IOCs the sole arbiter of these activities.\textsuperscript{15} Meanwhile, a purely fiscal relationship between the state and foreign company was maintained, as the state’s role was limited to collecting taxes and royalties.\textsuperscript{16} This was advantageous for IOCs because it provided them with unregulated decision-making powers in relation to the region, without imposing any liability on them to fulfil requirements of economic development, transfers, or social responsibility in the host state.\textsuperscript{17} In other words, IOCs were operating the production and nature of investment based on the needs of the West – in particular, the West’s economic growth. IOCs could thus maximise profits without engaging in the national economy of the host state.

\textsuperscript{11} FJ Al-Chalabi, \textit{OPEC and the International Oil Industry} (Springer 1981) 8.
\textsuperscript{12} Shahri (n 1) 113; The Concession covered ‘almost all territories of Iran, except for the five Northern provinces which were the traditional preserve of Russia’.
\textsuperscript{13} ibid.
\textsuperscript{14} Sampson (n 9) 24.
\textsuperscript{15} Al-Chalabi (n 11) 9.
\textsuperscript{16} ibid.
\textsuperscript{17} ibid 7.
The benefits are obvious for the IOCs, but for the host country it was less clear. The exclusivity and lack of liability in the traditional concession system is comparable to occupation and plunder of the colonial era. A critical observation of the system is the existentially exploitative relationship between the concessionaire and the state. In the Middle East, the Concession system was a remnant of the old colonial rule that initially secured the foothold for European oil companies, through the 1916 Sykes-Picot Treaty, and the 1920 San Remo Agreement. The former was an agreement to partition the Ottoman Empire’s provinces in the Middle East between France and Britain, and the latter a realisation of the imperial role in the region. This carve-up continued as the US increased its presence, and alleged that the ‘door’ to the Middle East be open to all victors of the First World War. This presence was driven by energy security objectives as the War demonstrated the importance of and dependence on energy. As Lord Curzon depicted, [Nation States] ... floated to victory on a wave of oil. In this sense, the Seven Sisters were positioned to pursue the energy goals of Western governments, acting as a buffer between them and the governments in the Middle East. Sampson described this as ‘oleaginous diplomacy’. Evidently, the concession system facilitated interests of the West and its dominance in the region, and can arguably be observed as a form of absentee colonialism.

For the purposes of this Article, absentee colonialism describes the nature of activities that are analogous to the colonial era but operated in the absence of direct intervention by Western governments. As mentioned, the buffer position of oil companies played a part in influencing the foreign policy and energy security objectives of the West, save that direct force was replaced by private commercial forces. Zygmunt Bauman, an influential sociologist, regarded such activities of contemporary capitalism as being shaped after the ‘pattern of the old-style ‘absentee landlords’’. This influence is demonstrated by the sheer fact that the British government acquired half of the shares of BP’s predecessor by 1914. This was part of Churchill’s plan to secure energy resources for Britain.

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18 The Sykes-Picot Agreement between Britain and France (19 May 1916).
19 The Treaty of Sèvres between Britain, France, Italy and Japan. The Treaty of peace between the Allied and Associated Powers and Turkey (10 August 1920).
20 Al-Chalabi (n 11) 8.
21 Sampson (n 9) 77.
22 Sampson (n 9). Sampson gives a detailed account of the idiosyncrasies of the oil industry vis-à-vis ‘oleaginous diplomacy’ or oil diplomacy and the role of American foreign policy. Although this is a key contentious area of the industry, and political and economic discourse, it is not the focus of this discussion.
along the Gulf Coast. In the age of corporate capitalism: the Seven Sisters were the contemporary ‘forerunners of the modern multinational corporation’; and unlike colonial conquests, corporate capitalism did not require war to plunder precious resources, but rather achieved the same through negotiated contracts. The full autonomy to exploit oil resources and maximise profits, enabled by traditional concessions, can also be argued as a feature of absentee colonialism. This is a parallel that can be drawn with the unscrupulous expansion of the colonial empire. The force of capitalist firms was described by Smith and Marx as driven without bounds and mercy to discover and open up new markets. However, oil exploration and production are very capital- and technology-intensive, which Iran and similarly oil-rich, yet less economically developed countries (LEDCs) were not initially equipped to undertake. Thus, it should be remembered that IOCs introduced knowledge and production inputs to develop the oil industry – a notion very much similar to the ‘development’ or ‘modernisation’ mandate of colonialism.

Another aspect that reinforced the oligopolistic structure of the oil market was the system of intercompany arrangements. There were three notable features of this system: the Redline Agreement, the Gulf-Plus pricing method, and vertical integration. Following a major oil field discovery in Iraq, the 1928 Redline Agreement divided the development of oil reserves, allocating monopolies. The terms provided each producer with a 23.75% cent share of all oil produced by the Turkish Petroleum Company – this covered all regions between the Suez Canal and Iran. The signing of this agreement was very significant in solidifying the Consortium’s dominance, notably due to its ‘self-denying clause’. This clause prohibited any members from undertaking independent oil production. It ‘stipulated that they “would not be interested, directly or indirectly, in the production or manufacture of crude oil in the Ottoman Empire … otherwise than through the Turkish Petroleum Co”’. Another arrangement was the ‘Gulf-Plus System’. This was similar to a currency peg. The cartel fixed its oil prices to the American oil price in the Gulf of Mexico. This was a system unanimously accepted amongst the major oil companies and protected American oil. It also ensured greater profits for other members. For example, ‘if BP supplied cheap oil from Iran to Italy, the oil would be charged as if it had come from the Gulf of Mexico to Italy’, and the profits of this phantom pricing

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25 Sampson (n 9) 76.
26 Al-Chalabi (n 11) 4.
28 ibid 31.
29 Sampson (n 9) 91.
would be split between the companies. Finally, the integrated nature of the commodity chain was advantageous because it allowed the major oil companies to jointly own or enter collectively in all phases of production.\textsuperscript{30} Through this, an ‘Integrated Oil Company’ was created, controlling the upstream phases (exploration, production, transport) and downstream phases (distribution, marketing) of oil production.\textsuperscript{31} Spreading the risks and profits throughout the commodity chain, the Consortium created a degree of market stability;\textsuperscript{32} if the marketer is also the producer, possession of a large distribution base in the marketing phase would ensure a degree of regular demand, and as a result enable more consistent production in the upstream phases. Various intercompany arrangements diversified the various processes part and parcel of the oil commodity chain for IOCs, creating stability in a typically volatile market.

For capitalists and ‘cartelists’, the International Consortium is considered an inevitable historical development in the oil industry.\textsuperscript{33} It is arguably a ‘natural monopoly’ that cannot be sustained in a free market according to the rules of supply and demand, and subject to the inevitable control of a single entity – be it the Standard Oil monopoly, the Seven Sisters oligopoly or the OPEC cartel. Oil consultant and economist Paul Frankel postulated that the variations in the market have little effect on demand: as dependence on oil is so high, people are willing to pay higher prices for it.\textsuperscript{34} There is also limited effect on supply because producers will continue to produce, regardless of the uneconomic costs, in order to keep the refineries operating. Therefore, the price of oil is inelastic as the industry fails to self-adjust.\textsuperscript{35}

Conversely, economist Edith Penrose argued that the oil industry is self-adjusting and operates like other free market enterprises in the sense that, ‘the greater the output of an oil field, the higher the cost of additional output’.\textsuperscript{36} The reason for this is that oil is non-replenishing, more difficult, as well as more costly to extract over time, as demonstrated by tar sands extraction and the controversial Arctic oil drilling in Alaska. Yet this does not eliminate the notion

\begin{thebibliography}{99}
\bibitem{Hawdon}
\bibitem{Sampson}
Sampson (n 9) 76.
\bibitem{Frankel1}
\bibitem{Sampson2}
Sampson (n 9) 47.
\bibitem{Frankel2}
\bibitem{Sampson3}
Sampson (n 9) 46.
\bibitem{Sampson4}
Sampson (n 9) 28.
\end{thebibliography}
that oil is considered an inevitable monopoly because an oil company requires vast economies of scale in order to be sustainable as production gets more capital- and technology-intensive over time. Additionally, the weak price inelasticity argument is convincing, as market volatility has existed since the beginning of the trade, being that there is always too much or too little oil.\textsuperscript{37} In this sense, the Seven Sisters viewed the oligopoly as representative of the fact that only big companies with markets and resources were in a sensible position to produce oil.\textsuperscript{38} Intercompany arrangements were seen as essential in an oil glut where ‘there would only be cut-throat competition and sudden floods of cheap oil’, thus providing a rationale to restrict supply.\textsuperscript{39} For the Standard Oil monopoly and Seven Sisters oligopoly, their control brought ‘order’ to the market.\textsuperscript{40} Notwithstanding this, the independent producers and state enterprise were subject to an unfair system that was controlled and manipulated by the Seven Sisters for their own profit maximisation.

2.2 Resource Nationalism

The closed-system conditions and oligopolistic power over oil resources in the Middle East provided a rationale for nationalisation, a movement that was reactionary to the loss of sovereignty and constraints the Iranian government experienced in relation to its oil industry. In terms of influencing the oil sector, the government was limited to the sphere of regulation: tax, import and export licences, and fiscal regimes were the only policy levers at its disposal.\textsuperscript{41} Combined with the exploitative terms of the concessions and financial inequalities, this normative system kept the state powerless to pursue national interests and direct action within the industry. Reluctance of the Anglo-Iranian Oil Company (AIOC) to renegotiate better concession terms, and the subsequent pervasion of American IOCs through the Iranian Consortium, reinforced sentiments to nationalise the oil industry and shift power and control to the state.

Resource nationalism was the erosion of the IOCs’ dominance. Characterised as a struggle between foreign influences and national interests,\textsuperscript{42} it was a ‘reversal’ in oil investment relationships and the replacement of IOCs with governments and state enterprise – in the ownership and management of oil resources.\textsuperscript{43}

\textsuperscript{37} MW Watkins, \textit{Stabilization or Conservation} (Harper & Brothers 1937).
\textsuperscript{38} Sampson (n 9) 149.
\textsuperscript{39} ibid.
\textsuperscript{40} Sampson (n 9) 76.
\textsuperscript{41} Frankel (n 32) 5.
\textsuperscript{42} Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2).
\textsuperscript{43} Al-Chalabi (n 11) 16.
Nationalisation of oil in Iran was the first major state intervention in the Middle East petroleum industry. The concept of absolute state control had a ripple effect and led to similar political developments in the region.\textsuperscript{44} Resource nationalism is understood as limiting the operations of IOCs and asserting sovereign control over natural resource development, shielding the national industry from foreign influence. The following discussion begins with a cursory account of Iran’s history of petroleum law and its key developments, which are categorised into three phases: the traditional concession phase, the hybrid phase and the general legislative phase. This lays the foundation for examining the influence of resource nationalism in the respective phases and their significant features, including concessions, the role of the state enterprise, the Consortium Agreement, the petroleum laws, and the Iranian Constitution.

Prior to the promulgation of Iran’s first petroleum law in 1957,\textsuperscript{45} the industry was characterised as being ‘lawless’,\textsuperscript{46} because Western IOCs were able to gain massive profits from oil resources, to the detriment of Iran’s national revenues.\textsuperscript{47} Nonetheless, contractual regimes existed to regulate the relationship between IOCs and the state. This constituted the rudimentary stages of Iran’s petroleum legal landscape, known as the traditional concession phase. Without a consistent legislative framework, this phase consisted of individually negotiated contracts or agreements. Two key agreements were the D’Arcy Concession and the 1933 Concession, both of which concerned the British-owned AIOC.

As aforementioned, the D’Arcy Concession was a major contract for the Anglo-Persian Oil Company (APOC; renamed AIOC in 1935). It granted exclusive rights to Iranian oil resources for 60 years (1901-1961). It was the first and largest concession granted in the Middle East. Agreed at a time when oil resources were not considered particularly valuable in Iran, the concession provided a nominal income for Iranian Shahs (or kings) who were unaware of the deal’s inequalities. It has been argued that the D’Arcy Concession ‘was awarded by the corrupt and inexperienced’.\textsuperscript{48} Reza Shah challenged the terms of the concession due to his dissatisfaction with the state’s entitlement to a

\begin{thebibliography}{99}
\bibitem{44} Saudi Arabia acquired 100\% of shares of Aramco by 1980. Iraq nationalised the Turkish Petroleum Company in 1972, and Kuwait nationalised the Kuwait Oil Company (founded by APOC and Gulf Oil) by 1975. See JW Plunkett, \textit{Plunkett’s Energy Industry Almanac} (Plunket 2009).
\bibitem{45} Petroleum Act 1957.
\bibitem{46} Shahri (n 1) 112.
\bibitem{47} ibid.
\end{thebibliography}
meagre 16% of net profit from the APOC, and the ‘precipitous’ decline in royalty payments in 1931. In 1932, the Iranian government abrogated the D’Arcy contract due to financial inequalities and the increasing influence of the British government through the APOC (owing to the latter’s 52.5% acquisition of the APOC). As a result, the Iranian government and the APOC (hereafter AIOC) renegotiated terms and signed the 1933 Concession Agreement otherwise known as the Supplement Agreement.

Although the 1933 Agreement provided more government revenue, it failed to ensure the Iranian government any sovereign control. Lacking considerable changes, it was a mere extension of the D’Arcy concession. For example, it maintained a 60-year term, the AIOC held full ownership rights of production and resources, and the government relinquished their right to abrogate the concession. Nationalistic sentiments heightened during this phase as working conditions at the AIOC oil fields and refineries deteriorated for Iranian workers, disparate to British workers. This disparity fuelled anti-Western views as the inequality of living conditions was compared to ‘images of the British as nineteenth-century imperialists’ with ‘tennis courts, and swimming pools’.

Thus the concession phase was characterised as exploitative, and although the rights to production and risks were vested in the concessionaire, the AIOC, the government had no control over its activities and posed little liability.

49 Shahri (n 1) 114. See Thomas B Phillips, Queer Sinister Things: The Hidden History of Iran (Lulu 2013) 57: ‘[APOC informed the Iranian government] that due to the precipitous decline in revenues as a result of the worldwide economic depression, the company’s royalty payments to Persia for Fiscal Year 1931 would not exceed £306,872. This is less than one-sixth the royalty revenues of the previous fiscal period and represents a major threat to further economic development [in Iran]’.


51 The core purpose of negotiations was to push for better fiscal terms. See Vanessa Martin (ed), Anglo-Iranian Relations since 1800 (Routledge 2005) 132: ‘Two meetings were held [on] 24 April and 26 April 1933, and the Shah agreed to a new sixty-year concession in return for [the conditions of the 1933 Agreement] 1. a minimum guaranteed payment of £750,000 annually plus a royalty of 4 shillings (gold) per ton of oil produced 2. 4 per cent tax to Iran ... 4. payment of 1 million pounds (by APOC) as settlement of all past claims....’

52 Shahri (n 1) 114.


54 An example of a liability in a concession agreement is a relinquishment clause, which forces a foreign company to return developed land to the host government after a certain period. This was not incorporated into Iran’s early concession agreements.
As the sole legal framework for oil production, concessions governed the relationship between the IOC and the state. The nature of this relationship and its legal character has been controversial in international law, especially in the context of resource nationalism. This has given rise to the question of whether a concession falls under public or private law. There are two prominent views: first, that concessions are private in nature, and must fall under the municipal law of the state party. This is because a concessionaire’s rights are analogous to those rights given under private law – for instance, the concessionaire may not require specific performance, but rather seek to recover investment. In *Anglo-Iranian Co v Idemitsu Kosan Co*, the Tokyo High Court held that the Anglo-Iranian concession was a contract of private law between the Iranian government and the IOC. It distinguished the concession rights not as a right to a ‘concession area’ but, ‘...only a right to extract petroleum in Southern Iran, refine and sell oil’, and that such rights were based in Iran and thus fell under municipal law. Another argument for such concessionary rights being characteristically private was highlighted by the International Court of Justice (ICJ) in the 1952 *Anglo-Iranian Oil Co Case*. This was a dispute brought by the UK against the Iran government’s nationalisation of the AIOC’s assets under the 1933 Agreement. The ICJ held that it did not have jurisdiction over the case, because the concession agreement was not a treaty or convention between the two countries, and the UK was not a party to it. This highlights the fact under public international law; concessions cannot amount to treaties, and corporations (AIOC) do not have legal personality.

However, concessions may also be regarded as a matter of public law, because the state is a party to the contract. Arguably, an oil concession is an ‘economic development agreement’ concerning a resource that is vital to a country’s interest. Thus the state’s abrogation of concessionary rights in the public interest can be justified if the ‘moral and economic welfare of its citizens’ is concerned. However, it seems that oil concessions are neither exclusively public nor private in character, as held in *Sapphire International Petroleum Ltd v*
National Iranian Oil Company,63 that a concession ‘gives the contract a particular character, which is partly public and private law’.64 These two views represent the complexity of applicable substantive law vis-à-vis concessions, particularly whether to turn to public or private law in disputes. Arguably, this uncertainty reveals the inflexible nature of the concession phase to provide a system of compromise between the interests of private foreign companies and the state. It lacked a level of stability to protect foreign interests, such as in UK v Iran,65 and lacked legislation or guidelines, which created inconsistency in the terms agreed by the Iranian government. Thus concessions could not provide stability in contracts, nor be evolutive between the principles of pacta sunt servanda (sanctity of contracts) and the clausula rebus sic stantibus (unenforceability of an agreement due to fundamentally changed circumstances) in private and public law.66 It seems that resource nationalism gave rise to this problem in the framework for oil production rights in Iran, which altered the relationship between IOCs and the state in the hybrid phase.

Prior to the hybrid phase was the nationalisation of Iran’s oil industry, resource nationalism created a pivotal change in the legal landscape of oil production. After the Second World War, nationalistic sentiments heightened with growing influence on Iranian politics. In 1949, the Iranian government attempted to renegotiate the 1933 concession terms, demanding a 50-50 profit sharing agreement with the AIOC. The British were reluctant to compromise, and, failing to acknowledge these demands, also failed to prevent encouraging nationalist aspirations in other regions of British interest.67 The AIOC was even criticised as ‘an anachronism’,68 as the the 50-50 deal had already existed between Saudi Arabia and Aramco (Arabian American Oil Company).69

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63 Sapphire International Petroleum Ltd v National Iranian Oil Company (1963) 35 ILR 136. A dispute arising from a joint agreement between the two parties. The dispute was brought to the Swiss Federal Court by Sapphire International (a private Canadian company). It concerned the legal principles governing choice of law. See also Rouhollah K Ramazani, ‘Choice-of-Law Problems and International Oil Contracts: A Case Study’ (1962) 11(2) International and Comparative Law Quarterly 503.


65 Anglo-Iranian Oil Co Case (n 59).

66 Mafi (n 50) 430. ‘Clausula rebus sic stantibus’ is a clause in international agreements and treaties, and in private international law that provides for the unenforceability or inapplicability of a treaty due to significant change in circumstances.


69 Svante Karlsson, Oil and the World Order: American Foreign Policy (Berg Publishers 1986) 123.
Mohammad Mossadeq, leader of the National Front of Iran, proposed the nationalisation of the AIOC’s concessions and assets, which was supported by the Iranian Parliament’s Oil Commission.\(^\text{70}\)

In 1951 both Iranian Parliaments\(^\text{71}\) promulgated the Oil Nationalization Act of 1951,\(^\text{72}\) which nationalised the entire oil industry, ‘exploration, development and exploitation were to be carried and controlled by the Iranian government’.\(^\text{73}\) The Act authorised the National Iranian Oil Company (NIOC) to manage and operate the AIOC’s assets and facilities as Iran’s state enterprise. For the Iranians, resource protectionism was a reaction against the British mercenaries and pervasive control over their oil wealth. The British found this as an ‘affront to the rights of private property’ and *pacta sunt servanda* (sanctity of contracts) and took nationalisation to the ICJ in *UK v Iran*.\(^\text{74}\) However, the project of nationalisation came to a premature end in 1953, when the Mossadeq regime was overthrown by a US-British backed military coup. Through this Western companies had resumed activity in the Iranian oil sector and in 1954 the Majlis (Parliament) validated the establishment of the Consortium, to encourage participation of non-British IOCs. Resource nationalism was a phenomenon that shook Iran’s oil industry: it went from a state of absolute government control and closure to foreign interests, to establishment of a new consortium and reopening foreign access. In these phases, the legal landscape of petroleum production first saw ‘lawless’ concession agreements, and then a stringent Nationalization Act 1951, resulting in the coup-d’état government validating the 1954 Consortium Agreement. This therefore supports the notion that resource nationalism has shaped petroleum law in Iran, in that legal changes have reflected the political and economic climate of the period.

The political economy of resource nationalism in Iran was complex and multifaceted. Nonetheless, three key driving forces can be identified: inequalities in concession terms, the ideology of state intervention, and rising oil demand.\(^\text{75}\) Inequalities in the concession system were a key motivation for the state, especially financial inequalities (see Figure 1), combined with exogenous factors such as rampant poverty, recession, high inflation and huge

\(^{70}\) ibid.

\(^{71}\) Prior to the 1979 Iranian revolution, two parliaments co-existed: the National Parliament and the Senate. Concessions and agreement had to be validated by both parliaments to come into effect.

\(^{72}\) Nationalization Act 1951 (Iranian Parliament).

\(^{73}\) Shahri (n 1) 116.

\(^{74}\) Anglo-Iranian Oil Co Case (n 59).

\(^{75}\) Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 10.
capital flowing out of Iran. The second was an ideological force: in the postwar period, there existed the popular view that the state should have an increasing role in the economy. It was generally accepted that ‘market failure’, imperfect competition (owing to there being a natural monopoly of the oil market) and asymmetrical information were problems that plagued the oil market. Solutions to this market failure were considered to be found in state intervention, from fiscal regulation, taxes on profits and ‘ultimately government ownership’. From the international sphere, this view was influenced by United Nations resolutions on the notion of ‘permanent sovereignty’ over natural resources. Resolution 2158 of 1966, was very explicit about this concept: it advised host countries to be in a position to ‘undertake themselves the exploitation and marketing of their natural resources so that they may exercise their freedom of choice ... related to the utilization of natural resources under ... favourable conditions’. Popular anti-Western sentiments also grew against the managerial freedom granted by concessions that allowed the AIOC to operate as a ‘state within a state’. In this sense, the company was the largest industrial employer, the key source of government revenue, and a symbol of globalisation and westernisation. The last factor was increasing oil demand, due to the rapid growth of the US, Western Europe and Japan or the ‘OECD Economic Miracle’ – unprecedented growth was met with very high oil demand. For instance, from 1958 to 1972, global oil demand grew from 16.5 million barrels per day to 46.3 million, along with an average annual growth rate of 8.1% from 1965 to 1970. The latter forces contribute to changing the state’s position in bargaining power over time, theorised as the ‘obsolescing bargain’, meaning that the dominance of the IOC diminishes once oil is discovered. This is a switch of relative bargaining power to the state that uses its position to increase its fiscal take by changing the terms of agreement. These

76 Karlsson (n 69) 121.
77 ibid.
78 ibid 7.
79 ibid 7.
80 UNGA Res 2158 (XXI) (25 November 1966) UN Doc A/RES/2158.
81 ibid.
82 Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 10.
83 Phillips (n 49) 57, 157.
84 Stevens, ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 11.
changes are motivated by the rise in oil prices, increasing demand, and political pressure from anti-foreign sentiment and independence.\(^{87}\)

**Figure 1: Comparison of Shared Petroleum Taxation Revenues of the British and Iranian Governments\(^{88}\)**

Following the short-lived period of resource nationalism (1951-1953), the industry’s structure proceeded into the hybrid phase. This phase describes two separate regimes that coexisted under the umbrella of Iran’s petroleum legal framework: the 1954 Oil Consortium Agreement,\(^{89}\) and the Iranian Parliament’s petroleum legislation (1957 Law).\(^{90}\) The 1954 Consortium Agreement established the oil Consortium,\(^{91}\) which included the Seven Sisters, as well as CFP\(^{92}\) and Iricon.\(^{93}\) The Consortium was a new coalition in Iran: BP held 40% of its shares, Shell 14%, and the US companies took 39%. Although the NIOC retained full ownership of oilfields and refineries, the Consortium operated concessions and purchased all the oil back from the NIOC (distributed relative to the companies’ shares in the Consortium).\(^{94}\)

The Consortium Agreement was a guise for a modern concession agreement that reinstalled the power of IOCs. Containing 51 Articles, the Agreement was complex because the parties sought to reconcile the terms with the 1951 Iranian

\(^{87}\) ibid.

\(^{88}\) Shahri (n 1) 115. Graph from Shahri has been reconstructed.

\(^{89}\) The Iran-Consortium Agreement 1954.

\(^{90}\) Petroleum Act 1957 (n 45).

\(^{91}\) ibid.

\(^{92}\) Compagnie Française des Pétroles (renamed Total in 1991) was a major French-owned oil company.

\(^{93}\) Iricon was divided into 12 shares distributed amongst a group of independent oil companies.

\(^{94}\) Karlsson (n 69) 134.
Nationalization Act.\textsuperscript{95} However, the Agreement merely seemed to mask old, concession-like terms. This was apparent in the change in language used. For instance, instead of the word ‘royalty’ (seen in traditional concession agreements), the term ‘state payment’ was used to avoid the historical connotations.\textsuperscript{96} The Agreement denied Iran a share in the Consortium\textsuperscript{97} and notably, stipulated that the Consortium were exempt from taxes and tariffs.\textsuperscript{98} With respect to a concession-like formulation, the Agreement was a guise that made the Iranian government appear as the owner, but in fact had no rights as its ownership ended at the oil wellhead.\textsuperscript{99} However, there was a modification in the Agreement term to 25 years,\textsuperscript{100} and there was a relinquishment clause to hand over land after 10 years.\textsuperscript{101} Still, there was a covert relationship between the companies in the Consortium, who signed the ‘participants’ agreement’. This created a regime that restricted production in Iran to avoid an oil glut, and agreed on terms to purchase oil.\textsuperscript{102} It held production levels at the lowest levels of demand of the companies; for example, Exxon and Texaco demanded the least oil because of their existing production in Saudi Arabia.\textsuperscript{103} Unknown to the public and the Iranian government, this agreement meant that the future of Iran’s income was dependent on a ‘private rationing system’ controlled by the major oil companies.\textsuperscript{104} Previously, resource nationalism attempted to shield foreign influence from the industry. Instead, it resulted in the re-establishment of foreign control that returned to the tendencies of the concession system.

The second regime acting parallel to the 1954 Consortium Agreement was the Iranian Parliament’s legislation. The 1957 Petroleum Law\textsuperscript{105} was unprecedented in Iran. It encouraged foreign interest by prescribing joint ventures with government participation. It allowed alternative contractual frameworks that facilitated joint ventures, such as Joint Operations Agreements (JOAs) and Production Sharing Agreements (PSAs). PSAs facilitated foreign investment, and oil companies earned returns through a share of oil.\textsuperscript{106} A condition under Article 6 required that the NIOC must have at least a 30% share in foreign

\begin{footnotes}
\footnote{95}{Nationalization Act 1951 (n 72).}
\footnote{96}{Shahri (n 1) 116.}
\footnote{97}{ibid.}
\footnote{98}{Consortium Agreement (n 89), art 28.}
\footnote{99}{Shahri (n 1) 116.}
\footnote{100}{Consortium Agreement (n 89) art 7, para 4.}
\footnote{101}{ibid art 7, para 3.}
\footnote{102}{Sampson (n 9) 146.}
\footnote{103}{ibid.}
\footnote{104}{ibid.}
\footnote{105}{Petroleum Act 1957 (n 45); Shahri (n 1) 117.}
\footnote{106}{Mahdavi (n 53) 242.}
\end{footnotes}
ventures. Different to the 1954 Consortium Agreement, foreign oil companies taking part in contracts under the 1957 Petroleum Law were liable for all applicable taxes. On that note, this legislation failed to address or regulate the territories granted to the Consortium. The Consortium was exempt from the law and operated separately under the 1954 Consortium Agreement. The 1957 Petroleum Law provided the legal backdrop for other IOCs to attract foreign investment and modern technology. As prescribed by the legislative framework, foreign oil companies could engage in Iran's oil sector in the form of partnerships with the state, and the Seven Sisters gained access with the Consortium Agreement. Coexistence of these regimes reflected the political climate of converging interests – that is to say, the major oil companies’ rearrangement to secure energy resources for the West was met with Iran’s motive to retain a form of sovereignty in the industry. Thus reopening access for foreign participation through these regimes was aimed at encouraging foreign investment while ensuring a degree of Iran’s control and ownership through the NIOC.

The promulgation of the 1974 Petroleum Act and Risk Service Contracts ended the hybrid framework, and commenced resource nationalism for the second time in Iran’s oil industry. The 1974 Act reinforced resource nationalism, providing that oil companies could no longer engage in Iranian oil production through partnerships and could only participate as contractors. It prohibited foreign investment in production and downstream operations, and replaced PSAs with a new contractual regime – the service contract system. As stated in Article 3, service contracts were the only arrangements permitted to facilitate foreign interest; companies were no longer entitled to oil as opposed to under concessions and PSAs, and could only receive remuneration for its services. In contrast, the first phase of nationalisation still allowed foreign companies to participate in the sector and still contracted through the NIOC, but provided ‘equity-like’ incentives for companies to explore oil. Iran demonstrated its limited interest in attracting foreign direct investment through adoption of service contracts, which completely vested the risk in its foreign contractors. Despite the incorporation of stabilisation clauses and arbitration

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107 Petroleum Act 1957 (n 45), art 6.
108 Shahri (n 1) 117.
109 Nationalization Act 1951 (n 72) art 1.
110 ibid.
112 Mahdavi (n 53) 242.
113 Petroleum Act 1974 (n 111), art 3(1).
114 Shahri (n 1) 118.
115 Mahdavi (n 53) 242.
procedures to protect foreign companies’ interests, the Iranian government already had a history of derogating from them. This was the case in *Sapphire International*¹¹⁶ the plaintiff agreed on a joint venture with the NIOC and was contracted to explore oil, being promised a reimbursement for the cost of its operations from the NIOC. However, the NIOC refused and cashed out the $350,000 guarantee (as Sapphire had failed to perform its obligations). The NIOC also refused to appoint an arbitrator. Returning to the argument of ownership, the 1974 Act was a legal change that maximised the state’s ‘permanent sovereignty’ over its resources. In effect, the state’s goal of resource nationalism took legal effect and once again changed the legal framework for petroleum production in Iran.

The Islamic Revolution in 1978-1979 was a drastic change for Iran. It had a direct impact on Iran’s petroleum law – namely, the annulment of all foreign investment and contracts before the revolution.¹¹⁷ This ultimately gave effect to the 1979 Iranian Constitution¹¹⁸ that restricted foreign parties from owning shares of Iranian assets, by which the ownership of the oil industry and right to exploit was completely vested in the NIOC,¹¹⁹ thus finalising nationalisation. The 1979 Constitution created a legislative framework that contained express provisions on natural resources and foreign interest, providing guidelines that confined the government as to the terms and contractual forms, which they could partake,¹²⁰ compared to the previous phases which allowed for greater flexibility, such as individually negotiated contracts (concessions and PSAs). The 1979 Constitution is the main example of how resource nationalism shaped the legal landscape of the oil industry. This was apparent in the prominent themes of the Constitution, which included nationalisation and permanent sovereignty over resources, driven by outrage against what was perceived as ‘imperialism’. This is evidenced in Article 3(5) of the Constitution,¹²¹ which clearly calls for the ‘complete elimination of imperialism and prevention of foreign influence’. Article 82 further imposes a prohibition on engaging foreign experts,¹²² and Article 153 prohibits any ‘agreement[s] resulting in foreign control over the natural resources … of the country’.¹²³

¹¹⁶ *Sapphire International Petroleum Ltd* (n 63).
¹¹⁹ Mafi (n 50) 242.
¹²⁰ Shahri (n 1) 118.
¹²¹ Constitution of the Islamic Republic of Iran (n 118), art 3(5).
¹²² ibid, art 82.
¹²³ ibid, art 153.
Protecting the Iranian oil industry was the clear goal of the drafters of the 1979 Constitution, as it prohibited participation of foreign companies and opportunities for foreign ownership in all production phases. Article 43(8) explicitly provides for the ‘prevention of foreign economic domination over the country’s economy’. This was arguably a whiplash reaction against the 1954 Consortium’s dominating operation (a ‘state within a state’), because it was detached from the national economy. It evidently controlled production and investment in Iran’s sector based on the global market and their individual interests. On that note, Article 81 determined that ‘granting of concessions to foreigners [companies and institutions] … is absolutely forbidden’. Foreigners no longer had rights under Iranian law to form companies to extract resources, which eliminated the possibility of JOAs. Thus the new Constitution asserts that the government is the only entity that can deal with natural resources. Overall, concessions, PSAs, JOAs and any contractual arrangement involving foreign participation (investment and ownership) are effectively illegal.

The nationalisation of the AIOC’s assets and the entire oil industry violated a cornerstone of the new world order, namely the free market enterprise. In this sense resource nationalism can be thought of as an antithesis to liquid modernity. In his theory of liquid modernity, Bauman uses the ‘liquidity’ and ‘fluidity’ characteristics of fluids as metaphors to capture the world’s postmodern state. Bauman conceptualises that for capitalist forces ‘to be free to flow, the World must be free of … barriers, fortified borders and checkpoints’. In the context of this Article, the latter is perceived in the sense that the AIOC effectively gained power over Iranian oil because there were no barriers of regulation or framework governing its activities. It thus had the opportunity to operate and exploit freely. Bauman describes this as the process of ‘melting of solids’, which in this sense is the liquefaction of the pillar of the state. However, such uncontrollable fluidity provoked protectionism, and resource nationalism effectively ‘solidified’ this pillar, which was antithetic to the flow of capitalism and the liberal market mandate of the new world order. Nevertheless, the ‘continuous growing fluidity’ of capitalist forces overcomes the nationalisation obstacle, enabling and reinforcing their ‘invincibility’. This

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124 Mahdavi (n 53) 247.
125 Constitution of the Islamic Republic of Iran (n 118), art 43(8).
126 ibid, art 81.
127 Shahri (n 1) 118.
128 Karlsson (n 69) 137.
129 Bauman (n 23).
130 ibid 14.
131 ibid 6.
132 ibid 14.
weakens resource nationalism and re-establishes the power of capitalism or IOCs, and the framework for production enters into a recurring cycle whereby resource nationalism is the state’s fluctuating intervention.

Through analysing the evolution of Iran’s legal policy and levels of the IOCs’ involvement in its oil sector, Stevens’ theory of resource nationalism as a *cyclical phenomenon* most plausibly fits in with Iranian legal policy towards the Iranian oil industry. Stevens postulates that the level of foreign participation and ownership, as well as the level of state intervention vis-à-vis resource nationalism, is relative to the influence of endogenous and exogenous drivers and is cyclical according to these forces. Endogenous factors are typified as the ‘obsolescing bargain’, which intensifies as oil prices rise, and exogenous factors include ideological forces of state intervention and independence, which is ever-present in a postcolonial world. According to Stevens, resource nationalism:

... [I]nevitably leads to less investment and a shortage of crude oil ... high prices encouraging further ‘resource nationalism’ as the obsolescing bargain kicks in and the need for capital and technology ... diminishes. [H]owever, markets work albeit imperfectly. The high price provokes a market response ... causing prices to fall. As they fall, the imperative of the obsolescing bargain diminishes and the need for access to capital and technology grows. ‘Resource nationalism’ recedes and the upstream opens.

In Iran’s legal framework what emerges is perhaps an image of peaks and troughs in legal policy. Such peaks would be the points at which there is a high level of state involvement (ownership and management), closing the industry to foreign interest. On the other hand, troughs refer to the industry’s reopening to foreign investment and equity. Iran’s legal landscape began with minimal state involvement in the concession phase, when the industry was completely open to foreign control (AIOC’s concessions); then faced a drastic closure to foreign ownership in the event of resource nationalism in 1951 through the 1951 Nationalization Act – positioning the state in permanent sovereignty over oil assets and production. It provoked the Western-backed coup, and the IOCs’ control was reinstated in the region with the signing and coming into force of the 1954 Consortium Agreement. This laid the conditions for the next round of dissatisfaction, which manifested in full nationalisation under the 1979 Iranian

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133 Stevens ‘National Oil Companies and International Oil Companies in the Middle East’ (n 2) 27.
134 ibid.
Constitution. Through strict contracts the Iranian government reflected their disinterest in foreign direct investment. However, the market remained imperfect and resource nationalism diluted in the 1980s, due to the spread of the Washington Consensus and market liberalisation, the 1986 oil crisis, and increasing difficulties in oil extraction. In the wake of decreasing oil prices the Iranian government reopened the oil market to foreign participation to expand production and increase government revenue, since the IOCs had the capital and expertise to undertake more risk and engage with complex geology (e.g. deep sea projects). This shifted the bargaining power to the IOCs once again, and inevitably led to weaker contractual terms. This would eventually sow the seeds for resource nationalism yet again.

III. CONCLUSION

What emerges from this discussion is the conclusion that resource nationalism created a major structural transformation in power and ownership in the oil industry. This was achieved through legal changes that were driven by the political and economic climate of resource nationalism, namely the 1951 Nationalization Act and the 1979 Iranian Constitution. Through this, the legal landscape saw an evolution of agreements and legal conditions pertaining to foreign oil companies, regarding their participation in upstream phases of petroleum production. Lastly, in view of resource nationalism as a cyclical phenomenon, I conclude that the fluctuating nature of state intervention has created parallel conditions in the legal landscape, by which strict and flexible mechanisms vary with the cycle of resource nationalism. The implementation of these legal tools exemplifies the state’s attempt to control and nationalise the forces of Western capitalism, which evidently adapted to flow in the shadow of resource nationalism.
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