

# CHAPTER 5 – [www.eisourcebook.org](http://www.eisourcebook.org)

## 5.1 Getting Started – Facts of EI Life

The world of legal and contractual relationships in the extractive industries is shaped by *two basic facts*:

- Every resource-rich country, prospective or actual, vests ownership of oil, gas and mining resources in the State; and
- Development of oil, gas and mining resources requires translation of this legal fact into a series of coherent policy choices, contract forms and fiscal instruments in a distinct structure or *framework*.

**Ownership** The first fact is always a ‘given’, even if it is stated in general terms. Most countries vest the ownership of sub-soil resources in the State on behalf of the people but may do so either in their constitution or in a distinct sector-specific law: a petroleum law or a minerals law.<sup>1</sup> This declaration affects all aspects of the extractives regime and makes its operation explicitly a matter of public policy. An example of this is the wide-ranging statement of ownership that is included in the Constitution of Ghana. Its scope is wide enough to grasp all the important areas where minerals may be found including offshore waters as well as on, and under, land:

“[e]very mineral in its natural state in, under or upon any land in Ghana, rivers, streams, water courses throughout Ghana, the exclusive economic zone and any area covered by the territorial sea or continental shelf is the property of the Republic of Ghana and shall be vested in the President on behalf of, and in trust for the people of Ghana.”<sup>2</sup>

Where a specialist law is concerned, the declaration of ownership might take the following forms:

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<sup>1</sup> Of course, they may also do both, with the sector law repeating the more authoritative statement contained in the constitutional document. For comparative studies of approaches adopted in mining, see Bastida, E., Warden-Fernandez, J., and Waelde T. (eds.) (2005). *International and Comparative Mineral Law and Policy*. The Hague: Kluwer International. For a comparable multi-author study on petroleum law, see Duval, Leleuch, Pertuzio and Weaver (2009). *International Petroleum Exploration and Exploitation Agreements* (second edition). New York: Barrows.

<sup>2</sup> Article 268 of the 1992 Constitution of the Republic of Ghana. Available at: <http://www.ghanaweb.com/GhanaHomePage/republic/constitution.php> (last accessed 15 March 2016).

Example 1: “Mineral resources belong to the State. The rights of State ownership in mineral resources are exercised by the State Council. State ownership of mineral resources, either near the earth’s surface or underground, shall not change with the alteration of ownership or right to the use of the land which the mineral resources are attached to”<sup>3</sup>(China); and

Example 2: “Title to, and control over, Petroleum in the Territory of Somalia are public property and are vested in Somalia, in trust for its people”<sup>4</sup>.

An exception to the default rule of *state* ownership of natural resources is the complex mix of private and public ownership arrangements used in the USA. A significant proportion of lands are in private ownership and the owners are also the owners of the sub-soil resources. They are entitled to negotiate leases with companies to develop mineral resources. Recent discoveries and development of shale gas and oil have been made overwhelmingly in lands owned by private persons.<sup>5</sup> Alongside this, there are extensive federal lands and offshore waters where public ownership is the norm.

International law provides support for a close linkage between state sovereignty and natural resources. The first expression of this in modern times was the 1958 Convention on the Continental Shelf, made as new technology was becoming available to explore for offshore hydrocarbons and eventually other minerals. The idea of a ‘permanent’ State sovereignty over natural resources was comprehensively elaborated in a UN Resolution in 1962 (see **Box 5.1**)<sup>6</sup>. This had its roots in a post-colonial world, where hydrocarbons and other mineral resources had initially been developed by foreign investors on terms highly unfavourable to the host states. Even today, the idea remains of fundamental importance<sup>7</sup>. It is nonetheless qualified by a greater appreciation of the need for any central state to respect the interests of local communities, particularly in areas affected by EI activities, the rights of indigenous peoples who may well have claims to sovereignty over natural resources on their lands, and by the obligations of States to their neighbours in relation to trans-boundary environmental accidents. The latter requires the ‘polluting’ State to notify and cooperate with neighbouring States to mitigate any damage.

<sup>3</sup> Mineral Resources Law of the People’s Republic of China, 1986, amended 1996: Article 3, para 1.

<sup>4</sup> Transitional Government of Somalia, Petroleum Law 2007: Article 5.1.

<sup>5</sup> See Newman, A. (2012). *We Shale Overcome? A US Court Issues an Unsettling Decision on Marcellus Property Rights*. *Journal of World Energy Law and Business*, Vol. 5, No. 1. Such leases will typically not contain an arbitration clause for the settlement of disputes, in contrast to the petroleum and minerals agreements between investors and states found outside the USA.

<sup>6</sup> 1962 General Assembly (GA) Resolution 1803 on Permanent Sovereignty over Natural Resources (PSNR). GA res. 1803 (XVII), 17 UN GAOR Supp. (No.17) at 15, UN Doc. A/5217 (1962). This has been supported by later judgments of the International Court of Justice.

<sup>7</sup> An authoritative discussion of this subject is contained in the following book: Schrijver, N. (1997). *Sovereignty over Natural Resources: Balancing Rights and Duties*. Cambridge: CUP.

### Box 5.1: Sovereignty over Natural Resources

The doctrine of Permanent Sovereignty over Natural Resources (PSNR) was set out in the UN General Assembly (GA) Resolution 1803 (XVII) in 1962. Approved by both capital exporting and capital importing states alike, it states in Article 1 that “[t]he right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.” The Resolution is non-binding but represents Good Practice.

Resolution 1803 itself was developed at a time when discussions about the New International Economic Order (NIEO) were robust, and post-colonial development issues framed the debates. This period came to an abrupt end with the 1986 world oil price crisis. This crisis followed two oil price shocks in the 1970s; but unlike the sharp escalations in prices in 1973 and 1979, the 1986 crisis led to a dramatic fall in the price of oil, not unlike the price fall in 2015.

An important provision in Resolution 1803 can be found in Article 3, which expressly recognizes the sanctity of the contract between the foreign investor and the state by stating that: “[in] cases where authorization [of the investment of foreign capital in the natural resources of the host State] is granted, the capital imported and the earnings on that capital shall be governed by the terms thereof, by the national legislation in force, and by international law... The profits derived must be shared in the proportion freely agreed upon, in each case, between the investors and the recipient State...”

However, Resolution 1803 does not empower the state to make unilateral changes to its laws in order to negate the terms of a contract. Article 8 of Resolution 1803 is clear on this point: “[f]oreign investment agreements freely entered into by or between sovereign States shall be observed in good faith.”

This doctrine of good faith and *pacta sunt servanda* (agreements must be kept) is also reiterated in Article 18 of the 1994 Energy Charter Treaty (ECT). This doctrine is also an integral component of more recent discussions on the rights of indigenous peoples to access and control natural resources on indigenous lands.

International law has also been active in addressing a feature of State sovereignty over natural resources that assumed importance after the UN Resolution: the delimitation of territory, particularly offshore and inland waters for hydrocarbons but also deep sea ocean spaces for mining (see Section 5.10 below). The value of such space has vastly increased with the development of technology to explore for

oil, gas and other minerals in ever-deeper waters. In a number of cases, the inability of States to resolve differences arising from boundaries has led them to refer the disputes to international courts and tribunals for independent resolution. Many other disputes remain unresolved and are potential sources of tension and conflict.<sup>8</sup>

Finally, we may note the ownership issues that arise from the fragmentation or break-up of states, as one part of a state elects to separate itself. South Sudan is a recent example of this, and Timor Leste is another. The emergence of new states from the end of the Soviet Union in the 1990s provides several other examples.

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**Development of a Legal Framework** The second basic fact is the need for States to develop a framework for investment and development of the resources. Even where public ownership is clearly enshrined in the constitution, or a specialist law, there needs to be supplementary guidance on how ‘ownership’ translates into a regime for the award of rights, the terms on which the rights are held and their duration, obligations, the form of contract, regulation of operations, institutional coordination and the distribution of revenues among the country’s citizens. This crucial step opens up a Pandora’s Box of multiple challenges and choices, with the final results – the framework of policy, law and contract - being decided through political bargaining in the country concerned. Government officials will often be faced with a plethora of options and advice and recommendations based in ‘best practice’.

An example of the above ‘flow’ in legal arrangements is found in Brazil. Article 176 of the Constitution provides that (1) “mineral deposits, whether exploited or not ... form property separate from the soil, for purposes of exploitation or use, and belong to the Union; and (2) unauthorized prospecting or exploitation is prohibited; while Article 177(1) authorizes state-owned or private companies to search for and exploit hydrocarbons; then Law 9,478/97 provides a licensing regime for the hydrocarbons activities, supplemented in 2010 by a PSA regime for so-called ‘pre-salt’ and strategic areas. As knowledge of the Brazilian offshore evolved, there was an elaboration of the regime for the allocation of rights.

Where ownership of the resource is a highly sensitive political issue, from Brazil and Mexico to Iran and Iraq, great care must be taken by governments in proposing or modifying the regime for resource development. The legacy of past choices will shape the policy context of the present. In such countries, a key question will be:

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<sup>8</sup> For an overview of the literature on maritime delimitation disputes see Cameron, P. (2006). *The Rules of Engagement: Developing Cross-Border Petroleum Deposits in the North Sea and the Caribbean*. International and Comparative Law Quarterly, Vol. 55, pp. 559-586.

what is to be the role of state enterprises in future exploration and production of the resource? Alternatively, for any existing state enterprises, what is their future role if they are currently involved in these activities? Are they to be instruments of government policy or should they become privatized, commercial entities?

The kind of contracts offered, their terms and the method of their award are typically matters of robust (but not necessarily informed or systematic) public scrutiny. They have to be designed in a manner that ensures their long-term legitimacy. Much of the available advice about the elements of a framework will also caution them that any choice needs to be supplemented by 'on-site customization': that is, it needs to be adapted to local circumstances if it is to work. Moreover, there will be more or less sharp differences according to whether the resources in question are oil, gas or hard minerals. Usually, the legal frameworks will be separate to take into account the differences between oil and gas on the one hand and mining on the other. In all of this, where does a government start?

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