NEAR EAST UNIVERSITY
GRADUATE SCHOOL OF SOCIAL SCIENCES
MASTER OF LAWS IN INTERNATIONAL LAW PROGRAMME (LL.M)

MASTER'S THESIS

PRINCIPLES OF GOOD FAITH IN THE FORMATION OF OIL CONTRACTS

Nahro Khasro Hussein

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I MAHROKHASRO HUSSEIN hereby declare that this dissertation entitled "Principles of Good Faith In The Formation of Oil Contracts" has been prepared myself under the guidance and supervison of "Asst.Prof.Dr.RESAT VOLKAN" in partial fulfilment of The Near East University, Graduate School of Social Sciences regulations and does not to the best of my knowledge breach any Law of Copyrights and has been tested for plagarism and a copy of the result can be found in the Thesis.

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ABSTRACT

The principle of good faith explains that contracting parties have to be honest and fair when dealing with each other, they should represent their motives and purpose faithfully, and they should not take unfair advantages of each other. Vienna Convention on the Law of Treaties buttressed more on the principle of good faith by suggesting an authoritative place in the international law concerning the interpretation and enforcement of treaties. According to Article 31(1) of this convention, the interpretation of treaties shall be done in good faith according to the given meaning to the terms of the treaty in their context as well as their object and purpose good faith is applicable to both individual and states in dealing with each other. The application of these principles to formation of oil contract is important to the contracting parties. Crude oil is a resource that must be used for the betterment of the people. Only state government can negotiate the terms of this contract and the question asked in this dissertation is whether the principles of good faith between the states and foreign companies in formation of oil contract have any benefit for citizen or only to contracting parties? This dissertation would shed light to different types of oil contract, the principle of fair dealing, the concept of good faith and bad faith and finally examine the principles of good faith in Iraqi oil contract and conclude whether this has been of any benefit to Iraqi people.

Keywords: Good faith, Bad faith, Fair dealing, Oil contract, Modern succession, Contractual terms, Joint ventures and Service contracts.

ÖZ

İyi niyet ilkesi iletişimde olan tarafların birbirleriyle iş yaparken dürüst ve adil olması gerektiğini, açıklamaktadır, niyetlerini ve amaçlarını birbirlerine göstermeli ve birbirlerinden kötü niyetli olarak faydalanmamalıdırlar. Antlaşmalar Hukukuna dair Viyana Konvansiyonu, uluslararası hukukta antlaşmaların yorumlanması ve uygulanması ile ilgili sorulara yetkili yer önererek iyi niyet ilkesini daha da destekledi. Bu konvansiyonun 31(1). Maddesine göre, antlaşmaların yorumlanması kendi bağlamında anlaşmanın şartlarının yanı sıra konularına verilen anlama göre iyi niyetle yapılacaktır ve amaç olan İyi niyet hem bireyler hem de birbiriyle ilişk ideoland evletler için geçerlidir. Bu ilkelerin petrol sözleşmelerinin oluşumuna uygulanması sözleşme yapan taraflar için önemlidir.Ham petrol insanların daha iyiye gitmesi için kullanılması gereken bir devlet kaynağıdır. Bu sözleşmenin şartlarını sadece devlet hükumeti tartışabilir ve bu tezde sorular sorular, petrol sözleşmeleri yaparken devlet ve yabancı şirketler arasındaki iyi niyet ilkelerinin sadece sözleşme yapan şirketleri için mi faydalı olduğu yoksa vatandaşlar için de faydalı olup olmadığıdır. Bu tez farklı türlerdeki petrol sözleşmeleri, adil iş yapma ilkesi, iyi niyet ve kötü niyet kavramlarına ışık tutacak ve son olarak Irak'taki petrol sözleşmelerindeki iyi niyet ilkelerini inceleyerek bunun Irak halkına yararlı olup olmadığıylas,sonuçlanacaktır.

Anahtar Kelimeler: İyi niyet, Kötü niyet, Dürüst iş yapma, Petrol sözleşmesi, Modern halefiyet, Sözleşme şartları, Ortak girişimler ve Hizmet sözleşmeleri.

DEDICATION

I dedicate my dissertation work to my family and many friends. A special feeling of gratitude to my loving parents, whose words of encouragement and push for tenacity ring in my ears, I also dedicate this dissertation to my many friends who have, supported me throughout the process.

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Nahro Hussein
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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION AND HISTORICAL BACKGROUND OF THE STUDY

The basic meaning behind the principles of good faith is the obligation placed on the contracting parties to be honest and fair with each other, to represent their motives and purposes faithfully, and never to take unfair advantages that might emanate from unintended interpretation of the agreement between them. Much attention is paid to the concept of good faith in the Vienna Convention on the Law of Treaties by suggesting an authoritative place in the international law the questions concerning the interpretation and enforcement of treaties.[1] According to Article 31(1) of this convention, the interpretation of treaties shall be done in good faith according to the given meaning to the terms of the treaty in their context as well as their object and purpose.[2] In this respect, the place of context and purpose within the principle of good faith reflects the fact that good faith strongly oppose the literal interpretations of words that might emanate from one of the contracting parties gaining an unjust privileges over another party.

Furthermore, the context of explicit agreements can be regarded as the second part of good faith principles, which is concern with duties of signatories to a treaty prior ratification. This is found on the obligation placed on states by international law stating that states must ratify treaties signed by their diplomatic agents but this has been replaced with the concept of discretionary ratification. This new concept of discretionary ratification argues that executive branch is obligated to make every effort in good faith to obtain the consent of the sovereign concerning the treaty signed by the agents of executive branch.[3] According to Article 18 of the Vienna Convention

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[1]D'amati, Anthony (1992). Good Faith in Encyclopaedia of International law, p.599.
[2]General rules of treaty interpretation, Article 31(1) of Vienna Convention on The Law of Treaties.
[3]D'amati, Anthony (1992). Good Faith in Encyclopaedia of International law, p.599.

on the Law of Treaties states the signatory, prior to ratification is mandated to prevent any act that can defeat the object and purpose of the treaty.[4] Lastly, apart from treaties or other agreements, the principle of good faith is applicable to the general performance of states under international law. The significant resolution of the United Nation General Assembly passed in 1970, which is titled "Declaration on Principles *of International Law concerning Friendly Relations and Co-operation Among States"* this principle states that every state has the duty to fulfill in good faith its obligations under the generally recognized principles and rules of international law.

Considering the significance of good faith, it becomes apparent that good faith is not limited to contracts formation alone, it must charter to all society in every aspect of relationship. Aristotle simply argues that if there is no good faith, there is no need for all intercourse among men, which is synonymous to the fact that all social intercourse requires good faith.[5] Though, this dissertation aims to examine good faith in the formation of oil contract but this should not limit our general perception about its significance. There is a very few research done so far about the principle of good faith in oil contract or possibly there is no article that basically talk about this research topic but there are different journals that analyze generally the significance of good faith and its application to civil law. Considering the general usefulness of good faith, it would be ideal that if it can be applied to oil contract law. The principle of good faith is a constitutional principle that requires that participants in social relationships act in goodwill, fairly and justly toward each other.

In looking at the key regulatory and contractual issues in the oil and gas and also metal minerals industries, there are different types of contract and several state of the art issues. These types are (1) modern concessions; (2) production-sharing agreements (PSAs); (3) joint ventures; and (4) service contracts, including risk service contracts, pure service contracts and technical assistance contracts. The historical or traditional oil contract type is concessions and then there different present day types of contract which are all common to oil and gas and also metal mineral extraction.

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[4] General rules of treaty interpretation, Article 18 of the Vienna Convention on the Law of Treaties

[5] Cited by Hugo Grotius in De Jure Belli ac Pacis, LibriTres (1625), and cited by J.F. O'Connor in Good Faith in International Law (Brookfield USA: Dartmouth Publishing Company Limited, 1991) p.56.

The state-of-the-art issues in oil contract comprise of; (1) contract renegotiations, commonly found in Bolivia, Ecuador and Venezuela; (2) the proposed Iraqi oil law; and (3) the handling of human rights and environmental issues by projects. The different types of oil contract and state-of-the-art issues does not prevent the application of good faith in oil contract law as it has been argued that good faith is needed for a fair and successful completion go every contract. The main purpose of setting out the principle of good faith in oil contract is to bring into economic relations fairness, justice, order and reasonableness that are everything required by the constitution.[6]

Historically, in the traditional days of legal systems as well as international system, there was a strong need of interpreting document literally. The words of agreement most in particular solemn international treaties were invested with an almost magical literal power. This simply explains the fact that in the traditional days of contract, if the written paper of contract is destroyed or lost, the contract is automatically terminated or dissolved. Thus if one party execute its obligation under a written contract and then lost the paper that the contract was written upon, the other party would not need to further on reciprocal obligation. This process of strict and literal formation of the traditional treaties led to unfair and unjust repercussions to one or more parties. As a result, there was need for the inclusion of designed clauses to deal with the questions of interpretation and performance in the treaties. Then as time goes on, the principle of good faith began to gain prominence in treaties, which led to declination of clauses both in size and prominence.[7]

The principle of good faith is rooted in a natural law conception of international law. Writers of international laws such as Grotius, Pufendorf and Suarez argued that international law is rooted in natural law, which they regarded as dictates of right reasons. Natural law is simply defined as an obligation placed on states within international environment to act in a manner that considers the reasonable expectations and needs of other nations in the international community. This necessitates the need for a treaty to be executed in a way that fulfils the purposes of

[6] Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1, p.1-2
[7] Ibid, p.2

the joint undertaking, which include the exchange of reciprocal obligations. The principle of good faith now has the authoritative status inherent in the natural law of foundations of general international law and also found in customary international law derived from the articulation of custom in numerous treaties in Article 31(1) of the Vienna Convention on the law of Treaties, Significantly, with respect to a member State's specific obligations to the United Nations, Art 2(2) of the United Nations Charter buttresses on the fact that those obligations shall be done in good faith.[8]

Historically, concession happened to be the principal contractual form in the extractive industry. This type of extraction gives a private company the exclusive right to explore, produce and market natural resources. This contractual form still exists till this present period basically in different forms. It should be noted that the lapses found in the traditional concession method led to the understanding of the modern concession and other contractual forms for exploiting natural resources. In this respect, there is need to account for some basic features of the traditional contractual form which is not applicable to the modern form to a larger extent. Most significantly, during this period, the financial bargaining that took place between n the host government and the foreign company was highly uneven, at times teetering on the verge of the unconscionable. Companies paid small sums to the host government for the rights over its natural resources. In addition, it could be found out that the compensation paid was nothing reasonable in compare with the value of resources extracted in the host country.[9] A vivid example can be found in the Oil Concession of 1934 between the State of Kuwait and the Kuwait Oil Company Limited (United Kingdom), which states that:

"(d) For the purpose of this Agreement and to define the exact product to which the Royalty stated above refers, it is agreed that the Royalty is payable on each English ton of 2.40 lb. of net crude petroleum won and saved by the Company from within the State of Kuwait-that is after deducting water sand and other foreign substances and

[8]D'amati, Anthony (1992). Good Faith in Encyclopaedia of International law, p.600
[9] Michael Likosky (2006). Contracting and Regulatory Issues in the Oil and Gas and Metallic Minerals Industries. Transnational Corporations, Vol. 18, No. 1 , p.2

the oil required for the customary operations of the Company's installations in the Sheikh's territories"[10]

The fact that companies determined the volume of production demonstrated the possibility of diverges of interest between the host governments and companies and illustrated the fact that it might not always be the interest of companies to exploit resources fully.[11] Additionally, there was a broad scope of the traditional concession most in particular, in the aspect of duration and geography. For example, The Kuwait contract was to run for seventy-five years (Oil Concession of 1934: Article 1. At times, the company secured rights over large tracts of land). This control could extend to the entire country.[12] This simply illustrates the fact that the interest of private companies in exploiting resources was not always in alignment with that of the host countries. Moreover, since the traditional concession gave exclusive rights to the foreign company for the period of the concession, it became impossible for the host governments to find another 'thirstier' company. This led to the emergency of exploration in the contractual form, which could be found in the case of Kuwait contract, which stated that:[13]

"(a) Within nine months from the date of signature of this Agreement

the Company shall commence geological exploration.

(b) The Company shall drill for petroleum to the following total aggregate depths and within the following periods of time at such and so many places as the Company may decide:

4,000 feet prior to the 4th anniversary of the date of signature of this Agreement.

12,000 feet prior to the 10th anniversary of the date of signature of this Agreement.

30,000 feet prior to the 20th anniversary of the date of signature of this Agreement."[14]

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[10] Oil Concession of 1934: Article 3(d).
[11] Smith, E.E. (1991-2). "From Concessions to Service Contracts", Tulsa Law Journal, 27, p. 495.
[12] Omorogbe, Y. (1997). The Oil and Gas Industry: Exploration and Production Contracts. Lagos: Malthouse Press p.58
[13] Michael Likosky (2006). Contracting and Regulatory Issues in the Oil and Gas and Metallic Minerals Industries. Transnational Corporations, Vol. 18, No. 1 , p.3
[14] Oil Concession of (1934): Article 2(a) and (b).

Another important point to be noted from this contractual form is base on the fact that companies had the excess freedom in determining the nature, scope and extent of exploration. In this respect, we cannot talk about the principle of good faith in the traditional contractual form whereby the relationship between the host government and private companies was uneven or one-sided. This type of contractual form could not survive the period of decolonization, the New International Economic Order and the creation of the Organization of the Petroleum Exporting Countries (OPEC). This thesis would examine the other modern contractual forms in order to evaluate the one with the best application of principle of good faith and recommend it to be ideal contractual form in oil contract.[15]

1.2 SIGNIFICANCE OF THE STUDY

There is many significance or reasons why this dissertation is relevant to the literature and readers considering the fact that there is little research or probably no research done so far about this research topic. Though, there are many researches about the principle of good faith and also oil contract law but the interest of applying good faith to oil contract has been a gap in the literature. In this respect, this dissertation would serve the following purposes to readers and in the literature;

- It would enlighten readers about the different types of contractual forms in extracting industry in order to distinguish between the traditional form and modern days form.
- It would buttress more on the significance of the principle good faith, which is not only limited to contract formation alone but generally the various kind of social relations within the society as well as in international environment.
- It would shine light to different contractual forms in order to evaluate the one with highest possibility of good faith principle, which would benefit both host governments and foreign companies and recommend this contractual form as the best. This is the most important part of this dissertation because even the modern

[15] Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1 , p.3

contractual forms in oil contract has many types and there is a need to recommend the best type by measuring the possibility of good faith in it.

- This dissertation is also relevant by contributing to the existing literature and serve as a source of academic reference to any future research around this research topic

CHAPTER TWO

LITERATURE REVIEW ON GOOD FAITH AND BAD FAITH

2.1 DEFINITION OF GOOD FAITH

The broad nature of conceptualizing good faith might make it difficult to have a universal definition for it. Juenger (1995) argues that there is no fixed meaning for good faith due to the fact that the term is loose and amorphous.[16] Powers (1999) did well in examining the meaning of good faith from different perspectives. Firstly the author argues that the term is an elusive one and it is better to leave it into the hand of lawyers and judges to define it over a period of time base on the requirement of the circumstances. Secondly, Power also define it as *"an expectation of each party to a contract that the other will honestly and fairly perform his duties under the contract in a manner that is acceptable in the trade community."* The author did not stop here because he also defined the term from international context as *"an international doctrine that requires parties to an international transaction to act reasonably, as they would expect the other party to act."*[17] Good faith is also defined from the set principle by courts to mandate the discretion of the contracting parties concerning any decision that might affect their rights and duties. In this respect, courts advocate for the fact that good faith requires the "discretion-exercising party" to be honest with each other in order "to protect justifiable expectations arising from their agreement."[18]

According to O'Connor (1990) good faith is associated with the legal rules that concern with honesty, fairness and reasonableness. The author describes good faith as "*a fundamental principle derived from the rule pactasuntservanda, and other legal rules, distinctively and directly related to honesty, fairness and reasonableness, the application of which is determined at a particular time by the standards of honesty,*

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[16]Juenger F.K (1995), "Listening To Law Professors Talk about Good Faith: Some Afterthoughts" 69 Tul. L. Rev. 1253 at 1254.

[17]Powers (1999).Defining the Undefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods. Journal of Law and Commerce, p.333-353

[18] Burton S.J (2001), Principles of Contract Law,2nd ed. (St. Paul, Minn.: West Group, at 444-445.

fairness and reasonableness prevailing in the community which are considered appropriate for formulation in new or revised legal rules." [19]

According to Black's Law dictionary, good faith is defined with the use of different words, which comprises the following: *"It is an intangible and abstract quality with no technical meaning or statutory definition and it encompasses a number of concepts; honest belief, the absence of malice, and absence of design to defraud or to seek an unconscionable advantage*[20]*, reasonableness or fair conduct,*[21] *reasonable standards of fair dealing,*[22] *decency as well as fairness and reasonableness,*[23] *and honesty of intention."*[24] In common usage it is ordinarily used to describe the state of mind denoting honesty of purpose and as requiring fairness and community standards of fairness, decency and reasonableness[25] or in other words being faithful to one' s duty and obligation.[26]

Defining good faith without taking into account the possibility of bad faith might be an incomplete exercise. This necessitates the need to briefly cross-examining what bad faith is all about.

"Bad faith performance is considered to take place with the use of discretion to recapture opportunities foregone upon contracting when the discretion-exercising party refuses to pay the expected cost of performance. Good faith performance, in turn, occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation to capture opportunities that were preserved upon entering the contract, interpreted objectively. The good faith performance doctrine therefore directs attention to the opportunities

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[19] O'Connor J.F (1990), Good Faith In English Law (Brookfield USA: Dartmouth Publishing Company, at p.102.
[20]Doyle v. Gordon, 158 N.Y. S 2d.248, 259, 260 N.Y. SUP. (1954)
[21] Eric. M Holmes, A Contextual Study of Commercial Good Faith: Good Faith Disclosures In Contract Formation, 39 U. PITT. L. REV. 381, 452 (1978)
[22]C FRIED, CONTRACT AS PROMISE 83 (1981).
[23] E. Allan Farnsworth, Good Faith Performance and Commercial Reasonableness Under the UCC, 30 CHI. L. REV 666,670 (1963).
[24]BRYAN A. GARNIER, BLACK'S LAW DICTIONARY, Seventh Edition, 701(1999).
[25] Richard Thigpen, Good Faith Performance Under Percentage Leases, 51 MISS. L. J. 315, 320 (1981).
[26] Universal Underwriters Ins. Co. v. Aetna Ins. Co. of Hartford Conn., 249 Cal.App.2d 144, 57 Cal.Rptr. 240 ,245,251(1967).

foregone by a discretion exercising party at formation, and to that party's reasons for exercising discretion during performance."[27]

Kelly J. in the case of Gateway Realty Ltd. v. Arton Holdings Ltd. and LaHave Developments Ltd. (No. 3) argues that

"... In most cases, bad faith can be said to occur when one party, without reasonable justification, acts in relation to the contracts in a manner where the result would be to substantially nullify the bargained objective or benefit contracted for by the other, or to cause significant harm to the other, contrary to the original purpose and expectation of the parties."[28]

2.2 HISTORY AND DEVELOPMENT OF GOOD FAITH

In tracing the historical development of the concept of good faith, it would be more reasonable to examine how good faith doctrine emerged and function under various legal systems.

2.2.1Roman Law: this law plays a pivotal role in appreciating the significance of the duty of good faith in around two thousand years ago. The Romans argued on the fact that a promise could lead to the emergence of a duty. And a duty involves a mutual right that could be carried out under some circumstances.[29] The Roman understanding on the assertion that a promise leads to the creation of duty led to the advent of the term promissory liability. Under Roman law, all enforceable promises had to fall under a specific narrow criterion to qualify for enforcement.[30] Roman law of promissory liability is divided into four different categories and one of them is known as "consensual contracts" (consensucontrahiturobligatio).[31] It was found out that consensual contracts have a very wide scope and they were the only categories that were recognized and enforced. The promissory obligation in these contracts was

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[27]Burton S.J (1980), "Breach of Contract and the Common Law Duty to Perform in Good Faith" 94 Harv. L. Rev. 369 at 373.

[28](1991) 106 N.S.R. (2d) 180 (N.S. S.C.T.D.); (1992) 112 N.S.R. (2d) 180 (N.S. C.A.).

[29] Robert H.J (1994), The Wrong Side Of The Mountain: A Comment On Bad Faith's Unnatural History, 72 TEX. L. REV. 1317, 1319.

[30] Robert H. Jerry, supra note 7, at 1320 Fn11 citing W.W. BUCKLAND & ARNOLD D. MCNAIR, Roman Law & Common Law: A Comparison In Outline 195, 193-96 (2d Ed. 1952).

[31] FRITZ SCHUTZ, CLASSICAL ROMAN LAW 524-525 (1951).

"flexibly defined by reference to good faith, and this gave the judges the privilege to take into consideration the facts relating to each case as well as using his discretion to make decision on the matter. Furthermore, after the declination of the Roman Empire, less attention was paid to the nations of good faith until the twelfth century when there was revival of Roman law and this interest also influenced the law that came prominence in England during this period.[32]

2.2.2 Canon Law: at the aftermath of the collapse of Roman Empire, there was an existing void and there was a need to fill up the void left behind by the Roman law, which led to the emergence of a new body of law known as canon law under the aegis of the Christian church. During Tenth and eleventh century, the church recognized some doctrines whereby a debtor could pledge his faith to fulfil his promise. The promise made by anybody would be respectively and significantly treated because the person had promised to fulfil his promise in good faith and if he fails to keep to his promises, he would have to give up his honour or his possibility of achieving salvation. There are many stated principles under Canon law by which the behaviour of contracting parties could be evaluated and one of the basic principles is good faith. As put forward by Holds worth, canon law "put into legal form the religious and moral ideas which, at this period, coloured the economic thought of all the nations of Western Europe, and thus contributed to enforce those high standards of good faith and fair dealing, which are the very life of trade." Canon law also experienced declination just like Roman law but both of them emphasized on the moral component of a promise and this morality had some basic influences on the formation of English law[33]

2.2.3 English Law: England law is regarded to be a common law, which has developed into a formal system whereby all the available remedies were governed by a number of writs. It should be noted that these writs have found to be ineffective to provide the basis for a general theory of contract law base on today's level of understanding. Considering the various changes that started in fourteenth century, the

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[32]AartiArunachalam (2002). An analysis of the duty to negotiate in good faith: precontractual liability and preliminary agreements. p.3-5

[33]Frederick Pollock & Frederic W. Maitland, The History of English Law before the Time of Edward I At 1(Reprint 1923). Hereinafter Pollock & Maitland, p.187-190

writ of assumpsit was expanded to include those promises that did not involve a debt and became the means for the recognition of liability upon a promise under the English law.[34] As explained by Powell, despite the fact that, there was provision of remedies by the law yet it is still considered to be ineffective and parties usually channelled their petitions to the Kings with the claims that one of the contracting parties violated the good faith and conscience and sought that their opponents be forced to perform their contracts.[35] This kind of assertions in the petition is found significant due to the fact that it easily attracts the attentions of the Chancellor and he could react to the matter by emphasising the duties of good faith and conscience-especially conscience. Furthermore, some English scholars tried to examine the relationship between commercial transactions and morality, which has been examined by David Hume and Adam Smith in theories by arguing that self-interest is the motive behind men honouring their promises and that self-interest becomes the moral obligation to observe promises.

2.2.4 American Law: there was a slow-rate of development concerning the doctrine of good faith in America and still largely remained unrecognized and little known in the country. The awareness of good faith doctrine started coming up as a result of some number of treatises written in the late nineteenth century. Some of these treatises tried to associate good faith only with unfairness or fraud. For example: if the contract was free from bad faith or fraud and if it is fair and reasonable. "In case a contract is susceptible of two constructions, the court will so construe it as to make it just and reasonable as between the parties, if that course can be taken without violating the evident intention of the parties, or infringing upon rules of law."[36] 1878 treatise 'Bishop on Contracts' is most probably considered as the most recognized duty of contracting parties and this argues that when there is a contract between parties, the law advocates for each of them to act in good faith toward each other and the law binds them together in terms of any requirement of good faith. "The implication may be derived from the words employed, from the acts of the parties

[34] Robert H. Jerry (1986), Supra Note 7, At 1327 Citing J.H Baker & S.F.C Milsom, Sources Of English Legal History: Private Law to 1750, At 482-505.
[35]Raphael Powell (1956, Good Faith in Contracts, 9 CURRENT LEGAL PROBS.16, p.22.
[36] Charles F. Beach (1896), A Treatise On The Modern Law Of Contracts 1784-85 (Indianapolis & Kansas City, The Bowen-Merrill Co.

viewed in connection with the thing contracted about, or from the nature of the transaction."[37] This explains the fact that though many scholars during nineteenth century defined good faith as only the absence of bad faith but scholars like Bishop gave a broader meaning to the concept and doctrine of good faith.

The significance of good faith could be found in clarifying two kinds of situations; it helps to simplify those complexities and ambiguities that might be found in the contract most probably when the terms of the contract seem to favour one party more than the other. This is to argue that the earliest cases that required the need for good faith doctrines involved contractual conditions that a recipient of goods or services be satisfied with the quality of the other party' s performance. In such cases, the recipient of the goods could claim for the doctrine of good faith. These cases helped in establishing the significance of good faith in all contacts even if the contract did not provide for it in express words.

Good faith placed limitation on the exercise of discretion in performance conferred on one party by the contract;" therefore, the use of discretion is found in bad faith "to recapture opportunities foregone on contracting, as determined by the other party's expectations or, in other words, to refuse" to pay the expected cost of performing." The second situation at which good faith is found significant is that it helped to salvage a contract that would have otherwise been held invalid. A suitable example to explain this kind of situation is found in the two decisions of the New York Court of Appeals in cases of Wood v Lucy, Lady Duff Gordon, which marked a certain degree of change from the laissez-faire law as well as generated a lot of attention.[38]

2.3 THE IMPLIED DUTY OF GOOD FAITH & FAIR DEALING IN CONTRACTS

Despite the fact that the implied duty of good faith and fair dealing is a centuries-old concept, many efforts have not been done to bring clarification to the concept. There are numerous questions that could be asked which remained un-answered in the

[37]Joel P Bishop, Bishop on Contracts § 106 AT 37-38 (St. Louis, F.H Thomas & Co. 1878).
[38]AartiArunachalam (2002). An analysis of the duty to negotiate in good faith: pre-contractual liability and preliminary agreements. p.9-10

literature such as what is the basic meaning of the concept? When is it applicable? Should it mean the same thing in the commercial context (when two private parties contract), as it does when the Government enters into a contract? Is it really necessary in twenty-first century business relationships? To start with, it would be ideal to examine the meaning of implied duty of good faith in contracts.[39]

According to the Restatement (Second) of Contracts 205, every contract whether commercial, government or oil contract mandated a duty of good faith and fair dealing over contracting parties in term of performance and enforcement of the contract. It argues that Subterfuges and evasions destroy the basic obligation of good faith in performance despite the fact that the actor believes his/her conduct to be justified. This good faith obligation argues further that bad faith consists of inaction and more than honesty is required in fair dealing. Though, there is never a full catalogue of types of bad faith but the following types have been considered as bad faith in judicial decisions: lack of diligence and slacking off, abuse of a power to specify terms, evasion of the spirit of the bargain, and interference with or failure to cooperate in the other party's performance. In addition, the Uniform Commercial Code defines "good faith" as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[40]

The second point to be examined in discussing the implied duty of good faith and fair dealing is looking at the Implied Duty of Good Faith & Fair Dealing in early cases. In the commercial context, the assigned obligations of good faith started as an unwritten provision that made it possible for an agreement to be enforceable in the cases of Wood v. Lucy, Lady Duff -Gordon, 222 N.Y. 88 (1917). In the case of Wood, the plaintiff and the defendant had an agreement that the plaintiff would be able to place the defendant's endorsements on others' fashion designs and sell or license the defendant's designs. And half of all of the profits and revenues would go to the defendant in exchange.

[39]Marcia G.M & Michelle E. L (2014). The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts An Age-Old Concept in Need of an Update? p.1-2
[40]U.C.C. § 1- 201(b) (20) (amended 2003).

Furthermore, the court did not support the defendant's argument: The defendant argues that there are no elements of contract. She insists that the plaintiff refused to bind himself to anything. Though in a true sense, it was found out that the plaintiff refused to emphasize much on his promise that he will be able to use effective efforts to place the defendant's endorsements and market her designs. But this does not necessarily hinder the promise to be fairly implied. A promise may be lacking, and yet the whole writing may be "instinct with an obligation," imperfectly expressed. But this would not hinder the effect of a contract. After the case of Wood, courts were able to find an implied duty to use reasonable effort in contracts even if it is sufficiently stated. In this respect, the driving force behind the application of duty of good faith and fair dealing in the commercial context is now considered to be the contracting parties' intent and reasonable expectations.[41]

In the context of government contracts, the implied duty of good faith and fair dealing had a different evolutionary path. Most in specific, public officials were obligated to act in good faith and this also extended to public officials' conduct in the execution or performance of government contracts.[42]In the cases of Clark v. United States, 73 U.S. 543, 545-46 (1867); United States v. Behan, 110 U.S. 338, 346 (1884). In the nineteenth century, the Supreme Court implied a duty of reasonableness to the Government in performing contracts. In the case of Behan, the defendant was given a contract to make improvements to the New Orleans harbour and afterwards, the government found out that the plan would not accomplish its goal, which has nothing to do with contractor's fault, but the government ordered the contractor to stop the performance of the contract. The Government further appealed a decision concerning the damages of the defendants claiming that there are no profits lost on the side of the appellee.[43]The Supreme Court did not support the argument stating that: the wilful and wrongful way of ending a contract and disallowing the other party to carry out the contract is a breach of the contract, which demands for the recovery of all damage on the side of injured party.

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[41] Ibid, p.2

[42]See The Schooner Betsey, 44 Ct. Cl. 506, 514 (1909) (presuming good faith in the sale of an American ship).

[43](110 U.S. at 342).

Furthermore, in the mid-twentieth century, the Court of Claims continued to apply the implied duty to government contract disputes. For example, in George A. Fuller Co. v. United States, 108 Ct. Cl. 70 (1947), the George A. Fuller Company sued for damages as a result of the delays caused by Government's inability to furnish models on time, changing the work, and in approving of the limestone to be used. There was no hesitation on the side of the court to immediately find the government responsible for the damages caused by its delays. The court states it that: Under prior decisions of this court and of the Supreme Court, It considers the defendant to be responsible for the damages caused by these delays. Though, there was no sufficient evidence that support the fact that government is directly responsible for the delay that affected the performance of the work and also there is no express provision that exempt government from this accusation therefore, it becomes an implied provision of every contract whether between private individuals or between individual and government, that neither party to the contract will do anything to prevent performance thereof by the other party or that will hinder or delay him in its performance. In continuation, the court argues that there is s generally in a contract subject to either an express or an implied condition an implied promise not to prevent or hinder performance of the condition."[44]

The third point to be examined in discussing the implied duty of good faith and fair dealing is its application in the modern era. There are considering aspects of this doctrine that is applicable to both commercial and government contracts in the modern era. In the both setting, the interpretation of the duty comes as an obligation not to hinder the performance or prevent the other party from enjoying the rewards of the bargain. See Precision Pine & Timber, Inc. v. United States, 596 F.3d 817, 820 n.1 (Fed. Cir. 2010); Centex Corp. v. United States, 395 F.3d 1283, 1304 (Fed. Cir. 2005); Bank of N.Y. Mellon Corp. Forex Transactions Litig., 921 F. Supp. 2d 56, 80 (S.D.N.Y. 2013). The duty of good faith and fair dealing is part of contract under both commercial and government sectors except it is expressly excluded. See Northwest,

[44](Id. at 411-12).

Inc. v. Ginsberg, U.S 134 S. Ct. 1422, 1431-32 (2014); Metcalf Constr. Co. v. United States, 742 F.3d 984, 990 (Fed. Cir. 2014)[45]

In the real sense, there might be some exceptional cases in the commercial setting whereby the duty can be excluded but it is very rare or if not impossible for the duty to be excluded from government. It should be noted as well that the duty cannot maximize a contract beyond its express terms or contravene terms of the agreement. See Metcalf Constr., 742 F.3d at 991; O'Tool v. Genmar Holdings, Inc., 387 F.3d 1188, 1195 (10th Cir. 2004). In addition, the application of the duty to both sectors requires the contracting parties to define the boundaries of a permissible application base on the parties' intent and their reasonable expectations in entering the contract. See First Nationwide Bank v. United States, 431 F.3d 1342, 1350 (Fed. Cir. 2005); Compass Bank v. Eager Rd. Assocs., LLC, 922 F. Supp. 2d 818, 825 (E.D. Mo. 2013). Lastly, in the decision of the court concerning both types of cases have argued that the duty is limited to contract performance and does not apply during negotiations. Scott Timber Co. v. United States, 692 F.3d 1365, 1372 (Fed. Cir. 2012); Market St. Assocs. L.P. v. Frey, 941 F.2d 588, 596-97 (7th Cir. 1991); Land O'Lakes v. Gonsalves, 281 F.R.D. 444, 453 (E.D. Cal. 2012).[46]

Moreover, the fact the doctrine is applicable to both government and commercial sectors do not hinder the differences in how the doctrine is applied in commercial contract and government contract cases. This is basically due to the fact that commercial contract disputes are litigated in state and federal courts under state law, whereby they lack a universal definition of the implied duty of good faith and fair dealing. See Northwest, Inc., 134 S. Ct. at 1431. Its application differs from different states, in some states a breach of then implied duty is an independent cause of action. While in other states, the doctrine is used as a tool to interpret a contract. In most commercial disputes, the jury is responsible to find the fact and usually d usually decides whether a party's conduct breached the duty. The doctrine is applicable to every type of commercial contract dispute, which comprises of insurance,

[45]Marcia G.M & Michelle E. L (2014). The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts An Age-Old Concept in Need of an Update? p.4
[46] Ibid, p.5

employment contracts, franchise and dealer contracts, leases, and construction disputes.[47]

There are considering three different reasons why the doctrine of good faith and fair dealing is different in government contract disputes; firstly, the government is a sovereign party to the contract. It brings complicated and strict regulations, which imposes significant requirements on contractors. The government also plays dominating role in negotiating position where is more able to set the contract terms and concurrently act as the enforcement authority. Secondly, the role of bad faith is different in government contract cases. In the commercial, the definition of bad faith is limited to what is not good faith. But in government context, there has been confusion, when court refuses to clarify the distinct concept of the implied duty of good faith and fair dealing from the evidentiary presumption of good faith on the part of public officials. And lastly, in contrast to the commercial context whereby the juries are responsible for making decision concerning the issues of fact, in the tribunals that resolve government contract claims, the judges are responsible to find facts and decide whether there is violation of the duty on the part of a party or not. [48]

2.4 THE ROLE OF BAD FAITH

Discussing the role of good faith in contract or oil contract law would not be a complete analysis without examining the situations of bad faith in both commercial and government contracts. There are certain conducts that can directly be classified as bad faith such as; Deception in practices or deliberate misinterpretation to prevent the payment of claims, unreasonable litigation conduct, intentional misinterpretation of records or policy language for avoidance of coverage, engaging in unreasonable standard in order to deny a claim, unnecessary delay in resolving claims or the failing attempt to carry out proper investigation, the use of force or abusive strategies to settle claim, unnecessary demand for proof of loss, failure to use proper and effective investigative procedures, failure to use your specified procedures to investigate the claim, forcing an insured to contribute to settlement, the failing attempt to promulgate

[47]Ibid, p.5.
[48]Ibid, p.6-7.

policy limits and explain applicable policy provisions or exclusions. These are conditions at which bad faith can prevail in every contract including oil contracts.[49]

In the commercial context, bad faith is singularly considered as the absence of good faith. It acts as an n excluder for what constitutes good faith. See Robert S. Summers, The General Duty of Good Faith – Its Recognition and Conceptualization, 67 Cornell L. Rev. 810 (1982). The instances of bad faith are enumerated in the e Restatement (Second) of Contracts; such as evasion, subterfuge, abuse of power, and wilful rendering of imperfect performance, as conduct that violates the duty. In addition, the concept of bad faith is also used by court when deciding whether a party breaches the implied duty of good faith and fair dealing. The U.S. District Court for the District of Columbia used this approach in Himmelstein v. Comcast of the Dist., L.L.C., 908 F. Supp. 2d 49.[50]In that case, there was a situation whereby the plaintiff destroyed his cable service agreement, disconnected the service and removed the Comcast's equipment. But mistakenly, Comcast's modem was left behind and the plaintiff was charged $220 for the unreturned equipment. They eventually forward the outstanding balance to a collection agency and reported to the national credit-reporting agencies. And when the plaintiff found out about this mistake, he had to return the modem to Comcast and the company gave him an assurance that his account would be corrected.[51]

Along the way, there was error found in the credit report of the plaintiff and he claimed he had to pay an additional $26,000. The plaintiff sued Comcast and collection agency, claiming that there is a breach of the implied covenant of good faith and fair dealing as one of four causes of action. The court cancelled the two accounts, which include the breach of the duty of good faith and fair dealing, with the evidence that the plaintiff could not allege bad faith. The court quoted the Restatement and expanded upon the notion of bad faith, stating: "The concept of bad faith goes beyond negligence or bad judgement: it has to do with the failure to implement some duty or some contractual obligation, not prompted by an honest

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[49] Ibid, p.7

[50](D.D.C. 2012).

[51]Marcia G.M & Michelle E. L (2014). The Implied Duty of Good Faith & Fair Dealing in Government & Commercial Contracts An Age-Old Concept in Need of an Update? p.8

mistake as to one's rights or duties, but by some interested or sinister motive and implies the conscious doing of a wrong because of dishonest purpose or moral obliquity."[52] The court decided that the actions of Camcast reflect different mistakes were not the result of an interested or corrupt motive.

Furthermore, a similar approach to this was used by a Wisconsin District Court in Tilstra v. Bou-Matic, LLC, F. Supp. 2d, 2014 WL 834531[53]. In explaining this case, Sid Tilstra and his dairy equipment company sued a dairy equipment manufacturer, with the claim of a breach of contract and interference with economic relations. Mr Tilstra was working as a dealer of a Bou-Matic since 1981, where he had been working under a dealership agreement that officially recognized Mr. Tilstra to have exclusive sales and service territory and provided Bou-Matic with the right to change, in its sole discretion, the territory (Id. at a1). In 2009, it was found out Bou-Matic threatened to remove Mr. Tilstra from his territory if he refuses to agree with the interest of selling his dealership and its assets to a neighboring dealer. This threat became the reason why Mr. Tilstra sold his dealership but the sued.

Bou-Matic defended his argument by stating that the elimination of Mr. Tilstra's territory could not be a breach because the dealership agreement allowed Bou-Matic the sole discretion to change his territory. This argument was not supported by the Court with the claim that is responsible for breach of the implied duty of good faith and fair dealing even if all of thecontract terms have been fulfilled. In addition, the court argues that under Wisconsin law, "a plaintiff alleging breach of the implied duty "must allege facts 'that can support a conclusion that the party accused of bad faith has actually denied the benefit of the bargain originally intended by the parties"[54]The conclusion of the court's judgement was that BouMatic violated the spirit of the termination clause by eliminating Mr. Tilstra's territory without providing notice and showing good cause base on the requirement of the contract.

The second point under the explanation of bad faith in commercial context is centered on the Bad Faith as a Motive, which explains the fact that some courts use

[52]Burnsed Oil Co. v. Grynberg, 320 F. App'x 222, 230 (5th Cir. 2009)
[53](W.D. Wisc. Mar. 4, 2014)
[54]Zenith Ins. Co. v. Emp'rs Ins., 141 F.3d 300, 308 (7th Cir. 1998).

bad faith as a proxy for motive. A typical case that illustrated this assertion is a case of TCBY Systems, Inc. v. RSP Co., 33 F.3d 925 (8th Cir. 1994), which arose as a result of a terminated franchise agreement. TCBY's brochure about franchises argues that TCBY strictly deals with real estate aspects of opening a store and both approval of optical location and identification of site option would be done by TCBY estate director.[55] The guideline of TCBY requires its store with the need of a population of at least 7,500 within one mile of the store, along with $25,000 of a median household income as well as, a median age in the high 20s or low 30s, and a focused market (Id). RSP had the interest of owning and operate a TCBY franchise in Crystal, Minnesota, a suburb of Minneapolis. However, it should be noted that TCBY would not in any circumstance approve any site near Twin Cities and instead approved a site in central Minnesota.

But quite unfortunate, this area was approved by TCBY division manager who did not obtain a demographic report for the area and was not able to cross-check whether it correspond with TCBY's guidelines or not of which it did not correspond. The estimated population of the area was around 3,756 with the $18,000 of the median household income (Id). RSP opened the store, and it was quite unfortunate that in the first year, the gross sales were less than half of TCBY's $250,000 estimate and store did not break. This precipitated to the termination of the agreement by the RSP and TCBY sued them with the claim that seeks the advertising funds and royalties' value it would have received, and RSP counter claimed. The court found TCBY guilty of violating its obligation of good faith and fair dealing in the performance of the franchise agreement, and TCBY appealed.

The Court of Appeals for the Eighth Circuit affirmed also argued that there was enough evidence for the first jury to find TCBY guilty of breaching the obligation of good faith and fair dealing (Id. at 928).The Eighth Circuit commented on the failure of TCBY to follow its guidelines for site selection and evaluation which reflects the fact that TCBY was not honest in fact and acted with a bad motive (Id.; but see Original Great Am. Chocolate Chip Cookie Co. v River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992).

[55] (Id. at 927)

In the case of Seidenberg v. Summit Bank, 791 A.2d 1068, 1078 (N.J. Super. Ct. App. Div. 2002), a New Jersey appellate court argued that t bad faith or ill motive has become a significant instrument for the maintenance of a cause of action based on the implied covenant of good faith and fair dealing. In this case, the plaintiffs happen to be the main shareholders of insurance brokerage companies and they sold their stock to the defendant. The plaintiffs are receiving shares in the parent corporation of the defendant, they retained their executive position in the companies and also they are receiving bonus on the virtue of anticipated growth. In addition, part of the plaintiffs' employment agreements stated that the parties would have a collective work in order to formulate joint marketing programs [56]

The plaintiffs were sued with the claim that base on the failure of the defendant to develop potential customers and relationships with other entities, and these allegations gave rise to an inference of bad faith (Id. at 1073). This action was dismissed by the trial court with the findings that show that the plaintiffs were seeking to enforce an n oral agreement made beyond the four corners of the written agreements. The appellate court stated that under the covenant none of the contracting parties have the right to do anything, which could have effect of destroying the right of the other party in receiving the benefits of the contract [57]

The second part is bad faith in Government Contract Cases. It was found out that bad faith has a different role to play in the government contract cases compare with the commercial contract cases when discussing the implied duty of good faith and fair dealing. The evidentiary presumption of good faith has been conflated by some certain courts, which is applicable to an official's conduct with the contractual obligation of good faith and fair dealing. The general presumption that public officials act in good faith can be found in the English law and Supreme Court invoked this assertion since 1816.[58]This presumption is not only applicable to actions related to government contracts alone but it is applicable to all sovereign acts, and is relied on when a plaintiff accuses a government official of fraud or some other sort of

[56](Id. at 1072).
[57](Id at 1074).
[58](See Ross v. Reed, 14 U.S. (1 Wheat.) 482, 486 1816).

wrongdoing. It is not applicable only to when a plaintiff violate ordinary contract.[59] Furthermore, as time goes on, the concept got more confusing and this led to the decision of court demanding for a contractor in order to show bad faith concerning government officials to succeed on a claim of a breach of the implied duty of good faith and fair dealing (See L.P. Consulting Grp., Inc. v. United States, 66 Fed. Cl. 238, 243 2005).

In the case of Metcalf Construction Co. v. United States, there was a clarification of this doctrine by the Federal Circuit. The Court of Appeals for the Federal clarified this s area in Metcalf Construction, 742 F.3d 984. This case has to do with a 2002 contract signed for designing and building housing units at a Marine Corps base in Hawaii. Metcalf complained that it was forced to bear higher costs than could have been expected. In addition, Metcalf argued that solicitation failed to provide sufficient description concerning the condition of the soil on which the housing would be built on. This is found out after a post-award testing was conducted during the performance period and the problem with the site became apparent, Metcalf raised them with the contracting officer.

The Court of Federal Claims held the view that although the Navy is wrong for not investigating the soil on time and could not issue a notice to proceed until months after it was required to do so, but the plaintiff as well failed to establish liability. In this respect, the Court of Federal gave liquidated damages against the plaintiff for failing to meet the completion date in the contract. The Court relied on Precision Pine, 596 F.3d 817, and denied the plaintiff's claim due to their inability to show that the Navy's actions were not accurate. On appeal, the Federal Circuit began by defining the duty of good faith and fair dealing in the following way; the doctrine of good faith and fair dealing imposes obligations on both parties to the contract, which states the duty not to interfere with the performance of other party and not to destroy the reasonable expectations of the other party concerning the benefits of the contract (Centex Corp. v. United States, 395 F.3d 1283, 1304 (Fed. Cir. 2005*). "Both*

[59] (See Tecom, Inc. v. United States, 66 Fed. Cl. 736, 771, 2005).

the duty not to hinder and the duty to cooperate are aspects of the implied duty of good faith and fair dealing."[60]

Additionally, the decisions of the Federal Circuit after Metcalf Construction Co. v. United States is another illustration of bad faith in Government contract cases. There were two decisions issued by the Federal Circuit, which could be used to discuss the duty of good faith and fair dealing since Metcalf has been sued. Firstly, Century Exploration New Orleans, LLC v. United States, 745 F.3d 1168,[61] the plaintiff alleged the new requirements under Federal Circuit can be applied to o drilling operations on the Outer Continental Shelf repudiated and breached its oil and gas lease. The Court of Federal gave the Government's motion for summary judgment, and the Federal Circuit affirmed. The case of Meltcalf was cited in order to explain the meaning of implied duty of good faith and fair dealing and the court decided that government has not violated the duty of good faith and fair dealing because the lease expressly officially permitted the Government to change the applicable regulatory requirements[62]

The second decision is found in the case of Lakeshore Engineering Services, Inc. v. United States, F.3d, 2014 WL 1394949[63], the plaintiff was given an indefinite delivery time and the quantity of contract to provide construction services. The contract states the nature of pricing to be determined with the use of coefficients proposed by the contractor and prices in the Universal Unit Price Book. After the two years of performing the contract, Lakeshore decided that the contract incurred higher costs than expected outcome and seeks an equitable adjustment. This request was rejected by the government and Lakeshore decided to sue the government. The Court of Federal Claims granted the Government's motion for summary judgment, with the argument that the contract put the contractor under high risk of error and this is not guarantee in the implied duty of good faith. However it should be noted that the court did not directly explain both good faith and bad faith is applicable to the conduct of a public official in n Century Exploration or Lakeshore Engineering. Instead, the court

[60] (Precision Pine, 596 F.3d at 820 n.1
[61](Fed. Cir. 2014)
[62](Id. at 1179).
[63](Fed. Cir. Apr. 11, 2014)

paid more attention on the provisions of the contracts at issue as well as the allocation of risk. Hopefully, the decisions and explanations of the Federal Circuit in the cases of Metcalf Construction, Century Exploration, and Lakeshore Engineering would be sufficient enough to clarify the confusion inherent in the e presumption of good faith afforded to a public official's conduct and the duty of good faith and fair dealing.

CHAPTER THREE

CONTRACTUAL ISSUES IN OIL CONTRACT

3.1 INTRODUCTION

The main materials used for the making of petroleum are strings of carbon and hydrogen, known as hydrocarbons, which is formed from the compression of organic countless years ago. It is regarded as ancient stuffs that still drive the modern age. Oil, gas, petrol, diesel, butane are from the same source which is hydrocarbons beneath the earth's surface and can be redefined for different use. In this respect, petroleum can also be used to include oil and gas, because both contain hydrocarbon compounds, and because they are often found in the same location. Though, the first thing that could come to mind when considering the products that could be obtained from the petroleum is fuel. However, it must be noted that there are many other materials and products that are obtainable which contains oil or gas such as toothpaste, candles, medicines, or even computers. This as well justifies the high rate of the significant of petroleum in this modern era. In the history, the contracts of petroleum were designed basically with the perception of crude oil and to a larger extent, this has dominated the logic and structure of the present era. Gas only became relevant in the recent years.[64]

Natural gas, or just gas, is usually classified within contracts as either non associated gas or associated gas. The associated gas is found along with crude oil while non-associated gas is found without crude oil. In respect to oil contract law or petroleum contracts, it has to do with how money is split and who makes what profits, it is the contract that determine who is in charge of the operations and how certain issues like environment, local economic development, and community rights are well taken care of. For example, the issues relating to the price of ExxonMobil, the question of who carries responsibility for Deepwater Horizon, whether a country will be able to regulate importing petrol and the cost of heating it are issues that directly influence the nature of oil contract signed between the oil companies and government

[64] Tim B, Marta P, Simone B, Heather K, Elisabeth S, Andreas D. Rachel O (2012).How to Read and Understand a Petroleum Contract?, p.9

of the host countries. For the past 150 years of oil production, the nature of these contracts has not been disclosed due to some reasons on the side of the government as well as commercial sector. The government claimed national security prerogatives to be the motive behind keeping it hidden and companies claimed commercial sensitivity.[65] This is why it is difficult to find necessary documents concerning the evaluation of the principle of good faith in the formation of the oil contract. But there has been little improvement in the past years, which saw the emergency of the idea that these contracts mean a lot to public interest and it should transcend normal considerations of confidentiality in business.

Another significant phase in the discussion of the formation of oil contract is known as contract transparency which is regarded as the next stage of the transparency movement. These initiatives started in 1990 around 'Resource Curse' which has led to the establishment of the Extractive Industries Transparency Initiative in 2002 that has facilitated the opening up of a public conversation. This has significant effect on the perception of oil contract by both the government and companies. They now acknowledge the importance of openness and business ethic which can also be regarded as good faith in the oil contract formation. Furthermore, Activists and journalists sometimes could succeed in penetrating the secret and dark corners and disclose it as well as triggering a public outcry occasionally to bring about desirable change. But it should be noted that the intensity of public suspicion remains high around the world as result of secrecy inherent in the formation of oil contract. The question of why or how "the government" or "the state" is being so secretive is not helpful due to the high rate of disfunctionality and asymmetry of information that could exist as a result of it.[66]

Oil Contract Types/Regulatory Model Attempt has been made in the first chapter of this dissertation to trace the historical development of contractual form of oil contract whereby it was found out that concession was the principal contractual form in the extractive industry. Private companies under concession had more advantage and exclusive right to produce and market natural resources as it was discussed in the first chapter. The case is not the same in the present era whereby

[65] Ibid, p.10
[66] Ibid,p.3

extraction contracts are now premised basically on the transnational public-private partnerships. In this respect, there is a possibility of companies and transnational group of governments to collective share the control over the exploration, financing, production and marketing of natural resources in different degrees. In exemplification, there could be a situation whereby a foreign government may engage in a project via an export credit agency, which can advance loans to a project company. Foreign governments find it possible to influence decision-making concerning a project through the use of export credit agencies. There is also a possibility of amplifying this influence in a situation whereby several export credit agencies are involved in a single project and coordinate their activities. Additionally, there is also a chance for intergovernmental organizations to engage in a project in some cases. In the case of export credit agencies' involvement along with the international financial institutions require them to have their own project documentation most usually in the form of loan agreements. There is different nature of overarching partnership, which is dependent on the type of the contract. In another word, the contractual clauses are found more usually significant the identifying the nature of the partnership than the type of the contract.[67]

3.2 TYPES OF OIL CONTRACT

There are many types of contract but the basic types are (1) modern concessions; (2) production sharing agreements; (3) joint ventures; and (4) service contracts. In a situation whereby there is high rate of anti-foreign sentiment and nationalism, the given name of an agreement maybe more important than its performance. Then the content of the contract would not necessarily depend on types but more dependent on specific terms. Attempt shall be made to discuss these types' different types of contract in this chapter. Such as service contract, which is found more relevant to the host state from developmental perspective due to the fact that it gives most independent privileges to the host state. This type is most practicable by the Middle Eastern countries where there is large rate of domestic expertise. Joint ventures contract also share some similarities with service contract base on the fact that it gives more participation to the host states. Production sharing

[67] Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1 , p.4-6.

agreements(PSAs) are presently a controversy matter but in a situation of high rate of exploration, it may be found more relevant in advancing developmental interests.

Aside the chosen types of contract, there are other issues that must be considered within the nature of contract such as the level of taxes and royalties along with the stipulating clauses of technology transfer and requirements of local sourcing. Considering the fact that contracts are mostly done in secret, its conditions vary from country to country and from project to project, which makes it difficult to determine directly the issues of good faith in its performance. Furthermore, there is no possibility of generalization in assessing the development impact of different forms and clauses of contract. Aside the fact that country varies in their level of domestic expertise and quality of their resources, there is also a possibility such as the case of Iraq, different projects within a country requires different types of contract. This leads to the basic argument that the contractual clauses can focus on national content, local training, host government control over key decisions, and participation by State-owned corporations all advance developmental objectives.[68]

The leading significance of the clauses of contracts in the determining the nature of revenue sharing makes it impossible to generalize the existing relationship between the forms of contract and method of sharing revenue. The contract will determine the nature of royalties and rates of taxation. This opens the importance of caution in coming to conclusion about the best type of a contract for development and financial purposes. Additionally, there is a visible difference between concessions, joint ventures and risk-Sharing agreements, on one hand, which can be termed as first model, and service contracts, on the other hand, which could be termed as second model. In the first model, the company has direct share in the revenue though the rate of this will be defined in accordance with the nature of the contractual clauses and legislation. In the second model, the host countries are assigned with the duty of compensating the company's base on the services provided. In this situation, the

[68] Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1 , p.6

company might not have the direct privileges to the revenue sharing, the company is meant to provide some services and get paid by the host governments.[69]

Furthermore, it is important to be aware of the fact that the evolution from traditional contractual types; concession to the modern participation agreements show how the different types of activities under contract have changed over time. In the present era, much emphasis is laid on the development of local capacity. In exemplification, contract now emphasizes that foreign company must be equal in all things, purchase inputs locally. Additionally, host government through a state-owned company now plays an active role in projects. The issues of human rights and environment commitments are now considered in the present eras to affect projects. These commitments are now inherent in the project documentation at the phase of multinationals, international financial institutions or private investment banks. Contract is considered now as the most significant tool at which the benefits and duties of projects are equally distributed. At the national level, the government may create an enabling environment for the better negotiation of contract. In addition, National regulatory action may also force the renegotiation of key contractual terms. At international level, the international organizations could influence the nature of contract between parties. For example, if the International Finance Corporation (IFC) lends money to a project company, then it will find it necessary to evaluate the conditions of the loan and how it is used. If, for example, the Multilateral Investment Guarantee Agency (MIGA) provides political risk insurance for a project, it will certainly affect the nature responsibilities among contracting parties.[70]

3.2.1 Modern Concessions

Traditional concession is different from modern concessions as it will be discussed later. The traditional concessions is now old considered to be relic, it survived and was successful in many parts of the world although as less politically charged license sometimes.[71] In the real sense, the basic difference between traditional and modern concessions is the shift from an unequal bargain-based model to a partnership-based one. The main aim of the modern concession is to fulfill national development,

[69] Ibid, p.7
[70] Ibid, p.8
[71] Omorogbe, Y. (1997). The Oil and Gas Industry: Exploration and Production Contracts. Lagos: Malthouse Press. p, 60

welfare goals and financial purpose. For example the contract between Indonesia and P.T. Stanvac Indonesia (PTSI) explains that: PTSI will be assigned with the duty of planning and conducting all operations under this contract for the purpose of a sound and progressive development of Indonesia's petroleum industry including a better consideration to the aspiration and welfare of Indonesian population as well as the economic development of the country. The conditions of the contract must also corporate with the government on the promotion in the growth and development of the economic and social structure of the country.[72]

In similarity with the traditional concessions, the modern concession that is in practice today grants companies the right of exploring, producing and marketing resources. The aspect of control over the projects is based on partnership and not dominance. The protagonists of this idea argue on the move from concession to participation.[73]The main distance that exists between the traditional and modern concessions basically depends on the natural attributes of the country. In this respect, the most significant set of nations are those that formed OPEC. Countries such as Saudi Arabia, Islamic Republic of Iran, and Iraq have all renegotiated the effectiveness of traditional concessions by replacing them with the profit-sharing systems.[74] In the production-sharing agreement, the conditions of participation are basically defined on a grant within a specified period of time. The shift from traditional to modern in many countries took place as a result of Government-initiated renegotiations and nationalizations. The existing terms of the modern types now vary on country to country and on project. OPEC played a pivotal role in pooling information on terms of renegotiation among member countries.[75] The basic critics against the traditional type are centered on the issues of foreign control, geographical scope and duration and also financial compensation, which the modern concessions had adequately taken care of. Host governments now have a say in the time a company should hand control of unexplored land back to the Government.

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[72] Petroleum Working Contract Between Indonesia and P.T. Stanvac Indonesia 1964: Article 15.

[73] Smith, E.E., Dzienkowski, J.S., Anderson, O.L., Conine, G.B., Lowe, J.S. and Kramer,B.M. (2000). International Petroleum Transactions. Colorado: Rocky Mountain Mineral Law Foundation (2nd edition), p.418-425

[74] Ibid, p. 418–422

[75] Ibid, p.419

3.2.2 Production-Sharing Agreements

The first country to practice production-sharing agreements is known as Indonesia.[76]This type of agreement is the basic point of controversies in oil extraction in the present era as result of regrets over its excessive use in the post-Soviet Russia[77] to its preferable use in the post-Iraqi war. It is not so common in mining.[78] Production-sharing agreements give opportunity to the company to enjoy the right of exploring natural resources and if there are no resources found then the loss is on the side of the company but if commercially exploitable resources are discovered then the company could regain its sunk costs and subsequently share the profit with host government. This contract type is different from the concession in the two basic ways. In the first sense, it refuses to grant ownership rights over the resources to the company. In this respect, the government might decide to take a large interest in technology transfer, and also decide to prepare for turning over of the resources to its hands. This is different from concession type, which gives the ownership right to the company for a specified period of time, PSA only grants an interest in the resources to the company and this is tied to the recouping of sunk costs and garnering of a profit. It is basically useful for any host government with the interest of encouraging a company to engage in the risk of exploration.

Furthermore, PSA is not only found useful for the host government alone but the company could also find it more relevant than modern concession type in a situation whereby a company is not sure about its ability to recoup its sunk costs within a specified period of time that is provided under modern concession. Dzienkowski identifies the three key issues that must be addressed in the PSA. First, the issue of work program or the rate of dollar contribution concerning development; second, the exploration duration and the phase of development; third, the method of sharing benefits of production between host government and multinational

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[76]Fabrikant, R. (1975). "Production-sharing contracts in the Indonesian petroleum industry" Harvard International Law Journal, 16, p. 3030.

[77]Stoleson, M.A. (1996-7). "Investment at an impasse: Russia's production-sharing agreement law and the continuing barriers to petroleum investment in Russia", Duke Journal of Comparative and International Law, p.677

[78]Barberis, D. (1999). Negotiating Mining Agreements: Past, Present and Future Trends.Leiden: Kluwer Law International.

company.[79] In the case of a successful post-discovery phase of cost recoup and profit sharing, it is found out that the host government takes more or larger financial share through the use of taxation and royalty. PSAs have been devised as an encouragement to the private investment in many untested areas. In this respect, special financial incentives are given to the companies to invest but they are responsible for the risk of not finding any commercial exploitable resources. Example of this is found in the case of Azerbaijan contract which grants the companies the *"sole and exclusive right to conduct Petroleum Operations within and with respect to the Contract Area".*[80]

In order to entice the companies to seek out resources, the host government grants recoup sunk costs and to garner an agreed-upon profit to the company after the discovery of resources. But if the company is unable to find resources, then it is responsible for the loss. This reflects in the Azerbaijan agreement, stating that *"2.2. Except as expressly provided elsewhere herein, in the event production resulting from Petroleum Operations, upon completion of commercial production from the Contract Area at the end of the term of this Agreement, inclusive of all extensions provided in Article 4 is insufficient for full recovery of Contractor's Capital Costs and Operating Costs as provided hereunder, the Contractor shall not be entitled to any reimbursement or compensation for any of its costs not recovered".*[81] If there is a successful commercial discovery, then the company is granted the right to recoup sunk costs and an agreed-upon profit. In exemplification, Azerbaijan contract indicates *"(a) Contractor shall have the right to get the recovery of petroleum costs as follows: (i) every cost of the operation must be gained back from total production; (ii) every cost spent on the capital must be gained back from a maximum of fifty (50) percent of Crude Oil and fifty (50) percent of Non-associated Natural Gas remaining out of Total Production after Crude Oil and Non-associated Natural Gas required to recover Contractor's Operating Costs"*[82]

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[79] Smith, E.E., Dzienkowski, J.S., Anderson, O.L., Conine, G.B., Lowe, J.S. and Kramer,B.M. (2000). International Petroleum Transactions. Colorado: Rocky Mountain Mineral Law Foundation (2nd edition), p.454

[80] Final Consolidated Version 3/30/96: Article 2, Section 2.1

[81] Final Consolidated Version 3/30/96: Article 2, Section 2.2

[82] Final Consolidated Version 3/30/96: Article 11 Contractor's Recovery of Petroleum Costs and Production Sharing, 11.2 Cost Recovery (a)(i) and (ii))

3.2.3 Joint Ventures

In similarity with the partnership-based model, the joint venture also allows the foreign company to have a business relationship with host government. There might a possibility for the venture to engage in jointly controlled project company. In comparison with the concessions and the PSA models, it would be reasonable to examine the main ideas behind venture's legal arrangement in order to ascertain the extent to which the control over the companies rests in foreign or domestic hands. The distinguishing feature of Joint Venture is that it emphasizes more on corporate relationship between the national state-owned company and foreign company, structured means for technology transfer and shared decision-making. Though these goals are also achievable using other instrument but a corporate partnership is considered to be the most strategic one. Joint venture might be found all around the world considering the fact those contracts are not mainly done in public; it became difficult to easily ascertain the extent at which it is practicable.[83]

Moreover, it would be reasonable to assume that political exigencies influence the content joint venture contract in every country in the world. In a situation whereby the host government engages strongly in the negotiating position, it will grant the local partner more strength compares with when host government does not really participate. Furthermore, it should be significantly noted that Joint venture could be easily incorporated into other types of contract such as PSAs. For example, the Azerbaijan contract involves mixed corporate participation. In similarity with the PSA, the JV arrangement puts a premium on technology transfer. This is aimed to enhance genuine independence by the State-owned company. In addition, the rate of technology transfer that would need in JV is based on the negotiation and bargaining strength of the host government.[84]

3.2.4 Service Contracts

Most commonly in this contractual type, host government has greater control over the exploration and exploitation of its resources through the use of service contract and foreign company is invited to perform strict specified tasks. In comparison with

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[83] Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1, p. 13

[84] Ibid.

modern concessions, PSAs and JVs, Service contract is considered as an instrument using by the host government to exert greater control over the execution of projects. In this respect, the host Government is only contracting in the foreign company to perform a carefully delimited service. The company has not right in the direct sharing of the generated revenue. This contractual type requires the host government to have the requisite technological know-how and access to capital. It must be significantly noted that this contractual type might be found relevant in a minor task thus preferable to the other contract forms. There are three main types of service contract, which are; the risk service contract, the pure service contract and the technical assistance contract.

Risk Service Contracts; comparing with PSA, this type of service contact explains a situation whereby a host Government aims to use private companies to bear the risk of exploration. There are two scenarios that might exist in this situation; it is either there are commercially exploitable resources or there is nothing like that. But if there is something like this then the company will receive cash remuneration for its efforts in addition to a possible stake in the subsequent enterprise. But if there are no resources found then the company is out of pocket.[85]

Pure Service Contracts; this is kind of a more straightforward type of service contract whereby a foreign company is invited to perform a specified task and it is rewarded accordingly. Comparing with the risk service contracts, the host government is responsible for all the risks. This type of contract requires the foreign company to acquire an interest in the extracted resources.[86]

Technical Assistance Contracts; it is the last main type of service contract with a narrower scope. In this case, the company is invited to perform a specified task with a fixed reward. As a contrast to the pure service contract, the company has no possibility of acquiring an interest in the resource (Omorogbe, 2000, p. 65). Most significantly, this type of service contract seems to be the closest to a transnational public private partnership whereby the host government has greater control over the

[85]Omorogbe, Y. (1997). The Oil and Gas Industry: Exploration and Production Contracts. Lagos: Malthouse Press.
[86] Ibid.

project. According to Smith et al., (2000, p. 512) the technical assistance is considered to be one of the different types of arrangement that can be used by host government to take advantage of multinationals' technological and managerial expertise and capital resources and grant the host government the control and ownership of its state oil company.

3.3 CONTRACTUAL CLAUSES

As it has been argued and clearly stated before that in some cases, the choice of contract type might be less important than the content of particular contract clauses. It should be noted that an attempt can be made to provide a comprehensive theoretical differences among the three contract types but in a pragmatic sense, it might difficult if not impossible to easily classify petroleum agreements into one category. This difficult might exist as a result of harmonization of agreements whereby the parties are borrowing the best type of agreement to fit a particular situation.[87] In a joint Venture agreement, there might be specification on the percentage held in the enterprise by the contracting parties in a contract. Such as the number of parties to such an agreement and their according shares will. Another important clause in a contract is considered to be a contract that sets out reimbursement for sunken exploration costs. In some cases, the foreign company will be responsible for risk as it has discussed before and in some cases, the host government takes part or cover all the risks. A clause might as well enumerate the responsibilities of a company during the phase of exploration whereby there would be specifications on the amount of money expected to be spent on the exploration. There could also be a provision in the contract stating the circumstances under which the company may be granted an extension of the time allotted for exploration.

Contractual clauses could also make provision for specific terms governing the production phase. It is possible for this phase to last for some years and it could be extended base on the conditions of the clauses as well. It would be ideal and recommendable for the host government to set out its commitment towards this phase because in some cases, there might be contradicting interest between the host

[87] Smith, E.E., Dzienkowski, J.S., Anderson, O.L., Conine, G.B., Lowe, J.S. and Kramer,B.M. (2000). International Petroleum Transactions. Colorado: Rocky Mountain Mineral Law Foundation (2nd edition).

government and foreign company. As it has been explained in the PSAs, majority of the decisions concerning the strategic exploitation of reserves could be under the control of oversight committee with representatives from the host Government and the companies. It would be ideal, if there is a designed mechanism for decision-sharing, which would be a useful way of resolving conflicting commercial and political interests. The contractual clauses can also set out certain local content preferences. In this respect, there might be a clause indicating that the company is to employ local workers as long as they meet certain qualifications in the formation of a contract. The host government can also state in the contract that foreign company should train local expertise. And a company on the other hand may agree to source goods in a local way. For example, the agreement between Egypt, the Egyptian General Petroleum Corporation and Esso Egypt Inc. (United States).[88]

The clauses of a contract may also require the company to keep certain records of its operation, which could be useful for the host government to determine its rate of taxation and royalty. Host government may not always have capacity to enforce certain revenue schemes and in this respect, this clause would be useful in reducing the burden on the government. The clause of the contract may as well set out the transfer of control away from the company and towards the host Government. In this respect, there might be a provision in the clause indicating that facilities will be transferred to the Government as the company leaves the country. The clause may set out the condition of the facility. Conclusively, it must be noted that, it is difficult if not impossible to generalize revenue-sharing and the prevalence of specific contract clauses within agreements. This kind of information is not made available to the public.

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Michael Likosky (2006). Contracting and regulatory issues in the oil and gas and metallic minerals industries. Transnational Corporations, Vol. 18, No. 1 , p.15-17

CHAPTER FOUR

PRINCIPLES OF GOOD FAITH IN IRAQI OIL CONTRACT

4.1 IRAQI OIL CONTRACT

There are different definitions of good faith but there is a meeting point between them. As it was explained in the first and second chapters of this dissertation, the principle of good faith emphasizes on the fact that contracting parties have to be honest and fair when dealing with each other, they are obligated to represent their motives and purposes faithfully, and never to take unfair advantages that might emanate from unintended interpretation of the agreement between them. However, the issues of confidentiality, secrecy in oil contract and the fact that there many types of oil contract and different types are inherent with different requirements make it difficult if not impossible to ascertain the level of good faith in oil contract law but in a real sense, contract remains valid as long as good faith is applicable because the bias practice on the part of a party to the contract would literally destroy the efficacy of the contract. Attempt shall be made to review Iraqi oil contract law generally and specifically to examine the recent changes that took place which made it more attractive to the foreign companies. This is to evaluate some principle of good faith by considering the level of transparency and fair dealing with the foreign companies. Several findings reflect the fact that Iraq has the fifth largest proved crude oil reserves in the world in countries such as Venezuela, Saudi Arabia, Canada, and Iran. And the country took second position as the largest crude oil producer in OPEC in 2014.[89]

Most of the major known fields in Iraq are producing or in development though it was found out that most of the hydrocarbon resources in the country have not been completely exploited. All the available known oil fields in the country are onshore and the considered largest fields in the southern part of the country have a low cost of extraction owing to uncomplicated geology, fields that are typically located in relatively unpopulated areas with flat terrain, multiple supergiant fields and the close proximity coastal ports. One of the basic features of Iraqi oil and natural gas field is its re-development program after several years of sanctions and wars. The has

[89] International Energy Agency, World Energy Outlook Special Report: Iraq Energy Outlook, (October 2012), page 54.

been a significant growth rate in the crude oil production estimating 950,000 barrels per day (bbl/d) over the past five years, which had increased from almost 2.4 million bbl/d in 2010 to almost 3.4 million bbl/d in 2014. These increases in estimated production include oil produced in the Iraqi Kurdistan Region, the semiautonomous northeast region in Iraq governed by the Kurdistan Regional Government (KRG).[90]

However, it should be noted that despite the significant increase in the production rate, there are many challenges facing the country considering the fact that there is a slower rate of production in the country than Iraq had expected due to the challenges of infrastructure bottlenecks in the south, supply disruptions in the north, and delays in awarding contracts. The government of the country had ambitious oil production targets by renegotiating its field production targets that was set in Technical Service Contracts (TSCs), which was previously signed with international oil companies (IOCs). The Energy Intelligence Group estimates that Iraq is now aiming for crude oil output of 9.0 million bbl/d by 2020 as a result of some of the target revisions that have already been announced.[91] But there are factors militating against the success of these plans such as expansion of "southern export infrastructure and storage capacity building a large common water supply and re-injection system in the south, passing a hydrocarbon law, a slow administrative process of doing business, and less favorable contract terms to attract IOCs to invest in new projects. Also, political instability, sectarian violence, and the threat of the Islamic State of Iraq and the Levant (ISIL) spreading to other areas of Iraq pose significant uncertainty for Iraq's future." But these challenges are not really part of the aim of writing this dissertation so less attention would be paid to examine them.[92]

4.2 FAIR DEALING IN IRAQI OIL CONTRACT

The minister of oil in the country as at 2009, Husain al-Shahristani gave a speech in 2009 immediately after the second oilfield auction claiming that *"I am more sure that both deals in the first and second bid rounds have been more transparent than any other deals I know about in any other OPEC member countries, as a matter*

[90] Country Analysis Brief: Iraq (2015): U.S Energy Information Administration, p.1
[91] Energy Intelligence Group, Iraq: Constraints to Production Growth, "June 28, 2013.
[92] Country Analysis Brief: Iraq (2015): U.S Energy Information Administration, p.1

of fact, we have laid a good foundation of transparency down for others to follow."[93] In respect to this speech, it seems that he was right considering the contract model that was published before an auction with just elements left blank, which are: the remuneration fee (the amount paid to the companies on top of reimbursement of their costs) and a targeted plateau rate of oil production. Invited companies were given the privilege to bid on these two parameters and the contracts would be awarded accordingly to whichever bidder offered to produce the most oil for the lowest remuneration fee. It was a televised exercise in order to make more transparent whereby companies made bid in a posted envelops in a glass box and these were opened openly as the exercise was projected on a screen.[94]

The first round focused on auction done in capital city of the country (Bagdad) in June 2009 whereby only one out of the eight offered contracts was favoured considered and awarded for the Rumaila field in southern Iraq. The winner was a consortium of BP and the China National Petroleum Corporation (CNPC). After Ministry announced its maximum remuneration fee that the oil Ministry has to pay, BP/CNPC accepted $2 per barrel (compared to their initial bid of $3.99); all other bidders declined to reduce their bids as far as the Ministry asked It became a shock and surprise to many observers wondering how possible BP would accept such a low fee because it looks pretty marginal at $2.[95] But after three month, the chief executive of BP then Chief Executive Tony Hayward made it clear that the company projected a 15-20% internal rate of return from the Rumaila project,[96] which was considered to be a very good rate of profits for a known field where there was no risk of not finding oil.

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[93]JasimAzzawi interview with Husain al-Shahristani, Al-Jazeera English Inside Iraq, 18 December 2009

[94] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.8

[95] David Strahan (2009). 'Thirty contestants, only one winner in the Iraqi oil licence gameshow', Independent on Sunday, 5-Jul-2009

[96] PIW, 'Tony Hayward: Getting BP Back On Track,' 5-Oct-2009

Furthermore, the conditions of the auctions required the contract to be signed by August[97] and there was only need for only two bid parameters to be inserted into the model of the contract. But the discussion was prolonged for more than three months before it was finally approved by the Iraqi Cabinet on the 13th of October and fully signed on the 3rd of November. Additionally, the second licensing round took place in December of the same year whereby seven contracts were awarded. And on the final note, two Chinese companies accepted the Oil Ministry's terms for a fourth first-round contract in 2010. This time the companies cut their bid by a staggering 90%, from $21.40 to $2.30.[98]

4.3 WHAT HAS CHANGED?

About the question of what has really changed in Iraqi oil contact, there are different interesting stories about it. Iraqi oil expert has been asking this question of what has changed that made the ExxonMobil and Eni consortia accept the Oil Ministry's remuneration fees, which they previously considered uneconomic. In response to this question, the ministry of oil has denied the proof that any significant change has taken place. Shahristani explained in October 2009 that the discussions that took place for three months were only meant for a clarification on tax regime in the country and not really a material change. And aside this, there has not been any change in the contract and we have not negotiated anything concerning the contracts. The contracts were made in the bid rounds and they were either accepted or rejected.[99]But this quite surprising that the company gave a different story. The president of ExxonMobil Upstream Ventures, Rob Franklin said that *"we have negotiated hard with the Iraqi government and the Ministry of Oil and we have come to an arrangement that we are happy with and they are happy with."*[100]

The Chief Financial Officer of Eni, Alessandrom Bernini explained to financial analysts in a conference that "we accepted $2 because basically, the fiscal terms are different now." He added that the new terms with a remuneration fee of $2

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[97] Ministry of Oil, Final Tender Protocol for Iraq's First Petroleum Licensing Round, 23 April 2009,p.5

[98] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.9

[99]Iraqi Oil Minister Hussain al-Shahristani on Bloomberg TV - 21 Oct 2009.

[100] Ben Lando, 'Exxon exec optimistic in Iraq entry,' Iraq Oil Report, 4-Feb-2010

were equivalent to the pre-bid terms at a fee of $4.50.[101] In this respect, there is now enough evidence to provide a comprehensive answer to the question of what has really changed in the Iraqi oil contract. Necessary information is obtained from a credible source, a version of the Rumaila contract with BP/CNPC dated 8 October 2009. On this date, it was found out that there was an agreement on a contract, which was initially signed and submitted to the Iraqi Cabinet for approval, which was given on 16 October. Apart from little changes that were requested by the cabinets, it became certain this contract is the final version that was signed. In the content of this contract, the companies made their bids by considering the result of their evaluation of the risks and rewards of the project. It is stated that, the full set of the contractual terms is important and if one of the terms changes in order to decrease the risks in the projects, then the companies would have the right to re-evaluate the profits they accept and submit lower bids. Some of the changes made in the contract model are considered to be important before the bidding process started.[102]

The first change is centered on the fact that at the time of the auctions, foreign companies would be compensated for OPEC quotas. This is done at the time of the auction stating that in a situation whereby the government-imposed curtailment of production (such as to comply with a future OPEC quota), the barrels that would not be able to be extracted due to this curtailment can be extracted later. And after renegotiation, it stated on a contrary that BP/CNPC would be compensated *by "payment of lost income to Contractor on the level of the estimated volumes that are not produced during the period for which the production levels are decreased."*[103] This simply means that the government will be responsible for the payment of remuneration fees for the barrels that foreign company does not produce, including those it produces.This might be a threat to the global oil market considering its significance to Iraqi oil. It also shows that the contracts signed between the two rounds would boost Iraq's oil production from the current 2.5 million barrels per day

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[101] Eni SpA, Q3 2009 Earnings Conference Call, 29-Oct-2009

[102] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.10

[103] Technical Service Contract for the Rumaila Oil Field, between South Oil Company of the Republic Of Iraq (SOC) and BP Iraq NV and Petrochina Company Limited and Oil Marketing Company of The Republic Of Iraq (SOMO), 8 October 2009, Article 12.5

(bpd) to around 12 million by 2017. Most oil experts argued that it is not possible for oil market to absorb such a great increase whereby analysis was made that market could absorb only around 5.5 to 7million bpd of Iraqi production.[104]

The second change explains that during the auction time, the contract model contained necessary provisions for the foreign companies to upgrade the pipelines and other infrastructure as required, and to treat their costs of doing this as supplementary costs.[105] But there is a risk concerning the available export infrastructure, which is not expanded to sufficiently meet with the increase in oil production and in this case, both the governments and foreign companies would share the lose revenues in that event. After the contract is renegotiated, it was stated on the contrary that Iraqi government would compensate BP/CNPC using the standard of OPEC quotas when Iraqi distribution and export infrastructure is not capable enough to receive the full produced amount, of either oil or associated gas.[106] In this respect, the Iraqi government is now fully responsible to previously shared risk and cost and the government might also end up compensating the foreign companies for oil that is not produced in which the payment of such would literally be deducted from the other public budgets.

Furthermore, most oil analysts when looking at the effect of this contract concluded that the country will not be able to meet up its ambitious targeted rates of production considering the low level of infrastructure to cope with its current production. For example, the pipelines to the southern tanker terminals were built in 1975 with a 20-year shelf-life. And nothing has been done since 1991 in terms of pigging because the pipes are unable to deal with pressure anymore. Though, attempts have been made by the government to deal with these infrastructural challenges such as the award of construction contracts to increase Iraqi southern export capacity by 2.4 million bpd, and the plan of oil ministry to expand northern export capacity as well as building of newpipelines through Syria carrying 2.5m bpd. But the fact still remain that even if all these plans are successfully implemented, findings show that

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[104] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.11

[105] Model contract, Articles 10.6-7, 17.7-8, 19.2

[106] Rumaila contract, Article 12.5(b) and (f)

the country would still fall short of 10 million or more barrels per day of increased exports if production targets are met.[107]

The third change explains that during the time of the auction, Joint Management Committee under the contract model is required to approve all projects expenditures above $20 million, and South Oil Company (SOC) approval of all expenditures over $50 million.[108] After contract increased the threshold for SOC approval to $100 million, renegotiation, with addition that there shall not be unreasonably withdrawal of the approval as well as if no objection were made within 45 days, it would be assumed that it is approved.[109] This automatically declines the ability of the government to ensure the conduction of the project in a way that meet its interest and obtain value for money. This also gave the foreign companies the opportunity to increase their benefits illegitimately at the detriment of the government. Looking at the effect of this situation, it can be argued that it is a normal thing for the investor to require the approval of state concerning its expenditures in oilfield development contracts.[110]

This would be helpful in the prevention of corruption, avoids tax avoidance through cost inflation and ensuring the possibility that the project gets value-for-money equipment and services (rather than, for instance, purchasing from an affiliate company). In this respect, foreign companies have the chance to earn higher remuneration fees if their costs are higher. Approval of expenditure by the government is considered to be significant in order to ensure the efficient and effective development of the field at the lowest cost to the Iraqi state. There have been growing concerns about the ability of institutions in the country to successfully

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[107] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.13

[108] Model contract, Article 9.20(c)

[109] Rumaila contract, Article 9.20(c)

[110] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.14

oversee the project considering the issues of the loss of expertise from the Iraqi oil industry since 2003.[111]

The fourth change explains that during the period of the auction, the specification made in the model contract states that if there is a suspension of oil operations for more than 90 days because of 'force majeure' which means an unforeseen event that prevents oil production, such as a natural disaster, industrial action, war or act of terrorism, this would necessitate an extension in the term of the contract accordingly.[112] This means that sharing of risks by delaying revenues for both sides is quite found reasonably considering the fact that it not the fault of any of the two sides. After renegotiation, the conditions change with the addition that in the event of a 90-day force majeure suspension, BP/CNPC would also be compensated from Iraqi public budgets for their lost income. In case the two sides are unable to decide on the nature of this compensation, international investment arbitration would be considered as a preferable option.[113] The full scale of the risk inherent in this state of suspension is completely transferred to the government. In addition, SOC is mandated to make provision for adequate security with the use of Iraqi armed forces and to carry liability for their actions and conduct. Foreign companies are also entitled to get a private security in case they find out that the security provided is not effective enough and charge the costs to the Iraqi state, as 'petroleum costs. Due to the inherent instability of Iraq's post-2003 political institutions and because of ongoing security risks and physical threats, foreign companies would not be charged for any human right abuses committed when defending their assets.[114]

The fifth change explains that during the auction time, the contract model stated the limited situations at which the foreign companies would not charge for consequential (indirect) damages.[115] After the renegotiation, the contract further expanded the scope of damages and losses that BP/CNPC would not be charged or found responsible for and in specific, the contract model listed damages to Iraqi oil

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[111] Ibid.
[112] Model contract, Article 31.4
[113] Rumaila contract, Article 31.4
[114] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.15
[115] Model contract, Article 24.4

reservoirs and formations to be included.[116] This became a huge opportunity for the foreign companies to maximize their profits making during the period of the contract without considering any damage done to the future prospects for the field. It is found out that under the sanctions from 1990 to 2003, the effect of under-investment and lack of access to international supplies and services made the oil industry in the country to produce oil from its fields in a way that damaged their long-term geological integrity. Furthermore, In order to optimize oil production for a long period of time, there is need for investment and careful reservoir management. It should be noted that, it is a normal and expected interest of every foreign companies to maximize their oil extraction during the period of the contract at the detriment of long term potentials in the country but it is also a duty of government to manage this situation in order not to destroy the future for the enjoying today. But this was found lacking on the side of Iraqi state after the renegotiation though in 2004/5, the government hired BP and Shell to find ways of managing the reservoirs so as to end the geological damage caused during the Saddam era.[117]

To conclude this part, it was found that during the early month of May, 2011, there was a discussion on whether there was any attempt made to renegotiate the content of this contract, which was found more cumbersome for Iraqi government. In this respect, the oil accepted the arguments of most analyst for almost 18 months concerning the fact that the high production targets set in the 11 oil contracts awarded in two auctions might be an impossible task for Iraqi state due to infrastructure constraints, and undesirable for their impact. Under the leadership of Minister Abdul-Karim al-Luaibi, the ministry officials now suggested 6-7m bpd might be more realistic rather than the contracted 12m bpd and they now proposed a need to renegotiate the contracts.[118] Some days later, the former Oil Minister Shahristani who

[116]Rumaila contract, Article 24.4

[117] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.16

[118] Tim Webb, 'Iraq halves oil output as reality replaces ambition', The Times, 5 May 2011

is now the Deputy Prime Minister for Energy rejected all the suggestions concerning renegotiation.[119]

What was lacking is this discussion was the way in which BP's secret deal became an obstacle to any renegotiation on the oil price. The original contract before the secret renegotiation stated that both the government and the foreign companies would share the risks of production being restrained by OPEC quotas or infrastructure bottlenecks. If this model contract remained unchanged then when the government wanted to reduce the oil targets production, it would have be of interest of the foreign companies and they would not have any problem to consider a new target they could actually meet. But the renegotiation of the contract transferred all these risks to Iraqi side in the sense that foreign companies get paid whether or not they produce the oil.[120] The oil ministry now realizes their mistakes on production rates but the model contract offered to BP during renegotiation deprived the Ministry of the opportunity to correct the mistake. The contract must be implemented in good faith.

4.4 TRANSPARENCY OF CONTRACTS

Both the government and people of the country have the right to be aware of the terms and conditions at which their natural resources are managed. It is very significant for this contract to be transparent enough in order to expose any abuse or wrong-done in the contract implementation. In this respect, it was found out that despite the fact the contracting in Iraq portrayed a significant level of transparency with a set of terms published in model of the contract; it later became apparent that the terms and conditions of these contracts were later re-written privately. On the 5th of April 2010,which is equivalent to over nine month, a version of the contract was belatedly posted on the Oil Ministry's website. This version, generalized for all fields, contained the important changes in the final Rumaila contract, as revealed in this contract. There was no significant explanation given on the account of why this new version is different from the official model contract published in the first place,

[119] Rania El Gamal, 'Iraq won't cut 12 mln bpd oil output capacity goal', Reuters, 8 May 2011

[120] To illustrate (rounding the figures to simplify), if everyone cuts equally, BP/CNPC would cut their increment from nearly 2m to about 1m bpd. So currently BP/CNPC are entitled to be paid for an increment of 2m bpd, even if they only produce 1m. Unless it offers extra payment, BP will be unlikely to accept only being paid for that 1m

indeed the Ministry continued to insist that no substantive changes were made. This necessitates the need to publish the final Rumaila contract, in order to confirm whether it contains the changes above, and to similarly publish all other contracts the Iraqi government has signed. Specifically, the situation seems that the un-awarded first-round contracts for West Qurna 1, Zubair and Maysan, were later granted to ExxonMobil, Eni and CNOOC, and these contracts adopted the same terms as the BP/CNPC contract for Rumaila. [121]

However, it should be noted that the leading international best practice in the extractive industries would be useful for a long-term development and operating contracts to be published. For example, this is standard practice is found practicable in countries such as; Azerbaijan, Bolivia and Congo-Brazzavile.[122] In addition, the International Monetary Fund gave full recommendations concerning publications of contracts with recognition that in practice, contract terms tend to be widely known within the industry soon after signing, so there is no commercial advantage lost by publication.[123] The US Treasury Department also calls for "presumption of disclosure" of contracts.[124] There would have been a requirement for publication of contracts, along with various other financial data and other information in the draft oil law in Iraq, which was approved by the Cabinet in February 2007, but never enforce by the parliament. Furthermore, Iraqi officials made a public notice that they publish the model of these contracts prior to the actual completion of the contracts.

For Example, in December 2009, Shahristani said on al-Jazeera that these oil contracts have been so transparent just like any other process in the world. "A copy of the contract is available, I can send it to you by email tomorrow; a copy is available to any Iraqi citizen and I would invite any interested person to come to my office and

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[121] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.15

[122] See Heike Mainhardt-Gibbs, 'Transparency of Extractive Industry Contracts: The Case for Public Disclosure', Bank Information Center, Oct-2007; Revenue Watch Institute, 'Contract Transparency.

[123] IMF, 'Guide to Resource Revenue Transparency, 2007', p.14

[124] U.S. Department of Treasury, 'Statement Concerning the Extractive Industries Review', JS-1841, 2-Aug-2004

ask for a copy, and it will be given to him."[125] This is found to be an empty promise considering the fact that the contracts have not been published yet and requests for copies by Iraqi oil experts and others have not been provided for. It is highly recommendable that if these contracts would consider the issue transparency better enough, the Iraqi Ministry of Oil is expected to publish its model on its website in their final form as they were signed. These should include the 2008 contract with CNPC for the alAhdab field, the eleven contracts awarded from the two oilfield licensing rounds, three gasfield contracts from the third licensing round, and (if completed) the contract with Shell/Mitsubishi for gathering, processing and marketing associated gas in Basra province. These would enable the citizens to monitor the implementation of the contract and ascertain their level of good faith and fair dealing.[126]

[125] JasimAzzawi interview with Husain al-Shahristani, Al-Jazeera English Inside Iraq, 18 December 2009

[126] From Glass Box to Smoke-Filled Room: How BP secretly renegotiated its Iraqi oil contract, and how Iraqis will pay the price. http://platformlondon.org/documents/glass-box-print-low-res.pdf, p.19

CONCLUSION

The principle of good faith has to do with the contracting parties only and it is applicable to all contracts formation and implementations. The significance of good faith is found relevant not only to the contracting parties but also every individual in the society when dealing with each other as well as the general performance of states in their relationship with each other within international environment as explained under international law. Every contract whether commercial, government or oil contract mandated a duty of good faith and fair dealing over contracting parties in term of performance and enforcement of the contract. Attempt has been made in the first and second chapter of this dissertation to buttress more on the meaning of good faith and its application to contract formation and implementation. In the second chapter of this dissertation, the implied duty of good faith and fair dealing in contracts was explained whereby the principles of good faith was examined in different cases. But it was found out that good faith is best applicable to commercial and government contracts, which oil contracts, could be classified under the two types. It is a contract made between the government and commercial or private companies over state resources (crude oil).

Furthermore, different types of oil contracts were explained in the third chapter of this dissertation whereby contractual types such as modern concessions; production sharing agreements; joint ventures; and service contracts were explained. Some problems were found in the evaluation of the principle of good faith in oil contract such as for the past 150 years of oil production, the nature of these contracts have not been disclosed due to some reasons on the side of the government and commercial sector. The issue of transparency made it difficult to ascertain which type of oil contract is used as well as it is possible for different types of oil contracts to be used base on changes that could easily take place in the contract model.This dissertation found out that the principle of good faith is of best advantages to the parties in the contract alone in order for them to be honest when dealing with each other. In this respects, business contracts of different forms would found these principles more advantageous in contract formation and implementations. Crude oil is a state property, which the citizens have the legal right to benefit from. The

application of good faith and fair dealing in oil contract could be found useful for both the state and foreign companies at the detriment of the citizens. This is the case of Iraqi and BPoil contract as explained in the last chapter of this dissertation, whereby the renegotiated contract favored the foreign companies and the government but at the disadvantage of the people. Good faith only cares about the contracting parties which made the case different in oil contract since the effect of this contract not only affects the contracting parties but the citizens in general. It can be concluded that good faith and fair dealing might be found relevant in the oil contracts between the government and the foreign companies but could be at disadvantage of the citizens and they consider the contracts not to be fair.

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