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Iraq and the Battle for Oil. A Historical Insight

Excerpt from The Control of Oil. 1977.

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Oil Companies Hold Down Production in Iraq

The following test is an excerpt from The Control of Oil (New York: Pantheon, 1977

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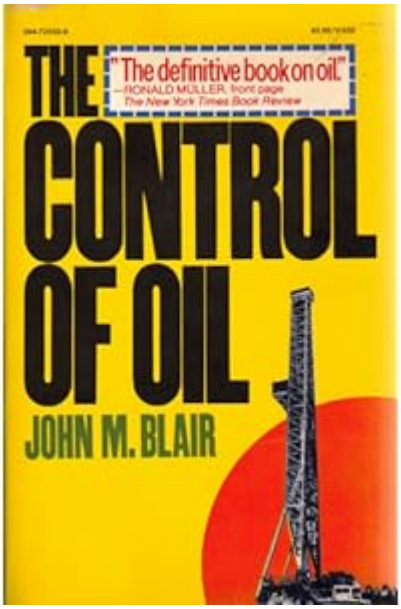

In this excerpt, John Blair shows how the US and UK companies held down production in their Iraq concessions, in order to maximize their worldwide profits. In spite of protests from the Iraq government, and opposition from their French partner, the Anglo-American companies maintained this policy until nationalization in 1972. In the last part of this excerpt, we see the active role of the US State Department in defending the oil companies' interests.

Although its original concession of March 14, 1925 covered all of Iraq, the Iraq Petroleum Co., under the ownership of BP (23.75%), Shell (23.75%), CFP (23.75%), Exxon (11.85%), Mobil (11.85%), and Gulbenkian (5.0%), limited its production to fields constituting only one-half of 1 percent of the country's total area. During the Great Depression, the world was awash with oil and greater output from Iraq would simply have driven the price down to even lower levels. Delaying tactics were employed not only in actual drilling and development, but also in conducting negotiations on such matters as pipeline rights-of-way. While such tactics ensured the limitation of supply, they were not without their dangers. If the Iraqi government learned that IPC was neither actively seeking new fields not exploiting

proved and productive areas, it might withdraw or narrow IPC's concession, or worse, award it to some independent willing and anxious to maximize production.

Suppression of Discoveries

From almost the beginning of its operations IPC not only suppressed production in Iraq (as well as in nearby lands) but went to considerable lengths to conceal that fact from the Iraqi government.

Of the many concession areas exclusively preempted by IPC, none was rapidly developed. IPC had held the area east of the Tigris River in the Mosul and Baghdad vilayets since1931, and by 1950 the only developed field was Kirkuk. Qatar is another illustration of "sitting on" a concession. Fearful that the area would fall to outside interests, Anglo-Iranian in 1932 obtained a two-year exclusive license for a geological examination of this peninsula. These exploration rights were expanded into a concession in 1935, and in 1936 were given to IPC under the terms of the Red Line Agreement. BP and Shell, however, were not anxious to develop more production in the Persian Gulf because of the effect this would have upon production in Iran. Although Mobil wanted more crude from the Persian Gulf, drilling did not start until three years and five months after the signing of the geological survey. A productive well was completed in 1939, and a few others were drilled after the war began; but in 1941, an official (Mr. Sellers) wrote: "….. as there is excess of petroleum products available from AIOC and Cal-Tex in Persian Gulf, it is obvious productive wells in Qatar will not be expedited at present time." Commercial production in substantial quantities did not begin until 1950- eighteen years after the first exploration of the area.

An interesting case of "technical compliance" is provided by IPC's actions concerning a concession in Syria. In 1933, IPC had obtained drilling permits in Syria, and two years later suggested that the Syrian government grant it a blanket concession over a large part of Syria, similar to the Iraq concession. Negotiations were opened for this purpose, but in view of the time which the negotiations would take, the IPC groups "agreed that the Company should drill shallow holes which would constitute technical compliance with Company's obligations, the Syrian government should be informed of the Company's intentions to do so." Negotiations dragged on and the British High Commissioner of Syria suspended the acceptance of any further drilling permits. But IPC was prepared to receive this blow with equanimity; the general manager wrote: "…..we have been steadily complying with the letter of the Mining Law by drilling shallow holes on locations where there was no danger of striking oil……."

However, when IPC encountered difficulty in getting the Syrian Parliament to ratify the concession, "serious drilling" was recommended by the High Commissioner and by the general manager of IPC. The latter wrote the secretary of IPC: "You should explain to the Groups that neither the High Commissioner, nor myself, are actuated by a hell for leather rush to find oil; we want to set up a convincing window dressing that we are actually working the concession……the High Commissioner can exert far more justifiable pressure in getting our concession ratified by the succeeding ministry than he would be justified in exerting if we merely stood by, content to watch events, doing nothing….."

In outlining to the groups the obstacles which stood in the way of obtaining better concession terms from Syria, the general manager of IPC also revealed the government's opinion of IPC: among the obstacles faced by IPC was the "Government's convinction that we did not intend to find oil, and if we found it we would advance a thousand and one

reasons for not producing it. In these circumstances my plan was to obtain terms that would be light to bear so long as we explored without result, whilst conceding to Government that if we did find oil, we would produce or pay."

Not surprisingly, IPC's policies of "sitting on" concessions endowed the company with the stigma of restrictionism. In 1936, the question arose as to whether IPC should negotiate directly, or indirectly through an intermediary, for concessions in Turkey, Saudi Arabia, and Yemen; the general manager of IPC stated that in his opinion:

> .....the indirect method.....might in the long run produce rather better terms than would be given to a company whose proprietors already hold many oil concessions, who have been identified with a policy of restrictive production, and whose object in obtaining fresh oil territory would not be associated with any irrepressible urge for intensive exploitation.By 1938, IPC's reputation for obstructionism had become firmly established throughout the Middle East. The general manager of IPC, who had been engaged in discussions on the Bahrein and Basrah concessions, described the attitude of the "various authorities and rulers" toward the IPC in these words:From the earnestness of their address in my conversation with various authorities and rulers on the subject of production, they will brook no sitting on concessions, regardless of what loopholes the terms may give us, particularly us, whom, one and all, they suspect as capable of cheating on production, the future leaves them cold; they want money now.

The pressure of governments and of public opinion appears to have induced IPC to dispense with some of its restrictions. In 1938, one oil company official wrote:

As regards the BOD and Basrah concessions it is the consensus of opinion of the Groups that it will be necessary to explore these concessions and if satisfactory oil is found, that same should be exploited, even though the production and the reserves from the IPC concession would amply cover the crude oil requirements of the Groups. We are led to this conclusion since we do not believe that public opinion or the Government would permit that these large areas were either left unexplored or unexploited if production were found.

World War II interrupted the operations of IPC in most of its concessions, and political disturbances handicapped its activities since that time. Yet even after allowing for these difficulties, in 1948 production in Iran was seven times larger than in Iraq, while in 1936 production in Iran was a little more than double that in Iraq. In Saudi Arabia commercial production did not begin until 1938, but by 1948 it was almost six times the production of Iraq.

The restrictive policies of the Iraq Petroleum Company during its early years have been summarized as follows:

Following the discovery of oil in Iraq in October, 1927, these three groups (BP, Shell, and Exxon-Mobil) employed a variety of methods to retard developments in Iraq and prolong the period before the entry of Iraq oil into world markets. Among the tactics used to retard the developments of Iraq oil were the requests for an extension of time in which to make the selection plots for IPC's exclusive exploitation, the delays in constructing a pipeline, the practice of preempting concessions for the sole purpose of preventing them form falling into other hands, the deliberate reductions in drilling and development work, and the drilling of shallow holes without any intention of finding oil.Restrictive policies were continued even

after a pipeline was completed, for in 1935, IPC's production was a shut back several hundred thousand tons. Moreover, for a time, a sales coordinating committee was established to work out a "common policy regarding the sale of Iraq oil." Again in 1938 and 1939, the Big Three opposed any "enlargement of the pipeline and the corresponding increase in production" on the ground that additional production would upset the world oil market. Although the Big Three eventually conceded to the demands of the French (CFP) for some expansion, no action was taken until after World War II.

While the restriction of Iraqi production during the 1930's had its roots in the generally depressed economic conditions of the time, the continued curtailment of Iraq's output after World War II stemmed from different causes. With the development of Saudi Arabia and Kuwait, the US firms- which owned 100 percent of the former and 50 percent of the latter- gained large-scale sources of supply that were far more attractive to them than Iraq, where their ownership interest was only 23.75 percent. A later complication was the emergence of Libya as an important and largely uncontrollable source of Middle East countries. To the question of whether Libyan output could be accommodated within the limits of the overall growth rate Page answered, "Of course, with Iraq down." Indeed, keeping Iraq "down" was the only means by which the high growth rates of iran and Saudi Arabia could be sustained in the face of Libya's expansion without creating a price-reducing surplus.

That the IPC continued its restrictive practices into recent years I corroborated by an excerpt from what Senator Muskie referred to as "this intelligence report," which he read into the record of the Senate Subcommittee on Multinational Corporations on March 28, 1974. According to the Senator, the report was "dated February 1967 and it has to do with this question of the potential in Iraq."

In 1966 a study was made of the geological, geographical and other petroleum exploration data of the areas of Iraq relinquished by IPC, Iraq Petroleum Co. The purpose of the study was to help government let new concessions and obtain more advantageous terms from foreign oil firms. The study indicated that the untapped reservoirs of oil in Iraq appear to be fantastic.There is every evidence that millions of barrels of oil will be found in the new concessions. Some of those new vast oil reservoirs had been discovered previously by IPC but they were not exploited because of the distance to available transportations, the heavy expense of building new pipelines and the fact that IPC has had a surplus of oil in its fields that are already served by existing pipelines.The files yielded proof that IPC had drilled and found wildcat wells that would have produced 50,000 barrels of oil per day. The firm plugged these wells and did not classify them at all because the availability of such information would have made the companies' bargaining positions with Iraq more troublesome. Many of these areas had been returned to the Government in settlement of the petroleum concession conflict between the Government and IPC.

Public Law 80

Word of IPC's restrictive practices could not be kept from the Iraqis indefinitely. The first concrete manifestations of their mounting happiness was the enactment in 1961 of Public Law 80, withdrawing IPC's rights to those areas in which it was not producing. The nature of the action was described in an internal State Department memorandum dated October 13, 1967, from Assistant Secretary Solomon to Under Secretary Katzenbach: "The Iraqis…….in December, 1961, took away over 99.5 percent could be returned to the company. All subsequent discussions have shattered on the selection of this crucial 0.5 percent – the

company insisting that it include North Rumaila and the government insisting that if not."

In response to a request from the Under Secretary, Andreas Lowenfeld of the State Department's legal office submitted a memorandum on "the validity and effect of Law No. 80 of December 11, 1961." Emphasizing the differences between the Iraqi action and "typical nationalizations, such as have recently occurred for example in Cuba or Indonesia," Lowenfeld pointed out: "Under Law No. 80, IPC's property as such has not been taken, and in fact IPC's operations have continued substantially unimpeded. What IPC has been deprived of is mineral rights granted in a number of concessions awarded by the government of Iraq. Thus, it may be argued that IPC's claim is at most a claim for breach of contract, and not a claim arising out of expropriation of property." None of the area expropriated, the memorandum stressed, was actually under production: "For the most part the area removed from the concession was unexplored territory, but the area included in several cases proven reserves. Our understanding is that IPC's production capacity (at least in the short-run) was not affected by Law No. 80….. The question of whether and under what circumstances the breach of a concession gives rise to a violation of international law is very much in doubt." If the matter were brought before some international body for adjudication, Lowenfeld warned, IPC on at least one point would be "fairly vulnerable," i.e., that the company had not governed its exploitation of Iraq's oil "solely according to the requirements of Iraq and the intention of the concession, but in accordance with the overall interests of the participating companies."

This issue could be raised with respect to the amount of exploration and production in Iraq; with respect to pricing and discounting policies followed by the company; and possibly also with respect to IPC's efforts to exclude competitors. Without in any way attempting to examine these charges in an international adjudication would not likely to be beneficial either Britain, France, and the United States…..A fairly substantial case could be made (particularly in an arbitration) that IPC has followed a "dog in the manger" policy in Iraq, excluding or swallowing up all competitors, while at the same time governing its production in accordance with the overall worldwide interests of the participating companies and not solely in accordance with the interests of Iraq. This of course has been one of the principal charges of the government of Iraq against IPC.

The memorandum concluded by stating: "While the legal issues in the IPC-Iraq dispute are numerous and complicated, law does not appear to provide solutions…….IPCs legal remedies are few, and we have no firm legal basis for telling independent American companies – let alone foreign companies – to stay out of Iraq.

State Department Pressure On Independents

Although lacking a "firm legal basis," top State Department officials were in fact exceedingly active in telling independent American companies to "stay out of Iraq," both before and after the submission of the legal memorandum. For example, on May 6, 1964, Governor Averell Harriman and other State Department officials met with E. L. Steiniger, chairman of the Board of Sinclair Oil Company, one of the largest companies without a Mideast concession. According to the Department's Memorandum of Conversation, Governor Harriman said that: "In the IPC case proved and probable reserve areas were taken away. We wonder whether it is wise for U.S. oil companies to approve this type of action which the same companies condemn in other parts of the world. . . . We hope you will not take any action which will appear to condone unilateral acts." In reply, Mr. Steiniger cited other instances (Peru, Argentine) in which Sinclair "had refused to enter the petroleum picture

since this would be to the detriment of an existing concessionaire," but he went on to refer to the danger that in Iraq "foreign companies—German, Japanese and Italian—would acquire concessions shutting Sinclair out." Governor Harriman replied: "We could not wish governments, such as Iraq, to get the impression that American oil companies can be pushed around." In return Mr. Steiniger alluded to the Achilles' heel of IPC's case: "Sinclair was not interested in taking proven areas which IPC wishes to exploit but Sinclair understands that many favorable areas in Iraq were drilled by IPC and then abandoned." Governor Harriman closed the meeting by suggesting that Sinclair "hint to the Iraqis that its offer is affected by what takes place between the GOI [Government of Iraq] and IPC." There is nothing in the record to indicate whether Steiniger conveyed this suggestion which, if accepted by the Iraqis, would have ruined his own changes of securing a concession.

Two weeks later, a similar meeting was held between Ambassador Jernegan of the State Department and James Richards of Standard Oil of Indiana, another large company lacking a Mideast concession. It would appear from the Memorandum of Conversation that this company (formerly a part of the old Standard Oil "Trust") evidenced a greater spirit of cooperativeness: "Standard of Indiana, he [Richards] said, has been very careful not to appear to do anything until it is clear that the company's action would not be infringing on the rights of another company. Ambassador Jernegan replied, 'That's what I wanted to hear you say.' He noted the worldwide repercussions which would emanate from Iraq's getting away with expropriation of IPC's concession territory, particularly if other American companies reached agreement with the Iraq Government prior to an IPC-GOI settlement. The ambassador was assured that 'Standard of Indiana would do no such thing.'"

By early July, the Department was able to report that it had successfully "interceded with all American companies which to its knowledge or belief have expressed interest in Iraq land concessions in order to deter them from making offers to GOI while critical IPC-GOI negotiations in progress."* In an outgoing telegram of July 8, Under Secretary George Ball stated, "The firms to which Department has spoken are Sinclair, Union Oil, Standard of Indiana, Continental, Marathon, Pauly, and Phillips. These companies have been responsive to Department's urgings and it is therefore incumbent on us to make same effort with any new American or American-affiliated company which appears to be entering Iraq picture."

Despite the fact that by the end of the year the Department had made its views known "forcefully and repeatedly to Sinclair, Continental and some 8 other companies," a cloud loomed on the horizon: "U.S. independents are becoming increasingly nervous lest other American or non-American companies get in ahead of them and cause them to lose out entirely." During the next two years the problem subsided as a compromise agreement was reached in 1965 between IPC and the Government of Iraq. But the agreement was never ratified, and in 1967 the issue resurfaced. The principal aspiring "poachers" (to use Secretary Rusk's term) were the Italians and the French. Here, the U.S. governments could engage in "harassment of majors," which, as Rusk noted, "dictates cautious approach to problem."

On May 13, the Financial Times of London reported a "'clash' of U.K., U.S., France and Netherlands with Italy over reported ENI [the Italian state-owned oil company] negotiations to take 20 million tons of crude from INOC [the government-owned Iraq National Oil Company] in return for leading role in exploitation of concession areas which were to have been explored by BP, Shell, Mobil and CFP." Protests were lodged with the Italian Foreign Office by ambassadors of the United States, the United Kingdom, France, and The Netherlands. According to Ambassador David Bruce, "Four companies and respective

government furious that Italians interfering with 1965 agreement." In this case, the gravamen of the Department's concern was made explicit: "Companies maintain ENI does not have outlets requiring 20 million tons. Thus their oil, taken as royalty in kind by INOC from IPC operations, would be released on world markets." At the same time, Ambassador Reinhardt in Rome called upon Foreign Minister Ortona to express the U.S. government's "particular concern." Ortona reported that ENI had "taken note" of the protests, but expressed the view that "in light of its own past experiences with major oil companies, it did not see why it should exercise self-restraint in this matter." The mere fact that ENI was a state-owned company, Ortona pointed out, did not mean that it was under the control of the Italian government: "There were limits to pressure Foreign Ministry could bring on ENI," given the fact that "Italy's long quest for sources of oil was [a] matter of continuing and acute public and political interest." Nonetheless, Ortona, said, a "warning" had been given to ENI by the Foreign Ministry. Whether because of the warning or differences over terms, the deal fell through.

Keeping French interests out of Iraq proved more difficult, and ultimately impossible. In the summer of 1967, Iraq passed a new law (No. 97) specifically barring the return of any known reserves to the IPC and giving the country's own Iraq National Oil Company the right to exploit those reserves either by itself or in partnership with other companies. Shortly thereafter a smaller French firm, ERAP, was granted a concession on territory taken from IPC. This was followed by a proposal on the part of the major French Company, CFP, that it establish a joint venture with the Iraq National Oil Company to develop the highly productive North Rumaila field. To the other IPC owners it was bad enough for outsiders to produce on lands IPC claimed as its own, but for one of the owning companies to do so seemed little short of treasonous. On October 13, senior officials of Exxon and Mobil met with Under Secretary Katzenbach "to urge Department to protest formally to GOF [Government of France] recent activities of CFP and ERAP that are detrimental to the interests of the Iraq Petroleum Company. Company representatives expressed their conviction that CFP has been pressured by GOF . . . by threatening to have ERAP negotiate for the venture if CFP does not."

A note was prepared, signed by the Secretary, for delivery to the French Foreign Office no later than October 18. While vigorously worded, its logic is somewhat difficult to follow. The fact that the Iraqi government would still entertain proposals from IPC related to the disputed areas is somehow twisted into an argument that Iraq recognizes "a continuing right in IPC to the areas. . . ." The same conclusion is drawn from the fact that the Iraqi government "has not attempted to cede any of the territory to other foreign oil interests." Yet the note itself ascribes this forbearance simply to the exercise of pressure on aspiring independents: "That no other companies have been granted rights to the disputed territory is due to the vigor with which the IPC shareholders and their respective governments have asserted the continuing effect of the concession agreement between the IPC and the GOI. . . ." That note also emphasized the danger of establishing harmful precedents: "The note also emphasized the danger of establishing harmful precedents: "The GOF must appreciate that the acquisition by French companies of territories claimed by the IPC can create precedents elsewhere which can weaken the security of Western oil rights and thereby adversely affect the national interests of France as well as of the United States." Yet how could developments in Iraq serve as precedents for countries where the growth rate had not been held down to less than half that of other leading Mideast countries, where proven and productive fields had not been suppressed for years on end, where misleading information had not been deliberately supplied to the host government and where, in the words of the

Department's own legal counsel, the company had not followed a "dog in the manger" policy?

The controversy escalated to a new height when on October 23, 1967, President Mostini of Mobil's French subsidiary met with Foreign Minister Giraud. Referring to protests lodged by Exxon and Mobil, Giraud commented that the "two letters had practically identical wording and seemed to have been written by same attorney." According to an account transmitted by the U.S. Embassy in Paris:

> He [Giraud] then strongly objected to part of letter raising possibility of legal action against CFP on oil eventually flowing from disputed areas. He asked how this should be interpreted. If this is simply a case of Mobil and Esso lawyers filing protests, French government would do nothing. However, if Mobil and Esso really contemplate legal action, the French government would consider this a declaration of hostilities and take appropriate action against the companies in France. Giraud stated frankly, "This is a threat." . . . Mostini acknowledged to us that Dica [the French regulatory agency] has unlimited scope for harassing local affiliate, can do "anything and everything under 1928 law."

It was not long, however, before the whole issue became moot, as Iraq moved inexorably toward complete nationalization, including the takeover of IPC's major producing property, the Kirkuk field. In 1964, the government established the Iraq National Oil Co. (INOC) for the express purpose of operating in those areas confiscated from IPC under Public Law 80; and three years later, the newly formed company was authorized to work in the expropriated areas. On June 1, 1972, all of IPC's properties were nationalized, and in March of the following year IPC formally accepted the nationalization. Perhaps because IPC realized that it had a weak case (as the State Department's legal counsel had predicted earlier), the company "desisted from taking legal action to prevent exports of Kirkuk crude." Thus forty-five years after it had brought in its first well in Iraq, the Iraq Petroleum Co. lost its rights in a land that was not only the original source of Mideast oil but remains a repository of "fantastic" reserves.

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