International Oil Companies-National Oil Companies Relationship

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Ladies and Gentlemen: Good Morning.

The past two years, I'm sure we all agree, have been the most cataclysmic for the oil and gas industry in many decades. That may also be true of other industry sectors, as the world has weathered an unprecedented financial crisis marked by the collapse of global credit markets, closely followed by the first global recession in history. But on top of that, oil and gas producers have had to cope with record volatility in the prices of the basic commodities they produce and sell, and massive uncertainty over future demand for those products.

Was there ever a time in the past 50 years when so many people questioned the conventional wisdom that the world's thirst for oil would grow for decades to come? Well, now we are at a fork in the road: One path winds through a rocky landscape of mounting environmental concerns - fears over issues such as global warming that are already driving profound changes in the energy consumption patterns of developed economies. Along this road, oil demand in the US, Europe, and Japan has already peaked and may soon start falling in other large economies, as policy frameworks increasingly aim for higher energy efficiency and lower carbon emissions. The other path resembles a motorway crowded with shiny new vehicles. These are the cars driven by the newly prosperous residents of emerging Asian and Middle Eastern economies.

Will the pent-up demand for private transportation in countries such as China and India be sufficient to keep global oil demand trending upwards over the long-term, or will the developing nations be among the fastest adopters of the energy alternatives that are starting to emerge? It is still too early to tell, creating an almost impossible planning scenario for oil producers who, for most of the past century, have assumed responsibility for keeping the world reliably supplied with affordable energy. To weather such uncertainty, many in our sector are now seeking new business models. They are also forging new alliances, in the hope of creating business structures that are more powerful, resilient and dynamic than the sum of their parts ... in short, more capable of negotiating the unexpected twists and turns of the road ahead.

In my speech today, I would like to examine the stakeholder relationships that have historically characterized the oil industry, and how they are evolving today. This is an important topic because the capital intensive and international nature of our industry makes such relationships essential. The ability to form alliances in which the interests of all stakeholders are appropriately balanced and aligned is therefore at the heart of the effective operation of our industry which, let's face it, remains crucial to global prosperity.

In the early decades of what I will call the global petroleum age, when it first became clear that oil would be the basic commodity underlying industrial and economic development around the world, the basic negotiations over oil exploration and development were conducted directly between the governments of sovereign states - often between heads of state. Thus, a historic 1943 agreement between King Abdel Aziz Al Saud of Saudi Arabia and the US president Franklin D Roosevelt set the stage for the development of the world's biggest concentration of conventional crude oil. Eventually, the statesmen and politicians charged either a cadre of technocrats or, in a few cases, private-sector industry, with implementing their agreements. Thus were born the National Oil Companies (NOCs) and International Oil Companies (IOCs) that remain important players on today's global energy scene. But even when private enterprise was sent forth to develop overseas oil resources, there remained a strong connection between commercial corporate interests and the national energy policies of the countries in which the new IOCs were based.

Until at least 1960, the top cards were in the hands of the IOCs and NOCs of powerful consumer states and the governments that backed them. In the first category, the US Standard Oil Company was the classic example. In the second, British Petroleum, as it then was, springs to mind. Those companies had the know-how, financial resources and ambition to drive ahead with large-scale resource development in far-off lands, but in too many cases without due regard to the disruptive effects of their operations on local communities, economies and cultures.

Thus, most contracts favored the more developed, better financed resources. Inevitably, this led to a resource-holder backlash, couched in accusations of colonial-style exploitation.

In 1960, five aggrieved resource holders formed the Organization of the Oil Exporting Countries (OPEC) at a historic meeting in Baghdad, initiating a seismic shift in the landscape of the global energy sector. What followed over the next two decades was a period in which the major oil producers quickly discovered they had considerable collective bargaining power and geopolitical clout by virtue of their ownership of vast reserves of a commodity that industrialized nations could not do without. Unsurprisingly, a number of oil producers, including the OPEC founders Saudi Arabia, Iran, Iraq, Kuwait and Venezuela, chose to take maximum control of their resources by nationalizing their oil industries. Others, such as the United Arab Emirates continued to allow foreign participation, but on much more stringent terms.

In short, during the period from 1960 to 1980, the IOCs and some quasi-IOCs, such as British Petroleum, found themselves on the back foot for the first time in their histories. Suddenly, instead of controlling more than three quarters of the world's oil proved oil reserves, they were on a path to controlling less than one quarter. As a result, the IOCs increasingly had to look to more marginal, remote and technologically challenging projects to maintain an adequate inventory of proved and probable reserves. Any that failed simply did not attract the capital they needed to survive. Indeed, many formerly powerful IOCs disappeared in the wave of consolidation that swept the industry in the 1980s.

While the more marginal nature of their operations meant that the IOCs continued to hone their technological powers, the combination of rising project costs and low energy prices that prevailed throughout much of the 1980s and 1990s meant that they had to conserve capital and human resources. Fiscal constraints, combined with the rise of Western environmentalism, meant that big oil companies were no longer broadly viewed as desirable employers, and many IOCs had trouble recruiting technical expertise. They reacted by outsourcing many specialized functions to oilfield services companies, which generally were agile niche-players that could perform the jobs more cost-effectively than the IOCs. There was nothing to stop these service companies from working for anyone who would pay them, as they gained in experience and competence and began to take on more complex projects.

For the most part, these NOCs had not been under the same sustained pressure as the IOCs and service companies to develop cutting edge oilfield technology. The oil reserves of most major exporting states could still be produced more simply and at lower cost than in the world at large. These NOCs were also quasi-government bodies with substantial social spending obligations that limited their resources for research and development.

For many oil exporting states, the solution has been to hire technically savvy service companies. This had two main advantages. First, there was less bad blood between the resource holders' governments and foreign oilfield services firms than IOCs. Furthermore, the service companies were broadly perceived as being more independent of Western government influence than the IOCs. Secondly, the oilfield services companies were content to operate under fee-based technical services contracts. They did not need to book reserves to satisfy their shareholders, as they operated under a different business model than the IOCs. Nor did they push for revenue sharing contracts, which were anathema to many resource nationalistic politicians and governments.

In 2002, the energy landscape shifted again, as crude prices embarked on an unprecedented seven-year bull run on the strength of surging Chinese energy demand. With the world anticipating an energy supply crunch, oil exporting states were again in the driver's seat. Moreover, their empowered NOCs were naturally ambitious to prove they had the technical competence to "go it alone". They began to demand more from foreign firms active in their oil sectors. Increasingly those included other NOCs - such oil companies controlled by the governments of energy consuming countries concerned about security of energy supply. The NOCs of oil-exporting countries, however, wanted technology transfer from their partners, as well as professional training for nationals - all of which would help them lessen their dependence on foreign expertise. At the same time, the governments of oil exporting countries wanted, and often got, a greater share of resource revenues. Libya, for instance, was able to renegotiate existing production sharing contracts on terms more favorable to the government.

As we all know, crude's great bull run came to a screeching halt in the middle of 2008. Since then, have we seen the pendulum swing back to favoring oil producers instead of consumers, from NOCs to IOCs? Not as much as one might have thought. To be sure, some tough-talking governments of oil and gas producer states have had trouble attracting international investment, and their capacity development and export projects have been falling behind. In our region, Algeria and Libya are two examples. Others, however, have continued to press for tough terms from foreign firms participating in their oil and gas sectors

Another significant development, I would contend, is the rise to greater prominence of regional rather than global or "international" oil companies.

Regional oil companies are not new, but previously mostly confined their activities to large politically stable blocks of countries such as North America or Europe. There, they have proved masters at coaxing maximum yields from those region's dwindling conventional oil and gas reserves and at tapping new unconventional hydrocarbon resources, such as Canadian oil sands, US shale gas and Australian coal-bed methane.

Now, partly as a result of the recent west-to-east shift in economic development, regional oil and gas companies are springing up in the developing world, where they are finding a growing need for their unique services and perspectives. This new breed of enterprise can offer distinct partnership advantages. The firms usually have roots in the regions in which they choose to operate and understand the local culture, or cultures. They can quickly build trust within their host countries and can help to build bridges between the various states in which they are active, vastly facilitating the development of shared infrastructure for such vital functions as transportation, marketing and domestic resource optimization. In a world still in the midst of one of the biggest, economic, social and political upheavals in history, private-sector enterprises that can play such a regional bridging role are more important than ever. Dana Gas is proud to be one of them.

So what can we learn from this tumultuous history? First, what are the main drivers of the power shifts I have just outlined? I would argue that there have been five.

Among the most important has been the relentless evolution towards economic globalization, which has helped establish oil as the pre-eminent internationally traded commodity. As global trade would now be impossible without oil, it has become the world's most strategic commodity, and the source of endless power struggles between producer and consumer interests.

Second, the world has undergone a profound shift from the age of "easy oil", in which cheap petroleum supplies fueled a revolution in the lifestyles of the citizens of industrialized nations, to a new reality in which "dirty oil" is viewed as a geologically scarce commodity that harms the environment. Consumers' ambivalence to what remains their most important transportation fuel, on the one hand as a lifestyle enhancer and on the other as a dire threat to the planet, has exacerbated consumer/producer tensions. It has also prompted a shift in emphasis throughout the industry from maximizing oil production to maintaining reserves.

Third, the fiscal regimes pertaining to oil production and consumption have evolved, not only due to the rent-seeking behavior of oil exporters, but also as the governments of consuming states have sought to derive revenues by taxing oil imports and consumption. This has also inflamed producer/consumer tensions, driving power shifts.

Fourth, the increased sophistication of many oilfield services firms has led to the development of new business models for international oil operations and a wider range of alternatives in the types of oil development contracts on offer and scope of oil sector alliances. This may prove to be a stabilizing factor, as it should allow the governments of producer states to adopt more flexible approaches to resource development.

Lastly, many oil firms have switched their focus from global to regional business development. This trend may intensify as industrialized nations, predominantly in the West, and fast-developing eastern hemisphere countries follow divergent economic paths.

Relationships will continue to be crucially important to the oil sector, and of course we want them to be healthy, not dysfunctional. From past experience, we can see that questions of resource ownership have be especially disruptive, so it is vital that oil and gas alliances should be based on a firm understanding that resources in the ground are the property of the host state and its people.

It would help if more host governments emphasized local economic benefits from what oil companies do best - finding and producing oil - instead of requiring them to supply infrastructure and social services that should really be the government's responsibility. An oil company would not be most rational people's top choice for building a medical clinic or administering health services, yet this is the type of corporate social responsibility activity that many governments expect us to undertake.

These examples illustrate that more care is needed to align the objectives of the resource owners and the companies that facilitate development. One way to align those objectives more closely would be for national and international firms to pursue joint ventures outside the host country's borders. This is a trend we are already seeing within our region, which is encouraging.

How has Dana Gas adapted its business model to the changing conditions in the global oil industry? For a start, we are regionally focused, and poised to benefit from the emerging trend to greater regional co-operation. In our approach to oil and gas development we prioritize supplying local gas needs. This is a regionally specific adaptation, as most countries in the Middle East face gas and electricity shortages. Importantly, this is one way we can leverage of core competence to exercise corporate social responsibility.

An extension of the approach is our Gas Cities concept, through which we promote the development of industrial clusters using gas as their main fuel supply or feedstock. Such developments should serve as a magnet for direct foreign investment, create local employment and help the host country derive greater economic benefit from its resources.

In keeping with out commitment to maintain close alignment between corporate and community objectives, Dana Gas is committed to sustainable development and mitigating the environmental impact of its operations. We believe that our focus on gas to replace more carbon intensive fuels is in keeping with that mandate.

Dana Gas values its private sector and government partners throughout the region in which it operates. Its highest aspiration is to venture together with those partners to assist communities with using energy resources more wisely. To this end, we are ready to foster bridging relationships that encourage regional energy co-operation, and to help our local partners expand their horizons.