

Iraq

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1. Introduction

Iraq's upstream petroleum sector witnessed three unprecedented interrelated developments post-2003: an opening to foreign direct investment; the offering of the most prized petroleum fields in a rather short period of time; and formulation of the basic model for long-term service contracts.

I would argue that if things go as planned and contracted, Iraq will become a major contributor to the world petroleum market; a magnet for foreign investment through the involvement of international oil companies, specialised service companies and other related activities; and could introduce a new but significant element in the legal and governing framework, which might have wide and lasting implications for the relationship between host developing countries and international oil companies. However, reality seldom coincides with expectations.

This chapter discusses the long-term service contracts in place for upstream petroleum development in Iraq. Due to the need to limit the extent of the analysis, the corresponding matters in the Kurdish region of the country are excluded, though a few references to the region are made. The analysis is based on the model contracts and, for verification purposes scanned copies of the signed contracts were consulted. However, because of non-disclosure commitment, no formal references will be made to any signed copies of these contracts. Also this chapter does not address matters relating to sub-contracting, or to contracts for front-end engineering and design, engineering, procurement and construction or other types of contract. Finally, limitations of space has prevented the use of data, statistics, annexes, maps and charts that are available on matters covered by this chapter.

Part 2 provides an updated review of petroleum upstream activities in Iraq with regard to exploration, development and production. Because of the importance of exports, a few paragraphs are also included on the expansion and diversification of export outlets.

The complexities, components and interconnections of the petroleum legal regime are addressed in part 3. This part elaborates on three major issues: petroleum law and relevant provisions, government take and payment to and privileges of international oil companies.

Part 4 sheds lights on the main features of and new development in Iraq's long-term service contracts. Further insight is provided in Part 5 on three critical current issues: the legality of concluded contracts, the situation of international oil companies who concluded contracts with the Kurdistan Regional Government, and

the reduction of production plateau targets and the renegotiation of contracts. The chapter ends with a few conclusions.

2. Upstream activities

The petroleum upstream sector constitutes the main pillar of the Iraqi economy. The national development plans, state budgets, the balance of payments and trade balance depend largely on oil production and consequent export revenues. Hence, the level and prospects of all economic activities in the country are affected by developments in upstream petroleum.

Ministry of Oil plans provide detailed information on the main components and direction of various activities within the upstream petroleum sector, while signed contracts illustrate the actual methods by which these plans are being implemented.

2.1. National Exploration Programme

Official Iraqi data issued in October 2010 shows proven oil proven of 143 billion barrels from known 66 oilfields, and this represent only 28% of the estimated oil in place, and proven gas reserves are estimated at 127 trillion standard cubic feet (tscf). Probable gas reserves are estimated to be 275-300 tscf.

The Ministry of Oil's plan for 2011-2014 aims to, "attain significant increase in the oil and gas reserves". Sources quantify these objectives as aiming at adding around 29 tscf of gas and 10 billion barrels of oil.¹

The National Exploration Programme with funding of \$644 million,² has three components: to hold a fourth bid round (which took place on May 2012); to launch massive exploration activities using national efforts and capacities; and finally to drill 12 exploration wells across Iraq.³

During the fourth bid round, 12 exploration blocks were offered: seven were gas-prone and five oil-prone. Only four blocks were contracted, three of which are classified as oil-prone.⁴

In the immediate aftermath of the fourth bid round the oil minister promised a new fifth bid round, stating that Iraq has more than 60 blocks ready for offer, and that preparations would start in few months for launching the round in which 10 to 15 oil and gas blocks would be offered. It is worth mentioning that Dr Shahristani, the Deputy Prime Minister for Energy, has reportedly asked the Ministry of Oil, "to sweeten the terms of the model contracts" for the new bid round.⁵

1 www.upstreamonline.com/live/article253707.ece.

2 Original data in Iraqi dinars converted at \$1= ID1168. See Ministry of Oil *Summary of the Four-Year Plan 2011-2014 for the Oil and Gas Sector* (February 2011) .

3 See www.upstreamonline.com/live/article253707.ece. However, the plan refers to 10 not 12 exploration wells.

4 For analysis of the fourth bid round pre and post the bidding event, see Jiyad, "The Forthcoming Exploration Blocks Bid Round in Iraq: Issues for Consideration" *Middle East Economic Survey Volume 54* Issue 23, June 6 2011, also posted on iraqog.com/oil/oillaw/jiyad62011.pdf and on www.iraq-businessnews.com/2011/06/06/the-next-iraqi-oil-round-issues-for-consideration/; and Jiyad, Ahmed Mousa "Iraq's Fourth Bid Round: Assessment of The Outcome" *Middle East Economic Survey Volume 55*: Issue 25, June 18 2012, also posted on www.iraq-businessnews.com/2012/06/19/iraqs-fourth-bid-round-assessment-of-the-outcome/.

5 www.iraqoilreport.com/politics/oil-policy/baghdad-re-asserts-itself-8522/?utm.

2.2. Expansion of development, production and export capacities

The second pillar of upstream activities comprises development, production and export capacities.

Most of Iraq's highly prized oilfields and three gas fields were offered to international oil companies through bid rounds and one by direct negotiation. International oil company involvement began through direct negotiation with the Chinese CNPC to convert the production sharing contract in respect of Alahdab oilfield, which had been concluded in 1997, into a long-term service contract, which was concluded in November 2008. The other oil and gas fields were awarded through three bid rounds between June 2009 and October 2010. A total of 15 contracts were signed covering 17 fields, including three gas fields and 14 oilfields.

The total oil production from oilfields offered under the first two bid rounds and from Alahdab will amount to 12.215 million barrels per day (mbd) when the contracted plateau targets are realised. Total oil production in the country would be even higher if oil production from other oilfields and those from Kurdistan are added.

Oil production also results in proportional volumes of associated gas. Technical information reveals that each million barrels per day of Iraqi crude oil produces 0.8 billion cubic feet per day of associated gas.⁶ Moreover, the development of three gas fields has a strategic importance independent from oil production.

Oil production is intended mainly to satisfy world demand as domestic demand for oil is limited, and any future expansion in domestic economic activities and improvement in the standard of living would not absorb even 20% of the projected plateau production. Therefore, most of the crude produced has to be exported. As a result expanding and diversifying export outlets are prerequisites to realising any level of production capacity expansion.

Without going into too many details on the likelihood of success, the Ministry of Oil adopted the Iraq Crude Oil Export Expansion Project to expand and diversify export facilities through the Arabian Gulf (8.5 mbd), Turkey (1.6 mbd), Syria (4.5 mbd) and even Jordan (1 mbd). Also there is a plan for a pipeline to deliver surplus gas to Syria and the Arab Gas Pipeline with a possibility of a connection to the port of Ceyhan (in Turkey) on the Mediterranean, or through Egypt and then on to the European network. To optimise the pipeline network and attain its export targets the Ministry of Oil signed a \$13.3 million contract in May 2011 with the Canadian consulting firm SNC-Lavalin.⁷

3. Petroleum legal regime

3.1 Petroleum law and relevant provisions

Legal regimes governing the petroleum upstream and midstream sectors are both complex and multi-layered, and some of their components are ambiguous.

6 This was based on an average gas to oil ratio for Iraqi crude after discussions with Dr Thamir Uqaily in September 2012.

7 www.iraqoilreport.com/oil/production-exports/iraq-moves-forward-on-strategic-pipelines-5673/?utm.

In Iraq, the pyramid of legal and regulatory frameworks governing the petroleum sector and its development (impacting its formulation and execution) is composed of many levels and each has a distinct authority and role within the framework of legal and legislative instruments.

At the top of the pyramid stands the Constitution, which provide the basic principles and constitutes the heart of the mandatory framework. Collective ownership (Article 111) and “highest benefit” (Article 112:2) are the most powerful core principles; participatory co-management (Article 112: 2) is a basic operational principle; encouraging private sector involvement, both domestic and foreign (Article 112: 2), is a necessary promotional principle; finally, existing laws remain in force until they are annulled or amended (Article 130), which is an important transitional validation principle.

The second level includes instruments specific to the petroleum upstream and midstream sectors comprises three broad categories of laws. The first comprises laws that existed prior to the Constitution and that remain valid such as Law 80 of 1961, Laws 97, 123 and 130 of 1967 on the Iraq National Oil Company (INOC), Law 101 of 1976 on the Ministry of Oil, Law 84 of 1985 on the Preservation and Protection of Hydrocarbon Endowment, Law 3 of 1997 for the Protection of the Environment; Law 113 of 1983 on Income Tax (and its amendment by Law 19 of 2010) and Law 22 of 1997 on Public Companies.

The second category comprises draft laws that have been stalled by political deadlock since early 2007, and therefore not actually enacted. This includes the proposed Federal Oil and Gas Law,⁸ the Iraqi National Oil Company Law,⁹ the new Ministry of Oil Law, the Revenue Sharing Law and the Public Commission to Audit and Appropriate Federal Revenues Law.

The third category comprises other laws which could have direct and indirect implications for petroleum related projects. Among them are Law 13 of 2006 on Investment, Law 64 of 2007 on Private Investment in Oil Refining, and Law 21 of 2008 on Provincial Powers.

There is a number of legal uncertainties, ambiguities and disparities that could affect the legal predictability of upstream arrangements, especially those involving international oil companies. Ambiguities and imperfections and different interpretations of certain constitutional provisions have generated daunting uncertainties on one hand, while reference has also been made to older, though still valid, laws on the other. This has caused some serious rifts between the legislative and executive branches with regard to their respective roles in the development of the upstream petroleum sector.

The principles enshrined in the Constitution have caused serious differences of

8 For further analysis of the Federal Oil and Gas Law see Jiyad, “Iraqi Federal Oil and Gas Law Revisited”. *Energy & Geopolitical Risk*, Volume 2, Issue 1 (January 2011); and Jiyad, “Federal Oil and Gas Law: Viability, Coherence and Functioning Perspectives”, paper sent to Iraqi Institute for Economic Reform as a contribution to the workshop on the Federal Oil and Gas Law, Baghdad, December 17 2011, and published at www.mees.com/en/articles/3496-federal-oil-and-gas-law-viability-coherence-and-functioning-perspectives and at www.iraq-businessnews.com/2011/12/20/federal-oil-and-gas-law-viability-coherence-and-functioning-perspectives/.

9 More analysis on INOCL is available from Jiyad (2009: May 2011)

interpretation, opinions, and generate ambiguities to the extent that observers find it necessary to resolve these ambiguities and make the required constitutional amendments.¹⁰

The most apparent and lingering problem is the legal status of contracts. While the executive branch – the Council of Ministers and the Ministry of Oil – considers that control of these contracts falls within its mandate and authority, others within the legislative branch – the Council of Representatives (Iraq’s parliament) – and outside think the government is illegally intruding on the parliament’s prerogatives. Informed legal and professional opinions tend to support to the position taken by the Council of Representatives.¹¹ Furthermore, international oil companies have expressed concerns about the legality of their contracts in the absence of a clear legal framework, although they accept the risk associated with such legal uncertainty. But many are worried that future governments and parliaments might cancel or radically modify these contracts, which might affect their economics. Indeed, during the March 2010 election campaign and in the immediate aftermath, political parties and groups declared their dissatisfaction with these contracts, and called for revision of them once the new government assumed office. That has been proven to be only election rhetoric this time.

(a) Regulatory bodies

Under the Constitution all legal instruments of the types referred to above are usually proposed by the government through the Council of Ministers (the executive authority), approved and enacted by the Council of Representatives (the legislative authority), and enter into force upon publication.

Accordingly, both the executive and legislative branches of government have their regulatory bodies, each with defined or assumed role and responsibilities.

The regulatory bodies within the executive authority begin with the relevant sector ministry, the Ministry of Oil. The Ministry of Oil prepares draft laws and refers them to the Energy Committee of the Council of Ministers, and the Council of Ministers approves the draft law after the State Consultative Council has confirmed that the proposed law is in conformity with the Constitution. Once the Council of Ministers approves the draft law, it formally refers the draft to the parliament for enactment according to the constitutional process.

This demarcation between the authorities, roles and functions of both the executive and legislative branches is not without its ambiguities. The cause of such confusion is the wording and terms used in Article 60 of the Constitution. That article, in its first subparagraph, mandates the President of the Republic and the Council of Ministers to present “draft laws”, and in its second sub-paragraph authorises “ten members of the [Council of Representatives] or ... one of its specialised committees” to present “proposed laws”.

10 Almost all Iraqi politicians express regularly and repeatedly the needs to address the ambiguities in the Constitution, especially with regards to the provisions pertaining to oil and gas issues.

11 Such opinions were expressed by three Iraqi lawyers, dated June 4 2009 and issued through the Iraq Energy Institute, and by Dr Akramulhaq Baker, an Iraqi lawyer, circulated by an email message dated August 13 2009.

The terms “draft laws” and “proposed laws” create rifts and different interpretations between the executive and legislative branches, which camouflages the positions and attitudes of the main political blocs in the country. The differences in interpreting Article 60 became apparent in July and August 2011 when two different versions of the Federal Oil and Gas Law were submitted. One was suggested by the parliamentary Oil, Gas and Natural Resources Committee and the other by Ministry of Oil as adopted by the Council of Ministers.¹²

More often than not, the relationship between the two most important regulatory bodies – the Ministry of Oil and the Oil Gas and Natural Resources Committee – is affected by the political situation in the country, since the chairman of the latter should, according to the established political order, not be from the same political bloc of the former. Therefore it has become normal to hear very different views among the members of Oil Gas and Natural Resources Committee on the same issue, reflecting their political affiliations.

(b) Types of agreement

Between 2004 and 2008, the Ministry of Oil concluded some 50 memoranda of cooperation with many international oil companies to provide, according to Dr Ibrahim Al-Olom, a former Minister of Oil, support in three major activities: joint technical studies, training and development, and technical consultancy. The international oil companies covered costs related to these memoranda, and their overall assessment is positive.¹³

The memoranda of cooperation helped the formulation of the technical support contracts, which were devised for implementation by the international oil companies during 2008 and 2009. These contracts focus first to halting the production decline of the major oilfields (Rumaila, Zubair, West Qurna 1, Missan and Kirkuk), and then increase production by 400-500 thousand barrels per day. The Ministry of Oil pays for both investment requirements and the international oil companies’ fees to achieve that target. Negotiations on these technical support contracts lasted from the fourth quarter of 2007 to mid-2008 without conclusion because of differences on serious issues.¹⁴

The Ministry of Oil then reduced the duration of the technical support contracts to one year. After that time they would overlap with the timing of bid rounds. The international oil companies refused the one year duration as too short for such contracts. Accordingly, the ministry abandoned the contracts to focus on the bidding rounds.¹⁵

12 For discussions of both versions, see Jiyad, “Brief Review of the Federal Oil and Gas Law Proposed by the Ministry of Oil” (August 2011) at www.iraq-businessnews.com/2011/08/30/new-draft-oil-law-expert-analysis/. And Jiyad, “Preliminary Remarks on the New Version of Oil Law” (the version proposed by the OGNRC) (August 2011) at iraqog.com/oil/oillaw/jiyadaug2011.htm.

13 I am very grateful to Dr Al-Olom and Mr Abduljabbar Al-Waggaa (former Deputy Minister of Oil) for useful discussions and information through direct communication on these memoranda.

14 Abdul Mahdi H Al-Ammedi, “Cooperation Policies with IOCs”, presentation made before the Symposium for Reviewing Iraq Oil Policy, Baghdad, Iraq, Feb 27 to March 1 2009 (in Arabic)..

15 According to Jabbar Luaibi, former Director General of South Oil Co, it was “a grave mistake” to call the contracts off, and he had recommended a five-year duration, but the minister refused that; see interview of May 20, 2009 at www.iraqoilforum.com/?cat=7.