

Iraq Draft Petroleum Law: An Independent Perspective

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Content

1.0 Introduction

2.0 The Draft Petroleum Law

3.0 The Negotiations

4.0 Concluding Remarks

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1.0 Introduction

1.1 Iraq may prove to have one of the greatest endowed petroleum resource base in the world, with oil potential reserves in excess of 215 billion barrels (mbpd) and proven reserves in the region of 115 billion barrels (bnb), which puts it on par with Saudi Arabia. Moreover, its finding and development costs are low – amongst the lowest in the Middle East. However, its historical maximum production rate in any one year has not exceeded 3.5mn barrel per day (mbpd), although its exploration and development history has stretched almost for eight decades. Iraq's oil production level historically has lagged behind its oil reserve capability and has not reflected its low extraction costs.

Present Iraq proven reserves can support a production plateau of 10 million barrels per day (mbpd) and maintain it for a decade. As such, priority should go to rehabilitation and production capacity build-up and not to exploration for quite a few years to come.

Planning oil field development for production capacity growth ought to be carried out on a composite master plan, which examines the capacities of the discovered and producing fields (including each producing formation within every field) from a technical and economic feasibility point of view. In the mean time, it should take into consideration Iraq's economic development plans and needs. This necessitates a centralisation of policy and planning.

1.2 Finding cost per barrel of oil is estimated at: <US Cent 0.5. Development cost per barrel of oil is estimated at: US \$0.5-1.0. This puts capital investment cost per 1 million barrels production capacity at US \$3 billion for expansion of existing production facilities and US \$6 billion, at the oil field boundary. These figures may go to up to US \$4.5 and US \$9 billion to account for security requirements and recent high oil equipment inflation cost. Operating cost per barrel is US \$1-2.

1.3 Today, Iraq's production facilities are either dilapidated, looted, sabotaged or war-torn to the extent that in September 2003, the country's production rate sank to around 1mbpd, in comparison to a pre-war level of March 2003 of some 2.8mbpd. Thus far, at the beginning of 2007, Iraq is producing around 2mbpd and exports around 1.5mbpd, a rate which is declining.

Iraq's oil industry has been governed by the concession oil agreements until the early seventies, and decrees and regulations since then. It is about time Iraq had a petroleum law that sets out clear terms and conditions for good oil and gas industry exploitation plans, policy and execution.

2.0 The Draft Petroleum Law

2.1 On the invitation of the Iraqi Minister of Oil, Dr Hussain Shahrestani, the Iraqi draft petroleum law was researched and drafted by a team of three independent Iraqi oil technocrats (including myself), who together have international, Middle East and Iraqi oil industry experience amounting to some 120 years. Invited to join the team was the Kurdistan Regional Government (KRG) Minister of Oil, but that did not materialise.

2.2 The law is based on Articles 111 and 112 of the new Iraqi Constitution, seen in the light of Articles 2, 49, 109 and 110, which broadly define the authorities and responsibilities of the Federal and Provincial authorities within the Petroleum sector.

In order to clarify the imprecise nature of these Articles and to work on the basis of a fair and sound interpretation, an objective and independent legal consultancy was sought. Interpretation of Iraq's Constitutional Articles Governing Oil & Gas was made by an independent legal firm and adopted by the Ministry of Oil (MoO).

In the forthcoming review of the Constitution it is expected that a large sector of the nation and in particular the large majority of Iraqi oil technocrats, will vote for modification of these critical Articles 111 and 112 governing the ownership of oil and gas and management of production, plans and strategic policy, respectively, in light of this legal interpretation. The draft petroleum law has been written on the basis of this legal interpretation irrespective of whether the review takes place.

2.3 The overall objectives of the MoO draft petroleum law is to optimise Iraq's oil and gas exploitation, maximise return, and unite the country and nation.

The draft petroleum law seeks uniformity of plans and policy throughout the country. It requires the MoO's consultation and participation with the Provinces. Supervision of oil and gas operations is shared between the Provinces and the central Ministry. The decision making process has built-in checks and balances to enhance transparency and anticorruption practices.

2.4 The law is investment friendly. It encourages private enterprise and welcomes the international oil companies (IOCs) to work in partnership with the Iraq National Oil Company (INOC). They have a recognised role to play in the transfer of up-to-date state-of-the-art technology, technical and managerial training of Iraqis, and in investment capital. Selection from among pre-qualified companies will be made through tendering in a transparent and accountable process.

Contract negotiations and decisions will be tasked to a high level Federal Oil and Gas Commission (FOGC) assisted by a Negotiating Entity and an independent

advisory Think Tank. However, the function and task of the later two entities has been changed in the latest and 3rd petroleum draft. Authority for signature is vested into the Council of Ministers by the Council of Representatives.

INOC will be an independent holding company, with affiliated regional operating companies with an interrelated directorship, to ensure proper communication and management as well as the participation of the Provinces. All discovered fields will be earmarked to INOC.

The central Ministry of Oil (MoO) will be tasked with the supervisory and regulatory role, in addition to the preparation of plans and policy in co-operation and participation with the Provinces. The 3rd draft had also tasked them and the Regional government of Kurdistan (KRG) with the role of negotiating oil and gas contracts

3.0 The Negotiations

3.1 As highlighted above, the overall objective of the draft petroleum law is to optimise oil and gas exploitation, maximise return, and unite the country. As such, the draft law was written by the drafting team to serve in the interest of the nation state as a whole, to apply equally to all parts of the country, with no margin for negotiation between the Federal Government and any one Region or Governorate or ethnic and sectarian groups.

3.2 The petroleum draft prepared by the drafting team was adopted by the MoO without modification.

However, with differences between rival sectarian and ethnic parties in the country at its peak, negotiations between the major parties have become the rule, in advance of democratic debate among the members of the Council of Representatives (the Parliament). The case of the draft petroleum law is no exception.

Hard negotiations have been taking place, essentially, between KRG representatives and the rest of the members of the Ministerial Committee, which was set up to examine and make recommendations on the draft petroleum law to the Council of Ministers. Once approved by the Council, the law would be passed to the Council of Representatives for ratification.

The KRG's position, expressed in their published Draft Petroleum Law, was based on a radical interpretation of the pivotal Article 111, allowing for the oil and gas in the Kurdistan as the property of the people of Kurdistan, not the whole Iraqi nation as an undivided asset. Their petroleum law is so designed as to contain terms and conditions vis-à-vis the Federal draft petroleum law, with a large margin for negotiation as demonstrated in their negotiating strategy.

As a result, the current negotiated 3rd draft, in my view, induce material changes that weaken the built-in checks and balances, which were carefully designed to ensure transparency and accountability. These changes do in fact compromise the interests of the nation as a whole, as explained below.

The Temporary Law for Administration (TAL), issued by the CPA, makes consultation or co-operation in the management of oil and gas resources by the Federal Government with the Regions and Governorates the only requirement, conditional on an agreed fair distribution of revenue.

The Constitution, however, requires consultation and co-operation in the management of resource. The draft MoO Federal petroleum law goes beyond that in sharing with the Regions and Governorates management and decision-making. It has been drafted for the interests of the nation state as a whole and to apply equally to all parts of the nation, with no built in margin for negotiations between the Federal Government and any one Region or Governorate.

3.3 The negotiations did not seem to start in earnest until the revenue sharing issue had been settled in principle.

The negotiations were slow, proceeding in a stop and go fashion over the last five months. An important break-through occurred around or just post the time when a senior KRG Minister stated in an oil conference in London on 8 December, 2006, that: following a recent definitive agreement between KRG and Federal Government negotiators over an acceptable scheme of oil revenue sharing, the KRG position on the interpretation of Articles 111 and 112 had changed and come into line with that of the central Government. He added that in due course, following the building of mutual confidence, the KRG might consent to the re-drafting of relevant constitutional articles. This was regarded by those Iraqis present as a genuine gesture by the Iraqi Kurdish nation acting in the common interests of the Iraqi nation.

Despite this declaration, however, the KRG official stand appears to maintain its earlier position of authority to negotiate contracts with companies independently of the Federal Petroleum Commission and without the requirement for its approval.

Another sticky issue is the KRG's half a dozen PSA contracts with small oil companies. These provide windfall profits well above and multiples of the norm reasonably required by the current draft petroleum law, in the order of an internal discounted rate of return of 60-100%. The central Ministry has decreed them unacceptable and without legal basis. Whether they are to be cancelled or, more likely, reviewed to be brought into line with the terms of the Federal petroleum law is another issue which is yet to be settled.

In my opinion, if the KRG maintains this position it would amount to a de facto rejection of Articles 111, 112 and other relevant articles of the Constitution, which task the Federal Government with the responsibility for the proper management of oil and gas resources. It would leave the door open for other Regions and Governorates to follow suit and set a damaging precedence. It could lead to diversified contract terms and conditions within a potential lack of transparency, accountability or the checks and balances built into the MoO draft Federal law.

However, recently a compromise solution has been reached. It would allow the KRG to negotiate contracts with companies in the presence of a representative from the central MoO and subject to the approval of the FOGC; and allow the KRG itself to re-negotiate existing PSA contracts to bring them in conformity with the Federal Petroleum Law, but their validity is subject to the approval of the FOGC. The wording is chosen rather diplomatically. However, it should not leave it subject to different interpretation or deny the FOGC having the final decision to approve or reject wholly or partly the negotiated contract.

The content of the 3rd draft petroleum law of mid-January was agreed among the Negotiating Committee, but has not been approved yet by the decision makers in the KRG. They, also demand to defer final approval until such a time when a complete, agreed and legalised package is finalised that includes laws for the establishment of INOC, petroleum revenue distribution and the re-organisation of the ministry of oil.

KRG approval has not been given despite the significant changes already made to the MoO draft during negotiations, which have adversely affected the process of checks and balances, and include changes to the management of INOC, efficiency and economy of planning and execution, amongst others. Among these are the following:

- a. The original MoO draft did not restrict the appointment of the INOC board of directors rigidly to the inclusion of members from the provinces and federal government as the latest 3rd draft seems to suggest. The original draft emphasised however, the need for INOC's independence financially and commercially. Such membership restriction could adversely affect the independence and efficiency of INOC's operational management.
- b. Furthermore, the latest 3rd draft stipulates that oil and gas exploration and development programmes need to follow the geographic distribution. While social justice may require it, nature unfortunately does not as the prospectivity for oil and gas is not equally distributed in all the provinces. The petroleum law could include such a provision, provided it does not affect the economics and efficiency of exploration and development operations.

c. The role of the independent advisory professional think tank, named in this 3rd draft as the Oil and Gas Independent Consultants Bureau (OGICB), has been considerably weakened and lacks transparency. Its former scope to examine all issues has been reduced to only those issues selected by the FOGC. The requirement to publish its annual report has been removed.

The appointment of its members is reduced to one year from five and the appointment requires unanimity of all the members of the FPC; a most strange rule, indeed. The appointments of the FOGC and OGICB members have been made to conform to Iraq's sectarian and ethnic groups; an alarming indication of politicizing the most vital economic commodity that concerns the nation when, instead, sound independent professional management is badly needed.

d. The FOGC has been enlarged from 9 to 20 or 30 members, depending on future development, which makes it more fit for a debating society than trustees tasked with a vital decision-making role on optimizing the proper resource development of the nation. Moreover, while its size has been inflated, its role has been considerably weakened. In fact, the negotiating role of the FOGC through the OGICB with regard to Kurdistan has been removed and given to the KRG. This is an invitation to the others to form Regions so as to follow suit without regard to the maturity of their institutions, and risking disharmony of practices which would neither encourage the major IOCs nor enhance the standards of the negotiated contracts.

e. The grant of rights to enter into development and exploration contracts, stated in the latest draft appears to emphasize the form rather than the quality content of the contract. It recognises the soundness of the contractor's qualifications, adherence of the negotiator to a form of negotiations process, and the use of model contracts, but does not examine the soundness of the terms and conditions agreed on. No contractor should be invited to bid unless it has been pre-qualified by the MoO in accordance with pre-set conditions and procedure. However, it is paramount that the proposed terms and conditions be examined by the FOGC and its OGICB to ensure maximum returns to the nation, as well as an adequate, fair and competitive rate of return for the contractor to operate efficiently.

f. The resultant checks and balances in the third draft are now insufficient to cope with Iraq's internal political complications, and are more of a façade, leaving the competence of authorities and the processes of the grant of rights open to manipulation by the political forces that prevail in today's circumstances in Iraq.

g. Further and critically for the future of Iraq's oil and gas industry, the balance of power in the management of Iraq's oil and gas resource would have shifted alarmingly from the Centre to the Regions.

h. The critical items that have been removed in the third petroleum draft are fundamental to professionalism, transparency and accountability. The principles are still there but the mechanisms for enforcing them, in a process of checks and balances within Iraq's current turbulent situation, have been removed or circumvented in a way that could produce damaging effects.

I would like to ascertain that this third draft law is extremely disappointing, in my opinion and that of Farouk Al-Kasim, a member of the drafting team.

4.0 Concluding Remarks

4.1 Without a central unified policy there will be disharmony and competition between INOC (operating on production and marketing its export oil to provide the state's income) and the Regions & Governorates (prioritising exploration for additional reserves that will not be required for many years to come), and among the various Regions and Governorates leading to disharmony and envy between the haves and have-nots.

Such development would cause instability which is discouraging to investment, as well as a multitude of damaging consequences contributing to fragmentation, instead of promoting the uniformity of oil and gas practices and the unity of the nation and country.

The Constitution has tasked the Federal Government with the job of management of the oil and gas resource management, not any one village, governorate or region. The initial draft law was drawn up to unify plans, policy and decision-making through participation (beyond cooperation or consultation) of the regions, governorates and the federal government at the centre without ignoring participation at the operating and supervisory processes.

4.2 Instability would lead to an unhealthy oil industry and would discourage the serious IOCs, who have the required knowledge, capital and markets. Iraq would then find itself accepting speculators with more promises than they can deliver, and the minor companies which do not have the capability to develop Iraq's giant oil fields.

4.3 IOCs, in my view, are advised to aim for urgently needed rehabilitation of the infrastructure, expansion of production capacity of partially developed fields, improving damaged reservoir performance, and to develop the many discovered but not yet delineated oil fields in partnerships with INOC, rather than going for extensive exploration for unnecessary new oil. A rush for exploration and development contracts at this particular juncture of Iraq's political and economic

development would be viewed as mortgaging the reserves of future generations. It would provide fuel to the view that the war was for oil.

4.4 There are today a number of damaging trends of 'Tsunami' dimensions, engulfing Iraq. There is a widespread lack of security and law and order, widespread killing for reasons of identity, ethnicity, sect, or for no reason other than criminal ends.

There is widespread lack of efficiency in government organisations and a near absence of institutional performance or sound management at the centre and, especially in the Provinces, in addition to a lack of investment and extremely high unemployment.

Action to reverse these damaging trends ought to be all embracing in nature, co-ordinated and united in approach, and having the welfare of country and nation at heart above all considerations. A healthy and robust oil industry would provide the revenue necessary for social and economic reform and the right environment for easing much of the above trends.

4.5 Last but not least I salute the stand of the MoO and the negotiators of the Federal government who were put in a position to reconcile two diametrically opposed views, the central MoO's view, and that of the KRG's radical and unacceptable interpretation of the constitutional articles governing oil and gas ownership and management. Furthermore, they have not been given their Federal government's full backing against the KRG negotiators who had all the backing and political support of their regional government.

Finally, I would appeal for a return to the spirit behind the declaration on 8th December by the senior representative of the KRG as a genuine gesture by the Iraqi Kurdish nation acting in the common interests of all the Iraqi nation.

