Iraq-Shell Gas Deal: Who occupy the driver’s seat?

Ahmed M. Jiyad

Vaksdal, Norway

Executive Summary

The Head of Agreement-HOA between the Ministry of Oil-MoO and Shell was signed and entered into force on September 22, 2008. A thorough and comprehensive examination of the said HOA had led to a number of discouraging conclusions all of which would indicate to detrimental impacts on the national Iraqi interests. The process and manner in which HOA was developed from inception to entering into force contravenes basic legal frameworks and thus can be legally contested. HOA would clearly and unambiguously indicate to Shell’s intention or possibility to acquire a position through this partnership that provide it with effective control to insure a prolonged capture of monopoly rent. Furthermore, HOA constitute and could create severe and effective restrictions that are tantamount to an unacceptable infringement on the country’s sovereignty in pursuing development policy to utilise its hydrocarbon resources. The presence or possible occurrence of any conflict of interest would results in significant erosion of Iraq’s interest and substantial financial losses over a very prolonged period. The potentiality and probability of abusive transfer pricing is considerable under “Economic Model” and the “Commercial Structure” of the agreement. HOA creates Joint Management Committee- JMC and vest it with enormous and powerful authority. In the mean time there is an alarming absence of any reference to good governance system to insure transparency, accountability and verifiability to provide effective oversight over JMC. Though HOA is supposed to be a preliminary and guiding framework, it contains clauses regarding “Legal Status”, international arbitration with defined forum, and “Termination”, all of which make HOA a binding document close to a contract!

Considering the fact that HOA entered into force on the day it was signed, MoO has established dangerous precedence of a “pre-emptive regulatory capture” attitude, which could seriously and gravely undermines the constitutional process in the country. It might be, or indeed is, too late for the executive branch to do anything to rectify the many deficiencies of HOA. The only option that is left to safeguard Iraq’s interest lies in the hand of the Parliament; it has the Constitutional power, the authority and the obligation to act immediately and address this HOA.

Introduction and Caveats

Probably it was conceived but definitely the agreement was constructed, formulated and drafted to let Shell occupy the driver’s seat. This is the conclusion arrived at after thoroughly analysing the text and the annexes of the “confidential” Iraqi-Shell “Heads of Agreement”/HOA from substantive, circumstantial, procedural and other perspectives.

This study aims basically at assessing HOA through contents as stipulated in its text, and whether the agreement coincide with and serve the Iraqi interests. The study is not a comparative feasibility of HOA as an alternative option to the national efforts through direct execution. Undertaking such techno-economic feasibility study with the purpose of identifying and selecting the best option requires good deal of economic and financial data,
and technical information derived from professional surveys and baseline situation analyses, which are not available for the time being. However, relevant questions will be aired in due course throughout the study.

The analysis is text-based and thus, one-sided interpretation will not be entertained and surely avoided. However, emphases will be given when possible interpretation is or could highlight detrimental consequences on the Iraqi interests. Long quotations from clauses of HOA are unavoidable since HOA is considered “confidential” and thus it is not assumed that the readers have its copy available for immediate referencing.

Also this study does not question the need for foreign investment, on the contrary it is in the views of this author Iraq has been deprived, for too long, from the benefits of such investment. However, foreign investment should adhere to the established norms and standard of partnership for development, and should not pursue exploitation, take advantages of opportunities, unequal relationship and one-sidedness.

Shell has originated the proposal for this agreement and submitted it to the Ministry of Oil on 22 January 2008. HOA was signed and entered into force on 22 September that year, and it would constitute the basis governing future cooperation between them. The purpose is “to establish a Joint Venture to reduce gas flaring in the South of Iraq and gather any gas for utilisation in the domestic and export markets”

HOA has a preamble, a “definitions” section, 18 clauses and three annexes, each on one page. The signatures appeared on page 13, and total number of pages, including annexes, is 16.

The following discussion and analysis of the agreement is done thematically covering the essential, if not all, components of the HOA.

A prolonged capture of monopoly rent.

Many provisions that were incorporated in HOA would clearly and unambiguously indicate to Shell’s intention to create the opportunity for itself, through the Join Venture, to acquire a position in this partnership that provides it with effective control to insure a prolonged capture of monopoly rent. This conclusion is evident from the following:

(a)- No location, producer or gas-type limitations: Many references, phrases and expression within HOA were made to broaden and expand the Joint Venture’s entitlement to the Iraqi gas regardless of the type of gas (free or associated), the producer (SOC, SGC or any other producer), the geographical location (within and outside southern Iraq). Examples of these provisions are: “any gas” (in sub (a) under Whereas), “any other areas” (Clause 1), “surplus Iraqi gas” (Clause. 2(c)), “pursue development of non-associated gas fields in southern Iraq” (Clause. 2(f)), “power generating .. and commercial power generation” (Clause. 2(g)), and to “all Raw Gas produced in the South of Iraq by either South Oil Company or any other producer” (Clause. 3(g)).

All above provisions would indicate to Shell ultimate aim to having strategic position through effective access to and control of Iraq’s gas, which could extend beyond the southern part of the country.

Moreover, the inclusion of sulphur (Clause. 2(e)) and power generation (Clause. 2(g)) would enhance Shell strategic significance even further and thus consolidates its pursuit to maximize the monopoly rent that it could generate form such a position.
(b) Duration of the Joint Venture. Under Clause 1., a long-term Joint Venture of “twenty five years extendable” was envisaged. While it is understandable to have a reasonable long duration for such project, the word “extendable” was mentioned without any restrictive qualifications. And thus it could have two implications; the first, the extension is mandatory not an option for MoO, and the second, “extendable” could mean, interpreted or construed as “renewable”, which in turn means for a similar duration, i.e., another 25 years. In other words, the Joint Venture could permit Shell to have at least a half century of a powerful and influential presence in this resource rich country and region.

(c) Deciding the “compensation” (not the price!) for Raw Gas is the sole prerogative for the Joint Venture and it has the right to “adjust” such compensation. Providers of such Raw Gas have no say in both setting and or adjusting the level of compensation or discuss the validity or verifiability of factors that led to such adjustment. (This issue shall be discussed further in item “Economic Model” hereunder.)

These provisions will logically lead to an imperative conclusion or outcome; a position through which the Joint Venture, and Shell accordingly, would have undisputed monopoly status for a very long period of time and thus would collect and capture a prolonged monopoly rent.

**Infringement on MoO/Iraq sovereignty and development plans.**

This agreement and the resulted Joint Venture places severe restriction on the MoO and any of its entities to undertake gas development efforts other than through or with Shell. Such limitations are tantamount to an unacceptable infringement on the country’s sovereignty in pursuing development policy to utilise its hydrocarbon resources. The followings are example of such provisions. “[T]he Joint Venture will be the sole gas company engaged in business,,, and providing gas for domestic and export markets” (Clause 3(k)).

This provision does not permit the MoO or any Iraqi entity, from engaging any company, private or public, in gas business no matter what the nature of such engagement is. Furthermore, neither MoO, any of its affiliated State Companies, and for that matter any other Iraqi entity, can or will be permitted to develop gas industry to satisfy domestic demand or for export.

A second paragraph asserts that MoO and its affiliates/companies “shall not participate in any similar Activities with any third party” (in the 2nd (ii), Clause 4).

This provision extends the infringement on the sovereign rights of MoO and its affiliates/companies to the extreme by including the expression, “any similar Activities”. This exclusive ban on the MoO and its affiliates/companies, which is an open-ended and very wide, is generated from the definition of “Activities” within HOA. “Activities”, in HOA, “means the activities relating to the Co-operation which are identified by the JMC to be pursued by the Parties”. In all practicalities, MoO under the said provision cannot even discuss any matter related to any such “Activities”!

The ring of limitations around Iraqi sovereignty is tightened and strengthened further by the following third example. MoO and any of its affiliates “shall not pursue any discussions with the intention of entering into a project [involving LNG export] with a similar scope to that set out in this HOA with any third parties.”, (Clause 7). It should be mentioned that this Cause 7
is about “mutual obligations”, and such limitation was meant to be impose on the Ministry than on Shell since such obligation on the latter goes without saying.

There could be a real possibility that the above clauses with such broad and open to different interpretation could jeopardise MoO’ efforts to develop the two gas fields, Akkas and Al-Mansuria, which are included in its first biding round, if Shell bid for them but fail. It is worth referring to the “arbitration” provision referred to in Clause 13 of HOA, and its possible restrictive impacts on MoO efforts in this regards.

Finally, neither MoO, nor any raw gas producers are permitted to supply gas to end users except through the Joint Venture, pursuant to Clause 3 (g) and the definition of “Utilisation” adopted by HOA. This means that MoO, SGC, SOC and any other producers cannot provide gas to power generation plants in the area or as feedstock to petrochemical industry or any gas processing facility etc unless it is done through the Joint Venture.

In conclusion, the above cited provisions and their possible impacts and implications could constitute or indeed could lead to impose severe restrictions on the Ministry and its efforts to utilise the country’s gas resources within its plan to develop the petroleum sector. Such severe restrictions are unacceptable gross violations and infringement on the sovereignty of the country and its endeavours to diversify the paths of developing its petroleum resources for the best benefits to the Iraqi people. Furthermore, it provides the Joint Venture with a de-jure oligopoly: a supplier’s monopoly created by legal instrument, HOA.

And from development strategy viewpoint, such restrictive provisions could eliminate or eradicate any comparative advantages that industrialisation and other economic activity should enjoy from the natural endowments such as gas.

Extra-territoriality and potential of conflict.

Specific provisions in this agreement would give the Joint Venture extra-territorial rights and privileges, in a contractual sense, over non-party entities.

Clause. 3(g), for example, asserts that “the Joint Venture will off-take and purchase all Raw Gas produced in the South of Iraq by either South Oil Company [SOC] or any other producer”

The question is what are the legal bases that give the Joint Venture this one-sided “off-take and purchase all Raw Gas” produced by totally independent entities, unless these entities inter into contractual relationship with the Joint Venture regulating such “off-take and purchase all Raw Gas” produced by them.

Its worth remembering that the parties to the Joint Venture are SGC (Not MoO) and Shell, and SGC, according to Clause 3 (a), was not nominated, or construed as the legal representative of MoO, though it was defined as Wholly Owned Affiliate of the Ministry. One could argue that SGC and SOC are both wholly owned affiliates of the MoO, and the latter coordinates the matters between its two entities regarding this. This might be the case, but that depends on the applicable Law of the Ministry and the Charters of SGC and SOC, as independent public companies within the structure of the ministry (Public Company Law No. 22, 1997, Article 1).

Leaving SGC and SOC aside, what about the “other producer”, especially if that producer is an IOC (resulting from MoO’ bidding rounds)? What mandate the Joint Venture or SGC has over such would-be other producer? And on what legal and or contractual premises such mandate could be established?
Since this is highly probable conflict-susceptive situation involving MoO, the Joint Venture and gas producers, it might require specific provisions for dispute settlement mechanism, which in turn introduce further complexities to different contractual regimes governing the involved producers.

In addition to the questions raised above regarding the legal mandate the Joint Venture might have over other producers, there are two specific issues of particular importance and significance: cost of installations from production (producer side) to gathering/transfer points (of the Joint Venture) and compensation mechanism for raw gas.

On the first issue HOA states the following, “such gathering and delivery at designated delivery/transfer points,..., as agreed and further detailed in the South Gas Development Agreement” (Clause 2.(b)). This sounds reasonable at first glance. However, HOA has very precise demarcation when it comes to delivery points for domestic sales, (Clause 3 (i)) states, “delivery points for domestic sales are the battery limits of the Joint Venture installations”.

The comparison between the texts of the above two clauses warrant the following conclusion: while Clause 2 (b) is not explicit and does not imply that the Joint Venture covers the cost of installations and transport from (producer side) to gathering/transfer points (of the Joint Venture), (Clause 3 (i)), on the other hand, it is very clear in its implications that cost of installations and transport from such “delivery points” onwards are to be shouldered by the Iraqi side, whoever that may be MoO, domestic consumers, another entity etc.

The financial aspects of this off-take and purchase Raw Gas complicates the issue even further and deeper and could generate further cause of conflict between the Joint Venture and raw gas producers. The unilateral determination by the Joint Venture of the level of compensation for the raw gas and its adjustment when needed is a very contentious matter since it could be done to enhance the financial gains of the Joint Venture on the expense of the gas producers. This shed further light on the necessity to examine thoroughly the final version of the “Economic Model” of HOA, before adopting it, as discussed next.

**The “Economic Model”**

HOA proposes an economic model to be used in deciding the compensation for Raw Gas, which the Joint Venture has the monopoly to off-take and purchase from the producers. Clause 3 (h) provides brief information on the model. The level of compensation “will be set as a fixed percentage of the revenues received by the Joint Venture for selling products”..., “at prices linked to international market prices”. Few issues deserve raising regarding this matter. First, what is the level of the “fixed percentage” and who will fix it and how? Will it be fixed by dictation or negotiation, by the Joint Venture unilaterally or through negotiation with the raw gas producers? Second, gas delivered by the producers could differ in quality, quantity, composition, location and pressure. How these factors are dealt with by adopting a presumably one fixed percentage to be applied to all? How these factors impact the products mix (gas, LNG, LPG and condensates) and how this would be reflected in revenue differentiation? Third, the above requires an elaborated system for measuring, registering, accounting and auditing starting from raw gas gathering points, through processing and production to selling and collecting revenues. Finally, there is a time lag between realised revenues (to the Joint Venture) and actual payment of compensation to the producers of the raw gas. The time lag has financial ramifications and the longer it is; it adds gains to the Joint Venture, and foregone interest/income, to the producers. The mentioned above Clause 3 (h) provides no answer to any of these queries.
The Compensation for Raw Gas, according to this Clause 3 (h), “will be adjusted (both upwards and downwards) if certain economic parameter such as the fiscal regime or cost structure of the Joint Venture undergo significant changes resulting from e.g. changes in the industry cost environment, gas composition and gas pressure.”

Again, HOA provides the Joint Venture with additional unilateral power regarding adjusting compensation for Raw Gas. Hypothetically, if cost structure of the Joint Venture reflects inefficiency, bad management and transfer pricing, then the Joint Venture has recourse to raw gas producers and reduces compensation for their gas. Furthermore, these conditions of unilateral power correspond to what the economic theory calls pure monopsony, where a situation in which the product, i.e., the raw gas in our case, of several producers is sought by only one buyer, the Join Venture, which has the power to decide and adjust the compensation for the raw gas at its own discretion. But since such power was granted to the Join Venture by decision it can be regarded, therefore, as de-jure monopsony and not a product of market forces and dynamics.

The MoO, according to the first paragraph of this sub-paragraph (h), will have “appropriate audit rights... on the realized revenues.” It should be stated that bookkeeping, auditing and verification of all records should be done in accordance with and in adherence to the relevant Iraqi laws and procedures. HOA cannot decide the degree and extent of the auditing procedure, extent and requirements, but has to comply with the legal requirements for conducting such function as stipulated in the relevant frameworks, such as the laws of the Board of Supreme Audit and of the General Inspection. It is worth mentioning that mixed companies, such as this Joint Venture, have to present their records and accounts for auditing and verification to the Board of Supreme Audit, Diwan al-raqaba al-maliya, pursuant to Article 133 (first), of the Private Company Law No. 21 of 1997 (as amended). Furthermore, limiting MoO auditing rights to “the realized revenues” implies denying the Ministry’s rights to audit all other items on the cost side of the operation. Imposing such restrictions on the Ministry role in conducting or requesting proper, full, complete and time-bond auditing jeopardizes Iraqi financial and economic interest. Finally, needless to say that project and joint venture involving transnational corporations with worldwide operations, such as Shell, presents additional auditing challenges and difficulties due to transfer pricing and inter-affiliate transactions, double taxation, headquarters overhead costs and the problem of double counting associated with it, jurisdictional limitation and access to information etc.

In addition to the above, Clause 3 (h) introduces another term, “fixed price percentage” without stating whether it is the same “fixed percentage” mentioned above or different. If the two terms are the same, then why confuse an already confused document? And if they are different, then what do they actually mean and for what purpose?

Another example of ambiguity and inconsistency in the HOA is related to who has the responsibility of formulating the economic model. While at the beginning of the second paragraph of Clause 3 (h) states the Model will be “developed by Shell and the Ministry”, the last sentence of the same paragraph asserts that, “Shell will provide the Economic Model”. Unless “developed” and “provide” has two distinct meanings with different implications, it is advisable to clear this matter and emphasising the role of MoO in developing, approving and insure proper use of the Economic Model.

HOA states the following regarding the qualities and purpose of the Economic Model. The Model “will with a reasonable degree of certainty calculate cash flows based on projected gas volumes, capital cost and operational cost, Raw Gas compensation and taxes.” The purpose of the model is to “assist the Parties in transparent way in the decision-making.”
Obviously, for the Ministry to make use of the model it should have unhindered access to all components upon which cash flows are based.

Finally, the inclusion of “taxes” and “the fiscal regime” among the factors affecting the compensation for raw gas is an indication of a manipulative approach to eventually reduce government revenues. This is because the compensation for raw gas is both a cost item to the Joint Venture and, eventually, a revenue item for Iraq/MoO, through SOC and other producers. The other revenue/income items, such as taxes, bonuses, royalties, etc are usually elaborated in the “fiscal regime” governing the Joint Venture, as well as the net returns or dividends on equity shareholdings. When an item, such as compensation for raw gas, is both a cost and a revenue item then reducing the compensation due to changes in taxes and fiscal regime would result in reducing government total revenues. The exact amount of such reduction depends on the specifics of the taxes, fiscal regime, the degree of changes in them, and propose formula that links such changes with level of compensation. The question here does Shell with its proposed Economic Model is trying an issue rendezvous, i.e., a return to similar situation of the “royalty expensing” issue of the mid sixties?

South Gas Development Agreement-SGDA

Annex 2 lists “Key points for the South Gas Development Agreement”. The agreement, which is binding, will set the framework for the envisaged development and the subject matter of the Join Venture.

The 10 key points mentioned in the annex 2 are very complex and important, and require high level of expertise and professionalism from related fields. What was surprisingly not mentioned in this annex are: the “Economic Model”, the transparency and accountability system, and auditing modalities. Considering the modus operandi and deficiencies of JMC and other flaws of HOA, as discussed in this study, it is highly advisable and recommended that MoO forms its own team to participate in all preparatory phases of SGDA. Leaving the matter in the hands of JMC and Shell is a recipe for unequal partnership with potential financial losses and contractual disadvantages, which in the final analyses compromise the Iraqi interests.

The “Commercial Structure”

HOA provides no specific clause explaining the financial complexity of what it calls “Commercial Structure”. Instead, annex three contains a graph of the said structure under title High Level Commercial Concept-Integrated, and characterised as “Most Confidential”, for discussion only.

The fiscal regime, which supposed to be a cornerstone in such a deal, is not included. It will be dealt with in during the course of preparation and finalisation of SGDA. It should be mentioned, though, that from the graph it appears Shell pays no taxes on its 49% of dividends. Tax exemption on a project such as this is totally and emphatically unacceptable indefensible and unjustifiable. MoO is therefore obliged to provide sufficient explanation on this matter.

Abusive Transfer Pricing

Experience with and literature on the behaviour of the Transnational Corporations/TNCs provide ample evidences on the pervasiveness of the abusive transfer pricing. To evade payments to the government of the host country the affiliates and or the strategic alliances of
the TNC tend to charge costs that are higher than the competitive value for goods, materials and services. The subject, methodologies and practices of transfer pricing, and allegations of transfer-pricing manipulations by TNCs are very complex issues, and the discussion about them covers and diverges between tax (double taxation) and managerial (efficiency) considerations.

Indications on possible occurrence of abusive transfer pricing are detected from provisions related, among others, to Shell’s strategic alliances (Clause 3), Shell’s Obligations (Clause 5), Cost and Expenses (Clause 8), Quick Win Assets (Clause 9).

The possibility is further enhanced by the way the JMC decision making is formulated and the apparent weak auditing role given to MoO under the agreement.

**Assets Evaluation for SGC’s Equity Shareholding**

Evaluation and estimation of the present value of various existing assets, installations and relevant infrastructure is crucial, complex and difficult. Accurate evaluation and estimation of existing assets decides the magnitude and composition of the Iraqi side's equity shareholding in the Joint Venture.

The fact that some of these assets were installed during the decades of the sixties through to the eighties, the assessment of their current conditions, requirement for refurbishment, repair and configuration to fits with the technological blueprints of the Joint Venture, is not an easy matter. Accordingly, assets valuation has to be made professionally and objectively by an independent team with relevant backgrounds and expertise.

According to Clause 3 (f) the South Gas Company-SGC “will contribute its equity shareholding [a 51 %] as a combination of existing assets (based on a jointly agreed evaluation) and the balance (if any) by cash”.

The problems with this paragraph are many. First, the expression (jointly agreed evaluation) implies evaluation ‘done and agreed upon’ by the two parties i.e., the equity shareholders SGC and Shell or ‘done by one party, in this case SGC, and agreed upon by the other party, Shell’ or ‘done by a third party and agreed upon by the two parties.’

Nothing in HOA that could indicates to any one of these three possibilities. Neither Clause 6, which outlines the MoO obligations, nor Clause 7, which addresses the mutual obligations, contains provisions leading to or suggesting such (a jointly agreed evaluation), by the Parties to HOA, unless JMC decisions are considered as jointly agreed evaluation. In that case it is legally and professionally far from been accepted as jointly agreed evaluation.

But what was mentioned in HOA, though, under Clause 5, which could be the reference points for such evaluation, namely Shell’s “verification surveys”, “initial assessment”, “refurbishment requirements” etc of the existing related assets such as “compression stations and field gas treatment units (Clause 5,(i) B); “pipelines and LPG storage and loading terminals (Clause 5,(i) C); “North Rumaila and Khor-Al-Zubair gas processing plans” Clause 5,(i) D) etc.

There is an obvious conflict of interest here on the part of Shell: It has an interest to reduce the value of SGC’s assets in order to increase the “cash” component of SGC in the equity share. That cash component will be used to finance the Joint Venture requirements from various equipments, installations, services, etc in accordance with the “project development/framework agreement(s)” prepared by Shell! (Clause 5, (iii) and (vi)). And when the Joint Venture “will procure technology, technical support and related matters from Shell
and/or its affiliate(s) who will be the lead provider of technical and operational support to the Joint Venture” (Clause 3, (c)), then conflict of interest becomes crystal clear.

Iraqi Private Company Law No 21 of 1997 under which the Joint Venture Company will be formed and operate according to Clause 3 (a), stipulates, in Article 29 (Second, (1)(2)), the following regarding assets evaluation: the evaluation be made by a Committee, agreed upon by the Company Registrar, composed of experts in Law, Accountancy and the related working field. The evaluation has to be professional and objective.

Information available indicates that since the sixties, Iraq started utilisation of gas and by 1976 completed 1st phase of South Gas project. During the eighties, South Gas that cost Iraq over $2 billion was completed and started operation through cooperation between SCOP and many international companies. The facilities are still there and some are still in operation, at different levels of technical and operational conditions.

It is abundantly clear that HOA provisions regarding asset evaluation is both ambiguous and does not rise to or satisfy the minimum acceptable standard. Furthermore, it contravenes the requirements referred to under Iraqi Private Company Law. In conclusion, Iraqi assets evaluation envisaged under HOA that is made by JMC based on Shell surveys and opinion is and should not be accepted.

One could suggest different approach to assets evaluation by an independent third party, or a parallel valuation, involving former Iraqi oil professionals to do the valuation, or to participate in a mixed-team valuation, to assess and verify the accuracy of the valuation or to act as arbitrators on assets valuation.

**The New Partner**

According to Clause 10 the MoO “has indicated a desire to include an additional international company to participate in the Joint Venture”. In fact many provisions in HOA could work against MoO “desire”.

To begin with, instead of MoO decides who that New Partner would be, it is Shell who “shall use its best endeavours to introduce,…, and lead any discussion with the potential New Partner” (Clause 10. (a) and (c)). To maintain the majority equity for SGC, Shell equity share of 49% will be revised “upon inclusion of a New Partner” (Clause 3 (a)). It is therefore against Shell interest to include an independent, i.e., outside Royal Dutch Shell Plc., as New Partner to the Joint Venture.

Provisions were incorporated to discourage a serious independent international company from accepting such partnership. The composition of the Joint Management Committee-JMC does not cater for inclusion of representative of the new partner, but it “may allow for attendance of an observer nominated by a New Partner” (Clause 4). An observer is usually has no authority for or influence on the decision process. Furthermore, its full name will not be announced but will be “referred to as the “New Partner”” (Clause 10. (b)). A partnership that remains anonymous creates no benefits for the New Partner on the stock exchange, which requires full name disclosure.

Finally, the insertion of the phrase “unless agreed otherwise by the Parties” in Clause 10 sub (d) could eliminate the need altogether for a New Partner if Shell fails to or does not “introduce” the new partner “within 3 months after signing of this HOA”, as stipulated in sub (c) of the same Clause.

The role of MoO regarding the New Partner issue is passive, week and submissive.
The conflict of interest that is so obvious would make one wonder about the “Business Ethics” that the Joint Venture shall adopt. (Clause 3. (d)). It is, therefore, very surprising that MoO have accepted such provisions undermining its role and compromising national interests.

Also this is the second case in which Shell’ has a conflict of interest situation.

**Partners’ Roles- effectiveness and symbolism**

A comparison of the depth, length and substance of clauses 5, 6 and 7, which defines the obligations of Shell, MoO and both respectively, would lead to the following conclusions: while the role and obligations of Shell (Clause 5) are very elaborated and qualitatively very substantive and significant, which enhances the effectiveness of its role, the role of MoO (Clause 6) was confined to a provider of data, resources and employees; a facilitator to obtain approvals and access rights; and the signing of definitive agreements. The mutual obligations (Clause 7) were very brief but extremely confined to and restrictive on MoO for the interest of Shell.

The qualitative differences in the roles that would be given by HOA to MoO and Shell, and their probable implications are dealt with in other parts of this study as well.

**The Joint Management Committee- JMC.**

The JMC is the fundamental organ in the implementation of HOA and prepare all the necessary requirements for the Joint Venture. To do so HOA vests JMC with enormous and powerful authority, which could supercedes those of MoO and Shell as well. Clause 4 of HOA contains and provides many provisions related to JMC, which are controversial and confound and thus need further scrutiny, from structural, organisational, functional and procedural aspects.

**Purpose of JMC:** Clause 4 of HOA gives the impression that JMC is an interim management structure with transitional responsibilities directly connected with the activities that have to be done during the validity of the HOA. The role and responsibilities of JMC would, therefore, end once the Joint Venture Company is established with its own management structure in place.

But the first paragraph of the said clause implies much broader functions that extend over much longer period, when it states as objectives of JMC is “to facilitate and implement the Co-operation”. The reference to “Co-operation” complicates and even confuses the matter. HOA defines “Co-operation” in a complicated fashion. At the end of Clause 3., it states (The Joint Venture and activities described in Clauses 1 to 3 are together referred to as the “Co-operation”). And “Joint Venture” was defined very broad, in Clause1, “The Parties agree to jointly evaluate the potential establishment of a long term (twenty five years extendable) Joint Venture in relation to the “South of Iraq” (...) and any other areas as may be agreed by them, between the Parties and/or their affiliates”. Furthermore, Clauses 1 to 3 refer to various activities and projects with regards to associated and non-associated gas, sulphur, power generation etc.

From the above it appears that JMC is the entity that will be responsible for every thing related to or projects agreed on within the duration of the Co-operation, 25 years extendable. But this seems neither possible nor feasible.
Furthermore, there is clear inconsistency in the decision-making processes mentioned in clauses 3 and 4: while Clause 3 (b) states “a decision making process whereby all decisions will be made with the approval of SGC and Shell”, Clause 4 confined the decisions with JMC.

**Composition:** JMC is composed of three senior managerial and commercial representatives one of them is the co-chair, from each of MoO and Shell. These representatives are nominated, and may be changed by their respective party through giving written notice to such effect.

Few observations are due here: first, it is not clear why the representation in JMC was limited to “managerial and commercial” professions only, which, if interpreted narrowly and strictly, it could exclude other professions such technical, legal, economic, engineering etc. Furthermore, the number of three members from each side permits the selection of the third representative from a third different but relevant profession. Second, the composition does not provide room for representation of the New Partner if and when this new partner joins in the partnership (this is discussed further under item New Partner)

Furthermore, the structures and compositions of the “specialised working group committee(s)”, referred to in Clause 4, were not defined and it is not clear if they are also composed of equal members, appointed by each party respectively.

**Decision making process:** JMC decisions are taken unanimously by at least two members, one from each party’s representatives, according to the “quorum” provision in Clause 4.

Before going further it is worth discussing the essence of this decision-making process:

First: unanimity. Though it is good and some times desirable to make decisions unanimously to insure smooth functioning of the operations and flow of management, it in the mean time could prove to be cumbersome and derailing for such functioning by having each party a veto power on the other party. It could create delays, gridlock and thus generate inefficiency. However, the unanimity condition in HOA is a natural outcome of this strange specificity of quorum that is limited to one natural person from each side: when there are two members only they either agree or disagree since there is no majority here! Such a quorum is, by intention or incident, a misleading interpretation and wrong application of the “one third membership” practice and usual rule in attaining quorum as established in the Law of Corporations regardless of the type of the corporation- Closely or Publicly Held Corporation.

To solve this matter there are three options: 1- Redefine quorum by increasing the number to two representatives from each party within the current number JMC membership (meaning a quorum of two thirds of each side); 2- Increase the membership to JMC to 12 members to retain a quorum of one third membership from each side, or 3- Specify a quorum of specific equal number over than one from each side regardless of the total number of JMC members that can be between 6 and 12 members.

Second: Neutralising the advantages and privileges of the majority shareholder’s status (if JMC purpose is linked to the Co-operation, as discussed above). It is known that the majority shareholder(s) has two interrelated advantages and privileges: a voting power in decision-making and the dividends on equity shareholding. What follows is that the erosion of power in decision-making the majority shareholder could lead to, effectively, lower dividends on its equity share, than it, nominally, receives and thus incur financial losses due to what I may call “diverting revenues”.
HOA has practically eliminated the privileges of voting power in decision-making within JMC through the unanimity condition, which implies equality, and by limiting the quorum to two persons. This by itself constitutes structural deficiency or irregularity that questions the legality of JMC, validity and enforceability of its decisions, since it contravenes an established principles in the Law of Corporations. Managerial decisions affects, in many ways, the functions of the Joint Venture, its contracts, agreements, the procurement of instruments, supplies and services, installation of facilities, and all other factors related to the “cost” components on the production function. On the other, managerial decisions are also critical on the revenue side from sales to domestic market and to export. Return on equity shareholding (the dividends) is a function of all the above. Incidents of transfer pricing, restrictive supplies and service providers, unilateral purchase of equipments (such as “Quick Win Assets”), insistence on “strategic alliance”, etc probably, or could be indeed definitely, lead to Shell have, in effect, higher return on its, nominally, equity share of 49%. This equally means SGC will, effectively, have less return on its, nominally, equity share of 51%.

But this is not the end of the story!

Furthermore, there could be a situation in which a majority shareholder representative becomes a minority in decision-making case. A meeting, attended by one representative from MoO and the three Shell representatives, satisfies quorum requirements, but creates an environment in which the MoO representative is a “de facto minority” in the decision – making process: in terms of number of attendants, time slots, one-versus- three background diversity, etc. Reconstruction theory would suggest that such meetings could be planed to discussing significant matters and taking crucial decisions regarding them when such matters are in favour of Shell, such as approval of (Quick Win Assets).

**Binding decisions**: JMC decisions are binding to both Parties, i.e., MoO and Shell, and other members of JMC. Actually, there are provisions, which give JMC decisions superiority over the MoO. One of MoO’s “obligations”, under Clause 6 (iii), is to “make appropriate resources (as agreed by the JMC) available,..., with the timeline agreed by the JMC”. And under Clause 6 (vi) MoO is further obliged to “provide employees (in such numbers and for positions as the JMC agree),..., The Ministry will nominate such employees. The JMC shall approve or disapprove such nominees.”

Apart from the wording of the above provisions, which give an individual (i.e., decision taken through quorum) appointed by the MoO supreme authority over the same ministry, such obligations could have de-capacity effects on MoO. As its known the Iraqi oil sector suffers from severe brain drain due to past and current conditions were thousands of professionals and expertise had left the country. By obliging MoO to provide employees in the number and specialisation solely decided by JMC puts heavy tool on the MoO staff and could deprive the ministry from the few expertise it has and surely need.

There is, moreover, efficiency issue here that worth considering. When JMC has the undisputable power to request from MoO specific number of employees, from any professional background and at timelines specified by JMC, and all are provided free of charge then efficiency considerations are bound to be compromised or forgotten. Simply, cost-free human resources are susceptible to wasteful and inefficient utilisation. This represents an economic irrationality to move human resources from a structure (MoO) that suffers already from a shortage in such resources to another structure (Joint Venture/Co-operation) that could under-utilise them. Additionally, JMC has the prerogative to veto any nomination by MoO, and thus request replacement. This could lead to JMC making the “selection” of what it wants from MoO’ manpower.
The authority given to JMC by virtue of the mentioned above provisions would, in all practicality, have a contractual Dutch Disease but with under-utilisation of scares human resources of the MoO. Ironically, there are no corresponding obligations on Shell!

JMC decisions regarding “cost” matters are also significant and, thus, deserve careful attention. Pursuant to Clause 8, JMC defines and agrees on a “cost recovery mechanism” and the “mechanism shall be approved in writing by the Parties” of any costs and expenses due to any third parties when used “by either Party (including its affiliates) to undertake any work”.

JMC can apply the cost recovery mechanism retroactively, “Any third party costs incurred prior to the first JMC meeting will be presented to the JMC to determine whether such third party costs will be cost recoverable”.

Furthermore and pursuant to Clause 9 (a) and (b), JMC approves the “Quick Win Assets”- QWAs, which Shell has “already identified and proposed” and “may identify further for additional Quick Win Assets”. The cost of goods, services and materials in relation to QWAs that are paid by Shell will be treated as part of the equity shareholding as defined in Clause 3 (f).

Cost items covered by clauses 8 and 9 are highly susceptible to abusive transfer pricing practices. Experience with, and literature on, the behaviour of the Transnational Corporations/TNCs provide ample evidences on the occurrence of the abusive transfer pricing. To evade payments to the government of the host country the affiliates and or the strategic alliances of the TNC tend to charge costs that are higher than the competitive value for goods, materials and services they provide. It should be mentioned that the subject, methodologies and practices of transfer pricing, and allegations of transfer-pricing manipulations by TNCs are very complex issues, and the discussion about them covers and diverges between tax (double taxation) and managerial (efficiency) considerations, and these are beyond the scope and purpose of this study.

Finally, the costs of approved QWAs are reimbursable to Shell by MoO if HOA terminates, as Clause 9 (c) stipulates clearly. Obviously this provides Shell with an edge and leverage, and thus restricting MoO freedom.

The above review shows JMC decisions are effective and final. However, recalling the quorum conditions to make such decisions would lead to a possibility that only one representative from MoO within JMC could contribute to decisions that are not in favour or protect the interest of MoO. Since HOA does not provide MoO with clear recourse rights or authority to question such decisions or request their revision, MoO has no other option but changing the representative(s). But this has no meaning or effect when harm was done.

What make this issue of JMC decision making so cumbersome and unacceptable is the alarming absence within HOA of any governance system, which guarantees transparency, accountability, verifiability and auditing of costs and records, and to provide effective oversight over JMC. Financial irregularities and corrupting practices usually flourish in business environment that lacks good and effective governance system and has no elaborated oversight mechanism.

Daily management functions: HOA is not very specific on how the day-to-day management is done and by whom. JMC, according to Clause 4, “meet at least once every month or when needed at a mutually agreeable location”. This gives the impression that JMC membership is not on a full-time base. In that case who perform the daily management responsibilities pre, post and follow up JMC meetings, coordinates all activities envisaged under HOA, and communicate with the Parties and their affiliates?
Management structure and procedure is needed also to deal with requirements of handling large number of agreements envisaged by HOA. Throughout HOA references were made to many agreements. In addition to the main Joint Venture Agreement there will be technology license agreements, operating services agreements, construction services agreements and technical services agreements (Clause 3 (c)); South Gas Development Agreement, “definitive binding agreements”, framework agreements (Clause 5 (iii)); secondment agreements (Clause 6 (vi))

Holding JMC meeting “at a mutually agreeable location” lacks specificity, could include locations outside Iraq, and thus could be very costly and compromising cost-effectiveness and efficiency considerations. Furthermore, holding meetings outside Iraq could make the Iraqi representative(s) vulnerable to giving-in atmosphere and corruption pressure. Finally, it is not permissible to hold meetings outside Iraq, pursuant to Private Company Law Nr. 21 of 1997, Article 90. But this bring another legal matter related to the status of JMC during the validity of HOA, simply under what law JMC operates. JMC cannot operate under the Private Company Law unless the Joint Venture Company is fully registered. In the mean time, JMC main purpose is to assist in the process of the formulation of the said company.

What could make sense is that the existence and functions of JMC is confined to and tied to the existence of HOA itself. Once the Joint Venture Agreement come into force and the Joint Venture Company established the role of JMC ends, and the board of the new company assume its responsibility.

In conclusion, obviously HOA is not very clear on JMC and further clarifications are needed. But more fundamental is that JMC provisions are full of flaws and could have very detrimental impacts and effects that eradicates Iraqi interests.

HOA is a Binding Document.

Though HOA is supposed to be a preliminary and guiding framework, it contains clauses regarding “Legal Status”, international arbitration with defined forum, and “Termination”, all of which makes HOA a binding document close to a contract!

This in fact is significant departure from the purpose of HOA, as defined in Clause 1, “to jointly evaluate the potential establishment of a long term (..) Joint Venture”. The purpose is so obvious it is about “evaluation” NOT commitment to “establishment” of a long-term Joint Venture. If the outcome of the evaluation is negative then the proposal will either be revised or put on hold. But the following clauses and their implications would make this HOA more of a binding document than a guiding framework.

International Arbitration:

Clause 13 states “Any dispute arising in connection with this HOA that cannot be resolved amicably by the Parties shall be resolved by arbitration under the International Chamber of Commerce (ICC) rules by a panel of three arbitrators in the English language. The place of arbitration shall be Geneva. The award of such arbitration shall be binding on both Parties.”

The question is: what are the justifications for incorporating such provisions in a document that is supposed to be a general framework or frame agreement.

The answers could relate to:

1- Put MoO in a situation that if the Ministry decides to terminate HOA it has to make the reimbursements referred to Clause 9 (c). Though this might be a legitimate justification, however, the decision process that verifies the origin of these
reimbursements is questionable, as was elaborated in item “The Joint Management Committee- JMC.”

2- But more significantly it is to limits MoO from taking any acts as discussed under item “Infringement on MoO/Iraq sovereignty and development plans.”

Legal Status:
Clause 17 was drafted in such a way that, in the final analysis and in all effectiveness, it favours Shell and enhances its negotiation position vis-à-vis the Ministry by making clauses that have direct benefits to Shell legally binding. This is evident by the last paragraph of this clause which states, “Clause 8 (Cost and Expenses), Clause 9 (Procurement of Certain Equipment (Quick Win Assets)), Clause 12 (Confidentiality), Clause 13 (Governing Law), Clause 14 (Amendment), Clause 15 (Assignment), Clause 16 (Liability) are intended to be legally binding on the Parties.”

Extension and Termination of HOA:
According to Clauses 11 and 18, HOA remains in force for a period of twelve months starting from the date of first meeting of JMC. Unless written notice of termination is given no later than 90 days prior to the expiry of the twelve months period referred to above, HOA, according to Clause 18, will be automatically extended for further six months, unless the parties agree otherwise. However, Clause 18 states, “Notwithstanding the termination of this HOA each Party shall remain bound by the provisions of” Clauses 8, 9, 12, 13 and 16.

Again as was the case with Clause 17, Clause 18 was drafted to re-emphasise clauses that are beneficial to and enhance the position of Shell.

Contrary to what the Ministry of Oil spokesman or indeed Shell might think of HOA as only non-binding agreement of principles, the clauses discussed above clearly and strongly suggest otherwise. Furthermore, they are effectively binding on the MoO from sovereignty, development plans as well as financial perspectives, and for the benefits of Shell.

HOA between the Legislative and Executive Branches:
The process and manner in which HOA was developed from inception to entering into force cause concerns, invite suspicion, and justify too many legitimate questions. Accordingly, HOA could have contravened certain provisions of many relevant legal instruments and thus can be legally contested. Legal contest and objections could be formulated on, among other things, the explicit and or construed interpretation of various principles enshrined in the Iraqi Constitution, Iraq’s commitments made with regard to the International Compact with Iraq-ICI, and Iraq’s obligations, as treaty party, under UN Convention against Corruption- UNCC.

Shell has originated the proposal for this agreement and submitted it to the Ministry of Oil/MoO on 22 January 2008. HOA, characterised as “confidential”, was signed and entered into force on 22 September 2008, and it is the same HOA referred to in the Council of Ministers Order No. 329 dated 7 September 2008.

The period between January and September 2008 was characterised with “feel good mode” and buoyancy due to an unprecedented high oil prices, optimistic forecasts on energy demands and continued growth worldwide. All this had faded away and the global financial
crisis will have deep rooted and long lasting consequences, while HOA obligations and implications remain effective.

The legality matters of HOA and the potential Joint Venture have to be examined in the light of existing relevant legal instruments and frameworks. Addressing the question of whether HOA was done in a legal manner and the Joint Venture resulting from it satisfies the legality requirements, one should not lose sights of the following: HOA and Joint Venture are petroleum resources related, mostly associated gas; it involves foreign direct investment but, as joint venture it is closer to Merger than to Green Field types of FDI; it is a manifestation of economic reform and restructuring effort in the country.

Considering the significance of the legality issue, it will be addressed with reference to the relevant articles and provisions of many legal instruments and frameworks in the following space.

The Constitution, in Article 112 (Second), mandates the government to “formulate the necessary strategic policies to develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment.”

First, the onus is on the MoO to proof that its deal with Shell “achieves the highest benefit to the Iraqi people”. The question is how could the Ministry be able to present such a proof without conducting comprehensive economic feasibility study? Since the Ministry did not do such a study, it is therefore, incapable of presenting the needed proof.

Second, competition and the choice of optimal option are among the “the most advanced techniques of the market principles”. The fact that the Ministry concluded the HOA through direct connection with Shell without any competitors, it violates a constitutional principle.

Third, encouraging investment, including FDI is necessary, important and timely. However, such FDI should be within the best forms and norms of Partnership for Development, and should not compromise the national interests. In more than one aspect the analyses of this study asserts that HOA and its Joint Venture are far from optimally serving “the highest benefit to the Iraqi people”.

Having said the above, then HOA and its Joint Venture contravene the Constitution.

One could argue that the above constitutional principles apply only to upstream activities while the HOA and its Joint Venture are related to downstream activity. This is not correct because the referred to Article 112 is general and does not specifically mention upstream. Even if it is correct and the article does not apply to downstream activities there are two reference points, which can be considered as relevant and justifiable as objective criteria for comparison as frameworks for downstream activities. They are the Refinery Law Nr. 64 of 2007 and Investment Law Nr. 13 of 2006, regarding the rehabilitation and modernization (R&M) programme of petrochemical SOEs within the Ministry of Industry and Minerals-MIM. Under both laws there is transparent bidding process, evaluation criteria and rigorous selection procedure by specialised committees. None of these were adopted by HOA.

The comparison between R&M of MIM and HOA is meaningful since both involve foreign direct investment in Merger-like more than Green Field. The concept, for R&M programme, is that the investor rehabilitates and manages the plant on his account against a share of production for a negotiated period of time (15 years), at the end of which all assets become State ownership.

Compared with HOA this implies first, MIM has no cash component to make for the R&M programme of petrochemical SOEs, while SGC has, under HOA, such cash obligation if the
assets are valued at less than its 51% equity shareholding. Second, the period under R&M is much shorter than the 25 years extendable under HOA. Third, while all assets at the end of the contractual period under R&M return to MIM, HOA is silent about this issue. Therefore, even if we apply the downstream test, HOA fails the test miserably.

Furthermore, JMC as the main managing structure for HOA lacks transparency and accountability system, and its quorum in decision-making could create corruption-enabling environment. This in fact negates Government commitments, as a treaty party, it has under UN Convention against Corruption-UNCC (Article 5 (1)), (Article 7 (1. (b), 4)), to take various preventive anti-corruption policies and practices.

The State, according to Article 25 of the Constitution, guarantees the reform of the Iraqi economy in accordance with modern economic principles to insure the full investment of its resources and diversification of its sources. To do so the Government made commitments, in the ICI, to introduce legal reforms that encourage competition and antimonopoly.

The Joint Venture, which HOA creates, adheres to neither legal norms to encourage competition nor antimonopoly. It will be established through a bilateral relationship between MoO and Shell without tendering or bidding process or procedure. From the inception of HOA proposal to its signing, the attitude carries the symptoms synonymous to inside trading. Competition is absolutely absent, and transparency is alarmingly lacking.

It goes without saying also, when HOA purpose is to great a Joint Venture with monopoly status and power, this is both counter productive and contravene with the reform and restructuring efforts, and has nothing of modern economic principles. It should be emphasised, in this juncture, a fundamental conclusion from the global experience with the privatisation and restructuring assert that replacing state monopoly with privatised one produces more disadvantages than benefits.

Does the Parliament have a role regarding HOA? Yes, for sure.

A distinction should be made between the power of the MoO to conclude and sign a contract or agreement, and authority and responsibility of CoR to approve such action. The power of MoO to negotiate and sign is provided for under Article 80 (Sixth) of the Constitution, which empowers the Council of Ministers “To negotiate and sign international agreements and treaties, or designate any person to do so.” Furthermore, in the absence of specific oil law the MoO could invoke Article 130 of the Constitution, which states, “Existing laws shall remain in force, unless annulled or amended in accordance with the provisions of this Constitution”, as further argument justifying its actions.

The acts of “signing” a contract or an agreement and “ratifying” or “approving” it by a specific law are important manifestations of the role that each of the “executive” and the ”legislative” branches have, and should be respected and adhered to, in the legalisation process of such contract or agreement. The requirements for ratification by legislative body is normal practice, and in many cases a fundamental prerequisite, under international private law (of contracts) when one party to that contract or agreement is or has the status of “state entity”. What at question, then, is not whether MoO has the authority “to negotiate and sign contracts”, rather the Ministry’s presumption that its “signature” is “supreme” and final and thus suffice to validate and enforce the contract or agreement it has signed. Accordingly, I am not questioning the authority of MoO, and for that matter any other state entity, to sign petroleum related contracts or agreement, but emphasising that such actions are not legally valid unless and until the Iraqi Parliament gives its approval, enacts the related law and such
law is published in the Official Gazette- *Alwaqee Aliraqia*, according to Article 129 of the Constitution. The burden of proof rests on the Ministry itself that its related action concurrences with the core constitutional principles. Otherwise, MoO is setting a dangerous precedence of a “pre-emptive regulatory capture” attitude, which could seriously and gravely undermines the constitutional process in the country.

Under the Constitution, Article 61, the Parliament is vested with significant legislative and oversight monitoring functions. Accordingly, this Council of Representatives- has wide range of powers, authorities, prerogatives to effect oversight, approval and even enquiry and investigation over the executive branch.

The various functions of the Parliament and related procedures are elaborated further through the Bylaws of the Parliament, published in the Official Gazette/-*Alwaqee Aliraqia* nr. 4032 date 2/5/2007. Two permanent Committees of the Parliament have particular responsibilities and role in the subject matter- Oil, Gas and Natural Resources Committee-OGNRC and the Economic, Investment and Development Committee- EIDC.

Article 91 of the Bylaw authorises OGNRC to, among other things, supervise petroleum policy, suggest laws and regulations to end the waste of petroleum wealth, follow-up refurbishment and construction of petroleum installations. Also Article 94 gives EIDC the authority to follow-up investment affairs, both national and foreign and suggests laws and decisions to encourage investment project. Furthermore, Article 77 authorises any Committee to request a minister and any other public officials to attend before it on matters under discussion within the said committee. Article 118 obliges the ministries to inform the relevant Committee of any “strategic decisions” it has taken.

Obviously and on the bases of the mentioned and other articles these two Committees have particular roles and direct responsibility regarding both the HOA and the Join Venture. The chairman of together with members from OGNRC came out publicly questioning the legality of MoO action by signing HOA and its consequences.

**Matters of Protocol, Form, Style and Referencing.**

It is not specified in HOA who are the two gentlemen whose signatures appeared on HOA and what are their positions in the entities they represent. Do they have a documented authorisation to sign the agreement, and if yes why then the authorisation was neither mentioned in nor attached to HOA. If, in case of the Iraqi side, such authorisation was granted through the Council of Ministers Order No. 329 dated 7 September 2008 (referred to in WHEREAS (d)) then this should be stated clearly, for accountability purposes.

HOA does not show where it was signed, in Baghdad, other part in Iraq or abroad. Though this seems a formality however, in case of dispute and arbitration it might have an importance. Except page 13, where the signatures appear, the other 15 pages were not initialised, and no seal of either party appear on any page of HOA. Hypothetically, any party, or for that matter any person, could reproduce any, some or all other pages with completely different text. In such a situation and in case of a dispute which of the two texts is or will be deemed to be the accurate?

It is not clear how many “authentic” copies were signed, whether there is an Arabic version, and if there is more than one copy are they “equally authentic”.

The date of signing and signatures were placed in the “Title” location, while the titles were not provided. Other deficiencies related drafting definition and referencing were identified.
Defining a “Wholly Owned Affiliate” in terms of “voting capital ownership” might be accurate for Royal Dutch Shell Plc, but not accurate for Iraq. State Public Company, is fully owned by the State and not by the related ministry according to Public Company Law No. 22, 1997 Article 1, which has no reference “voting capital”.

In Clause 3 (d), HOA states, “the Joint Venture shall adopt principles (e.g. Business Ethics, Respect of the Environment, Social impact and Respect for Local Communities) similar to the ones applied by Shell in its worldwide operations provided that they comply with local laws and regulations”.

This clause has few flaws. First, the word “local” should be replaced by “Iraqi” to include all local, regional and federal laws and regulations. Second, the standard should not be limited to Shell but to the “best business practices” worldwide. Third, adherence to relevant norms, guidelines and standard established by various international instruments, should be specified.

Conclusions

From the above the following are the main conclusions:

1- **Controversial and questionable approach.** The process and manner in which HOA was developed from inception to entering into force contravene the following instruments and thus can be legally contested. Legal contest could be formulated on the explicit and or construed interpretation of various principles enshrined in the Iraqi Constitution, Iraq’s commitments made with regards to the International Compact with Iraq- ICI, and Iraq’s obligations, as treaty party, under UN Convention against Corruption- UNCC;

2- **A prolonged capture of monopoly rent.** Many provisions that were incorporated in HOA would clearly and unambiguously indicate to Shell’s intention or possibility to acquire a position in this partnership that provide it with effective control to insure a prolonged capture of monopoly rent;

3- **Infringement on MoO/Iraq sovereignty and development plans.** Specific provisions in this agreement and the resulted Joint Venture constitute and could create severe and effective restriction on the MoO and any of its entities to undertake gas development efforts other than through Shell. Such limitations are tantamount to an unacceptable infringement of the country’s sovereignty in pursuing development policy to utilise its hydrocarbon resources.

4- **Conflict of interest.** The presence or possible occurrence of any conflict of interest would, in accordance with an acceptable code of conducts and the Natural Law, be used to suggest disqualification of a party from performing its function under a concluded agreement. There are at least two significant possibilities, which indicate the presence of conflict of interest on the part of Shell. They are the “assets” estimation and evaluation of South Gas Company-SGC with regards to SGCs’ majority equity shareholding of (51%), and the issue of incorporating “New Partner”. The outcome could be significant erosion of Iraq’s interest and substantial financial losses over a very prolonged period;

5- **Abusive Transfer Pricing, “Economic Model” and the “Commercial Structure”**. Experience with and literature on the behaviour of the Transnational Corporations/TNCs provide ample evidences on the prevalence of the abusive transfer pricing. The potentiality and probability of such abusive transfer pricing might be considerable under HOA. Particular attention should be given to and careful analysis should be
made on the “Economic Model” of HOA, which will be used to estimate and determine Iraq’s revenues from the Joint Venture. The provisions regarding the Model suffer from ambiguities, inconsistencies and potentially limited auditing obligations. Though it is essential, there was no explanatory clause regarding “Commercial Structure” in HOA, except a graph format in Annex 3. It appears from the graph referred to, Shell pays no tax on its equity share!

6- Unequal treatments. Provisions in HOA make specific reference to “prices linked to world market prices” when providing gas products for domestic consumption. However, such linkage to world market prices was not mentioned regarding “Shell (and or its affiliates) off-take and purchase any LNG produced by the Joint Venture”. The wording as such indicates to different treatment to the detriment of the Iraqi side.

7- Partners’ Roles- effectiveness and symbolism. A comparison of the depth, length, contents and substance of clauses defining the obligations of Shell, MoO and both respectively, would lead to the following conclusions: while the role and obligations of Shell are very elaborated and qualitatively very substantive and significant, which enhances the effectiveness of its role, the role of MoO, on the other hand, was confined to a provider of data, resources and employees; a facilitator to obtain approvals and access rights; and the signing of definitive agreements. The mutual obligations clause was very brief and provides further extremely restrictive measures on MoO for the interest of Shell;

8- The Joint Management Committee- JMC. HOA creates JMC and vest it with enormous and powerful authority, which could supersede those of MoO, and Shell as well. In the mean time decisions by JMC can be taken, unanimously, by two members only- “quorum”, one from each party, are binding to all! On the other hand there is an alarming absence of any reference to good governance system to insure transparency, accountability and verifiability to provide effective oversight over JMC. The role of JMC is supreme and final for issues such as “cost recovery mechanism”, approving the (Quick Win Assets) “identified” by Shell etc. Furthermore, there are other provisions, which could create a conviction that considerations of efficiency and cost effectiveness could be compromised, and puts Iraqi members of JMC in a “vulnerable to corruption” situation.

9- Legal Status, Arbitration and Termination. Though HOA is supposed to be a preliminary and guiding framework, it contains clauses regarding “Legal Status”, international arbitration with defined forum, and “Termination”, all of which makes HOA a binding document close to a contract!

10- Matters of format and style. HOA does not show where it was signed, who are the two gentlemen who signed HOA and what are their positions in the entities they represent. Except page 13, where the signatures appear, the other 15 pages were not initialised, and no seal of either party appear on any page of HOA. It is not clear how many “authentic” copies were signed, whether there is an Arabic version, and if there is more than one copy are they “equally authentic”. The date of signing and signatures were placed in the “Title” location, while the titles were not provided. Other deficiencies related drafting definition and referencing were identified.

Considering the above, it appears that HOA has many serious problems and could have considerable negative consequences on Iraq’s national interest, and could constitute an infringe on its sovereignty and development and petroleum policies. In the mean time it sets
dangerous precedence for other foreign direct investors -FDIs especially at the time when MoO is preparing for its biding rounds. Since HOA entered into force on the day it was signed, MoO has, then, established dangerous precedence of a “pre-emptive regulatory capture” attitude, which could seriously and gravely undermines the constitutional process in the country. It might be, or indeed is, too late for the executive branch to rectify the many deficiencies of HOA. The only option that is left to safeguard Iraq’s interest lies in the hand of the Parliament; it has the Constitutional power, the authority and the obligation to act immediately and address this HOA.

To contact the author: mou-jiya@online.no