

Iraq's Second Petroleum Licensing Round

**Address by
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Good Morning, Ladies and Gentlemen, welcome to Istanbul and the industry presentation for Iraq's Second Petroleum Licensing Round. It is a great pleasure for me to be able to attend and address this important event.

My colleagues from the Petroleum Contracts and Licensing Directorate in the Ministry of Oil will provide you with more details on Iraq's Second Petroleum Licensing Round later this morning but I would like to spend a few moments with you to discuss the progress we have made over the last year in Iraq's petroleum sector as well as the challenges remaining,

In particular I would like to address:

- The progress in Iraq and the commitment of the Government to this initiative
- The results of Round 1 and its implications for Round 2,
- What aspects will change from Round 1 and what aspects won't change from Round 1

First, the situation in Iraq. The terrorist attacks across Baghdad last week were deeply disappointing to the Government and to all Iraqi people. However, we do not believe these events are representative of the progress that has been made, nor of the overall attitude and sentiment in the country. While the number of violent incidents remains at an unacceptable level, it is only 10% of the level a year ago. Control and responsibility for the security of our cities was formally handed over to the Iraqi government at the end of June and we will not allow these acts to shake our resolve to rebuild Iraq's economy and nation,

Let us look at some other signs of progress - only an estimated 3.1% of Iraqi households are described as "food insecure" in the latest World Food Program survey. This represents a huge improvement on 15.4%, the figure when the survey was last carried out in 2005.

A more subtle point on the road to recovery was the recent reopening of the National Museum which had been ransacked following the invasion in 2003. Iraq's National Museum contains the country's most treasured symbols of its culture and heritage.

We were also pleased to note that in July our crude oil exports exceeded the 2 million barrel per day mark - the highest level since the regime change in 2003 - and our current production is about 2.5 million barrels per day.

I think the other aspect that has become clearer over the last year is the increased and broadening level of political support for the involvement of foreign oil companies in Iraq's petroleum sector as a necessary element to allow the redevelopment and growth of the national economy. Even those who have opposed different aspects of the offerings have acknowledged the underlying need for a substantial involvement of the international oil companies in Iraq's upstream sector. The 2 contracts that have been awarded to date each had strong support in the Cabinet and we expect a similar level of government support for future awards.

I would now like to talk about Round 1 as I think there are several aspects of that process that are especially relevant now as we embark on the second round.

The first Petroleum Licensing Round was launched on June 30, 2008, and completed one year later, as scheduled. The process was characterized by an open and candid dialogue between the Ministry of Oil and the 32 companies from 19 different countries that participated in the round.

The overarching objective of the process was to craft a framework that would be resilient and work under a variety of conditions, which means it had to be an agreement that was balanced and fair to both sides. The fact that oil prices have gone from almost \$150 per barrel down to \$30 and back to \$70 per barrel over 12 months is a powerful reminder that we need to construct a business relationship that can withstand inevitable changes in prices, costs and risks.

I think we did that – and this was evidenced by the number of companies that came to and actively participated in the bidding process in Baghdad.

As you know, however, only one contract area was awarded. While, at one level, we were disappointed that we were only able to award one contract area in that process, we were pleased with many positive aspects.

Consider the following facts:

- 22 of the 32 qualified companies showed up and bid in the first major event in Baghdad with the full participation of executives from most of the world's leading oil companies. Notwithstanding an unfortunately timed sandstorm, the event went smoothly, to schedule and without interruption.
- The biggest field (both in terms of current production as well as proposed production expansion) was awarded. To add further context, this field, Rumaila, is about the same size as the combined production of the remaining 7 fields.
- The competitive process for Rumaila resulted in a savings of over \$20 billion for the people of Iraq over the life of the contract.

It is also worth considering what happened for the fields that received bids from the IOCs but where the winning consortia were unwilling to accept the Maximum Fee level set by the Ministry.

I am sure, as you sit here, you will want to know what to tell your colleagues and managements in your respective home offices when they ask "how can we be assured that after we make a strong and costly effort to evaluate the fields, we will not end up in a mismatch of expectations that was apparently seen in the bidding in Round 1?" It's a good question....

Here is my analysis and what we have done to consider this perception in respect of Round 2.

- First, as you know, for several years each of the fields that were offered in Round 1 had been under a Technical Memorandum of Understanding between many of your companies and the Ministry of Oil.
- Those MOUs resulted in a lot of technical work and analysis of the fields. Their attributes and potential were thoroughly assessed and discussed between the Ministry and the IOCs.
- That work influenced not only the Ministry's setting of the scope and quantum of the minimum work commitment but it also heavily influenced our expectations in terms of the likely production levels.
- The top production levels that the IOCs bid for the oil fields in Round 1 were, on average, more than twice the minimum production bid levels that we had set, The high bid for West Qurna was almost 4 times the minimum.
- So the companies took a much more aggressive and optimistic view than we did. Now ordinarily this would not be a problem in a competitive environment. However, in this case, the aggressive assumptions on production levels had a strong and commensurate effect on the level of fees the companies would require to earn them a suitable return on their capital.
- The Maximum Fees set by the Ministry – all of which were done in advance of the bidding - were, however, based on the lower expected production levels suggested by the results in the MOUs.
- That is how we got to a mismatch of expectations.

With respect to the oilfields that were not awarded in Round 1, the Ministry is currently considering its options. Whichever option is chosen, it will certainly be based on competitive rather than bi-lateral principles.

Thus, while we were thrilled with the optimism with which the IOCs assessed the potential of our fields, we have made some changes to Round 2 to ensure that the same scenario would not be repeated.

Foremost, the Round 2 fields are basically greenfield developments. Thus, many of the more complex aspects of Round 1 which had to deal with the reality of the situation on the ground are not present –

- There will not be a contractual baseline
- There is no need for the joint ROC-IOC operating entity, the "FOD" – in this case an IOC will be the operator on behalf of the Contractor group
- There will be far fewer complications regarding the existing workforce, existing contracts, preexisting environmental conditions, etc, etc. – all in all, a much simpler business proposition
- In addition, while we recognize that the value to Iraq comes through maximizing production, we will reweight the bidding evaluation to increase the significance of the fee component relative to the production component
- The signature bonus will be a fixed amount for each Contract Area and will be smaller than Round 1 but it will not be recoverable under the Contract.

Looking at it from a high level, I think we (Iraq and the IOCs) are in a good position - The 2 most essential conditions are in place, these are that: (i) the IOCs see plenty of production potential in the assets; and (ii) they are prepared to compete aggressively in order to do business in Iraq. This round will undoubtedly benefit not only from the past year of dialogue, discussion and evolution of thinking but also by virtue of the relative simplicity of the offering compared to Round 1. One thing from Round 1 that will not change is our unreserved commitment to the principles that guided us – transparency, competition and dialogue

Regarding the contractual structure – we will maintain it as a form of service contract. We have considered other options, but have concluded that the only structure that would be acceptable given the long history of crude production and the importance of the sector to all Iraqis is a form of “Service Contract.”

We know this structure is less attractive on its face to the IOCs but we have attempted to address what we consider are the most important aspects for the IOCs as you discharge your obligations to your respective shareholders – we have endeavored to develop a contract model that provides profitability and materiality within a form that allows the companies to exercise considerable discretion over how these fields are developed.

Mr Abdul Mahdy will shortly go through the details in the proposed model but I can characterize it simply as a model in which

- The IOCs set up a joint venture to develop the fields with an Iraqi State company holding a 25% interest. The IOC will fund, drive, manage and operate the developments.
- The IOC will be reimbursed for its actual costs on a dollar for dollar basis.
- The IOC will receive a fee (which it determines and bids) for lifting and delivering barrels, including the equivalent in processed associated gas, where agreed in an approved Development Plan.
- The fee will apply to all production – including the limited current production in 4 of the fields being offered in this round.
- The IOC may lift crude oil at Iraq’s export points as payment for the fees.

Mr. Abdul Mahdy will also go through the details of the proposed process but in short, if you are here, you are a prequalified company. In addition to the companies in Round 1, we also are pleased to welcome an additional 10 companies (and a further 4 countries) to this process. We have also advised each of the companies of their operator qualifications since certain of the fields are quite challenging and require an “unrestricted operator” classification. Today we will provide you with an overview of the proposed contractual model, a brief technical review of the fields themselves and the process which we will follow in this effort. We intend to carry out this process in a competitive and totally transparent manner and to complete it before the end of the year.

Information packages comprising technical data sets, model contract, petroleum regulations and summary technical reports will be made available in the coming days.

We understand that these efforts are costly from the IOC side (as they are from ours) in terms of dedication of highly qualified and experienced people so we are committed to a very strong effort to sticking to the timetable, as we did in the first round.

The process we desire is one of open and candid dialogue – we will listen to the companies' concerns and wishes and consider them in good faith - just as we would expect the companies to recognize our aspirations and constraints. We do recognize that it has to work for both sides or it won't work for either side.

We expect to receive comments on the proposed contractual framework and we have designed our process around the expectation of a constructive dialogue. We expect some things to change between now and when we award the contracts for the development of these fields but we also expect these to be considerably more modest than last year as the result of the considerable dialogue and evolution that we went through in the First Round, and such changes as may be contemplated are expected to focus on the different nature of the fields on offer rather than issues considered and addressed previously. As I mentioned earlier, there are other aspects we do not expect to change – these are our commitment to keeping to the schedule, to an open dialogue with the industry and to the complete transparency in the process.

We continue to believe strongly that Iraq will benefit from a freer and fuller influx of capital, technology and business practices and recognize that such inflow can only be achieved and sustained where the conditions are fair, transparent and evenly administered.

Thank you very much for being with us here this morning. I look forward to working with you in meeting the challenges and opportunities of the continued development of Iraq's oil and gas sector.