

# **Iraq's Upstream Industry The Next Legislative Challenge**

Thamir A. Ghadhban  
Chairman of the Advisory Commission,  
Office of the Prime Minister  
Iraq

**IRAQ FUTURE ENERGY 2010  
ISTANBUL**

Mr. Chairman,  
Distinguished participants,  
Ladies and gentlemen

It is a great pleasure for me to be present among this distinguished gathering and I hope we have fruitful discussions over the next two days. Iraq's upstream industry is going through very interesting times and the period to come will be crucial to the success of the tasks at hand. It holds many challenges, and the outcome will no doubt have an important impact on the regional and global energy scenes.

Let me start first by outlining those challenges, before I touch on the legislative dilemma we have been facing under the outgoing government, and the legislative reform that needs to go hand in hand with the unprecedented transformation of our oil and gas sector. Before signing off, I will share with you my views on the period to come and the issues that will face any new government that will take over next.

As you know, Iraq has embarked on a substantial program to build up the country's crude oil and gas production capacity as well as export capacity, in cooperation with international oil companies. There are three main features of this grand opening which are worth stressing here. The first is the very transparent and highly competitive way in which contracts were awarded to international oil companies in the first and second bid rounds. The second is the model contract that was used in the two oil bid rounds, which marked a departure from the classic production sharing contracts. The third is the unprecedented high economic return that will accrue to Iraq as the host government, under this type of contract.

The 12 oil field development contracts that were awarded in the two bid rounds - and in direct renegotiation of an older contract in the case of Al-Ahdab development contract - will help increase Iraq's current oil production capacity several folds in the next decade. Once realized, it will put Iraq back in a leading position among world's oil producers, and play a major role in insuring world stability, through its participation in guaranteeing a steady energy supply. This production increase shall be achieved through further development of producing fields, as well as bringing some partially developed or non-developed fields into production. Additional output would come from fields operated by our four regional oil companies; North Oil Co, South Oil Co; Missan Oil Co and the newly created Midland Oil Co, as well as from Iraq's federal region of Kurdistan.

There are many objectives behind the award of recent service-type contracts besides ramping up production capacity and increasing oil revenues. Among these is the transfer of technology; the introduction of modern technical and financial type of management; capacity building and training of Iraqi personnel in all required skills; as well as providing work opportunities to Iraqis through the required utilization of national content. However, it is the IOCs' responsibility to provide investment, further develop oil fields in accordance with approved development plans, and shoulder the responsibility for meeting production targets.

We are currently seeing the first steps of the huge work that needs to be executed under these contracts, such as the drilling, completion and workover of

several thousands of wells; the construction of gas processing plants and the laying of thousands of kilometers of flow lines and pipelines. Implementation on the ground is progressing on schedule since the contracts entered into effect, and the management structures stipulated in the contracts are already in place. We will soon see a huge ramp up of the oil and gas production and processing facilities, together with a sophisticated water injection network inside the fields, and a huge water supply system put in place. The gas network got to be expanded in line with the development of oil production capacity. The Oil export network is undergoing an expansion push which comprises adding storage capacity, large diameter export pipelines and offshore loading facilities.

In parallel to this effort taking place on the ground, there is another process taking place at the government level, which aims at introducing the right legislative and economic reform, to rise up to the challenges that the new oil production capacity and associated increase in state revenues, will bring about in the next few years.

The rationale behind legislative reform stems from constitutional obligations.

Article 25 of the constitution of Iraq states that “The State shall guarantee the reform of the Iraqi economy, . . . , to insure the full investment and diversification of its sources, and the encouragement and development of the private sector”.

Furthermore, Article 106 of the constitution calls for the establishment of a public commission to audit and appropriate federal funds; to verify the fair distribution of grants, aid, and international loans; the ideal use and division of the federal financial resources; and finally to guarantee transparency and fairness in appropriating funds.

Two more very relevant articles, Article 111 and 112, define ownership of oil and gas reserves, the management of present fields, equitable distribution of revenues and finally the formulation of oil and gas strategies. The constitution stipulates in those articles that those mandates shall be regulated by laws. Moreover, the constitution stipulates that Iraq is a federal state and powers of the authorities are classified as either exclusive, shared or regional powers. Hence, old legislations that once regulated the oil industry, are not adequate anymore, and do not address the new conditions in Iraq. Another motivation behind the need for new legislation is the need for good governance, which entails among other requirements, the separation between regulatory, commercial and operational tasks. This applies to the ministry of oil as well as others.

This takes me back to the package of four draft legislations, in particular the draft oil and gas law that became subject of debate during 2007, inside and outside of Iraq. Those drafts were prepared to regulate the upstream sector of the Iraqi oil industry and to achieve a fair and equitable distribution of revenues. The draft oil and gas law has been with the Council of Representatives since 2007 and was followed later by the INOC draft law. There were several reasons behind the legislative stalemate, but the main one is the request of the Kurdish parliamentary block to

postpone the debate on oil legislation until an accord is reached regarding the pending issues in the oil and gas law. The main pending issues are related to demands for changes that were presented by the Kurdish side, represented by the Ministry of Natural Resources. Here is a quick overlook of these demands for changes of the relevant articles:

- Article 8: that the role of the Council of ministers should be limited to “follow up” but not “supervisory” as it was agreed in the original draft.
- Article 12: that a “specialized entity” which could be a regional oil ministry, and not the federal Ministry of oil, should have the right to award and execute oil operation supply contracts that are outside the exploration, development and production contracts.
- Article 14: that the KRG would share in the management and operation of fields in the Kurdish region which are assigned by the proposed Federal Oil and Gas Council to INOC.
- Article 39: that assets ownership shall belong to the “specialized entity” meaning KRG’s Ministry of Natural Resources, but not to the federal authority or ministry on expiry of contract.
- Article 45: regarding arbitration, that a dispute shall be referred to the “specialized entity” but not the Ministry of Oil if it can’t be resolved amicably.
- Finally regarding the Annexes to the oil and gas law, there was disagreement on the allocation of certain fields to INOC.

It is worth noting here that all of the above points, except for the last one, were raised by the KRG well after the negotiating committee, of which the KRG minister of natural resources was a member, had completed drafting and unanimously agreed to the now famous text of Feb 15<sup>th</sup> 2007, and after the council of ministers had approved it on Feb. 26<sup>th</sup> of the same year.

The Ministry of Oil and the federal government are of the view that downgrading the role of the council of ministers, from a supervisory role to a follow up role, is inconsistent with the status of the council of ministers. Similarly, the management of INOC, as a national oil company, cannot be shared, irrespective of the geographic location of its operations, a proviso for its success.

What made it more difficult to introduce the much needed legislations I referred to earlier, is the conflict created by the unilateral signing by the KRG, of numerous production sharing contracts for exploration and development of oil fields, and the response of the Ministry of Oil and the federal government.

Issues such as the legality of awarding those contracts; the type of model contract used; the lack of transparency in awarding them; the award of some contracts in the so called disputed areas; failure to reach a sustainable solution to the evacuation of oil produced in the region; and more recently the trucking of the oil produced in the region across Iran to the Arabian Gulf regardless under what form and whether it’s

crude or refined; all of these were not conducive to reaching an agreement on the legislation needed for the Iraqi oil sector as a whole.

I firmly believe that had the package of four legislations been passed, we wouldn't be in such a situation. The formation of a Federal Oil and Gas Council with its powers and the representation of all players on its board, as stated in the draft oil and gas law, would have provided an effective tool and a streamlined process of awarding contracts, in addition to defining the right policies, and provide planning and supervision. The council, according to the same draft, would be in charge of issuing regulations for licensing and contracting, the prequalification of companies and preparation of model contracts for exploration, development and production. It would have the powers to assess and decide on contracts negotiated by competent entities, once they are initialed. It was to be tasked with deciding on production, at the national level, and its variation as required. So, in reality the Federal Oil and Gas Council should – and would have been - the highest executive body in the country, in charge of overseeing the upstream sector.

Similarly, the package of laws would have resulted in the reorganization of the Ministry of Oil, in such a way that it would concentrate on being more of a regulatory body, as far as the upstream sector is concerned. The ministry would be in charge of:

- Proposing federal policies, laws and oil plans;
- The preparation of draft regulations and issuing of directives and procedures;
- The monitoring and supervision of oil operations, in coordination with regions and producing governorates, to ensure unified implementation, adherence to federal laws and regulations, and contractual terms;
- Verification of cost and government take.

It would also prepare the draft exploration and development policies and plans, in consultation with regions and producing governorates, to determine production levels, optimum solutions for geographic distribution, and timing of development programs. All of the above would be presented to the Federal Oil and Gas Council for review and approval.

Once these reforms are introduced, INOC would take the responsibility of almost all the upstream operations. The draft legislation of INOC authorizes it to become a holding company, owning all of the existing operating companies from day one.

But let's turn now to the future which, as I said in my introduction, is not less challenging. As you know, it has been quite a while since legislative elections took place on March 7<sup>th</sup>. The negotiations between the winning parties on the formation of the new government have taken too long. But I hope we will soon see the birth of a new coalition government. However, rest assured that the oil issues we are discussing

are of paramount national interest, and as such, they are well attended to by the council of ministers, even during this transitional period. Only last week, the cabinet approved the latest projects related to the massive oil field development effort I talked about in the beginning, which are the water injection scheme, and the pipeline network which will expand the country's export capacity.

I am of the opinion that Iraq's future government is fortunate as far as the upstream oil industry is concerned, due to the fact that it shall reap the benefits of what the present government has achieved so far. Having said that, and in view of the importance of oil and gas to the future and wellbeing of the Iraqi people, the next government will have the following issues on its agenda that it will be required to deal with as a matter of priority:

- First, is the effective implementation of currently signed contracts in accordance with the contractual obligations. This will include the removal of all bottlenecks in logistics and easement of regulations and procedures related to the movement of people and goods; the speeding up of various governmental acts together with carrying out all related projects such as pipeline network, export facilities...etc. Whatever the shape or color of the next government, it will abide by the signed contracts and will expect the IOCs to abide by their contractual obligations as well. If anyone has any doubt about the validity of those contracts, I refer you to a recent federal court decision regarding the case brought on by one MP concerning one of those contracts. If anyone on the other hand has any doubts that those contracts could be renegotiated, I want you to rest assured that there will be no renegotiation.
- Second, is the need to find an amicable and comprehensive solution, to the issues related to production and export of oil produced in the federal region of Kurdistan. Such a solution is urgently needed for the benefit of the whole country. However, any solution needs to be based on a solid foundation, in order to be sustainable. Payment of costs to oil companies in the KRG ought to be carried out according to the terms of the contracts signed and according to the same procedure followed in contracts signed by IOCs in the rest of Iraq. In other words, those costs should not be paid from the KRG's 17% share of revenues. In order to do so, the KRG contracts should be made entirely available to the ministry of oil and the federal government, for review and vetting in order to reach agreement on the process to follow. The ministry of oil cannot act as a pay master, for obligations that it has not been party to, nor has full knowledge of.
- Another priority of the next government would be a review and final agreement on the oil and gas legislative reform. I expect any future government to give priority to the package of four draft laws related to the oil

and gas sector, in order to put them in their final form for parliamentary debate and legislation. As I said earlier, passing those laws followed by the relevant bylaws and procedures in time would put in place the necessary legal and institutional framework that shall regulate the upstream industry, and provide a healthy business environment in the whole of Iraq, and put an end to the conflicts we have seen in the past.

- The re-establishment of INOC as a state owned upstream company that is administratively and financially independent, reporting directly to the Council of Ministers, and chaired by a member of the board with a rank of minister is another priority.
- The gas sector is another priority. Here I stress on the need to finalize the south gas project and put an end to the flaring of the much needed gas on one hand, and the awarding of contracts for the development of the three non-associated gas fields of Akkas, Mansouriah, and Siba on the other hand, in the event where those two are not finalized by the outgoing government. Exploration for gas, especially in the Western Desert should also be one of the priorities on the agenda of the next government.

In conclusion, I would like to say that I'm very optimistic about the future of Iraq, and my high expectations can be justified in the following points:

- I expect the disagreements between the federal government and the KRG to be solved swiftly and fairly to the benefit of all.
- I expect the IOCs who signed field development contracts with Iraq, to stick to the contractual schedule, and the government of Iraq is already doing its utmost to carry out its obligations towards those contracts on time.
- There is a high degree of alignment between the two parties, and I mean by that the government of Iraq and the IOCs, to insure a beneficial relationship on the long term.
- The focus of our energy sector will be next on gas, be it associated or non-associated gas, in order to cater for the basic service of providing adequate electricity generation to our people. We need to put an end to the flaring of our associated gas soonest, we need to develop the discovered gas fields, and as I said earlier we need to explore for additional gas reserves in under explored and high potential areas. This concerted effort in the gas sector will insure self sufficiency in natural

gas for power generation and the industrial sector as well turn Iraq into a gas exporter in the next few years.

- Finally, I would like to end on an optimistic note. Iraq's democracy is a nascent experience, and the delays in government formation might be frustrating to many. But rest assured that this is a process in the making and Iraq is on the right track.

Thank you for your attention and I would like to thank The Energy Exchange for having us here in Istanbul.