

Russia Consolidates Its Position In Iraq Upstream Petroleum

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The Iraqi Ministry of Oil confirmed in late July that Russia's Bashneft had accepted the ministry's maximum acceptable remuneration fee (MARF) for exploration Block 12, which was offered in the fourth bid round that took place at the end of May (MEES, 4 June). This is in line with what I anticipated in my assessment of the results of the fourth bid round.¹

This 'newcomer' to Iraq post-2003 upstream petroleum would consolidate further the position of the Russian companies and strengthen their presence and role in the country's oil production. This also manifests clearly a petroleum asset seeking strategy and demonstrates that there has been a learning curve from previous bid rounds. The Russian position could be consolidated even further if the speculation about the possible entry of another Russian company, Rosneft, materializes – but Gazprom might rock the boat.

Let us begin with Bashneft and then discuss the possibilities for Rosneft and Gazprom.

The remuneration fee originally requested by the consortium of PetroVietnam (30%), Premier Oil (40%) and Bashneft (30%) for Block 12 was \$9.85/barrel of oil equivalent (boe), while the MARF was \$5/boe. The consortium refused to reduce its fee to that of the ministry's target during the bidding day.

Since the MARF was disclosed the consortium had two options: either reduce its fee and accept the MARF; or face possible competition if and when this block 12 would be included in a future fifth bid round, which could push the remuneration fee downward (in similar fashion to what took place with 'Akkaz gas field). In the first bid round held on 30 June 2009, 'Akkaz gas field was offered, and received one bid only – with a fourfold difference between the \$38/boe remuneration fee requested by the Edison/Petronas/CNPC/Kogas/TPAO consortium the ministry's MARF of \$8.50/boe.

It is worth remembering that the maximum remuneration fee of \$8.50/boe that the ministry set for 'Akkaz in bid round one should not have been taken as a benchmark; but if it was, then it must have been taken by the international oil companies (IOCs) as a minimum instead of a maximum benchmark for the remuneration fee. Nevertheless, a Kogas/KMG consortium offered, in bid round three held on 20 October 2010, \$3/boe less than what the Ministry of Oil offered to the consortium Edison/Petronas/CNPC/Kogas/TPAO in June 2009.²

What had happened was that Kogas broke from the consortium of June 2009 and formed a new consortium with KMG in October 2010, leading to winning 'Akkaz gas field with a remuneration fee of \$5.50/boe. And after the withdrawal of KMG due to the delay in concluding the contract, Kogas took full control of the deal on its own in June 2011.

So, for the PetroVietnam/Premier Oil/Bashneft consortium to accept the MARF for Block 12 they would have to change the composition of and/or participation interests of its partners. This might have been done through increasing PetroVietnam's and/or Bashneft's equity, possibly at the expense of Premier, for cost or strategic considerations. (This would be similar to what CNPC did for the Rumaila oil field in the first bid round, which had led to increasing the participation interest of CNPC compared with that at the time of bidding. The 75% participation interests of the BP/CNPC consortium was divided 50% to BP and 25% to CNPC at the time of bidding, but soon after the bidding that composition changed to 38% and 37% respectively. And of course this was similar to what Kogas did in 'Akkaz case, as mentioned).

Undoubtedly Bashneft's initial decision to go for it alone had come after consultations with the other two partners, which apparently declined to come along. In addition to accepting the MARF of \$5/boe, Bashneft would pay a \$15mn signature bonus, commit to \$120mn minimum expenditure, and undertake to execute a minimum work program to shoot 2,000 sq km of 2D seismic (or equivalent in 3D) and drill one exploration well. The block covers 8,000 sq km and is located approximately 80km southwest of Samawa city (Mothana province) and about 130km west of Nasiriya city (Thi Qar province). However, a few weeks later Premier Oil changed direction and announced its readiness to join Bashneft as a junior partner, with 30% instead of 40% participation interest.³

This indicates the determination of Bashneft as a newcomer to Iraqi bid rounds, although it was one of the contenders for East Baghdad oil field before 2003.⁴ The deal will also consolidate Russia's position in Iraqi upstream petroleum and clearly indicates an asset seeking strategy among the Russian oil companies.

As of today the main Russian presence in the Iraqi upstream petroleum sector comprises the following:

- Lukoil has 75% participation interest (after the departure of the Norwegian Statoil) in West Qurna-2 oil field. The field has about 12.9bn barrels of reserves with a contracted production plateau target of 1.8mn b/d for a duration of 13 years;
- Gazprom has 30% interest in Badra oil field, which holds 756mn barrels of reserves,⁵ with a contracted production plateau target of 170,000 b/d sustainable for seven years. The other partners in the consortium are Kogas (22.5%), Petronas (15%) and TPAO (7.5%);
- Lukoil has 60% in oil-prone exploration Block 10 (area around 5,500 sq km) with partner Inpex Corporation holding 40%; and
- Bashneft has 70% in oil-prone exploration Block 12 (with "estimated resources in excess of 1bn barrels", according to Premier Oil, which holds 30%).⁶

The Russian drive to consolidate its position in the Iraqi upstream petroleum sector could be cemented even further if the speculation pertaining to Russia's top crude oil producer, Rosneft, comes to fruition. Rosneft has been reportedly holding parallel talks with ExxonMobil and with Lukoil.⁷ The talks with ExxonMobil are to secure a 20% (or even more) interest in West Qurna-1 oil field (which holds 8.6bn barrels of reserves and has a contracted production plateau target of 2.85mn b/d sustainable for seven years). Negotiations with Lukoil are for a 30% stake in West Qurna 2. However, two issues pertaining to Rosneft are still not clear.

The first issue is whether the company would accept both or only one of these two offers, and which one. The decision on this issue depends largely on the financial, technical and managerial capacity of Rosneft and its business strategy considerations. If Rosneft decides (and is accepted by Iraq, as discussed below) to be a partner in both oil fields, this could have serious ramifications regarding 'unitization' of the two West Qurna oil fields and their optimal development, which has clear advantages for Iraq. If on the other hand the company chooses only one of the two offers, available information indicates it might prefer ExxonMobil (West Qurna-1), due to their strategic alliance, formed earlier this year to explore and develop Arctic petroleum potential, over Lukoil (West Qurna-2) unless the latter further sweetens its offer. But this is not a straightforward option.

If Rosneft succeeded in becoming a partner in either or both giant oil fields, this would undoubtedly boost the position of the company to one of the leading global companies in oil production, probably second to Saudi Aramco, especially "if its declaration of interest in buying BP's 50% stake in the TNK-BP joint venture bears fruit."⁸

The second and more complicated issue is whether Iraq's Ministry of Oil would accept and approve the participation of Rosneft in both or either of the two oil fields. Formally, Rosneft did not apply for pre-qualification for bid round one, and this might represent an eligibility problem for the company to access West Qurna-1. But the company was pre-qualified for the second bid round, making it eligible to access West

Qurna-2, though it did not bid for any field during that round because it was unable to form a strong enough consortium.

Rosneft might encounter a more serious hurdle to access both or either of the two oil fields due to its ties with the UAE-based Crescent Petroleum.⁹ The latter had concluded agreements with the Kurdish Regional Government (KRG) and holds positions in the Chemchemical and KhorMor gas fields in the Kurdish region.

For the federal Iraqi government all contracts and agreement concluded without its consent and approval are considered illegal, and thus it blacklists the companies involved and prevents them from participating in upstream petroleum activities. However, Rosneft and the Ministry of Oil could overcome this serious hurdle through a well-drafted exclusivity clause and undertakings by Rosneft pertaining to full, complete and continued exclusion of Crescent Petroleum, its affiliations and subsidiaries from participating directly and indirectly in contracts Rosneft concludes with the ministry. Also, the ministry could request Rosneft to sign a legally binding undertaking similar to what it has introduced lately in the Termination Clause [8.1-(a)-(iii)] of the contracts for bid round four. In this regard it would be relatively easy for Rosneft to sign such undertakings if it decides to go for West Qurna-2 with Lukoil, since the latter has already accepted such a condition when it bid for and got exploration Block 10 during the fourth round. On the other hand it might be difficult or rather complicated to sign such undertaking if Rosneft decides to go for West Qurna-1 with ExxonMobil (and Shell), since ExxonMobil's position in West Qurna-1 has, since October 2011, some legal difficulties with the ministry after the company signed agreements with KRG.¹⁰ Nevertheless, there are no strong reasons to prevent Rosneft from concluding and signing such undertakings if it decides to go for West Qurna-1 since such action binds the company alone and not the other two partners, ExxonMobil and Shell. And if Rosneft signs such an undertaking, that would weaken the position of ExxonMobil even further in its standoff with the Ministry of Oil.

Again, some recent developments might complicate the matter for the Ministry of Oil even further. There are reports of a possible deal between Gazprom and KRG "on at least one block – a 40% non-operator stake in Western Zagros's Garmian block."¹¹ Obviously this could affect the position of Gazprom and the development work on Badra oil field. The work on the field seems to be progressing well, and the threshold production of 15,000 b/d to commence cost recovery could be realized earlier than initially planned, in the last quarter of 2013. Due to demining, completion of the 3D seismic survey,¹² drilling of the first batch of appraisal and development wells,¹³ and other engineering, procurement and construction services,¹⁴ it was reported the above threshold would be "pulled forward to early 2013, with 60,000 b/d expected by mid year, and 120,000 b/d by the beginning of 2014".¹⁵

As long as the stalemate and differences between the federal government and KRG remain (and the resolutions appears to be remote for the time being), the problem with ExxonMobil is not resolved and the Ministry of Oil position *vis-a-vis* Crescent Petroleum persists, it is vital for Rosneft to consider carefully its options in the light of the above. It appears partnering with Lukoil in West Qurna-2 is more feasible and viable than with ExxonMobil in West Qurna-1. But for the federal Ministry of Oil interests it could be the other way around. Nevertheless, if Rosneft decides to go for both or either of the two oil fields, and such a move is approved by the federal oil ministry, this undoubtedly could enhance Russia's position in the development of Iraqi oil production, and Rosneft's global ranking among the leading IOCs. But the rumored entry of Gazprom, as with ExxonMobil, puts the Ministry of Oil and the federal government in an uncomfortable 'Catch-22' situation, which requires action rather than empty rhetoric.

Notes:

1. A M Jiyad, 'Iraq's Fourth Bid Round: Assessment of The Outcome' (MEES, 18 June 2012).
2. A M Jiyad, 'Gas Fields Bid Round in Iraq: Success with Risk' (MEES, 8 November 2010).
3. <http://www.upstreamonline.com/live/article1260424.ece> (accessed 16 July 2012).
4. Direct communication with the oil professional Arif M Rafik Arif.
5. Other source gives 3bn barrels of proven reserves: see http://www.oilvoice.com/n/Gazprom_Neft_Selects_Schlumberger_to_Drill_in_Iraq/eaeb8a0c6.aspx (accessed 22 June 2011). Also, *International Oil Daily* reported 1.2bn barrels and Gazprom people in the field believe reserves could exceed 3.0bn barrels "once the 3D seismic had been com-

- pleted and appraisal wells drilled" (http://www.energyintel.com/print_me.asp?document_id=719593&pID=31 (accessed 21 May 2011)).
6. <http://www.iraq-businessnews.com/2012/07/16/premier-oil-to-join-bashneft-in-oil-block-12/> (accessed 20 July 2012).
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 8. http://www.energyintel.com/Pages/ViewFullPortlet.aspx?Control_ID=4&mail=EA07-26-2012 (accessed 27 July 2012).
 9. 'Rosneft Takes the Back Door Into Iraq', *Nefte Compass*, 26 August 2010. (http://www.energyintel.com/DocumentDetail.asp?document_id=683730).
 10. A M Jiyad, 'ExxonMobil-KRG deal: A puzzling move at a critical time', 12 November 2011 (<http://www.iraqoilreport.com/oil/production-exports/exxon-risks-west-qurna-on-new-kurdistan-deals-6596/> and <http://www.iraq-businessnews.com/2011/11/12/exxonmobil-kr-g-deal-a-puzzling-move-at-a-critical-time/>).
 11. 'Russians To Invest As Iraqi Crisis Escalates', (*MEES*, 30 July 2012).
 12. 'Gazprom Neft completes seismic survey in Iraq' (<http://www.gazprom-neft.com/press-center/news/4108/> accessed 22 June 2011).
 13. 'Gazprom Neft Selects Schlumberger to Drill in Iraq', (http://www.oilvoice.com/n/Gazprom_Neft_Selects_Schlumberger_to_Drill_in_Iraq/eaeb8a0c6.aspx accessed 22 June 2011).
 14. 'Petrofac has confirmed the award of a \$330mn contract to work on the Badra oilfield in Iraq', (<http://www.upstreamonline.com/live/article304992.ece> accessed 24 Feb 2012).
 15. <http://www.iraq-businessnews.com/2012/05/17/gazprom-to-start-pumping-from-badrah-early-2013/> (accessed 17 May 2012).