Iraq's Fifth Licensing Round

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LONDON — Over the course of 2017, security has consistently increased in Iraq. Now, Iraqi troops are in control also of the Iraqi-Syrian border, which was the area where the last few strongholds under the Islamic State were located. Of course, this military success does not mean that the on-the-ground conditions are completely back to normality because many Islamic State fighters have not been captured yet because they are on the loose having blended in with the local population.

On December 9, 2017, at a conference in Baghdad, Prime Minister Haider al-Abadi of Iraq declared victory over the Islamic State and the following day, still in Baghdad, Iraq held a military parade to celebrate the victory. Mr. Abadi's declaration and the military parade had symbolic value, and in a certain way they marked in Iraq the passage from a war phase to a new phase whose goal is to attract foreign investment to Iraq to improve the economy.

And after these two celebratory events, it has become always more evident that, despite several internal problems linked to the war waged against the Islamic State—Iraq is a country exiting three years of military efforts—and despite the present geopolitical tensions running throughout the Middle East, Iraq is still a country capable of attracting foreign investments.

A simple look at BP's Statistical Review 2017, shows why Iraq is one of the main oil and gas players at the world level. Indeed, the country is an energy giant with 153 billion of proved oil reserves (5th in the world) and 3.7 trillion cubic meters of gas reserves (12th in the world), without mentioning that large swathes of the country have not been explored yet.

However, there is something more. In the Middle East, the most relevant geopolitical tensions pertain presently to the rivalry played out between Saudi Arabia and Iran, which is exemplified by the proxy wars fought throughout the Middle East. In such a complicated area, in the past months, the Iraqi government has been able to develop energy relationships with actors belonging to both sides of the Saudi-Iranian rivalry game.

And in this regard, it's worth underlining that Iraq needs investments to quickly rehabilitate its economy and that, because of the country's history of the past decades, the country cannot be easily framed as belonging to one side or the other of the Saudi-Iranian rivalry. Among the most important energy relationships carried out by Iraq over the last six months it's worth mentioning

- Signature with Baker Hughes of a contract for modular natural gas liquids plant solution for flare gas recovery regarding the Nassiriya and Al Gharraf oilfields (July 2017)
- Request to BP to evaluate the Kirkuk oil field to increase production to 1 million barrels of oil per day (bpd) (October 2017)
- Signature with Saudi Arabia of 18 memorandums of understanding concerning the energy sector (December 2017)
- Discussion with Gazprom Neft about possible changes in the contract for the Badra field development project in Wasit Governorate (December 2017)
- One-year deal (subject to a possible extension) between with Iran on swapping up to 60,000 bpd of crude oil—Iraqi oil from Kirkuk to Iran and Iranian oil to Iraqi southern ports (December 2017)
- Discussions on the sidelines of the recent OPEC and Oapec meetings with Qatar Petroleum (QP) and Qatar's Ministry of Energy with the goal of having QP to develop projects (upstream, refining, infrastructure, and petrochemicals) in Iraq (December 2017)

In addition to the above-mentioned relationships, over the course of the past six months, Iraq's Ministry of Oil has held meetings with many oil companies, for instance, ExxonMobil, Kogas, Petrofac, Petrochina, Total, Lukoil, and Petronas.

Until now, in Iraq, apart from the production sharing contracts (P.S.C.s) signed by the Kurdistan Regional Government (K.R.G.), which are considered illegal by Baghdad, the federal government has signed with the international oil companies (I.O.C.s) only technical service contracts (T.S.C.s), which have been awarded to the company bidding the lowest remuneration fee per barrel of crude oil produced. Most of the Iraqi T.S.C.s have a remuneration fee per barrel of about $2. The fee covers capital and operational expenditure and provides some profit to the I.O.C.. Until now, starting in 2008-09, Iraq has organized four licensing rounds for the development of its oil and gas fields. The results have been mixed. In specific, the fourth round of May 2012, was negative because only three exploration blocks out of twelve were awarded (with fees of $5 to $6 per barrel).

A few months after the fourth round, in the summer of 2012, Iraq's Petroleum Contracts and Licensing Directorate (P.C.L.D.), which is part of the Ministry of Oil, stated that it was working on launching the fifth licensing round. At that time, the idea was to have a licensing round only for exploring for gas and to ease the tough contract terms of Iraq's T.S.C.s to have contracts more appealing to the international companies. Today, after more than five years, Iraq has still to carry out its fifth licensing round.

In the first months of 2013, the Ministry of Oil planned to have its fifth licensing round for 10 oil blocks and not any longer for gas prospects; this project foundered as well. However, some months later, all the energy projects were put in the backburner because the Islamic State acquired global prominence conquering large swathes of the Iraqi territory droving out the federal forces from key cities during its western Iraq offensive and then capturing the city of Mosul. In brief, the federal priorities were at that time quite different.

In February 2015, the Ministry of Oil demanded that the I.O.C.s freeze or reduce their development expenditure, because the government did not have the means to repay the companies on time. Difficult negotiations ensued, but, in the end, some I.O.C.s reduced their expenditure. For instance, Lukoil, the operator at West Qurna 2, reduced its spending levels by more that $800 million, and Shell, the operator at Majnoon, reduced its spending levels by more than $600 million.

Then, on August 22, 2016, completely reversing the policy of February 2015, Iraq sent the I.O.C.s the letter “Targets of the Service Contracts,” in which the Ministry of Oil demanded the companies to push forward with development plans despite the low oil prices. In practice, Iraq wanted to increase production, utilize all the associated gas, and develop projects to support reservoir pressure. However, the companies complained at that time that Iraq was always late in repaying the companies’ costs, while, according to the signed T.S.C.s, cost recovery should have had a quick turnaround.

In the second part of 2016, the Ministry of Oil was planning to offer 12 small- to medium-sized oil fields—of which four in Basra Governorate and five in Missan Governorate, which are Iraq’s two most important oil-producing governorates. The plan required oil companies to discuss the contractual terms together with the Ministry of Oil on the basis of individual negotiations. Nineteen companies, mostly from Asia, prequalified, but then, in November 2016, the Ministry of Oil postponed this project—it affirmed that it wanted to develop itself some of the offered fields and to replace some of the initially tendered fields with some others.

Finally, in July 2017, the Ministry of Oil announced the launch of a new project (it’s called the “Project”) to explore, develop, and produce nine onshore and offshore exploration blocks in south and middle Iraq near the borders with Iran and Kuwait. None of the 9 blocks is part of the 12 existing oil fields that the Ministry of Oil intended to offer in the second part of 2016.

Five out of the nine blocks included in this project are in Basra Governorate. They are the three blocks Khudher Al-Mai, Jebel Sanam, and Al Fao on the Kuwaiti border, the Sindibad block (including the Sindibad oilfield, which is jointly owned by Iraq and Iran, and which could have 3 billion barrels of recoverable oil) along the Iraqi-Iranian borderline, and the Arabian Gulf block in the Arabian Gulf. The other four blocks are in four different governorates, all on the Iraqi border with Iran. The Naft Khana block is in Diyala Governorate, the Zurbatiya block is in Wasit Governorate, the Shihabi block straddles between Wasit Governorate and Missan Governorate, and the Huwaiza block is in Missan Governorate.

The fields located on the Iraqi-Iranian border have until recently been a source of tension between the two countries because the border is not well demarcated. However, in February 2017, Iraq and Iran signed an agreement establishing a joint commission tasked with finding a solution to this problem. Similarly, in April 2017, Iraq and Kuwait agreed to create a committee to examine the exploitation of their border fields—the Iraqi-Kuwaiti relationships have been quite difficult until recently.

The Ministry of Oil affirmed one more time that, for the fifth licensing round, it would introduce a new type of contract and a new mechanism to award the contracts. At the Ministry of Oil there is always the idea that the new model contract should result from a discussion about new fiscal and commercial terms with the I.O.C.s. The first draft model to be shared with the I.O.C.s should be ready by the end of February 2018. Then, in April 2018 there should be a workshop in which the companies could express their point of view about the new model contract before the final contract and tender protocol are issued by the end of May 2018. Then, at the end of June 2018, it should happen the submission of bids and the awards. This is the official schedule at the time of this writing.

In the 1970s, some successful exploratory drillings had been done in some of these nine blocks on offer, but the start of the Iran-Iraq War in 1980 and then the start of the Gulf War in 1990 have stopped all the activity almost until now. After 2003, it was discovered the Sindbad field, in Basra Governorate very close to the border with Iran. However, despite the limited assessment carried out in relation to the nine blocks until now, the scarce available data seem to already confirm that some of the blocks might have important deposits of oil and gas. Among the nine blocks, those that might have the largest deposits are the Shihabi block and the Zurbatiya block.

If Iraq wants to improve the attractiveness of its upstream petroleum sector, it has to revise its T.S.C.s. In fact, if on the one hand, the Iraqi petroleum model contract gives satisfactory results to the Iraqi government when oil prices are high, on the other hand, it has a disastrous impact on the Iraqi coffers when oil prices are low. The reason is that, despite low oil prices, the federal government must always pay the same fees to the I.O.C.s.

In fact, according to the T.S.C.s, the payments from the federal government to the I.O.C.s are based on production levels and not on the specific project revenue—it's always a fixed amount for every barrel of crude oil produced. So, with low oil prices, the government earns necessarily less. But, to add insult to injury, as per their contract, until they reach the established production plateau, the I.O.C.s must increase their crude oil production. And the more barrels are produced, the more fees the federal government must pay to the I.O.C.s despite low oil prices. In general, this payment is done in kind, which means that, with low oil prices, the federal government needs a greater volume of crude oil to pay the I.O.C.s.

At the same time, the I.O.C.s have never been particularly fond of the T.S.C.s because the reimbursement fee was quite low for production after a certain threshold and because there were important upfront costs they had to sustain. In any case, at the time of their signature, the I.O.C.s decided to invest in Iraq because

- it was important to re-enter Iraq after the nationalization of the 1970s

- the rounds concerned already-discovered fields with no exploratory risk
- the cost recovery was quite rapid so that project financing costs were reduced

However, also for the I.O.C.s. there is something more. With low oil prices, the T.S.C.s prescribe that the I.O.C.s' remuneration should remain the same, but if the federal government is not able to pay, it will postpone its payments, i.e., the I.O.C.s will have increased financing costs. In addition, cost recovery is capped to a percentage of "deemed value," which is "net production" in a quarter multiplied by the "provisional export oil price" for that quarter. This means that with low oil prices, there could be a decrease in the amount received by the I.O.C.s. as well. Additionally, I.O.C.s complain consistently about procurement procedures in Iraq.

The Ministry of Oil has repeatedly said that it would like to renegotiate the terms of its service contracts with the I.O.C.s to link the fees the companies receive for developing the fields to the oil prices and to have them share the burden when oil prices decrease. However, discussions between the federal government and the I.O.C.s have been going on for the past two years with no tangible results until now. Companies affirm that they have submitted some recommendations, but then the process has not moved on.

At this point, it seems that to have a successful fifth licensing round, the federal government must produce in the coming months a new model contract (or at least an amended version of the present T.S.C.s) capable of satisfying according to different price levels both the government and the I.O.C.s. Otherwise, it's difficult for Iraq to reach the production target of 6 million bpd of crude oil by 2020, especially if other neighboring countries might soon offer better contractual terms.

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