INOC Law: Shaky Premises And Doubtful Prospect

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Background

The Speaker of the Iraqi Parliament, Usama al-Nujaifi, said in a press conference in Baghdad on 16 March that the Iraq National Oil Company (INOC) law was due for first reading in the parliament. That reading took place and was televised on 31 March to commence the administrative process, but more substantive debate is expected before and during the second reading of the draft law before the final version of the proposed law would be tabled for the House vote according to the by-laws and constitutional requirements.[1]

The recent focus on the INOC law, and the so-called hydrocarbon "package of four laws" – comprising the Federal Oil and Gas Law (FOGL), the Ministry of Oil Law (MOOL), the Revenue Sharing Law (RSL) and the INOC law – seems to be linked to the political horse-trading and the "agreement" that led to the formation of the current government. [2]

The purpose of this paper is to make a contribution to the ongoing debate on the INOC law, shed more light on this law, identifying its main flaws and weaknesses and highlight the new approach and *modus operandi* sought by the parliamentary committee in dealing with this law and other related 'packaged' laws.

Priorities And Approach

In an interview given to *Iraq Oil Report* and on other occasions the current Chairman of the Oil, Gas and Natural Resources Committee (OGNRC) of the federal parliament, Adnan al-Janabi, provided his vision and approach in dealing with laws that fall under the mandate, responsibility and prerogatives of OGNRC. To be specific, and with particular reference to INOC, Mr Janabi [3] aims to:

- Adhere to "what's constitutionally right and in the national interest."
- Look into all pending legislation (the package deal) to "reactivate in parallel."
- Prepare for consultations with "all key parties and experts within the government institutions and outside."
- Make the INOC law "his first priority".

Giving priority to the INOC law could explain the recent tabling of the said law for first reading in the parliament. There are, though, implications. First, when the draft of this law is finalized (and not necessarily enacted, as it will be tied to the parallel reactivation within the package deal) the detailed provisions regarding INOC in FOGL become redundant and thus have to be either removed or radically reduced. Second, since the current draft of the INOC law is not identical, in form and substance, with the related provisions in FOGL, the current INOC draft has to be harmonized to take into consideration the relevant provisions in FOGL. Finally, there is high possibility that the Kurdistan Regional Government (KRG) would oppose this prioritization as KRG stood against (a strong) INOC, on the pretext of centralization. Also, INOC is not among KRG's "negotiations conditions" that preceded the formation of the current government. [4]

Participatory Approach And Consultations

The proposed consultation beyond the circles of the parliament is a significant step in the participatory development. But to make such endeavour effective, real and meaningful, such consultations have to be inclusive, representative and transparent. To be so, two levels of participation are important and should be carefully considered and executed.

The first level is OGNRC participation. Currently, OGNRC has 16 members and all except one, Bayazid Hassan 'Abd Allah Muhammad, are new to the role. Mr Muhammad was a member in the previous committee, and thus one can assume he is well informed on petroleum matters, while Mr Janabi is a well known oil professional. I assume, as confirmed by inside sources, that other members of OGNRC need a good deal of capacity development in their field of mandate to be able to address the legal, economic, technical and developmental complexities of petroleum sector. In conducting consultations with external (outside OGNRC) sources, it is not viable or advisable to involve all members of OGNRC. Equally so it is politically improper and dangerous to confine the consultation to one person only – the chairman of OGNRC. Hence the options of one or all should be avoided, as the first is incorrect and the second is dysfunctional. My proposal is to limit the participation from OGNRC to three members only: the chairman, the deputy and the secretary of the committee. This should not cause any problem as the three are already selected and do represent the three major political blocks (Iraqiya, State of Law, and Kurdish Coalition, respectively). The three representatives should report to OGNRC promptly and fully on their consultations.

The second level concerns the external parties to the consultation. The external consultations could be difficult, time consuming, susceptive to pressures from interest groups (business or political), and financially costly. Hence there could be real possibilities that such difficulties derail the debate and divert it towards self-serving orientations. Nevertheless, such consultation is necessary, beneficial and fundamental. I would suggest for OGNRC representatives to hold external consultations with three parties representing the state-business-society (SBS) triangle. The SBS formula could enrich and organize the proposed consultations provided they are conducted with carefully identified and selected representations.

The 'state' representation is usually from the petroleum professionals currently employed by the related governmental apparatus who have direct involvement in oil sector: the ministry of oil, regional oil companies, and oil and energy committee in the council of ministers. This consultation could secure functional channel of communication between the executive and legislative branches of state authorities to smooth differences and insure harmonious and coherent coordination between the parliament and the government on the related legislations.

The 'business' representation should come from the known Iraqi private companies currently involved in oil sector development. Recent information indicates there are some 50 such companies, which could enrich the debate. Effort should be made to avoid the domination of powerful business interests in such debate as this could lead to weaken national entities under the pretexts of competition, market principles and assumed efficiency. The current drafts of FOGL and the INOC law are full with provisions that have and could lead to uncontrolled liberalization and privatization of the upstream petroleum sector.

Finally, the 'society' representation could be confined to petroleum experts outside the sector such as retired technocrats, scholars and consultants residing inside or outside the country. For practical and financial considerations, the consultations with expertise outside the country could be done by using information and communications technology or on and *ad hoc* basis through conferences or roundtable discussions etc. However, availability of financing for direct consultations with external expertise could be a prohibiting factor. An important factor for societal involvement is accessibility to information and the possibility to make a contribution. For this purpose and to avoid misunderstanding, for time saving and to have a unified debating platform it is highly desirable to post the draft of the INOC law on the parliament website. In addition to the consultations mentioned above, the informed public should be invited to make their comments on the draft of the law during a specific period of time and provide web-space to post such comments.

The proposed consultations and the way they would be done, as explained above could deliver good results and help in developing functional legislations that could set the right and feasible path for solid development of the petroleum sector and a well established INOC.

Proposed INOC Law

INOC is a state company and should remains so. As a basic premise the company should be supported by the state financially, institutionally and legally. In the meantime it must have a good degree of independence in conducting its business and operations, and this should be maintained by legal instruments including its

laws and by-laws. INOC should have and adhere to strict good governance with uncompromised standards of transparency, accountability and efficiency.

The current draft of the INOC law has 30 Articles, divided over eight sections and a preamble. It is somewhat slightly different from the earlier two drafts of the law, which have been circulated since 2007, and I have addressed this law on many previous occasions,[5] thus there is no need to repeat most of the assessment of the law. However, basic issues deserve highlighting in the remaining space of this article.

INOC As A Public, Not Holding Company

The current draft refers to INOC as a "public company", reinstating what was mentioned in the 2007 draft but different from the term "holding company", which was used in the INOC law that was approved by the Council of Ministers on 28 July 2009 and sent to the Parliament and, thus supposed to be the one that has gone through the first reading on 31 March 2011. But the currently circulated draft for FOGL uses also the term "holding company", causing further confusion on which version of the INOC law is actually under debate by the parliament.

In my previous assessments of INOC law referred to above I addressed and opposed using the term "holding company" for INOC. Furthermore, it is vital that this term is not used in FOGL, otherwise there will be serious legal contradiction between the INOC law and FOGL.

The new draft, as in the previous one, maintains that provisions of public company law (PCL – in this case PCL No 22 of 1997) apply to INOC except what contravenes this proposed law. But disparities between the two laws are so many, so substantive and so effective that it makes no sense nor serves any good purpose to have INOC governed by the PCL. This adds even more ambiguities and creates further legal complexities that could affect the functions of INOC and its legality.

What is mystifying is that, while PCL provides the possibility of excluding any "extractive company" in upstream petroleum from the provisions of PCL (Article 41), the proposed law puts INOC under the umbrella of the PCL unnecessarily. This, once again, testifies that quick fixes and hasty proposals seem to dominate policymaking, an attitude that could only result in more confusion and further procrastination.

INOC's Areas of Operation

INOC, according to the proposed law, would be mandated to manage, develop and operate "current producing fields" and "the discovered not developed fields". However, two matters would effectively impact such mandate. First, the law does not specify by name these "current producing fields" and "the discovered not developed fields", thus open the possibility for different interpretation, as Article 112 of the constitution does. There should be no difficulty in specifically naming these fields, as the Ministry of Oil had, in October 2010, provided detailed information on 66 oil fields and surely the ministry has equally sufficient data on gas fields, which permits identifying the field (developed or not yet) that would be earmarked for INOC. Also in this respect, though the draft of FOGL clearly assigns fields mentioned in Annexes 1 and 2 for INOC, the two annexes are not provided in the said draft, and thus one cannot know for sure which fields are listed in the two annexes, especially these annexes were compiled in 2007 and much tampering have been done with them. Second, the fields (developed or not) would be assigned to INOC by a proposed Federal Oil and Gas Council (FOGC). The implication is that INOC has no real but only symbolic mandate, since it is FOGC which would effectively be the decision maker on which fields are to be assigned to INOC. [6]

In addition to the above "mandate" INOC would be allowed to conduct exploration, development and production in "areas outside its areas of operation, in accordance with FOGL". However, the current draft of FOGL mentions "competitive bases" among all 'licence holders' inclusive of the INOC as condition for having business in areas outside INOC's areas of operation.

There is an apparent bias against INOC involvement in petroleum operations in these areas for a number of reasons. To begin with and for strategic as well as sound policy, it is wrong and harmful to treat the INOC on an equal footing with those known IOCs. The pendulum definitely tilts against the INOC due to the large qualitative edge that works in theory and practice for the benefit of IOCs at the expense of the INOC. On the contrary, the INOC should receive preferential treatment, particularly as it faces international companies

with a huge potential compared with its modest one, which has suffered from the disastrous consequences of more than a quarter century of war, sanctions, occupation and the absence of normality and security. INOC is not yet reinstated, yet it is expected to compete with well established, more powerful and better organized IOCs. This is surely a non-starter for INOC.

Second, which other OPEC member treats its national oil company in the manner this FOGL is advocating for INOC? I doubt very much that any national oil company in a developing, transitional or developed country has been subjected to such a crippling precondition.

Third, even the very developed countries, such as Norway, [7] grant their oil companies' favourable treatment until they stand fast on solid ground. Why then does FOGL deny the INOC this widely recognized practice?

Fourth, as shall be discussed below, while FOGL emphasises competitiveness, the INOC law suggests "administrative" profit margins, operating costs decided externally (by FOGC, Ministry of Finance or another entity), and all its decisions are to be approved externally as well. Obviously this indicates an intention to prevent incompatibility between financial constraints, through administrative capital and profits, and the requirements of international competitive norms. The outcome would work against INOC for the benefits of IOCs, leading to further weakening of INOC and national efforts in upstream petroleum.

To sum up, there appears to be too many ambiguities regarding the mandate of INOC, its area of operation and what it is entitled to do outside these areas. By intention or omission, the outcome of such flaws in the law would weaken INOC, an outcome that would eventually serve the liberalization and privatization of the upstream sector.

To overcome all unfavourable provisions in the INOC law and FOGL and their possible disastrous consequences, I suggest an alternative comprising the following main principles:

- Since INOC is fully a state entity, each and every petroleum field (regardless of their exploration, development and production status) should be, by virtue of INOC law, earmarked for INOC. Provisions regarding petroleum fields located in Kurdistan region would be negotiated between the federal government and KRG.
- INOC should be mandated to develop these fields in cooperation with qualified Iraqi and foreign oil companies subject to: providing detailed economic and technical feasibility studies; approval by higher authorities as required by the law such as the Councils of Ministers (COM) and/or FOGC; such cooperation not taking the form of concession and/or production sharing contracts/agreements; and, when cooperation involves a foreign oil company, the related contract has to be approved by the federal parliament and enacted by law according to the constitutional process.

Capital Requirements And Financial Entitlements

Chapters 3 and 7 of the proposed INOC law cover the "Capital" and "Entitlements and Obligations" of INOC, respectively. As a fully owned state company, the capital of INOC and its operating costs – capex and opex – would be covered by the state. INOC will have ID400bn, increasing subject to the approval of COM after an economic feasibility study justifying such an increase. The company can borrow from internal and external sources to finance its investment requirements. Also it can issue bonds, which are exempted with their accrued interests from taxes.

A few observations are due on capital requirement and financial entitlement. As a state entity, INOC cannot borrow externally without the approval of the parliament, hence the approval of such borrowing by COM is neither sufficient nor constitutional. The law is silent on whether foreign individuals and or entities can buy the bonds. There are no clear economic justifications for issued bonds and their interests being tax-free. INOC begins paying back its capital to the state five years after achieving "net profits" (NP), at specific percentages of annual net profits starting from 50% and rising to 100% of NP when INOC has accumulated a value of the "reserves account" of four times its capital.

Provisions governing these matters are not free from ambiguities and inconsistencies. However, the most unspecified concept is the "profit rate", which the whole fiscal regime of INOC practically relies upon. Ac-

cording to Articles 16 and 17, INOC is entitled for each barrel of oil and gas in terms of barrels of oil equivalent delivered at any specific delivery point remuneration equals to that barrel's "operating cost and profit percentage". The barrel's "operating cost" is to be negotiated between INOC and the Ministry of Finance, and if they fail the FOGC will have the final word. The "profit rate/percentage" would also be decided by FOGC "in accordance with INOC's annual investment plan, provided that the remuneration is not less than the operation costs."

The above indicates that INOC financial entitlements are basically administered by FOGC. The questions now are: how competent and qualified this *ad hoc* body, FOGC, would be in determining INOC revenues; what are the main parameters it uses to reach a rewarding profit margin and accurate operating costs; and could this become a disincentive for INOC or even a powerful leash to hold it from playing an active role in upstream petroleum development? After all, FOGC is an entity that will be created pursuant to FOGL and is thus an unknown entity now! [8]

Finally, by focusing on operating costs that are, by definition, geared to production of oil and gas, INOC would have less incentive for exploration activities that could augment the national reserves to replenish production.

Management, Governance And Oversight

The proposed law provides that INOC would be attached to the COM but have its own management board; however, all decisions by this board have to be approved by FOGC. At the outset the attachment of INOC to COM while its decisions are the prerogatives of FOGC would surely create conflict, confusion or a multiplication of authority over INOC. When INOC is institutionally attached to COM, why then has FOGC the oversight and approving authority over decisions taken by INOC management board? These are serious matters that have to be cleared, resolved and drafted properly and effectively in the proposed law.

Also, the attachment raises the question of whether COM will supervise INOC's operations directly, or via an entity within the COM organizational structure, or the Deputy Prime Minister for Energy (currently Husain al-Shahristani). Moreover, as COM is a very politically-driven council this could lead to INOC becoming more politicized and affected by the devastating *Muhasasa* (party quota system) of Iraqi politics. Thus the current law would lead to either conflict or confusion or multiplication or overlapping of authorities over INOC, and this could very well generate serious managerial difficulties with detrimental consequences.

Even if the above confusion of COM and FOGC control over INOC is resolved, there are no compelling reasons justifying full oversight of FOGC over all decisions taken by INOC board, as suggested by the proposed law. Such strict oversight by an ad hoc body, which has less sector-specific professional competence than INOC itself, is unnecessary, unjustifiable and unproductive. Therefore, FOGC approvals should be confined to strategic and important decisions that can be specified in the by-laws of INOC.

The composition of the INOC management board is an important matter, especially under the above-mentioned strict oversight by FOGC and COM. Members of INOC board should essentially represent oil companies under the umbrella of INOC such as South Oil Company (SOC), North Oil Company (NOC), Misan Oil Company (MOC) and any other oil/gas producing entities. In addition to these there should be one ministerial representative from each of the ministries of oil and of finance. The first is to insure sector-specific harmonization and coordination, while the second is to insure financial coordination since the Ministry of Finance has a vital role in affecting the fiscal regime, as discussed above.

The proposed INOC law suggests representatives of the Central Bank of Iraq (CBI) and the Ministry of Planning as members of the INOC board. I actually do not see compelling reasons for these representations. CBI, according to its current law, is an independent entity, and thus its role is very different from what it used to be prior to 2003. Hence, its representation could either contravene its own law or would not be effective. Also, the representation of the planning ministry is redundant on this operational level since the ministry would be represented in FOGC, which oversees INOC.

The chairman of INOC, who would also be the head of its management aboard, would have ministerial status, with executive powers and authorities. However, the law does not specify the modalities of nominating and approving the chairman's appointment.

A suggestion was made to give the chairman ceremonial duties while the real day-to-day authorities should be given to the Executive Director. I do not see too much benefit in such suggestions for the following reasons: INOC is fully a state entity and thus it is structurally different from corporations, which usually have a chairman and chief executive/director for reasons of governance and efficiency of operations. Second, if the chairman has ceremonial duties s/he should not have a ministerial status while the one who has the authority and responsibility has lower status.

In light of the above, provisions of the law pertaining to INOC's attachments, its management board and the supervisory role higher authorities are full of flaws requiring very serious revisions and thoughtful consideration.

Concluding Remarks

Most Iraqi oil professionals inside and outside the country have called repeatedly for INOC to be reconstituted, although their views can differ depending on the changing circumstances. It is my view that re-establishing INOC is essential and deserves full support. However, all due attention must be given to ensure the company is re-established on a sound basis so that it can play an effective role in developing the nation's petroleum resources.

Unfortunately, and despite many published constructive views, the currently proposed law would effectively create a very weak INOC since its profit rates, its operating cost, and all its decisions including those related to petroleum fields assigned to it are decided externally. Such conditions would surely compromise the efficiency, effectiveness and performance of INOC.

In the meantime, and in addition to having been recently reinstated, the FOGL requires INOC to compete with IOCs for petroleum fields outside its areas of operation. This in all practicality is a camouflaged call for privatization of upstream petroleum. Was this the main intention of the INOC law and FOGL? Only time will tell!

Notes

1. However, at the time of writing this article, 9 May 2011, the draft of the proposed INOC law is still on the list of "project laws" with serial number 56, which implies the law has not been tabled for first reading. Moreover, the INOC law is not listed on the laws that are under first reading phase.
2. For more information see, A M Jiyad, 'Iraqi Federal Oil and Gas Law Revisited', *Energy & Geopolitical Risk,* Vol 2, No1, January 2011.
3. http://www.iraqoilreport.com/politics/oil-policy/qa-adnan-janabi-5591/?utm_source=rss (accessed 13 April 2011).
4. The 'Negotiation Conditions of Kurdistan Region…', Irbil, 21 August 2010, focused on two laws only: FOGL (draft dated 15 February 2007 and its amendments dated 23 April 2008); and Federal Financial Revenues Law – known as the Revenue Sharing Law (RSL – draft version dated 20 June 2007 and its amendments dated 23 June 2008).
5. See A M Jiyad articles and presentations as follows: 'Remarks on the Proposed INOC Law', presented to the MENA 2009 Oil and Gas Conference, Imperial College, University of London, 28-29 September 2009 (http://www.targetexploration.com/MENA09.pdf) and *MEES*, 5 October 2009; 'Technical Assessment of the INOC Law', *Iraq Oil Report* (http://www.iraqoilreport.com/the-biz/technical-assessment-of-the-inoc-law-2121/); 'The New Draft Law Takes Us Back to Square One', *Energy Intelligence* (http://www.energyintel.com/n/portal/iraqs-second-oil-gas-bid-round.aspx).
6. I am aware that very liberal and private interests are advocating that INOC should not have a clear mandate for "the discovered not developed fields." Rather, they suggest, INOC should compete with others for these fields in competitive biding rounds.
7. In fact the Norwegian government adopted a strict strategy of 'Norwegianization' that worked well in favor of domestic nationals and firms relative to foreigners, without compromising economic efficiency considerations. For further information see UNCTAD, World investment Report 2007, page 170.
8. For further analysis of FOGC see A M Jiyad, 'Federal Oil and Gas Council: Basic Issues for Consideration', Iraq Energy Institute, UK, 2009 (http://www.iraqenergy.org/).