

**Developing border-fields and utilizing associated natural gas: Important projects,
dubious and not transparent contracts**

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Information from and about the Ministry of Oil has been published and circulated extensively, in the last few days, concerning two important subjects or projects, each of which could have immense direct and effective impacts on the Iraqi economy and on the national interest. The first concerns the development of border fields with Iran and Kuwait, and the second is related to utilizing associated natural gas from Nassiriyah and Gharraf oilfields in Thi Qar province.

After thorough reviewing all information from the mentioned sources and analyzing what relates to both projects, I made a few remarks, diagnosed some flaws, inaccuracies and inconsistencies, and then proposed some practical suggestions and alternatives that I hope will attract the attention of the Ministry; especially those related to the necessity of utilizing “National Efforts” in developing border fields.

The extent and implications of lacking competitiveness and transparency, which consequently lead to questioning the integrity of the contractual process, have also been clearly identified. It should be recalled that the Iraqi Constitution emphasizes two basic principles directly related to these two projects: the first concerns achieving "the highest benefit for the Iraqi people" and the second “using the most advanced techniques of the market principles". In the light of what was presented and analyzed below, it is clear that the Ministry did not comply with these Constitutional requirements and obligation.

This contribution was premised on formal/official information from the following sources:

- 1 – The Ministry’ Press Office information related to the visit of the Minister to Missan province 8 and 9 July 2017;
- 2- The interview with the Director General-DG of the Directorate General of Licenses and Contracts (PCLD) in the Ministry, Abdul Mahdi al-Ameedi, with Iraq Oil Report-IOR (Iraqoilreport.com), published on 10 July;
- 3 - Statement of the Ministry’ Press Office on 11 July;
- 4 - The “corrected” announcement by PCLD of 12 July;
- 5- Statement of the Ministry’ Press Office of July 13 on the associated gas project;
- 6- Other sources referred to throughout this paper.

The paper discusses the border fields/ blocks first then addresses the utilization of associated gas.

THE DEVELOPMENT OF "BORDER EXPLORATION BLOCKS"

According to the ministry's statement, the Oil Minister announced the “launching of project for exploring, developing and rehabilitating nine exploration blocks on-land and offshore in the middle and southern Iraq; these include exploration blocks of (Khodr Alma, Jabal Sanam and Um Qaser) on the borders with Kuwait and the exploration blocks of (Sindbad, Howaiza, Shihabi, Zurbatiya and Neft Khana) on the borders with Iran. And one offshore block on the Iraqi territorial waters on the Arabian Gulf”

Before proceeding in assessing the basic contents of the Ministry's announcement and its intentions, it is useful and necessary to provide a brief note on the peculiarity and priority of developing border fields.

To begin with, I strongly and emphatically support Iraq's development of its border fields, regardless of the "comparative economic feasibility" that determine priorities and sequences of fields' development and their timing. This is mainly due to the consequences and impacts of "rule of capture" - which determines pattern and norm of developing such fields (not only between countries but even between exploratory blocks and shared fields by many provinces in one state) in the absence of " Unitization" agreement.

It is internationally known practice that a country (or entity) that has the “minor” share in a border field which develops the field first (or without cooperation with) the neighboring country, tends to adopt a strategy of maximization production for the shortest period of time, which ensures the extraction of the largest volume of proven reserves without regard to the principles of maximum efficiency rate (MER) or the "prudent management of oil reservoirs " or "enhance the recovery factor” in the medium-to-long-term perspectives. Moreover, that first developer tends to use directional and horizontal drilling to penetrate further more in the reservoir to accelerate and increase production.

It is logically expected that this strategy leads to negative damaging consequences on the reservoir, especially the phenomenon of "premature depletion," which leaves significant part of the proven reserves unrecoverable except only through using advanced technology at a very high cost, that renders such extraction uneconomical.

To avoid losses or consequences of unilateral development of border fields, there are two alternatives:

I-Reciprocal Competitive Development-RCD

This is mutual unilateral development (by the Party or parties sharing the border field or exploration block or geological structure). Under this alternative, each party adopts a competitive active strategy leading to the consequences on the oil reservoir (as mentioned above).

Evidently, RCD of border-field usually causes regional and international disputes and tensions the examples for which are many, such as what happened between Iraq, Iran and Kuwait.

In the case of fields or exploration blocks within one country, legal procedures are often used to address abuses or consequences, as occurred in India in November 2016. Partners in the deep-water KG-D6 block off the southeast coast of India say the Indian government is seeking about \$1.55 billion for natural gas said to have migrated from neighboring blocks.

II-Joint cooperation development

According to this option the concerned parties (countries) agree to joint development of the border field, especially through unitization formula. Both countries agree to select a specialized upstream oil company to develop the related field and conclude a tripartite (at least) contract involving the concerned countries and the selected company.

Under this alternative, the development of the field (theoretically and logically) is expected to be more consistent with good practices in the upstream petroleum industry.

In the case of a border field between (neighboring) countries, the unitization development contract tends to be complex, lengthy and requires covering three broad basic considerations and requirements:

The **first** includes considerations of international public law and matters of sovereignty, treaties and international relations (bilateral and multilateral);

The **second** covers a range of contractual, financial, economic, regulatory and operational aspects;

The **third** includes technical and geological aspects related to various dimensions and geological characteristics of the field, size, extensions and its structures among others.

Arriving at the final contracts and unitization agreement may require long-term perspective, integrated negotiation efforts and skills. For example, the Russian-Norwegian negotiations lasted more than 40 years before they reached (in 2010) an agreement on the search for oil and gas and drilling wells on their border area in the Arctic.

It is worth mentioning that international consulting and law firms have developed models of specialized contracts for "unitization" development of border fields.

After the above brief preview on unitization and in the light of the above, I will return to discuss the Ministry's announcement on the development of the border exploration blocks.

First: discovered fields not exploration blocks

It is rather strange and misleading for MoO to identify or called these as "exploration blocks"; while they are not and their number is nine, which is not the case either. All "exploration blocks", except the offshore one, have been discovered for years or, in fact, for decades and some have been producing.

In the light of official information from the Ministry regarding proven oil reserves published in October 2010 we provide the following examples, which completely refute what was categorized in the announcement.

Neft khana oilfield was one of the producing oil fields in the middle of the last century and, thus, it is a brownfield with its "remaining reserve" is only 1.5% of "initially (proven) reserves" at estimated "recovery factor" 49.3%.

The first well in Howaiza oilfield was spudded in the late 1970s but the drilling was suspended due to Iran-Iraq war. According to the information provided by the DG of Missan Oil Company, Adnan Nushi Sachit (according to the Ministry of Oil website 5 December 2016), the proven reserve of the field is estimated at 219 million barrels, which qualifies the

field to produce between 20 to 30 thousand barrels per day at completion of development. (Note that the Ministry's information indicates more than double that as the remaining reserve is estimated at 480 million barrels, which is 100% of proven reserves indicating Howaiza as a greenfield- discovered but not developed yet.

The same applies to Sindbad oilfield. According to Khaled Hamza Abbas, Assistant DG for “Fields Affairs” at South Oil Company (now Basra Oil Company) in last February, that drilling of two, out of planned five, wells was completed; indicating to the start of production between 3 to 6 months. (Note that the Ministry's information for 2010 referred to above on proven reserves did not include this greenfield).

Ironically, the Minister himself has recently (according to MoO first and second Press Office reports dated 20 July) said, upon the inauguration and completion of the third well and the near completion of the fourth well in this field will be developed by “national efforts or through contracting foreign company”. He states the field production capacity at 50,000 barrels per day and praises the “speedy at a lower cost” drilling operation because it was done by the “national efforts”; by the Iraqi Drilling Company-IDC, which, as he stated, has expertise and capacities comparable to international drilling companies, (hence, contradicting his categorization of IDC as “loss-making company” only a few weeks ago); a continued inconsistency and lukewarm ministerial statements.

As to the number of nine "exploration blocks", it is also inaccurate or not precise. PCLD' information, for example, says "Howaiza exploration block" comprises: Howaiza oilfield and south Howaiza structure (both are green); and “Neft Khana exploration block” comprises Neft Khana (brown) field; the southern Neft Khana structure and two Neft Khana fields: Naudoman and Tal Ghazal. (Both fields Naudoman and Tal Ghazal are greenfields where the proven reserve of the first is 100 million barrels and the second is 10 million barrels at estimated recovery factor of 15% each). Hence, that would be a combination of 12 fields, exploration blocks and geological structures. Moreover, the latest statement by MoO Press Office dated 20 July refers to “10 border oilfields”!!

What matters here is not only the inaccuracy of the information by calling "discovered fields" as "exploration blocks" but the legal consequences of the contracts, as it is known that the exploration contracts are usually formulated and structured on the basis of “high” business risks and business uncertainty. Moreover, such inaccurate and confused terms could lead to wrong impression that: those who cannot distinguish between exploration blocks and discovered field cannot understand the complexity of contracts that are legally drafted by IOCs to ensure their own maximum interest.

As PCLD is promising to prepare and offer “information folder” on all these blocks/fields, for a fee of \$100,000, to the interested prequalified IOCs, it is highly advisable to be very clear and specific and avoid using technically and legally confused or inaccurate categorizations.

Second: preferring foreign companies over the national companies and efforts

All indicators and available information show that all these exploration blocks (or discovered fields) will be offered to foreign oil companies and, thus, will not be developed through national effort as the following demonstrate:

(1) - Despite his repeated statements that he supports national effort to develop fields, all current Minister's deeds are completely contrary to his words. He has already proposed to assign to Karbala provincial council the three oilfields of the Middle-Euphrates through contracts with foreign companies. Then, he offered 12 small and medium fields on the same formula. He also promised to allocate two fields to the province of Basra; and then negotiated with ExxonMobil to "tie-up" the development of Ratawi (2.47 billion barrels of proven reserves) and Nahr Ben Omar (6.34 billion barrels of proven reserves) oilfields through dubious and un-transparent contract; and now he offers these "exploration blocks". So, what is left for the national effort or for the Iraq National Oil Company-INOC?????

(2) - This preference towards foreign companies is also clearly inconsistent with the plans of national companies in the producing provinces, which aims to develop fields with the national effort, indicating that the minister imposed and imposes his preference for foreign companies at the expense of the national efforts!!!

"The field development plan will start in the new year and with the national effort," said the DG of Missan Oil Company, Adnan Noshi Sachit, on the Howiza oilfield. Also, Khalid Hamza Abbas, Assistant DG of Field Affairs at the South Oil Company (Basra), said in last February, "the start of production in the field of Sinbad begins between 3 to 6 months". (Both referred to above)

(3) - The Minister of Oil (during his interview with al-Sharqiyah, which I thoroughly discussed at the time) stated that Iraq has no right to discuss border fields with Kuwait when these fields are contracted to foreign companies. If this is the case, what is the reason for the Minister's insistence on offering these borders fields to the foreign companies when he is fully aware and convinced that these assignments will deprive Iraq of its legal and sovereign rights??

In addition, according to what the Senior Deputy Minister, Fayad Nema, said in April 2016, Iraq signed a memorandum of understanding with Kuwait on developing border fields through "unitization" formula and the Ministry prepared a similar memorandum with Iran. Therefore, by offering these borders fields to IOCs the Minister is actually sabotaging these unitization efforts.

Third: Absence of competitiveness and transparency

The Ministry of Oil requests "to obtain proposals from qualified companies participating in the project their commercial models of oil contracts for the purpose of adopting the best of them and which is in the interests of the parties."

There must be a serious evaluation pause on this very alarming request.

(1) - Not in the history of oil relations between any developing country and international oil companies, what indicates that a host government offers such a number of fields and blocks and requests at the same time those companies to submit contracts governing the development of these fields and blocks. Neither historical evidence nor practical considerations nor negotiation practices nor the realization of the national interest nor the image of a country that the history of its oil industry nearing a threshold of an entire century justifies such a request!!

(2)- One of the basic practices, lessons learned and principles of the international negotiations is that whoever prepares the basic draft (for a contract, an agreement, a memorandum of understanding, etc.) gets more bargaining power than the one who receives it. In other words the negotiation starting position and preparedness (reactive, proactive or predictive) could impact its outcomes.

In this case, international oil companies (because of their negotiating expertise and their legal, technical, financial, contractual and human resources take proactive and predictive position) are capable (logically) for submitting a form or terms of contract that achieves the highest ceiling for their interests; and any subsequent negotiated concessions of any kind would leave that contract in their favor rather than the other party (Ministry of Oil with its reactive position).

And here we only have to remember the magnitude of the proposed/bidden “remuneration fees” by IOCs during the previous bid rounds that were "sky high" compared to the "contracted" fees accepted by those companies. For example, the three Missan oilfields where the discrepancy between the “bidden and the contracted” fee is approximately ten folds; the same, though at a lower discrepancy, applies to Zubair field contract.

Therefore, it is, rather, naive to expect international oil companies to offer a "mutually beneficial" terms as a starting base for negotiation!!

(3)- Also it becomes more difficult and complex in the case of "qualitative and quantitative imbalances" between the human and organizational capacities of the negotiating parties. As described above, what was offered by the Ministry of Oil is classified into three categories: producing (brown) field; discovered (green) fields (some with drilled wells and some with none) and one offshore block. Therefore, each group ought to have its relevant or special contract that differs substantially (but at varying degrees) from the other two groups.

(4)- Moreover, the Ministry's announcement refers to only nine blocks, while the details of the announcement refer to 12 blocks, geological structures and fields. If we assume there will be only one company (alone or a consortium of companies) for each of the nine blocks, the Ministry will have at least nine completely different contracts. Hence, here are the following questions which the Ministry needs to consider:

Does PCLD have the human, institutional and logistical skills and capabilities to analyze and evaluate contracts submitted by these companies?

What are the contract selection/ acceptance criteria in the absence of a competitive offer?

What are the competitive criteria for differentiation in case there is more than one offer for any area? (PCLD did not state in its announcement these standards or when it discloses them).

Fourth; Type of contracts

The official information and statements indicate that the contract will include a broad set of activities and obligations: "seismic surveys, exploration and appraisal wells, survey and clearance of explosives and un-exploded ordnances, crude oil production, optimal utilization of free gas or associated gas, and provide funding, expertise, technology, equipment, machinery and services."

This means the duration of the contract (regardless of its legal nature) could necessarily be of a long-term that could very well exceed 15 years; however, that depends on development plans that determine the level of production in the light of the proven reserve of the field in question; for exploration blocks it is usually longer in case of confirming the commerciality of the discoveries.

During his interview with the Iraq Oil Report (IOR) PCLD'DG, Abdul Mahdi al-Ameedi, was cited as saying "We asked companies for their suggestions regarding the commercial model of the contract ... related to the **revenues of the production, the costs, the distribution of the profits and other details related to the terms of payments**,"; "We will hear from the companies their suggestions, and then we will decide the final model for the contract." He added: "Certainly, we **don't do production sharing contracts**."

In this regard, I consider it very necessary to:

(A) Avoid the use of a "profit distribution contract" because this contract may be (in legal, economic and actual terms) the monetary side of a production sharing contract (PSC), especially when this contract provides the foreign company with the right of mercantile title to claim future profits;

(B) - The Ministry should benefit from the experience it has so far with the contracts of bid rounds and avoid their shortcomings, especially with respect to the rate of capital costs recovery and the structure of paying their remaining balance. In this regards there are many possible alternatives and options the choice of which depends largely on the status of the related field or exploration block;

(C)- Define clearly and accurately the main parameters of the "competitive criteria", against which all offers will be measured, after proper and professional examination and evaluation of these standards and under different assumptions several scenarios.

(D)- It may be very useful for PCLD to undertake consultation activity for presenting, discussing, evaluating and selecting best options for the "distribution of profits", "the proportion and structure of capital costs recovery", the components and standards of the "competitive criteria" and "the final contract model" among others in a thorough, professional and careful manner before submitting them to the IOCs. It may, also be useful to involve or solicit views of known Iraqi experts and consultants, from outside the official circle, in the consultation process.

(E) – It might also be necessary to include a paragraph in the text of the "final contract" relating to Iraq's right to include the field in “unitization” agreement when necessary.

That said, I strongly support and call for developing all border fields solely by “national efforts” for economic, legal, operational and contractual considerations; especially when the intention is to develop these border fields with Iran or/and Kuwait through “unitization” model.

UTILIZATION OF ASSOCIATED NATURAL GAS FROM NASSIRIYA AND GHARRAF OILFIELDS IN THI QAR PROVINCE

The continued flaring of associated natural gas is powerful manifestation of the failure of petroleum policy in Iraq. Although contracts for the second bid round oblige both the Ministry and contracting companies to utilize associated gas, and Basra Gas Company (as a joint venture with both Shell and Mitsubishi) use part of the associated gas produced by some of the southern fields, the rate of gas flaring is still high and increases in tandem with increasing oil production causing significant environmental damage and huge economic losses. Despite all the declarations, promises and plans, the percentage of associated gas flaring increased from 72% in January to 75% in April this year.

A recent statement by the Minister of Oil (posted on Alkhbaar.org on 20 July) indicates that “gas flaring will end by latest end of 2019” without specifying how and through which projects and under what financing that would address this chronic gas flaring problem. Moreover, he made a rather strange and confused comparison when saying, “by the end of this year the rate of gas utilization will arrive at 60% of the total flared gas”; the comparison should be related to total production of the associated gas not to the flared volume!!!!

In this regard, the Ministry of Oil announced (13 July, 2017) that a project for utilizing associated gas from the above mentioned two oilfields was contracted with GE (represented by Baker Hughes; as both companies merged lately forming a new BHGE company). The project will be executed in two phases and upon completion it will have a 200 mscf/d capacity; it provides dry gas for power plants and exports tons of LPG and condensate.

It is worth noting that this project is the result of the "Partnership Agreement", the first of its kind signed by the Ministry with General Electric (GE Oil and Gas) in April 2016 (at the time of the former Minister) covering several areas and activities in the oil and gas sector and power generation.

I must emphasize that any serious project that utilizes associated gas constitutes an important addition to the Iraqi economy and, thus, deserves support and praise. But such a project requires a preparation of a sound and realistic feasibility study on the one hand and full transparency and disclosure of its contract(s). This is what the Ministry of Oil did not do or explain.

(1) - The Ministry of Oil has not announced, to date, any details regarding the contents and conditions of the above-mentioned “partnership agreement”, or the legal frameworks governing it, especially with regard to the financial matters. And the fact that the Ministry is the signatory to this agreement, it is constitutionally considered as international agreement, which requires the approval of the Iraqi parliament by a law that should be published in the Official Gazette – *Al-waqae Aliraqiya*. Has the Ministry done that? There is no credible evidence it has done so.

(2) The Ministry also did not clarify the legal and contractual obligations of (or between) GE and Baker Hughes with regards to both: the partnership agreement and this project.

(3) – Obviously, this project has been awarded to the company directly, behind closed-doors, without call for bidders and without any competitive offers.

(4)- Moreover, no information was provided regarding the contract for this project or its main terms. Hence, the absence of competitiveness and lack of transparency increase the likelihood of doubtful and questionable integrity of the contract. It is internationally and legally proven that competitiveness, transparency and integrity are among the pillars of good governance that also ensure the principle of "value for money" for project contracting.

(5) - It is not known whether the economic feasibility of the project has been prepared and the cash flows (capital and operating costs and returns) annual and total were calculated or known; structure, sources and conditions of financing; internal rate of return (IRR) among other important issues that are usually covered by project feasibility studies. According to Law 84 of 1985, MoO is obliged to prepare such feasibility study.

In conclusion, it should be recalled that the Iraqi Constitution (in Article 112 - second) confirms two basic principles that are directly related to the two topics/projects discussed above: the first concerns achieving "the highest benefit to the Iraqi people" and the second adopting "the latest techniques of market principles". This analysis shows that the Ministry did not comply with these constitutional requirements in both subjects!!!!.

* This is an updating version of the paper that was written in Arabic, shared within my professional network on 16 July 2017 and posted on <http://www.akhbaar.org/home/2017/7/230939.html>

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