Ending ExxonMobil Presence in WQ1 Oilfield
Legal-Contractual Discussion with Economic-Financial Analysis

Ahmed Mousa Jiyad
Development Consultancy & Research
Norway

Information indicates that the Iraqi Ministry of Oil-MoO proposed to acquire (buy) ExxonMobil's participation interest-PI in West Qurna 1-WQ1 oilfield for $300 million, and the final decision depends on the formation and approval of the new government. The proposal revives the divergent positions that prevailed within MoO when discussing a similar situation in 2018 relating to the same oilfield. The likelihood of re-occurring similar outcome of that divergence requires analyzing and evaluating those situations to determine their relevance and adoption in deciding whether to acquire the share of ExxonMobil, in which direction and at what amount.

The first part of this article discusses the legal and contractual aspects pertaining to the purchase deal by discussing what have been recently raised through statements by two senior officials as representing their views and positions in 2018 and highlighting what they have not addressed of important issues directly related to the topic. The second part undertakes and provides computation necessary for economic- financial analysis of the deal.

When discussing the contractual legal aspects, I use the methodology of text analysis, precedents or physical evidence, internationally known practices in oil field development contracts. In the financial economic analysis part, I will identify and estimate the values of the variables and indicators known and common in economic feasibility studies and investment evaluation. These are cash flow, net present value, internal rate of return-IRR and investment amount recovery period.

The article suggests a number of concluding remarks that I believe should be considered by the MoO before finalizing the purchase of ExxonMobil's stake in this supper giant oilfield.

Part I: Discussion of Legal and Contractual Aspects

When discussing the possibility of the Ministry of Oil to "buy" Shell' PI in WQ1 oilfield in 2018 for $500 million, the discussion within the Ministry's "advisory body هيئة الراي" focused on two positions: the first represents views of the former legal adviser to the Ministry (Dr. Sabah Al-Saadi), as he circulated on 14/5/2021, and the second expresses the opinion of the former Director General of Petroleum Contracts and Licenses Directorate-PCLD (Abdul Mahdy Al-Ameedi), as he expressed by his e-mail dated 16/5/2021. It is noted that the disclosure of both positions coincided with the recent news regarding the Ministry's intention to buy ExxonMobil's PI for $300 million.

Al-Saadi's opinion is summarized as follows:

1. The service contract stipulates in Article 28 the right of the foreign company to transfer its rights and obligations to a third party with the approval of the Ministry of Oil / Basra Oil Company but did not provide for the "sale".
2. This amount, i.e., the $300 million, has no equivalence in kind or moral ليس له مقابل عيني أو معنوي to have a price.

3 . MoO and the Basra Oil Company-BOC are the owners of the field and have authorized Shell to work on it and the field has not been sold to Shell in order to be a refundable price.

Al-Saadi, accordingly, believes that MoO and BOC should acquire Shell' PI for free and he cited three similar cases to support his view, namely the withdrawal of Statoil from West Qurna 2 field, the withdrawal of Occidental/Oxy from Zubair field and the withdrawal of Shell from Majnoon field, without financial compensation, and the service contract for this field was termination.

Contrary to Al-Saadi, Al-Ameedi asserts, "South Oil Company (BOC) has no right to acquire the share for free" and he proposes, "Shell pay a percentage of (35%) as tax, on the value of its deal with Itochu Company of (500) million dollars, to the General Tax Authority, where the amount of tax is (175) million dollars."

After reviewing the details of the positions and opinions of the mentioned two officials (at the time), I would like to state the following:

First, article 28 in all service contracts adopted by the MoO is the same in structure and content, and such an article in international law is called a "common article": that is, the article exists in the same text, in more than one contract, convention or protocol, except as is necessary in relation to the subject matter of the contract, convention or protocol.

In addition, in all service contracts there is an article in which definitions are included (which is the first article in all these contracts), each article has a number, a title, and a text/content that provides in detail everything related to that article or the subject matter of the article. This means all the details of Article 28 must be taken into account when citing them in the presentation of opinion as far as the contract in question is concerned. Also, it is not appropriate to premise legal opinion on a narrow "linguistic" understanding of a single word, as discussed below.

Second, it is true that the word "sale or sell" is not mentioned in Article 28 of the service contract, but the focus on the linguistic aspect, i.e. one word and the very narrow Arabic translation, on the one hand, and ignoring the broad content of the said article and what this article covers and means and the actual practices in the oil extractive industry on the other hand, has greatly weakened the legal argument for Al-Saadi's position, which I believe he departed away from the legal analytical approach and stick to the narrow linguistic approach. My assessment was based on the following considerations and evidence:

1- In terms of meaning, and even linguistic translation, the term Assignment (which is the title of Article 28) has many meanings, including, evidently, sale or sell; therefore, the sale should not be excluded to formulate a legal opinion! Note that Article 1, which is for definitions, in all those contracts did not include the definition of this word- Assignment.
2- There is no consensus, within the Ministry of Oil and its officials, on a single unified "translation" of the same word: **Al-Saadi** translates it as "transfer", and **Al-Ameedi**[1] (in his important book published in 2021) sees it as "transfer of ownership" when translating the title of Article 28, and explains the importance of the article by saying, "It concerns the transfer of ownership, transfer or assignment ..." (p. 168), and later used the word "sale" (p. 211). The **Ministry** translates the title of Article 28 as "waiver" (as stated in contracts

written in Arabic and signed by contracting parties and witnesses, such as service contracts for Badra oilfield and for exploration blocks 8, 9, 10 and 12).

3- If we turn to the contents of Article 28, there are references to the possibility of selling or similar to the possibility of selling. Paragraph (4) of this article authorizes the acquisition or taking by the first contracting party (the South Oil Company/Basra in WQ1 contract) of the Company's share offered to a third party "with the same terms and conditions as offered" to the third party. In actual, practical and contractual terms, the "terms and conditions offered" are either financial, expressed by a specific amount, or exchanged with other physical assets. Whatever these "terms and conditions offered" are, as a result, actual and contractual they relate to a sale and purchase deal. In mentioning this paragraph, Al-Saadi referred to it as the same as the " right of preemption" in Iraqi law. But the right of pre-emption never allows the object in question to be obtained free of charge, neither in Iraq nor in Norway – where I reside – and I have not heard of any application of this right as meaning to obtain the object for free!!.

In this regard, Al-Ameedi seems to come closer to Al-Saadi's interpretation and writes, "The phrase 'with the same terms and conditions as the third party' at the end of paragraph (28.4) does not imply the existence of an amount, value or price for the assignment of the share of participation").

Again, it is true that the phrase in question does not specify the existence of an amount, value or price for the assignment of the participation share, but at the same time and in the legal interpretation it does not negate the possibility for material compensation, whether amount, value or price. Moreover, it is not legally possible for international oil companies to “give” their contractual shares free of charge to a third party- other international oil companies!!!. Where such an amount, value or price exists, it becomes unreasonable and illegal to deny it; otherwise, this paragraph (28.4) has no legal or contractual value at all!!!.

Paragraph (5) of this Article also states, "For the purpose of financing petroleum operations, any entity constituting Contractor may pledge, or otherwise encumber totally or partially its rights under this Contract to an internationally recognized bank and/or financing institution acceptable to SOC…”

Hence, it is logical and legal that who can “pledge or encumber” rights can sell those rights. It is worth mentioning that the possibility of " pledge or encumber" is a common practice in oil field development contracts, whether they are service contracts or production/profit sharing contracts. It is useful to mention, inn this juncture, that most well-known banks and international financial institutions that finance production/profit sharing contracts have specialized divisions for reserve-based lending.

Third: Financial or in-kind compensation

In his objection to the purchase of Shell's PI, Al-Saadi said, "This amount has no remuneration/ equivalence in kind or morality to have a price for it."

In fact, I find it very difficult to understand this opinion, especially since Al-Saadi himself admits that the Japanese company paid $500 million to acquire Shell’ PI; this in itself is powerful evidence of the existence of material and in-kind compensation. Otherwise, what is the explanation for the payment of this amount by the Japanese company if it does not have a corresponding material or in-kind value!!!

Fourth: The owner does not buy what he owns

I completely agree with Al-Saadi in his statement above, but I completely disagree with him in his application of this opinion to the topic under discussion. I believe Al-Saadi has a problem in determining "the subject-matter of ownership: ownership of what."

In all service contracts signed by the MoO as a result of the four licensing rounds, IOCs **have absolutely no right to own the oil fields, nor to the oil or gas produced, nor even the materials, instruments, devices and equipment used in the execution of those contracts as soon as they enter Iraqi territory, except those that are used on the basis of rent or imported temporarily, provided that they are re-exported from Iraq when they are no longer needed.** This is stated in all signed contracts by Article 22 on “Title to assets”.

But what the IOC owns is only their "remuneration fees" and "additional remuneration fees" and exclusively; the employee - that is, the foreign company - only who owns the "right to his wage", not who pays the "wages", and only the employee has the right to dispose of his future wage within the contractual provisions. Hence, neither the South Oil Company (nor other Iraqi oil companies) has the right to acquire the future remuneration fees of the IOC free of charge, but has the right and priority to purchase future remuneration fees as implicitly provided for in article 28, paragraph 4.

Fifth: Citing previous withdrawals of companies

Citing previous withdrawals plays an important role in negotiations with foreign oil contracted companies, especially in international arbitration sessions to resolve disputes over the performance of the contract in question, and this is what is called in the international negotiation and arbitration literature "Power of Precedence". In order to benefit from such a citation, the person using it must not be selective, be familiar with the circumstances of the cases cited and finally be familiar with the details of the contract in question.

After reviewing the database and scrutinizing the three withdrawals cited by Al-Saadi, I found it helpful to make the following observations:

1- The citation was absolutely selective in stating only cases in which they did not entail the payment of any declared amount, while ignoring cases whereby the PIs of the companies concerned were "sold" and with the approval of the Ministry. The cases under which the sale against payments took place are: ExxonMobil selling part of its PI in WQ1 oilfield to CNPC (China) and Pertramina (Indonesia), Shell selling its entire PI in WQ1 to Itochu (Japan). Kuwait Energy sold 10% of PI in Exploration Block 9, now renamed the Fayhaa oilfield, to the Egyptian Petroleum Company in 2015, then sold 15% to its partner in the field – Dragon (UAE) in 2018 and finally sold the remainder of its 45% PI to a company within the United Energy Group Limited-UEG (China) in 2019. Kuwait Energy also sold its 25% PI in Siba gas field to the same company in UEG. So why did Al-Saadi ignore all these sales cases, while Al-Ameedi referred to them in his letter referred to earlier.

2- Only the names of the withdrawing companies and the names of the oil fields in question, were cited without any details of the subjective and objective circumstances that prevailed at the time that led to the withdrawal without declared material compensation. Citing in this way is not a credible argument and does not serve at all the view calling for a free-of-charge withdrawal in favor of the Iraqi contracting party. In order to assess these withdrawals of the three companies, consideration must be given to both the entire Article 28 of the Contract and Addendum One, the "Heads of the Joint Operating Agreement" -

JOA. I will try to present very briefly the circumstances that led to the withdrawal of the said companies.

(1) Statoil withdrawal from West Qurna 2 oilfield

Norwegian company Statoil (currently called Equinor) withdrew from WQ2 oilfield contract (signed as part of the second licensing round for green fields) less than two years after the contract went into effect and its PI was 18.75%. Because the company did not find a third party to sell its share (according to Article 28), the only other foreign partner, the Russian company Lukoil, was obliged to either withdraw from the contract or remain with having the Norwegian company's PI without compensation in application of Article 8 of the "Head of the Joint Operating Agreement"; it chose the second option (since it had previously contracted this field in 1997 on production-sharing agreement- this is a long story whose details cannot be addressed here). The takeover brought Lukoil's PI to 75%; that is, the PI of the withdrawing company was not transferred to the State Partner, the North Oil Company.

(2) Occidental/Oxy withdrawal from Zubair oilfield

At the time of signing Zubair field service contract on 22 January 2010, the shares of the contractor's consortium were as follows: Italy's Eni (32.81%), the U.S. Occidental Company (23.44%), Korea's Kogaz (18.75%) and the state partner – Maysan Oil Company (25%).

In light of the contract second amendment signed on 15 July 2013, the state partner PI was reduced to 5% and the reduction was distributed to the rest of the participants, where the share of Eni increased to (41.56%), Oxy to (29.69%) and Kogaz to (23.75%).

Oxy expressed its intention to withdraw from this contract in the last quarter of 2015 and its withdrawal was completed in September 2016 at which time the production of the Zubair field was 400kbd, which is more than double the base-line production when the contract was signed. Under the withdrawal, Oxy's entire PI was transferred to BOC without compensation.

To understand this withdrawal case and the usefulness of citing it, we have to try to answer a number of important and relevant questions.

The first question, why did Occidental withdraw? In light of the circumstances that prevailed at the time, one can answer by focusing on three reasons: 1- the significant deterioration in international oil prices since mid-2014; 2- The ability of the Ministry of Oil to pay IOCs dues was negatively affected by the coincidence of the decline in export oil prices, the impact of ISIS/Daesh and KRG control of some of the fields of the North Oil Company; 3- Oxy strategic decision to divest its activities in the Middle East region to strengthen its presence elsewhere.

Question Two: Why hasn't Oxy sold its PI to a third party? There is more than one explanation; it did not find anyone to buy its PI, or it did find a third party, but the other partners – Eni and Kogaz – did not agree to the new partner.

Question Three: Why haven't the other two partners bought or acquired Oxy's PI for free?

Neither of the other two partners was obliged to do so since they can, contractually, acquire that stake for free as long as the company has not found a third party to purchase its stake. But why didn't they get the PI for free then? To answer, two possibilities can be envisaged: First, unwillingness of both or either of them to bear the additional financial burdens resulting from having Oxy PI. The second is their conviction that the acquisition of Oxy PI by SOC/BOC free of charge will be useful and will help facilitate the execution of the contract since SOC/BOC is the first contractual party and at the same time, it will become within the second contractual party.

In this regard, Al-Ameedi writes in his letter, "With a proposal for a decision from the Director General of the PCLD........ , Italy's Eni and South Korea's Kogaz were forced to give up the share of the withdrawal of the US company Occidental from the contract and the acquisition of this stake by the South Oil Company." Here, it must be asked why Al-Ameedi did not mention this proposal in his book where he wrote, "It is surprising that Occidental did not resort to selling its share" (p. 229)!! And why didn't the Ministry of Oil "force" the oil companies that sold their PIs after September 2016!!!

Fourth question: What are the consequences of SOC/BOC acquiring Oxy's PI for free?

1- BOC receives its share of the net remuneration fee (after corporate income tax) at the rate of $0.386 for each additional barrel produced above the balance of the base-line production adjusted after estimating the impact of the natural decline rate as of September 2016.
2- BOC shall pay (31.17%) of the total quarterly capital and operational cost for the development of the Zubair field at the same time (upfront) in which the other two partners pay (share of its participation and share to cover the share of the state partner). Economically, this means that BOC bears the payment of annual interest calculated on a quarterly basis for the total quarterly capital and operational cost. In other words, it is true that BOC has acquired Oxy's PI without payment, the upfront payment effect continues until the development of the oilfields reaches the plateau production target.
3- From a contractual legal point of view there may be a problem that BOC, which is the first party to the contract, becomes part of the second party to the same contract. This problem may arise in an effective way if the article on international arbitration is invoked for any reason whatsoever. I will return to this issue in the second section.

(3) Shell's withdrawal from Majnoon oilfield

The service contract for Majnoon field came into force in January 2010, and the participation interests of the IOCs was as follows: Shell (45%), Petronas (30%) and the State Partner – Maysan Oil Company (25%). The field was offered in the second round of licenses for the development of the green oilfields - with a remuneration fee of $ 1.39 per barrel.

Shell reluctance to implement its contractual obligations in developing the field and in reducing associated gas flaring, prompting the MoO in July 2013 to send an official letter on

the subject in which it estimated the damage to Iraq at more than $ 4.6 billion. In September 2017, it was announced that MoO and Shell had reached a mutual agreement under which Shell would exit from Majnoon field. Since Shell is the contractual operator of the field and its partner Petronas appears unwilling to be the operator, the service contract was terminated. It is not yet clear what the contents of the consensual agreement that terminated the service contract were and what was done about the above mentioned damage to Iraq. Therefore, it is not accurate to say that Shell withdrew from the field for free!!
Curiously, neither Al-Saadi nor Al-Ameedi mentioned anything about the circumstances of Shell's exit from this field!!!!

From the foregoing, it is clear that the citation of the three free of charge withdrawals was selective, didn't and address the circumstances that led to the withdrawal and did not prove by solid evidence that they were all without compensation or cost. In addition, the common denominator between these cases is the absence of a third party, which has become inevitable, contractually, to withdraw without compensation (in the cases of Statoil and Occidental) or termination of the contract, consensually, in the case of Shell/Petronas.

Sixth: Imposition of Corporate Income Tax
In his letter, Al-Ameedi affirms that the sale of IOCs PI were approved by the ministry easily and without problems, "except for the position of the PCLD (which was a personal position when I was the general manager of this department) which demands that Shell pay a percentage of (35%) as tax on the value of its deal with Itochu of ($500) million to the General Tax Authority, where the amount of tax is ($175) million. We have notified the General Tax Authority and Basra Oil Company on this. This position is based on... The value of the transaction represents compensation for the expected profit wages [Remuneration fee] in the future. Since profit wages are taxable, the transaction amount is taxable too."
I think this proposal represents a step in the right direction, but at the same time I have the following remarks:

1- The possibility of a weakened contractual legal basis because the proposal effectively means the re-imposition of the income tax previously paid by the foreign oil company for its share in the remuneration fee before the sale of its share, and perhaps for this reason Al-Ameedi did not mention any response by the General Tax Authority to his proposal at the time.
2- The new foreign oil company will pay income tax for the continuation in the production of additional oil from the production capacity that was prevalent at the time of the sale of the PI of the withdrawn company and at the time of the purchase of the PI by the new company, (I will clarify further in the second part of this intervention the economic and financial calculations of this sale and purchase of PIs).
3- Despite the importance of this proposal, Al-Ameedi did not mention anything about it in his book referred to earlier. He also did not explain in his letter why his proposal was limited to Shell only and did not mention the rest of the similar deals mentioned in his letter.
4- In February 2014, I proposed to the Council of Ministers, the Ministry of Oil, the State Shura Council and the General Tax Authority the need for a new law on the imposition of a

"financial gain tax" on transactions relating to selling shares of the contribution of foreign oil companies in service contracts.[2] Had such a law been enacted at the time, Iraq would have benefited financially from the sale of shares of these oil companies. It worth mentioning that MoO introduced in the profit-sharing contract for the fifth, failed and suspicious, licensing round (2018) what looks like a financial gain tax in the name of "Transfer fee" in Article 28.10 and at the rate of 35% according to Article 1 of the contract for that round.

Seventh: What the two former officials did not address

In the discussion above, I explained what was included in the positions of the two former senior officials, who, by virtue of their high official positions within the structure of the Ministry, had an important and influential role in the day-to-day course of events pertaining to the subject under discussion, which also means that they had all the possibilities to obtain the relevant data and information. Since both are now retired, it is expected they are free from "job pressure" that, in some circumstances during service, does not allow transparency, clarity and candor, and that they now have enough time to review and reflect; all this prompts "thinking outside the box"!

Below are the most important issues related to the subject that were not addressed by Al-Saadi and Al-Ameedi:

1- They did not mention and did not estimate the financial and economic impacts of reducing the State partner share when selling the shares of the participation of foreign oil companies.
2- Failure to provide information regarding the value of the similar previous deals, noting that IOCs are contractually obliged to provide such information in order to obtain prior MoO approval for such deals.
3- Failure to prepare and present the financial economic analysis of the current proposal by MoO regarding the acquisition of ExxonMobil's PI in WQ1 for $300 million.
4- Failure to discuss the contractual and operational aspects and implications of such purchase of ExxonMobil and to play its role as the operator on the one hand, and the “duplicate role” of BOC as the first contractual party and at the same time the "main contractor and operator" of the field within the second contractual party.
5- Failure to assess the likelihood of activating the international arbitration clause in service contracts by ExxonMobil, the extent, and consequences of the impact on Iraq and its cost if loses the arbitration lawsuit.

Part II:
Economic-Financial Analysis of the Ministry of Oil's Proposal
Purchase of ExxonMobil's PI in WQ1

This section aims to prepare and evaluate the financial economic feasibility of this transaction through the available data, identify the known indicators in this field and estimate their values in the light of the relevant variables, and used MS Excel program in all calculations and charts.

First: Changing Participation Interest-PI for International Oil Companies-IOCs
The service contract for this field was concluded on January 25, 2010, was amended several times between August 18, 2010 and March 23, 2018, and these amendments included many matters, all of which, in the final financial outcome, work for the benefit of foreign companies (as I have explained more than once during my many previous interventions)[3], the most important of which is the change of PI of the companies that make up the second contractual party (which is the contractor-operator party). MoO justified these amendments to compensate the contractor for reducing production plateau target and extension of the contract period. There seems to be an implicit assumption that this reduction provides fiscal incentive for foreign companies to remain and implement the projects throughout the contract period, but, apparently, the ministry has neglected to introduce the corresponding amendments necessary to prevent foreign companies from exploiting this reduction, as I will explain later.
The participation interests at the time of signing the contract were as follows:

ExxonMobil	**60%**	**This constitutes 80% of the 75% PI of foreign oil companies.**
Shell	15%	This constitutes 20% of the 75% share of foreign oil companies.
State Partner	25%	Iraqi Oil Exploration Company - OEC

The share of OEC was reduced from 25% to 5% in November 2013 and the reduction was given to the other two partners, which contributed to increasing the share of ExxonMobil to 76% and Shell to 19%; that is, increasing the share of both companies by 26.7% at the expense of the Iraqi interest, as I will explain and demonstrate later. It is worth mentioning, and surprisingly, that this change comes despite and after ExxonMobil signed contracts with the Kurdistan Regional Government-KRG in October 18, 2011.

Under the fourth amendment, signed on February 19, 2014, the PI became as follows, after ExxonMobil sold parts of its stake to China (CNPC) and Pertamina of Indonesia as shown below. To date, it has not been announced when these sales took place (I believed to have taken place in December 2013 or January 2014), nor the amount and terms of each of these deals.

ExxonMobil	32.7%	This constitutes 34.4% of the 95% PI of foreign oil companies.
Shell	19.6%	This constitutes 20.6% of the 95% PI of foreign oil companies.
CNPC	32.7%	This constitutes 34.4% of the 95% PI of foreign oil companies.
Pertamina	10%	This constitutes 10.5% of the 95% PI of foreign oil companies.
State Partner	5%	

On 23 March 2018, Shell website announced the sale of its PI for $550 million to Japanese company- Itochu (of which $406 million in cash and $144 million are debts on Shell to be repaid by the Japanese company; Shell has not mentioned any information about those debts, to whom and when they are repaid and the repayment instalments... etc.), remembering that both Saadi and Ameedi mention only $500 million as the value of the deal.

In my calculations I adopt the $550 million because the announcement of Shell was in the form of "Notes to editors", which carries much credibility because of its impact where the company's shares are traded on the relevant international exchanges. [4]
When Shell sold its share to Itochu, its PI was 19.6 percent, including 4.6 percentage points, or 26.7 percent of the sale amount; meaning that Shell received about $146.7 million as a result of the reduction of the state partner's participation stake.
In my opinion, the above amount is considered a financial loss incurred by Iraq and MoO was supposed to recover it from Shell before it granted approval of assign/sell its share to the third party - Itochu, because the justification for reducing the state partner PI is the continuing of Shell in the development of the field and the implementation of the contract, not to gain financially by selling its share to a third party.
After deducting the above amount from the value of the transaction, an amount of $403.3 million remains and Shell has to pay 35% of it (as an income tax according to the proposal of Al-Ameedi or a financial gain tax according to my proposal referred to above, noting that I have not proposed the percentage of this tax and that the law on this tax has not yet been enacted) which is about $ 141.2 million.
In the end, Iraq could have recovered from Shell a total of about $287.9 million, or at least $146.7 million, and I believe MoO should have asked Shell to payback the above amount or assess the legality and feasibility of filing a lawsuit in Iraqi courts accordingly.
The same methodology can be followed on the sale of part of ExxonMobil's PI to both CNPC and Pertamina that took place in late 2013 or early 2014. As mentioned above, neither MoO nor the two former officials disclosed the amounts of these two deals, so it becomes difficult to try at the moment to estimate what ExxonMobil should return to Iraq, which is equivalent to 26.7% of the amount of each of the mentioned two deals. I also believe MoO should demand a refund of the amount required from ExxonMobil during the negotiations for the current deal.
If we adopt the same methodology on the proposal of MoO to buy ExxonMobil PI for $300 million, I believe the amount of the deal will be $142.935 million and not $300 million, after recovering the waived state partner PI, of $80.1 million and the imposition of a tax of 35% on the remaining amount, which means the deduction of another amount of $76.965 million, so the total amount to be deducted is about $157.065 million or equivalent to 52.4% of the deal amount of $300 million.
From the foregoing, I believe that the **Ministry's negotiating position** with ExxonMobil should be based on the application of the two principles, the principle of recovering the share of the state partner and the principle of paying tax on the remaining amount of the transaction, on all the sale of the company's PI past and current transactions.

Evaluating the Deal

Notwithstanding the above, I will try in this part to conduct an economic-financial assessment of the feasibility of buying ExxonMobil's stake for $300 million, as stated in MoO proposal. In order to prepare the required calculations, it is necessary to identify the basic **variables**, explain their content, estimate their values, and then present the **indicators** of the economic-financial feasibility of the proposed transaction.

Net Future Participation Interest-PI

Contractually and specifically, the subject matter of the transaction relates to purchasing ExxonMobil's future net PI in the remuneration fee-RF (i.e., remuneration fee post payment of corporate income tax) for each barrel of oil produced **additional to** the **base-line production**, its contracted **natural decline rate** and the **production capacity** of the field at the time of concluding the purchase.

Variables needed to calculate ExxonMobil's net remuneration- NRF for each additional barrel of oil produced are:

- ✓ Remuneration Fee of $1.9 per barrel of additional produced oil – RF
- ✓ ExxonMobil's remaining PI in RF is 32.7% - PI
- ✓ Income tax on oil companies at 35% of RF - CIT

Therefore, the result of the equation for calculating ExxonMobil's net share in the remuneration fee is about **40.4 US cents as a maximum for each additional barrel of oil** as follows:

NRF= (RF*PI)*(1-CIT)= 1.9*0.327*0.65= 0.403845 (1)

Net Base-Line Production- NBLP

In order to estimate the level or volume of additional production at the time of purchase, it is first necessary to estimate the remaining balance (net) of the production of the BLP in the light of the values of the following variables specified in the service contract (Article 19, paragraph 5 (d)) for this field:

- The production level of the base-line at the time of signing the contract is 244 kbd (thousand barrels per day)- BLP
- Annual Natural Decline on base-line production level calculated by a compound rate of 5% per year - NDF
- The natural decline coefficient is calculated on a quarterly base in line with the timing of payment of the contractor's dues (Capex, Opex, remuneration fee) as specified in the contract. The sequence of quarter number (n) starts from (1), which represent the first quarter following the entry into force of the contract and so on, raised to power (^) (number of previous quarters divided by 4). In the following equation, (1-NDF) is equal to 0.95 for ease of calculation.

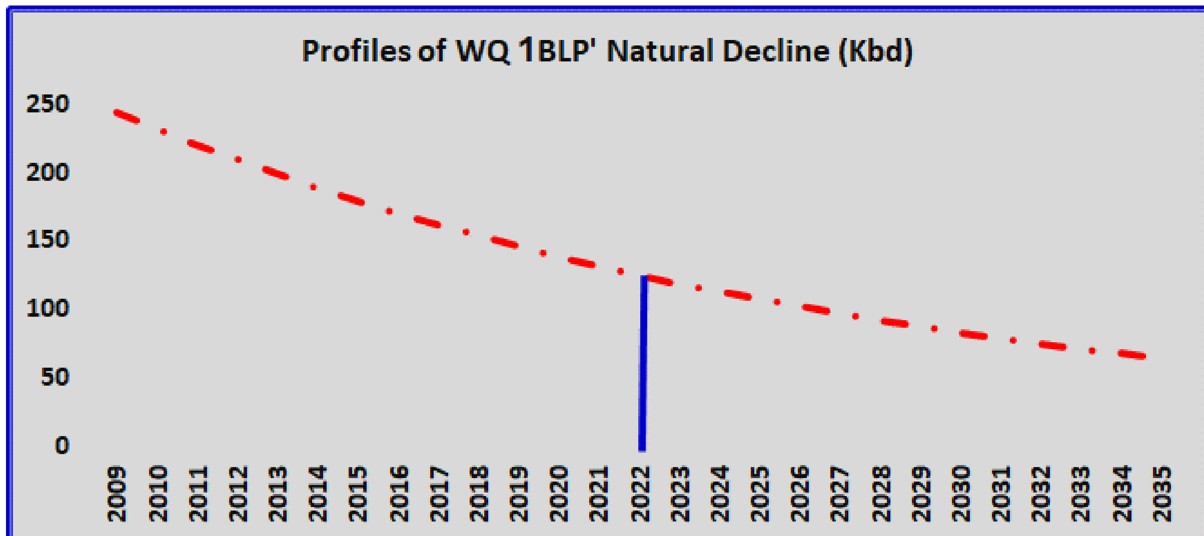
The daily average of the net level base-line production at any quarter is therefore calculated on the basis of the number of past quarters or the relevant quarter number-n as follows:

NBLP=(BLP*(1-NDF^n/4)) (2)

Using the above equation, the remaining level of production of the base-line is estimated for the forthcoming years to evaluate the value of the purchase deal.

The following figure represents a preliminary estimate of the net level of production of the starting line of the WQ1 using the above equation and based on the number of the fourth quarter of each year.

Figure 1
Net Base-Line Production, WQ1 (Kbd)



Additional Production (AP) when Purchasing the PI

Additional production over the balance of BLP is the basis on which remuneration fees are paid and estimated, calculated through two variables:

- Daily total production level at the time of purchase of the company's participation share- TP
- Net base-Line Production Balance- NBLP estimated through equation No. (2)

Additional production is calculated on a quarterly or annual basis according to the following formula:

AP= TP-NBLP (3)

MoO website does not provide any statistical series related to total production from WQ1 oilfield, but I was able to compile sporadic data on this production from different sources and at different times.

In light of these date, total production has fluctuated for many reasons between 330 kbd in May 2011 and 465kbd in June 2019, to fall to 414kbd in August 2021 but began to rise steady to reach about 520kbd in mid-June 2022.

Despite this variation in daily production rates, **production capacity** of the field developed through the service contract was increasing to reach about 550kbd in mid-2022. Therefore, when estimating the value of the future share, consideration must be given to both the last, and assuming sustainability, rate of actual daily production and the production capacity of the field developed under the service contract.

Hence, if June production rate is adopted at about 520kbd and the balance of the BLP at the end of the same month at about 128kbd, the rate of additional production at the end of the month is about 392kbd, and, accordingly, the net share in remuneration fee for ExxonMobil is about $ 158307 per day, or $57.8 million per year. This amount increases in conjunction with the decreasing balance of BLP, which leads to an increase in the rate of additional production until

the entire level of BLP is exhausted, then additional production becomes equivalent to total production of the current production capacity of 550kbd.

This is, in my view, the economic-financial basis for evaluating a deal to acquire ExxonMobil's PI.

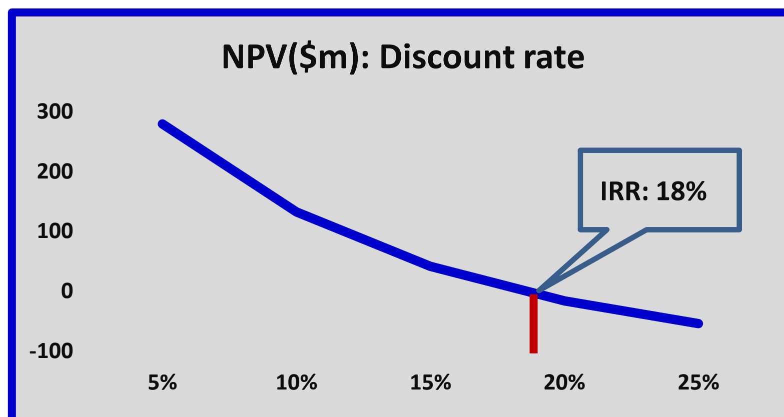
The estimates of the feasibility indicators for the deal were based on the values of the above variables (total production rate, additional production rate, BLP balance, production capacity and ExxonMobil's net share in remuneration fee) for the time period starting from the beginning of 2023 to the beginning of 2035.

Net present value of the transaction

The purchase of this stake for $300 million at the end of 2022 will generate a cash return (the sum of the company's net share in the remuneration fee) accumulated at the beginning of 2035 estimated at about $826 million over 13 years; that is, it gives a net cash return of $526 million, which is equivalent to a deposit of $300 million at an annual interest of approximately 8.1%. However, this net cash flow/return does not mean much economically because it omits the time factor in assessing this cash flow, so it is necessary to calculate the net present value of the entire cash flow above (including the value of the transaction and the company's net annual share in remuneration fee during the said period).

For this purpose, the net present value of the deal was calculated by using discount rate ranging from 5% annually to 25% annually. As can be seen from the following chart, the net present value decreases, but remains positive until 15% discount rate, and then turns negative under 20% discount rate.

Figure 2
Net present value (Million USD: Discount rate)



Internal Rate of Return- IRR

This rate is one of the important indicators usually used in the economic feasibility studies of projects and investment- the higher the rate, the more economically viable the investment. But compared to what?

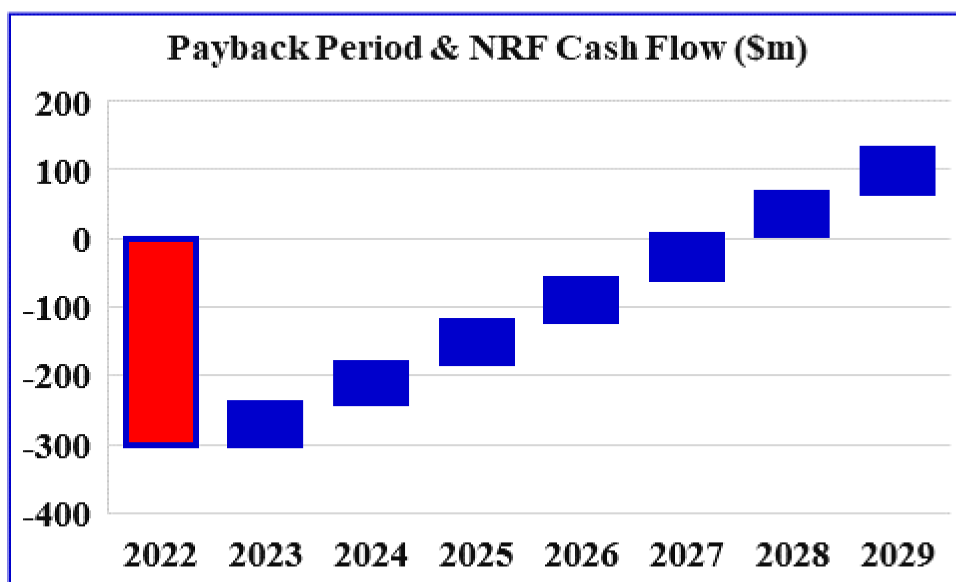
Each oil company, especially an international company, has its own internal return rate that reflects the "opportunity cost" of its new investments; if the internal rate of return of the new investment is higher than the company's internal return rate, the new investment is

economically feasible and vice versa. But strategic considerations and long-term planning may prompt a company to accept an IRR that is lower than its internal return rate.
The internal return rate of this transaction has been calculated at 18%, as also indicated in the chart, is considered within the lower acceptable limits in the oil extractive industry.

Payback period

This is the third, most basic and simplest indicator, used to assess the economic viability of an investment, which determines the number of years during which the full amount of the investment is recovered through ongoing annual cash flows; the fewer years the more feasible the investment will be.
The following figure shows annual returns of the deal compared to the amount of the purchase, it indicates that the full amount of the transaction (investment) will be recovered before the end of 2027; that is, five years later if the transaction is finalized before the end of 2022.

Figure 3
Investment Recovery Period (Million USD)



The additional opportunity generated by the transaction

The above analysis was limited to the purchase of ExxonMobil's share of the net future remuneration fee for the field's production capacity of 550kbd.
However, this production capacity constitutes only half of the plateau production capacity of the contracted reservoirs after the fourth amendment to the contract signed on February 19, 2014.
This means that the deal allows MoO to receive net remuneration fee for all additional production above the 550kbd level. But, the Ministry must bear its share of the capital and operational cost of any further development in production capacity from 2023 onwards at the same time as other consortium partners in the development of the field.
Due to the Ministry's failure to provide information on the field development plan, it becomes impossible to estimate total capital and operational cost and therefore, cash flows and indicators

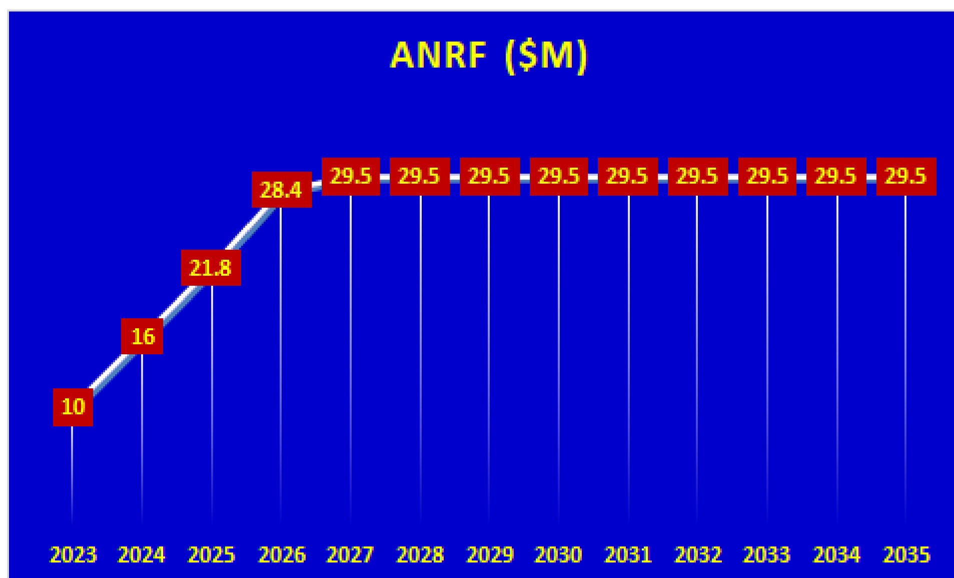
for the coming years accurately. However, future net remuneration fee for added production capacity can be estimated based on the contract for drilling wells in this field singed with Schlumberger.

The drilling contract began to take effect in late October 2021 and includes the drilling of 96 wells (horizontal and vertical) within five years and will add a total of 200kbd. With the exception of the contract value of $480 million, the ministry did not disclose the number and cost of horizontal wells, the number and cost of vertical wells, production from each well, well drilling schedule, number of drilling rigs that will be used to carry out the task, capital and operational cost of surface installations and facilities for this additional production capacity... etc.

In the light of the lack of adequate information, the following was adopted:

1- Assuming the rate of drilling per well, regardless of its type, takes 19 days, and all wells are drilled sequentially where the drilling rig is moved to another location after the completion of the drilling of each well (noting that it is normal that the timings of the drilled wells change in the case of using more than one drilling rig, especially when using rigs for horizontal/directional drilling and others for drilling vertical wells),
2- Each well adds 2082 barrels per day,
3- The annual data was calculated based on the average wells drilled in the year in question up to 200kbd from the beginning of 2027 until the end of the evaluation period in 2035.

Figure 4
Annual Net Remuneration Fee from Added Production Capacity (million US$)



What MoO will receive from the deal, which is the net remuneration fee from the added production capacity (ANRF) during the period from the beginning of 2023 to the beginning of 2035, is a total of about $342 million; starting with about $10 million during 2023 and then increasing with the increase in the number of drilled wells to reach about $ 29.5 million annually, after the completion of the drilling of all contracted wells at the beginning of 2027, and remain at this level until 2035.

On the other hand, the Ministry has to pay (31.17%) of the total quarterly capital and operational cost associated with this additional production for the development of WQ1 field at the same time (upfront) in which the rest of the other partners pay their shares and proportional coverage of the state partner. As mentioned above, this means economically the Ministry bears the payment of annual interest calculated on a quarterly basis for the total quarterly capital and operational cost. In the absence of data on these total costs, estimates will be limited to the cost of drilling. The remaining 96 wells are summarized in the following table:

Table No. 1
Number and cost of drilled wells and MoO share in drilling cost

	2023	2024	2025	2026	Total
Drilled Wells	20	19	19	16	74
Drilling Cost ($m)	100	95	95	80	370
MoO Share in DC ($m)	31.2	29.6	29.6	24.9	115.329

IRR of the added production capacity

This rate was estimated based on assumed ratios of drilling cost to cost of added production capacity; if it is 50%, the value of IRR is about 9%, which is low and indicates a lack of economic feasibility. On the other hand, if the percentage is 75%, the value of IRR is about 21%, which is good and indicates encouraging economic feasibility.

The results of the assessment may vary when MoO provides sufficient data on the cost of development of this additional production capacity and the pattern of its time distribution.

Other important considerations and concluding remarks

In addition to the above, I believe it is necessary to draw attention to the following important considerations and I hope the Ministry of Oil takes them seriously before finalizing the deal.

1- From the perspective of the political economy of petroleum, the greater the contribution, role and share of Iraq in the development of this field, the more this deal works for the benefit of Iraq if the indicators of economic feasibility are good. Therefore, I strongly reject the opinion that approves the sale of ExxonMobil PI to a third party (another IOC) and opposes the sale of the same PI to an oil company affiliated with the Ministry of Oil!!

2- I believe the value of the deal should be much less than $300 million, by retrieving the PI of the state partner that were ceded in order for the said company to continue the development of this field and not to benefit financially from the sale of its share to third parties or to the Ministry of Oil. This, in my view, strengthens the negotiating position of the ministry and leads to a substantial reduction in the value of the deal.

3- MoO should also reduce the value of the deal due to recent news indicating the sale of ExxonMobil another 10 percentage points to Pertamina; this means ExxonMobil's PI is reduced to 22.7%, which will lead to a reduction in all economic feasibility indicators estimated above.

4- To move away from the idea of having ExxonMobil's PI free of charge based on Al-Saadi' views discussed in the first part of this intervention, because I am convinced that such a thin-based idea would lose if the international arbitration article in the service contract is activated.
5- ExxonMobil is the operator of the field according to the service contract; therefore, the Ministry of Oil should assess the feasibility of one of its producing companies (for example, Basra Oil Company) acting as the operator, given the important role of the operator in the implementation of the contract and the joint operating agreement. This is a very important issue that must be evaluated with all seriousness especially if the deal concerns the remainder of ExxonMobil's PI. Will the rest of the oil companies contributing to the field accept that Basra Oil Company becomes the operator, and what will happen in case of refusal!? Is it acceptable for CNPC to be the operator as a possible alternative given that this company has the largest PI!?
6- From a contractual legal point of view, there may be a problem that Basra Oil Company, for example, becomes the first party to the contract, and at the same time part of the second party to the same contract, as mentioned above when discussing the acquisition of Oxy PI in the Zubair field. This problem may arise very significantly in the event that the international arbitration clause is invoked for any reason, as well as in the event of the exclusion or abandonment of any of the foreign companies of the contractor's group, in implementation of Article 28.6 of the Service Contract.
Therefore, and because of the importance of the matter from contractual legal aspects, **I suggest consulting the State Advisory (Shura) Council on this subject, transferring the share of the Basra Oil Company to another company, or finding legal way-out before amending the service contract as a result of the proposed deal with ExxonMobil!**
7- I reiterate my proposal of 2014 to promulgate a new law on "**Financial Gain Tax**" to protect Iraq national interests and call upon the Council of Ministers, the Parliament and the Ministry of Oil to take necessary measures to finalize this urgent legislation soonest.
8- I call upon the Ministry of Oil to make its approval of any assignment pursuant to Article 28.3 conditional upon fully recovering of the waived state partner PI, as the case may be. For the same purpose and effect I suggest amending Article 28.3 in all existing service contracts.

Notes

1- Abdul Mahdi Al-Ameedi, Oil Service Contracts for Licensing Rounds 1 and 2, History and Analysis. 2021

2- http://www.iraq-businessnews.com/2014/02/10/capital-gain-tax-on-iocs-in-iraq/
Arabic translation was posted on *Iraq Today* newspaper, Baghdad, Iraq, 12 Feb 2014

3- ExxonMobil's exit from the Iraqi oil sector https://akhbaar.org/home/2021/4/282575.html

4-https://www.shell.com/media/news-and-media-releases/2018/shell-to-sell-its-stake.html

Norway
5 September 2022