

Hydrocarbon Resource Management in the Context of a Federal System

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Ashti Hawrami 8th April 2009

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The Constitution

There are 3 principles that MUST be kept in mind:

- a) Ownership and Revenue
- b) Policies to Maximize Revenue
- c) Management & Administration

Ownership and Revenue

- Article -111 states that Oil and Gas belongs to all Iraqi people ...etc. The practical meaning of that ownership is explained in Article-112;
- Article -112 demands that revenue derived from the oil and gas extracted from the producing fields to be distributed according to population; ...etc.

Policies to Maximize Revenues

- Article -112: The federal government, together with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment.

- The implementation of such agreed policies and formulation of any policies not agreed upon, fall under the sole decisions of the regional and producing governorates in accordance with Articles-115 and 121.

Management & Administration

- Article -112 states that the federal government, together with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields;
- Articles -115 & 121 carve out the management of non-producing fields and exploration leading to new fields to Regions and Governorates;

The Reality

On "Ownership and Revenue": We all agree on the principles set out in Constitution. I am not aware of any real differences of opinion in the Constitutional interpretation on these Articles, except that:

- 1) Desires f Some People to Carve out Revenue Prior to Sharing:
 - Some people would like to allocate a percentage of the revenue for so called Strategic Projects, and prior to any revenue distribution.
 - Furthermore, they also wish to do so:

- Without defining the meaning of Strategic Projects, or stating the aims of such projects; and
- Without committing to a fair allocation of such projects across the regions and governorates; or
- At least accepting a small percentage limit for such undefined projects, and then the additional funding, if need, to be allocated by agreement.

We fear that ability of carving out large sums based on arbitrary & discretionary decisions, without any legal base, to be unfair and may lead to possible abuse, hence impacting the real distribution entitlements of Regions and Governorates.

2) The Unhelpful and Misunderstood US Benchmark:

- The 3rd US Benchmark set in July/August 2006 for progress in Iraq states: “Enacting and implementing legislation to ensure the equitable distribution of hydrocarbon resources (i.e. oil and gas revenue) of the people of Iraq without regard to the sect or ethnicity of recipients, and enacting and implementing legislation to ensure that the energy resources of Iraq benefit Sunni Arabs, Shia Arabs, Kurds, and other Iraqi citizens in an equitable manner”.
- Nothing is wrong or unusual in this the wording of this benchmark in itself. In fact this benchmark was just echoing what is clearly stated in Article-112 of the Constitution.

- However, intent of the benchmark was badly handled and incorrectly communicated to Baghdad and Erbil. Various diplomats and other US officials kept mixing it up with, or just calling it, the Oil and Gas Law (which is an investment law and not a Revenue Sharing Law).
- Therefore, instead of working on the Revenue Sharing, the focus shifted to the Oil and Gas law. In other words, the cart was put before the horse. So, without a prior agreement on the revenue sharing law, the oil and gas law then became unnecessarily contentious as.

One can cite many other reasons for the delays and for the misunderstandings, but for sure by not enacting the Revenue Sharing Law; we continued to be at the mercy of many of the argumentative budgetary mechanisms. Often, this has resulted in serious delays in receiving the agreed monthly settlements.

This cannot go on much longer. According to the Constitution, we suppose to be stakeholders, hence directly receiving a share of the revenue. We should not to be made to beg or wait for piecemeal budgetary handouts to cover our expenditure and Baghdad being allowed to keep all the surplus revenue.

Constitutionally, when it comes to the oil wealth distribution of this country, we are all real “shareholders, not workers”, and this makes the big difference between budgetary mechanisms and revenue distribution.

In summary, we should learn from these past delays and mistakes. We know that we still have many differences on what kind of Iraq we aspire to live in, but for sure a real revenue sharing will bind us all together. We can unite around that revenue sharing achievement, and no doubt this will help to rebuild our trust in each other and to resolve all our other differences.

A final word on this issue, it is my personal belief and any real concern that if a fair, transparent and an unambiguous Revenue Sharing Law is not enacted soon, and if instead futile attempts to strengthen or maintain the current centralized

economic policies and financial controls, then the unity and the future of the country would be at risk. All our political leaders and the Federal Parliament must take their responsibility seriously about this matter and act accordingly.

On "Policies to Maximize Revenue": It is a constitutional requirement on all of us to do so by formulating the necessary strategic policies:

- To develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people; and by

- Using the most advanced techniques of the market principles and encouraging investment.

- Oil revenue is, and shall continue, for a long time ahead to be the backbone of our economy and the single source of stability for our country.

- The Oil Ministry, which is tasked for these important resource MUST be run professionally and by professionals. It must be outside politics and political influences as far as possible and organized as a business and not as a charitable organization or a commercial wing of this party or that party.

- The leadership of the Ministry must be accountable and judged by results. So let me for the record, first examine some of its "achievements" in this regard:
 - It has continued with the old regime operational policies, and having spent some \$8 billion over the last 3 years, still failed to boost oil production, indeed often production has declined instead;

 - It has kept the outdated practices and at every opportunity adopted policies to actively discourage inward investment;

- It has interfered with the agreed Draft Oil Law on many occasions, including guiding the Shura Council to make fundamental unauthorized changes to the text, thus derailing the process;
- It has created and used strong-arm tactics of black listing companies working or attempted to work in Kurdistan in a stark reminder of the former oppressive regime practices;
- It has failed to bring even one of many ready-made discoveries on stream to arrest/ease the production decline from the giant fields, and instead and in desperation it continued to overproduce from giant fields, thus inflicting permanent reservoir damage and loss of potential oil reserves from these fields;
- It has continued to irresponsibly flare the vast amount of the associated gas, amounting to well over \$10 Billion per year in value, yet it has made no any real attempt to cooperate with the electricity ministry to at least utilize some of this valuable the gas for power generation to solve peoples' problems.
- It has ceased every practical and media opportunity to undermine KRG's achievements, including the use of idle gas to solve our power shortages (by black listing companies and accusing us acting illegally). Obsession with halting KRG's progress and achievement became the main focus of the Oil Ministry's target as appose to their real job of increasing production.
- Almost years ago it has embarked on the policy of TSAs and told them and all the IOCs told that such contacts would not help Iraq and that IOCs would not consider the. The ignored all the advise, only to discover much later that IOCs did not want to do consulting jobs and mission failed;
- Again for long time now they are trying to invent a new service contract model which is riddled with inconsistencies, and ill conceived discouraging ideas for

production and reserves optimization. Conference after conference, deadlines after deadline came and passed, but still there no model or progress.

- Manipulated the meaning of the risk-reward contract model (another name for PSAs or PSCs) agreed in the draft of February – 2007 Oil Law, and fought bitterly against the KRG model contract, and misrepresented the intention of such model to the public. Then suddenly they say that the Oil Ministry will also consider PSAs, if so why did you fight it for 2 years? If so then you are agreeing with KRG's model and there should not be any more hostility to our projects.

- Ladies and Gentlemen, colleagues and friends, I can go on and on about this, but all know about the big shortfalls, and I hope that you agree with me that by any standards such damaging policies and mismanagement of our precious resources should no longer be tolerated, as these are very divisive policies, do not maximize returns and certainly contrary to market driven principles. In my view, in any real democratic country such open abuse of power and poor performance would have long time ago lead to parliamentary impeachment, but sadly in Iraq the Parliament appears to be unable to do its job.

- Well, I have to be fair and MUST tell you about us at the KRG too and then allow you a chance to ask, and examine our records. Yes, we could have been more engaged on our negotiations on the Oil Law, but the fact remains that we were blocked from and, often not invited to any meetings after the February-2007 draft. May be, we have not been allowed to even join any delegation for promotional trips, or on oil and gas rounds discussions and we have been even black listed in attending any conference organized by the Oil Ministry. We should have been more persistent, but we came to the conclusion that one cannot do anything or make any constructive contributions or useful contributions under these circumstances.

- Nevertheless less, in a short period of time we have managed to create some real opportunities for the benefit of all Iraqis within the KRG, these include:
 - Commissioning the reengineering, redevelopment and completion of the 2*20000 B/D refineries which started by the Oil Ministry some 4 years ago, but failed to go beyond the first phase of development;

- We have commissioned another 6*20000 B/D modern refineries and these are all under construction right now, and will be completed in 2 years to will solve the regional fuel supply shortages;
- We have completed an advanced integrated project involving the transfer of reservoir gas to processed gas then to electricity in a world record time to solve a substantial part of our power needs. We will continue to expand on this project to solve the remaining power problems of the region.
- We have enacted a constitutionally compliant Regional Oil and Gas Law and developed a state-of-the art modern and transparent model contract for small block size exploration activities in the region.
- We have signed some 25 E&P contracts, involving 15 countries and over 30 efficient, risk taking companies with excellent track record of exploring and finding oil, minimizing costs and maximizing project returns.
- We have made 3 new discoveries so far and, hopefully, more to come this year adding some 4 billion barrels of oil to Iraq's reserves. We are ready to export 100,000 B/D right now; that will gradually increase to 250,000 B/D once the additional field pipelines are completed by the end of this year or early next year.
- We could have been exporting this oil well over a year ago, but due to the lack of cooperation from the oil ministry, the oil export was kept back, thus Iraq has lost billions of dollars so far and will continue to lose million of dollars every day if this damaging policy is not stopped. KRG gets its 17% of the Iraq's budget anyway, so the losers are all of us in Iraq, and not just the KRG.
- For the record, and contrary to the general belief KRG contract arrangements are:

- Contractor takes all the risks and pays all the costs;
 - Contractor recovers its costs from only a percentage of the produced oil;
 - The profits are shared ~88% to the Government and ~12% for the contractor;
 - This ~12% contractor share is an undiscounted figure and once it is adjusted for an exploration risk of say 30% to bring it in line with the low risks involved with many of Iraq's actual discoveries; then the actual risked contractor profit share will reduce to only ~4%;
 - This is just equivalent to cost of money borrowing, or a delay in project start for one year in terms of the net present value of project returns.
 - If contractor fails to find commercial oil or gas, it will bear all the costs, which shall not be recoverable at all;
- The contractor has no right to ownership of oil in the ground, and only assume title to its share of oil at an agreed delivery point, which could be Gehan in Turkey, or any other place in Iraq that the parties may agree to from time to time;
 - By agreement, the contractor may receive the equivalent market value of its share of oil in cash payment at the delivery point, but in either case the ownership of oil in the ground has never been compromised;

- Ladies and Gentlemen, I believe that in a small way we have been and are doing something for the country, and have done so without costing the Country anything, or any single dollar;

- I call that a complete compliance with the constitution and we are happy to submit to any standards to justify and defend our actions, both legally as well as commercially.

- I do not regard this being a KRG vs Oil Ministry issues, I would have done the same if I were going a similar job in Basra, Misan or Mosul'

How to Proceed?

- On Revenue Sharing Law we should go back to the May-07 draft and as the basis to enact the law as soon as possible, or at least go back to the June draft and do not try carve outs or instruments for slush money aside prior to sharing and distribution;

- On the Oil Law we should go back to the draft February-07 Oil Law and take the contents of the agreed side letter into account by also defining the role of the Oil Ministry as a Regulator and Operator, and define a clear role for INOC.

- Set-up a legal-constitutional committee to review these document to ensure compliances with the constitution and clearly state the role of KRG to avoid confusion or misunderstanding in the future, then send the documents to the Parliament.

- The Revenue Sharing Law should take the priority, as by agreeing this law the rest will be much easier to deal with.

- These two draft laws can also be adjusted before submission to incorporate any constructive recommendations that may follow from this conference and from UNAMI.

- However, on reflection and past experience I can state that:
 - In short the arguments are always have been about the Constitution, but staged as around the Oil and Gas rights and policies;

 - The real battle is about Centralism versus Federalism and power sharing;

 - Constitutionally, KRG has a special place and even the opponents of Federalism accept and recognize that;

 - In most cases their fear is not about KRG being different, but their desire to keep the rest of the country more centrally controlled;

 - Well to me that means a two region Federalism or a country with one Federal Region only, as oppose to 2 or 3 regions;

 - In that case then you may also call it an asymmetric solution and build around that the power sharing and other rights to oil and gas and revenue; which could be equivalent, or at least similar in value to those defined in the Constitution;

 - KRG has always shown flexibility in the past to imaginative initiatives, and continues to look at new ideas constructively, if these may lead to solutions that will not compromise on constitutional arrangements.

- Ladies and Gentlemen, frankness and telling the truth some time may not be welcome as it may hurt others feelings, but in the interest of making progress I have chosen to be factual and accurate with the chronology of events, so I hope that you all see it that spirit.

THANK YOU