Iraq's Petroleum Law: Problematic Issues & its Fate, By Tariq Shafiq*

1.0 Background

In May 2006, following the initiation of Dr Maliki's cabinet of national unity and the appointment of Dr Hussain Shehristani to the portfolio of the Ministry of Oil (MoO), I was approached with the task of drafting the Iraq petroleum law.

Two associates Iraqi oil technocrats and I, who have then had a combined international oil industry experience of more than 120 years, prepared the draft law within a few months and submitted it to the MoO in August 2006. Please refer to attachment 1:PL 2006 Iraq.

The draft was adopted by the MoO and submitted to the Prime Minister, who in turn appointed a ministerial committee, which represented a spectrum of interests and views, including in the main representatives from the Regional Government of Kurdistan (KRG). It took some eight months of stop-and-go negotiations, chiefly to resolve the emerging disputes between the mainstream in the federal government and the KRG. The discussions did not start in earnest until agreement on the revenue distribution was secured.

The final negotiated draft was announced on 15 March 2007 (often referred to as April 2007 Draft), by unanimous agreement within the ministerial committee, which was chaired by Kurdish Deputy Prime Minister, Dr Barham Saleh.

Regretfully, the original first Petroleum Law 2006 which we drafted has been modified to such an extent that I and my colleague Farouk al-Kasim believe that it no longer provides for the standards of optimisation, efficiency, accountability and transparency, nor is it any longer in keeping with maintaining the unity of the nation nor securing the broader national interest for generations to come. Please see Attachments: PL 2006 Iraq, TES Farouk, TES & FK PL 2006

However, like the January 2007 draft before it, the April 2007 draft was soon denounced by the KRG, on the basis that their government had not been party to examining the four attachments, three of which allocate the

discovered fields between Iraq National Oil Company (INOC), the MoO and the regions, while the fourth defines 65 exploration blocks. Even today, there is no sign of a successful outcome.

The KRG had already published their own draft petroleum law, based on a radically different interpretation of the constitutional articles governing the oil and gas resources from that adopted in the draft of the federal MoO. The divergence in positions was somewhat narrowed down by December 2006, when a senior KRG minister declared that it was prepared to "voluntarily" come to an interpretation which was more or less close to the federal perspective, but not without two major concessions secured in the January draft and again in the latest April draft in favour of the KRG and the Governorates but at the expense of the country's interests.

The absence of a petroleum law governing the upstream oil and gas exploration and production has left Iraq oil & Gas clearly under the dictate of politics. Often personality cult played major role in shaping plans and policy irrespective of sound economics and/or governance.

The explanation given by a leading KRG member, at a conference held in Dubai later that year to discuss the Draft petroleum law, was that the KRG "threw it in the rubbish bin, on account of it being authored by "Baathists" and "Chauvinists". I can assure you ladies and gentlemen that we are neither! He also said that the April 2007 draft was rejected because of "unauthorised" changes. This has been the attitude of the KRG and it appears unchanged as long as the central Federal Government is too weak and divided to manage the affairs of the country and as long as Iraq's so called 'democratic' system is paralysed by a system of 'tawafeq' (consensus) and 'muhasasah' (exchanges of interests) among the political powers, neither of which are compatible with the wider national interest.

2.0 Petroleum law constitutional articles

The overall objective of the MoO's original draft petroleum law was to optimise Iraq's oil and gas exploitation, maximise return for the nation and to unite the

country. It was based on Articles 111 and 112 of the new Iraqi Constitution, as seen in the light of Articles 2, 49, 109 and 110

Articles 111 and 112 seen in the light of Article 2, 49, 109 and 110 broadly define the authorities and responsibilities of the Federal and Provincial authorities within the Petroleum sector.

Article 2 First states that: “Islam is the official religion of the State and is a foundation source of legislation,” and that, “No law may be enacted that contradicts the established provisions of Islam.”

Islamic Shari’a Law confirms that *natural resources are undivided assets owned by all the people.*

Article 49 First states that:

“The only political entity representing all of the people of Iraq is the Council of Representatives.”

Article 109 states that: “The federal authorities shall preserve the unity of Iraq.”

In the absence of an official legal interpretation of these articles, the authors, with the MoO’s consent, based their draft on a constitutional interpretation given in a study published in May 2006 by the Iraq Revenue Watch (www.iraqrevenuewatch.org), “Iraqi Oil Policy-Constitutional Issues Regarding Federal and Regional Authority”, authored by Joseph C. Bell, Hogan and Hartson LLP, and Professor Cheryl Saunders, University of Melbourne Australia. **Please refer to attachment PL Bell & Saunders**

3.0 What are the key issues

I will try to summarise these for convenience into four key ones and provide quotations from Joseph Bell et al Study in the analysis:

Firstly: The **Constitution and its review**

The constitutional background is such that the Temporary Administration Law (TAL) designed by the Coalition Provisional Authority (CPA) set out the principles of the 2005 Constitution. This planted the foundation for governance on an ethnic and sectarian basis, exemplified by the membership make-up of the Governing Council and the Interim Provisional Government. It denied the Federal Iraqi Government sufficient authority and granted the Regions (that is, the KRG) de facto confederate status, and the Provinces

sufficiently wide authority to form distinctive enclaves, devoid of the national culture and broader national interest of the country.

The constitutional articles governing Iraq's oil and gas assets' management were drafted by a committee of more than fifty members on political and ethno-sectarian bases. In the face of a lack of consensus or 'muhasasah', the Committee set out alternative versions for the many vital issues, which proved too controversial to agree on. The articles were further corrupted by the main political party heads' use of ambiguous language, which has given rise to different interpretations under the rules of 'muhasasah', with the KRG bringing its own American advisor to the meetings. The revisions gave powers to the Regions and Governorates to be able to nullify national laws in the event of conflict on the shared competencies under Article 114.

The Oil and Gas Articles were thus subject to considerable influence from within and without Iraq, resulting in politicised amendments. The draft Constitution was passed by Parliament conditional on a future revision, within four months from Parliament's first meeting, but it has not as yet seen the light of day as while a committee was formed but their amendments have been ignored.

The Constitution, therefore, is not the social contract it was envisaged to have been, binding the future human, civil, social and cultural interests of the Iraqi nation together.

Secondly: Ownership of oil and gas resources

Article 111 of the Constitution is unequivocal on this point, that: Iraq's oil and gas resources are owned by "all the people of Iraq in all Regions and Governorates" (emphasis added). According, "The language does not admit for the ownership of any particular resource by any particular group or geographical or political region. In effect, it gives all citizens of Iraq, wherever resident, an undivided interest in all the oil and gas resources of the country. Notably, it does not invest oil and gas resources in the state, nor does it

allocate resources to particular Regions or Governorates. The latter are addressed solely in the collective form". Re Joseph Bell et al.

This view is supported by the Islamic Shari'a law, which makes petroleum and other natural resources the common undivided property of the whole nation. The authority to exercise this sovereignty resides in the Federal Council of Representative, the Parliament, in accordance with Article 49.

It follows that "all actions taken with respect to the oil and gas industry will be based on the appropriate laws. In other words, the granting of rights to the petroleum sector will be done on the basis of Iraqi Federal Law." Re, Joseph bell et al.

A question was put by me to Joseph Bell: "Does Article 111 mean that contracts (old and new), even if they were in contradiction with Article112, still need to be approved by the federal parliament since they involve the disposition of the peoples property?" His reply was, "I went through the Arabic document and did not see any problem with your analysis arising from the language. Also, I believe the Law in 112/1 is referring to the entire Article since it is all one sentence in Arabic." Clearly this makes all KRG PSA agreements illegal.

Thirdly: Management of resources

The power of the Federal Government: "Article 112/1 provides that the Federal Government, with the 'producing' Governorates and Regional governments, shall manage oil and gas 'extracted from present fields' subject to a revenue distribution formula. "Management' in Article 112 is not defined nor is it subject to any words of limitation. Thus Article 112/2 provides that the Federal Government, again with the producing Regional and Governorate governments, shall establish the strategic policies for the development of oil and gas in accordance with certain standards."

As explained above, Article 112 envisions two functions: the establishment of oil and gas policies and the management of the oil and gas resources.

“The leadership of the Federal Government in Article 112 is further reinforced by Article 110, which sets out those areas where the Federal Government has “exclusive authority”. Among these are ”formulating foreign sovereign economic and trade policy” and “regulating commercial policy across Regional and Governorate boundaries in Iraq”. Thus, the shared authority under Article 114 is cabined by the power of the Federal Government to prescribe and set policies whenever trade or investment crosses national, Regional or Governorate boundaries or involves trade or investment moving in and out of Iraq. Regional action in violation of such policies would be unconstitutional as it infringes upon areas committed to the exclusive authority of the Federal Government.”

However, the KRG has always applied its own plans, policy and interpretation of the Constitution, supported by a paid consultancy study from a Cambridge Professor to justify its unilateral action of granting 49 PSA agreements without reference to the Federal laws and regulations or Parliament.

The draft Petroleum Law of July 2006 is compatible with the above interpretation. It seeks uniformity of plans and policy throughout the country. It requires the MoO’s consultation with, as well as the participation of the Region and Provinces. Supervision of oil and gas operations is shared between the Provinces and the Federal Ministry. The decision-making process has built-in checks and balances to encourage transparency and anticorruption practices.

Under the draft, INOC should be an independent holding company, playing a pivotal role in the country’s oil industry, with affiliated Regional operating companies and an interrelated directorship to ensure proper communication and management, as well as the participation of the Provinces.
A pivotal role is given to INOC by ear marking to it all the discovered fields.

The first draft tasked the MoO with a supervisory and regulatory role, in addition to responsibility for the preparation of plans and policy, in co-

operation and participation with the Region and Provinces. The draft also tasked the MoO with the role of pre-qualifying IOCs, preparing tenders, and a specialised semi-independent "Unit" (it includes a representative of the region and/or province concerned) with negotiating oil and gas contracts to a model approved by the "Council of Oil and Gas", with decision-making authority retained by the Council.

All contracts, however, were required to be compatible with five principle terms:

1. National control.
2. Ownership of the resources.
3. Optimum economic rent to the country.
4. Appropriate return on investment to the investor.
5. Reasonable incentives to the investor for ensuring solutions, which are optimal to the country in the long-term.

Let us apply these terms and condition to the KRGs' PSAs and the MoO Service Contracts:

KRG PSAs fail to satisfy the principle terms (1), (3) and (4), in addition to the absence of competitive tendering, lack of transparency, withheld publication, and absence of the Federal Parliament for legal cover.

The MoO service contracts**,** on the other hand**,** fail the above principle term (1) (decision making mirrors the PSA model where the Government is not the ultimate decision maker). Contracts are too long in duration for a service contract, adopt unrealistic high plateaus (which are being remedied but under non-transparent and non-competitive conditions) and bidder's selection lacked assessment of their proposed oilfield development program to ascertain that the proposal ensures optimum recovery of the oil field at minimum unit cost.

Furthermore, these PSAs and Service Contracts fail on a legal ground: they are not compatible with Law 84 of 1985, the Hydrocarbon Preservation Law, and lack Federal Parliament approval.

Fourthly: Regional power to nullify decisions pursuant to Article 112

"The Constitution gives the Regions and the Governorates certain powers to modify or nullify federal legislation, but neither can be reasonably read to apply to Article 112. Article 115 provides: All powers not stipulated in the exclusive powers of the Federal government belong to the authorities of the Regions and Governorates that are not organized in a region. With regard to other powers shared between the Federal government and the Regional government, priority shall be given to the law of the Regions and Governorates not organized in a region in case of dispute."

Since the powers in Article 112 do not appear in the list of exclusive powers of Article 110, the first sentence in Article 115 could be read to give the Regions and Governorates authority in the areas covered by Article 112. This construction, however, would make Article 112 a nullity and thus cannot stand. The second sentence of Article 115 applies by its terms to the "shared" powers of the Regional government and the Federal government. The shared powers are specifically dealt with in Article 114 and this reference should be limited accordingly to the powers set out there." Re Joseph Bell et al.

Article 121 also gives the Region certain powers. That Article provides:
"In case of a contradiction between Regional and National legislation in respect to a matter outside the exclusive authorities of the Federal government, the Regional power shall have the right to amend the application of the national legislation within that region."

Nevertheless, this Article does not apply to the activities of Article 112, as this is not an area where the Regional government has authority to adopt legislation, pursuant to Articles 114 or 115. On its face, moreover, this section only applies to those areas where the Federal and Regional governments have shared competency. These areas are set out in Article 114, and it is in these areas where there is conjoint legislative authority that the Regional government, pursuant to Article 121, has the limited authority to modify the Federal legislation operative in its region. To hold otherwise, would again make Article 112 a nullity, not only nullifying the Federal authority, but also the

rights of the other producing Governorates and Regions to participate in policy formation provided for by Article 112."

However, the KRG's unilateral policy has gone as far as taking over the Khurmala Dome, which is the third dome of the Kirkuk field and has been under Government development and production since the late 1920's; indeed it is strange that neither KRG nor the MoO has enlightened the people on this strange take overt!

As mentioned above, the KRG has been granting exploration and production rights to third parties with complete disregard a common federally approved policy and the Constitutional articles governing the management of oil and gas assets.

Their action implies, on analysis, the transfer of power from the Federal Government to the Regions and Governorates as follows:
Iraq has proven reserves in excess of 115 Bbbl, housed in some 80 fields and remaining some 415 structural anomalies (having potential reserves), estimated to contain in excess of 216 Bbbl. The proven reserves (under the Federal Government management) are being depleted while the larger potential reserves (under the management of the Regions and Governorates) are being built-up, and with negative, analysed below.

Neither the discovered fields nor the prospective structural anomalies are distributed evenly over the 18 Iraqi Governorates and quite a few straddle the borders. Basra for example, contains over 50% of the proven reserves, while many are among the have-nots as far as oil reserves are concerned.

I have often stressed that without a central unified policy there will be disharmony and competition within Iraq, between INOC and the Regions & Governorates, between the Regions & Governorates themselves, between the haves and have nots, leading to damaging consequences involving the fragmentation of the country as well as the destabilisation of the global energy market.

4. Conclusion:

Whereas the objective of the first draft Petroleum Law of the MoO was to optimise oil and gas exploration and development, maximize return and unite the nation through uniform policy and plans, its modification by the Ministerial Committee, under the extreme conditions of a failed state, dominated by ethno-sectarian interests and under pressures from within and without, managed to derail the Law from its principal objectives and removed its checks and balances.

Whereas the Constitution makes Iraq's oil and gas resources the property of the whole nation, neither the PSAs nor the Service Contracts have the approval of the only representative of the people, the Federal Parliament.

Whereas the Constitution requires the application of uniformity of policy and plans, and optimum return to the nation, the two-track development by the KRG and the Central government, violates Article 112 Second of the new Constitution, as well as Law 84 of 1985 and The Hydrocarbon Preservation Law and contributes to inefficiency and lack of transparency.

Whereas the constitution demands a government in the service of the whole nation, there remains lack of provision of basic services and deadlock on many draft laws and regulations, including the most vital, the Constitutional Review and the Petroleum Law. This is symptomatic of the divisive and destructive elements that characterise Iraq's failed state condition today.

Whereas the Constitution demands that the management of Iraq's oil and gas assets produces the optimum return to the nation for today's generation of citizens, as well as for future generations, never in the history of the global oil industry have so many reserves been committed to IOCs in such a short duration. The planned capacity of 13+ mbpd (million barrels per day), which seems to have been decided on a whim, is beyond Iraq's primitive institutions and IOCs ambitions to achieve by 2017. The global market demand is estimated to be around 6 mbpd by 2020 and 8 mbpd by 2035, according to

the authoritative IEA's 2012 study. Unless the Iraqi government reduce its planned production capacity radically, it would be freezing valuable large investment and facing penalties of remuneration to IOCs for full built production capacity, regardless of its being produced or not.

Can we trust that the KRG and other players are able to return to the principles of conduct under a unified nation, governed in peace and stability, by adopting a Federal model that enjoys the advantages of decentralization, without the disadvantages of the current divisive ethno-sectarian politics?

Can we Iraqis contemplate returning to a healthy State in which the central Government is capable of managing the affairs of the country in the best interests of all the people?

Only then can a sound Petroleum Law have the chance of a healthy revival and non-politicised, professionally informed amendments can be made within the framework of enlightened Constitutional reform. Otherwise, we will continue to surrender the nation's precious assets to the benefits of the major consumers, their IOCs and government powers.

Oil and gas resources are Iraq's most valuable assets. Its is down to us, Iraqis, to decide our own policies and plans in a way that ensures our best interests in this turbulent new world order, in which protective boundaries are removed and life is for the strongest and the fittest.

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Attachments: TES Farouk, TES &FK, PL Bell & Saunders and PL 2006 Iraq.

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