



Special Edition

Iraq's Petroleum Industry: Unsettled Issues

*The Middle East Institute
Washington, DC*





Middle East Institute

The mission of the Middle East Institute is to promote knowledge of the Middle East in America and strengthen understanding of the United States by the people and governments of the region.

For more than 60 years, MEI has dealt with the momentous events in the Middle East — from the birth of the state of Israel to the invasion of Iraq. Today, MEI is a foremost authority on contemporary Middle East issues. It provides a vital forum for honest and open debate that attracts politicians, scholars, government officials, and policy experts from the US, Asia, Europe, and the Middle East. MEI enjoys wide access to political and business leaders in countries throughout the region. Along with information exchanges, facilities for research, objective analysis, and thoughtful commentary, MEI's programs and publications help counter simplistic notions about the Middle East and America. We are at the forefront of private sector public diplomacy. *Viewpoints* are another MEI service to audiences interested in learning more about the complexities of issues affecting the Middle East and US relations with the region. The views expressed in these *Viewpoints* are those of the authors; the Middle East Institute does not take positions on Middle East policy.

To learn more about the Middle East Institute, visit our website at <http://www.mei.edu>

Cover photos, clockwise from the top left hand corner: Flickr user YourLocalDave, USG, Wikipedia user Guitar guy, Flickr user YourLocalDave, Flickr user YourLocalDave, Flickr user MATEUS 27:24&25, and USG.

Viewpoints

Iraq's Petroleum Industry: Unsettled Issues

Iraq's Petroleum Industry: Unsettled Issues

Viewpoints

Preface	5
Introduction, <i>by Thomas W. Donovan</i>	6
Iraq's Oil Bid Rounds: Politics and Pitfalls, <i>by Saifaldin D. Abdul-Rahman</i>	9
Political and Legal Obstacles in Iraq, <i>by Nicholas Skibiak</i>	12
The Status of Forces Agreement and Investing in Iraq: Risky Business? <i>by Andrew L. Fono</i>	15
Charts & Maps	18

Preface

Iraq has the world's third-largest oil reserves. However, the development of Iraq's petroleum sector has been severely hampered by decades of war, sanctions, underinvestment, the exodus of scores of technocrats, and sabotage. Repairing Iraq's oil infrastructure and expanding exploration, development, and production is of paramount importance to the country's future. In June 2009, the Iraqi Oil Ministry embarked on an effort to help meet this challenge by offering service contracts to international oil companies (IOCs) in two rounds of tenders. The essays contained in this special edition of MEI *Viewpoints* explore the official expectations and current status of the contracts awarded to IOCs. They also provide a sober assessment of the legal and political obstacles yet to be overcome, as well as sage advice as to how those seeking to invest in Iraq's petroleum sector can minimize the hazards of doing business there.

MEI wishes to thank Mr. Thomas W. Donovan, who played an instrumental role in all phases of the development of this publication.

Introduction

Thomas W. Donovan

With the recent conclusion of the first and second bid rounds to license foreign international oil companies (IOCs) to operate in specific Iraqi fields, many commentators have predicted that the country is now on its way to meeting the very ambitious 12 million barrel per day (bpd) oil production benchmark. In making such predictions they cite the diminished violence in the nation, the seemingly free and fair 2010 elections, and especially the better organized 2009 bid rounds which granted IOCs the ability to develop petroleum in a profit sharing capacity.

While all of us involved in Iraq want the best for the Iraqi Government and its people – who have endured so much – it is difficult to overlook several major obstacles in the upstream petroleum industry. A viable and dependable upstream production cannot take hold in Iraq without clear and timely resolution of several integral issues. This special edition of *Viewpoints*, which I am pleased to moderate, seeks to isolate these issues, understand them in a domestic and regional light, and offer pointed assertions by leaders in their field on how to improve the upstream production and domestic off-loading capacity. The stakes could not be higher: the future of stable worldwide petroleum production and the ability to fund a democratic Iraq hang in the balance.



Thomas W. Donovan is a corporate attorney and partner in the Iraq Law Alliance, PLLC. He may be reached at Thomas.donovan@iqilaw.com

THE PRIZE

According to dated publicly available surveys, there are 28 giant fields in Iraq, which hold an estimated 12% of the entire proven global reserves. Discovered as early as the Ottoman Empire, the largest giant field is Rumaila, located near Basrah in southern Iraq. The giant field of Qurna (also called West Qurna or Qurna I & II) is also located in the Basrah Governorate. The Majnoon field in the north is the third largest giant in Iraq. Each of these fields is estimated to be between the 3rd and 9th largest fields in the world.

The extraordinary size of these fields and their highly sustained productivity are due to a nearly perfect combination of a large subterranean geological structure and a highly permeable reservoir. These special sedimentary properties make the ultimate recovery (ability to extract a high percentage from the giant field) and success rate (defined as the number of successful wells completed as divided by the number of wells drilled) among the highest in the world. Moreover, the proximity of these giant fields to a usable port for offloading via pipeline in Umm Qasr (located on the Persian Gulf in the disputed

Shatt al-Arab waterway) is small as compared to other giant fields in the North Slope of Alaska or Central Asia. This proximity to a port, high success and recovery rate, along with the superb geological properties of the petroleum itself, contributes to a highly lucrative prize for any IOC willing to engage in the sizeable risks associated with an Iraqi investment.

Understandably, this prize has brought serious international competition. Of the 21 bidding consortiums involved in the 2009 petroleum bidding, 17 involved Chinese parties. Once added to overall demand from mainland China, Chinese corporate interests are now the largest foreign investor in Iraq and the largest developer and consumer of upstream petroleum in Iraq as well as the largest recipient of petroleum from the Middle East.

According to dated publicly available surveys, there are 28 giant fields in Iraq, which hold an estimated 12% of the entire proven global reserves.

POLITICAL AND LEGAL CONSIDERATIONS

Notwithstanding the ultimate prize of Iraqi upstream production, there remain several legal and political risks which cannot be ignored. These risks remain, as with everything in Iraq, disproportionately high as compared to other developing democracies. Specifically, such issues as security concerns, Kurdish political disputes, the dubious legal structure of the petroleum regime itself, and legal inconsistencies with the production sharing contracts signed by IOCs in the 2009 bid rounds add to the legal and political risk.

Any discussion of the development of the Iraqi petroleum industry cannot underestimate the differences in legal treatment between the areas of federal Iraq and the semi-autonomous area under the rule of the Kurdistan Regional Government (KRG). Despite the 2005 federal Iraqi Constitution which has ambiguous language to the contrary, the KRG today formulates and governs upstream petroleum production in the provinces under its control; namely Dohuk, Erbil, and Sulamaneiyah. In a possible contravention of law, all licensing, monitoring, and production sharing is conducted by and between the KRG and the IOCs.

The KRG issued a parsimonious petroleum law well before it began production in 2009, granted concessions in a profit sharing capacity with foreign operators, and has today many large international petroleum corporations actively operating within its borders. While the production and development is still in the early stages, the international corporations have a vested interest in the development and further estrangement of the KRG from the rest of federal Iraq. The producing fields in the KRG are smaller than the giant fields in federal Iraq. Granted, the federal government believes that the KRG is overstepping its bounds and cites the clear provisions of the 2005 Constitution in support. However, as these Kurdish political factions are needed to create a workable majority in Iraq's Parliament and therefore form a federal government, there exists no ultimate deterrence for their actions. In the absence of such, the KRG has aggressively pushed forward in developing, marketing, and exporting its own reserves.

Unlike the KRG, federal Iraq has been acting without a parsimonious oil law since the current sovereign Government of Iraq has been in existence. The environmental and legal underpinnings of upstream production are instead grounded

in the laws which remain in force from the previous Saddam Husayn and General Qasim regimes. These authoritarian and socialist structures created a nationalist monopoly on the production, transport, and export of oil, and only allowed the involvement of foreign companies if the Iraqi Parliament specifically allowed such activity (Law 97 of 1967). In the absence of a direct approval by Parliament, and incorporating a strict interpretation of Law 97, each and every IOC in Iraq successful in the 2009 bid rounds would need a specific vote in Parliament to be operating in Iraq legally. If there is no such authorizing vote, their presence is arguably illegal under Iraqi domestic law or operating in an *ultra vires* capacity. This dubious legal structure has dissuaded many supermajor petroleum companies from investing in Iraq and participating in the bid rounds.

This gap in Iraqi jurisprudence has recently been challenged in federal Iraqi court by former parliamentarian Shadha Musawi. She argues that the Prime Minister and the Oil Minister had begun, without Parliament's approval, to decide the nation's petroleum policy through their licensing efforts in the first and second bid rounds. Musawi's contentions are that oil policies, contracts, and licenses should be approved in greater concert with the regional governorates (which includes her native Basra Governorate) as well as the federal Parliament. In Musawi's view, and in a strict and literal reading of Law 97 of 1967, all contracts between Iraq's Ministry of Oil and any third parties must obtain a separate vote of approval from Parliament to prove binding, legal, and enforceable under Iraqi law. The case is now pending in a Baghdad federal court. Its potential success on its merits is keenly watched by international observers.

One of the most interesting aspects of the growth in the upstream petroleum production is that internal refining and distribution capacity within Iraq has not developed significantly. Still operating on a pre-war level, the increase in infrastructure development consistent with the sheer massive foreign investment following the bid rounds will undoubtedly grow. The opportunities for foreign investment in this sector will also be large and keenly competitive between American, European, and Chinese interests, among others.

CONCLUSION

The current chapter in Iraq's modern history will ultimately be judged by the capacity and pace with which it re-engages its Middle East neighbors and immerses itself in the rapidly changing global economy. While always a steep road to plough, it will be markedly more difficult without a clear resolution of the legal and political issues herein presented as well as the internal political and bureaucratic obstacles which exacerbate the enormous risks associated with any Iraqi investment. Therefore, I am pleased to introduce this special edition of *MEI Viewpoints*. As always, the authors welcome readers' contributions and feedback, which undoubtedly contribute to the greater understanding of these issues and how they present themselves in our interconnected world.

Any discussion of the development of the Iraqi petroleum industry cannot underestimate the differences in legal treatment between the areas of federal Iraq and the semi-autonomous area under the rule of the ... KRG.

Iraq's Oil Bid Rounds: Politics and Pitfalls

Saifaldin D. Abdul-Rahman

The first rounds of bidding to develop Iraq's oil fields were perceived to have been a failure because only the BP-led consortium accepted Iraq's bid parameters. However, the second round — with seven groups of international oil companies (IOCs) eventually signing contracts to develop fields and two more deals from the first round signed — was a success. This represented a major breakthrough not only for Iraq (particularly because the terms negotiated are very favorable to the host government), but also for Iraqi Oil Minister Husayn Shahrastani, who almost singlehandedly pushed the licensing round policy. Nevertheless, some potential problems lie ahead.

THE CONTRACTS

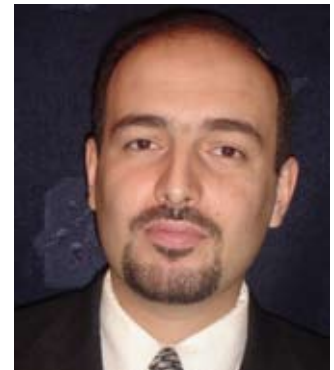
The major fields and the companies that will develop them are:

- Rumaila — BP / CNPC
- Qurnah 1 — ExxonMobil / Shell
- Zubair — ENI / Oxy / Kogas
- Majnoon — Shell / Petronas
- West Qurnah 2 — Lukoil / Statoil

While these fields represent a majority of Iraq's discovered and producing acreage, it is important to point out that most of the fields awarded are located either in Basra Province or one of the surrounding southern provinces. This has several noteworthy implications. First, the residents of these provinces will be looking to the oil companies to provide jobs and to return some of the oil production earnings to them. Yet, contrary to the residents' perceptions, the contracts are structured so that the companies will merely improve production, leaving all of the other financial details to the central government. Furthermore, the Iraqi central government wants to limit the amount of money that is allocated to these oil-producing provinces in favor of federal projects.

POTENTIAL PITFALLS

Discontent may spread among the residents of Iraq's oil producing provinces, who are likely to feel cheated not only by the federal government but also by the IOCs. In fact, this scenario has already started to play out at Alahdab field, where local residents say that the Chinese have not hired anyone locally and have brought in their own workers.



Saifaldin D. Abdul-Rahman is Vice President of IWG a US / Iraqi firm providing consulting, logistics, and construction work in Iraq. He is also a partner in the Taj Al-Khairat Group for Investment. He has held senior posts in the Iraqi government, including as Advisor to the Vice President of Iraq (2009), Chief of Staff to the Speaker of Parliament (2005), and Chief of Staff to the Minister of Industry & Minerals (2004).

The persistence or intensification of this discontent is problematic at two levels. At the micro level, the disgruntlement could lead to instability, as has occurred in the Niger Delta region of Nigeria. At the macro level, the issues are more numerous and complex. At the top of the list is the absence of a legal framework for apportioning the revenues accrued from oil production. Impeding efforts to establish this framework are the competing concerns of Iraq's three main ethnic/sectarian groups: the Sunnis, who still feel that they have no stake in the new Iraq or its oil; the Shi'a, who feel that they do not receive enough of the oil revenues; and the Kurds, who are wrangling with the central government over their rights to produce and sell oil. This contention over the hydrocarbons law and revenue sharing stems from the fact that there is not yet an agreed upon social contract binding the state together. Put differently, Iraqis have yet to agree on the most fundamental of state functions and where sovereignty lies. The stakes will only be higher as oil revenue begins to increase and as some regions and provinces begin to develop more rapidly than their neighbors. Whether they know it or not, many of the major oil companies are now at the center of this potential maelstrom.

Iraqis have yet to agree on the most fundamental of state functions and where sovereignty lies.

The second major issue is what is likely to be a disparity between promises and results. Iraq has embarked upon one of the most ambitious oil development plans in history. Iraqi Oil Minister Husayn Shahrastani has declared that Iraq's production would reach six million barrels per day (bpd) within three years and over ten million bpd within seven years. Most analysts do not believe that these goals can be attained. However, setting such overly ambitious goals risks creating unrealistic expectations which, if unfulfilled, are apt to cause peoples' confidence in the central government to erode. Some political groups (e.g., the Sadrists) might exploit the situation by fomenting unrest in order to undermine establishment politicians.

Setting unrealistically high oil production goals also unnecessarily antagonizes Iraq's neighbors, particularly Saudi Arabia and Iran, adding a new dynamic to the already complex relationships between the three countries. Were Iraq to reach the six million bpd threshold, it would begin to challenge Saudi Arabia's role as OPEC's leading producer. Reaching that threshold also would complicate Iraq's relationship with other OPEC members, which might seek to limit Iraqi production because of price concerns. Whether Iraq will accept such limitations, given the years of sanctions and lack of investment in the oil sector, is an open question.

Equally uncertain is the role that Iran might play should the situation in the Gulf deteriorate. For example, in the event of a military strike against Iran, the possibility of Iranian retaliation against Western oil interests (i.e., oil companies operating near its border) cannot be ruled out.

Finally, Iraq has yet to finalize all of the legal frameworks associated with signing the development contracts with the IOCs. Nor do its laws adequately address some of the questions raised in the Iraqi Council of Representatives. What if a new prime minister or Council of Representatives seeks to change or dissolve the contracts that have already been

signed? This issue is particularly important now that the Sadrists have a significant bloc in the Council and historically have sought to undermine the Oil Minister and the contracts he promulgated, which they believed were not in Iraq's best interests.

THE WAY FORWARD

While the aforementioned issues are numerous and complex, international oil companies can take steps at the local level (i.e., in Iraq's southern provinces) and Iraq's central government can adopt measures at the national level to address them.

The central government must initiate an education campaign highlighting the role of the IOCs in Iraq and the need for the technology and investment they bring in helping to develop Iraq's fields. This must be coupled with a transparent policy that spells out precisely how much of the revenues will be returned directly to the producing provinces. The IOCs can, and should, help Iraq reach this target, not by directly talking to Iraq's government, but by lobbying their own governments to push Iraqi leaders and the United Nations to draft such a policy and widely disseminate it. Iraq's constitution stipulates that provinces which previously had been unfairly deprived of resources could be compensated. Applied judiciously, this provision could be used to placate both the southern provinces and the Sunni provinces, which, since 2003, have been deprived.

In addition to a transparent policy on revenue distribution, the federal government should clearly outline an energy strategy for the country that includes the development of the energy sector and the surrounding infrastructure. This would help stimulate construction in the provinces where oil is being produced, which in turn could alleviate some of the popular discontent.

The oil companies have already done some things right in training Iraqi oil engineers on new technology outside Iraq. This needs to turn into a comprehensive program to develop a cadre of local technocrats who can be genuine partners for the IOCs in the years to come. Such a program would involve identifying talented students, offering them scholarships to study engineering and other fields needed for Iraq's upstream and downstream oil development, and enabling them to gain hands-on experience with the IOCs themselves. The IOCs must ensure that they do not become benevolent foundations, which would only engender more problems. They should target projects and sectors that would aim both to quell discontent and to serve their interests where they operate.

While the situation in Iraq is fraught with many pitfalls and dangers, there is a huge potential to create model policies which, if developed and implemented effectively, could mitigate many of them. The Iraqi government and the major oil companies operating there would be well advised to look beyond the narrow view of oil development and think of this as a broad step towards better institutions and a more stable state.

The Iraqi government and the major oil companies operating there would be well advised to look beyond the narrow view of oil development and think of this as a broad step to better institutions and a more stable state.

Political and Legal Obstacles in Iraq

Nicholas Skibiak

Since June 2009, the Government of Iraq (GoI) has secured nearly a dozen major oil field technical service agreements with international oil companies (IOCs) after two highly publicized bidding rounds. The deals are seen as the cornerstone of Iraq's economic development in the coming years. While future oil production has been rather optimistically projected as high as 12 million barrels per day (bpd) by 2020, significant obstacles to the development of the oil and gas industry remain. The country's infrastructure and skilled labor supply are insufficient, the security situation remains tenuous although much improved, and billions of dollars of investment are needed to facilitate oil field development and exports.

In addition, legal challenges from within Iraq's fractious political system also threaten to derail development of the oil and gas industry. Central to this issue is the ambiguous legal framework that undergirds Iraq's oil industry. The absence of any national hydrocarbon law leaves lawmakers and regional governments at odds over procedural issues. A draft law to govern investment and production has been in limbo since 2007 amid disputes between Baghdad and the Kurdistan Regional Government (KRG) over the proper mechanisms for revenue sharing.

The Iraqi National Constitution as written (particularly Article 112(2) and Article 115) would seem to grant significant power to regional governments to manage hydrocarbon resources, as well as negotiate their extraction. However, the GoI has insisted on the primacy of the central government in negotiating and signing any deals with IOCs. Furthermore, the process by which the GoI negotiated contracts following the two rounds of oil auctions in 2009 was so centralized around the Ministry of Oil (MoO) that it has drawn wide and vocal accusations of unconstitutionality.

One internal row that has drawn significant publicity, both within Iraq and abroad, is the recent lawsuit filed by outgoing MP Shadha al-Musawi against the GoI, which challenges the constitutionality of the November 2009 BP-CNPC Rumaila deal, and aims to settle the question of whether Iraq's prime minister, parliament, or provincial governments have the legal authority to finalize oil contracts with foreign firms. Musawi and her allies point to a pre-invasion law (Law 97 of 1967) that required federal oil contracts to be ratified by parliament, and argue that the same requirement should hold for the Rumaila development. The GoI, and the MoO in particular, have argued that the Rumaila and other IOC deals are merely technical service agreements, and thus do not



Nicholas Skibiak is an Associate at Dunia Frontier Consultants, specializing in upstream petroleum production and investment risk analysis in the Middle East.

warrant the same scrutiny as the production licenses envisioned by the 1967 law.

Even if Iraqi courts accept the government's defense, there are serious questions about how the MoO developed the model contracts upon which the IOC deals were based. It is unclear whether government lawyers and ministers outside the MoO were given the opportunity to scrutinize the contracts before they were signed and declared legally binding.

Beyond these specific legal challenges there are quiet rumblings among Iraq's political factions about the possibility of revisiting the oil contracts once a new government is formed. 'Iyad Allawi, the leader of the *Iraqiyya* coalition, has promised a review of the IOC contracts if he becomes Iraq's next prime minister. Among the most vocal critics are the followers of Shi'ite cleric Muqtada al-Sadr (the Sadrist Trend), the Fadhila Party, and some other Iraqi nationalists, who have accused the GoI of surrendering the nation's oil wealth to foreigners, and insist that Iraq can develop its oil resources relying solely on national efforts. Hazim al-Araji, a senior member of the Sadrist Trend, said his party might challenge the legality of the IOC contracts, claiming that there had been "great mistakes" in the negotiations.

It is unclear to what extent the promises to revisit IOC contracts are anything other than political rhetoric. The GoI has quietly assured IOCs that the legality of the existing contracts will not be challenged, but their confidence seems based on the assumption that, given the importance of oil revenues to Iraq's economic future, no one would jeopardize the development of the oil industry by suspending field operations or demanding lengthy renegotiations.

Another consequence of failing to pass a national hydrocarbon law has been the lingering dispute between Baghdad and the KRG over oil production and exports in Iraq's northern provinces. Frustrated by stalled negotiations over a national oil law, the KRG passed its own hydrocarbon investment law in 2007 based on a contentious interpretation of the Iraqi constitution, and began independently issuing production sharing agreements (PSAs) to several dozen smaller IOCs. Baghdad has condemned these PSAs, which have drawn international scrutiny over allegations of impropriety (if not outright corruption). In addition, the central government blacklisted any IOCs operating in partnership with the KRG, barring them from its 2009 oil auctions.

Despite the strong stance taken by the MoO against the Kurdish PSAs, the promise of \$2 billion in annual oil revenues eventually compelled Baghdad in June 2009 to allow Kurdish oil exports, but only after negotiating that all revenues would be channeled into the federally managed Development Fund for Iraq, rather than directly to Erbil. At the same time, Baghdad refused to spend oil revenue on contracts it did not have a hand in negotiating, which left the KRG unable to pay its IOCs. After months of squabbling between the governments, which saw Kurdish oil exports halted in October 2009 and restarted in February 2010, the GoI reportedly agreed to cover the costs of foreign firms operating in the Kurdish region, including paying exploration and extraction costs, but not their profits. On February 14, the

The saga of the Kurdish oil industry reinforces the importance of a national hydrocarbon law in allowing for the full development of Iraq's oil industry.

KRG agreed to publish the details of its PSAs online. The saga of the Kurdish oil industry reinforces the importance of a national hydrocarbon law in allowing for the full development of Iraq's oil industry. Without such legislation there is no clear mechanism for dispute resolution and arbitration between the central and provincial governments on issues related to oil investments.

Additionally, at the nexus of the oil law and the KRG dispute rests the central legal and political issue of Iraq's political future: the long-running dispute over the administration of the ethnically mixed and oil-rich area around Kirkuk. Iraqi Kurds have repeatedly called for the area's energy resources to be placed under KRG administration. At a minimum, the Kurds insist that they be included in potential deals on oilfields near Kirkuk, and otherwise have threatened to withhold security for any IOCs working the field. The local Arab population, along with local Turkmen and other ethnic minority groups, are equally insistent that Kirkuk and its oil remain outside the KRG domain. The failure to resolve the issue of the eventual status of Kirkuk and its oil threatens the prospects for permanent political stability in Iraq.

The failure to resolve the issue of the eventual status of Kirkuk and its oil threatens the prospects for permanent political stability in Iraq.

While the Kurds had hoped to use their seats in the new parliament to win concessions on Kirkuk, an unexpected strong showing by the *Iraqiyya* coalition may have cut their leverage. Whichever coalitions succeed in forming the country's next government, oil and gas will dominate Iraq's political landscape for the foreseeable future. IOCs and international investors are all eagerly waiting to see how events unfold. The GoI must adopt a new national hydrocarbon law, reduce tensions among Sunni and Shi'ite Arabs, as well as Arabs and Kurds, and reach a political consensus on the future of Kirkuk and its oil. None of these tasks is easy. Nor will they be achieved in the near-term. While Iraq has made significant progress during the years since the US-led invasion, this progress has been punctuated by periods of intense political and security crises. There is little doubt that conditions in Iraq will continue to improve, but for now we must expect the same staccato march into the future.

The Status of Forces Agreement and Investing in Iraq: Risky Business?

Andrew L. Fono

In spite of ongoing security and political instability, Iraq remains one of the most fertile yet volatile regions in the world for emerging business opportunities, specifically in the petroleum industry. Since the completion of the widely successful “surge” and implementation of the Status of Forces Agreement (SOFA), Iraq has experienced slow but steady improvements in security and economic opportunities in the petroleum sector. As a result, there has been an influx of international companies eager to engage Iraq’s ministries for access to these lucrative markets. However, many challenges lie ahead, including the volatile security environment, the absence of a hydrocarbon law, and an infrastructure (political, economic, and physical) urgently in need of rehabilitation after years of abuse and neglect under the Saddam regime, as well as further deterioration since 2003. However, two principal questions remain. First, what level of stability and security will be present in the petroleum industry following the withdrawal of US military and security personnel? And second, what safeguards must a company put in place to protect its investment and its employees from the massive political and economic risks involved in establishing an Iraqi presence?



Andrew L. Fono is a partner leading the Iraq practice group of the international law firm of Haynes and Boone, LLP. As a Lt. Colonel in the US Marine Corps, Andrew spent considerable time in Iraq as a judge advocate, and was also involved in Rule of Law and domestic legal developments in the Iraqi judiciary. Andrew.Fono@haynesboone.com

From 2003 until 2008, foreign oil and gas contractors had been able to reduce legal risks in Iraq by operating under certain key privileges and immunities offered under Coalition Provisional Authority (CPA) Order No. 17. These privileges enabled companies to insulate themselves from the Iraqi legal system, while operating in a volatile business environment that was constantly affected by the insurgency. This changed dramatically with the execution in 2008 of the Status of Forces Agreement between the United States and the Government of Iraq (GOI), which removed most immunities extended to foreign contractors.

THE STATUS OF FORCES AGREEMENT

The SOFA, which came into effect January 1, 2009, governs the presence of US and related foreign forces in Iraq until their withdrawal, according to a negotiated phased withdrawal period. Article 5 of the SOFA sets June 30, 2009 as the deadline for all US forces to be withdrawn from Iraqi cities, towns, and villages. Article 24 sets December 31, 2011 as the deadline for all US forces to be withdrawn from all Iraqi territory, water, and airspace. Articles 5 and 24 are not hard and fast rules, considering that Article 4 provides that the GOI may request temporary assistance of US forces to support its efforts at keeping the peace and stability of Iraq, including training and supporting the

Fono...

Iraqi Security Forces (ISF).

The SOFA's greatest impact on companies conducting business in Iraq is that private US citizens, contractors, and their employees no longer benefit from the limited privileges and immunities offered under CPA Order No. 17. In other words, contractors are now subject to the jurisdiction of the Iraqi civil and criminal courts, and can be arrested or detained for violations of Iraqi law. In particular, Article 12 eliminates the contractor privileges and immunities offered under CPA Order No. 17. Additionally, the SOFA does not guarantee that any US citizen arrested or detained is entitled to basic due process rights. The US citizen is left entirely in the hands and at the mercy of the Iraqi judicial system. Thus, contractors conducting business in Iraq must familiarize themselves with the Iraqi judicial system, and its criminal and civil laws. This provision, among others, creates a significant negative impact on foreign companies conducting business in Iraq. For purposes of this essay, we will focus mainly on new changes in the SOFA that impact the civil side of conducting business in Iraq.

[M]any challenges lay ahead, including the volatile security environment, the absence of a hydro-carbon law, and an infrastructure ... urgently in need of rehabilitation after years of abuse and neglect under the Saddam regime, as well as further deterioration since 2003.

COMPANY REGISTRATIONS

Following the guidelines in the SOFA, all petroleum companies must register to do business in Iraq in order to continue to perform their existing contracts, or enter into new contracts. Moreover, the Technical Service Contracts outlined by the Ministry of Oil (MoO) mandate that all foreign companies maintain a "domestic presence." While this may take the form of a branch office or limited liability company (LLC), it is a required element of the first and second petroleum bid rounds that companies have a domestic license and comply with the yearly reporting requirements.

POST-REGISTRATION OBLIGATIONS

Once registered as a branch office or LLC, there are further post-registration obligations. For example, branch offices and LLCs involved in the petroleum industry must register for a corporate income tax file with the General Commission for Taxes' Corporate Tax Department, and an employee must register for an income tax file with the General Commission for Taxes' Employee Wage Withholding Department. They must also register a social security file with the Social Security Administration of the Ministry of Labor and Social Affairs.

VISA AND RESIDENCY ISSUES

Once registered to do business in Iraq, a company can sponsor non-Iraqi employees for visas and residency permits. Visas must be obtained prior to an employee's arrival in Iraq (except for entry via the Kurdistan Region). Importantly, no visas may be obtained on arrival. All visas are approved by the Ministry of Interior (Residency Directorate) and then

Fono...

forwarded to the Iraqi Embassy in the country of application for finalization. When entering Iraq, foreign employees must report to the Residency Directorate within ten days of their arrival, and must present themselves to the Ministry of Health for an HIV blood test within the same time period. However, stays of less than one week do not require such reporting. Business visas are typically one month in duration. During this time, the employer must apply for a residency permit for resident employees, and obtain all necessary visa extensions. When planning to depart, non-Iraqis in Iraq must obtain an exit visa within six days of their desired departure date. For non-Iraqis who hold a residency permit, the exit visa will include a reentry visa, valid for up to three months from the date of departure. Failure to return within the three months will void the residency. A non-Iraqi will not be able to leave Iraq unless he or she is in possession of an exit visa. Finally, new HIV blood tests are required for non-Iraqis after extended absence from Iraq.

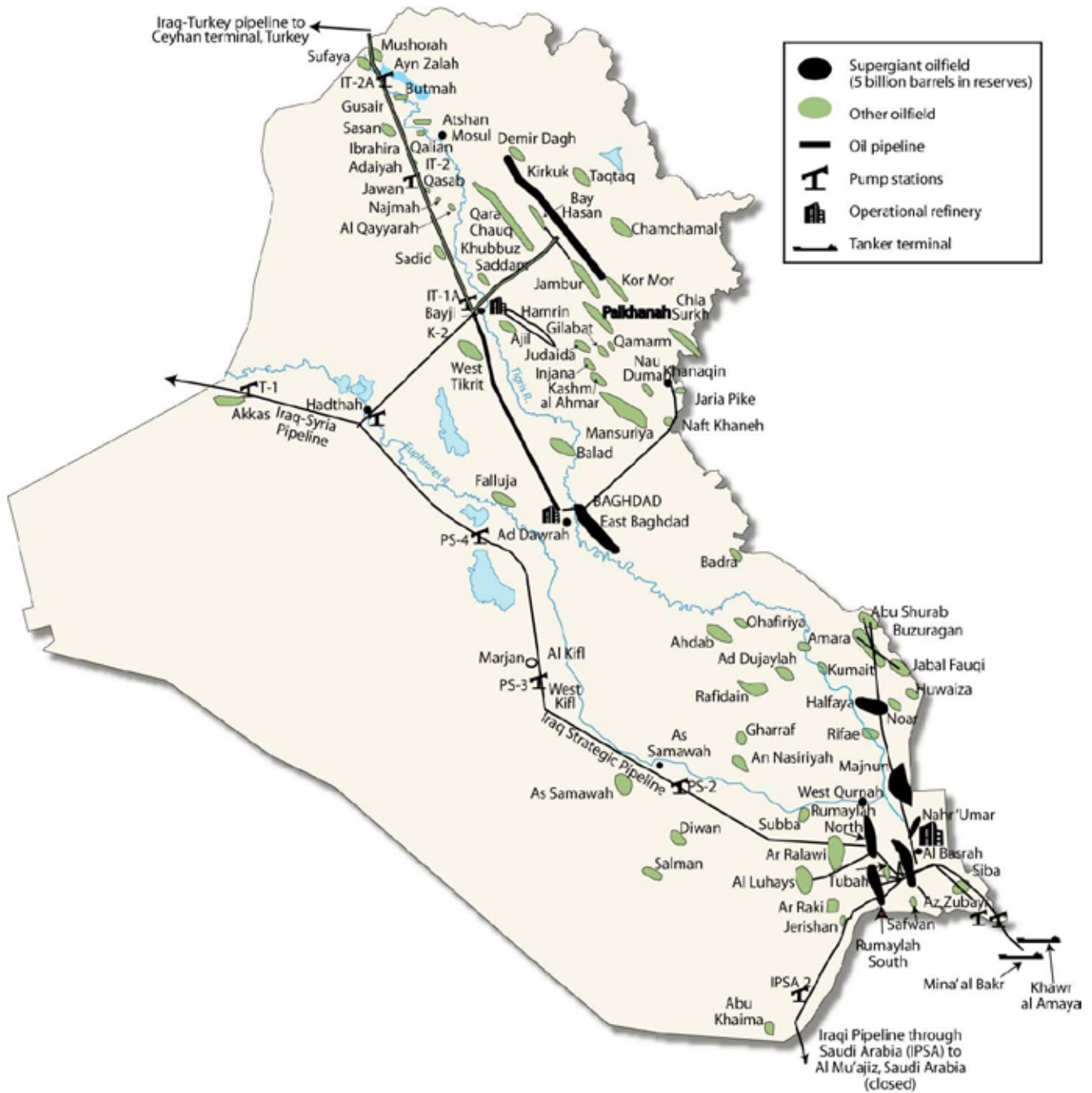
PREPARING FOR BUSINESS INVESTMENTS IN IRAQ

When considering business investments in Iraq, you must be financially well prepared. Under the new SOFA, US contractors and employees are no longer protected from Iraqi prosecution and enforcement of Iraqi laws. If your company is considering leaping into business in Iraq, it must register quickly. This takes time, so do not wait for any grace period to expire. Also, be sure to educate and culturally sensitize employees to the environment they are entering. When contracting, remember that the Riyadh Convention is the preferred avenue for arbitration, and Jordan is a preferred jurisdiction. Obtain legal advice from US and Iraqi counterparts to ensure your company is in compliance with registration, tax, employment, and visa/immigration laws. You also will wish to establish procedures for your Iraq company and employees to follow in case of arrest or detention so that they know who to call, including their consulates (Iraq is a party to the Vienna Convention). Remember that Iraq is in a transitional phase, and government capacity is low, which can sometimes lead to arbitrary and capricious treatment by government officials. Nothing in Iraq happens quickly, and with an infrastructure that is in such poor shape, there are many instances when phone systems, email, and other methods of communication just are not available. Finally, have patience. The ultimate payoff will be well worth the effort for both your company and for the ultimate success of Iraq as a stable country in a volatile region.

Under the new SOFA, US contractors and employees are no longer protected from Iraqi prosecution and enforcement of Iraqi laws.

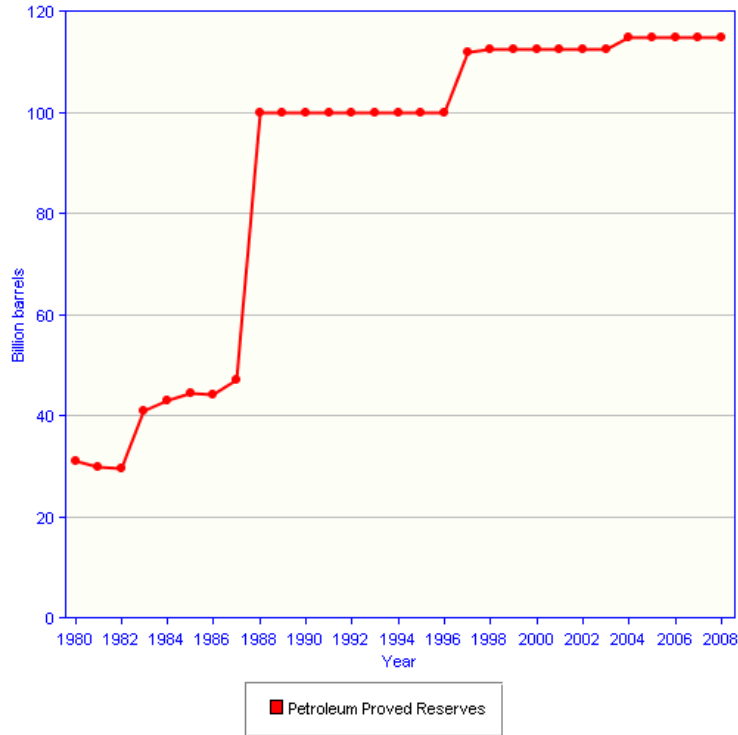
Charts & Maps

IRAQ'S OIL FIELDS AND INFRASTRUCTURE



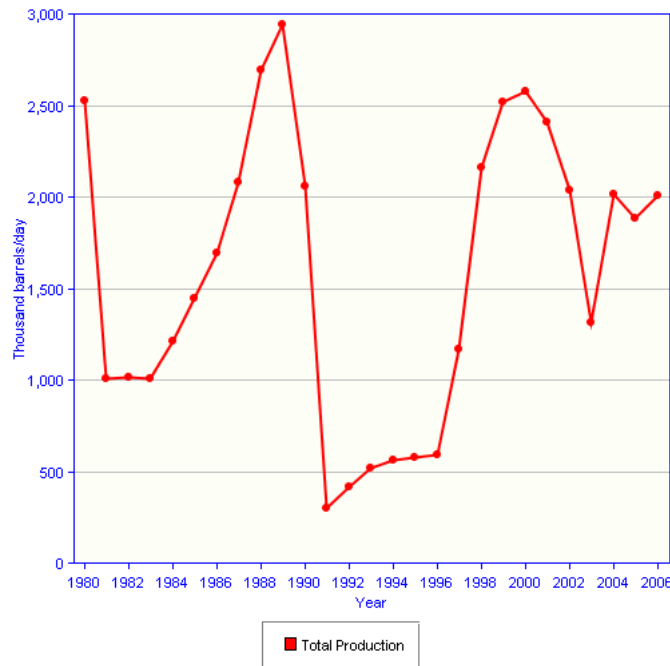
Congressional Research Service, October 1, 2008

PROVEN PETROLEUM RESERVES IN IRAQ



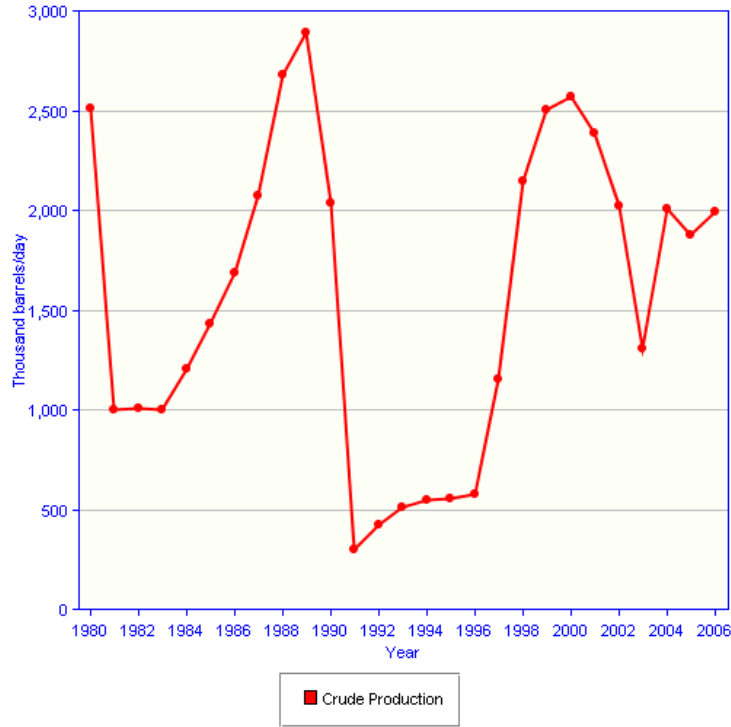
US Energy Information Administration, January 1, 2010

TOTAL OIL PRODUCTION IN IRAQ



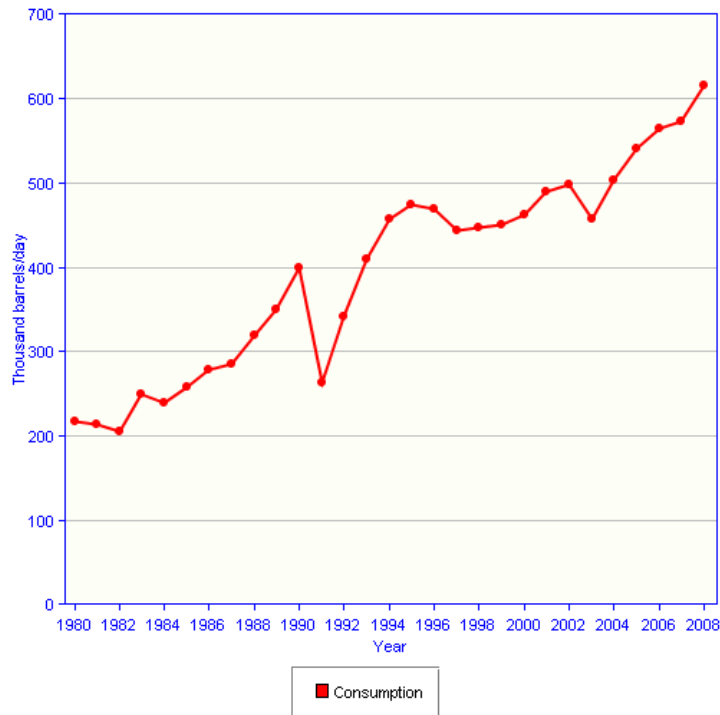
US Energy Information Administration, January 1, 2010

CRUDE OIL PRODUCTION IN IRAQ



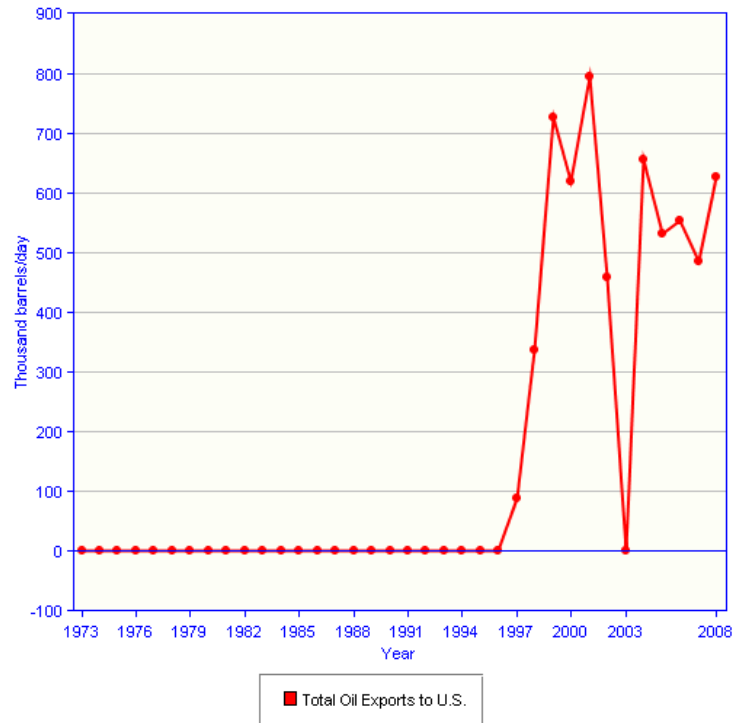
US Energy Information Administration, January 1, 2010

OIL CONSUMPTION IN IRAQ



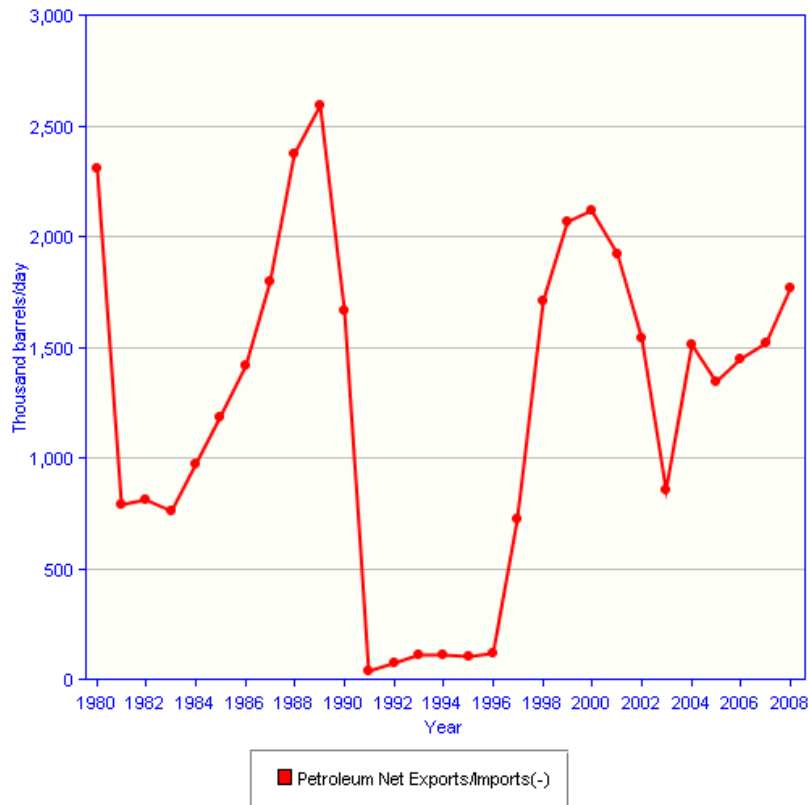
US Energy Information Administration, January 1, 2010

IRAQ'S OIL EXPORTS TO THE US



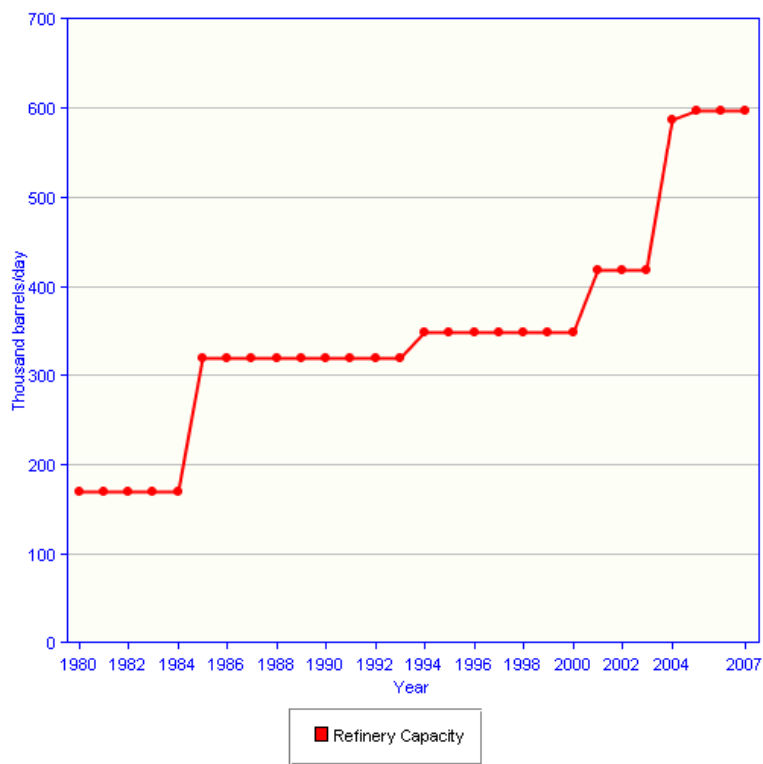
US Energy Information Administration, January 1, 2010

NET PETROLEUM EXPORTS/IMPORTS IN IRAQ



US Energy Information Administration, January 1, 2010

REFINERY CAPACITY IN IRAQ



US Energy Information Administration, January 1, 2010



Middle East Institute