Oil and War: The 2007 Draft Petroleum Law of Iraq

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Abstract

For more than a year Iraq's Central Government (ICG) has been attempting to pass its first post-invasion national petroleum law (Oil Law). If passed by the Iraqi Council of Representatives, the Oil Law will provide the legal framework for the future exploitation of Iraq's vast oil wealth. First approved by the Council of Ministers in February 2007, the final draft Oil Law was submitted to the Council of Representatives for an expected vote in May 2007. With no vote in May, a slightly modified version was resubmitted to the Council of Representatives in July 2007, where it has been fiercely debated. A deal on the Oil Law had apparently been reached but imploded when the Kurdistan Regional Government (KRG) passed their own regional oil law in August 2007, and the Sunni coalition in the Council of Representatives pulled out of the deal. There is little hope that the law will be passed, or even voted on, soon. Although the political reconciliation needed to pass the Oil Law is failing, the law is an important piece of legislation that will eventually play a crucial role in the reconstruction of the oil industry in Iraq. The proposed law authorizes oil sector privatization in the form of production-sharing contracts, or PSCs. Under the new Oil Law, PSCs permit foreign oil companies (FOCs) to sign contracts directly with the ICG to develop specific areas of Iraq's petroleum sector in exchange for a share of the oil profits. Iraq's oil sector has been greatly damaged by decades of conflict, and is now in need of massive redevelopment, foreign investment, and expansion. Through minor modifications to the Oil Law, moderated FOC involvement will be greatly beneficial to Iraq, while at the same time giving an equitable share of the oil profits to the FOCs for their contribution.

Introduction

As the Iraq war grinds well into its fifth year, an equally important political battle is being fought over the future of Iraq's vast oil wealth. With chaos in the streets, Iraq's Central Government (ICG) is in the final stages of passing its first post-invasion national petroleum law (Oil Law): the first step in establishing the legal framework needed for the future development of Iraq's oil industry.[2] First approved by the Council of Ministers in February 2007, the final draft Oil Law was submitted to the Council of Representatives for an expected vote in May 2007.[3] With no vote in May 2007, a slightly modified version of the Oil Law was resubmitted to the Council of Representatives in July 2007, where it has been fiercely debated.[4] The United States (US) has marked the passage of the Oil Law as one of the key benchmarks in accessing the progress and effectiveness of Nouri al-Maliki's Shiite coalition government.[5] Deadlines near, however, and passage of the Oil Law remains tenuous.[6] While a deal on the Oil Law had apparently been reached, it imploded when the Kurdistan Regional Government (KRG) passed their own regional oil law in August 2007, and the Sunni coalition in the Council of

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[2] Alissa J. Rubin, Iraqi Lawmakers Split on Oil Law, New York Times (July 22, 2007)
[3] Sunni Clerics Group Attacks Iraq's Draft Oil Law, Reuters (Mar. 6, 2007)
[4] Rubin, supra note 2.
[5] Id.
[6] Iraq Oil Law Deadline Approaches, Middle East Economy & Finance (July 27, 2007)

Representatives pulled out of the deal.[7] There is little hope that the law will be passed, or even voted on, in the near future.[8]

As political infighting and resentment towards the US occupation grows, the possibility of a quick resolution to the Oil Law continues to wane. However, while the political reconciliation needed to pass the Oil Law is failing, the law remains an important piece of legislation that will eventually play a crucial role in the reconstruction of the oil industry in Iraq. Advocates of the Oil Law hold that foreign investment and technical expertise are critical to the redevelopment of the dilapidated oil infrastructure in Iraq.[9] Opponents hold that the Oil law will amount to nothing more than an economic sell-out to the West.[10] They further hold that the Oil Law's centralized revenue-sharing scheme will only exasperate the growing sectarian divide. Either way, the new Oil Law will require strength from the currently weak – and growing weaker – ICG, and thus passage of the Oil Law remains uncertain.[11]

Through its stated desire to attract foreign investment in the petroleum sector, the Oil Law legalizes a form of production-sharing contracts (PSCs).[12] While titled "Development and Production Contracts" in the final draft Oil Law, the language in the new Oil Law permits contracts very similar to a model PSC.[13] PSCs are a form of oil sector privatization where a foreign oil company (FOC) contracts with a host state to develop a specific area of that country's oil sector in exchange for a share of the oil profits.[14] PSCs have been criticized as a contemporary legal instrument used to exploit a foreign state's oil wealth. However, PSCs have been, and can be, used as a highly effective foreign investment tool. If managed properly by the host country, PSCs can bring in large amounts of foreign capital and expertise without relinquishing excessive control and profits to outside interests.[15] Hence, success or failure of the Oil Law will not turn on FOC involvement. Equally important is the willingness and capacity of the host state to responsibly regulate the exploitation of its petroleum reserves.[16] The ICG must create a fair, equitable and transparent system that will effectively develop their oil sector and make their natural resource abundance an economic blessing rather than a curse. Through an analysis of the new Oil Law, this paper will examine the role of the PSC in terms of its impact on the future development of Iraq's oil and gas resources.

A Brief History of Oil in Iraq

Sitting atop the third largest oil reserves in the world behind Saudi Arabia and Iran, Iraq possesses at least 115 billion barrels of proven oil reserves.[17] Representative of 10 percent of the world's proven oil reserves, oil is Iraq's most important asset and constitutes 70 percent of its GDP and 95 percent of the Iraqi government's revenue.[18] Five countries in the Persian Gulf region hold almost two-thirds of the world's proven oil reserves.[19] Unfortunately for the FOCs, these reserves have been mostly inaccessible since the Middle Eastern oil nationalization movement of the 1970's.[20] These protective nationalized oil systems forced FOCs to look elsewhere for oil.[21] They found it in places like the North Sea, Alaska,

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[7] James Glanz Compromise on Oil Law in Iraq Seems to be Collapsing, New York Times (Sept. 13, 2007).
[8] Id.
[9] Tariq Shafiq, Iraq's Draft Petroleum Law: An Independent Perspective, Middle East Economic Survey, Vol. XLIX, No. 8 (2007).
[10] Rubin, supra note 2.
[11] Id.
[12] Ben Lando, Analysis: Iraq Oil Law Coming Soon, United Press International (Sept. 5, 2007) /
[13] Id.
[14] Covering Oil: A Reporter's Guide to Energy and Development, Open Society Institute (Svetlana Tsalik & Anya Schiffrin eds., 2005), 13.
[15] Id. at 14.
[16] Tariq Shafiq supra note 9.
[17] Lando, supra note 12.
[18] Iraq's Oil: That Long-awaited Share-out, The Economist, Vol. 382, No. 8518 (Mar. 3, 2007), 52.
[19] These five countries include Saudi Arabia, Iran, Iraq, Kuwait, and the United Arab Emirates.
[20] Daniel Yergin, The Prize: The Epic Quest for Oil, Money, and Power, Free Press (1992), 660-672.
[21] Id. at 667.

the Caspian Basin, and offshore West Africa.[22] However, oil from these regions is limited and expensive to produce. It is not surprising that the oil-consuming world is again looking for opportunity in the Middle East. The relationship between FOCs and Middle Eastern countries is not new: it is a relationship that has existed for nearly a century.[23]

Discovery of oil in Iran in 1908 and the creation of the Anglo-Persian Oil Company (Anglo-Persian) (later becoming British Petroleum (BP)) in 1909, marked a new era in Middle Eastern history.[24] In 1911, the Turkish Petroleum Company (TPC) (later becoming the Iraq Petroleum Company (IPC)) was founded and thus solidifying foreign involvement (British and German) in the extraction of Middle Eastern oil.[25] For a large part of the last century, the national interests of Middle Eastern governments were closely linked to the interests of FOCs, and it is this symbiotic relationship that has driven FOC involvement in the Persian Gulf region.[26] Until the oil nationalization movement of the 1970's, oil resources in Iraq were dominated by oil companies from the West.[27]

The history of Iraq from the late 1950's until today is indicative of this struggle between the interests of the modern Middle Eastern state and the interests of the FOC. British control of Iraq came to an end with a 1958 coup.[28] The new government of General Qassim immediately placed demands on the IPC, and in December 1961, it passed Iraq's first national petroleum law: Public Law 80.[29] Public Law 80 called for the expropriation of all oil field concessions held by the IPC, except those oil fields that were currently in production.[30] This amounted to an appropriation of 99 percent of the IPC's holdings.[31] Public Law 80 also formed the Iraq National Oil Company (INOC).[32] In August 1967, the Iraqi government passed Public Law 97, and further consolidated control of Iraq's oil in the INOC.[33] One month later, they passed Public Law 123, which brought the INOC under the direct control of the Iraqi government.[34] In 1968, the Baath Party once again came to power (after a brief period in the early 1960s) and controlled Iraq until the Iraq War of 2003.[35] Saddam Hussein, as Assistant General Secretary of the Baath Party, spearheaded the movement to complete the nationalization of Iraqi oil.[36] In a final power play in 1972, the last of the IPCs assets were nationalized, thus completing the nationalization process in Iraq.[37]

Finally coming to power in 1979, Saddam Hussein's reign would be marked with war, strife, isolation, and sanctions that severely limited his country's ability to extract and sell its most precious commodity.[38] Despite its enormous oil endowment, Iraq has never been able to push its production above 3.5 million barrels per day (bbl/d).[39] During the first Gulf War, production fell below half a million bbl/d.[40] During the period of United Nations (UN) sanctions in the 1990's, Iraq was able to increase its oil production to around 2.5 million bbl/d in large part because of the UN oil-for-food

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22 Id. at 665.
23 See generally F. William Engdahl, A Century of War: Anglo-American Oil Politics and the New World Order, Pluto Press (2004).
24 Valérie Marcel, Oil Titans: National Oil Companies in the Middle East, Chatham House (2006), 16.
25 Id.
26 Id.
27 Id. at 18.
28 Joe Stork, Middle East Oil and the Energy Crisis, Monthly Review Press (1975), 102.
29 Marcel, supra note 24, at 27.
30 Id.
31 Stork, supra note 28, at 105.
32 Id.
33 Id.
34 Id.
35 Tarik Kafala, The Iraqi Baath Party, BBC News Online (Mar. 25, 2003)
36 Id.
37 Stork, supra note 28, at 106.
38 Waleed al-Nuwaiser, The Oil Market in Post-war Iraq, Global Financial Sector Development, British Institute of International & Comparative Law (2005), 343.
39 Id.
40 Iraq: Energy Data, Statistics and Analysis, Country Analysis Briefs, Energy Information Administration (June 2006)

program. Iraq is currently producing less than two million bbl/d.[41] While experts hold that Iraq has the capacity to be pumping over ten million bbl/d, it will require great effort, time, stability, and capital to even achieve Iraq's stated short-term goal of raising production to 3.5 million bbl/d.[42] For comparison, the largest oil-exporting country in the world, Saudi Arabia, is currently producing approximately 11 million bbl/d.[43] Iran, with the second largest proven reserves in the world at 133 billion barrels, is currently producing approximately 4.2 million bbl/d.[44]

In the period since the March 2003 invasion, the production of oil in Iraq has remained low.[45] While the Ministry of Oil (MOO) has continued to function, the INOC has ceased operation.[46] Despite attempts to secure the Iraqi oil industry, the current conflict has severely damaged the oil infrastructure in Iraq.[47] Rehabilitation programs initiated by the US have awarded billions of dollars in foreign contracts to engineering firms such as Bechtel and Kellogg, Brown and Root.[48] However, their efforts have not resulted in noticeable improvements.[49] Pipelines are under the protection of occupation forces, but they continue to be the targets of sabotage.[50] The MOO has had limited success in rehabilitation and maintenance of oil facilities due to lack of funds, lack of security, and excessive bureaucracy.[51]

Despite the seemingly insurmountable challenges, Iraq remains a highly attractive oil prospect for FOCs.[52] Iraqi oil is extremely inexpensive to extract; its development and production costs are among the lowest in the Middle East.[53] Crude oil costs about a dollar a barrel to produce.[54] Even with the security costs that will be associated with extracting Iraqi oil in the near future, the average cost per barrel will be significantly cheaper than oil extracted from almost anywhere else in the world: oil deposits in Iraq are near the surface and easily accessible.[55] Furthermore, Iraq oil remains relatively undeveloped.[56] Of the 80 discovered oil fields in Iraq, only 17 have been developed,[57] and only about 2,300 wells have been drilled (of those, only 1,600 are currently pumping oil).[58] This is fewer wells than have been drilled in the North Sea.[59]

The allure of Iraqi oil is not limited to Western FOCs. In the lead up to the Iraq War of 2003, Saddam Hussein made an attempt to raise capital and increase production by offering development contracts to a number of Russian, Chinese and Indian oil companies.[60] While UN sanctions prevented these contracts from being signed, some of the FOCs, such as Russia's

Lukoil, have actively expressed an interest in re-opening contract negotiations with the current Iraqi Government.[61] Whether all of these contracts will be successfully renegotiated is unclear.[62] However, the recent trip by Iraq's Minister of Oil, Hussain al-Shahristani to Moscow indicates that the

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[41] Id.
[42] Tariq Shafiq supra note 9.
[43] Saudi Arabia: Energy Data, Statistics and Analysis, Country Analysis Briefs, Energy Information Administration (Feb. 2007)
[44] Iran: Energy Data, Statistics and Analysis, Country Analysis Briefs, Energy Information Administration (Aug. 2006)
[45] Issam al-Chalabi, what is Happening to Iraqi Oil? Middle East Economic Survey, Vol. XLVIII, No. 41 (2005)
[46] Id.
[47] Id.
[48] Rubin, supra note 2.
[49] al-Chalabi supra note 45.
[50] Id.
[51] Id.
[52] Shafiq, supra note 9.
[53] Id.
[54] Id.
[55] Id.
[56] Saeed Shah Scramble for Iraq's Oil Begins as Troops Start to Pull Out, The Independent (Feb. 23, 2007)
[57] Shafiq, supra note 9.
[58] Id.
[59] Id.
[60] Fouad al-Amir, Discussion of the Iraq Oil Law, al-Ghad (Feb. 20, 2007)
[61] Anna Smolchenko, Iraq Says Lukoil Will Get a Fair Shake, The Moscow Times (Aug. 9, 2007)
[62] Lukoil has sold a significant interest in its pre-war contract to ConocoPhillips. ConocoPhillips has been actively lobbying the Ministry of Oil to re-sign Lucio's pre-war contact.

deal may still be on the table.[63] Regardless, the potential competition from non-Western oil companies represents a legitimate fear to Western FOCs.[64]

The history of oil in the Middle East highlights the importance of national oil sovereignty, the rise of the national oil company, the historical instability of the region due to war and imperial power struggles, and the pursuit of oil by the West.[65] On one side is the ever increasing need for crude oil by the oil-consuming world, and on the other side is the resistance by the people of Iraq to relinquish their right to control their most valuable asset.[66] The new Oil Law represents these two competing interests. The government of Iraq has been forced into balancing the pressures exerted upon them by oil-consuming countries – who want Iraq to open its oil fields to FOCs – with the responsibility of securing Iraq's oil wealth for its own population.

Production-Sharing Contracts

The PSC was first used in Indonesia in the 1960's when the nationalist government refused to grant new concessions to FOCs.[67] The PSC is essentially a profit-sharing contract between a host state and an FOC.[68] The contract is termed to allow FOCs to put up capital to develop oil fields in an oil-exporting state in exchange for an agreed portion of the oil production.[69] In theory, the PSC is the perfect solution for relations between a FOC and an oil-exporting state. Preeminent University of Dundee oil and gas law professor Thomas Wälde describes that PSC as a tool which "gives to the government political and to the company commercial satisfaction. The government can be seen to be running the show – and the company can run it behind the camouflage of legal title symbolizing the assertion of national sovereignty."[70] However, the PSC has been met with mixed results. Recent criticism of the PSC has resulted in the perception that PSCs are overly generous to FOCs and that they lock the state into long-term contracts with unfair terms.[71] Critics of the PSC view them as a modern form of the traditional concession agreement, a revival of an imperial relic allowing FOCs to exploit the resources of developing countries.[72]

While the oil resources technically and legally remain with the state, the PSC permits the FOC to manage and operate the development of the oil field.[73] The PSC has been most effectively used in small, poor, developing countries with potential oil reserves.[74] These countries lack the financial resources and the technical expertise to efficiently locate and extract their oil.[75] Therefore, the state will contract with the FOC to locate and extract the oil on behalf of the state for a share of the production.[76] In countries where the amount of oil in the ground is unknown, the FOC is assuming

[63] Lukoil Hopes to Salvage Quran Deal with Iraq, RIA Novosti (Aug. 8, 2007).
[64] See generally Exposed: British Government Pushing Oil Interests in Iraq, Platform (Mar. 9, 2007)
[65] Yergin, supra note 20, at 409-430.
[66] Iraq oil employee unions have been protesting the new Oil Law since its inception. They are demanding that the new Oil Law be discussed in an open and democratic manner, and that the Iraqi government represent the interests of the Iraqi people by protecting Iraq's oil wealth from outside interests.
[67] Kristen Bindemann, Production-sharing Agreements: An Economic Analysis, Oxford Institute for Energy Studies (1999), 10.
[68] Id.
[69] Id.
[70] Thomas W. Wälde, The Current Status of International Petroleum Investment: Regulating, Licensing, Taxing and Contracting, CEPMLP Journal, University of Dundee, Vol. 1, No. 5 (July 1995).
[71] Ian Rutledge, The Sakhalin II PSC – A Production "Non-sharing" Agreement: Analysis of Revenue Distribution, Sheffield Energy & Resources Information Services (Nov. 2004), 3.
[72] Greg Muttitt, Crude Designs: The Rip-off of Iraq's Oil Wealth, Platform (2005), 15.
[73] Wälde, supra note 70.
[74] Id.
[75] D. Babesiae et al., Oil and Gas Exploration and Production: Reserves, Costs, Contracts, Editions Technip (2004), 199.
[76] Bindemann, supra note 67, at 10.

enormous financial risk.[77] If no or little oil is extractable, the FOC stands to lose all of its investment.[78] If oil is discovered, the FOC is rewarded with large profits.[79] However, this high risk, high reward model may not apply to the sophisticated and developed oil economies of the Middle East as oil in Iraq is not only known, but has been significantly surveyed. However, the FOC that agrees to develop oil fields in Iraq will be bearing significant risk in the form of political and legal instability.

Under a typical PSC, FOCs carry most of the financial risk in the exploration and development of the oil field.[80] This usually requires large capital investment over a fairly long period of time.[81] Once the oil is discovered and the upfront capital is invested, the FOC develop the oil field over a set period of time.[82] If successful, the project then enters into the production phase. This is when the financial terms of the contract become important. Under a PSC, the FOC is entitled to recoup its capital costs once the project is producing oil. This is called the cost oil.[83] There are two kinds of cost oil: capital cost oil and operating cost oil.[84] Capital cost oil is the percentage of oil that the FOC is allowed to take until the capital investment has been paid.[85] The percentage of capital cost oil that the FOC is allowed to recoup can range from 20 to 100 percent, but 30 to 60 percent is more common.[86] Once the capital costs are recouped, the PSC moves into a profit oil scheme, which controls the percentage of oil that is retained by the state and the percentage of oil that is awarded to the FOC.[87] However, the FOC is still allowed to recoup its operating cost oil from the total production, usually at 100 percent.[88]

The remaining oil, minus any royalties and bonuses paid to the state based on total production, is the profit oil.[89] The ways of calculating the profit oil share can be extremely complex. They can be straight splits of the profit oil (typically splits are for sixty percent to the state and forty percent to the FOC), or the share can be determined by sliding scales based on the project's rate of return.[90] The total government take in the oil project is not limited to its portion of the profit oil. As mentioned, PSCs also often call for royalty, tax, and bonus schemes as a way of increasing direct revenue to the state.[91] Royalties are often paid at all phases of production, and usually range between 10 and 20 percent.[92] Taxes are normally based on the FOCs profit oil share after all operating costs have been paid.[93] In many cases, taxes are assessed on the FOC at the rate of the state's national tax regime. However, tax regimes specific to a PSC are common, and can include excess or windfall profit taxes as well.[94] Bonus payments are also common under PSCs.[95] The final government take is the state's profit oil

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[77] Babesiae et al., supra note 75, at 200.
[78] Id.
[79] Id.
[80] King & Spalding, An Introduction to Upstream Government Petroleum Contracts: Their Evolution and Current Use, Oil, Gas & Energy Law Intelligence, Vol. 3, Issue 1 (Mar. 2005).
[81] Id.
[82] Id.
[83] Stalk & Schifrin, supra note 14, at 76.
[84] Id.
[85] Id.
[86] Babesiae et al., supra note 75, at 200.
[87] Id.
[88] Netivot Pong Siri, Partnerships in Oil and Gas Production-sharing Contracts, The International Journal of Public Sector Management, Vol. 17, No. 5, (2004), 432-434.
[89] Id.
[90] Id.
[91] Stalk & Schifrin, supra note 14, at 76-77.
[92] Pong Siri supra note 88.
[93] Id.
[94] Windfall taxes can be an effective way of preventing FOCs from earning excessive profits where the contract has resulted in an inequitable portion of revenue going to the FOC. See D. Babesiae et al., Oil and Gas Exploration and Production: Reserves, Costs, Contracts, Editions Technip (2004), 207.
[95] Bonuses are bulk sums paid by FOCs at various stages of the project (stages commonly demanding bonuses: upon signing the contract, after discovery of oil, and at the commencement of production). See Kristen Bindemann, Production-sharing Agreements: An Economic Analysis, Oxford Institute for Energy Studies (1999), 16.

percentage plus all additional revenue.[96] As a result of these additions, most PSCs provide a total government take that calculates to between 75 and 90 percent of the project's total revenue.[97]

The goal of the state in negotiating a PSC is to maximize revenue by limiting the FOC's access to oil, while at the same time creating a legal regime that allows the state the flexibility to modify the terms of the project.[98] The goal of the FOC, on the other hand, is to maximize profit by maximizing access to oil reserves, while at the same time limiting risk through contract

stability.[99] These competing interests can make for difficult contract negotiations.[100] However, with fair and equitable negotiations, both parties can achieve their desired goals. One way to equitably distribute profit oil in light of oil market volatility is to base the profit oil percentages on the project's profitability, through the use of so-called R-factor ratios.[101] These R-factor ratios can help reduce the possibility of windfall profits going to the FOC when oil prices are high.[102] At the same time, R-factor ratios can give a greater profit oil percentage to the FOC when production is low.[103] R-factor ratios (based on the ratio between the project's cumulative receipts and its cumulative expenditures) adjust to changes in oil price and varying production levels.[104] The greater the profitability of the project, the greater the profit oil percentage that goes to the state.[105]

While the fair, good faith negotiations of the economic terms are critical, so too are the negotiations of the PSC's contract durations[106] The potentially lengthy contract durations – ranging from 25 to 40 years – have been criticized. However, in many ways these contract durations are unavoidable. PSCs are usually enormous, capital-intensive projects that require massive infrastructure development.[107] Further, the PSC usually covers exploration, development, and production phases, each of which is time consuming on its own. Commonly, the exploration period ranges from three to five years with the possibility of extensions.[108] The development phase can last up to 10 years in areas where massive infrastructure developments are required.[109] The production phase can range from 10 to 20 years, again with the possibility of extension if further production is viable.[110] The lengthy term of the PSC can be somewhat mitigated by reducing the possibilities for extending the length of the contracts. The host state should also be able to reduce the production phase of the contract if there is only limited risk for the FOC in the exploration and development phases (arguably less risk, less entitlement to profits).

Another key provision in a PSC is the stabilization clause.[111] Stabilization clauses go to the heart of the FOC's interests.[112] An FOC wants to freeze the terms of the contract so that successive economic and political conditions cannot be used as a way for the state to justify modifying the terms of the contract.[113] While there is a need for the FOC to be able to rely on the terms of its contract without the fear of constantly changing terms, there is also a need of the host state to retain some flexibility in its contractual obligations.[114] To counter the effects of stabilization clauses, the state can use renegotiation

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[96] Babesiae et al., supra note 75, at 202.
[97] Id. at 209; See also Kristen Bindemann, Production-sharing Agreements: An Economic Analysis, Oxford Institute for Energy Studies (1999), 18.
[98] Bede Nweke, To What Extent Can Renegotiation Clauses Achieve Stability and Flexibility in Petroleum Development Contracts, 2 I.E.L.T.R. (2006), 56, 57.
[99] Babesiae et al., supra note 75, at 202.
[100] Nweke, supra note 98, at 56-57.
[101] Bindemann, supra note 67, at 17-18.
[102] Id.
[103] Id.
[104] Id.
[105] Id.
[106] Muttitt, supra note 72.
[107] Bindemann, supra note 67, at 17.
[108] Id.
[109] Id.
[110] Id.
[111] Margarita T.B. Coaled, Stabilization Clauses in International Petroleum Transactions, 30 Den. J. Int'l L. & Pol'y 217, 220-221.
[112] Id.
[113] Id. at 221.
[114] Nweke, supra note 98, at 56-57.

clauses to protect itself from situations where the PSC becomes inconsistent with a state's legal regime or where the FOCs profit margins become too great.[115]

When fairly negotiated, the PSC can be used as a highly effective tool in mitigating many of the risks – for both the FOC and the host state – associated with upstream oil exploration and production contracts. However, with the currently sustained upward global oil prices there has been a resurgence of the oil nationalization movement, and PSCs have come to represent the exploitive intent of FOCs in foreign lands. In Iraq, the PSC is an integral component to the new Oil Law. If passed, the negotiation of the specific terms of the PSCs will determine whether FOCs will be able to work compatibly with a host state striving to retain its oil sovereignty.

The Final Draft Petroleum Law

Now in its fourth final draft version, the new Oil Law is awaiting passage by Iraq's Council of Representatives.[116] The new Oil Law is a framework law and will require many companion laws in order to give full legal protection to Iraq's oil and gas sector.[117] For example, Iraq's Council of Representatives recently passed a law, distinct from the framework Oil Law, permitting foreign investment in the new construction of oil refineries in Iraq.[118] Further laws on revenue-sharing provisions and taxation are mandated under the framework Oil Law.[119] The revenue-sharing law has been particularly controversial, and will require significant political compromise before being passed into law.

While the varying companion laws present their own set of complicated issues, the framework Oil Law is itself no stranger to complex, controversial, and politically charged circumstances. At first blush, the new Oil Law appears to be an anomaly. Compared with oil laws in many other oil-exporting states, the new Oil Law is a somewhat unique model for managing a state's oil sector. The Oil Law calls for a nationalized oil system while at the same time permitting substantial FOC involvement.[120] While many oil-consuming nations would like to see the oil sector in Iraq fully privatized, the citizens of Iraq would like to deny almost all FOC participation.[121] The result is an Oil Law attempting to accommodate the interested parties: the government of Iraq, the people of Iraq, the regional governments of Iraq, the governments of oil-consuming nations, and the FOCs.[122]

The Iraqi Constitution holds that Iraq's oil wealth belongs to all the people of Iraq. Article 108 of the Iraqi Constitution states "oil and gas is the property of all the Iraqi people in all the regions and provinces."[123] However, the phrase "in all the regions and provinces" has created a number of problems in the various draft versions of the Oil Law.[124] Article 109, 110, and 111 of the Iraqi Constitution divest considerable authority in the regions.[125] This has been troublesome for the Iraq Central Government (ICG) especially in Kurdistan where the Kurdistan Regional Government (KRG) has drafted its own oil law: the Petroleum Act of the Kurdistan Region of Iraq (Kurdistan Oil Law).[126] A final draft version of the Kurdistan Oil Law was issued on September 9, 2006.[127] A modified version was resubmitted to

115 Id.
116 Iraq's Parliament Debates Amended Oil Law, Middle East Economy & Finance (July 5, 2007).
117 Id.
118 Iraqi Legislators Approve Law on Investment in Oil Refineries, The Associated Press (July 25, 2007)
119 Shafiq, supra note 9.
120 Id.
121 Ariel Cohen & Gerald P. O'Driscoll, The Road to Economic Prosperity for a Post-Saddam Iraq, The Heritage Foundation Backgrounder, No. 1633 (Mar. 5, 2003)
122 FOCs wanting a share of Iraq's oil are not limited to the Western oil companies and include such diverse entities as private and state oil companies from Algeria, Vietnam, Libya, Norway, China, Russia, India, and Austria.
123 Federal Constitution of Iraq, Translated from Arabic by The Associated Press (Oct. 15, 2005)
124 Id.
125 Id. at 26-27 (Articles 109-111).
126 Petroleum Act of Kurdistan Region of Iraq, Final Draft for Submission to the Parliament of Kurdistan (Sept. 9, 2006)
127 Id.

the KRG Parliament on June 29, 2007,[128] and was passed into law, along with a model PSC, on August 9, 2007.[129] Eager to start signing contracts with FOCs, the relatively peaceful and oil-rich Kurdistan region wants to use its own petroleum law as a way of encouraging the ICG to pass a federal version of their oil law.[130] The KRG has opened up a number of exploration blocks for bidding, and began signing PSCs with small FOCs, such as Norway's DNO,[131] the United Arab Emirates Dana Gas[132], and Dallas-based Hunt Oil Company.[133] The signing of these contracts has thrown negotiations on the new Oil Law into a tail-spin; the ICG in Baghdad holds that such contracts are illegal.[134] The KRG responded by stating that the contracts signed are legitimate, constitutionally sound, and completely outside the jurisdiction of the ICG.[135]

The issue between the KRG and the ICG relate to the level of autonomy the regions will have in developing their oil resources.[136] The first question to be answered is whether the regions of Iraq have the authority to negotiate and sign PSCs with FOCs, or whether such decisions are retained by the ICG.[137] The KRG holds that Articles 109 and 110 of the Iraqi Constitution give the KRG the authority to operate and control their oil and gas sector independently.[138] Article 110 only stipulates that the "federal government will administer oil and gas extracted from current fields."[139] The Kurdistan Oil Law interprets current fields as any producing oil fields prior to August 28, 2005: the date that the final draft of the Iraqi Constitution was read to the National Assembly.[140] All other fields, the KRG holds, are to be controlled and administered by the Kurdistan region exclusively.[141] Combined with Article 109, the KRG claims that they have the authority to negotiate and develop their oil sector independently from the ICG.[142]

One of the major objectives of the Oil Law is to help unify the country.[143] The final draft Oil Law attempts to resolve many of the conflicts with the KRG.[144] Under the most recent final draft Oil Law, the KRG has the authority to negotiate contracts with FOCs, but the contracts are subject to approval by the ICG through the Federal Oil and Gas Council (FOGC).[145] However, in order to accommodate the regional interests of the KRG, critics claim that the concessions made to the Oil Law shift the balance of power in the management of Iraq's oil industry from the center out to the regions.[146] In order to increase regional autonomy in the federal version of the Oil Law, a number of the checks and balances in the prior drafts have been stripped away, resulting in a structure that can easily fall victim to political manipulation.[147]

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[128] Petroleum Law of the Kurdistan Region – Iraq, Final Draft for Submission to the Parliament of Kurdistan (June 29, 2007)
[129] Oil and Gas Law of the Kurdistan Region – Iraq, Law No. 22, 2007, Approved by the Kurdistan National Assembly on August 6, 2007 and entered into force upon the assent of President Masoud Barzani on August 9, 2007.
[130] Tariq Shafiq, Kurdistan Regional Government Hydrocarbon Law: A Commentary, Middle East Economic Survey, Vol. XLIX, No. 37 (2006)
[131] Id.
[132] Masada al-Askari, Iraq's Kurdistan Opens its Arms to Gulf Investors, Gulf Times (May 21, 2007).
[133] KRG Signs Oil and Gas Contract with US-based Hunt Oil, Kurdistan Regional Government Press Release (Sept. 8, 2007).
[134] Qassim Abdul-Zahra, Official Says Iraqi Oil Talks Deadlocked, The Washington Post (Sept. 13, 2007)
[135] KRG Responds to Dr. Shahristani' s Recent Statements on Oil, Kurdistan Regional Government Press Release (Sept. 11, 2007)
[136] Shafiq, supra note 130.
[137] Id.
[138] Id.
[139] Federal Constitution of Iraq, Translated from Arabic by The Associated Press (Oct. 15, 2005).
[140] Shafiq, supra note 130.
[141] Id.
[142] Id.
[143] Shafiq, supra note 9.
[144] Id.
[145] Id.
[146] Id.
[147] Id.

In addition to dealing with questions of regional authority, the Iraq Oil Law sets the organizational and fiscal structure of the Iraqi oil sector.[148] The Oil Law calls for the establishment of the FOGC, the re-establishment of the Iraq National Oil Company (INOC), and the re-organization of the Ministry of Oil (MOO).[149] Article 5 of the Oil Law sets out the competencies of the various authorities tied to the oil and gas sector.[150] The Council of Representatives and the Council of Ministers are responsible for proposing, formulating, and passing legislation related to the oil and gas sector.[151] The FOGC is responsible for assisting the Council of Ministers in shaping Iraq's oil and gas policy.[152] Most importantly, the FOGC is tasked with final approval authority on all contracts awarded, including all PSCs.[153] Interestingly, Article 5 also calls for an Independent Consultants Bureau (ICB) to be established in order to consult the FOGC in contract negotiations.[154] The ICB is to be composed of oil and gas experts, both Iraqis and foreigners.[155] The Oil Law indicates that the MOO is to be the federal body for regulating, supervising, and monitoring the oil and gas sector in Iraq.[156] It further requires that the MOO make significant methodological and institutional changes.[157]

The INOC is to be re-established and will be wholly owned by the ICG.[158] However, the INOC will operate financially and administratively independent of any government body.[159] The INOC will be responsible for managing and operating all existing fields that are currently in production.[160] Additionally, the INOC has the right to participate in all oil and gas exploration and development projects.[161] This means that the INOC has the right to participate as a commercial partner in all PSCs signed with the Iraqi state.[162] Thus, the Oil Law basically gives the INOC a monopoly over gas and oil projects in Iraq, while at the same time allowing the state to sign PSCs with FOCs.[163] Unless the INOC is able to have a controlling interest (over 50 percent) in the PSCs that are signed, it appears somewhat inconsistent to claim a nationalized oil system while at the same time permitting extensive foreign involvement.

Petroleum revenue is discussed in Article 11 of the Oil Law.[164] All oil revenue will go into the "Oil Revenue Fund."[165] A portion of the revenue from that account will be diverted into the "Future Fund," which is to act as a stabilization fund.[166] Article 11 also authorizes the Council of Ministers to draft a law for the regulation all oil revenue collection and distribution.[167] While the Iraqi Constitution vests Iraq's oil wealth in the citizens of Iraq, the Oil Law unfortunately does not indicate how oil revenue will be distributed.[168] Applaudingly, however, Articles 36 and 37 set out the framework for increasing transparency and implementing anti-corruption laws.[169] Article 15, which calls for capacity building in the oil sector, is also commendable.[170] Article 15 states that holders of oil contracts should

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148 Final Draft Iraq Oil and Gas Law, Republic of Iraq Council of Ministers: Oil & Energy Committee (Feb. 15, 2007)
149 Id. at 9-13 (Article 5).
150 Id.
151 Id. at 9-11 (Article 5, Part C).
152 Id.
153 Id.
154 Id. at 10 (Article 5, Part C, No. 6).
155 Id.
156 Id. at 11-12 (Article 5, Part D).
157 Id. at 14 (Article 7).
158 Id. at 13-14 (Article 6).
159 Id.
160 Id. at 12 (Article 5, Part E).
161 Id.
162 Id. at 13-14 (Article 6).
163 Id.
164 Id. at 18 (Article 11).
165 Id. at 18 (Article 11, Part C).
166 Id. at 18 (Article 11, Part D).
167 Id. at 18 (Article 11, Part A).
168 Id.
169 Id. at 30-31 (Article 36-37).
170 Id. at 21 (Article 15).

undertake to employ Iraqi citizen, purchase Iraqi products, and use Iraqi services whenever possible.[171] Similar to the details concerning the distribution of oil revenues, the tax regime for the oil sector requires further implementation: "the appropriate monitoring authority is authorized to establish a law regulating the methods of taxation, the tax rates, and the tax exemptions applicable to petroleum exploration, development, and production activities."[172] Royalties, on the other hand, are explicitly set at 12.5 percent of gross production.[173]

Although titled "Development and Production Contracts," the contracts legalized under the Oil Law are like a model PSC.[174] While the new Oil Law does permit foreign service contracts (such as typical non-risk bearing service contracts and risk bearing buy-back

contracts),[175] the law also clearly permits certain types of PSCs. Article 13 states that the holder of an exploration and production contract is the given exclusive right to conduct petroleum exploration and production within the contract area.[176] Further, Article 13 also sets forth the limits on contract duration: a typical feature of PSCs.[177] It differentiates between the exploration phase and the production phase.[178] During the exploration phase, the initial period is set at four years with the ability to extended the time period twice for up to two years each.[179] In the event of discovery, an additional two years extension is possible in order to access the commercial viability of the project.[180] The development and production period is not to exceed 20 years.[181] However, up to three five year extensions are available if "technical and economic considerations warrant a longer production period."[182] Thus, contract duration can be up to 35 years.

While the new oil law permits risk bearing buy-back contracts of the sort that have been successfully employed in the Republic of Iran, the underlying legal regime of the new Oil Law sets forth a framework more characteristic of a standard PSC than a standard buy-back contract[183] The difference between Iran and Iraq in terms of future FOC involvement is that Iran does not permit PSCs.[184] In general, if given the option between signing a PSC or a buy-back contract in Iraq, a FOC will most assuredly prefer to protect its long-term investment with the greater protections provided under a PSC. While the terms of the PSCs allowed under the new Oil Law are relatively protective of the Iraqi state, the new Oil Law is written in a way to assure that FOCs are given their share of Iraq's oil wealth. Limiting the new Oil Law to buy-back contracts is a readily apparent way to limit FOC involvement while at the same time attracting foreign investment and avoiding the politically sensitive issue of preserving national oil sovereignty.

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171 Id.
172 Id. at 29 (Article 33, Part B).
173 Id. at 29 (Article 34).
174 Id. at 19-23 (Chapter III, Articles 13-20).
175 Buy-back contracts are a sort of hybrid between a service contract and a PSC. These contracts have allowed countries with national oil companies (NOCs) to attract foreign investment for oil development without giving much control to the FOC. Under such a contract, the FOC provides capital and technically expertise in an oil development project. The FOC is reimbursed for its capital investment and is remunerated in cash at rates dependent upon the success of the project. Once in the production phase, the FOC remains on the project under non-risk bearing technical service contracts. They are also allowed to buy back oil the project produces (from the NOC) at an arranged, usually discounted, rate. The buy-back contract is a way for an oil-exporting country to encourage foreign investment without being critically regarded as selling out their nationalized oil sectors. See M. Bunter, The Iranian Buy-back Agreement, Oil, Gas, & Energy Law Intelligence, Vol. 1, Issue 2 (Mar. 2003).
176 Final Draft Iraq Oil and Gas Law, supra note 148, at 19 (Article 13, Part A).
177 Id. at 19 (Article 13, Parts B-F).
178 Id.
179 Id. at 19 (Article 13, Part B-D).
180 Id. at 19 (Article 13, Part E).
181 Id. at 19 (Article 13, Part F).
182 Id.
183 M. Bunter, The Iranian Buy-back Agreement, Oil, Gas, & Energy Law Intelligence, Vol. 1, Issue 2 (Mar. 2003).
184 Id.

Recommendations

The passage of the new Oil Law should be delayed, and a moratorium placed on all new oil development contracts in Iraq. A moratorium on all new oil contracts would help calm American and British fears that other oil-consuming countries, less concerned with the rule of law, will sign oil contracts in Iraq regardless of whether federal petroleum legislation has been passed. Unfortunately, however, this may no longer be an option. The Iraqi Minister of Oil, Hussain al-Shahristani, stated at a conference in Dubai in September 2007 that the MOO would begin to tender contracts for the development on current fields before the end of the year regardless of whether or not the Oil Law is passed.[185] While calling the KRG's contracts with FOCs illegal, al-Shahristani stated that he had the legal authority to sign development contracts under the legal regime put into place during Saddam Hussein's reign.[186] While it may not be in Iraq's best interests to pass the Oil Law in its current state of great political weakness, it is equally damaging for the Minister of Oil to announce that contracts can be tendered under Saddam-era laws. The result of such carelessness will result in the indefinite postponement of the Oil Law, as well as, creating further anxiety among Western countries who will be tentative about signing contracts amidst such legal uncertainty. The MOO should refuse to sign new contracts until a new legal framework is established.

The focus in Iraq should be on creating the political stability needed to pass a federal oil law that will providing long-lasting legal protection for Iraq's vast oil resources. In the meantime, the ICG should focus on rebuilding their damaged oil infrastructure enough to raise production back to its pre-war levels;[187] a feat which may not require FOC involvement at all. Before Iraq can create a system for the equitable distribution of its oil wealth, it must be able to create a viable state with strong institutions and political processes. Further, in Iraq's current state of war and political weakness, it makes little sense to extract oil at a rapid rate only to have that oil lost to smuggling and graft.[188] Even Tariq Shafiq, a drafter of the Oil Law, concedes that a "stampede for exploration and development contracts at this particular juncture of Iraq's political and economic development would be viewed as mortgaging the reserves of future generations. It would also fuel the view that the war was about oil."[189]

It is undisputed that the oil industry of Iraq needs significant investment in order to rebuild and develop its oil infrastructure. This will certainly require foreign investment and a national legal regime to protect those investments. However, the passage of a national petroleum law may not be ripe amidst the current chaos and political instability in Iraq. To get production back to the 3.5 million bbl/d level, it has been estimated that five to seven billion dollars will be required.[190] A further 56 billion is said to be needed in order to raise its production to 6.5 million bbl/d by 2015 – its stated goal.[191] Nationalists argue that raising production to the 3.5 million bbl/d level is possible with no direct foreign investment.[192] Critics of such a plan say that this would lock up too much of Iraq's revenue; revenue that is needed for reconstruction of other sectors of the economy.[193] They further hold that FOCs are eager to provide the capital needed to develop Iraq's petroleum sector, and that the sooner Iraq can increase its production, the faster oil revenue can be used to rebuild Iraq.[194] While Iraq may be able to internally fund the increase to the 3.5 million bbl/d mark, foreign investment and expertise will be required to reach its stated long-term goal of 6.5 million bbl/d.

While foreign involvement in a nationalized oil system has been an issue of contention, allowing FOCs to help in the redevelopment of the petroleum sector in Iraq is critical and should be viewed as an issue of moderation as opposed to absolute exclusion. The current model among oil-exporting

[185] Iraqi Oil Minister Vows Tenders This Year Even if New Law Isn't Ready, The Daily Star (Sept. 10, 2007)
[186] Abdul-Zahra supra note 134.
[187] See supra notes 45-59 and accompanying text.
[188] al-Chalabi supra note 45.
[189] Shafiq, supra note 9.
[190] al-Nuwaiser, supra note 38.
[191] Lando, supra note 12.
[192] al-Amir supra note 60.
[193] Id.
[194] Shafiq, supra note 9.

countries is to expropriate concessions and force the renegotiation of contracts with FOCs.[195] However, there are other models that are being used to balance concepts of nationalization with the realization that FOCs can provide much needed capital investment and technical expertise.[196] In Qatar, PSCs have been used equitably to attract foreign investment.[197] By maintaining tight control over their oil sector, Qatar has been able to prevent FOC windfalls.[198] In Azerbaijan, the mandatory involvement of its state-owned national oil company has proven an effective means of keeping national interests alive in a foreign oil projects' decision-making process.[199] In Iran, buy-back contracts are being used to bring in foreign expertise and much need capital, while still maintaining a nationalized oil system with complete state ownership over their oil reserves.[200]

Despite the political uncertainty surrounding passage of the oil law, it remains the duty of Iraq's Council of Representatives to make sure that the new Oil Law provides for a fair and equitable system for the development of their oil resources. Since this paper's focus is on the contract terms permitted under the final draft of the new Oil Law, it is from this perspective that recommendations will be made. There are several simple changes that can be made to the Oil Law through amendment or modification that would render more equitable contracts.

First, there should be a distinction made between exploration and development contracts, and those contracts that will just develop already discovered fields. Exploration and development PSCs carry more risk and should give the FOCs a larger percentage of the profit oil. Development PSCs, which do not carry nearly as much risk, should only allow a very modest percentage of the profit oil. Second, the contract durations should be shortened. Considering the limited risk and relatively low capital investment costs that will typify FOC development projects in Iraq, PSCs lasting for up to 35 years are excessive.[201] Third, the Oil Law should require that profit-sharing is based on the profitability of the project through R-factors or IRRs.[202] Fourth, the Oil Law should require annual caps on capital cost recovery by the FOC.[203] Fifth, the PSCs awarded in Iraq should require a 51 percent interest going to the INOC in all contracts signed with FOCs. This will assure that there is a controlling Iraqi interest in the project. Sixth, the Oil Law should stipulate that regional oil funds are created in each region and that they are monitored by regional citizen's councils. A specific portion of Iraq's oil revenue should be placed in these regional oil funds commensurate with their population. Even if there is the risk of losing some of the funds to corruption and graft in the short-term, it is important to demonstrate that the oil of Iraq really is the property of all its citizens.

While the issues relating to the contract provisions in the Oil Law appear to be the least daunting problems currently associated with the passage of the Oil Law, it is nonetheless important to compel the legislators debating the Oil Law to amend some of the more inequitable contract provisions. The Parliamentary process will allow for changes to be made to the law before it is passed. It is now Iraq's responsibility to modify the latest final draft of the Oil Law into a petroleum law that is equitable to all the interested parties. Such modifications will demonstrate to the Iraqi people that its government represents them and not various competing foreign interests. Unfortunately, while foreign investment and expertise are going to be an necessary, beneficial, and integral part of Iraq's future development in its oil sector, one could certainly argue that the political instability in Iraq is not ideal, ripe, or advantageous for the negotiation of a law that is so critical to the future of Iraq and its population. Of equal concern, however, are the recent comments by Iraq's Minister of Oil.[204] If in fact the postponement of the Oil Law will only mean that the ICG will begin signing contracts under the

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195 From Venezuela to Algeria to Bolivia, oil-exporting countries are forcing the renegotiation of contracts with foreign oil companies on the grounds that they are not receiving a fair percentage of the profits. See Barking Louder, Biting Less, The Economist, Vol. 382, No. 8519 (Mar. 10, 2007), 55, 56.

196 Id.

197 Id.

198 Id.

199 Azur Bagirov, Azerbaijan Oil and Gas Legislation, 11 I.E.L.T.R. (2000), 282.

200 Bunter supra note 183.

201 See supra notes 177-182, and accompanying text

202 See supra notes 101-105 and accompanying text.

203 Babesiae et al., supra note 75, at 200.

204 Iraqi Oil Minister Vows Tenders This Year Even if New Law Isn't Ready, supra note 185.

Saddam-era legal regime, then it is important for the ICG to gather the political will needed to pass the Oil Law.[205]

Conclusion

As the war in Iraq rages into its fifth year, instability and violence continues to rise. The new Oil Law was designed to curb some of this instability by helping to unify the sectarian divide, while at the same time providing much needed revenue for post-war reconstruction, or so the argument goes. However, critics of the new Oil Law see it as nothing more than an imperial means by the West to access Iraq's oil without long-term physical occupation.[206] However, there is little doubt that foreign involvement in the development of Iraq's oil sector will be beneficial to both Iraq and foreign oil-consuming countries. The major issue with the new Oil Law is not in its authorization of FOC involvement, but rather the extent of involvement that the new Oil Law permits. Neither a completely privatized oil sector nor a completely nationalized oil sector is in Iraq's best interests. The new Oil Law should allow for foreign involvement, but in manner that is compatible with Iraq's ideals of oil sovereignty. Iraq is now tasked with modifying its Oil Law, despite its political weakness, into an equitable legal framework for the future exploitation of Iraq's oil reserves. This is no easy task. Balancing the oil-consuming world's pursuit of petroleum against growing economic poverty, violent instability, sectarian division, lack of political cohesion, and the need for oil revenue – Iraq's leaders have a challenging road ahead.

[205] Lando, supra note 12.
[206] Antonia Judas, It's Still About Oil in Iraq, L.A. Times (Dec. 8, 2006)