Understanding Petroleum regimes in the MENA region

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MENA and Petroleum contracts

The Middle East and North Africa (MENA) region has vast petroleum resources with Iran, Kuwait, Saudi Arabia and the United Arab Emirates within the top ten oil producing countries in the World.

National Oil Companies ("**NOCs**") in conjunction with International Oil Companies ("**IOCs**") typically develop these petroleum resources and the legal regime governing the relationship between a NOC and an IOC varies depending upon the project, the resource and the host country. Historically, host counties were dependent upon the IOC's know-how, technology and finance but this dependence has reduced as projects were developed and know-how and technology transferred to the NOCs.

Projects are, in the most cases, awarded to IOCs following success bids on tenders and, at the end of 2017, Oman, Egypt and Iraq announced tenders over certain oil and gas blocks in the region.

The legal framework surrounding the development of petroleum projects differ between countries although there are two defined regimes, **Concessions** and **Contracts**. It is important to identify and evaluate a country's petroleum regime in order to understand the rights and obligations of, and the relationship between, the IOC and NOC in the event of a successful tender process. The legal regime may also affect the availability of third party funding, if required.

This article will review the basic and general differences between concessions and pure contract-based arrangements in the oil and gas sector.

Concessions

Concession arrangements can be identified as traditional or modern and, under concessions, title to petroleum is generally transferred and owned by the IOC upon extraction at the wellhead. An example of an early concession is the concession agreement between Petroleum Concession Limited (a British based company) and the Sultan of Muscat and Oman which was entered into on 24th June 1937 for a period of 75 years.

Under a traditional concession, the IOC is typically granted long term, uninterrupted and exclusive mining rights over a large defined area of the host country to undertake, at the IOC's sole risk, exploration and production of hydrocarbons. The IOC is allowed control over petroleum operations and, in return, fiscal payments (taxes, bonuses and royalties), based upon the value of production, are made.

The main benefit to the host country under this type of arrangement is that it assumes little or no risk; the IOC funds all operations and takes the risk of discovery. However, the host country invariably has little control over the operations, and together with its long-term nature, the traditional concession is unpopular. This has resulted in the development of the modern concession arrangement.

A modern concession tends to work in phases, the first phase for exploration (generally being between 5 - 10 years, and which may include a defined work programme), and a second longer phase, subject to

discovery, for production. The owner of the mineral interest (usually the host country) grants a lease or licence to the IOC, in return for payment of a rent and, upon production, a royalty.

Moreover, national courts and legislation create the regulatory environment within the host country by supplementing concession terms with conditions, including matters of taxation.

Contracts

Under a pure contractual petroleum regime, the entire arrangement between the NOC and IOC is set out in an agreement, which has been negotiated between the parties.

There has been a trend towards more contractual-based arrangements and the MENA region typifies this trend; for example in Egypt where Tax and Royalty Concessions were replaced in the mid 1970's with Production Sharing Agreements and in Kuwait a variety of contracts have been utilised since the late 1990's, including Operating Service Contracts, Enhanced Technical Service Contracts and Oilfield Service Contracts.

The types of contracts vary, but the forms widely used are Production Sharing Agreements, Participation Agreements and Service Contracts.

The Production Sharing Agreement is a commercial and regulatory instrument and allows the host country to regulate operations without the need for adopting specific regulations within its national legislation. Under a Production Sharing Agreement, in most instances, title to the extracted petroleum remains with the host country and the contract grants rights to the IOC to recover its costs from production (cost oil) before dividing the remaining production between the host country and the IOC (profit oil). The precise calculations of cost oil and profit oil are negotiated within the contract and may include adjustments to allow, for instance, for changes in economic conditions and the type of petroleum recovered (oil or natural gas). The contract shall also include any taxes and royalties which are to be paid.

In a Participation Agreement (either by way of equity or contractual joint venture), the host country will participate with a working, carried and/or free interest. With a working interest, the NOC shall be deemed a private party, sharing risks with the IOC, and contributing to a share of costs, typically after a discovery is made. With a carried interest, the cost of participation by the NOC is funded (that is, "carried") by the IOC with costs recovered from production. With regards to a free interest, the NOC receives a share without obligation for any contribution.

Generally, the potential rewards are considered to be greater for a host country under these types of arrangements than under concession arrangements, although the element of risk is greater too. Control of operations under these arrangements depend on the agreed terms although the IOC will typically take the role of operator under a Production Sharing Agreement and under a Participation Agreement a committee, with members appointed from the IOC and NOC, usually govern operations.

Under Service Contracts, the oil or gas produced remains the property of the host country and the IOC is paid a fee for providing services. Concerns surrounding sovereignty are addressed under Service Contracts, since as the hydrocarbon owner, the host country has management and operation control and the contracting IOC will work under command of the NOC. However, the host country but may not reap the same rewards that a Production Sharing Agreement or Participation Agreement bring.

Depending on the type of Service Contract, the fee may be paid from proceeds of production and the contractor may have a right to acquire petroleum at a discounted price.

Conclusion

Concessions and Contracts are the two defined regimes for the exploration and production of petroleum setting out the roles and responsibilities of the IOC and NOC. Each differ in respect of claims to ownership of petroleum, control over and operation of the project and the sharing of hydrocarbon products.

In the Middle East and North Africa, the trend is towards more contract-based regimes but the regime selected by the host country is generally determined by the type and status of proposed projects, the involvement of any National Oil Company and the requirement to attract foreign investment and know-how.