PETROLEUM CONTRACTS UNDER THE IRAQI LAW: NATIONAL AND INTERNATIONAL PERSPECTIVES

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***ABSTRACT*:** *Petroleum contracts have influenced socio- economic as well as political conditions of the oil producing countries. These contracts have played a significant role in international relations between nations. Iraq has entered into petroleum contracts with a number of countries across the globe. A question is often asked whether petroleum contracts could be considered as investment agreements and whether they require special arbitration channels in case of litigations. This study is a lucid description of different petroleum contracts in the context of Iraqi law. It has also studied the level of legal status granted to these contracts by the Iraqi government and whether they are subject to national litigation or international arbitration. The evidence of this study suggests that the Iraqi law does not recognize petroleum contracts as international agreements, in spite of foreign investors being a party. All petroleum contracts differ procedurally from international treaties and therefore are subject to the domestic Iraqi law. The study recommends the type of contract suitable for Iraq. Future studies could discuss the arbitration clauses in the domestic laws as well as their implications in maintaining bilateral international relations.*

Key terms: Petroleum Contracts, arbitration, international agreements, a joint venture

INTRODUCTION

Iraq has entered into petroleum contracts with a number of nations across the globe. A petroleum contract is a fundamental legal instrument between the host state and a petroleum company, which allows the latter to explore and exploit petroleum wealth in the former's territory. Petroleum contracts have played a significant role in international politics and economics[1] however contracts signed prior to Second World War did not succeed due to lack of coordination between the host country and the investment company.[2] One of the reasons for the failure of these contracts was the lack of capital and technical expertise with the host country and a greater degree of economic and political control demanded by the multinational company.[3] Owing to these factors and supremacy of the petroleum companies, the economies of the petroleum- producing countries affected very badly, depriving them of the petroleum revenue for their development.

However, after the Second World War, a lot of change was observed due to growing foreign investment in petroleum countries and the emergence of competitors. The host countries turned more diplomatic and new types of contracts appeared bearing names like service contract, production- sharing contract and participation agreement.[4] Iraq had not been an exception since petroleum was the main source of its revenue. Like other countries in the region, international petroleum companies had monopolized the Iraqi petroleum industry and were making an impact directly or indirectly on the development of the Iraqi petroleum industry and shaping the Iraqi economy.

The Iraqi government had no significant role in the management of its petroleum industry until 1958 as it was bound by several petroleum agreements, a few of which had unfair clauses.[5] In 1958 the government of Iraq promulgated laws related to the petroleum sector and nationalization of petroleum. The government also reviewed many of the prior petroleum agreements signed with petroleum companies. The Iraqi government realized that their vast reserves of petroleum and a relatively lower exploration costs should be adequately utilized. Hence, the Iraqi government allowed the state intervention in the industry and invited bids and proposals for exploration and exploitation of petroleum in Iraq. As a result, several new competitors came forward to end the monopoly of a few petroleum companies. In addition, the UN resolutions which encouraged host states to control their own natural resources also helped Iraq to exercise control over the companies.[6]

The Iraqi constitution of 2005 also declared petroleum as Iraq's most valuable natural resource and that it shall be owned by the Iraqi people. Hence, the nature of petroleum agreements changed drastically and they started getting the status of a sort of investment agreements, however, in the event of disputes, the Iraqi law issued directives to keep the disputes settlements of petroleum agreements different from the investment arbitrations. Moreover, petroleum agreements offered a dual legal privilege to the investor company, which was subjected to both public and private laws of the country. This brought flexibility in the Iraqi contract law which kept petroleum contracts different from the investment contracts. Moreover, under the new regulations, the Iraqi state acquired an increased awareness of petroleum as a vital resource and also succeeded in acquiring equality of economic relationship with the petroleum companies. Henceforth, under the new laws, instead of merely collecting royalties, Iraqi government continued to own its resources as well as received shares in the companies' profits.

This research study examines the nature of these newly framed contracts in the context of the Iraqi economy and how the country was benefited by these contracts. It highlights that all new contracts are actually time bound concession agreements given to a company for the purpose of exploration and exploitation of petroleum and pay a certain percentage if its profits to the host government. This study has also attempted to find out whether these contracts could be seen similar to investment treaties.

PETROLEUM CONTRACTS

Historically, all oil-producing countries have signed two types of contracts: Traditional and modern. A traditional contract is an agreement between two parties; the first is the host state and the second is the petroleum company. The host state gives the company rights to exploration, extraction and production

extraction within the territory of the host state for a certain period of time. The contract states that after the discovery of petroleum in commercial quantities, the two parties would establish a company with the host state contributing to the capital of this company while the petroleum company would invest its technical know-how and expertise. The petroleum company would also agree to pay a self-determined royalty to the host state on the quantity of petroleum produced, without taking into consideration the market price.[7] For example, in the agreement between Iraq and Kanaqin Oil Company, the company paid just 4 gold shillings for each ton of petrol extracted.[8] The governments of Muscat and Abu Dhabi were paid still lesser for each ton of petroleum.[9] In traditional agreements, the company was also granted the exclusive right for the area designated in the contract.

For instance, the agreement between the Iraqi government and the Bahamas Petroleum Company (BPC), London in 1938 provided the BPC with the right to drill anywhere in Iraq and extract petroleum and natural gas with the first party (the host state) agreed not to renegotiate the terms of the contract once signed.[10] the major drawback of this type of contract was that a company would take possession of all the petroleum produced in any quantity, while the host state received only a small amount of taxation or royalty in return.[11] Last, but not the least, the petroleum company was also not subject to the local judiciary with regard to any issues related to the contract and issues, if any, were settled through international arbitration.[12] Iraq, however, did not adopt the traditional form of contract on many occasions.[13]

On the other hand, the second type of contracts, the modern contracts, evolved due to a number of political and economic events. The petroleum producing countries by this time had realized the significance of petroleum in domestic as well as the global economy; it was known to them how the petroleum revenues could benefit other sectors of their economy like agriculture, industry, education, and transport. Consequently, these countries opted for modern methods which included nationalization of the petroleum industry and renegotiation of existing contracts and signing new contracts through open market thus inviting new companies to enter the market.[14] Several new companies now appeared to compete with the already existing monopolistic companies, with more favorable terms to the petroleum countries.[15] Meanwhile, the Organization of the Petroleum Exporting Countries (OPEC) was also formed which initiated a new kind of relationship between producing countries and petroleum companies.[16]

The modern type of contracts differed from the traditional in many respects. First, there were greater financial benefits in modern type for the petroleum countries through royalties, taxes, rents and bonuses. The royalties depended upon the amount of production, paid by the petroleum company to the host state, which was fixed for each unit of petroleum production, irrespective of profits made by the company. The Iraqi law of Oil and Gas No.22 of 2007 imposed royalties based on a density criterion (article 37/E) and fixed 7.5% for heavy crude oil and 10% for light and medium petroleum. In 1950s, taxes were introduced in Petroleum contracts [17] on profits made by the companies. Unlike royalties, the tax percentage increased if the company achieved high revenue and decreased if profits were low. Additionally, the petroleum companies paid bonuses to the host government at various stages such as after signing of the contract, at the start of production, and when the exploration started. [18] The host countries also charged the petroleum company a rent as a part of the revenue. The rent was charged for the territory where the petroleum field was located. With these additional revenue sources, the petroleum producing countries succeeded in subjecting the companies to their demands and gained the upper hand in the decision- making at all stages of production.

A major feature of the modern type of contract was also the relinquishment clause which restricted the petroleum company's right to control over the land of the host country, politically and economically.[19] Under the relinquishment clause, the company was allowed to leave those areas where oil was not discovered in commercially viable quantities and move to areas where petroleum was found in larger quantities. [20] This clause not only allowed the investor companies to implement the contract on time but also helped the host country to retain its sovereignty over the land. Moreover, the company's right to exploit petroleum-rich areas was not absolute but was restricted only to the period of the contract, which was much shorter than the traditional contracts. The modern type of contracts also contained adaptation or re-negotiation clauses, which helped the contractual parties to avoid a dispute in changed circumstances. The two parties could re-negotiate the contract in accordance with changes in political or economic policies or due to an alteration of laws. [21]

DISCUSSION

Iraq was too quick in switching over to the modern form of contracts because after the nationalization of Iran's petroleum industry in 1951, the production in Iran had decreased [22] and petroleum companies had begun to extend their activities to Iraq. [23] Moreover, Iraq was a major contributor to the reconstruction phase post Second World War in many countries by meeting their petroleum demands. There were mainly three different forms of modern contracts namely production sharing contracts, service agreement contract, and participation agreement contracts signed by Iraq with different multinational companies..

Production Sharing Contracts (PSC)

Under PSC, a company agrees to conduct exploration at its own cost until the discovery of petroleum. The host state only bears the expenses of the survey and logistics to reach the petroleum reservoirs. [24] If the oil at the exploration site is discovered in commercial quantities, the two parties would then enter into a contractual relationship or a Production Sharing Contract (PSA). But if the company does not find petroleum in sufficient quantities, there would be no responsibility placed on either party and the host state would not be required to share the cost of drilling or any geological activities conducted by the petroleum company.[25] Thus the host country retained its control over the petroleum wealth. If oil is discovered the petroleum company only receives a proportion of the production as would be laid down in the contract.[26] The production sharing agreement thus sends the message that petroleum is under the ownership of the host state and that only the host state has a right to its disposal. Such an agreement also proves the sovereignty of the host state over natural resources.[27]

Additionally, if the oil is discovered, the petroleum company usually takes 30% to 40% of oil towards the cost of production. The remaining oil, known as profit petroleum, is split between the petroleum company and the host state according to the ratio agreed in the contract. This percentage always depends upon the quantity of production. It often starts with 25% to foreign partner followed by a reduction whenever production increases. The petroleum companies also pay taxes on such outputs.[28] Iraq signed two production sharing agreements for the first time with a coalition of Russian companies for the western part of Qurna oil field in southern Iraq in March 1997 [29] and another contract with a coalition of Chinese companies for the Al- Ahdab petroleum field, also in the south of Iraq in July 1997. [30] The Iraqi president Saddam Hussain signed these contracts with the aim of attracting investment from foreign oil companies, and to use these companies as a means of pressurizing the international community to lift sanctions on Iraq.

In 2006, the Kurdistan Regional Government (KRG) of Iraq signed another PSC for the Twake oil field with Norway. Subsequently, there were a number of contracts signed with different petroleum companies such as Dana Gas from the UAE; the Western Sands from Canada; Heritage Oil, from UK and Reliance Oil from India.[31] These contracts were signed despite objections from the central government in Baghdad which questioned the validity of these contracts and their clauses which primarily targeted Iran and other rival oil producing countries. The KRG, however, argued that PSCs signed with international petroleum companies were in accordance with Articles 110, 114 and 115 of the Constitution of Iraq of 2005, which although identified the exclusive and shared powers of the Iraqi Federal Government (IFG) but did not refer explicitly to its right to limit oil and gas production activities of any regional government.[32]

Service Agreements Contracts

Another form of contract known as service agreement contract allows a petroleum company the rights to explore and extract oil in return for a fixed fee agreed in advance with the host state.[33] Some countries try to make this contract more attractive by allowing the petroleum company to have crude oil as a fee. This is called a buyback agreement as it was initiated in some oil fields in Iran. [34] The international petroleum company under this contract, therefore, would act only as a service contractor to the host country's national petroleum company. Under this contract, therefore, there is no legal relationship or ownership of the foreign company on the petroleum resources in the ground. The oil produced belongs to the host state, which has a right to dispose of the oil and is committed to paying all the costs accrued by the contractor.

This type of contract promotes nationalization of oil resources in the host state. The national oil company of the host country remains the owner of the petroleum resources.[35] The first service agreement in the Middle East took place in Iran in 1966, between Iran's National Oil Company and the French company ERAP, which was followed by seven more service contracts till 1974 with Iran as a host state. [36] The first service contract by Iraq was signed with the Iraq National Oil Company (INOC) and the French company, Enterprise de Recherches et d'Activités Pétrolières (ERAP) in 1968, followed by two more contracts, one with the Petrobras Oil Company of Brazil, and a second contract with the India Oil and Natural Gas Company. By signing these service contracts, Iraq thus closed the door to investment by international oil companies that were not interested in entering into service contracts and preferred a share in the production of the oil. This created tension between Iraq and international oil companies; however several attempts were made by the European Companies Group to resolve these issues but were rejected by the Iraqi government.[37]

Participation Agreement Contracts

The third type of contract is called Participatory Agreement Contract under which the national petroleum company owned by the host state acts as partners sharing the exploration and extraction activities but without bearing any risks or costs until the oil is discovered in commercial quantities. If oil is found, the contract changes into a development and production contract making the activity as a joint venture. The host state in this joint venture plays a significant role and also maintains its sovereignty. As a joint venture, the foreign company contributes in the form of capital, technological equipment and expertise while the host state allows access to its oil fields. [38] The foreign company also pays royalties and taxes if it achieves profit.

The participation agreement is considered to be more beneficial to the national partner since it gets an opportunity to participate in exploration operations, management and planning the joint venture and acquire the skills to conduct exploration activities in future. Such participation agreement contracts first appeared in Iran, Egypt and Indonesia between 1957 and 1960 with Italian companies. Iraq also accepted this new type of agreement as it already had accepted the recommendations of the San Remo convention which provided in Article 8 that petroleum countries have a right to share a percentage of the corporate capital with the international oil company. Consequently, Iraq signed several participatory agreements contracts with multinational companies. [39]

PETROLEUM AGREEMENTS VS INVESTMENT AGREEMENTS

Owing to the involvement of foreign partners in all types of petroleum agreements, a question is often asked whether petroleum agreements could be categorized as investment agreements and whether it requires a special regime of arbitration. There are studies that have argued against treating petroleum agreements as investment agreements for a number of reasons. First, petroleum contracts contain a risk element, not only from the internal clauses of the contract specific to oil industry but also from external factors such as revolutions or coups or changed political circumstances, in the petroleum-producing countries, particularly in states dominated by dictatorial regimes. These events might create an unstable environment for petroleum contracts since changed political contexts may lead to a change in the economic policy of the host state. Second, new laws by host states, for example, nationalization laws, might also adversely affect the petroleum contracts for which there is no arbitration or compensation. Third, the scope of the petroleum contracts covers wide areas of land and sea, including territorial waters; and also the duration sometimes exceeds 75 years, unlike any investment treaty.

These factors would undeniably justify petroleum contracts as unique but under the Iraqi Law they do not enjoy a special status and are treated as investment agreements. The Iraqi government also argues that the risk factor can be found in other contracts too; the nationalization could also affect investment treaties as it was done in the case of the Suez Canal, which was nationalized by the Egyptian government in 1956. About the duration issue, the Iraqi government argues that modern petroleum contracts have lesser duration than the traditional ones. Hence, it is found out in this study that the petroleum agreement in Iraq is just another kind of investment agreement.[40]

However, in order to fix the scope and provisions of oil and gas as a different type of investment, Iraqi Investment Law No 13, Article 29 of 2006 excluded oil and gas extraction and production from its jurisdiction. The law thus treats petroleum contracts as investment contracts but gives them a special position by not subjecting them to the provisions of other investment agreements. Hence, in the cases of arbitration, if any, petroleum agreements contracts need special arbitration provisions compatible with their special status.

One of the objectives of this study is also to find out the type of legal status Iraq has granted to petroleum contracts and whether they are subject to national litigation or international arbitration. The evidence of this study suggests that the Iraqi law does not recognize petroleum contracts with the foreign investors as international agreements, hence there is no question of international arbitration in case of litigations. According to Iraqi law, a petroleum contract cannot be given the status of an international treaty because it distinguishes procedurally from an international treaty. Hence, all Petroleum contracts are subject to Iraqi law rather than international law.[41]

Moreover, another distinction that this study found out that under Iraqi law, an international treaty cannot stand valid unless approved by the Iraqi Parliament, whereas a petroleum agreement does not need to be validated by the Iraqi Parliament. Secondly, the international treaty parties are nation states, whereas the parties to petroleum contracts are two petroleum companies, one at the host state and another from a foreign location. [42]

These findings are both consistent and contrary to several critical opinions held by experts and critics. For instance, Stephen Schwebel, a former judge of International Court of Justice (ICJ) argued that petroleum contracts must be treated as an international treaty, subject to international law.[43] Friedmann, another expert on international matters, emphasized that petroleum contracts contribute to the building of the national economy of the host state. [44] Hence, the foreign investor or partner should be considered equivalent to a state and petroleum contracts as "economic development agreements." [45] Bowett, on the contrary, stated that a petroleum contract cannot be regarded similar to an international treaty since a treaty under international law is signed between two equal, sovereign states while a petroleum contract is an agreement between a state and a private party governed prima facie by the state's own law. [46] Similarly, Mansour Al- Saeed asserted that petroleum agreements are not in fact treaties since one of the parties in the economic agreement is a private individual or a corporation; though superficially petroleum contracts look very similar to treaties, both in their negotiation and drafting. Moreover, he also emphasized that petroleum agreements cannot be regarded as treaties since they are not included as subjects of international law.[47]

This view is consistent with the Vienna Convention resolution passed on the Law of Treaties, 1969, Art (a), which stipulates that a treaty means an "international agreement concluded between States in written form and governed by international law." [48] The Vienna Convention resolution also suggests that a petroleum agreement is not an international treaty because the parties of international treaties are states whereas, in the case of a petroleum agreement, one of the parties is a company or private individual.

A few examples of litigations can be cited here to understand this controversy. For instance, a dispute arose between Iran and the Anglo-Iranian oil company when Iran passed a law to nationalize its petroleum industry. The UK counterpart took this dispute to the ICJ where it was rejected owing to lack of jurisdiction. The Court did not accept that the contract signed between the Iranian Government and the Anglo-Persian Oil Company had an international character. It was seen only as a concessionary contract between a Government and a foreign company, with the United Kingdom government not a party to it. In other words, it was not a contract between the Government of Iran and the Government of the United Kingdom. Therefore, under the contract, the Government of Iran cannot claim from the UK Government any rights which it can claim from the Company, nor can the UK government be held accountable for any action performed by the company. This case proves that a contract is signed to regulate the relationship only between a government and a company, and not to regulate the relationship between the two governments. [49] Similarly, in the *Saudi Arabian v. Arabian American Oil Co (Aramco)*, [50] the arbitration tribunal did not apply international law to the agreement because the contract was not considered to be an international treaty.

CONCLUSION

This study has taken a brief look at various types of petroleum contracts in order to understand the true nature of Iraq's policies and views about international contracts related to oil and petroleum. The findings revealed a number of contracts commonly followed by oil-producing countries and also found out Iraq's priorities and preferences about these contracts. Some international organizations have though tried to persuade Iraq about production sharing agreement as the best form of contract for attracting foreign investment companies, in view of the unstable security situation. However, this study would recommend Iraq not to prefer this type of contract as it will demotivate petroleum companies to invest in Iraq. Production sharing contracts are suitable for countries where the probability of discovering petroleum is minimal, but not in the case of Iraq which has the third largest reserves of petroleum. They are also suitable for developing countries lacking the financial ability to fund exploration operations where there is a possibility of petroleum reserves. However, this study also recommends that Iraq should provide the petroleum companies with a climate of security so that petroleum companies should perform their exploration operations in a safe and secure environment. Future studies could focus on the need for arbitration in case of breach of these contracts.

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