

Iraq 5th Bid Round
Summary and Preview
June 1, 2018
Pedro van Meurs

This is a preview of our report on the results of the Iraq 5th Bid Round scheduled to be published in August 2018. This report will be part of the 3rd update of our 2018 World Fiscal Rating of Oil Terms, which is a detailed rating of the world fiscal regimes in 160 countries published by Van Meurs Corporation (www.vanmeursenergy.com).

Currently the World Fiscal Rating of Oil Terms rates 660 fiscal systems from the most attractive to investors (number 1) to the least attractive to investors (number 660). Our preliminary evaluation is that Iraq's 5th Bid Round terms will rate as 645, making it one of the toughest in the world for investor companies and the most advantageous to the host government. This is based on the average fiscal terms of the Bid Round results for Iraq for the five blocks.

The typical average Iraq government take of the 5th Bid Round is 95%. This is the same or higher than under the previous TSC's for comparable fields and blocks of similar size.

However, the 5th Bid Round terms offer much better protection for Iraq under lower oil prices. As was dramatically experienced during the last few years, under the previous TSC's the government take could drop to as low as 88% under low prices, depending on cost levels and the level of the remuneration fees.

Under the 5th Bid Round terms however, the cost limit for cost recovery is automatically lower under low prices. This provides a far better protection for Iraq under lower oil price conditions.

The 5th Bid Round terms also offer a significant improvement in the overall fiscal structure for the benefit of Iraq.

Under the previous TSC's the remuneration fee was a fixed fee per barrel, adjusted with an R-factor which creates a higher remuneration under higher costs.

This creates the undesired effect of giving higher profits to the investor companies when their costs are higher. At the same time the TSC cost recovery and remuneration fees can be taken as crude oil. This gives a strong incentive for overspending by the investor companies - , i.e. the higher the costs, the higher the profits, so the more oil can be taken from Iraq.

Under the 5th Bid Round terms by contrast, the higher the costs, the lower the investor company profits. This creates an automatic incentive to be cost efficient and is in line with good international practice in terms of structuring fiscal terms from the government perspective.

Another shortcoming of the previous TSC terms is that the remuneration fee is not related to the price of oil. This made companies less interested to invest in Iraq when oil prices go up compared to other international investment opportunities. This creates under-investment under higher oil prices - precisely the opposite of what Iraq is trying to achieve in order to expand its oil production capacity. However, the 5th Bid Round terms address this issue as well, as they are based on a sharing of net revenues after application of a royalty. Therefore, the higher the oil price, the more incentive the investor companies will have to invest in Iraq, which better aligns their interests with those of the Iraqi government and people. This is a more rational framework in line with international norms and best practice, creating an important incentive to increase the level of Iraqi oil production as oil prices increase.

The government revenues under the previous TSC's also depended on the ability of the Government to verify and control costs, putting a huge burden on the government administration and leading to bureaucratic delays. It also created an incentive for companies to over-charge for costs as this would increase their profits, and this in turn increased the likelihood of disputes between investor companies and the Government, leading to further delays and economic losses for both sides.

Under the 5th Bid Round conditions however, the 25% state company participation was removed, since most of the fields and blocks are undeveloped with little or no production, and instead a 25% royalty was imposed. The significant advantage of the royalty is that it is paid upfront based on top line gross revenue and therefore does not depend on cost and cost control. It essentially secures income for Government, regardless of project costs incurred by the investor company. Therefore, the Government revenues under the 5th Bid Round should be easier to collect and more dependable.

In addition, the removal of the 25% state company participation makes the Government's job clearer as a regulator and will make the decision-making process more streamlined. This in turn will make it possible to implement increases in production faster.

In general, it can therefore be concluded that the 5th Bid Round terms are a significant improvement on the previous TSC terms from the government's perspective, and represent an important step forward for Iraq. The terms should increase the benefits from petroleum production for the people of Iraq, while they establish at the same time a more rational relationship and alignment of interests with the investor oil companies.

Our fuller August 2018 report will go into more details as well as discuss possible further improvements which might be considered in future Bid Rounds.