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Analyzing the Successes and Failures of Iraq's 5th plus and 6th Oil and Gas Bid Rounds

by Muhammed Abed Mazeel al-Aboudi (/experts/muhammed-abed-mazeel-al-aboudi)

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ABOUT THE AUTHORS

Muhammed Abed Mazeel al-Aboudi (/experts/muhammed-abed-mazeel-al-aboudi)
Dr. Muhammed Abed Mazeel al-Aboudi is an expert at the Petroleum Research and Development Centre (PRDC).

Brief Analysis

For the sake of the Iraqi labor market and of developing domestic expertise in oil and gas management, the government should seek to become more attractive to major IOCs outside of the Chinese companies currently drawn in by its bids.

On May 11 through 13, 2024, Iraq held a combined "fifth-plus" and sixth oil and gas bid licensing round. The combined offerings of oil and gas contracts had been brewing since May 2022, when the Ministry of Oil (MoO) announced the round with thirty exploration blocks. Of these, sixteen were blocks originally offered in the fifth bid round (fifth-plus), which comprised eight proven oil discoveries and eight prospective blocks with no discoveries. The remaining fourteen blocks were new "sixth round" opportunities, including three proven gas discoveries and eleven prospective gas blocks with no discoveries. These gas opportunities were "free gas" or "non-associated gas," meaning pure gas projects with no oil that could be fully produced even if Iraq cuts its oil production due to OPEC quotas or falling demand.

The Ministry of Oil was keen to ensure a geographical distribution for the projects and therefore included all of the country's governorates to contribute to security and economic prosperity in these areas.

The government also had three other objectives for the bid round:

- to increase the exploitation of non-associated—or free gas—fields, whose much-needed gas production is not a byproduct of oil production, which can be limited by OPEC quotas
- to revitalize international investment in Iraq's energy sector at a time when Western energy investors are losing interest

- to replenish Iraq's oil reserves with a pipeline of new discoveries
- to ensure contracts include provisions to capture and transfer associated gas to the state, instead of flaring (burning) it

Did the Bid Round Achieve Its Objectives?

It is fair to say that interest in the bid round was underwhelming. Of the thirty opportunities, only ten were awarded, and more than half the blocks received no bids at all. Of the ten awarded, seven went to Chinese firms and three to a single Iraqi company. In contrast, the world's largest oil companies have expressed only lukewarm interest in the ministry's latest terms. Of the non-Chinese companies that prequalified for the fifth-plus and sixth bidding rounds—including BP, TotalEnergies, Shell, Eni, ADNOC, QatarEnergy, and PETRONAS—only two so far have placed bids. Shell and ADNOC bid jointly for Maysan's Al Daimah oil field, but lost out to KAR Group.

Nor did the bid round focus on free or non-associated gas. This author, as head of Iraq's Reservoirs and Fields Development Directorate, suggested that the sixth (gas exploration) bid round should focus exclusively on free gas projects. Gas projects are considered riskier and more difficult than oil ventures; thus, centering the bids on gas alone would prevent investors from relying on oil bids. Unfortunately, in the merged fifth-plus and sixth licensing rounds, the gas exploration blocks were mixed with oil fields, allowing investors to focus on the simpler oil projects and failing to create a contract model to optimize non-associated gas exploration for the investor and for Iraq.

The Oil Ministry amended its standard contract model in 2018 with its fifth licensing round after negative feedback from international oil companies (IOCs) operating under the technical service contracts that were awarded in four bidding rounds starting in 2009. The newer model, which was also the basis for the five-plus and sixth rounds, is a profit-sharing contract. And though a degree of geographic coverage was achieved, it did not meet the government's hopes, with northern and western Iraqi fields still viewed with caution due to security concerns.

On the other hand, the Oil Ministry's latest contracting round gave Chinese companies a major opening to further expand their dominant footprint in Iraq. Winning bidders included large, state-backed companies like Sinopec and China National Offshore Oil Corporation and other service companies not specialized in upstream oil and gas, like Geo-Jade, Zhenhua Oil, ZPEC, and Antonoil.

The lack of Western investors attracted by the bid round is a loss for Iraq—in training, technology transfer, geopolitical relations, and local involvement. Chinese companies in Iraq are known for employing foreign staff and leaving Iraqis without work. Most of the non-Iraqi foreign workers employed by Chinese companies are not technically qualified. Chinese companies regularly fail to employ Iraqis even for simple roles they are trained to perform, such as driving, and monopolize everything—building facilities, provision of materials, and the supply of technical labor from China—leaving Iraqi private small and medium-sized companies unable to compete.

Moreover, most of the participating companies did not have an oil production history that qualified them to develop the fields. Some of them included a drilling company or service companies funded by the Chinese state. Obtaining contracts from those companies to develop Iraqi oil fields and service solely because they offer a lower price is a dangerous turning point for Iraq in developing its industry, since lower prices could mean low quality.

The Chinese companies lack experience and are acquiring it through the Iraqi fields—likely at Iraq's expense. Mistakes in operations given this inexperience is likely, and Iraqi regulatory models are not up to addressing these potential slip-ups before they do real damage. In the future, it is better to accept higher price offers from established companies than lower price offers from inexperienced companies.

Fixing the Problems in the New Licensing Round

Given the shift back to oil in these previous rounds, Iraq needs a non-associated gas contract round in the near future that focuses purely on the U.S.-backed goal of gas self-sufficiency for Iraq. This is a multistep process; even if

Iraq captured all the gas it currently produces, it would need more gas in the future.

There are reasons that Iraq has fallen back to the more attractive oil bids this time around; Iraq is not a free gas country with many pure gas fields and has little history of exploring and extracting free gas reservoirs. This means a high geological risk for non-associated gas exploration and gas reservoir development, as well as additional challenges in infrastructure, pipelines, end consumers, security, and regional stability.

The economic model must therefore be very profitable, with a high internal rate of return and a very positive net present value in proportion to the challenges. It may even be possible for the Oil Ministry to or participate in well-exploration costs if the free gas reservoirs are not found, in order to encourage international oil and gas companies to go with free-gas exploration blocks.

Furthermore, to avoid the delays in payments to contractors that plagued the early years of the previous contracts due to disputes over what is considered a petroleum cost, and in contrast to previous provisions requiring the ministry to pay the disputed costs first and solve the dispute later, the new contracts will state that only undisputed costs will be considered petroleum costs.

The substitution of a remuneration fee with a share of the profits creates a hybrid between a service contract and production-sharing terms. The major question is, what is the maximum net revenue share the Oil Ministry will have in mind when (and if) IOCs bid with their best net revenue share offer? Will the government be able to turn these bidding tours into a real opportunity for development? Time will tell, but continuing with the same approach will only lead to more challenges and disappointments.

In addition, Iraq needs to prioritize diversifying beyond low-bidding Chinese investors. Over the past twenty years, Iraq has generally spent more than $1.5 trillion in poor-quality imported materials, instruments, house requirements, services, and infrastructure, and is continuing on this path with unqualified energy companies.

The Reservoirs and Fields Development Directorate has suggested that Iraqi national oil companies, such as Basra Oil Company, Midland Oil Company, and others develop small and medium fields rather than using Chinese non-oil operation companies. For the sake of the Iraqi labor market and of developing domestic expertise in oil and gas management, the government should seek to become more attractive to major IOCs outside of the Chinese companies currently drawn in by its bids. While it might be more expensive in the short term, Iraq’s current approach to its oil and gas bids will prove much costlier in the long run. ❖

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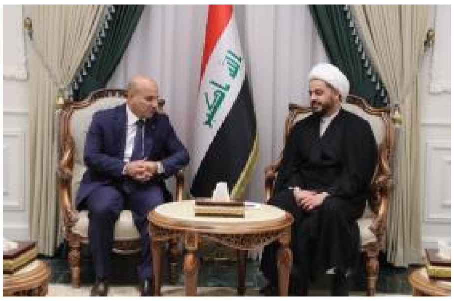

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