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Petroleum Contracts in Iran

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Abstract

In an oil industry, the oil counter purchase in which a foreign investor makes a pledge to finish all or part of a project in identifying, exploration and exploitation of the field or specific fields by providing goods or raw materials and guarantee the return of the capital by providing machinery and services equipment and intellectual property rights. Buy-back contract has a name which the main reason behind its formation is available in the basic law. Of course, government's ownership and its sovereignty toward oil and gas resources which keeps the interests of the country should be included in all contracts. Iran has the second place after Saudi Arabia among countries which are having oil resources and these oil resources have made other countries to understand the importance of Iran.

Keywords: Petroleum project, Investment, Intellectual property, Oil reservoir

Introduction

Attracting foreign investment is one of the problems in Iran as well as sanctions which Iran faces from time to time. In addition to political problems there are some juridical problems in investment which refers to principles 44-45-77-81-82 of basic laws. Of course Iran has tried to fix the problem by registration of foreign company branch or agency of a foreign investment. So, we can consider buy-back contracts as an appropriate approach in an indirect foreign investment in the country's oil and gas industry. The difference in buy-back contracts is the delivery of equipments, machines or a full factory from another country. Therefore, in buy-back deals instead of two sides, three sides are present, in addition to the supplier and the recipient the machines of the third party is present as well which provides a loan for this purchase.

Common contracts in oil industry are concession contract which are the oldest and most basic oil contracts but due to the deep political transformations, these contracts have changed their shape and turned into 50-50 contracts which first was carried out in Venezuela.

In concession contracts one company has a complete ownership to oil and gas resources of a country for period of time but in buy-back contracts the ownership is in the hand of a host country. In the concession contracts, the operating company is monitoring the all phases of the operations, including the exploration, exploitation etc but in a buy-back contract the host government is monitoring the entire processes. In a concession contract, there is no obligation to transfer the technology, but in buy-back contracts the technology transfers as well as staffs' training are included. In partnership contracts, Government as the owner of oil resource gives the production to petroleum companies under specific conditions. Petroleum companies as concession contracts invest on all manufacturing operations as well as exploitation and the profits are split in half between the Government and the investor.

Buy-back contracts in Iran's oil and gas industry

Buy-back contracts in the oil and gas industry is defined as oil counter purchase as a long or some kind of medium term contracts that whereby a foreign investor through supplying the machineries, equipment, services and intellectual property rights, including patents and trademarks, technology makes a commitment to finance all or part of a project in identifying, oil exploration and exploitation of mining areas or specific areas of oil and gas resources or the development , restoration and modification of existing oil and gas resources . A commitment of being responsible for the required services including capital goods , raw materials or interfaces and to supply investment and the interests of the contract resulting from the place of production only of the same project and other projects and the economic performance of the investment project (Saber, 2009).

At first we will have a look at historical record of buy-back contracts in our country and then we review the common contracts in oil and gas industry of the country and compare them with the buy-back contracts and at the end we will review the principles of Iranian petroleum buy-back contracts.

Review of the literature

As mentioned, the main reason for the formation and development of buy-back contracts in the oil and gas industry of our country and the existing restrictions in the normal laws of the Constitution for direct domestic and foreign investment in this area is strategic.

In relation with the history of oil counter purchase the formation of such contracts can be caused by the continuation of the process which in Iranian different oil contracts from the system of concession to potentiality and from potentiality to partnership and particularly in transformation of partnership to purchase contracts of contracting services. The current oil counter purchase contracts are actually the new version of former contracts that has seen a slow development through changes caused by nationalization of oil industry (Akhlaghi, 2010).

The first oil counter purchase contract was signed in 1995 with Total of France and PETRONAS of Malaysia in relation with development of A and B oil field. In the same contract of oil counter purchase, the largest gas field of Iran was given to total fina gasberom of Russia and PETRONAS of Malaysia in order for them to develop the phase 2 and 3 of this gas field. The third oil counter purchase contract was signed between Iran and Ajib of Italy in order for them to develop the 4^{th} and 5^{th} phase of south pars gas field in 2000 and the fourth oil counter purchase contract was signed in 2000 between Iranian National oil company and Petropars company in order for the company to develop the 6^{th}, 7^{th}, and 8^{th} phase of the gas field.

Types of common contracts in oil and gas industry

The contractual arrangements in the oil and gas sector can be divided into two groups: 3-1) A concession system 3-2) A contractual systems, systems are having variety of concession contracts. Concession contracts whether on their traditional form which were used till 1950 and the type of concession was a lot broader or whether on its new form which started from 1950 and was transformed into fifty /fifty 50/50 formula from that time on, are included in this group.

Systems of contracts can be divided into two groups of partnerships contracts in production PSA and service contracts. Partnerships contracts in investment can also be considered as a developed type of partnerships contracts in production. Service contracts are also divided into three groups including just service contracts, risky service contracts and counter purchase contracts. In the following section the important contracts such as Concession contracts, partnerships contracts in production and joint venture partnerships will be elaborated.

Concession Contracts

Concession contracts are the oldest and most basic oil contracts in the world. In this type of contract the investor company accepts all related costs and provides the owner of the reservoir in two ways, first is to pay royalty till the contract is over and second is to give sum of its income to the owner of the reservoir as a tax or part of its income. In this type of contract the operating company owns the oil and gas reservoirs, produced gas and the entire operation, including operations, marketing and exploration. This type of contract is applicable if it succeeds in oil and gas exploration for almost 5-6 years and in the event of discovery of gas and oil field, the company is in charge of it forever which it takes about 25 to 40 year.

Due to deep political transformations concession, contracts have changed their shape and turned into 50-50 formula. Based on this formula which first took place in Venezuela the Government received half of the benefits under the tax system.

The current concession contracts, in terms of the duration of the concession area and share interests are very different from the past ones. At first awarding points to Governments would last for a long time, fifty to one hundred years and on a large area, sometimes up to one million square kilometers with special interest was given to the holder that had full control of the development and production of oil from different directions. However, in today's concession contracts the concession area is limited. In European concession contracts the restricted area is 50 km on land and 220-250 square kilometers in the Sea. The right to explore is given for a short period that is less than 10 years, and production time of discovered interest is between 30-40 years.

The new contracts of the host country and participation in concession contracts through national oil company. In comparing concession contracts with buy-back contracts the following differences will appear:

(A) In concession contracts the company owns the oil and gas resources and the reservoirs, but in buy-back contracts oil and gas resources and the reservoirs are owned by the host State

(B) The operating company controls the operation, including operations, marketing and exploration. But in buy-back contracts all phases are controlled by the host Government.

(C) In concession contracts there was no obligation in transfering technology to the host country, but in buy-back contracts there is term which supports staff training and technology transfer as well.

Partnerships Contracts

In the production based on this type of contract, government as the owner of oil resources gives the production and operation license under certain terms to the oil companies and an oil company like concession contracts starts investing in the entire production operation. The outcome of the production is divided in two based on what the state and the investor have agreed on and the investor company can both provide the state with cash or give it a share from the production.

The differences which can be found between concession contracts and buy-back contract are included in the following items (Akhlaghi, 2010)

1. Counter purchase contracts are having very short period of time 10-8 years which in anyway are much shorter than the lifetime of field and considering the benefits of the contractor and National Iranian oil company NIOC in the framework of such deals is very difficult.

2. Even though the counter purchase agreement is a contract which the interest rate is fixed but it does not create a motivation in the contractor to increase recycling of the project to its and NIOC's benefit.

3. The included terms in the contract may not have the enough flexibility, hence while facing with unexpected circumstances there will be problems.

4. Once the contractor receives all money and compensation, it may not pay enough attention to the problems that NIOC may face later in the project when it takes control over the affairs.

5. The contractor works as a Manager of the oil field during development operation.

6. In partnership contracts the company's share can reach to 10-90 percent of the total available resources while the average of this share is about 35 percent in the world and in counter purchase contracts the share of the contractor from extraction of resources is less than 5 percent.

Partnerships in investment contracts which some of the professors have named these contracts as state contracts because it is not always in the form of a company and investment is also one of the joint venture activities arising from it. There are two major forms of joint venture, one is contractual and the other is based on company and as the one which is based on company is a lot common they have given the joint company's name to it. In summary, the properties of partnership contracts on investment can be found in the following steps:

(A) The framework of the contract is very similar to participation in production contract

(B) In this contract, the owner of oil participate in investment

(C) Usually the amount of participation of the host country is in accordance with the financial power which is set to 50%

(D) The country which owns the oil is also involved in participation risks. However, in many modes the risk of exploration is given to the company through an agreement and the Government is only responsible for its share after the discovery of the oil. In a comparison drawn between a partnership agreement on investment and buy-back trading the most important thing which can be mentioned are as follows :

In a partnership agreement on investment, Government and the owner of the oil participate in the exploration or development plans of oil and gas fields with the contractor company which means they both perform joint operations and common investment takes place. But as mentioned before, in buy-back contracts the contractor is responsible for financing the project and again it is the contractor which supplies all costs and equipment needed for the implementation of the project and the refund of these costs is paid after getting to specific rate of interest according to the contract.

The framework of the third generation agreements of buy-back contracts

1. In this type of contracts, the early production is anticipated as one of the possible contingencies in order to provide some of the investment through sales of the produced oil and gas.

2. In this type of contracts an exploratory operations and manufacturing of the field is proposed by contractor through a comprehensive Master development plan in which, in addition to observing the principles and standards of international oil and gas regulation, the internal conditions of the national oil company requests and demands are also considered.

3. In this type of contracts, the development of oil and gas fields takes place gradually and phase to phase. The entire plans for development of the field plans are based on information and technical data coming from the resources, the risk of being involved in such projects is based on the information we have about the oil and gas resources.

4. In this type of contracts, second handed or minor contracts are signed through partnership of experts in the oil industry and the confirmation of national oil firm. It is done in a way that assignment strategies, maximum use of the possibilities and abilities within the country and as well as their management must be agreed prior to the conclusion of the contract by the national oil company.

5. Establishing the administrative, executive, financial, technical or other operations centers are permitted only in Iran and if the contractor wants to establish a center or other centers in other countries it is not allowed.

6. The contractor is supposed to train the national oil company's staff appropriately and prepare them technically for operation based on the principles and standards of international conduct.

7. In this type of contracts, the contractor as well as the employer are obligated to observe the conditions of the oil and gas resources. The terms and procedures associated with maintaining the reservoir before concluding the contract is very necessary, by protection of the reservoir we mean controlling the pressure of the reservoir or any other factors which may decrease the efficiency of the reservoir in short time.

8. In this type of contracts, the contractor is required to maximize the capabilities in all fields within engineering construction, the relevant commercial issues. On the other hand an important guarantee for achieving the goals, the contractual remuneration mechanism of R&P in case of increase or decrease of at least 5% of the contracted amount is anticipated. While that does not prevent legal actions to guarantee performances.

9. In this type of contracts, the first item is the knowledge and technology transfer. Based on these guidelines the contractor is required to transfer the latest technical achievements including the used technical knowledge during the course of the development of the operation and the period of operation and production to the National Iranian oil company.

The technology Transfer indices in improving and increasing oil is to protect oil extraction and reduction of waste :the objectives of above mentioned subjects include (A) to identify opportunities and the ability of the staff of the national oil company in gaining technical knowledge and to expand them in the oil and gas sector in the country's development .

(B) Promoting new technical knowledge to the country.

(C) Promoting collaboration and consulting industrial contractors in Iran.

(D) Promoting collaboration and partnerships with academic institutions and universities contractors in Iran.

Petroleum contracts after the Islamic revolution

The company which has signed a contract with National Iranian Oil Company has the responsibility for financing and implementation of the whole project till the production phase. Providing all kinds of technical equipment, machinery, the required experts, subcontractors and monitoring their activities is the responsibility of the company as the main contractor as well. While the National Iranian oil company is the representative of the State, it also signs and implements the development of hydrocarbon field which after implementation of the development and realization of the production rate that is specified in the contract, all costs plus fees, the risk and financial costs are refunded from the production place. It is in the form of selling the oil per day price and a about maximum of 60 percent of the production of the field is done by the contractor.

As a result, the contractor has no right on oil or oil resources. When the operation of development and reaching to the objectives of comprehensive development are successfully over, the contractor is obliged to hand over the developed field along with all the equipment, facilities and technical, financial and contractual files to the National Iranian oil company. From then on the company has no right to interfere or cause any kind of manipulation, capture, management, or control in the course of production and operation of the field

These contracts, in addition to providing the possibility of ownership and capture of the Government to the oil and gas reservoirs of the country, give the full control and management in production phase as well as detailed and accurate monitoring on enforcement of the contracts. It should be remembered that the counter purchase approach had been set up based on the specific requirements and political, economic conditions of the government in the past few years. Any adjustment or change in conditions of these kinds of contracts or other contracts in the oil industry in order to benefit the most is possible and is not inconsistent with the nature of those contracts, because no legal or standard framework is defined for these kinds of contracts.

The existence political tensions of Iran's with the outside world and economic sanctions of the world and the America has made Iran's oil contracts fees to rise. It can be concluded that in addition to the legal, economic and political constraints that are in relation with counter purchase contracts, the national risk apart from the framework of petroleum contracts have affected the amount of foreign investment as well as costs of the contracts. In case of removal of these limitations it can play great role in attracting foreign investment in the oil and gas sector and other economic sectors of the country as well.

Iranian Petroleum contracts within 100 years

Darcy Concession

It was Iran first oil contract which was signed in the year 1933 and the concession of digging and production of the oil were given to an English William Knox Darcy for more than 60 years. Of course, before this contract, Naser-ed-Din Shah, had granted a concession to Dutch Albert which could not meet the end.

Darcy Concession had been set at 18 articles which Darcy's company was bound to give 20000 lira in cash and other20000 lira as a stock plus 16percent of real profit to Iran.

The nationalization of the oil industry

On March 1950, Iranians were completely dominant over their oil resources but did not succeed in the economic aspects. In this day, Mossadegh read the report of the Commission on the oil which was passed in the National Assembly and the Senate, respectively. " In the name of prosperity of the Iranian and in order to contribute for maintaining world peace, we suggest that Iran's oil industry without exception to be nationalized across the country. In other words, all operations of exploration, extraction, to be in the hand of Iranian Government". Through nationalization of oil industry and obstacles that had created by England, the production of oil was decreased to 20,000 barrels. Oil cartel together with harmony replaced Iranian oil with other countries oil which practically put Mossadegh in a deadlock.

Consortium Contract

After the coup in September 1333 by the United States which replaced United Kingdom in Iran and the country's foreign policy, a Consortium consisting of five American companies with shares of 40%, the UK and Iran petroleum company which had started its activities after receiving its repayment caused by nationalization of the oil industry with shares of 40%, the Dutch company of Royal Dutch Shell with shares of 14 percent and France with 6 percent were established and signed based on 50/50 principle . This contract was supposed to last for 40 years, with the right to extend the contract for more 25 years as well which Iran had no power to change or abolish the contract that against the principle of nationalization of the oil industry.

Petroleum Shock

Oil producing countries came to understand the importance of energy and its full possession little by little. On the other hand oil was getting out of the control of petroleum companies. Therefore, in 1960 countries established (OPEC) which played an important role in fulfilling these demands. In this regard, OPEC leaders including Shah (Iran's king at that time) desperately wanted to put an end to Consortium contract at the end of its deadline (1979). The Petroleum Shock took place in the year 1973 which made Shah to ask for changes in rules governing oil industry on the international scene. In this regard and based on new conditions a new contract was signed between Iran and consortium in the year 1973 in which Iran took control over oil installations as well as assigning general changes in the initial contract. This contract is known as "San Mortis" which was implemented for five (1973-1379). Iran's shares of the production was about 5/10 billion and the daily production increased from 666 barrels a day in 1950 to 6 million barrels per day in the year 1977.

In ranking the underground energy resources, oil has always been in the first place and its importance is known to everyone to the extent that any political event in the world is affected by oil and its issues. In other words, since the discovery of oil, social and political events of the world has always been on its direct impact.

Therefore, oil is in the first place, and its importance is known for everyone. So accordingly they should pay a careful attention to types of the contracts they assign. Mutual trade is a good method to remove money from international transaction and it is appropriate for countries which are having problems in their payments.

The specific method of oil costs repayment differentiate these contracts from other existed ones which is considered as a new experience for Iran's oil industry as well as the rest of the world. It is defined as a mutual interaction with foreign investor and a way of funding in order to implement the comprehensive development of oil resources.

Based on this contract, the contractor will be in charge of financing and implementation of the project till the production phase.

After World War II, the United States and the Soviet Union entered Iran's oil industry for the sake of their own benefits. Russia, the Soviet Union mainly wanted to earn concession of North's oil but American petroleum companies wanted to work in all areas. Consequently a competition started between the United Kingdom and the United States which they later became an Alliance.

Conclusion

Oil industry experts believe that for taking advantage of all the features and the ability of the country, control management and monitoring interactions with international companies in order to increase profitability and gaining more income from oil and gas reservoirs, the contracts should get of foreigners hand and be in our own control. Our country ranks the second in the underground energy resources and this has led to direct impact on political and social events of the world. But, when the economy of a country is dependent on a particular product it would be very vulnerable because any mistake in the process of producing it will be disaster and Iran is considered as product country as it has significant petroleum resources. So it should consider the right consumption and the way of assigning petroleum contracts with other countries as well as paying careful attention to petroleum contracts. A new replaced energy should be considered instead of oil and pay attention to the fact that it might be affected by sanctions for several years. Therefore, in addition to paying attention to oil and improving the technology for better exploitation and extraction with higher quality, it should also consider that being dependent to oil should not prevent us from developments in industry and other field but by relying on oil we have to progress in all aspects and not to be affiliated to anywhere.

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