

THE CHAMBER OF COMMERCE OF THE
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IRAQ BUSINESS INITIATIVE

INVESTMENT CLIMATE UPDATE
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ECONOMIC CLIMATE UPDATE

Each month, we'll examine key commercial and legal developments of interest to our Iraq Initiative Members. This month's developments include:

- **Minister of Oil Shahrastani to Meet with Oil Company Representatives in London:** Iraq's oil minister announced he will be in London next month to meet with representatives of 35 foreign companies qualified to bid for the development of eight oil and gas fields in the country. The Minister will provide information about the energy fields being offered and conditions for signing long-term service contracts.
- **Shell Completes Natural Gas Deal and Announces Baghdad Office:** Royal Dutch Shell completed a multibillion-dollar natural gas deal with the Iraqi government this week and announced that it has already established an office in Baghdad — the first foreign petroleum giant to do so since Iraq nationalized its oil industry more than three decades ago.
- **China Reaches Deal with Iraq to Develop the Ahdab Oil Field:** the government of Iraq agreed to a \$3 billion technical services contract with the China National Petroleum Company to develop the Ahdab oil field, which was originally the subject of a production sharing agreement with China in 1997.
- **European Steel Giant Seeking to Invest in Basrah:** Arcelor Mittal, the world's largest steel company, submitted a bid to rehabilitate a major steel mill in Basrah. Its initial investment would be \$1 billion and the total investment could be \$3.2 billion. The company is looking to enter the steel market in Iraq as reconstruction picks up. It is also hoping to supply steel throughout the region.
- **MasterCard Debit and Credit Cards Launch in Iraq Through Banking Consortium:** a newly formed banking consortium in Iraq, known as AMWAL, will provide MasterCard branded debit and credit cards to Iraqi consumers. This will provide Iraqi consumers with a reliable and secure way to access and utilize their personal funds. The products will be offered first through the Commercial Bank of Iraq and the Bank of Baghdad.

- **Iraq's Bonds Yield High Return Compared to Other Emerging Markets:** emerging market bond indexes showed that Iraq's \$2.7 billion of its 5.8% bonds due in 2028 increased in value by 45% over the last year. During that time, according to JPMorgan indexes, Iraq's bonds had the highest returns among the emerging markets and their yield spread was smaller than for Argentina, Ecuador, Ukraine and Venezuela.
- **Top U.S. Official Notes Positive Signs in the Iraqi Economy:** Outgoing Coordinator for Economic Transition in Iraq, Ambassador Charlie Ries stated that the Iraq economy is on track for "solid growth" in 2008. While core inflation is still relatively high -- at around 12 to 15 percent -- it has been reduced substantially. He recommended that the government work to improve its ability to spend budgeted money on capital projects and other necessities and to do more to diversify the economy and reduce corruption.

LEGISLATIVE UPDATE

As the saying goes, if you're not in politics, then get out of business! In this section, we'll summarize recent actions and upcoming priorities for both the Iraqi Council of Representatives (parliament) and the U.S. Congress.

IRAQI COUNCIL OF REPRESENTATIVES

- The Council of Representatives (COR) returned from recess on September 9. Its foremost priority was to pass a provincial elections law, which it had been debating for months. The major stumbling block was how to go forward with provincial elections in Kirkuk.
- On September 24, it passed a new version of the provincial elections law. The new version paves the way for balloting in most parts of the country by January 31 and could lead to progress on national reconciliation.
- Elections will be held in 14 of Iraq's 18 provinces. Not included in the legislation are three provinces in the Kurdish semi-autonomous region and Tamim province, of which Kirkuk is the capital. The election legislation was approved only after Kurdish, Arab and Turkmen lawmakers agreed to a compromise brokered by the UN that calls for the creation of a

parliamentary committee to review the status of Kirkuk, which the Kurds seek to incorporate into their region.

- Iraq's three-member presidency council, led by President Talabany, vetoed the last attempt by parliament to pass provincial elections law. This time the presidency council is expected to approve of it.

U.S. CONGRESS

- With Congressional and Presidential elections set for November 4, Congress will likely be in session only until September 26. At least one lame-duck session will be held after elections in November, with a potential for a second session in December. These sessions will address essential matters, such as a response to the current economic crisis, pending trade legislation, and passing the FY2009 budget.
- Several issues related to Iraq will receive Congressional attention. In particular, Congress will address issues related to funding U.S. military operations and reconstruction activities in Iraq and will continue oversight of Bush Administration policies in Iraq.
- The House Budget Committee held a hearing on September 16 on "Iraq's Budget Surplus." Witnesses from the GAO and Congressional Research Service testified, as well as two experts from the conservative American Enterprise Institute and the liberal Center for American Progress. During the hearing, the GAO reported that Iraq will have a budget surplus of \$79 billion at the end of the year, while the United States is spending \$10 billion a month on military operations there. Committee Members seized on this report to demand Iraq take over more of the financial burden for reconstruction from the United States.
- Additionally, the Democratic Policy Committee, a partisan committee of Congressional Democrats, held a hearing on September 22, 2008 entitled "Second Insurgency: How Corruption and Waste Are Undermining the U.S. Mission in Iraq." The hearing focused on how billions of dollars in U.S. aid were wasted by corrupt Iraqi officials and in some cases even diverted to Al-Qaeda groups. Democrats have pledged to increase scrutiny of Iraqi corruption.

- Congress has increasingly scrutinized the Bush Administration’s conduct in Iraq and will continue to do so through the end of the Administration. Recent developments may lead to additional Congressional hearings (including by the House Government Reform and Oversight Committee) or legislative action. These developments include:
 1. The Congressional Budget Office reported that the United States is on track to spend over \$100 billion on private contractors in Iraq, where the ratio of civilian contractors to U.S. military personnel (190,000 to 144,000) is higher than any major conflict since the Revolutionary War
 2. The Department of Defense’s Inspector General reported that the U.S. military purchased as much as \$6 billion in Iraqi commercial products without the legally required documentation
 3. A recent decision by the Department Justice to pursue criminal investigations against Blackwater, a defense contractor, for its role in the deaths of Iraqi civilians
 4. A Small Business Administration (SBA) audit revealing that Blackwater may have improperly received an SBA grant for some of its activities in Iraq

LEGAL FRAMEWORK UPDATE

The cost of government intervention on business—and profits—is of particular interest to our members. This section of our update will analyze the legal and regulatory framework in Iraq with a focus on how it impacts foreign investors. **This month’s update focuses on the law regulating the oil industry.**

THE LAW IN FOCUS: Laws Governing the Oil Industry in Iraq

1. **Status of Laws Governing the Oil Industry in Iraq:** for more than two years the Council of Representatives has been locked in a debate over new legislation that would govern the oil industry and the future management and development of Iraq’s oil resources. This legislation is actually a

package of laws which include: (1) a hydrocarbons framework law that would create a regulatory and policy development structure for future oil and gas exploration and production; (2) a revenue sharing law; (3) a law to create the Iraq National Oil Company; and, (4) a law to reorganize Iraq's Ministry of Oil. Until these laws are passed, the oil sector in Iraq is governed by basic principles in the Constitution, the decisions of the Ministry of Oil led by Minister Hussein al-Shahrastani, and the patchwork of laws enacted prior to, and during, the Saddam Hussein regime.

2. **The Constitution:** the 2005 Constitution set up a system of federalism in Iraq. This system is reflected in the provisions governing oil resources. Article 111 states that oil and gas are owned by all the people of Iraq in all regions and all governorates. Article 112 states that the national government, along with the producing regional and governorate governments, will manage the petroleum resources in the country and distribute the revenues in a fair manner in proportion to the population in all parts of the country.
3. **Authority Over the Oil Industry and New Contracts:** until the new hydrocarbon laws are passed, the Ministry of Oil, headed by Hussein al-Sharastani, has primary responsibility for decisions relating to the oil industry in Iraq. His actions are governed by the Constitution and by the laws still on the books from the Saddam regime relating to the oil industry. Sharastani appears to have exclusive authority for approving oil contracts, with the possible exception of the Kurdish Region, which acts under its own semi-autonomous regional government and has continuously asserted an independent right to negotiate contracts for exploration and production within the region. [See the section below on the Kurdish Regional Government oil law].
4. **The Proposed Hydrocarbons Legislation:** the proposed legislation would facilitate the concepts embodied in the Constitution and establish a new procedure for granting exploration and production rights. Under the new law, the Oil Ministry (or the regional government in the case of the Kurdish Region) can enter into contracts with domestic or foreign countries after a competitive licensing process. Only companies pre-qualified by a new entity, the Federal Oil and Gas Council, may participate in that process. A key criteria in the granting of rights under the law is "optimum return to the country." The proposed hydrocarbons framework law also has a provision that requires both the Ministry and the Federal Oil and Gas Council to review all contracts that were entered into before the passage of the law, within three months of its passage. This provision suggests that

any contracts entered into before passage of the law may be invalidated if they do not provide “maximum economic return for the people of Iraq.”

5. **Prospects for Passage of the Legislation:** the hydrocarbons legislation has been the subject of intense negotiation in the Iraqi Parliament during the last year. Despite pressure from the US Government to pass the law, key voting blocs within the Iraqi government have been unable to reach agreement. A major stumbling block is the concept of division of authority between the federal government and the regions within the hydrocarbons framework law, especially with respect to management of new exploration and production contracts. The Kurdish Regional Government (KRG) has insisted the law give it the right to maintain a degree of control over the issuance and management of contracts within its region that leaders in the central government, including Minister Shahrastani, have been unwilling to accept. Minister Shahrastani and proponents of the central government, on the other hand, argue that management and control over the oil industry in Iraq should rest exclusively with the central government. The KRG believes Constitutional principles give it the right to share management responsibility for fields within its territory and to oversee new contracts. The KRG has further argued that the central government has failed to demonstrate that it supports policies that will effectively encourage foreign oil companies to form partnerships with the government of Iraq, which it believes are essential to rebuilding Iraq’s oil sector and maximizing Iraq’s oil wealth. Given the significant delay on the framework law, it is not possible to predict when it will actually pass. The parties are much closer, however, to reaching agreement on the other laws, including the revenue sharing law.
 - a. In the absence of the new legislation, the Baghdad government has announced its intention to proceed with oil exploration and production licensing under the terms of an interim registration process administered by the Ministry of Oil.
 - b. Minister Shahrastani has stated that he will cancel all contracts entered into by regions or governorates without approval of the central government Ministry of Oil.
6. **Position of the U. S. Government:** the passage of the Hydrocarbons law continues to be one of the highest priorities for the U.S. Government. The US Government has sought to dissuade companies in the US and other countries from entering into contracts in Iraq prior to the passage of the

hydrocarbons laws. The U.S. Government announced its opposition to contracts entered into by a few U.S. companies with the KRG last year. Minister al-Sharastani also opposed those deals, sparking a war of words with the Kurdish Regional Government, which instructed him to stay out of the affairs of the Kurdish Region.

THE LAW IN FOCUS: Oil and Gas Law of the Iraqi Kurdistan Regional Government

1. **Background:** in August 2007 the KRG enacted its own regional oil and gas investment law. The law cites to Articles 111 and 112 of the Constitution as the basis for the right of a region to pass an oil law to govern the oil sector within its territory.
2. **Shared Responsibility:** the Kurdish Region law states that the KRG, together with the Federal Government, will jointly “manage” petroleum operations related to producing fields. In contrast, the law states that the regional government alone has the obligation to “oversee and regulate” operations.
3. **Shared Revenues:** according to the law, all revenues obtained by petroleum operations in the region are to be deposited into a general petroleum revenue fund for Iraq.
4. **Regional Council:** the law creates a Regional Council made up of the regional Prime Minister, Deputy Prime Minister, Minister of Natural Resources, Minister of Finance and Minister of Planning. The Regional Council is responsible for formulating petroleum policy, overseeing production levels and approving contracts.
5. **Management:** day to day management of the industry is given to the Ministry of Natural Resources and to a number of newly created entities, including the Kurdistan Exploration and Production Company (KEPCO), Kurdistan National Oil Company (KNOC) and Kurdistan Oil Marketing Organisation (KOMO). Revenues are to be managed by the Kurdistan Oil Trust Organisation (KOTO).
6. **Exploration and Development:** Article 24 of the law governs exploration and development of new oil fields. It provides that the Minister may enter into exploration and production contracts in specified areas, after obtaining approval from the Regional Council. The Minister is expressly permitted to

enter into production sharing contracts or into any other types of contracts which the Minister deems to provide good return to the people of the region.

- a. Article 24 permits foreign petroleum companies to enter into contracts with the regional government. For any company to be eligible, it must demonstrate two criteria: (1) the financial capability and technical knowledge to carry out petroleum operations in the region; and, (2) a record of compliance with the ten principles of the global compact launched by the UN.

7. **Disputed Territories:** the law asserts that the Federal Government may not practice new petroleum operations in any of the disputed territories without approval of the KRG until such time as the referendum under Article 140 of the Constitution is passed. It is doubtful that the central government would comply with this provision.

ABOUT THE AUTHOR

David Tafuri, Esq. assists clients on international business, litigation, and public policy matters. Mr. Tafuri is experienced in finding creative, multi-forum solutions for clients facing problems in the United States and overseas. He has tried cases in federal and state court and advocates on behalf of clients to members of Congress, their staff, and the Administration, and serves as the Counsel for the U.S. Chamber of Commerce's Iraq Business Initiative. Mr. Tafuri recently returned from 15 months in Iraq, where he served as the Department of State's Rule of Law Coordinator for Iraq at the U.S. Embassy Baghdad. He was responsible for advising the U.S. Ambassador and staff on the Iraqi justice system. He also designed and managed justice development programs for the U.S. Government and led a joint U.S. military and civilian team responsible for drafting the strategic plan to strengthen the Iraqi justice system. During his time in Iraq, he managed a number of U.S. Government contractors and non-profit organizations responsible for implementing Iraq reconstruction efforts.