

Kuwait Project

Overview:

This overview highlights the importance of Kuwait Project for going ahead with it to preserve the State pioneering role in oil production which is the main source of the national economy and the pivot for the Kuwaiti people welfare.

The overview tackles various aspects, including the project's technical justifications, the contractual model and the contractual relation between Kuwait and International Oil Companies (IOCs). It also tackles the general framework of the financial system, the key financial elements of the project, the major steps it made and others yet to make before awarding the operational services contract to the successful international consortium.

Production Strategic Plan:

The main features of the production strategic plan up to the year 2020 of Kuwait Oil Company (KOC), the instrumental tool of Kuwait Petroleum Corporation (KPC) for upstream activity inside Kuwait, include reaching the targeted production rates, maintaining these rates, disburdening Greater Burgan Field (Gr.B.F), increasing the production capacity of other fields and simultaneously raising the State oil reserve and oil recovery from productive reservoirs in addition to exploration in locations other than the currently productive areas and fields along with developing, upgrading and qualifying the national manpower for the management of oil projects and reservoirs, transfer, accommodation and development of modern technology in line with the State needs.

However, KOC was unable to implement its strategy for reaching the targeted production rates over the past few years as that strategy included among other things the need to recruit IOCs for benefiting from their expertise to increase the northern fields production. Hence, the need emerges for developing those fields as Gr. B. F. alone will not be able to produce 3 million bpd. The huge oil reserve in the northern oil fields incompatible with their production rates necessitates speeding up their development to meet the State plan in this respect.

Future Technical Challenges:

The expertise currently available to the local oil sector does not fulfill future requirements although this sector enjoys long experience in the domains of primary production, traditional vertical drilling and cost-effective easy oil production. As for the future requirements, including secondary production associated with good application and management of water of water injection

projects, non-conventional drilling, oil production by artificial lift, water treatment, effective management of corrosion and secondary production projects, the expertise of the local oil sector is limited or unavailable.

Management of the northern oil fields reservoirs is the most critical technical challenge for increasing the production. These reservoirs have complicated geological formations that require secondary production. The difficulty lies in their management, addressing the corrosion problems, water treatment and pumping, controlling the excess in production costs and the time consistency between surface and subsurface projects for hiking the economic feasibility of the project. Therefore, there is an urgent need for new and difficult production methods in the future. The current production is relatively easy and comes from sand reservoirs with easy geological formations where oil is produced by natural pumping at a low cost, whereas the future production will be difficult and from carbonic reservoirs with complicated geological formations where oil will be produced by artificial lift at a high cost and with higher quantities of associated water besides corrosion problems.

As a matter of fact, most governments of oil producing countries control most of underground oil resources while foreign companies control the technology necessary for the optimal recovery of these natural resources. Therefore, it is wise to start honest fruitful cooperation for the benefit of the two parties and create an atmosphere of trust, reassurance and mutual equivalent respect.

Actual results have indicated the achievement of maximized joint interests and profits for the governments and their partners through an agreeable formula that takes into account the interests and needs of both parties in a balanced way.

Project Definition:

Kuwait Project is a project for presenting operational services under which international consortiums provide the necessary funds and expertise to transfer modern technology to Kuwait, develop the production of northern oil fields and increase their production capacity to 900,000 bpd during a limited period vis-à-vis specific cash fees to be agreed upon for the benefit of Kuwait without prejudice to the State right to the ownership of its natural resources or seizure thereof in any way.

Contractual Model:

The contract does not allow the foreign party any sharing in the oil resource or the returns resulting from oil sales, since the contractual formula is not a concession or production – sharing. The foreign party is not authorized to make strategic decisions special for production development, marketing, fixing oil sale

prices, transport or otherwise. Therefore, the model selected for contracting has been an operational services contract that gives oil companies only wages vis-à-vis their services while the State maintains full ownership of its oil resources from crude to carrier.

Contract Objectives:

The contract objectives are represented in the desire for further development and operation of 4 fields located in North Kuwait, namely: Raudhatain, Sabriya, Ratqa & Abdali, for producing crude oil by the set date, maintaining this production for as a longer period as possible, reaching the technical aim of improving the reservoir management practices, maximizing the economic recovery of hydrocarbons and developing the more difficult fields.

The contract objectives further include hitting the economic target through effective development of the fields in terms of cost optimization, maximizing the State economic take and reaching the developmental goal by training and finding work opportunities for the Kuwaiti manpower, transfer and application of technology and modern management approaches.

General Principles:

The Operational Services Contract with International Oil Companies maintains in full the rights of the State which has full sovereignty over all its territory and resources and is free to draw up and execute strategic decisions, adopt fields development plans and work programs and exercise full right to commence any activities separate from the operations assigned to foreign companies in the area of the contract. The State also has the right to obligate foreign companies to all its interests, hold all assets and information special for the Project, take delivery of, market and sell all the product of the contract area, receive the returns and reduce the production up to OPEC requirements. Local products and services shall have priority in case they are equal to other peers of the same nature.

Therefore, the contract general principles stipulate abidance by the provisions of the Kuwaiti Constitution and operative laws, the State retention of land ownership, equipment and all the installations, besides foreign companies commitment to all Kuwaiti laws and regulations alongside the State right to technical and financial control over all their activities according to the laws and regulations in practice. In case of resorting to arbitration for any disputes or claims, the Kuwaiti Law will be the umpire. The contract is subject to the provisions of the Kuwaiti Law and, the Kuwaiti Court is the competent authority for considering the disputes that arise there from.

Contractual Relation between Parties to the Contract:

The contractual relation between the Kuwaiti party and oil companies is represented in the latter's role as a contractor for developing, employing a fixed minimum Kuwaiti manpower, transferring technology, training the Kuwait manpower to use, accommodate this technology locally, carrying out research, fields development and operation, production of oil and handing it over the Kuwait. Furthermore, oil companies shall implement, accomplish the new installation projects, bear capital and operational costs, take operational decisions and shoulder the responsibility of all operational matters, support and encourage the national economy, develop and manage oil reservoirs by the use of the most modern and most appropriate methods of oil industry.

Status of Kuwaiti Labor force in the Project:

As for the status and development of the Kuwaiti labor force in the project, the present labor force has the right to decide transition to the foreign company or staying. The foreign company undertakes to develop the employees, activate the role of training, draw an integral comprehensive qualifying development program and continue the Kuwaitization process. It further undertakes to provide the employees benefits equally or better than they used to get at the time of signing their employment contracts with this foreign company, and that any of their acquired rights remain untouched.

The contract further stipulates that foreign companies shall abide by employing not less than 70% Kuwaities of the total labor during the first 18 months and that this ratio increases by rate of 2% annually so that it reaches 80% by the end of the 10th year of the contract term. Appointment shall include all leadership, administrative, technical and operational jobs in such a way that ensures upgrading all the competencies required and commitment to organizing training courses that include programs for involving them, as employees with these companies, in jobs outside Kuwait for the exchange of expertise.

Support of Local Economy:

As for procurement, subcontracting and insurance, the contract obligates foreign companies to buy all goods, equipment and needs from the local market as long as they are of quality and a competitive price in comparison with their peers of other sources. The contract further obligates them that in case of subcontracting, some works should be assigned to local contractors in accordance with the terms and regulations of the Kuwaiti laws and regulations. These companies are also required to obtain and maintain insurance during the term of the contract so that it covers all potential risks as deemed by the State along with giving priority to Kuwaiti insurance companies should they present competitive prices and terms.

Financial Model:

Any financial model chosen for Kuwait Project should meet all objectives and needs of Kuwait, ensure harmony between the State interests and those of IOCs and balance between the risk and compensation for the companies, which will reduce the risks of renegotiation with them. The model should also ensure a higher return for the State and realize the expected production levels cost – effectively without prejudice to adopting the best production policies, industrial methods and the companies' continuous commitment to their long-term obligations without making windfall profits but compatible with reservoir variables and nature. The model should observe the commitments of the parties to the agreement and motivate foreign companies to continue improving their performance. Therefore, the general framework of the financial model for the operational services contract is represented in the operation, management of fields and assets by foreign companies, their production and delivery of oil to Kuwait, bearing all actual capital and operational costs at a time the State sells the oil and receives the returns. Foreign companies receive their total returns in the shape of cash wages only and share with the State the saving that results from cost reduction. Pre-tax net profit of foreign companies is subject to income tax in Kuwait.

The main financial elements are the companies' total oil wages made up of production-related fees and actual cost-related payments. They are also represented in the income tax and sharing of the saving that results from cost reduction.

General Structure of the Financial System:

In the general structure of the financial system, foreign companies' income is made up of the total old and new oil and gas fees plus 50% of the actual allowed operational costs minus expenses which are all allowed operational costs, all actual allowed capital costs, the State share of the saving resulting from cost reduction and income tax. From all the aforesaid, the net profit of foreign companies results. The State income is made up of the total returns of oil and gas sales besides the share of the State in the saving resulting from cost reduction and the income tax minus the expenses which are the total wages paid to foreign companies.

Therefore, the economic model realizes the State objectives by avoiding that foreign companies obtain unexpected profits through sharing a proportion of the saving made from cost reduction, income tax and reaching the targeted production realized through production-related wages, which gives an incentive for reaching the targeted objective and maintaining it for as a longer period as possible besides cost optimization as the companies' profits are connected with realizing this optimization. The companies will recover only 50% of their costs,

which motivates them for such cost optimization and for achieving other objectives, i.e. commitment to paying the capital and operational costs and recovering them throughout the project term and realizing consistency through giving the companies suitable fees that enable them to recover their expenses and make an agreeable return.

Next Basic Steps of the Project:

The project has made many basic required steps. Other steps are hoped to be accomplished in the next few months. Completed were the procedures of pre-qualifying oil companies as operational and non-operational, issuance of the initial procedures protocol, opening the information room for pre-qualified companies, presenting the Kuwait project documents to the parliamentary committee for financial and economic affairs, providing this committee with all the information and data it requested, issuance of the draft operational services agreement and the initial financial elements document, formation of consortiums, receipt and review of development plans and remarks concerning the draft operational services agreement and the initial financial elements documents, endorsement of the final financial system and the Operational Services Agreement by the Higher Committee of the Kuwait Project and the Technical & Financial Committee of the Supreme Petroleum Council, endorsement by the said Council of the final financial system and the operational services agreement. The remaining basic steps and procedures are the presentation of the Kuwait Project to the National Assembly, determining the legal status, issuance of the project documents for the consortiums to present their bids after obtainment of the requested approvals.

Communication:

We have been communicating with the public opinion within the framework of transparency and publicity for over 4 months through meetings with non-profit societies, opinion think-tanks, experts and writers with the aim of presenting the Project and its objectives, listening to all remarks and responding to all relevant queries.

Captions:

- ❖ 1st Publicity Forum on Kuwait Project.
- ❖ Meeting with Financial & Economic Affairs Committee – Kuwait National Assembly (Parliament).
- ❖ Kuwait Economic Society.
- ❖ Legal & Legislative Forum of National Resources.
- ❖ Kuwait Graduate Society.
- ❖ Kuwait Engineers Society.
- ❖ Kuwait Lawyers Society.
- ❖ Kuwait Trade Union Federation.