

# **Kuwait Project : A new form of relationship**

By

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Today's industrialized world is more dependent than ever on the abundant and secure supply of long history of relatively low priced oil and gas resources from this region. Oil importers and exporters are inextricably tied together. Importing countries need the oil to maintain their standard of living and to fuel their economic growth. Many oil exporting countries are critically dependent on oil revenues to sustain their economies. Kuwait, Venezuela, Nigeria, Algeria, Saudi Arabia and several other nations earn 90% of their export earnings from oil.

It is widely accepted that global demand for oil will increase at a steady rate. Unfortunately, production from the super majors is relatively flat. Many energy companies are pumping less oil today than they were a year ago; and despite Shell's quarterly profits of \$ 4 bn, up 54 % year-over-year, the company pumped 5 % less oil and gas than it did at this time last year. ConocoPhillips' 75 % profit jump occurred while its production fell 5 %.

Therefore, on the supply side, a major assumption is that the key producers of the GCC region will meet most of the growth in future oil demand. Yet, a majority of these countries face stringent self-imposed restrictions on their ability to invite foreign companies to assist them in developing their hydrocarbon resources.

Recent estimates of long-term oil demand from the IEA indicate that world demand for oil will increase from the current level of 80 million bpd to 120 million over the next 25 years, and with the Middle East holding half of the world's oil reserves, it will meet at least two thirds of the increase in demand. This will require an increase in capacity from Kuwait. Developing Kuwait's Upstream Oil Projects plays a key role in securing the escalation of that supply.

In his address at NBK's forum on the prospects of our industry, a forum which was held last December, H.E. MoE stated that Kuwait's oil sector's expansion plans are expected to spend some \$ 40 Billion over the next 15-20 years. We have indeed since then signed contracts worth billions of dollars.

Despite that, "That level of investment, according to an OAPEC study remains insufficient in relation not only to the Arab States' huge hydrocarbon resources, but also to the expectations and needs of consuming countries. This finding is backed by an earlier study published in November 2003, which indicated that the total investment needed to 2030 is \$16 trillion. This figure is much larger than was spent over the previous 30 years. And there was another surprise: 51% of that investment is needed simply to replace and maintain existing capacity.

Yes, the year 2004 was a great one for the Oil sector. It was a year of record oil prices, which still seem to be rising. The drivers behind price escalation last year were mainly due to concurrent geopolitical conflicts, unforeseen environmental calamities, diminishing spare capacities, and an increase in demand for hydrocarbon supplies. The prices rose unabatedly despite improved effectiveness in the use of technology, enhanced production practices, additional reserve finds and increased operating efficiencies.

Nevertheless, I believe our industry is truly at a strategic inflection point. One which could have long lasting implications for our industry. This inflection point is perhaps as strategic as was the decision to create OPEC in 1960. Hence, our business may never be the same. Its fundamentals are being reshaped. And all of us here: international oil companies, national oil companies and host governments – need to adapt and change too.

We are entering a phase that is being shaped not only by globalization in production and trade, economic growth and surging demand, and declining oil production in the OECD countries, but also a reopening of vast areas which were prohibited to foreign investors. These factors are creating the ground for a new energy equation and with it new forms of agreement and a rethinking of resource policies and regulations.

The timing of the conference is therefore quite appropriate as we are about to enter into a major phase of expansion in the oil sector in Kuwait

Over the past decade, for various economic and political reasons, Iran, Iraq, Kuwait and Saudi Arabia, have been actively searching for mechanisms to facilitate foreign investment in their upstream oil sector. These four countries, collectively, possess over 53% of the world's proven oil reserves, and currently provide 23% of the world's oil production and are expected to supply 31% of the global oil requirement by 2020.

We are now at a turning point. For despite widespread rhetoric of how diverse oil supplies have become, the Middle East is still the "oil king" destined to play a much larger role on the world stage of energy for at least the next twenty years and likely longer.

Yet, a majority of these countries face stringent self-imposed restrictions on their ability to invite foreign companies to assist them in developing their hydrocarbon resources.

Meanwhile, the strategic choice that these resource-rich countries have to make, involves the inclusion of foreign oil companies for capital, managerial capabilities, and cutting-edge technology to meet the world's future energy demands, as well as, the socio-economic and political expectations of their own increasingly youthful population.

My task today is to give you an overview of the Kuwait Project, a proposition that could be a new model for cooperation between IOCs and NOCs.

In order for the State of Kuwait to shoulder some of the future burden of quenching the thirst of the industrialized and developing nations for oil, it will have to increase its oil production rates by some additional 2mmBOPD. KOC alone is unable to carry out the entire development program needed to

reach its strategic production target of 4mmbopd by 2020. We need the cooperation and active involvement of all stakeholders, and the sharing of knowledge amongst each other to increase awareness and improve productivity.

No one can deny that IOCs, through their Technical Service Agreements (TSAs), have positively contributed in many of KOC's business areas, including: management processes, fields' development, exploration, drilling, reservoir management, HSE and the implementation and transfer of technology.

IOCs have indeed helped KOC by introducing processes related to strategy formulation and rollout, corporate planning, economic analysis and modeling, and performance management. IOC staff further contributed in the design of a full multi-year integrated transformation program for strategy implementation.

In the area of reservoir development, IOCs helped introduce many valuable processes and best industry practices such as integrated development plans, introduction of focused and integrated surface and sub-surface studies.

To sum up on the TSA performance, KOC has perhaps saved at least five times what it has paid to IOCs for their services during the last 12 years, according to a statement made by its ex-chairman, Mr. Ahmad Al-Arbeed, in October of last year.

Hence, one may ask: why should KOC change the nature of its relationship with IOCs when the current TSAs seem to be a success and KOC is benefiting from it.

The answer to this question is that KOC today is assuming the full risk in handling the new approaches of developing projects, and its ability to harness new technologies and adapting it effectively is still in its infancy.

Although the North Kuwait area contains enormous reserves, however in exploiting these reserves KOC will be exposed to the many challenges that it had never had to face in its past, particularly in the area of water and gas injection projects, water handling and corrosion management. KOC's recent experience in such projects has resulted in unexpected delays in execution, and less than optimum performance.

Having vast resources of hydrocarbons does not necessarily translate into long-term richness and prosperity, as it heavily depends on how well the state exploits such reserves. The optimum exploitation of resources can be achieved when you use the right technologies and the right know-how at the right time. The sooner such an optimum exploitation plan can be put in place, the longer the life of existing resources will be, and therefore the higher economic value of such resources will become.

The proposed relationship between Kuwait and IOCs in the Kuwait Project is the natural evolution from what we have today. It is this second phase of our relation that takes into account the strengths and limitations of the existing relation. The Kuwait Project proposes to expand IOCs role from an advisory role to a fields' management and operation role, where IOCs will act as a super contractor under the guidance and strategic management of the state.

Burgan is not Kuwait's only giant field. There are other giant fields in both North Kuwait and West

Kuwait. These fields however are at earlier stages of development than Burgan, and do not enjoy such a supportive aquifer. We have recently commenced waterflooding in several reservoirs within these fields, and are facing many new challenges associated with secondary recovery operations.

It is a fact that most of Kuwait's giant Oil Fields have been producing for over 40 years, and at times at their maximum capabilities. Today some of these giant oil fields have reached their half life, while the rest will require greater effort and effective reservoir management. It is these latter reservoirs that provide great and attractive opportunities to the major International Oil Co's.

The involvement of International Oil companies under a mutually agreeable, risk balanced, contractual agreement for developing such reservoirs will lead to minimizing the risk on Kuwait in capital projects, where Kuwait doesn't possess the necessary skills nor the know-how in managing such projects effectively. In addition, the IOC's participation will provide an environment for competition between the international and local experience which will lead to enhancing the local experience to the level of the IOC's and also will open a new venue for access by the local management to the IOC's management style which will help raise the local capabilities and skills in improving performance.

Another benefit for such relationship is the IOC's capability in reducing production expenditure, which they have successfully demonstrated in other parts of the globe. Such practices could be transferred to the local staff to apply in oil field areas within Kuwait to achieve similar successes rather than trying to re-invent the wheel and take a huge risk, which would cost Kuwait significantly.

The IOCs also stand to gain tremendously, as they will be offered the opportunity to participate in an area well within their core competencies in what is perceived to be low risk opportunities. The participation in the North Kuwait fields will undoubtedly have a positive influence on IOCs' share prices, value, portfolio divestment and growth opportunities.

It is for these reasons that Kuwait has developed a contractual agreement model that would incentivise the IOC's to provide the best technology and expertise to Kuwait to operate and develop the oil fields to increase production capabilities to achieve the production target of 3 MMBOPD. In essence Kuwait requires the type of relationship with the IOC's, which is primarily based on operating services where the IOC's are paid a fee per bbl of oil produced.

Kuwait stands on a unique footing and therefore the model of agreement should also be unique. Neither the concession model nor any equity sharing model is allowed by the nation's constitution. An ideal model for Kuwait should be mainly structured to have unhindered access to and transfer of the state of the art technology and also ensure correct adaptation of this technology to achieve the following objectives, whilst meeting IOC's profitability and other objectives.

To further elaborate on the kind of model agreement, it can be said that it should obviously be based on technology focus and a cost driven model. We all know how much international oil companies are proud themselves of their technologies and processes which have indeed lowered their costs, increased their productivity and effectiveness. We believe there is wider scope for them to repeat such successes in Kuwait and share the benefits. We strongly believe that the oil industry is an innovative industry and therefore capable of inventing a new model for Kuwait which can be used elsewhere if proved successful for both the parties. The production sharing, revenue sharing, risk service, buy-back agreements are all innovations of this industry and all proved their success in certain circumstances.

The model agreement that Kuwait is seeking retains the ownership of oil by the country. It provides sufficient incentive to international oil companies to minimize costs and maximize production. Since the establishment of OPEC, Kuwait has proved its commitment to strictly adhere to OPEC quota. We would like to maintain this image in future as well. This will necessarily mean that the model agreement should contain enough flexibility for Kuwait to meet its commitment towards OPEC. In addition, this model leaves room for Kuwait to change production targets if the strategic needs arise.

The proposed contract includes clauses that encourage expansion of relations in other areas of business and to give equal rights to both the parties to have the opportunity of benefiting equally in the successful assets of each other. The joint efforts of the parties in the field of research and development in finding new ways of using oil without affecting the environment and to make the oil industry environmental friendly will be an excellent area of potential long term relationship.

In a few days time debates will continue in Kuwait's Parliament. The debate will focus on the legislative framework under which Kuwait will allow foreign investments in its upstream sector.

It is our hope and intention that Kuwait will soon demonstrate to the industry an example of a new partnership combining modern technology, management skills and large reserves that will make a contribution to the long term stable, viable oil price and supply/demand environment, and thereby, to the world's economy, as well.

In conclusion, oil plays a critical role in Kuwait's economy in terms of revenue generation and contribution to the GDP. We have very ambitious expansion plans in all sectors and expect to spend some \$ 40 Billion over the next 15-20 years. However we want to maximize the effectiveness of our investment by increasing the utilization of our workforce, local goods and services. We have invested a great deal of time to Understand the drivers of the companies we are trying to attract, understanding their corporate strategy, philosophy, risk appetite, portfolios, regional strategies, etc is of critical importance, and are now in the process of revising many of our policies and procedures to creating the conditions for success. Notably creating an acceptable balance between perceived risks and achieving commensurate rewards, improving synergies and creating an amiable environment for foreign oil companies. This will require us working closely with the international oil majors, our local & international contractors & suppliers. The Kuwait Project, will hopefully be tendered within this budget year, and will enable the resurgence of the eminence of Development of Kuwait's Upstream Sector.

The petroleum industry is living through one of the most exciting periods in its history. It is not a time for business as usual; it is a time for new ways of doing business.

By the grace of God Almighty, we hope to succeed in making a difference.

Thank you for your patience.