Economic analysis of Buy Back Agreements in Iranian law

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Abstract

Buy back agreements are a type of risky service contracts. In this type of contract, the government or the National Oil Company assigns the field to a foreign company for exploration and development. Exploration and development operations in the name and on behalf of the government / National Oil Company are the responsibility of the foreign company. The risk of the agreements is also borne by the contractor. According to this study, Buy Back Agreements does not create a favorable convergence between the interests of the employer and the contractor, and this reduces the benefits of cooperation. In terms of flexibility, the production participation agreement is in a better position; This is because the structure of the agreements allows the parties, both at the time of concluding and during the execution of the contract, to create more harmony between the provisions and the structure of the contract with their specific conditions. Recognizing the inefficient points of the Buy Back Agreements through the application of economic analysis tools of the contract on it, has the benefit that by modifying the contract can increase the total profit of the parties from the project and create a more appropriate framework for cooperation to extract oil resources. In this descriptive-analytical study, we will try to study and analyze the economic Buy Back Agreements in Iranian law.

Keywords: Buy Back Agreements, Cost, Flexibility, Economy, Contract

Introduction

The growth and explanation of economic analysis of law over the past few decades and the use of analytical tools in microeconomics in contract explanation and analysis, has made it possible to assess which type of contract ensures greater efficiency. In other words, with the formation of the idea of economic-legal analysis, the element of efficiency in the field of law has also entered. In fact, economic analysis of law does not emphasize the efficiency of legal rules and this is used as a touchstone for thinkers in this field to evaluate legal rules[1]. Economic analysis of the contract is no exception, and any contract that has more efficiency for the parties, is a more desirable example and is preferred over other contracts. In general, from the point of view of economic-legal analysis, law should move in a direction that increases the efficiency of the contracts concluded under its jurisdiction.[2] A contract model that is more efficient based on the principles governing the economic analysis of the contractor and is able to maximize the total wealth of the parties, compared to a contract that eliminates or hinders a large part of the benefits of cooperation without considering the above principles and ia superior than other contracts. [3]In this descriptive-analytical research, we will try to analyze the economic Buy Back Agreements in Iranian law.

1- Examining The Concept and Principles of Buy Back Agreements

Service contracts (Buy Back Agreements) are a type of risky service contracts.[4] In this type of contract, the government or the National Oil Company assigns the field to a foreign

[1] Posner, Richard.A. Economic Analysis of Law, Aspen Publishers, 6th edition, New York, 2003, p.15

[2] Schwartz, Alan, "The Law and Economics Approach to Contrac Theory", in: Economic Analysis of Law Selected Readings, Edited by Wittman, Donald.A, Blackwell Publishing, 2003, p. 144.

[3] Bahmii, Mohammad Ali; Faraj Mehrabi, Hassan (2014), Oil Contracts of Partnership Production and bye back from the Perspective of Economic Analysis of Law, Quarterly Journal of Legal Research, No. 68, p.141

[4] Risky service contracts are divided into:

Buy back for development operations

company for exploration and development[5]. Exploration and development operations in the name and on behalf of the government / National Oil Company are the responsibility of the foreign company.[6] The risk of the contract is also borne by the contractor. The contract must start from the effective date of the contract and continue until the oil costs and the contractor's fee are reimbursed, and this period must not exceed the amount specified in the contract.[7] The contractor shall provide all the capital, machinery, equipment, technology, eligible skills, etc. necessary for the execution of the development operation in accordance with the contract [8]and shall begin the development operation within a specified date from the effective date of the contract[9]. The contractor must also carry out the development operation in full compliance with the laws of the host country and always consider his rights and interests[10].

On the other hand, the host country has the right to do any necessary control and supervision in accordance with the terms of the contract to ensure that the contractor fulfills its obligations

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Buy back for Exploration & Development operations

[5] One of the differences between Buy back and the risky service method is that in Buy back, the production operation is not assigned to a foreign company, while in risky service contracts, in addition to exploration and development operations, the production operation is assigned to a foreign company.

[6] Sample Service Contract between National Iranian Oil Company and Contractor for Development operations, 2003. (herein after "Iran Contract") in Article 3: N.I.O.C. authorizes contractor to conduct the development operation on behalf and in the name of N.I.O.C. from the effective date to the conclusion of the development phase.

[7] Another part of Article 3 of "Iran Contract": The contract shall commence from the effective date & shall continue through the development phase & thereafter until contractor has recovered petroleum costs & remuneration fee. This period shall not exceed … year &… months from the effective date.

[8] Article 2 of "Iran Contract": Contractor shall provide all capital, new machinery, equipment, technology, qualified skills, etc. necessary for the conduct of the development operations under the contract

[9] Article 2 of "Iran Contract": Contractor shall provide all capital, new machinery, equipment, technology, qualified skills, etc. necessary for the conduct of the development operations under the contract.

[10] Article 7 of "Iran Contract": Contractor shall carry out the development operations in strict compliance with Iranian laws, rules & regulations, and shall always remain mindful of the rights & interests of NIOC.

correctly and completely[11]. In this regard, documents related to development operations, which include daily drilling reports and monthly operation reports can be received [12].

All decisions are made by the Joint Committee Management by agreement of the parties. The parties have equal members and votes in this committee and all decisions must be taken by unanimity of all members in order to be valid and bind the committee.[13]

The duties of the Joint Committee Management include: Supervising, overseeing, controlling, supervising development operations from technical, financial, practical, commercial and managerial aspects and ensuring that the development operations are in line with the work plan and budget and correctly achieve the objectives. Development operations are in motion[14]; Review, revise and approve any changes in the scope of activities, add or subtract work in the master development plan proposed by either party[15].

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[11] Article 5 of "Iran Contract": NIOC has the right to exercise all necessary control & supervision, in accordance with the terms of the contract, require to ensure that contractor is in full compliance with its obligations under the contract.

[12] Another part of Article 3 of "Iran Contract": NIOC has the right to receive from contractor documents related to the development operations, including inter alia daily drilling reports and monthly operations reports.

[12] . Joint Committee Management (J.M.C.)

[13] Article 17 of "Iran Contract": All decisions of the JMC must be made by unanimous vote of all members to be valid & binding upon the JMC

[14] Another part of Article 17 of "Iran Contract": Overseeing, supervision, controlling & monitoring the development operations from technical, financial, operational, commercial aspects and ensuring that the conduct of the development operations is in line with work program & budget and is properly heading towards the achievement of the objectives of development operations.

[14]Master development plan (M.D.P.)

[15] Reviewing, revising & approving any change in scope, additional work or reduced work in the Master development plan submitted by NIOC or contractor.

The contractor must pay all costs in the same amount as stated in the project accounts and in accordance with the accounting procedure[16], and then after the start of production of the contractor all costs by the host country in equal monthly installments will be reimbursed only from the reservoir.[17] . This reimbursement is through the allocation of part of the field production to the contractor[18]. In addition, the contractor is entitled to a specific fee, which will be paid to the contractor after the completion of the development and delivery of the field to the host country according to the program stipulated in the contract[19].

2-Specific Rules of Bye Back Agreements

In bye back agreement, goods and services are exported and goods that are reciprocally redeemed are linked in a production process. In other words, bye back is a new form of back trade on the basis of which the exporter, who is usually from an industrialized country, agrees to acquire the equipment, machinery, technology and information, the necessary financial resources, etc. to build or develop a economy project and in return in another contract is required to repurchase part of the products produced in that economic project and through this repurchase it is the manufactured products that receive the costs and benefits.[20] bye back agreements have four basic characteristics, which are:

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[16] Article 22 of "Iran Contract": Contractor shall recover petroleum costs, duly entered in to the project accounts, in accordance with the accounting procedure.

[17] Article 22.1.1 of "Iran Contract": Capital costs & non-capital costs, incurred & paid by contractor …, together with Bank charges shall be amortized in equal monthly installments

[18] Another difference between bye back agreement and risky service contracts is that in bye back agreement, the foreign oil company is entitled to receive its costs and profits from part of the field resources, while in risky service contracts it is required to pay from part of the field resources. It was not, but it was possible to repay from the whole field.

[19] Another part of Article 22 of "Iran Contract": In addition to the petroleum costs, Contractor shall be entitled to a remuneration fee of … U.S. Dollars following the completion of the development operations and after the handover.

[20] Rouhani, Fouad (1974), History of OPEC, translated by Manouchehr Rouhani, Tehran, Pocket Books Company, p. 48

1. Long Time project

2. Heavy Bye Back contracts

3. Production relationship between exported goods and repurchased products

4. Existence of two separate contracts.

2-1 Specific Rules Related to Contract

In the current pattern of bye back agreement, the foreign oil company does not own the production assigned to them at the source or at the point of export. Hence, they claim that they should be able to own the oil and gas allocated to them; They should have ground facilities, as this will allow them to register reservoirs in accordance with international stock exchange and securities rules[21].

n order to conclude a contract, the subject of the contract must first be selected by the applicant and the international market for the goods it intends to produce must be researched and information obtained, and a copy of the text of the contract must be submitted to the relevant ministry[22]. Also, when concluding bye back contracts, unpredictable changes in market conditions that may increase pre- capital costs limitshould be taken into account, and because the comprehensive master plan is based on a series of time figures. The adjustment is being prepared. It is possible that as more information becomes available as a result of the development operation, it will need to be changed, in which case the foreign oil company must obtain the approval of the National Iranian Oil Company or burdern more capital cost, if needed [23].

[21] Feshaki, Fereidun, 1976, Development of the Iranian Oil Industry, International and Domestic Aspects, Praeger Publisher, New York .876
[22] Khoshrou, Saeed and Mobaseri, Dariush (2001), Oil Contracts in Time, Oil, Gas and Petrochemical Monthly, Vol. 9, pp. 40-38
[23] Mousavi Esfahani, Zeinab Sadat (2013), Buyback Oil Contracts in Production and Its Applicability in Iran's Oil Industry, Islamic Azad University, Damghan Branch, Master Thesis in International Trade Law, p.93

Obviously, because the reimbursement of costs and fees depends on the realization of the objectives of the contract (ie Plateau) and if these objectives are not achieved, the foreign oil company will burden heavy losses, this issue should also be considered at the time of conclusion. It should also be noted that production from the field is insufficient or when oil prices are low and the foreign oil company is unable to recover all costs and fees[24]. At the time of concluding the bye back agreements, any delays in the commencement of work that may adversely affect the project costs should be anticipated, and any delays in achieving the production level that delayed the return of costs and fees and reduced rate of return on investment will also have to be considered. In a bye back agreement, a fixed fee in return for the investment and acceptance of the risk to the foreign oil company must be determined, which must be commensurate with the capital costs to provide a fixed return type (eg 15%) [25]for the company. Foreign oil guarantees, of course, generally in Iranian mutual service services contracts, the rate of return on investment is included in the contract as limit, and in practice, the real rate of return on investment may be less than that.

2-2 Specific Rules Related to Implementation

Bye back can be done in one step or in several stages, but in general, due to the large volume of calculations and enlargement of projects, they can be divided into several stages or phases, of course, in each phase all calculations should be done separately from the beginning to the end[26].

In a production phase, it is possible to have both early production (for example, 30,000 barrels of oil per day) and final production (for example, 90,000 barrels of oil per day). Under the new bye back model, if all works goes according to plan and the project is completed

[24]Mousavi Isfahani (2013), the former, p.94
[25] D.C.G.P.O. Papers Relating To the Foreign Relation of the United States, Vol.111. Washington, (1920).p. 765
[26] Musa Isfahani (2013), the former, p.98

within the capital expenditure limit, the maximum reward given to foreign oil companies is a fixed amount or the same fee[27].

Foreign oil companies don't intend to incur heavy exploration and development risks for a fixed amount only. They expect that if a rich field is discovered and developed as a result of their participation and investment, they will benefit more[28].

Costs and fees will be reimbursed from production revenue over a period of time (usually several years), but will be returned to the National Iranian Oil Company once the field development is completed for the extraction phase. Therefore, any reduction in production will have a negative impact on the foreign oil company. In this type of contract, if during the development phase, due to unforeseen factors related to wells, ground facilities and other issues, it is necessary to make changes in the master development plan and ultimately lead to additional costs, this cost to will be reversible to capital expenditure limit and, if increased, will be imposed on foreign oil companies. However, excess costs resulting from overwork will be reimbursed even if the capital expenditure limit is exceeded if it leads to an increase in contract objectives. Foreign oil companies claim that the costs of changing the master plan should be reversible, even if they do not increase the contract objectives[29].

2-3 Specific Rules Related to Termination

Obstacles and conditions of termination of the contract must be mentioned exactly in its text. For example, the conditions for the continuation of force majeure that would suspend the performance of the contract or when it would be considered as a factor of termination should be specified in the contract. In bye back contracts, conditions such as validity period, expiration conditions and termination of the contract are mentioned[30].

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[27] Shirvi, Abdolhossein et al., Exploration and Development of Iran's Oil Fields through bye back Agreements (2009), International Law Journal, Journal of the Center for International Legal Affairs, Vol. 26, No. 41, p. 249

[28] Ibid

[29] Adepetum, Production Sharing Agreement 20 At. S.H... Longigg, Oil in The Middle East, (1968). p. 432

[30] Alavi, Seyed Abuzar (2008), Rules Governing Oil and Gas Contracts in the Iranian Legal System, Islamic Azad University, Bandar Abbas Branch, Master Thesis in Private Law, p.165

In bye back contracts, the contract period is valid from the effective date until the end of the contractor's fee and fee payment period. In general, the pay back period to the contractor should not exceed 8 years from the date of first production, except in If the parties agree and the duration of the development operation if it exceeds the period stipulated in the contract. Bank interest is not accrued on the contractor's capital and expenses for an additional period of time, unless the National Oil Company requests and if the National Oil Company is responsible for delaying the operation on time, bank interest is accrued to the contractor.

The National Oil Company and the foreign party (contractor) can each cancel the contract if the other party violates the obligations by sending a written notice. Also, in case of force majeure (Cairo force) occurs, the contract may be suspended for a short period of time, and if the contract is not continued after the obstacle is removed, the contract will be terminated. In some cases, the National Oil Company can cancel the contract based on the contractor's refusal to fulfill the main obligations, the contractor's bankruptcy, non-compensation of the contractor's overdue obligations, in which case the contractor will not be entitled to the product cost or fee[31].

Conclusion

1- Lack of optimal flexibility in the face of changing circumstances, limited financial resources, as well as high costs of searching and concluding a transaction in a bye back contract, are among the negative points of this contract from the point of view of economic analysis and law. The main reason for this situation can also be found in some inefficient elements and tools of this contract, such as having capital costs limit, the absence of the contractor in the field for the direction of production while dependent on his income, field production and even factors such as limited rates. Return on investment.

But the most important inefficient element of the bye pack contract can be considered the low convergence of the interests of the employer and the contractor at the time of concluding and executing the contract; In fact, the direct relationship between project costs and

[31] Writers Group (2000), Anatomy of Oil Industry Investment, Tehran, Kavir Publications

contractor revenue in this contract, whereby higher revenue for the contractor requires higher costs of project capital, has led to a serious conflict of interest between the employer and the contractor.

2- The selection of the contract model needs to be thoroughly examined and it is not possible to replace the proposed contract model to foreign contractors just for the sake of more efficient contract structure and without considering other existing conditions and backgrounds.

However, recognizing the weaknesses in the structure of the bye back contract, which leads to its inefficiency compared to other oil contracts, has the advantage that by modifying it in terms of the efficiency of the contract, its shortcomings specifically in terms of transaction costs, cooperation and flexibility can be addressed. As Iraq has been able to combine the benefits of a production partnership contract and a service purchase contract to provide a new contract model that, despite retaining all property rights to its natural resources, has many motivating factors for the contractor and creates favorable convergence.

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