

# A template for infrastructure investment in Iraq

The Basrah Gas Project has faced down challenges to serve as an example of public/private enterprise going forward.

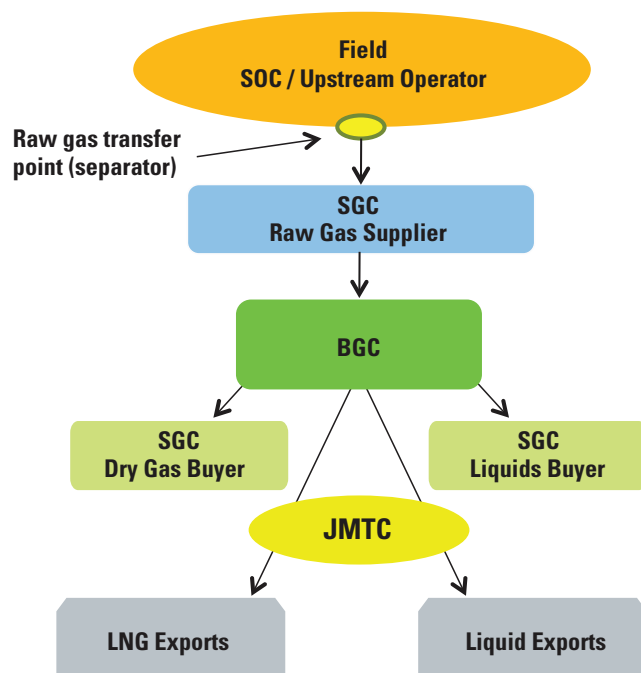
**Christopher B. Strong**, Vinson & Elkins LLP

With a total estimated investment of more than US \$17 billion, the Basrah Gas Project represents the largest foreign investment project in Iraq outside of the upstream sector and the first substantial foreign investment in Iraq's midstream and downstream sectors in Iraq's post-conflict era. This innovative project will provide substantial benefits to its investors and, most importantly, to the people of Iraq. In addition, its unique structure could serve as a template for future investments in Iraq's midstream and downstream sectors.

## Strategic background

The principal goal of the Basrah Gas Project is to capture and use associated gas produced from three major fields in southern Iraq – Rumaila, Zubair, and West Qurna (Phase 1). Because of a lack of processing and transportation infrastructure, a significant portion of the associated gas produced from these fields – more than 21 MMcf/d (750 MMcf/d) on average – has historically been flared. This not only represents a significant waste of a valuable resource but also has a substantial negative impact on the environment. This adverse environmental impact is exacerbated by the fact that, because of the poor state of repair of the separators in the three fields, crude oil and other liquids are included in the flared gas stream, increasing the carbon content and resulting in the “black flares” that are an all-too-common sight in the Basrah region.

Through a combination of rehabilitating the existing gas processing and transportation infrastructure and investing in new infrastructure, the Basrah Gas Project will reduce and eventually eliminate the flaring of associated gas from the three major fields. This will have the benefit of providing a source of dry gas for power generation and industrial development; capturing LPG and condensate, which will enable Iraq to become a net exporter of LPG; reducing costs currently incurred by the Iraqi government to import fuel oil for power generation and LPG; and reducing air pollution and carbon emissions.



The Basrah Gas Project will enable Iraq to become a net exporter of LPG by 2014. (Image courtesy of Vinson & Elkins LLP)

## Legal structure

Basrah Gas Co. (the legal entity through which the Basrah Gas Project is being implemented) is organized as a mixed limited liability company under the Iraqi Companies Law No. 21 of 1997. A mixed limited liability company is a unique type of entity under Iraqi law that allows both public and private sector entities to be shareholders. Although the provisions allowing for mixed limited liability companies have been part of Iraqi law for a number of years, Basrah Gas Co. is the first mixed limited liability that has been formed.

The shareholders in Basrah Gas Co. are South Gas Co. (a state-owned entity under the direction of the Ministry of Oil), which holds 51% of the equity interests, with foreign investors holding the remaining 49%. Management of Basrah Gas Co. is overseen by a higher management



committee with members appointed by each of the shareholders. Under Iraqi law, limited liability companies do have boards of directors, but the shareholders in Basrah Gas Co. were able to create a body with analogous powers through a contractual agreement as reflected in a shareholders' agreement. Management positions are filled with appointees from South Gas Co. and the foreign investors, with an intention that as time goes on expatriate managers will gradually be phased out in favor of Iraqi nationals.

Following the formation of Basrah Gas Co. and immediately prior to its commencement of operations, South Gas Co. contributed existing gas processing and transportation infrastructure to Basrah Gas Co. at an agreed valuation (as determined by an independent appraiser). The contribution of assets excluded rights to the underlying real estate, which was instead leased to Basrah Gas Co. under a long-term agreement.

The contribution of assets was deemed to constitute a shareholder loan from South Gas Co. to Basrah Gas Co. in an amount equal to the appraised value of the assets. Going forward, the foreign investors will be obligated to make capital contributions (in the form of shareholder loans) to Basrah Gas Co. until their combined contributions are equivalent in value to the assets contributed by South Gas Co. After that point, all shareholders will contribute capital sufficient to fund Basrah Gas Co.'s capex program on a *pro rata* basis in accordance with their shareholding percentages. All capital contributions will be in accordance with a work program and budget that will be jointly developed and agreed upon by the shareholders in the manner contemplated by the Basrah Gas Co. shareholders.

## Commercial structure

Under the technical service contracts for the Rumaila, Zubair, and West Qurna (Phase 1) fields, the operators are required to deliver all associated gas that is not used for petroleum operations to South Oil Co., a state-owned entity under the direction of the Ministry of Oil. That company will transfer the associated gas to South Gas Co., which will in turn sell the gas to Basrah Gas Co. under a long-term raw gas supply agreement. Basrah

Gas Co. will then process the gas and sell the resulting dry (processed) gas, LPG, and condensate back to South Gas Co., which will sell those products in the domestic market. Once LPG production in Iraq is sufficient to satisfy domestic demand (expected to occur in 2014), Basrah Gas Co. also will be able to export LPG. As the Oil Marketing Co. of the Republic of Iraq (SOMO) has the exclusive legal right to export petroleum products from Iraq, Basrah Gas Co. and SOMO have entered into an export agency agreement under which SOMO will act as Basrah Gas Co.'s export agent. The agreement also provides for the establishment of a joint marketing committee between Basrah Gas Co. and SOMO to determine marketing strategy and act, in effect, as Basrah Gas Co.'s export marketing department.

Once gas production in Iraq is sufficient to satisfy domestic demand, Basrah Gas Co. also will have the right (subject to certain conditions) to develop the first project to export LNG from Iraq. As with LPG, the LNG will be sold through an export agency arrangement with SOMO.

As with LPG, the LNG will be sold through an export agency arrangement with SOMO.

## Challenges

As a first of its kind, the Basrah Gas Project faced a number of challenges. Although the mixed limited liability format is recognized under Iraqi law, such a company had never been formed before. The transfer of state-owned assets into a company with private-sector ownership also presented new issues, as did the lease of state-owned real estate and the capitalization of Basrah Gas Co. via shareholder loans. In fact, the list of "firsts" that the project presented from an Iraqi perspective is so extensive that it would be far beyond the scope of this article to discuss them all. But through patience, persistence, and cooperation, the participants in the project were able to work through the many complex issues and develop a legal and commercial framework that should form the basis for lasting success. Importantly, the Basrah Gas Project also should serve as a template for other projects in Iraq, particularly those that are contemplated to be structured as partnerships between state-owned entities and foreign investment and those that contemplate the refurbishment and expansion of state-owned assets. **E&P**

**As the first of its kind, the  
Basrah Gas Project  
faced a number of challenges.  
Although the mixed limited  
liability format is recognized  
under Iraqi law,  
such a company had  
never been  
formed before.**