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Abu Dhabi Oil & Gas Update

Perspectives on latest developments

Upstream Opportunities for New Entrants

by Christopher Gunson

The Abu Dhabi National Oil Company (ADNOC) has reportedly invited select international oil companies (IOCs), and possibly some national oil companies (NOCs), to pre-qualify for the expected award of oil exploration and production concessions in 2014. It is also believed that ADNOC is in the final stages of setting tender procedures to evaluate bids. This newsletter summarizes the upstream framework in Abu Dhabi and potential opportunities for new entrants.

Abu Dhabi accounts for about 3% of global oil production and up to 10% of the world's proven oil reserves, yet perhaps surprisingly, there is little law covering oil and gas. The legal framework for upstream development is substantially based on precedent. An introduction to the opportunities in 2014 should therefore begin with some historical background.

A Brief History of Abu Dhabi Oil and Gas Development

In January 1939, a subsidiary of the Iraqi Petroleum Company (IPC), a consortium of British, Dutch, French and US companies, was awarded a concession by the Ruler of Abu Dhabi to explore and produce oil over the "whole territory of the ruler of Abu Dhabi" for a 75-year term.

Following a disagreement between the parties regarding whether or not the "whole territory" covered offshore areas, the Ruler and IPC went to arbitration in 1951, and the arbitrator's decision limited the 1939 concession to the onshore territory and shallow coastal waters. Abu Dhabi then entered negotiations to separately award the offshore areas, and in 1953 granted a concession for a 65-year term to a French-British consortium, which acted through an English company with the name Abu Dhabi Marine Areas Ltd. (ADMA).

These two original concessions were typical of the era in that the terms were very favorable to the contractor. As resource nationalism swept Iraq and Iran in the 1950s, and following the establishment of OPEC in 1965, the oil producing states of the Middle East sought more favorable terms for upstream oil development. In Abu Dhabi, a tax system was first introduced in the late 1960s, and shortly thereafter ADNOC was established in 1971 to directly participate in the concessions, first taking a minority stake and ultimately acquired a 60% majority interest in the 1939 concession and 1953 concession by the late 1970s. Unlike many neighboring countries, such as Kuwait and Saudi Arabia, the upstream interests of the IOC concessionaires were not terminated or fully nationalized. The primary IOCs active in IPC and ADMA were the predecessors of ExxonMobil, BP, Total and Royal Dutch Shell. These companies remain active participants in Abu Dhabi's upstream sector to this day.

Once ADNOC was involved in the concessions it set up local operating companies. Abu Dhabi Onshore Oil Company (ADCO) is the operator for the 1939 onshore concession, and Abu Dhabi Marine Areas Operating Company (ADMA-OPCO) is the operator of the 1953 offshore concession.

Some fields discovered by IPC and ADMA but deemed not commercial were carved out from the two main concessions and awarded to French and Japanese government-backed interests. One such concession was Upper Zakum, which is currently owned by way of concession by Japan Oil Development Company (JODCO), ADNOC, and most recently ExxonMobil, and which is operated by the Zakum Development Company (ZADCO). ZADCO also operates other fields awarded to JODCO and ADNOC.

The two original concessions did not address natural gas because there was no infrastructure to export or domestically consume gas. In the 1970s, ADNOC led the development of two major gas projects with IOCs, one to liquefy all offshore gas and export it as LNG, and the other to process associated natural gas produced from onshore oil fields and use for domestic electricity generation.

Abu Dhabi Oil and Gas Law and Institutions

The 1971 UAE Constitution provides that the natural resources of each Emirate are the public property of that Emirate. Accordingly, only Abu Dhabi law, and not UAE federal law, applies to oil and gas development in the Emirate. Abu Dhabi has passed discrete laws from time to time regarding taxation, petroleum resource management, natural gas ownership, and operating company establishment, but there is no comprehensive petroleum law.

Two institutions hold jurisdiction over licensing and regulating the upstream oil and gas sector:

- **ADNOC** is the primary state actor and functions simultaneously as a concession participant, operator and regulator.

- The **Supreme Petroleum Council (SPC)** of Abu Dhabi was established in 1988 to take the role of the board of directors of ADNOC. The SPC has grown into the core decision-making institution concerning oil and gas and is made up of senior members of the Emirate's government.

Abu Dhabi has not passed any substantive laws regarding the upstream sector since the establishment of the SPC, the decisions of which have the force of law over the oil and gas sector.

Imminent Opportunities

The 75-year term of the 1939 concession expires in January 2014. This concession covers three supermajor fields (Asab, Bab, and Bu Hasa) and a number of other important producing fields, having total production estimated at up to 1.4mbpd. Holding any portion of one of these fields would constitute a substantial prize for any energy company, including a supermajor IOC.

Although Abu Dhabi could renew the 1939 concession, industry sources report that Abu Dhabi plans to let the 1939 concession expire and tender the fields to current participants and opening up to new bidders. There is already some indication of this, and in recent months it has been reported that ADNOC has proposed public tenders and invited some IOCs and NOCs to present their qualifications to participate.

The recent trend in recent years has also been to expand the historically narrow pool of participants, and to award oil concessions and gas projects on a field-by-field basis. Evidence of this includes the following:

- the award to Occidental of a concession covering two onshore fields in 2008 (no ADNOC participation);
- the award to ConocoPhillips of the Shah sour gas contract in 2008, from which ConocoPhillips later withdrew and was replaced by Occidental in 2011 (ADNOC participation as 60% shareholder of the project);
- the award to Korea National Oil Corporation (KNOC) of a concession covering two onshore areas and one offshore area in January 2012 (ADNOC participation as 60% interestholder in the concession);
- the award to OMV and Wintershall of a gas appraisal contract for a sour gas field near Shuweihat Island in Western Abu Dhabi in June 2012 (ADNOC majority participation expected if the project advances from the appraisal stage to development and production).

Four Core Elements of a Successful Bid

Notwithstanding the public reports that ADNOC is inviting select companies to submit credentials, ADNOC has not announced how bidders will be qualified or how bids will be evaluated, and such criteria may not be released publicly. Even so, we anticipate that prospective bidders should prepare a bid based on four core elements:

1. **Sufficient Technical Expertise.** Many of the onshore fields have been producing for decades and will require new technology, such as for enhanced oil recovery (EOR), in the near future. Bidders seeking to invest in these producing fields must showcase cutting-edge EOR technology that will be the most effective in extracting Abu Dhabi's remaining reserves.

2. **Concession Economics.** Abu Dhabi is considered to be a low-risk upstream market. This puts the Emirate in a strong position to encourage competition among bidders and negotiate the best deal. Since the 1980s, the economic terms for concessions in Abu Dhabi have had some of the most favorable terms to any resourceholder in the world. A bidder must be prepared for competition and to accept small margins.

3. **Access to Financing.** Any concession will require the contractor make substantial investments. This is anticipated to include carrying out exploration, building pipeline and transportation infrastructure, and development of extraction and production facilities. The ability to carry out these investments will therefore be crucial, and financing may prove to be a particularly valuable element of a bid, especially given the ongoing effects of the credit crisis and the financial turmoil in Europe. Accordingly, a bidder that is in a position to bring competitive financing, such as from an Export Credit Agency with experience in Abu Dhabi, will be in a strong position to get involved.

4. **Abu Dhabi Relationship.** The sector is part of Abu Dhabi's bilateral foreign relationships. Thus government-to-government (G2G) relationships are an important element of obtaining an upstream concession. In January 2012, KNOC was awarded a concession covering three substantial unexplored areas of Abu Dhabi onshore and offshore, and that award was reported to be a direct result of the involvement of the Government of the Republic of Korea.

   Bidders without a G2G relationship can develop a direct relationship of trust with Abu Dhabi's decision makers. Occidental launched its business in Abu Dhabi through joint ventures in the energy sector with Mubadala Development Company, the Emirate's strategic investment venture. This was followed by an onshore upstream concession in 2008 and the Shah sour gas-processing venture with ADNOC in 2011.

Strategies for New Entrants

The conventional route for a company to seek an opportunity in Abu Dhabi's upstream sector is to directly engage with ADNOC. It has been reported that a number of IOCs were recently invited to set up offices in Abu Dhabi and have sent key personnel to explore opportunities. It is also believed that some NOCs have recently been holding direct talks with ADNOC.

As it will be a challenge for any bidder to independently meet all four bidding requirements, a joint bidding arrangement may be the natural route to a successful bid. This month, the consortium of OMV and Wintershall signed a sour gas appraisal agreement with ADNOC. OMV has a relationship to Abu Dhabi's key institutions, and Wintershall has demonstrated technical expertise, so working together they combined their respective strengths.

For those companies that have not been invited by ADNOC to bid, the route to Abu Dhabi's upstream sector may be to "tag along" with a successful bidder. For example, GS Energy was included as a 6% minority partner in the concession granted to KNOC in January 2012, despite having no office in Abu Dhabi, no renowned technical expertise, and no established relationships with Abu Dhabi's institutions.

As the foregoing indicates, events are developing rapidly, and those IOCs and NOCs that are interested in participating in Abu Dhabi's upstream sector should be considering and developing their strategies now.

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