

# Petrochemicals Projects in the Middle East: Implementation and Risk Management

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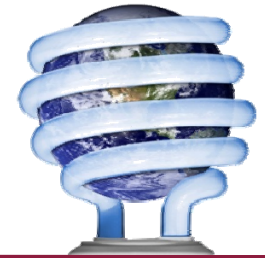
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# Introductions

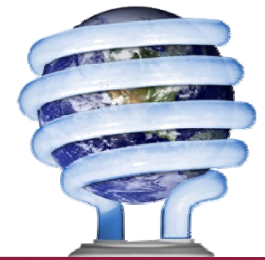


**Raid Abu- Manneh** joined the London office as a partner in November 2008. Raid specializes in construction and engineering disputes, including power, process plants and infrastructure projects. Disputes arising from large and complex projects in the Middle East have become an important part of Raid’s work in recent years. He is a fluent Arabic speaker and has advised on projects in many countries in the region, including United Arab Emirates, Saudi Arabia and Qatar.



**Jeff Durkin** joined the London office in January 2009. Jeff is a senior corporate lawyer with many years experience with BP and, more recently, with Ineos. He has been engaged on major projects in Europe, Asia, USA and the Middle East and has extensive contacts in the projects space, particularly in the Oil and Gas Petrochemical sectors.

# Petrochemical Projects in the Middle East : Implementation and Risk Management



- Distinguishing features of local law and dealing with the risk— Raid Abu-Manneh
- Commercial and Strategic considerations – Jeff Durkin
- Avoiding and resolving disputes – Raid Abu-Manneh

# *Shari'a* law



- *Shari'a* law has played and continues to play an important role in the Middle East as is demonstrated by the importance of Islamic Finance in projects in the region.
- *Shari'a* is a religious law providing a comprehensive code of behaviour covering ethical standards and legal laws.
- Sources of *Shari'a* are mainly:
  - *Koran*
  - *Sunna* (sayings and deeds of the prophet).

# *Shari'a* law



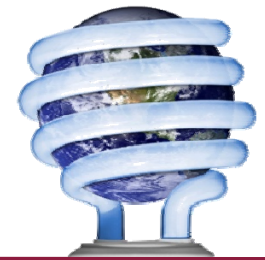
- *Shari'a* schools evolved which interpreted the *Koran*-the *Hanbali* school is prevalent in the Gulf.
- Al Majallah-*Shari'a* based Civil Code introduced in the Ottoman empire around 1870.
- Up to the introduction of the Arab Civil Codes in around 1950s *Shari'a* dominated the Middle East.
- Saudi Arabia continues now to apply *Shari'a* law and Saudi government regulations are subject to *Shari'a* law (Article 48 of the Saudi Basic Regulation).

# Contracts under *Shari'a* law



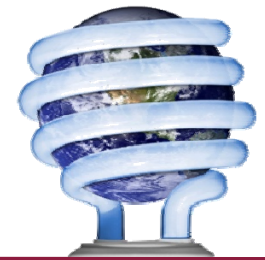
- Evolved through set contracts the most important contract under *Shari'a* was the contract of sale (*Bay'*).
- *Shari'a* strives to ensure justice and equity in respect of contracts and a proper balance of benefits between the parties.
- Contractual principles:
  - Sanctity of contract-*Aqd*
  - Duty of good faith-*Huson Alniyah*
  - Prohibition on *Riba*
  - Prohibition on *Gharar*-uncertainty.

# Arab Civil Codes



- Establishment of the Arab Civil codes:
  - *Al Sanhoury* –author of the Egyptian Civil Code of 1949 which was replicated across the Middle East.
  - *Al Wasit*-provided in 8 volumes an interpretation of the civil code.
- Recognition of the influence of *Shari'a* law which distinguishes the Arab Codes from other codes.
- Upholding the contract-Sanctity of Contract:
  - Article 147(1) Egyptian Civil Code/ Article 171(1) Qatari Civil Code/Article 196 Kuwait Civil Code –“*Contract is the law of the parties*”
  - Article 267(1) UAE Civil Code-“*..not permissible..to resile..*”

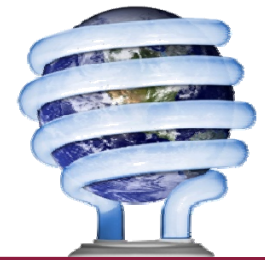
# Principles of Fairness



- As is the case with *Shari'a* law, contract rights are subject to principles of fairness.
- Principles of fairness are embedded in the Arab Civil Codes
- Examples are:
  - **Good faith** (Articles 246 UAE, Qatari 172, Kuwaiti 197, Egyptian 148).
  - **Doctrine of changed Circumstances** (Articles 249 UAE, 171(2) Qatari, 198 Kuwaiti, 147(2) Egyptian).



# Duty of Good Faith



- Article 246(1) of UAE Civil Code reflects the French and German codes:

*“The contract must be performed in accordance with its contents, and in a manner consistent with the requirements of good faith.”*

- Applies to all contracts.
- Duty of good faith should not be treated lightly-a failure to comply with the duty of good faith amounts to a breach of contract.
- Precise effect of duty of good faith will depend on the facts and specific contract terms but in construction contracts expect positive obligations of cooperation.

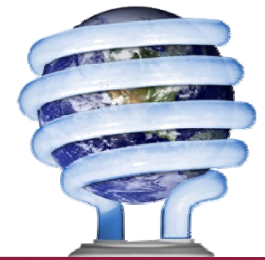
# The doctrine of Changed circumstances



- A related concept to the duty of good faith.
- Adopted by *Al Sanhoury* from French law (doctrine of *imprévision*) and *Shari'a (Udur)*.
- In France, *imprévision* applies only to administrative contracts.
- Arab contract law applied the doctrine of changed circumstances to all contracts.
- Adopting *Al Sanhoury's* wording from the Egyptian Civil Code, Article 249 of the UAE Civil Code provides:

*"If exceptional circumstances of a general nature which could not have been foreseen occur as result of which the performance of the contractual obligation, even if not impossible, becomes oppressive for the obligor so as to threaten him with grave loss, it shall be permissible for the judge, in accordance with the circumstances and after weighing up the interests of each party, to reduce the oppressive obligation to a reasonable level if justice so requires, and any agreement to the contrary shall be void."*

# Changed circumstances-continued



- The doctrine of changed circumstances cannot be contracted out of.
- Four conditions necessary for its application:
  - **Exceptional events:** e.g. a general strike, substantial increase or decrease in the price of raw materials. Credit crunch is a possible example of an exceptional event.
  - **General in nature:** not specific to a particular project but affects a whole industry.
  - **Unforeseeable:** unexpected event which could not have been foreseen (see also UAE Federal Case No. 14 24/6/1987).
  - **Excessively onerous:** as a direct result of exceptional event obligation is unduly onerous threatening excessive loss but not making it impossible to perform.

# Changed circumstances-continued



- If above conditions are fulfilled judge/arbitrator can:
  - (a) suspend obligations until they become more bearable to perform.
  - (b) add counter-obligations to the “creditor” in return for maintaining the more difficult obligation of the “debtor”.
- As to (b), say as to price escalation, judge/arbitrator would expect that part of the increase which is exceptional to be shared between the parties not “usual” increase.

# Principles of fairness-continued



Further examples in the Arab Codes:

- **Abuse of rights** (Articles 106 UAE, 63 Qatari, 30 Kuwaiti, 5 Egyptian).
- **Adjustment of agreed compensation** (Articles 390 UAE, 265 Qatari, 303 Kuwaiti, 229 Egyptian).
- **Fraud and gross negligence exceptions** (Articles 266 Qatari, 309 Kuwaiti and 225 Egyptian).

# Tips for Contracting in the Middle East



- Proper analysis of the risk of local law and its impact.
- Appropriate balance between the parties in contracts to avoid issues of unfairness.
- Use recitals to record intention of the parties and the bases for the contract.
- Draft clear and unambiguous terms.
- Adhere to formalities during contract formation.

# Why the Middle East ?

## - Where are the Petrochemical Growth Markets ?



GDP real  
growth rate %\*

Polyethylene per  
Capita consumption  
kg/person\*\*

- Growth Markets

- China

11

10

- India

9

2

- Central / Southern  
America

8

10

- South East Asia

7

8

- Russia / CIS

7

6

- MENA

6

12

- Low Growth Markets

- Africa

5

2

- Europe

3

24

- North America

2

36

Sources: \*CIA world factbook, Photius, \*\*CMAI

# Where is the Advantaged Feedstock ?



- **Europe**
  - Little/no advantaged feedstock (North Sea)
- **USA / Canada**
  - Canada Tar sands / Alberta gas
- **Central/South America**
  - Large oil/gas reserves in Venezuela & Mexico ; major discoveries in Brazil
- **MENA**
  - Advantaged feedstock position
- **Africa**
  - Region as a whole small reserves, specific pockets of potential e.g. Nigeria / Angola
- **Russia / CIS**
  - Huge gas reserves in Russia ; potential for advantaged gas/LPG
- **China**
  - Not a major oil or gas producer ; advantaged coal
- **South East Asia**
  - Region as a whole small reserves, specific pockets of potential e.g. Malaysia / Indonesia (gas)
- **Indian sub-continent**
  - Little / no advantaged feedstock



# Feedstock in MENA/Russia/Canada



Country	Gas		Oil		Gas Prod (bnscfd)	Ethane mtpa	No. of crackers Potential	Future	LPG Potential
	reserves (Tm <sup>3</sup> )	R/P (yrs)	Reserves (bnb/d)	R/P (yrs)					
Algeria	4.52	53.3	12.3	16.8	8	8.5	4-6		Yes already exporting
Egypt	0.19	43.3	3.7	15	4.5	1.4	1		
Libya	1.5	98.4	41.5	61.5	1.5	1.9	1	Gas production to increase with new discoveries	Yes from Mars-El-Brega and Mellitah fields
Iran	27.8	>100	138.4	86.2	10.8	7.9	4-5	Gas prod to increase to 39bnscfd by 2025 7-8 crackers	
Iraq	3.17	>100	11.5	>100	1.4	-	-	High ethane potential; 4-5 crackers	
Kuwait	1.78	>100	101.5	>100	1.2	1.4	1	1 additional cracker although all ethane allocated to existing projects	
Oman	0.69	28.6	5.6	21.3	2.3	2.1	1	Potential for additional 1 cracker	
Qatar	25.6	>100	27.4	62.8	5.8	4			LNG expansion potential of 3 crackers
Saudi Arabia	7.17	>94.4	564.2	69.5	7.3	7.7	4-5	1-2 additional crackers	Large LPG potential
UAE	6.09	>100	97.8	91.9	4.8	4.4	2-3	Expanding oil production by ~1 mbpd	Has rich gas therefore high LPG potential
Canada	4.63	8.9	27.7	22.9	17.8	7+		Oil sands?	
Russia	44.65	73.5	79.4	21.8	58.8	-		Change in flaring to capture associated petroleum gas offers huge potential	Rich gas therefore LPG potential 17

# Barriers to Entry (1)



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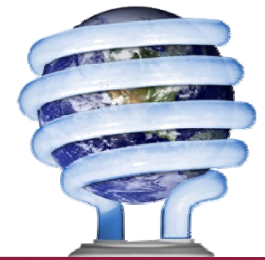
## Political Environment

- Is the Country politically stable?
- Is foreign investment encouraged ?
- Are investment processes liberal and pragmatic or restrictive, bureaucratic and lengthy ?

## Security

- What is the extent of the risk (and cost) of protecting investors' assets and personnel during construction and operation ?

# Barriers to Entry (2)



## Legal, Regulatory and Tax

- Is the legal environment benign in terms of obtaining licenses and permits ?
- What are the practical issues eg requirements for Feedstock allocation, EIA's and JSC holding company with local investors (private and public)
- Local tax issues for foreign investors including dividend remittance
- Impact of local law

# Barriers to Entry (3)



## Restrictions on Petchems Expansion Capacity including

- Production constraints – KSA, Libya
- Lack of Investment in New Discoveries – Libya, Iraq
- High Cost of new Extraction and/or Transportation/Infrastructure facilities – Libya, UAE, Iraq
- Feedstock Commitment to existing Projects – Libya, Qatar, Kuwait

# Practical Implementation Issues (1)



## Access to Leading Edge Technology

- Owned or licensed in on good terms

## Relationships with Local Decision-makers – eg in KSA

- Ministries - SAGIA, MINPET
- Saudi Aramco

## Requirement for employing a % of Local workers and Management

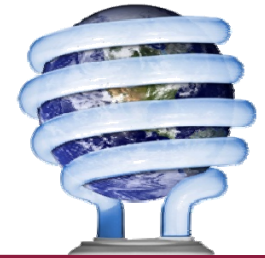
# Practical Implementation Issues (2)



## Strategic Alliances – necessary to:

- provide links to key decision-makers
- secure feedstock and assist with regulatory approvals including JSC formation and shareholding requirements
- provide local operational management and technical support
- provide access to local downstream markets

# Practical Implementation Issues (3)



## Access to Capital – eg KSA

- SIDF and PIF
- Export Credit Agencies
- Islamic Finance
- Project Financing
- Sovereign Wealth Funds

## Cashless Deals

- Asset contribution JV's
- Reverse integration investment

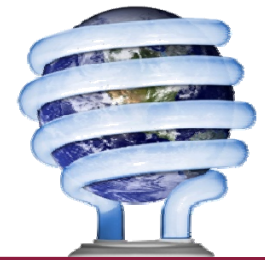
# Basis for Petrochems Implementation Strategy



Opportunities		JV	Cashless Deal		Advantaged Feedstock			SWF * over \$45bn	Comments
			Asset contribution	Reverse Integration	Oil	Naphtha LPG	Gas Ethane		
Algeria	Sonatrach	✓	✗	✓	✓	✓	✓	Politics Security	
Egypt	ECHEM	✓	✓	✗	✓	✓	✓	✗	Feedstock position marginal
Libya	NOC	✓	✗	✓	✓	✓	✓	✓	Large potential for advantaged feedstock, NOC has \$10bn for investment
Iran	NPC	✗	✗	✗	✓	✓	✓	✗	Politics
Iraq	State Petrochemicals	✗	✗	✗	✓	✓	✓	✗	Security, large potential for advantaged feedstock
Kuwait	KPC	✓	✓	✗	✓	✗	✓	✓	DOW dimension
Oman	OOC	✓	✓	✗	✓	✓	✓	✗	Feedstock position marginal New gas discovery (BP)
QATAR	QP	✓	✓	✓	✓	✓	✓	✓	Asset contribution difficult due to 'JV's'
Saudi	Saudi Aramco	✓	✓	✓	✓	✓	✓		
UAE	ADNOC/IPIC	✓	✓	✓	✓	✓	✓	✓	Borealis Dimension
Canada	Nova	✓	✓	✗	✗	✗	✓	✗	Existing JVs Alberta Gas R/P ~ 10 yrs
Russia	Sibur / Gazprom	✓	✓	✓	✗	✓	✓	✓	Politics



# Avoiding and Resolving Disputes



- Include Early Warning Mechanisms in contracts
- Seek amicable resolution as it is culturally preferred.
- Avoid local courts because they do not provide a satisfactory means for resolving disputes.
- Provide for International Arbitration- it is increasingly accepted.
- Consider Bilateral Investment Treaty arbitrations as this may be key for the recovery of entitlements in certain jurisdictions.