Study mutual rights and obligations of the Employer and Contractor

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Abstract

The growing trend of political and security stability of the Islamic Republic of Iran in the region and the world are factors that have not tended internal administrators and managers industry and trade cycle to enhance their partnerships internal and external private sectors, but has increased interest of international investors. In this paper, by examining the legal aspects and impacts of different generations of buyback contracts in recent years, we try to identify challenges of this area and suggest appropriate ways to prevent occurring the challenges. One of the proposed methods in this regard is legal risk management and using the IPC model. Although IPC contract is a service contract, but it has flexibility that might create win-win game and bring business and technology space for the country's oil industry in the next negotiations.

Keywords: international contract, buyback, legal risk management, IPC.
Introduction

As an important step in economic and industrial self-sufficiency, financing industrial projects has always been one of the major concerns of authorities. The contract, which it is mainly used for oil and gas projects in Iran, is classified in service contract group. Foreign investor company undertakes to provide all investment funds such as installation of equipments, start-up and technology transfer and then leaves them to host country after launching them. Return on investment and capital gains of Investor Company will be taken place through receiving the produced products. In general, it can be said that foreign contractor is responsible for project finance, executive and engineering affairs, orders, production and installation of equipments, will pass from the host country by joint management committee and technology transfer, which all mentioned stages will be performed by technical and financial monitoring of the host country.

In oil and gas industry, economic and legal requirements have caused that buyback method is followed seriously, including lack of credit resources, legal restrictions and lack of modern technology to take advantage and extract oil resources.

Effects of Buyback Contracts

Contractor rights

a) Remuneration and compensation

Remuneration is an amount that the contractor is entitled to do petroleum operations under the contract. Remuneration is carried out into account for the project from the date of the first commercial production.

Repayment of oil costs and additional costs, pay remuneration in cash will be conducted within 60 days from the date of presenting statement.

b) Investment profit

The rate of investment profit is determined for financing at acceptable rates of the Central Bank. All expenses and costs of contractors as well as the employed capital interest and the agreed profit rate will be refunded by the obtained income of selling goods.

c) Appropriate reward

In sale contracts, there is considered award(s) to encourage contractor to save on running costs.

d) Security

One of the factors to attract investment is security and stability in the invested country. Issues such as stability, governance limits, rule of law in the country, danger of indifference to contracts
by government, corruption in administrative system etc were new variables that entered to literature of investment and economic growth at this stage.

**Contract Obligations**

*a) Observing laws of employer's country*

The contractor should observe all laws of the employer's country (Iran), from beginning to deliver the project to the National Iranian Oil Company.

In governmental contracts, the law the Islamic Republic of Iran is the governing to execute the contract. In non-governmental contracts, Iranian party can stipulate abide the contract from the rules of Iran, due to the autonomy principle.

*b) Observing the international standards*

Observing technical standards and principles in project implementation is essential and it is one of obligations that should be included in contractor contracts. Therefore, if the contractor damages the employer or its personnel and property due to lack of considering technical principles, it will be known as responsible.

*c) Employing internal forces*

To employ in different executive and operational sectors, Iranian citizens are preferred, unless there are not available Iranian expert personnel.

According to the clause, the contractor obligates to use human resources or goods and services of contractors in the invested country for its projects.

*d) Training and transferring technology*

Training human force through short and long-term training courses or granting scholarship to study specialty in foreign universities is one of the ways that has been emphasized in many investment contracts to increase technical capacity of professionals in developing countries.

*e) Financing of project*

The contractor is obliged to pay all current expenses, tax of social security and income tax and the employer is obliged to pay them. In the buyback contracts, the contractor is responsible for financing and the contractor is obliged to take necessary coordination with credit and financial institutions and provide the required financial resources to implement the project.
f) Tax obligations and work necessities

In the buyback contracts, tax plays a formal role, without any role in controlling the amount of income of the contractor. This means that when allocating oil to contractors, numbers should be adjusted so that the net payment to the contractor is without tax.

Employer Obligations

a) Paying fees to the contractor

In such contracts, the employer’s liability provisions is that in commercial discovery of oil, there will be paid a defined fee as allocating a given amount or production share to the contractor. In Iran, the buyback contracts recognize three categories of costs: capital costs, non-capital costs, operating costs.

b) Export commitments

The employer must pay fees by 60% of the produced oil and gas on those reservoirs. Therefore, it is responsible to expert the amount of oil and gas to repay costs of contractor.

c) Non-financial commitments

The employer has non-financial commitments with the contractor that can be referred as arrangements of works or provide appropriate context and background to execute the contract.

General Conditions of the Contract

a) Implementation and how to resolve disputes

Ensuring to do commitments is one of factors that persuade parties to conclude contracts with each other because according to the wisdom and wise approach, the person will not conclude a contract, if he does not ensure to adhere other party to the commitment.

b) Enforcement guarantee of the buyback contracts

It is for the first time that Iran uses buyback contracts in the oil and gas industry and will observe their quality process during time, so that in new formula of the buyback contracts, there is considered a sanction of risk and reward in the interest of both parties.

Risks associated with contractor

Risks of international oil companies on the buyback contracts include cost risk, risk of delays in completing project, risk of failure to achieve contract manufacturing, risk of falling oil prices.
Price risk

In the buyback contracts, development costs are classified in several main groups:

- capital costs
- operating costs
- bank charges

Risk of falling oil prices

Since the costs and rewards of contractor are repaid through maximum 60% of revenues of the project, risk of falling oil price is one of the contractor risks so that it is not possible to refund rights of the contractor.

The risk of delay in completion of projects

It is one of risks in most projects, especially oil projects. In the first, second and third generation of exploration and development, there has not been considered certain rewards and penalties to accelerate or delay in completion of projects.

The risk of failure to achieve level of contract manufacturing

In the buyback contracts, level of contract manufacturing is determined at the beginning of the contract, based on preliminary data and sometimes, old data. After a period, the contractor may no access to conventional production levels. In this case, the contractor does not receive remuneration of field development.

Risks related to employer

The government risks include risk of lack of preserve production, risk of declining production after delivery the project, cost risk and risk of cost overestimation.

How to resolve disputes

Settlement of disputes in the global oil industry includes the steps of friendly negotiations, conciliation, mediation, arbitration and courts. In the buyback contracts, all subject of possible courts and proceedings is begun from friendly negotiations and in case of disagreement of senior managers with complete awareness on the project problems, it will be referred to a mutually acceptable arbitrator.

Conclusion

As Iran's oil industry has experienced different types of contracts before the Revolution and by considering the given circumstances after the Revolution, it is necessary to conclude service
contracts. The contracts are concluded as “buyback contracts” by considering the development of oil and gas reservoirs due to production fall in oil fields, the importance of recognizing and exploiting shared oil fields and aquifers as primary priorities to provide national interests, gas injection to preserve tanks and gas, by taking into account the necessity of increasing production in accordance with the share of 14% in OPEC, necessity of potential and influential presence of our country in the world oil market and maintain future production in development projects.

Buyback contract has been set due to legal and environmental constraints of the country. Theoretically, this type of contract will eliminate most of concerns of Iranian party; ownership and sovereignty is not transferred to others and Iran government has no obligation to refund the expensed costs by the contractor. Although buyback contracts had considerable merits in their times, but performance review of buyback contracts indicates that there has been only carried out the first generation of development contracts and among third generation of buyback contracts, there has been only transferred one field to the foreign contractor. In the contracts, there has been only 58% of production as compared with the desired program on the most optimistic estimation. In most projects, the considered production has not been achieved or has been quickly dropped after a 21-day trial period. The studies also show non-compliance of production preserve standards in buyback contracts. It seems that due to structural problems in buyback contracts, the foreign contractor has no motivation to preserve and maximum production and in many cases, the contractor seeks to deliver field according to program production contract on the 21-day period to implement reimbursement of his capital and reward.

The most important structural deficiencies of buyback contracts can be briefly summarized as follows:

1. Short duration of the contract and trial period to maintain production at the program level;
2. Lack of proper distribution of risks between the parties;
3. Lack of direct and indirect incentives to use and transfer advanced technology;
4. Lack of proper interaction between the employer and the contractor during performance of the contract;
5. Lack of contract flexibility in oil prices and the related costs;
6. The lack of local opportunities and potentials to use in project;
7. The lack of sufficient incentives to save capital costs and using local capacities against the direct relationship between contractor remuneration and capital expenditure;
8. Lack of adequate supervision of contractor on project and approve comprehensive plan of developing the proposed field by contractor without extensive review of the field

Some features of the buyback contracts has caused resistance of the major oil companies in Iran that its venture is one of them.
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