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Regulation of Upstream and Downstream Oil and Gas Operations

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Map of session

1. Regulation: What? Who? Why?
   - constitutional context: Iraq's regulatory needs
   - "technical" / "physical" and "economic" regulation
2. Principles of regulation
3. Regulatory institutions
4. Regulation in a Federal System
5. Key issues for discussion

Regulation – What is it?

"The government function of controlling or directing those activities of enterprises, state as well as private, that are not subject to adequate disciplining by competitive forces"

- Examples:
  - "technical" or "physical" regulation:
    - controlling depletion of petroleum reservoirs
    - minimizing pollution from petroleum operations
  - "economic" regulation:
    - pricing of monopoly-pipeline services
    - controlling oil exports

Constitutional context: Iraq's regulatory needs

- Iraq's constitution points to the need to regulate resources "owned by the people of Iraq" (article 110):
  - "management of oil and gas…" (article 111-first)
  - in order to "achieve the highest benefit…" (article 111-second)
  - and "ensure protection of the environment" (article 113-third)
  - "internal freedom of movement of goods" (article 24)
  - "foreign trade policy" (article 109-first) and "commercial policy across regional and governorate boundaries" (article 109-third)

Regulation – Who?

- Technical / physical and economic regulation must apply to all actors, including state companies
  - i.e. “self-regulation” doesn’t work
- Government regulation (and policy making) must be separate from
  - industry ownership
  - internal governance of oil & gas firms
- State companies must not have a regulatory role
  - especially not in relation to private sector partners or competitors

Regulation – Why?

A. Objectives of "technical / physical" regulation:

- maximize recovery of petroleum
- deal with disputes regarding reservoirs
- ensure human health and safety
- protect the natural environment

B. Objectives of "economic" regulation:

- ensure that owners of natural monopolies do not abuse dominant positions
- encourage the free working of markets and consequent maximization of resource values

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“Technical” / “physical” regulation – How?

- Example: when oil and gas rights <u>issued</u> (Session 2)
  - receive, assess and rule on applications to carry out all construction and operations, impose requirements
  - receive reports, make inspections, monitor compliance, impose penalties
  - receive complaints, adjudicate between parties

“Technical” / “physical” regulation – How?

Options

- Update existing standards?
- Adapt international ones?
- “Standards-based” (prescriptive) or “goals-based” regulation?
- Or simply “Best Available and Safest Technology” (BAST)?

Probable best outcome: a <u>mix</u> of the above

"Economic" regulation – How?

Natural monopolies

- When application made to build natural monopoly facilities (example: pipelines):
  - set "fair" prices and access terms for their services
- When facilities are in operation:
  - adjust prices and access terms, adjudicate disputes between owners and users

"Economic" regulation – How?

Promoting a free market

- When addressing oil and gas markets:
  - set maximum prices in relation to costs
  - encourage competition between suppliers
  - progressively withdraw market interventions (subsidies, price controls)
  - deal with social issues by income supplements rather than price controls

“Economic” regulation – How?

“Apportionment” – a special case

Example:

OPEC quota is less than technical export capacity: What do you do?

- Considerations:
  1. Technical (e.g. this field rather than that one)
  2. Regional (e.g. impact on regional distribution of revenue)
  3. Rights ownership (state company vs private, domestic vs foreign)
  4. Effects on aggregate revenue flows (i.e. ability to maximizing national revenues)
  5. Fulfillment of existing contracts

Principles of regulation

- Sound engineering and economics
- Transparent processes:
  - the rules are public (regulations, standards)
  - procedures are fair, all parties have a "right to be heard"
  - the decisions are published, with reasons
  - there is an opportunity to appeal decisions
  - but: commercial secrets are protected

Regulatory institutions

- Two basic models:
  - (a) a ministry of petroleum (reporting to politicians)
  - (b) an independent commission or board that makes decisions
    - – within predefined areas of activity
    - – in accordance with explicit policies
    - – with limited control by politicians over decisions in specific cases
- Option (b) is increasingly the norm because
  - – it is administratively convenient
  - – it improves confidence of public and industry

Technical regulation in a federal system

- Options:
  - by federal government (Mexico)
  - by each resource-owning government separately (Australia, Canada, USA)
  - jointly (Canada east coast offshore)
- Considerations:
  - federal / joint regulation economizes scarce human and financial resources, better way to share knowledge
  - separate regulation may be better able to adapt to local circumstances (type of resource, surface rights owners)
- Choice LESS CRITICAL to cohesion of the federal state

Economic regulation in a federal system

- Which level of government can / should regulate:
  - inter- and intra-national trade activity?
  - facilities (pipelines) for such trade that have natural monopoly characteristics?
- Choice is CRITICAL to federal cohesion: need to retain federal authority in order to
  - safeguard the economic union, internal free trade, address natural monopoly
  - pursue and uphold the national interest in international trade, exports and imports

Economic regulation in a federal system

Apportionment in a federal system (a special case again)

- Cannot be achieved through separate regional regulation
- As a minimum, requires joint regulation
- If federally regulated, requires close technical and economic consultation with regions

Key issues for discussion

- Is it *feasible* and *desirable* for Iraq to adopt <u>independent and transparent regulation</u> involving:
  - i) <u>joint</u> management of technical regulation by federal and regional governments?
  - ii) economic regulation by the <u>federal</u> government alone?
- How can and should these issues be addressed in law?