

# **Supreme Petroleum Council, Ministry of Energy and Kuwait Petroleum Corporation: Issues of a trilateral organization**

**By**

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***Good Governance of the national petroleum sector  
workshop 2***

***Sept 21-23 2005 - London***

***A joint Chatham House- CEPMLP project***

# Introduction and Historical notes:

Oil was discovered in Kuwait by the Royal British navy in 1913. A consortium of British Petroleum and Gulf Oil was given the first concession to exploit Kuwait Oil in 1934. Known as **Kuwait Oil Company**, it discovered the first commercial well in Burgan field in 1938. The first shipment of Oil was exported in 1946.

The contribution of oil to the Kuwaiti economy was sudden and substantial. From the outset in 1947 the state oil revenue was 0.4 million Kuwaiti Dinar Equivalent, then 57% of total state income, rendering a surplus of 53% in the books. Three years later, in 1950 the oil revenue reached 4.0 million KD, a tenfold increase, contributing 94% of the total income with a surplus of 69% (1). It is interesting to note that the state after half a century since still receive over 90% of income from oil revenues exceeding 8.0 billion KD with considerable surplus, a situation most similar to the early days.

**Regulation of the oil business was developed** from primitive royalty agreements to profit sharing with tax scheme in 1950,s to total control and nationalization in 1976. The regulatory orders were established early on to protect the petroleum treasure, starting with **law 19/1973** which enabled the state (through the ministry of finance and oil) to inspect the petroleum operators. This was followed soon by the establishment of the **supreme petroleum council** (chaired by the prime minister) in 1974 to draw general petroleum policy.

The **ministry of oil** was separated from the ministry of finance in 1975 and took over all petroleum affairs. The executive state arm was formed last in 1980 to take over all production, manufacturing, distribution and sales of the hydrocarbon industry in the form of **Kuwait Petroleum Corporation**. The various operators were hence consolidated under KPC'S umbrella. We now describe the assigned functions of each entity. This would be entirely a summary from the relevant legal documents (2).

# The Supreme Petroleum Council:

SPC is the highest policy body for the hydrocarbon wealth in Kuwait. More specifically, it has supervisory authority upon Kuwait Petroleum Corporation (KPC) as regards:

1. Approval of general policy.
2. Approval of changing capital.
3. Approval of administrative and financial bylaws.
4. Establishment of personnel system.
5. Regulation of purchase contracts.
6. Approval of company establishments, takeover, merger and dissolution.
7. Discussion and endorsement of annual report, financial results, budget, and profit allocation.
8. Appointment of auditors.

# Ministry of Oil (Energy):

1. Suggest the general policy of the oil sector and follow its implementation.
2. Supervise operating units in oil and gas sector and assuming the state's interest in it.
3. Assist SPC and supervise execution of its decrees.
4. Cooperate with government and non-government entities in oil and gas issues.
5. Perform geological studies and supervise exploration for mineral resources.
6. Represent the state in international oil related affairs.

# Kuwait Petroleum Corporation:

Assumes all hydrocarbon related industrial operations in Kuwait and abroad including exploration, production, storage, refining, petrochemicals, transportation, services, R&D and Sales. More specifically:

1. Establishing, purchasing, merger of companies alone or in partnership.
2. Financial operations including loaning, borrowing, bond issuing, real estate ownership etc.
3. Development of national expertise in oil and gas sector.

# The Implementation Process

## A- Policy Function: SPC Role

If a comprehensive strategy was a major output of policy making, then it is fair to notice its absence till 2003 (3). The SPC was certainly active, considering the tremendous responsibilities mentioned above. However, it was not until after the 1990 Gulf war that major issues were raised. Among them:

- Lack of operative performance.
- Decline in international demand for Oil and hence state revenue.
- Pressure from law- makers regarding financial scandals and pollution.
- Revived interest in privatization/IOC participation.

The SPC had no permanent subcommittees to address the major issues consistently. A suggestion was presented in 1993 to form technical committees. In 1998 a committee was formed, and was chaired by the minister of oil. In 2000 that committee was replaced by three: strategy, technical and financial. Since then, major initiatives were completed including **performance evaluation, 2020 strategic directives, restructuring and commercialization**

**Participation of the private sector** in major initiatives started early in 1992 with Equate Petrochemical Company, but didn't pick up momentum till after 2000. The major initiatives that were realized were the gasoline stations sale, the aromatics project, the Olefin project, the calcined coke plant and the chlorine plant sale. Several factors contributed to this success but most notably the maturity of the leadership, stability of oil minister's position and private sector involvement. Comprehensive privatization is still

Limited but plans are underway.

## **B- Regulatory function: The Ministry**

The ministry of oil had a major role in the seventies when it had direct contact with the operators both international and national. This role however suffered a setback since the nationalization of the operators and incorporation of KPC. The law 19/1973 concerning petroleum resource custody was implemented since 1975 through the initiation of its bylaws (minister decree 72/1975) and the establishment of the Petroleum Resource Custody Council (minister decree 73/1975).

# The Problems:

Immediately after KOC nationalization (law 10/1976) its chairman started disputing the validity of law 19/1973 on the grounds that it was intended for foreign and/or private operators (letter dated Oct 1976). Three years later, the oil minister responded by emphasizing compliance (letter dated Nov. 1979)!

The bylaws were revised in 1989 (decree 43/1989) to account for technological advances. The implementation still limited by lack of conviction and enforcement. In October 2002 the KPC executive president sent a letter to the ministry of oil in defiance of the validity of the law 19/1973. The undersecretary of oil replied in November 2002 emphasizing compliance. Both letters carried the same essential arguments that were exchanged in 1976/1979!

Other functions of the ministry have had better degree of acceptance. Those include financial audits, information services, government co-operation and international affairs. The ministry maintains that the later two requires more enforcement.

## **C- Operator's Role: KPC**

Kuwait Petroleum Corporation enjoyed vast monopoly and authority. All government shares in the nationalized companies were incorporated. No other entity has the right to perform any petroleum or petrochemical related activity but KPC. Fledgling chemical companies depended on the support of KPC for raw material and utilities. Several leading professionals moved from the operating companies and the ministry of oil to KPC.

KPC was especially prudent in acquiring handsome international assets. Although criticized as high cost acquisitions, outfits like Santa Fe drilling, Hoechst chemicals turned out to be profitable investments. Last year KPC sale of its share in Aventis and Celanese reaped tremendous cash profits for KPC. The strategic directives of SPC allowed KPC to retain its revenue from Aventis sale (KD 2.2 Billion) in a rather bold and unprecedented move. This would allow KPC to fund the proceeds for much needed future projects.

# A Snap shot on KPC financial audited results (in million KD), (4)

	<b>1989</b>	<b>1999</b>	<b>2005</b>
<b>Assets</b>	<b>6738</b>	<b>8366</b>	<b>13614</b>
<b>Net worth</b>	<b>4345</b>	<b>6557</b>	<b>9482</b>
<b>Revenue</b>	<b>3741</b>	<b>4374</b>	<b>13704</b>
<b>Net Profit</b>	<b>211</b>	<b>575</b>	<b>3775</b>

The rosy picture of revenue and asset growth shows undisputed operative and financial achievement for the Kuwaiti oils sector at large. However, this abstraction does not reveal chronic problems at KPC: lack of investment and project delays. One painful consequence of this problem was escalation of major accidents, notably Shuaiba refinery explosion (June 2000), Mina Al-Ahmadi explosion (June 2000), and GC-15 explosion and fire (January 2002). The investigations that followed revealed several logistics, administrative, and safety problems. This encouraged KPC to commence a major review on its operative procedure, increased training intensity and introduce massive HSE campaign. This was followed later by comprehensive shuffling of top positions, although this was interpreted as a strategic move from the oil minister to inject new leadership rather than direct reaction to the accidents.

## **Relationship among the three entities:**

It is informative to notice that the ministry of oil was the sole player in the oil sector during the 60's and early 70's. It was by design diluted by former minister of oil (and finance) to provide sophisticated governance of the massive oil sector and its revenue (5). The establishment of SPC and KPC were meant to split the governance roles of policy, operation and regulation. Although these roles have authoritative laws, the environment for implementation has varied over time.

Period	1961-1980	1980-1998	post 1998
Leadership	Ministry	KPC	Shared
Regulation	Active	Relaxed	Active
Expansion	Major	limited	major
Policy	Nationalize	Consolidate	Commercialize

## **Commercialization has taken two fronts, Private Equity Sharing and Restructuring**

### **Activities of private equity sharing (including international participation) and year incorporated:**

- Equate Petrochemicals Project 1993
- Olefin Complex 2004
- Aromatics Complex 2004
- Al-Oula Fuel Inc (Gasoline distribution) 2004
- Kuwait Oil Tankers Co pending
- Kuwait Foreign Exploration pending

# Activities of Restructuring type:

- Kuwait Gulf Oil Company  
2002
- Kuwait Oil Development Company 2005
- Kuwait Oil Services Company 2005
- Reformed tendering procedures  
2005
- Reformed financial bylaws 2005
- Reformed Accounting protocol  
expected 2006

# **Regulator function revisited: the Case study**

Among the functions of ministry of Energy, it was the supervisory-audit activities that were the most disputed. In what follows we describe briefly who this issue was handled by the Supreme Petroleum Council for the purpose of reaching a working resolution.

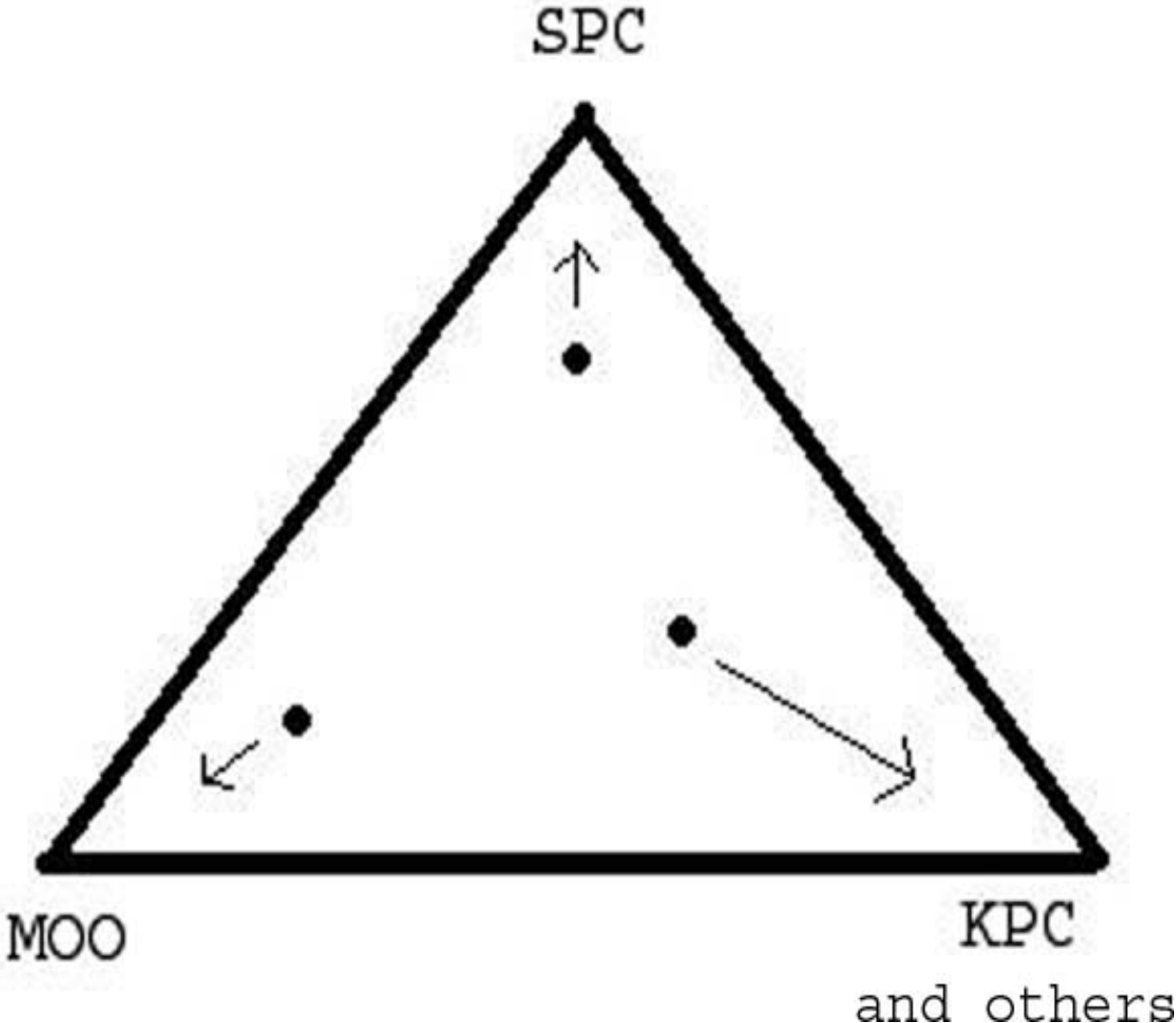
## **The MOO resurrection:**

The ministry of oil in its new leadership decided to start a new strategy in order to activate its regulatory function. The strategy was adopted in 2001 and its action plan approved in August 2002. In order to activate the plan the MOO sought co-operation of KPC. It did not come.

## **The SPC Leadership:**

SPC was made aware of the problem and decided that the MOO plan should be reviewed. The strategy committee held five meetings to try to pick up the pieces. The parties were advised that this exercise should be kept away from the press to ensure calmness and integrity. The positions in the beginning were far apart. KPC maintained that law 19/1973 has expired by its establishment. MOO maintained that the law is applicable and demanded full implementation.

# Oil Sector Governance, Current and Desired



# The Analysis and Resolution:

The committee decided that this is a technical matter and sought help of a prominent lawyer who is also a member of SPC. A. Al-Haroun (6) produced his analysis and presented it in front of the committee. The analysis was clear and simple. The Law 19/1973 is applicable but its bylaws are not workable. Modification of the bylaws to maintain KPC independence was required. The committee and SPC adopted a win-win resolution and charged the minister with implementation responsibility (7). One key item was to dilute the MOO authority in operational permits, while maintaining its audit responsibilities.

# The Implementation:

The ministry moved forward and hired a consulting firm to draft new bylaws. The firm (I H S Energy) produced a draft in March 2005 (8). The minister of Energy issued a decree (9) to redefine the role of the ministry. The decree held the major SPC resolution of July 2003, focused MOO's responsibilities and prepared it for the forthcoming role on privatized operations.

# The Views (KPC)

In order to get a feel of potential success, I held interviews with both sides. Hani Hussein, KPC executive president had this view (10):

1. The oil sector is subject to multiple audit requirements. The parliament, the audit bureau, the Public Authority for the Environmental Protection, the ministry of finance, the central tender committee, SPC and the MOO all have audit role. Additional audit requirements would delay the already slow decision making and plan implementation.
2. The oil sector should focus on developing the industry and manpower not to add bureaucracy.
3. The proposed bylaws are under review by KPC and should be endorsed in the spirit of flexibility.
4. The ministry should focus on newly privatized operations were its role is vital. Downstream industry, especially petrochemicals has distinctive features and need not be regulated by the MOO.

# The View of MOO:

Mr. Eissa Al-Own, deputy Energy Minister for Oil has the following views (11):

1. The regulator role is essential for integrity of the oil sector. The commitment from both the minister and the SPC towards the MOO's role is encouraging.
2. The MOO's role is clearly identified by the law and relevant minister's decrees.
3. The proposed bylaws are compatible with international best practice, coupled with an Integrated System for Supervision and Audit (ISSA).
4. The MOO is reorganizing its internal structure to match the proposed functions and system.

# A Consultant View, The World Bank (12):

The author obtained these comments during a private presentation on 12th September 2005.

1. Governance in Kuwait is less clear cut as of which entity performs policy, regulation and operation.
2. KPC is primarily an operator but fills gaps in regulation.
3. Some operational decisions are constrained through detailed regulation.
4. The ministry should consider establishment of autonomous regulatory body like Norway Petroleum Directorate (NPD).
5. Regulatory/policy function should include **economic, HSE, and consumer protection**.
6. In fuel stations for example, the regulator should monitor and enforce prices, margins, service standards and HSE standards.

# Author's Comments:

1. The Oil sector in Kuwait has started to appropriate the role of each of its constituencies for the first time since KPC establishment.
2. The leaders of all authorities have shown equal interest in co-operative relationship among all agencies.
3. The legal framework is sufficient to protect all parties in their pursuit towards implementing regulatory requirements.
4. The regulatory framework and systems proposed by the MOO needs to be thoroughly understood and evaluated by KPC before implementation.
5. The ministry should consider situations and or operators were regulatory function or part of it may be better performed by other agencies.

# Potential Black Holes:

**We list here situations that need to be avoided at any cost:**

1. The oil sector may be tempted to use different regulatory rules and or systems leading to different rules for operators in competition: *a constitutional and legal suicide.*
2. The oil sector may restructure the MOO leaving duplicate or vacant functions in KPC and or its subsidiaries: *an operational suicide.*
3. The oil sector may regulate the operators in such away that interrupt or delay approved operational plans, causing operators to through the towel at the regulator: *system failure.*

# Conclusions:

1. The governance of the Kuwaiti oil sector has seen increasing balancing of power among SPC, KPC and MOO.
2. Major hurdles of good governance have been overcome.
3. The major constituents: KPC and MOO are being restructured towards better alignment with their future direction.
4. Close co-ordination among all parties is needed to realize the benefits of the new strategy.
5. Major challenges are still to be addressed in terms of commercialization and privatization before success can be claimed.

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