Special Report: Iran leaps into South Pars

As Iran undertakes the unilateral development of the largest gas field in the world, observers wait to see if the project will be a success against tremendous odds or mission impossible. Mohammad Sadegh Amini, Special Correspondent

In a year named by Iran’s Supreme Leader “Year of Double Effort and Double Work,” Iranians see a dramatic change in their oil and gas industry. Analysts and experts within Iran unanimously consider this to be the most significant event in the country’s 102-year oil and gas industry history. The reason is that Iranian authorities have decided to complete the projects that make up South Pars in the absence of international companies such as Total, Eni, Shell, Statoil and others.

There are many reasons why Iran’s decision to develop these projects in the largest gas field in the world has been the center of international attention. One reason is that the decision of Iranian authorities to sign US $21 billion in contracts with companies inside Iranian came just one week after the fourth United Nations Security Council approved additional sanctions against Iran. The sanctions are meant to punish Iran for what the Security Council has deemed questionable nuclear activities. Clearly, Iran’s decision to issue the contracts clearly was politically motivated.

Iranians have put on the agenda the simultaneous development of 19 projects in South Pars. Iran has decided to launch six new projects, while developing 13 mega projects currently under way. The goal is to complete the work in 35 months, finishing in mid-May 2013. Meeting this goal will require an unprecedented commitment of domestic expertise, experience, and financial resources.
Iran and Qatar are independently developing the largest gas field in the world. In Qatar, it is called the North Field. Iranians call the field South Pars.

**Mission impossible?**

Although Iranian managers, experts, and workers are pleased with the decision to pursue these multibillion-dollar projects with domestic companies, experts have fallen into two distinct camps in their reaction to this ambitious plan.

The first group believes completing these projects in 35 months is impossible. They consider the decision to be a political statement by President Ahmadinejad that is not based on technical capability, in part because the deadline for completing the projects is exactly the amount of time remaining in his term as president.

This group of experts bases its argument on the fact that completing two phases of the North Dome development in Qatar in 63 months by major international companies (without challenges such as financing or sanctions) is regarded as a record. The record for the fastest project completion in development of phases 4 and 5 of the South Pars project in Iran is 68 months. The record was set by Italy’s Eni, which had the support of international banks in the form of buyback. The six new projects that are part of the Iranian government’s plan have no support from foreign banks. Pars Oil and Gas Co. (POGC), operator of the South Pars Projects, is to finance the projects through internal resources and the selling of shares in South Pars.

The issue of timely financing is a great concern, but it is not the only obstacle. Tightened sanctions in reaction to perceived nuclear and missile activities of Iran have created problems for Iranian companies trying to transfer money, open letters of credit and exchange foreign currencies.

Another reason this group of experts gives for the unlikely completion of this project is that the companies that have signed contracts for the South Pars work (Petropars, IDRO, Sadra, and Khatamolanbia) are the same companies that have many half-completed projects in progress.
Their executive teams, management expertise, and human resources will be needed for several years to complete South Pars phases 12, 15, 16, 17, and 18. Six years after signing the initial contracts, these companies have progressed only halfway to completion and continue to face challenges in management capacity, planning, and maintaining a supply network.

Experts in this group question the ability of the contracted companies to develop new phases 13, 14, 19, 22, 23, and 24 of South Pars. They predict effective completion would take at least 70 months at best without limitations. Realistically, the group says, thoughtful planning and good management could allow the offshore projects to be completed within the specified timeframe, but the onshore component will require considerably more time.

**Tightening the snare**

The skeptics also are evaluating the effect of tightening international sanctions, which led to the recent withdrawal of Khatamolanbia Construction Quarters (the biggest trading company of Iranian Revolutionary Guards Corps) from phases 15 and 16. In an official announcement in 3Q 2010, the company and its affiliates abandoned operations in the $2 billion consortium of phases 15 and 16 because of what they called “possible endangering of the national interests.” In the announcement, which received extensive media coverage in Iran, the company gave no reason for “possible endangering of the national interests” except the issue of sanctions.

According to experts, this statement indicates tightening sanctions can prevent even a large and powerful company from completing its projects. That said, company officials repeatedly claimed the sanctions were ineffective and the absence of foreign contractors and international companies would not limit the ability to complete the South Pars projects.

Following the company’s announcement, however, Iran’s oil ministry (through its website) stressed that development phases 15 and 16 would not encounter difficulties. Experts analyzing the difficulties of circumventing the sanctions and the challenges of purchasing goods from foreign manufacturers that refrain from selling certain sensitive items such as wellhead or drilling equipment, believe the Pars Oil and Gas Co. (POGC) which has replaced Khatamolanbia, will face many challenges in providing equipment needed to complete phases 15 and 16.

This challenge is critical because 60% to 65% of the costs incurred in each project go to equipment purchase. Although domestic manufacturers are capable of manufacturing most of the required equipment and goods inside Iran, critics believe Iranian manufacturers are unable to build high-tech equipment and that some of the basic equipment will take more time and cost more money than acquiring equipment abroad.

**Everything is possible**

Those who believe accomplishing the country’s objectives in South Pars is unlikely provide many reasons for seeing the project as impossible, but a second group is more optimistic. This group believes the challenges and hurdles will not prevent Iran from completing six mega-projects in 35 months. They acknowledge that Iran was not able to carry out South Pars projects in the past without foreign participation, but they believe today domestic companies can manage the South Pars projects by applying the experience and knowledge they have gained in the
 offshore industry over the past two decades.

At the contract signing ceremony for the remaining phases of South Pars projects in Asalouye on June 15, 2010, Iranian President Ahmadinejad said: “Today is the most glorious day in Iran because one of the biggest wishes of our nation has come true. Ten years ago, if we had talked about implementing South Pars projects by Iranian specialists and internal resources it would have seemed unbelievable, but today our specialists with courage and high self-reliance took this responsibility, and this should turn into a principle for building Iran.

Ahmadinejad rejected the viewpoint that implementing the projects using only Iranian contractors would be impossible. “Any nation seeking independence, advance, freedom, and glory should know that the way to realize these ideals is self-confidence, self-reliance, and resistance,” he said.

“What happened in Asalouye on June 15 is a starting point for a new era in the country’s oil industry,” Ahmadinejad said. “The present fund management must be changed, and I hope we won’t need some mean human beings any longer to finance our projects in the future. We all must build Iran together by means of thoughtfulness, expertise, and Iranian resources, and this is possible. Today’s contracts showed that the Iranian nation can do it. Today is a big day. I want you to pay attention to different aspects of today because this is just a start.”

Dr. Ali Vakili, managing director of POGC, has repeatedly supported the president’s remarks about the ability of Iranian companies and contractors to develop remaining South Pars phases in due time. “Today, exploiting the South Pars gas field does not require any equipment or products that cannot be domestically manufactured,” he said. “The kind of technology needed for development and exploitation of these phases is now 100% available in Iran. The same technology used for developing the first phase of the gas field can also be used for the last phase because there is no change in the reservoir tank.”

The Iranian government signed contracts with domestic companies to develop the South Pars field at a signing ceremony in Asalouye, Iran, on June 15, 2010. (Photo courtesy of Shana/Mohammad Ghadamali)

Iranian contractors have decided to develop new phases by copying the engineering and designing documents of the old phases, a practice that some think will results in a savings of an entire year in the document preparation process.

Supporters of the national plan believe Iranian contractors have gained a unique opportunity to seriously test their abilities to develop South Pars projects despite increased costs brought about by sanctions and the resulting withdrawal of major oil companies like Total, Eni, and Shell.
This perspective is significant because in the past Iranian companies have encountered two recurring obstacles: First, the authorities distrust their abilities regarding major international companies. Second, Iranian companies faced myriad problems working inside Iran.

Regardless of some problems with domestic equipment production, these experts think Iranian companies have been able to gain most of the technologies needed and that they can manufacture the required equipment.

Defending their views, this group of experts points out that in partnership with Total, Eni, or Statoil in the past, the share of Iranian companies was about 32%. This share is going to increase from 32% to 60%. According to these experts, since equipment capex accounts for 60% to 65% of project expenditure, improving the capabilities of local manufacturers can lead to the inflow of huge sums of money that can be spent implementing the different phases of South Pars gas field.

The contract signed between POGC and domestic contractors adds up to $4.5 billion in development costs for the two phases. For each billion dollars spent, about $600 million will go toward equipment. This means that in the 35 months that it will take to complete the project, $2.7 billion is needed. According to these calculations, this group of experts says, in less than three months, Iran will need to purchase products and equipment worth approximately $10 billion, and injecting this huge amount of money into small and large Iranian businesses will advance them considerably. In addition, these companies will have the chance for the first time to produce equipment without financial concerns.

In an interview with the state-owned newspaper, Vakili stressed that the absence of big foreign banks in the process of financing new projects creates no problem for Iran’s oil and gas industries.

Three solutions have been provided to permit the new projects that are under way in South Pars to be financed: a specific budget from oil revenues, selling securities, and establishing internal financial syndicates.

In the first solution, Iran’s parliament, the Majles, has allocated 40% of the development resources of the National Iranian Oil Co. to the development of South Pars in this year’s budget. Given the current price of oil, the POGC share has been estimated at about $4 billion. Furthermore, the Central Bank of Iran (CBI) has authorized the issuance of 3 billion euros worth of participation bonds and an additional 3 trillion rials of bonds for South Pars development. The third solution suggests that obtaining credit through energy funds would help to finance oil projects by CBI. Vakili has predicted $13 billion will be absorbed from bonds selling and other resources this year based on an understanding among the Iranian government, Parliament, and the Central Bank.

Supporters think if everything goes according to plan, it will be possible to execute new development projects in 35 months, but that the final development will require an additional five months for completion.
This position is reflected in the POGC documents. Operator POGC states 35 months will be necessary for primary development and 40 months for the final component.

Iran Oil Minister Seyyed Masoud Mir Kazemi is among the optimists. “In the Islamic Republic of Iran, everything is possible,” he said.

In an interview with Iranian state TV he added, “Although developing projects in 35 months is difficult, if things are done in parallel and not consecutively, achieving our goals will be possible.” He stipulated that the deadline set was based on standards and project control criteria, not on previous projects. Before setting this deadline, the Minister said, many meetings were held especially in the oil industry working group with the domestic contractors and every single issue scrutinized. Also a lot of research has been conducted into this matter.

**The road ahead**

Although Iran faces many challenges, the country is economically, socially, and politically motivated to secure the South Pars resources through the execution of this project. According to the special representatives of the president in the “Oil Working Group,” any Iranian company that fails to complete the projects on time will face a $50 million penalty for each month of delay. If a company should finish early, it will be rewarded with the same amount.

Interestingly, gas production from South Pars in past years has made up more than 63% of Iran’s domestic energy use, which has kept oil consumption in the country down. In other words, the fact that Iran uses the gas from South Pars means that a big share of its produced oil can be exported to generate revenue. Based on its intent to use the huge resources of South Pars domestically, Iran launched an extensive gas supply network that delivers gas for energy use. Access to each square meter of natural gas saves one liter of liquid fuel.

Iran has launched six new projects on the South Pars Field, while continuing work on the 13 mega projects currently under way. The goal is to complete the work in 35 months, with a scheduled date of completion in mid-May 2013. Meeting this goal will require an unprecedented commitment of domestic expertise, experience, and financial resources. (Image courtesy of Mohammad Sadegh Amini)
South Pars, in addition to giving Iran a presence in various international energy markets, has enhanced the country’s competitiveness in the oil and gas sectors.

**Benefits of success**
Statistically, Iran’s share of South Pars amounts to $5 trillion if everything goes according to plan. Iran’s revenue from this gas field will top the country’s income from oil. It is important to note, however, that any delay in exploiting these common reserves results an advantage to Qatar and a decreased share for Iran.

What is happening in South Pars can be regarded as a double sweet deal. Boosting Iranian contractors and domestic capabilities is one plus. Increasing the Iranian share of this commonly held field is another. An additional point in Iran’s favor is that the successful execution of this project could place Iranian companies on a more equal footing with international contractors that have chosen to absent themselves form in Iran’s oil and gas projects. If Iran is successful, the country can be much more competitive against foreign oil and gas giants. As the Oil Minister said, “Since the conclusion of contracts with Iranian companies, the presence of foreign ones is impossible, and now they must negotiate and cooperate with domestic contractors if they still want to take part.”

Even those who believe the projects cannot be done on time are pleased with Iran’s willingness to take charge of developing its natural resources because even if operations take more than five years, the success of Iranian companies to develop this project under the pressure of sanctions and without the participation of foreign giants will be a great achievement.

With the successful completion of some of this work under their belts, some of the Iranian companies could become serious rivals for international contractors, and by offering lower prices could take a larger stake in regions like the Middle East, Africa, and Latin America.

Only time will tell if Iran will be able to realize its dream of $100 billion in revenue from South Pars and the equalization of its share of this commonly held field. In the coming months, the world will discover whether the Iranian oil industry can survive under these strict sanctions and still manage to execute a world-class project.

In less than 1,000 days, it will become apparent whether President Ahmadinejad’s goal will be achieved and whether Iran’s oil minister’s belief that the Islamic republic of Iran always makes the impossible possible turns out to be true.

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