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Deep-Water Knowledge Will Be Key to Saudi Aramco’s Red Sea Play

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The fast tracking of the **Kingdom of Saudi Arabia’s** (KSA) first **major offshore natural gas fields** in the Red Sea heralds the start of a massive n**ew energy programme** for the Kingdom, which will ultimately create new commercial opportunities for service companies with **deep-water experience**.

State oil company Saudi Aramco has announced $25 billion of capital expenditure to develop oil and gas reserves lying in deep water in the Red Sea, following the discovery of the Ahmar-1 field of non-associated gas approximately 24 kilometres north-west of Duba in the Tabuk Province on the west coast of the Kingdom.

A major gas processing facility and a large power plant are scheduled for construction in Duba, which will become the apex of a pipeline network to carry gas south to industrial cities along the Red Sea coast.

Deep-water oil and gas production means that companies with extensive operations in Europe's North Sea and the Gulf of Mexico should be well positioned to secure work when future tenders are released, but establishing the right in-country presence will be key to the process.

Hugh Fraser, Managing Partner of Andrews Kurth’s Dubai office, said: “The impact of developing oil and gas assets in the Red Sea will be massive if full-scale production goes ahead. Red Sea oil and gas reserves could add 100 billion barrels of oil equivalent (boe) – or 38% – to the 267 billion boe of proven reserves currently declared by Saudi Aramco.

A significant part of the crude oil currently burnt in Saudi Arabia goes to feed power supply and petrochemical industries that could use much cheaper natural gas if available in sustainable quantities, so there is a clear commercial imperative for Saudi Aramco to pursue these deep-water opportunities.”

Since the liberalisation of the foreign investment laws in KSA in 2000, the limited liability company (LLC) has become the accepted vehicle for foreign companies wishing to do business in the Kingdom where the Saudi Arabian General Investment Authority (SAGIA) licenses all foreign investment. Foreign investors may wholly own approved foreign investments or a foreign investor and a Saudi national may jointly own them.

“The LLC is generally considered the most appropriate corporate form available to foreign companies and is the one that most opt for when seeking to conduct business in Saudi Arabia,” explained Kerry Calvert.

Since 2001, foreign companies who wish to operate in the country without a Saudi partner can open offices and appoint representatives in order to pursue business with various government departments directly.

“Although a local partner is no longer mandatory, the Saudi Government strongly favours companies with extensive Saudi participation or investment. Some contracts will require a minimum amount of subcontracting with Saudi companies. The government may favour companies of which a majority is Saudi-owned and companies which use Saudi-manufactured goods and services. A foreign company will generally improve its position by aligning itself closely with Saudi interests, through joint ventures or otherwise, when bidding for a government contract,” said Kerry Calvert.

The most critical issue for a foreign investor is the ability to obtain the appropriate form of license from SAGIA to enable the LLC to conduct business in KSA. Recent experience has shown that it has become more difficult to satisfy the criteria imposed by SAGIA, and SAGIA will rigidly apply the criteria for grant of any particular category of license. The most common license types for energy-focused LLCs are the service license, industrial license and trade license.

A service license will permit the LLC to obtain and execute contracts for the provision of services but does not permit the LLC to engage in the manufacture or sales of products. SAGIA has recently introduced some fairly onerous conditions to the grant of a service license, including what is effectively a 2% performance bond – backed by an unconditional and irrevocable bank letter of guarantee – in favour of SAGIA as a deterrent against foreign companies leaving the country prematurely with unfilled contract commitments. The 2% will be calculated on the anticipated/projected KSA sales revenues of the LLC and will be reviewed and (if necessary) increased annually.

An industrial license will permit the LLC to locally manufacture products, sell them into the local market and to export products. The industrial license will not permit the provision of services. Certain criteria will be required for granting of an industrial license, in particular that the licensee has a factory in KSA for the purposes of manufacturing its products.

A trade license will allow the LLC to import its products (and other products) and to sell them in the KSA market. The terms of the trade license will not permit the LLC to manufacture equipment. Overriding policy decisions will come into play in the application for a trade license, whereby SAGIA may wish to encourage local manufacturing and will generally look more favourably on an application to manufacture, particularly in the context of job creation and capital investment in the local economy.

Kerry Calvert said: “When it comes to the licensing of the LLC, an application to SAGIA will generally be strengthened by placing as much focus as possible on the in-country value to be achieved as a result of the foreign party’s investment. Particular emphasis should be placed on local manufacturing, employment of Saudi nationals and capital investment.”

Saudi Arabia’s energy industry has $1.1 trillion of projects underway or planned, according to MEED, and the country’s market is therefore one that few service companies can afford to ignore. Enhanced oil recovery, unconventional gas, heavy oil, refining and petrochemicals, renewables and potential deep-water activity are some of the areas where major new opportunities are arising within the country.

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