

OIL AND GAS | SEPTEMBER 2016

Oil and Gas in the Kingdom of Saudi Arabia — An Overview

Sector Profile

The Basic Law of Saudi Arabia (Royal Decree No. A/90 dated 27/8/1412 H (1 March 1992)) vests all of the Kingdom of Saudi Arabia's oil and gas wealth in the Government. The Ministry of Energy, Industry and Mineral Resources ("**MEIM**") (previously the Ministry of Petroleum and Mineral Resources) develops and implements policies relating to oil and gas and represents the Kingdom's oil production and pricing policies internationally. In May 2016, the Kingdom announced reorganisations of the oil and gas sector, including the replacement of oil minister Ali Al-Naimi, who had served in that position since 1995, with Khaled Al-Falih, chairman of Saudi Arabian Oil Company ("**Saudi Aramco**"), the Kingdom's national oil company.

The oil and gas sector is, by a significant margin, the most important contributor to the Kingdom's economy, which traditionally runs a significant annual current account surplus, as well as a major source of the country's global financial and political influence. The Kingdom has some 265 billion barrels of proven and recoverable oil, accounting for up to a quarter of global oil reserves, and up to 258 trillion cubic feet of natural gas, the fourth-largest reserves in the world.

Oil Price Crash

In 2014, the world saw a stunning fall in oil prices from a peak of US\$115 per barrel (Brent) in June 2014 to under US\$35 at the end of February 2016. OPEC's Annual Statistical Bulletin reported that petroleum export revenues for OPEC Countries fell in 2015 to US\$518.2 billion, a drop of nearly 46% compared with 2014 and the lowest level since 2005. Total OPEC crude-oil exports, meanwhile, stood at 23.6 million barrels a day in 2015, up 1.7% from 2014, with nearly 62% of OPEC's oil exported to the Asia Pacific region. World oil demand rose by 1.7% to 93 million barrels a day, with the largest increases taking place in Asia Pacific countries such as India and China.

During the OPEC Conference in Vienna in June 2015, proposals were made to curb oil production in reaction to the tumbling price by reducing the aggregate 30 mb/d ceiling. The Kingdom played a key role in OPEC's ultimate decision to block any such production cuts by arguing that OPEC must seek to protect its market share from US shale oil producers. The Kingdom's then-current oil minister, Ali Al-Naimi, was emphatic in his support of maintaining high production levels, stating, "demand is going to increase anyway ... nothing has been curtailed. We have a responsibility to maintain our 12.5 million-barrels-a-day capacity." The Conference noted that the global economic recovery had stabilised, albeit with growth at moderate levels, and that the sharp decline in oil prices witnessed at the end of 2014 and the start of 2015—caused by oversupply and speculation—had abated, with prices moving slightly higher in the months leading up to the Conference. The Conference noted that world oil demand is forecasted to increase in the second half of 2015 and in 2016, with growth driven by non-OECD countries.

The Kingdom maintained its stance on production with crude oil exports from the Kingdom during the first half of 2016, with supply 3.5% higher than during the same period in 2015. The Kingdom exported 61% of its crude oil

to Asia in 2015. This figure has risen to 65% in 2016. The International Monetary Fund expects that the Kingdom's oil production will average 10.34 MMbpd in 2017, as compared to 10.22 MMbpd in 2016.

However, the expectation of a further rise in crude oil production from the Kingdom will likely have a negative impact on already struggling crude oil prices. As at the time of writing, the Brent crude price is moving within a tight range surrounding US\$50.

Impact of Saudi Vision 2030

It is against the backdrop of reduced oil prices and the correspondingly reduced oil revenues, upon which the Kingdom has been historically so dependent, that the Kingdom's "Saudi Vision 2030", which seeks to diversify the economy away from reliance on hydrocarbons, is driving significant structural changes to the governance of the oil and gas sector. Saudi Vision 2030 aims to address the impact that these reduced oil revenues are having on the Kingdom's economy by:

- seeking new sources of revenues to replace the lost oil revenues, which is why the Government is aiming to see the Kingdom's non-oil revenue increase from SAR163 billion to SAR1 trillion by 2030; and
- reducing Government expenditure, through down-sizing the Government and the public sector, privatising government enterprises and promoting private sector investment (both domestic and foreign) in areas like social infrastructure.

The Government also plans to list up to 5% of Saudi Aramco's shares with foreign investors invited to participate in the listing. The proceeds of the Saudi Aramco listing will go to Public Investment Fund, a sovereign wealth fund that will also hold the government's remaining portion of Saudi Aramco's shares.

Refineries and Petrochemicals Projects

The Kingdom's refining and petrochemical sector has registered a strong double digit growth year-on-year since 2007. Ten percent of global petrochemical export products have been manufactured in Jubail and Yanbu on the Kingdom's east coast. These dedicated industrial cities are the centre of the Kingdom's petrochemical industry and play a key part in the Kingdom's determination to develop its hydrocarbon-based industries further down the value chain. Despite the global economic downturn, we understand that the Kingdom plans to expand its petrochemical industry three-fold over the next 10 years to build new plants, expand existing ones and integrate refineries with new or existing petrochemical units. Saudi Aramco (which is described further below) or SABIC (to a lesser extent) are always participants in new refineries or petrochemicals projects in the Kingdom.

Saudi Aramco

While functionally independent from MEIM, Saudi Aramco is directly overseen by the highest levels of Government and its board comprises the Ministers of Energy, Industry & Mineral Resources, Finance and Communications together with the secretary of the Supreme Council of Saudi Aramco, the rector of King Fahd University of Petroleum and Minerals, three overseas representatives and Saudi Aramco's new president and CEO, Amin Nasser.

Saudi Aramco is responsible for all exploration, drilling and production activities in the Kingdom. International oil companies operate through joint ventures with Saudi Aramco in Saudi oil fields and refineries.

Examples of Saudi Aramco's recent major projects include:

- **Petro Rabigh** - the largest integrated refining and petrochemical complex in the world. It is a joint venture between Saudi Aramco and Japan's Sumitomo Chemical.¹
- **Saudi Aramco Mobil Refinery Co. Ltd.** - a joint venture between Saudi Aramco and Mobil Yanbu Refining Company Inc., which processes approximately 400,000 barrels of Saudi Aramco's crude oil per day.
- **Saudi Aramco Total Refining and Petrochemical Co.** - a joint venture between Saudi Aramco and France's Total Oil Co. for 400,000 bpd refinery with integrated petrochemical production at Jubail.
- **Sadara Chemical Company ("Sadara")** - a US\$20 billion joint venture between Saudi Aramco and The Dow Chemical Company, which is the world's largest chemical complex ever built in a single phase, with 26 integrated world-scale manufacturing plants that produce more than three million tons of products every year.²

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¹ Shearman & Sterling LLP has advised Rabigh Arabian Water and Electricity Company in connection with the IWSPP being developed for the Petro Rabigh project.

² Shearman & Sterling LLP advised The Dow Chemical Company on all aspects of the Sadara project. Shearman & Sterling LLP (or its lawyers) has also worked on a number of other significant projects in the Kingdom's oil and gas sector, including National Petrochemicals Company's 400,000 tpa polypropylene and propylene manufacturing complex in Madinat Yanbu Al-Sinayah, SABIC's US\$5 billion Yansab Petrochemicals Project, Basell and Sahara Petrochemical Company's propane dehydrogenation and polypropylene plant at Jubail and the Shoaiba Fuel Oil Terminal Project.