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SUBJECT: HUNT OIL SIGNS AGREEMENT WITH KRG UNDER KRG OIL LAW

SUMMARY

¶1. (SBU) The Kurdistan Regional Government (KRG) recently signed a production sharing contract (PSC) with Hunt Oil Company that covers oil exploration and production in "the Dohuk area." Comments by Hunt officials indicate that the block is actually in the Ninewa Governorate's northern administrative districts. The PSC marks the first oil deal signed by the KRG, following enactment of the Kurdistan Region's hydrocarbons law on August 6, 2007. Considerable legal ambiguity surrounds the PSC with Hunt Oil, as the districts in northern Ninewa to be explored by the company are classified as "disputed territories" under the Iraqi constitution. A senior Hunt Oil manager told RRT Erbil's Team Leader that northern Ninewa province has significant potential for oil production, and that this factor trumps the legal ambiguities and risks associated with the company's PSC with the KRG. The oil potential of northern Iraq continues to attract significant investor interest. Several other international energy companies are expected to announce oil deals with the KRG during coming weeks. Despite the KRG's aggressive pursuit of foreign direct investment to develop the Kurdistan Region's hydrocarbons production potential, KRG Prime Minister Nechirvan reiterated the KRG's commitment to the federal hydrocarbon revenue sharing agreement that allocates Iraq's oil wealth to all Iraqis on a per capita basis. Meanwhile, senior central government officials expressed their dismay that the KRG enacted a regional hydrocarbons law, and that the KRG continues to pursue oil investment from foreign companies in advance of enactment of comprehensive national hydrocarbons legislation. [NOTE: The ability of regional governments to sign contracts has been among the key

issues of contention during negotiation of the national hydrocarbon law. The KRG has reluctantly agreed, at times, to refrain from finalizing agreements in advance of a national law, but have maintained that they would not wait indefinitely for national legislation to be approved by the Council of Representatives. END NOTE.]

KRG Contract with Hunt in Disputed Territory

¶2. (SBU) On September 8, 2007, the KRG, Hunt Oil Company, and Impulse Energy Corporation (IEC) jointly announced they had signed a PSC covering petroleum exploration activities "in the Dohuk area of the Kurdistan Region." Hunt Oil's General Manager for Europe, Africa and the Middle East, David McDonald, told RRT Erbil's Team Leader on September 5 that the envisioned "Dohuk area" of operations under the PSC consists of the administrative districts of northern Ninewa province. McDonald did not disclose the exact areas in northern Ninewa to be initially targeted for exploration by Hunt Oil but he mentioned Shekkan and Akra as areas they had visited. While the land to be explored by Hunt Oil has been behind the Green Line of KRG control for many years and is occupied by a majority Kurdish population who considers itself part of Dohuk Governorate, the area falls within the legal boundaries of Ninewa province. Northern Ninewa is "disputed territory," according to the Iraqi federal constitution, and the legal boundaries of the area are eventually to be decided by a public referendum pursuant to Article 140 of the federal constitution.

¶3. (SBU) During discussions with RRT Erbil's Team Leader, McDonald seemed less than fully informed about the potential ramifications of Article 140 on Hunt Oil's negotiations with the KRG. He did not express concern about the potential controversy surrounding signature of a PSC with the KRG that covers areas of operation currently outside the KRG's legal control. He said, "This is a significant opportunity that outweighs the legal ambiguity." Hunt Oil CEO Ray Hunt also discounted the fact that the northern Ninewa districts targeted under the PSC are not yet within the KRG's

legally defined borders. He expressed satisfaction on September 8 that his company was "actively participating in the establishment of the petroleum industry in the Kurdistan Region of Iraq."

¶4. (U) Enactment of the KRG's new oil law may have spurred completion of the PSC with Hunt Oil. The PSC was announced shortly after publication of the English translation of the new oil and gas law on the KRG's website. Before the law was enacted, only one PSC had been signed for the Dohuk area - with DNO of Norway. That PSC covered operations only within the legal boundaries of Dohuk Governorate. Enactment of the KRG oil law and the subsequent announcement of the deal with Hunt Oil may accelerate the signing of PSCs with other international oil companies. Several are reportedly on the verge of signing PSCs with the KRG during coming weeks. Article 19 of the KRG law states that "the Federal Government must not practice any new Petroleum Operations in the disputed territories without the approval of [the KRG] until such time as the referendum required by Article 140 of the Federal Constitution is conducted." Article 20, however, allows the KRG to

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sign PSCs with foreign oil companies in disputed territories, based on articles 112, 115 and 121(3) of the Federal Constitution.

Potential Bonanza Trumps Legal Ambiguity

¶5. (SBU) While McDonald said Hunt Oil must conduct further assessments about the speed and scope of their operational activities in northern Ninewa, with decisions regarding the focus of initial seismic tests to begin "by the end of October," he was optimistic about the oil potential of the region. McDonald said portions of the topography in all three districts of northern Ninewa bode well for oil exploration. He said, "It's like shooting fish in a barrel." A Hunt Oil company spokesman in Dallas said the company will begin geological survey and seismic work by the end of 2007,

with plans to be in a position to drill an exploration well in 2008.

KRG Boldly Enacts Regional Hydrocarbons Law...

¶6. (U) The KRG deal with Hunt Oil marks the first PSC signed with a foreign oil company following KRG enactment of the Oil and Gas Law of the Kurdistan Region on August 6, 2007. Speaking of the KRG's rationale in passing a controversial regional hydrocarbons law while a draft national oil and gas law remains intensely debated, KRG Prime Minister Nechirvan Barzani told reporters on August 7, "Successive governments in Iraq have deliberately left our oil in the ground as an effort to keep our people [ethnic Kurds] poor and to deny our aspirations for a better way of life. Today, with the passage of this new Kurdistan Law in a federal Iraq, we know that those days are gone."

¶7. (U) While espousing the benefits of foreign direct investment in the Kurdistan Region's oil producing areas, Nechirvan acknowledged federal constitution provisions that require any oil revenues generated under the KRG's hydrocarbons law to be shared equally with all Iraqis. He confirmed the KRG intends to limit itself to its constitutionally mandated share of national oil revenues, regardless of whether the oil is sourced inside or outside the Kurdistan Region. He said, "We will receive 17 percent of all revenues from all oil production in all of Iraq."

¶8. (U) KRG Minister of Natural Resources Ashti Hawrami echoed those comments. Hawrami said on September 9, "We believe that the [KRG's] production-sharing agreements are the best way to move swiftly forward and help not just the Kurds but all Iraqis." He envisions that the Kurdistan Region will produce one million barrels of oil per day within five years. To achieve this goal, the KRG intends to sign PSCs with other large international oil companies. On September 9, Hawrami told Dow Jones, "I think we'll be having an announcement with a blue-chip company soon."

While Criticizing Central Government Paralysis

¶9. (SBU) Following passage of the KRG hydrocarbons law, KRG officials recommitted themselves to the February 2007 national hydrocarbons framework agreement. Nechirvan told RRT Erbil's Team Leader on August 28 that he hoped the new KRG law "would spur movement in Baghdad" to enact a national hydrocarbons law. During that meeting, however, Nechirvan expressed disappointment with political developments in Baghdad and pessimism about "whether the Sunnis and the Shi'a want to live together." He said the KRG does not want Iraq's central government to "hold up development of regional resources for another ten years."

Arab Leaders Critical of KRG Oil Law

¶10. (U) Senior central government officials in Baghdad condemned the oil deals signed by the KRG in advance of enactment of national hydrocarbons legislation. Abdul Hadi al Hasani, Deputy Chairman of the national parliament's Energy Committee, said recently that such contracts may be overturned by the federal government, though he conceded that such a move could discourage potential foreign investments in Iraq's oil sector. Sami al Askari, a parliamentarian and senior advisor to Prime Minister al Maliki, told reporters on September 7 that a federal oil and gas council to be formed under the national hydrocarbons law could decide whether to rescind the KRG's handful of oil contracts with foreign investors. In a concession to the reality that foreign direct investment in Iraq's oil infrastructure remains both valuable and scarce, the parliamentarians said the private firms that signed deals with the KRG should not be blocked from winning future oil contracts in Iraq.

COMMENT

¶11. (SBU) USG policy has discouraged companies from signing oil deals with the KRG until Iraq enacts its national hydrocarbon framework law, as such regional contracts could act as an impediment to negotiations toward a comprehensive national settlement that equitably distributes Iraq's oil wealth. Such contracts also remain subject to significant legal ambiguity. This has not deterred Hunt

Oil and the other handful of companies that have signed PSCs with the KRG. Their concerns about the nebulous political environment and possible eventual dissolution of their PSCs have been overridden by the prospect of huge profits - from getting first access to the choicest oil exploration fields in northern Iraq, and from establishing productive relationships with key KRG and central government officials. The potential pitfalls are especially acute in cases (e.g. Hunt Oil and its junior partner IEC) where investors will commence operations in disputed territories. It remains doubtful that the KRG was legally entitled to enter into a binding contract with Hunt Oil that covers oil exploration and eventual hydrocarbons production in an area (i.e. northern Ninewa province) that the KRG does not legally control. Legal considerations aside, the KRG's actions complicates enactment of a national hydrocarbons law.