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SUBJECT: KRG PM PROBING GOI TO RESOLVE OIL EXPORT IMPASSE

¶1. (U) This is an RRT Erbil cable.

¶2. (C) Summary: Kurdistan Regional Government (KRG) Prime Minister Barham Salih told RRT Team Leader that he has begun to explore with GOI officials how to resolve the impasse over payment to the producing companies on the two pre-2005 Kurdistan Region (KR) oil fields. He noted that because of this impasse Iraq is losing 100,000 barrels per day of revenue. Salih made no reference to KRG Minister of Natural Resources Minister Ashti Hawrami being involved with this process. Moreover, in a separate meeting, Hawrami seemed to be out of the loop on the PM's efforts. Both Hawrami and Salih reiterated that KRG policy is to allow all oil revenues from the KR's oil fields to go into GOI coffers with the KRG subsequently allocated its share. Hawrami reiterated his frustration with the GOI on the export issue: the KR had pumped \$400 million worth of oil through the pipeline with no information about the proceeds. Now that they have stopped exporting, the companies can continue to cover operating expenses through sales to local refineries but cannot cover capital costs. Hawrami said the KRG -- apparently without involving the GOI -- is encouraging Turkey to consider purchasing either gas from the KR or gas-powered electricity. He posited that the attraction of KR oil and gas was a significant factor in GOT-KRG dtente. Hawrami said it was unfair for the USG to oppose oil and gas investment in the KR but not in the rest of Iraq. End Summary.

Barham Salih's Cautious Feelers to GOI:

¶3. (C) In a meeting with Senior Advisor on Northern Iraq (SANI) Misenheimer, RRT Team Leader asked KRG PM Salih about his recent meeting with a delegation from the GOI's Ministry

of Oil. Barham joked that Shahrستاني was "sending him flowers." Barham, who has criticized Shahrستاني in other meetings, said Shahrستاني seems to appreciate him now. Barham characterized the visit from Baghdad as primarily a gesture of goodwill, not a detailed policy discussion. The delegation congratulated Barham on his new job.

¶4. (C) Cautioning that he does not want to raise expectations and will say nothing publicly, Barham revealed that he intends to work through channels to try to find a solution that would allow the KRG to resume exports from the Taq-Taq and Tawke fields. He noted that these two fields, unlike others, were old fields and therefore there is no legal issue about the legitimacy of the contracts. He said the only issue in dispute is how the companies get paid. (Note: The GOI insists that payment come out of the KRG's share of the proceeds, whereas the KRG feels it is unfair to ask them to bear the full costs of production out of their small share of gross revenues. End Note.) Meanwhile, Salih pointed out, Iraq is losing 100,000 bpd of revenue. He said he has spoken to GOI Minister of Finance Jabr who seemed to have a positive reaction to Salih's efforts.

Keeping Ashti out of the Loop?

¶5. (C) When asked about KRG Minister of Natural Resources Ashti Hawrami, Salih grinned and said he will keep Hawrami "very close." (Note: An American here in the oil business who is close to Hawrami and other KRG insiders told the Team Leader that Nechirvan Barzani pushed hard to ensure that Hawrami retained his position in the new KRG government, even after the allegations of insider trading against Hawrami became public. Salih told PolOff that he settled for having the new Kurdistan parliament question Hawrami, when he knew that he couldn't get rid of him. End Note.)

¶6. (C) In a separate meeting later the same day, Hawrami seemed unaware of Salih's feelers to the GOI on the oil export issue. Hawrami said that a Deputy Minister from the

GOI MOO had led the delegation to Erbil earlier this week. Hawrami said this Kurdish Deputy Oil Minister is under investigation but that Shahrستاني has protected him, so the Deputy Minister is trying to help Shahrستاني by setting up a meeting with Salih. Hawrami did not meet with this individual and said that he was not familiar with the particulars of the visit which were not coordinated with his ministry. He said that the visit was ostensibly to congratulate Dr. Barham on the formation of the new government and that a secondary motive was to visit the production facility at Khurmala (this visit was planned at the last minute with no consultation with the KRG Natural Resources Ministry and ultimately did not take place). Hawrami suspects that another motive for the visit was to try to convince Salih to get Kurdish MPs in the COR not to support a no-confidence vote against Minister Shahrستاني. Hawrami believes that it will be easy to obtain the 50 signatures necessary to bring the matter to debate and that Shahrستاني will be removed from office eventually. (Note: It is doubtful that Shahrستاني will be removed from office in the diminishing time left before national elections. With Exxon Mobil and others gearing up to sign contracts with the GOI that could eventually increase total Iraqi oil production to 6 million bpd, his removal is even more remote. End Note.)

No GOI-KRG Engagement but KRG accepts Revenues going to GOI Cooffers:

¶7. (C) Regarding the way ahead for KRG/GOI cooperation on production and revenue sharing, Hawrami said there are currently no/no discussions with Baghdad. He believes no progress will be made until after the election. He believes the pre-election period is the time to start discussing policy with potential coalition partners (but he seemed to be saying this is not the KRG's approach. Hawrami stressed the importance of focusing on a revenue-sharing law before a hydrocarbons law, to build confidence on both sides about how the proceeds of oil will be allocated. (Note: Former KRG PM Nechirvan Barzani made the same point when he met Secretary

Gates this summer. End Note.)

¶8. (C) Hawrami (like Salih) reiterated that KRG policy is to accept that all oil revenues generated by the KR would go to the Central Government, according to Articles 18 and 19 of the Constitution. (Note: This is a position consistently taken by every KRG official with whom the RRT has had oil-related discussions, including in President Barzani's presence. President Barzani's recent public statement that oil produced in the KR belongs to the Kurds is out of sync with longstanding KRG policy. End Note.) Hawrami pointed out that there is a provision in the KRG's 2007 oil and gas law that requires the revenues to go to the GOI. Hawrami said that the KRG's motivation in developing its oil was not merely for the revenue but also to create employment and develop local expertise as well as for industrial development.

Exporters only Covering Operating Costs:

¶9. (C) Hawrami said that DNO and Genel Enerji stopped exporting because of non-resolution of payment modalities. These companies are generating sufficient revenue from local sales to cover their day-to-day operating expenses, but not enough to recoup their capital investment. They are pumping about 40,000 barrels per day that is used in local refineries. He did not estimate how long they could remain in operation under current conditions. Hawrami noted that the KRG pumped over \$400 million worth of oil into the pipeline to Turkey over a 3-1/2 month period to show the Central Government its capabilities and that the proceeds went into the GOI's coffers. However, he expressed frustration that SOMO and the GOI had provided zero information to the KRG about the marketing or revenues, let alone agreement on how the companies would be paid. When asked if there were any process to solve the problem of lack of payments to the companies, Hawrami responded that there was "no one to talk to."

¶10. (C) Hawrami scoffed at reports that Shell might contract with the GOI to work on the Kirkuk field, questioning how Shell would overcome security concerns. He also said that Shell should have talked to the KRG as well (presumably because of the Khurmala Dome). He believes the contracts signed in the south (he mentioned BP in particular) are not advantageous to Iraq. In his opinion, the contracts offer no incentive to exceed benchmark production levels; they are a win-win deal for the companies, which stand to earn large profits no matter how much oil they pump and no matter how well they manage the fields.

Potential Gas or Power Exports to Turkey a Factor in Detente:

¶11. (C) Hawrami envisions an expansion of the KR's gas production. His first priority is to produce enough gas for local (KR) consumption. He would then look at supplying gas to the rest of Iraq or Turkey, wherever there is a market. He believes that the KR could build gas-fired electrical generating facilities close to the Turkish border (on either side, depending on which the Turks would prefer) to provide power to Turkey. Hawrami was recently in Istanbul for the Atlantic Council-sponsored talks between KRG officials and Turkish civil society figures. He said that Turkish interest in KR gas and oil is a factor in the recent improvement in KRG relations with Turkey. He added that the use of KR-origin gas to provide competitively-priced power to Southeastern Turkey could help the GOT with its domestic Kurdish policy, since it could help attract investment to the Southeast. He made no mention of the GOI having a role in KRG discussion with Turkey on gas issues.

U.S. Policy One-sided:

¶12. (C) Hawrami cannot understand why US policy singles out the KR in discouraging US investment in the petroleum sector and does not take a similar stance toward US companies investing in the rest of Iraq. He believes that GOI blacklisting has had some negative effect on the willingness of companies to come to the KR. Ashti thought that the State

Department had softened its position on US oil and gas investment in the KR, but was informed by the Team Leader that there had been no change of policy.

Comment:

¶13. (C) That Salih is apparently keeping Hawrami out of his discussions with Baghdad is understandable given that: a) Hawrami's relations with the GOI in general and Shahrastani in particular are poisonous; and b) Hawrami's reappointment as Minister was reportedly forced on Salih. The last time the GOI and KRG reached a deal on oil issues was in late 2008 when they agreed on a way forward for the Khurmala Dome project. Then, too, it was the KRG PM (Nechirvan Barzani), rather than Hawrami who negotiated with Baghdad. Given the relatively small amount of money under dispute compared to the potential revenue for both the GOI and the KRG, Salih has a reasonable chance of parlaying his good relationships in Baghdad into progress towards a solution on the export issue.