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SUBJECT: RRT ERBIL: OIL FOUND AT SEVERAL NEW SITES IN KURDISTAN REGION

¶1. (SBU) Summary: The hydrocarbon potential of the Kurdistan Region was almost completely ignored until only the past few years, when the regional government launched an aggressive program to develop the area's hydrocarbon potential. Exploration, while still in the early phase, is already yielding positive results and oil geologists are extremely positive about the potential for finding additional oil in the Kurdistan Region (KR). In addition to two fields already producing, companies have recently discovered oil at four new sites (although further drilling will be necessary to determine if these are commercial discoveries). Experts estimate that the region's potential reserves could range from 10 billion to as many as 45 billion barrels. Companies are aware of the political risk involved but feel that the commercial gain outweighs this risk. End Summary.

¶2. (SBU) RRTOff recently met with representatives of three oil exploration companies to discuss their activities in the Kurdistan Region: Talisman Energy (formerly BP Canada), Gulf Keystone Petroleum International (UK), and Niko Resources (Canada).

Strong Potential for Commercial Discoveries

¶3. (SBU) The first exploration for oil in Iraq actually started in what is now considered the Kurdistan Region, but ceased abruptly upon the 1927 discovery of the Kirkuk mega field. In the early 1960s, the Iraq Petroleum Company started drilling in Taq Taq (Erbil Province). Work was halted when the GOI, in a dispute over royalties, passed a law preventing foreign oil companies from exploring for oil outside of producing fields. In 1978, the government-owned North Oil Company recommenced exploration at Taq Taq and found what it estimated to be a commercial discovery, but development was abandoned after the Iran-Iraq War broke out. Taq Taq would lie undisturbed until 2004, when the Turkish oil company Genel Energi (later joined by the Canadian/Swiss Company Addax) signed a contract with the Kurdistan Regional Government (KRG) to develop the field. Taq Taq is now one of two producing fields within the Kurdistan Region. Once connected to a pipeline, Taq Taq would be able to produce 30,000 - 40,000 bbl/d (barrels per day) with a possibility of rising as high as 300,000 bbl/day according to the operator. The Taq Taq operator estimates that the field contains 2 billion barrels of oil.

¶4. (SBU) The second producing field is the Norwegian DNO field Tawke. Tawke is estimated to have reserves ranging from 0.9 to 1.9 billion barrels with a current expected value of 1.3 billion barrels. DNO is currently producing an estimated 10,000 to 11,000 bbl/day. It has built a 34-kilometer pipeline/metering connection to the north-south Kirkuk - Ceyhan pipeline to Turkey (the Northern Strategic Pipeline). Once this pipeline is turned on, DNO will be able to export 50,000 bbl/day; estimates of eventual output, once additional facilities are constructed, range from 100,000-175,000 bbl/day.

¶5. (SBU) Contacts are extremely optimistic about the potential for finding additional commercial discoveries of oil in the Kurdistan Region. Although a comprehensive oil and mineral survey of the region has never been done, visible signs pointing to the likely presence of oil deposits are plentiful, such as oil seeps, creeks whose water is mixed with oil, and spring water with the telltale smell of rotten eggs. When the government and private land owners Qsmell of rotten eggs. When the government and private land owners drilled artesian wells in Chamchamal, Qaradagh, and Tasluha (Sulaimaniyah province) during last year's drought, they discovered oil mixed with water at a depth of 200 to 300 meters. Gulf Keystone says that the KR has the potential to be a world-class hydrocarbon region, noting that no oil company has ever dug a dry well in the Kurdistan Region. The company stated, however, that there is less likelihood of finding a super giant field similar to Kirkuk, which lies immediately to the south, because of the geological features of the region. Company managers and geologists estimate that reserves range between 10 billion barrels to possibly as high as 45 billion barrels. The higher estimate would place reserves in the Kurdistan Region on a par with those projected for Nigeria and Libya.

The KRG's Hydrocarbons Business Model

¶6. (SBU) From 2003 to 2008, the KRG awarded 33 blocks to foreign companies, either individually or in conjunction with the Kurdistan Exploration and Production Company (KEPCO). The Kurdistan Region model Production Sharing Contract (PSC) includes an initial five-year exploration term extendable for seven years for economic evaluation. The entire development period is 20 years, extendable for 10 additional years (two five-year options), for a maximum of 30 years. The KRG interest during the initial period is executed through one of the two public companies whose production-sharing

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participation interest is a minimum of 5% to a maximum of 25%. The KRG retains 85% of the production from these fields once the exploration expenses have been recovered by the PSC contractor. The remaining 15% is revenue for each contractor. At the time when all the royalties and profits are distributed, the actual working interest will be closer to 90% for the KRG and 10% for the contractor. In addition, there is a "signing bonus" that each company has agreed to pay. The amount of these bonuses varies based on the specific block location, size, or quantity occupied.

Current State of Play - Some Examples

¶7. (SBU) Talisman signed a contract with the KRG for block 39 in June 2008. They began seismic in November, and expect to complete it in the next few week. After an additional two to three months necessary to process the data, they expect to drill their first well. According to their agreement with the KRG, they have the option to enter into a new agreement at each phase. For instance, if seismic results are positive, the company has the option to drill exploratory wells. The decision at each stage lies with Talisman, not the government, leaving Talisman to feel that the contract leaves it very much in the driver's seat.

¶8. (SBU) Gulf Keystone (UK) has interests in two blocks in Dahuk province. It is the operator in block 5, with MOL (Hungary) as the partner. (The roles are reversed in block 10, where MOL is the operator and Gulf Keystone is the partner.) Based on an expressed commitment by the KRG to award it the block, Gulf Keystone completed geological surveys, gas chemical analysis, surface mapping, and other assessments of block 5 even before the company signed its contract in November 2007. The company then immediately began conducting seismic surveys. Gulf Keystone expects to start drilling its first exploration well between March 10 and 20; the rig is currently en route from Turkey. As soon as the well is completed, the rig will be transferred to block 10, and the first well will be dug there.

¶9. (SBU) Niko Resources is the operator of Block 27, in Sulaimaniyah Province, in partnership with Vast Exploration (Canada). Although the company signed the contract on the block in June 2008, it only commenced seismic in February. The 2-D seismic, which cost USD 15 million, should be completed in six months, after which Niko plans to drill its first w%\Wq#Q4OQOQaQ In addition to incurring costs involved with exploration, they have made a commitment of $200 million to build capacity and infrastructure, principally in the areas where they are operating. While this additional expense is a contractual obligation, it is a further sign of confidence on the part of the oil companies.

Comment

¶12. (SBU) Despite the fact that political negotiations between the central government and the KRG over development and exploitation of the region's hydrocarbon resources remain deadlocked, activities in the KR are proceeding full speed ahead. Oil companies are optimistic that the most recent discoveries are just the tip of the iceberg. The production sharing agreements utilized by the KRG is helping to force the pace of exploration, since the operating companies are required to act within a set period of time or risk forfeiting their interests in their blocks. The acceptance of risk is characteristic of the smaller, more entrepreneurial companies operating in the region -- we note that none of the oil "majors" are present.