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SUBJECT: AFTER INITIALING OIL CONTRACTS, IRAQ DEMANDS
CHANGES

¶1. (C) Summary: The Government of Iraq (GOI) has demanded significant changes to its contracts with the three winning consortia in Iraq's first oil bid round on June 30. While sixteen of these changes were incorporated in advance into the revised model contracts used for the second bid round in December, the GOI subsequently demanded an additional four changes to first and second bid-round contracts after they were awarded. Of the first round contracts, the Eni- and Exxon-led consortia are reportedly willing to accept some of the contract changes; the BP-led consortium accepted none of the changes. Reports of the reactions of second bid round winners are sketchy, but only one (Angola's Sonangol) of the seven winners appears to have accepted the last four contract changes. Whether the GOI's actions stem from incompetent legal preparation or ill-advised attempts to further squeeze investors is unclear. Regardless, the GOI's repeated attempts to unilaterally change contracts, after negotiations have concluded and contracts have been initialed, jeopardize the development of Iraq's oil sector, tarnish its already poor investment climate, and risk undoing much of the progress the GOI showed in its transparent handling of the oil bidding process. End summary.

GOI Demands Unilateral Changes to Initialed Oil Contracts

¶2. (SBU) Following months of arduous negotiations leading to what one company called "a carefully balanced deal," the GOI and IOCs initialed the three first bid round contracts during the first week of November. However, within weeks the GOI

demanded sixteen unilateral changes, several of them potentially material, to each of these oil field development and production contracts. (Note: Two of the contracts -- the ExxonMobil contract for West Qurna (Phase 1) oil field with UK company Royal Dutch Shell and the Eni contract for Zubair oil field with both U.S. company Occidental Petroleum and Korea Gas Corporation (Kogas) -- had been initialed but not yet approved by the COM or signed. The third contract -- the BP contract for Rumaila oil field with China National Petroleum Corporation (CNPC) -- had been approved by the COM and signed. Only one of the contracts has entered into force -- the BP/CNPC contract. The initialed contracts are awaiting approval by the COM and signature. End note.)

¶3. (C) The initiative to change the contracts resulted from a review by the prime minister's legal advisor, Dr. Fadel Jawad Kadhim. Fadel was not involved in the original contract negotiations and is now objecting to all three contracts, primarily citing technical legal issues stemming from conflicts with Iraqi law. Based on his objections, on November 26, the GOI demanded sixteen changes to each of the three first round contracts. These sixteen changes then were incorporated into the model contract used in the second bid round, held in December. With much public fanfare, each of the seven contracts awarded in the second bid round were initialed between December 20 and 30. On January 3, the GOI then demanded another four unilateral changes to the Eni, ExxonMobil, and all second round contracts.

Several Material Changes Among Those Demanded by GOI

¶4. (C) Although some of the contract changes are minor, several are significant enough to derail the ExxonMobil contract and others. These changes include (a) eliminating the waiver of sovereign immunity from legal proceedings or judgment enforcement if contract disputes arise (allowing Iraq's national oil company to claim sovereign immunity and

thus exemption from legal duties, penalties, or liabilities resulting from contract disputes); (b) eliminating reimbursement of costs incurred and payment of remuneration fees accrued if an Iraqi authority invalidates or voids the contract; (c) declaring that the Iraqi national oil company can never be found in default; (d) eliminating guarantees of customs-exempt entry of capital goods and equipment; and (e) requiring that all contracts and guarantees be backed by the ultimate parent company. In short, these contract changes would appear to give the GOI immunity from legal judgments or arbitral awards and indemnification from damages resulting from GOI decisions, however capricious.

ExxonMobil and BP Have Not Accepted All the Contract Changes

¶5. (C) MOO and BP contacts inform us that MOO only "requested, not formally demanded," changes to the signed BP/CNPC contract, and that the consortium rejected the request. MOO also intimated to BP that, in light of the low remuneration fees bid during Iraq's second oil bid round, it might demand that the remuneration fee in the BP/CNPC contract be lowered. We have received conflicting information as to whether the Eni-led consortium, which includes U.S. company Occidental Petroleum, has accepted any changes. The ExxonMobil-led consortium accepted only five of the first sixteen changes.

ExxonMobil Has Asked for Advocacy to Resolve This Impasse

¶6. (C) Before Christmas, European Union ambassadors and separately Ambassador Hill (ref B) pressed Prime Minister Maliki, stressing that attempts to change carefully negotiated and initialed contracts were unacceptable, counter to Iraq's own long-term interests, and could derail the contracts. Nevertheless, the GOI subsequently made it clear

that it is now demanding, not requesting, all twenty contract changes before approving the contract with the ExxonMobil-led consortium (and presumably with each of the other consortia that do not yet have signed contracts). ExxonMobil has again approached Post, seeking renewed advocacy to Prime Minister Maliki. ExxonMobil wants the GOI to approve and sign the contract (initialed on November 5) with the ExxonMobil-led consortium with only the five changes it has accepted. Post will continue to press the issue at senior levels. Italian emboffs inform us that the Italian Ambassador intends to approach Prime Minister Maliki to express similar concerns.

Comment: Egregious and Counterproductive

¶7. (C) If the GOI continues to demand changes to these contracts (contracts that were carefully crafted and that all parties have already accepted and initialed), it would do Iraq great harm. It would set the dangerous precedent that an initialed contract is not a final agreement; it could damage the already precarious confidence of IOCs -- and other businesses -- in Iraq as a viable business partner; and it could hamper near-term development of Iraq's oil sector and the accompanying revenue growth on which Iraq is almost wholly dependent. The GOI made a favorable impression with its transparent handling of the oil bid round process; that impression is now at risk.