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SUBJECT: OIL RAPPROCHEMENT? KRG PUBLISHES TWO CONTRACTS

¶1. (SBU) In the next step of a an apparent (and very ginger) rapprochement between Baghdad and Erbil over Iraq's oil sector management, the KRG published on January 17 the full texts of its previously secret oil field development and production contracts with oil companies DNO and Genel Energy, a move it previewed for the Ambassador during his recent visit to Erbil (septel). This action follows recent remarks from KRG Prime Minister Barham Saleh offering to seek a resolution to the longstanding conflict with the GOI over these and other unilateral KRG oil contracts. It also appears to reciprocate an olive branch extended by Baghdad in November 2009, when a Ministry of Oil delegation led by Deputy Minister Abdul Kareem Luaibi traveled to Erbil to meet with newly elected KRG PM Saleh. Neither GOI Oil Minister Shahristani nor KRG Oil Minister Hawrami -- adversaries over the issue of these contracts -- participated in this series of meetings.

Comment

¶2. (SBU) Publishing these two contracts is an important step, but will not by itself resolve the continuing conflict between Baghdad and Erbil over the management of oil investments. Only after Baghdad accepts these contracts as legitimate will it likely agree to make "profit oil" payments and "cost oil" payments to reimburse the foreign oil firms for both accrued and future capital expenses. Although Erbil does not recognize Baghdad's right to pass judgment on the contracts' legitimacy, Erbil badly needs to reimburse the capital expenses accrued by oil companies working in Iraqi Kurdistan, perhaps setting the stage for a tradeoff.

¶3. (SBU) The sustainability of the KRG's current and future production increases will depend on this reimbursement of both operating expenses (which, evidently, the companies have already been receiving) and capital expenditures (which the companies have not been receiving) as well as payment of suitable profit. According to the data published by Erbil, the companies are owed $800 million in accrued capital expenses. Erbil's January 17 announcement also leaves the definition of suitable profit for ensuing negotiations. Baghdad and Erbil have not agreed to the amount, schedule, and process for payment of cost reimbursement and profit. Future negotiations could be arduous, since each party has very differing views and priorities, such as Baghdad's fundamental commitment to service contracts and Erbil's equally strenuous commitment to production-sharing contracts.

¶4. (SBU) Other contentious issues could also arise: for example: (1) transferring to Baghdad the revenues from Erbil oil production that has been used in KRG refineries or utilities; (2) the disposition of signing bonuses from Erbil's contracts, particularly given that all the signing bonuses from Baghdad's ten bid round contracts will be paid to the central government, not to a particular region or province; (3) the process through which the contracts were awarded and through which future contracts will be awarded (including openness, equitability, competitiveness, and transparency); (4) the structure of and process for managing the contractual relationship with the companies and the petroleum operations conducted under the contracts; (5) the conformance of contract terms and conditions with existing national laws and regulations; and (6) Iraqi government liability under the contracts.

¶5. (SBU) Erbil has oil field development and production contracts with other companies that could be even more controversial. A process to review and legitimize (from Baghdad's perspective) these contracts, and any future contracts, is still needed. There also is no agreement on national hydrocarbons legislation (including establishing an industry framework and reestablishing a national oil company) and how Baghdad and Erbil will cooperate in the development of Iraq's oil sector. If the two sides can agree on a mechanism to review and legitimize these other KRG contracts, and a process for concluding and administering any future oil contracts, this agreement could open the door to expansion of oil and gas production in the north. That would offer the chance of greater exports via Turkey as well as possibly KRG gas being fed into the Nabucco pipeline.