

View Point



Murat Yazıcı,
Founding Partner

YAZICI LAW OFFICES

A brief look at the recent history of oil in the Kurdistan Region of Iraq from a legal perspective

As in all geographies, insight into doing business in the Kurdistan Region of Iraq turns on an understanding region's recent history. I will attempt to share my understanding of the legal and historical background of the region in this article, inevitably from the perspective of an oil and gas lawyer.

Kurds have been ethnically distinct from both Shia and Sunni Arabs in Iraq for as long as anyone can remember. As such, intermarriage with the Arabs is not often found, despite the fact that Kurds are mostly Sunni. They have generally been excluded from the Arab dominated central administrations in Iraq.

Economically, the result of this subtle ethnic demarcation has had clear consequences in the oil and gas industry, the country's primary source of wealth. I can safely say that the northern part of Iraq, predominantly populated by Kurds, is extremely under-explored in terms of oil reserves in comparison to other parts of Iraq. A couple of wells were drilled in early 20th century but afterwards exploration activities in the region were mostly abandoned, predominantly because development of resources in the region was not high on the country's priority list. Some wells were even plugged and abandoned after discovery.

Politically, Kurds were granted some autonomous rights by a constitutional amendment in recognition of their separate identity in 1970. However, these rights were obliterated in the Saddam era. The subsequent sad history of the Kurds in the Saddam era is relatively well known. However in retrospect, it can be argued that the Kurds started to enjoy a level of autonomy unprecedented in the Iraqi Republic during the Saddam regime. The real turning point came after the First Gulf War when the Saddam regime lost all control of the predominantly Kurdish northern Iraq.

From the First Gulf War in 1991 to the ratification of the constitution in 2005, the Iraqi government lacked sovereign command over Iraq's northern region. The feudal social structure in the region allowed for the Kurds, who constituted the pre-dominant majority in the region, to fill this void in a relatively orderly manner.

Despite infighting, from 1991 to 2003 two feudal Kurdish leaders, Barzani and Talabani, performed the main duties of a government in the region. They governed effectively, formed a legislature, provided for an organised judiciary, enlisted people to the army, controlled police forces, printed money and even registered births and deaths.

The main funding for these activities came from the UN Oil for Food Programme through which Iraq sold its oil after the First Gulf War. Under the Oil for Food Programme, the UN collected all the revenues from the Iraqi oil sales and distributed them among the parts of Iraq based on a ratio that factored in population and development levels. Accordingly, the Kurdish region's share was 13 percent of the entire oil revenues of Iraq collected by the UN. Effective government and stable income allowed the Kurdish region of Iraq to become a de facto autonomous political entity in this period; although it was never a state, lacking the required recognition from the international community.

This is not to say the outside world ignored the reality on the ground. In 1996, the United States, Great Britain, and Turkey activated the Ankara Process to broker a peace between Barzani and Talabani. Fighting since 1994, the feud ended in 1998 with the Washington Agreement whereby the two Kurdish leaders agreed on a joint administration structure and parliamentary elections. The agreement also stipulated that if Barzani and Talabani did not contain the Kurdish terrorist organisation

PKK and prevent it from staging cross border incursions into Turkey, they would be held responsible. It was clear that Barzani and Talabani were perceived as the real rulers of the region and accordingly held accountable.

In 2002, Talabani invited Genel Enerji A.S., of Turkey, to negotiations for the development of oil fields in the region. His objective was twofold: he wanted to establish good relations with Turkey through commercial ties while simultaneously demonstrating to Saddam that he was the legitimate ruler of the land. Genel Enerji A.S. signed a Production Sharing Agreement (PSA) with the Kurds that same year; the first of many PSAs between the Kurdistan region of Iraq and international companies over the next couple of years.

Following the Second Gulf War in 2003, the new Iraqi Constitution was enacted in 2005. Crucially, article 117 defined Kurdistan as a federative region. With all other federative entities labeled "governorates", Kurdistan thus became the only such "region" in Iraq. In Article 110 the federal government sets out a structure by which exclusive powers rest with the central authority, leaving other matters to the regional and provincial governments in Article 115. Furthermore, Article 141 affirms that legislation and government decrees (including court decisions and contracts) enacted in the Kurdistan region since 1992 will remain in force (unless they contradict the Constitution); therefore validating the pre-Constitution PSAs signed by the Kurds. Some see this as an admission that Barzani and Talabani's possession over the natural resources between 1991 and 2005 was in fact good title.

Prior to 1991, Iraq boasted a very well qualified labor force in terms of the oil and gas industry. However, due to the embargo enforced since the First Gulf War, oil production in Iraq has massively deteriorated. Skilled Iraqi geologists, engineers and field workers of the 1970s and 1980s had inevitably lost track of the technological innovations of the last two decades. Equipment and production techniques had also suffered, resulting in development activities considerably behind global productivity standards.

Thus, the Iraqi federal government's main policy is based on rehabilitating existing fields in order to bring them up to the potential today's technology allows. The exploration of new fields is effectively on the back burner. While this general policy of increasing productivity may be reasonable for the rest of Iraq, it substantially hinders the potential of the chronically under explored Kurdistan region.

Because of these factors, oil fields in the new constitution are accordingly divided into separate exploration and production assets.

Following the ratification of the Constitution in 2005 the Iraqi Parliament started drafting its oil law. Article 112 of the Constitution stipulates that the federal government, the producing region and the governorates shall together manage and formulate policies for oil and gas development. The law however has not been enacted since then.

The main point of contention is Article 10, covering the region's and governorates' say over contractual terms with the E&P companies. Having come to the conclusion that these issues would not be resolved anytime soon, the Kurdistan region enacted its own oil law and PSA agreements in 2007.

Despite uncertainty with the oil legislation, there are two important points to emphasise. First, oil and gas policy is not set under Article 110 of the Constitution among the matters in which the Iraqi federal government will have exclusive authority. Second, it is crucial to bear in mind that the oil produced anywhere in Iraq, including the Kurdistan Region, belongs to all of Iraq pursuant to Article 111 of the Constitution.

Luckily there is a consensus between the Kurdistan Region, the other governorates and the federal government on the existing distribution ratios established by the Oil for Food Programme (but slightly increased to 17 percent to account for a population increase in the Kurdistan Region). As a result, the Kurdistan region's share will be 17 percent of any oil revenue from anywhere Iraq, including the region itself.

While there is a consensus between the KRG and Baghdad over the amount the KRG will receive from their own fields, the two sides disagree over the method by which contractor company's are paid under the PSAs.

It seems reasonable and logical to assume that, since the Kurdistan Region is not taking any direct revenue from its production, the contractors should be paid from the gross Kurdistan oil sales revenue. Subsequently all net revenue after the contractor's entitlements should be added to all other federal revenue for sharing with the Kurdistan Region.

I hope this problem will be resolved by taking into account the payment of the contractor shares in the oil contracts recently signed by the federal government. Considering how the legal landscape of the country has been pieced together over the last couple of years, I remain confident the issue will be resolved to the agreement and mutual benefit of both parties in a reasonable timeframe.

Murat Yazıcı
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