



# The Necessary U.S. Role in Fixing the Baghdad-Kurdistan Energy Dispute

Michael Knights



## Executive Summary

**O**n February 15, 2022, Iraq's Federal Supreme Court (FSC) issued a ruling regarding a ten-year-old case (no. 59 of 2012) that concerns the constitutionality of the 2007 oil and gas law of the Kurdistan Region of Iraq (KRI). The FSC ruling concluded that the law is unconstitutional and that the numerous production-sharing contracts and oil sales agreements referencing the law must therefore be reviewed. Since the ruling, relations between the Iraqi federal government in Baghdad and the Kurdistan Regional Government (KRG) in Erbil have deteriorated rapidly. Baghdad has sicced its lawyers on the KRG's international oil and gas investors and threatened to withhold the customary monthly \$138 million transfer from the federal Ministry of Finance to the region.

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The reason for such rapid escalation is that the politics behind this issue are extraordinarily toxic—and potentially very damaging to U.S. interests in Iraq as well as the global economy. At stake is the resolution of a longstanding debate about federalism in Iraq and the division of powers between Baghdad and the KRG, which could make or break the idea of a multiethnic federal democracy, as envisaged in Iraq’s 2005 constitution. Beyond the longer context, Iran-backed Shia factions and anti-Barzani Kurdish factions are using the FSC ruling to punish and coerce the KRG leadership for a variety of stances it has taken, such as supporting Shia leader Muqtada al-Sadr’s effort to exclude Iran-backed factions from government, and calling for an ongoing U.S. military presence in Iraq.

If Baghdad’s lawyers can successfully prevent oil exports via Kurdistan, then the world market will almost immediately lose 500,000 barrels per day. Under this scenario, the future includes increased potential for higher oil prices, expanded windfalls for Russia and Iran, a raised risk for recessions, the collapse of relations between Baghdad and Erbil and maybe also between Baghdad and Ankara, and an economic crisis in Iraqi Kurdistan affecting five million people on Europe’s doorstep, within easy reach of numerous terrorist recruiters. Much of the benefit of OPEC production increases this year will be lost.

This paper is a recommendation for the United States to act in partnership with other concerned states. First, it categorizes the key sub-issues of FSC implementation into higher- and lower-consensus items and explains both sides’ views in an unvarnished, direct manner. Second, the paper suggests where the “deal space” still exists on the key sub-issues, stimulating thought and debate with a proposed win-win solution. Third, the paper outlines the ways in which U.S. and partner efforts—political urging and technical and financial assistance—could guide the Baghdad-Erbil energy dispute toward a long-overdue resolution that would greatly aid U.S. interests and the global effort to find a substitute for Russian and Iranian oil and gas.

### Abbreviations

FSC	Federal Supreme Court	KROC	Kurdistan Regional Oil Company
INOC	Iraq National Oil Company	MNR	Ministry of Natural Resources (Kurdistan)
ITP	Iraq-Turkey Pipeline	PSC	production-sharing contract
KDP	Kurdistan Democratic Party	PUK	Patriotic Union of Kurdistan
KOMO	Kurdistan Oil Marketing Organization	SOMO	State Oil Marketing Organization
KOTO	Kurdistan Oil Trust Organization	UNAMI	United Nations Assistance Mission for Iraq
KRG	Kurdistan Regional Government		
KRI	Kurdistan Region of Iraq		

**O**n February 15, 2022, Iraq’s Federal Supreme Court (FSC) issued a ruling regarding a ten-year-old case (no. 59 of 2012) that challenged the constitutionality of the 2007 oil and gas law of the Kurdistan Region of Iraq (KRI). The ruling concluded that the law is unconstitutional and that the numerous production-sharing contracts and oil sales agreements referencing the law must therefore be reviewed. As Bilal Wahab, an expert on Iraqi Kurdistan, wrote at the time: “Ruling that KRG oil exports and contracts with international oil companies are illegal, the court granted the federal government the right to annul such contracts, claim ownership of KRG oil, and hold Erbil liable for past oil revenues against budget allocations received from Baghdad.”<sup>1</sup>

Since the ruling, relations between the federal government in Baghdad and the Kurdistan Regional Government (KRG) have deteriorated rapidly. If a window existed for early de-escalation, it has mostly closed.<sup>2</sup> Despite multiple rounds of talks, and proclamations of progress by both sides, the search for middle ground has proven elusive. Instead, Baghdad has sicced its lawyers on the KRG’s international oil and gas investors and threatened to withhold the customary monthly \$138 million transfer from the federal Ministry of Finance to the region. The KRG, meanwhile, has declared the FSC itself unconstitutional and improperly established from the outset.

From these incompatible positions, new middle ground must be developed. A new window for compromise must be created. This paper looks at which sub-issues are most promising for international players to open up a “deal space” for negotiation. Baghdad-Kurdistan relations are currently cycling downward and circling the drain, but arresting that dynamic and cycling them back upward again is always possible.

## What’s at Stake for the United States?

This author has long argued that helping resolve Baghdad-Kurdistan disputes could be the most valuable role left for the United States and its partners in Iraq. The 2003 U.S. invasion transformed Iraq in one fundamental way—from a brutal dictatorship to a fragile democracy—but left another major schism untouched: the manner in which the Iraqi state had consistently been alienated from the country’s largest ethnic minority, the Kurds. Helping Iraq find peace with its largest non-Arab community is a worthy strategic initiative and one that appeals to U.S. partners like Britain, France, Canada, and numerous European countries.

One need only look at today’s Iraqi Kurdistan to see the negative effects of Baghdad-Kurdistan animosity. If Baghdad issues legal injunctions against Kurdistan oil exports, the FSC ruling could promptly remove nearly 500,000 barrels per day from world markets, a figure that includes around 410,000 bpd of Kurdistan-operated crude and around 90,000 bpd of Baghdad-operated Kirkuk crude, all of which utilizes Kurdistan’s oil pipeline to reach Turkish export markets. Such a development would more than wipe out the market rebalancing effects of increased OPEC production at a time when Brent oil prices are already more than \$100 per barrel.

Considering the lengths to which the United States has gone to secure Saudi Arabian support for around 200,000 bpd of OPEC production increases, will Washington and other energy-dependent European capitals really do nothing when staring down an avoidable loss of half a million barrels?

Baghdad-Kurdistan synergies could not only help stabilize today’s oil prices; in the future, northbound energy flows via Turkey could also reduce Turkish and European reliance on Russian and Iranian oil and, more significantly, gas. The idea of a Southern Gas Corridor—from Central Asia and the Middle East to Europe—is returning to the forefront of energy

security thinking, and the provision of Kurdistan-operated and Iraqi-operated gas flows could help wean Turkey and Europe off Russian gas. At the very least, why would the United States want to let that potential flow be ruled out by an avoidable Baghdad-Kurdistan legal and constitutional crisis?

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## Narratives and Needs of the Two Sides

If the United States and its partners are to help bridge the wide gap between Baghdad and Kurdistan on energy issues, then it is important to look in a very blunt and straightforward way at the calculations of different parties in Baghdad and Kurdistan. This means getting beyond the rhetoric and diplomatic language, and digging down into what no one will openly say in negotiations and communiqués. It also means being realistic about the personal pressures felt by Iraqi and Kurdish policymakers, which set the real boundaries on practical dealmaking. Without understanding how to help policymakers mitigate personal risks and likewise perceive incentives, think tank advisors can often miss the real motivational factors enabling or constraining conflict resolution.

### Baghdad Perspectives

In Baghdad, officials genuinely fear opening themselves up to prosecution or, at the very least, dismissal if they are seen to be holding back on implementing the FSC ruling. Within very recent memory, top Iraqi cabinet officials such as Hoshiyar Zebari and Luay al-Khateeb have been grilled by parliament and dismissed from their posts with votes of no confidence; the latter was detained and his properties impounded.<sup>3</sup> The Iraqi judiciary is presently providing rulings against Kurdistan on a “made to order” basis, dictated by both Iran-backed politicians and even Iranian intelligence officials. Thus, if you are an Iraqi official, you have a very real

fear of being targeted if you simply ignore the FSC ruling or obviously slow-time it. This will inevitably create an escalatory pattern of legal assaults on the Kurdistan energy sector until a change occurs in overall Baghdad-Kurdistan dynamics.

Some Baghdad officials need no coercion and are plainly delighted by the FSC ruling. Within Iraqi ministries like the Ministry of Oil and its marketing arm, the State Oil Marketing Organization (SOMO), it has historically been common to hear a statement such as: “We believe as technocrats that Kurdistan should not do X or Y in the energy sector, but it is a political issue, and we will get our orders from the government.” Now, to the satisfaction of many Oil Ministry officials, the politicians are being given their marching orders by the FSC ruling—a ruling that mirrors the ministry’s view of the need to recentralize oil marketing within SOMO and reintegrate the Kurdistan Region’s independent energy sector under the ministry.

Finally, it must be fully appreciated that Baghdad officials feel they are in a very strong position vis-à-vis the Kurdistan Region, and also a strong position in the International Chamber of Commerce arbitration against Turkey over Ankara’s allowance of Kurdistan oil exports via the Iraq-Turkey Pipeline (ITP) system. Oil Ministry officials and lawyers also genuinely believe they are correct to argue that Iraq should have only one energy-sector-regulating ministry and one oil marketer—not parallel Erbil and Baghdad agencies.

There is some objective truth to this position. Iraq has one OPEC quota that includes Kurdistan’s output, but Baghdad has limited control over Kurdistan’s production. Twin marketing arrangements have resulted in Kurdistan’s oil being sold at a much lower price than almost equivalent-specification crude from Baghdad, creating competitive tensions and an avoidable loss of value exceeding \$10 per barrel. Oil traders and Turkish officials have leveraged the Baghdad-Kurdistan dispute to achieve discounts and charge higher pipeline fees, which would conceivably stop if Baghdad had a stronger role in oil marketing and export of Kurdistan crude.

## Kurdistan Perspectives

Baghdad officials have tried to portray implementation of the FSC ruling as a narrow box-checking exercise, with allowance for cosmetic fixes that leave the Kurds with most of their current energy sector functions. For Kurdish officials, the FSC ruling looks more like the top of a slippery slope, at the bottom of which is the dissolution of the Kurdistan Region's unique regional prerogatives in the Iraqi constitution, which far exceed those of individual provinces. Thus, for the Kurds, the issue is anything but narrow: they fear not where the journey begins but where it will end.

As with Baghdad's views, the Kurdish position is not purely pragmatic: for understandable reasons, Kurdish decisionmaking carries much emotion. The Kurds of Iraq are a post-genocidal people who suffered unspeakable atrocities within living memory at the hands of the Iraqi government during the Saddam Hussein era. Trust is hard to come by, and this puts a premium on reversibility in any arrangements made with Baghdad. If the Kurdistan Region agrees to share oil marketing and banking responsibilities with Baghdad, its officials need to be assured that the process can be reversed if relations deteriorate—as is often the cause of collapse in Baghdad-Erbil agreements. Thus, Kurdistan's proven way to generate revenue—independent oil sales—must not be fully and irreversibly transferred to Baghdad in the early stages of any deal. There needs to be an incremental process. International guarantors with real commitment are needed to ensure any deal is monitored and implemented.

Kurdish officials cannot publicly recognize some of their objections to involving Baghdad. The region's oil and gas sector is not quite the hotbed of corruption that many Iraqis—including Iraqi Kurds—believe, in part due to the regulating effects of international investors and their strict compliance policies. Yet the sector is undoubtedly unconventional, due partly to the difficulty of sub-sovereign borrowing for a sub-national government like Iraqi Kurdistan. This has historically driven the use of innovative borrowing and repayment models, which can

encourage predatory behavior by lenders. Opacity has been an important check against politically motivated legal actions by Baghdad players against such emergency economic arrangements. Fully opening the books of all oil sales, pipeline tariffs, and contract terms could therefore become a major vulnerability for Kurdistan if Baghdad chose to exploit such access aggressively and outside the spirit of a dispute resolution mechanism.

Finally, it should be noted that there is no fully united Kurdish perspective. As political disputes have worsened between the two family-led political parties—the Barzani-run Kurdistan Democratic Party (KDP) and the Talabani-run Patriotic Union of Kurdistan (PUK)—the latter's position on the energy dispute has moved closer to Baghdad's than to the KDP-dominated KRG. The PUK appears willing—unless the KDP agrees to intensified power sharing—to see the region stripped down to the level of a province and for the PUK-dominated Sulaymaniyah province to become Baghdad's most-preferred Kurdish governorate at the expense of Kurdistan's independent energy policies. As a result, for now, the PUK tracks closer to Baghdad's views on governance of the energy sector and revenue management.

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## High- and Low-Consensus Aspects of the Dispute

Not all the sub-issues related to implementing the FSC ruling are created equal. In some, an acceptable middle road could be surprisingly easy to reach. In these areas, solutions have long been discussed and sensitivity is relatively low. Other sub-issues are heavily politicized and public, with strong emotions surrounding them. Some sub-issues look easy to resolve from an outsider's perspective but are in fact hard to agree on, often for unspoken reasons the negotiators cannot fully broach in their bilateral sessions, as discussed earlier. The following sections explore the key sub-issues, from the easiest to the hardest to resolve.

## Review of the Kurdistan Region's Energy Contracts (Higher Consensus)

Iraq has two ostensible problems with the Kurdistan Region's production-sharing contracts (PSCs) signed with international oil companies. The first is whether the region has the right to sign any contracts at all, and the second is a reservation specific to contract types. In Iraq's constitution, oil is declared the property of the Iraqi people, a clause that has been interpreted in Baghdad in various literal ways that manifest as objections to Kurdistan's use of PSCs. Whereas Baghdad places end-user restrictions on its crude sales—i.e., they go only to refiners, to prevent uncontrolled resale—the Kurds sell to oil traders such as Glencore, Vitol, Trafigura, and Rosneft. Likewise, Baghdad objects to contracts that nominally create the expectation that the investor is paid in crude oil.

In reality, the divide is much less clear between how Kurdistan and Baghdad act. Curiously, Baghdad *does* currently recompense its foreign oil investors in crude oil, as opposed to cash, while the KRG *does not* yet pay any of its contractors in crude—as they would prefer. Additionally, Baghdad's contracts are slowly heading in the direction of Kurdistan's, with greater price-linked inducements to investors and guaranteed tranches of oil allocated as payment. The KRG is arguably moving in the opposite direction, seeking greater government “take” in its oil contracts and slowly reducing inducements. There would thus seem to be a degree of convergence on contract models that is already apparent and could be much more apparent in future years.

Baghdad has requested in writing that the Kurdistan Region's energy investors share their contracts with Baghdad in a legal review process. Baghdad's Oil Ministry has claimed—with some credibility—that it absolutely wants to avoid the numerous international arbitrations that could ensue if the energy investors feel the need to defend their English Law (i.e., UK law) contracts. Baghdad's view has been: trust us, the changes will be cosmetic. As a risk-averse Iraqi bureaucracy seeking the path of least resistance, the

Oil Ministry may be quite sincere in this statement—at least for now.

While the Kurdistan Region objects to Baghdad directly sourcing the contracts from the foreign investors, the KRG seems to have no objection to sitting with Baghdad and jointly reviewing the contracts as two governments.

The key bone of contention is how the contracts might be reviewed: Baghdad wants to select a panel of foreign consultants who will advise of any changes required to make the contracts compatible with Iraqi law and the Iraqi constitution. The Kurds want a role in choosing the consultants and approving any recommended changes before a report is issued. Foreign investors and their governments would achieve a major improvement in their commercial position if, at the end of a Baghdad-Erbil negotiation, the contracts remained under international law (and thus international arbitration) and tied to a Kurdistan oil and gas law—which could be reissued with Baghdad's agreement. Both foreign investors and the KRG would secure a significant net win on the issue of licensing because Baghdad would have finally recognized the reviewed contracts as fully legal.

## Banking and Revenue Management (Medium Consensus)

Another issue of relative consensus is the means by which the Kurdistan Region would receive income derived from its oil, and presumably gas, sales. Assuming that the marketing of Kurdistan-operated crude moves to some kind of joint marketing arrangement involving SOMO, then the resultant oil sales revenues must reach a bank and thereafter the KRG (see below sections). In the future, annual budget law articles or a more permanent revenue-sharing law could create formulas for the exact amounts to be transferred to the region, after payments to oil-producing companies (see below). For now, a more mechanical issue is under discussion: namely, who owns the bank account

and how can the Kurds be sure they will be paid as reliably as they are today.

Both Baghdad and Erbil agree that an international bank should be used to collect the revenues from the oil buyers. Both agree that each would have full observer access to the account, creating greater transparency and building trust—not only between Baghdad and Kurdistan, but potentially even between the KDP and PUK, and between Kurdish society and parliament and the government. On the not inconsequential issue of who owns and administers the account, both sides predictably want to be the sole administrator. But Baghdad portrays this as a cosmetic arrangement only, proposing an escrow arrangement whereby even if Baghdad owns the account, the agreed monthly payments to the region would automatically transfer within two weeks of each month's end unless both Baghdad and the KRG object in writing—which logically Erbil will never do.

To reassure the Kurds, this so-called KRG override would need to be carefully written and overseen, perhaps by international observers as well as the bank. Without a formula for calculating the Kurdish dues—one that relies on a much more complex negotiation and ideally a revenue-sharing law—an escrow deal might become confused and dysfunctional. But on the bright side, this could be an opportunity for both sides, and international mediators, to put real effort and momentum into setting an enduring revenue-sharing formula, which would be a logical adjunct to an agreement on banking.

### **Marketing of Kurdistan's Oil Production (Low–Medium Consensus)**

On the face of it, Baghdad and Kurdistan, and foreign investors, are somewhat aligned on the benefits of greater SOMO involvement in marketing Kurdistan-operated oil. Due to political risk and prepayment discounts imposed by oil traders, along with expensive oil export pipeline tariffs, Kurdistan Region

crude has typically sold at a steep discount to Brent benchmark prices amounting to no less than \$10 per barrel and often much more. This discount may increase as a result of rising uncertainty related to the FSC ruling.

If SOMO were involved in selling Kurdistan-operated crude, the price would rise sharply. SOMO would have more leverage over traders than the KRG currently does, being that the same traders want to protect their access to Baghdad's own much larger oil sales out of Basra. SOMO could also lobby Turkey to lower its oil export tariffs, potentially using leverage generated by the strong Iraqi likelihood of a favorable decision and a multibillion-dollar award in the ITP arbitration against Turkey in the International Chamber of Commerce.<sup>4</sup> (SOMO transports crude at less than \$1.75 per barrel via the ITP, but Kurdistan-operated crude has a harder-to-explain transit fee exceeding \$3 per barrel.) These costs could decline, and SOMO could give meaningful assistance to the Kurds in standardizing the oil blends sold by Iraq and Kurdistan from the Turkish port of Ceyhan. SOMO involvement would probably be a relief for foreign oil companies, which struggle to gain transparency into how crude is priced by the KRG and their own resulting contract entitlements.

For Baghdad, an apparently meaningful transition to SOMO marketing is a must to show the FSC ruling has been implemented. Transfer or sharing of marketing duties is an emotive issue for Baghdad politicians and Oil Ministry officials, given their long careers within a centralized oil sector in which SOMO is a venerated institution. The FSC will be seen to have been implemented if Iraq returns to its roots, before Kurdistan's independent oil exports, of having one oil marketer that can maximize the value of sold oil. Baghdad wants this win so badly that it is probably ready to absorb remaining KRG debts to oil traders (in the \$1–3 billion range) into the federal balance with traders.

Kurdish objections to the transfer of marketing have been couched in organizational terms—e.g.,

suggesting a largely cosmetic rebranding of existing marketing arrangements with a tidier face—a Kurdistan Oil Marketing Organization (KOMO) entirely controlled by the KRG, or with token SOMO involvement. Underlying these arguments is the touchy issue of reversibility—i.e., ensuring Kurdistan still has the trader relationships in order to restart direct oil sales in case of another breakdown in any Baghdad-KRG deal.

If Kurdistan were to effectively “sell” its future marketing rights back to Iraq for Baghdad’s absorption of its debts, the region has signaled that this must go beyond the \$1–3 billion of remaining trader debt and be backdated to include all the debts incurred by the region since Baghdad cut Kurdistan’s revenue share in 2014. This sum would likely come to \$5–10 billion (if not more) of borrowing, some of which is already repaid. The marketing issue is thus a very tricky challenge due to the Kurdish need for reversibility and Baghdad’s need for a real change in the mechanism for Kurdistan-operated oil sales.

## **Governance of the KRG Energy Sector (Low Consensus)**

Another very challenging issue is future governance of the KRG energy sector. At heart, the Baghdad Oil Ministry has always deeply resented the existence of a parallel energy ministry in Erbil. Beyond simple institutional rivalry, Iraqi oil officials have a deep conviction that it is simply wrong to have two energy regulators in one country, in the same way they consider having two oil marketing agencies a mistake. If there is one area where Iraqi Oil Ministry officials appear to be going beyond the strict requirements of the FSC ruling and pursuing a broader agenda, it is regarding the governance of the Kurdistan energy sector and particularly the attempted demotion of the KRG’s Ministry of Natural Resources to sub-ministry status.

On sector governance so far, Baghdad’s ideas would appear to involve forming a new Kurdistan Regional Oil Company (KROC) that is registered in Baghdad

under Iraqi law but operates in Erbil. In Baghdad’s view, KROC would not be the coequal equivalent of the Iraq National Oil Company (INOC) but instead analogous to the Oil Ministry’s Kirkuk-based North Oil Company—a subsidiary of INOC. In explicit terms, Baghdad proposes that KROC manage all aspects of the Kurdistan oil and gas sector except two areas of interface in which the Oil Ministry will lead: first, marketing, as discussed above, and second, the annual approval of field development plans and budgets.

This second clause—the keys to the kingdom, in energy sector terms—reflects the Oil Ministry’s deep suspicion, almost entirely unfounded, that the Kurdistan energy sector is somehow being less efficiently stewarded than that of Baghdad. A lack of transparency seems to have convinced Baghdad that, for instance, reservoir life span is being shortened by less sustainable extraction practices in Kurdistan, whereas in reality foreign oil engineers bring significant expertise to each project. In fact, Baghdad’s experts do not have anywhere near the understanding of Kurdistan’s complex geology or exploration operations that the Ministry of Natural Resources (MNR) and oil investors do. Through its foreign oil contractors, Kurdistan could add greatly to the Oil Ministry’s technical capacity.

Kurdistan officials, by contrast, perceive a new KROC as coequal to the INOC and seek for it to be registered in Erbil under Kurdistan law. To Kurdish leaders, having two regulators in the energy sector is essential, reflecting the region’s fundamental right in Iraq’s system of asymmetrical decentralization—wherein regions have greater devolved powers than provinces. Yet underlying Kurdish discussion of this seemingly dry issue—where KROC is registered and how it should coordinate with the Oil Ministry—is the larger fear that the Kurdistan Region’s special status will be eroded. If the MNR is not the equivalent of the Oil Ministry, then why not demote other KRG ministries? If a KRG ministry subsidiary in Kurdistan (e.g., KROC) is being directly administered by a Baghdad ministry, why have ministries in the region at all? Where does it end?

## Roadmap for Progress

Taking into account the picture presented above, a realistic international approach to aiding the negotiations must follow. (Table 1 summarizes the key views of Baghdad and the KRG on the

sub-issues raised by the FSC ruling.) The remaining deal space is discussed thereafter, along with some ideas for win-win outcomes that may be within reach.

Table 1. Baghdad and KRG Preferences on Key Energy Dispute Sub-Issues

ISSUE	BAGHDAD PREFERENCE	ERBIL PREFERENCE
<b>Marketing</b>	State Oil Marketing Organization (SOMO) markets, with token KRG involvement.	Kurdistan Oil Marketing Organization (KOMO) markets, coordinating on price with SOMO.
<b>Bank account</b>	Baghdad opens/owns account; KRG has observer access.	KRG opens/owns account; Baghdad has observer access.
<b>Revenue management</b>	KRG automatically receives owed transfer if no Baghdad signature by month-end plus 15 days.	KRG automatically receives month-end transfers in sync with Baghdad month-end payments.
<b>Contracts review</b>	Baghdad selects international consultants who recommend changes.	KRG can veto selection of international consultants, and recommended changes are not made public until unanimous approval by both Baghdad and KRG.
<b>Governance</b>	<ul style="list-style-type: none"> <li>■ The Kurdistan Regional Oil Company (KROC) is a subsidiary of the federal Oil Ministry, not the Kurdistan Ministry of Natural Resources (MNR).</li> <li>■ KROC administers all KRG oil/gas operations except two interfaces with the Oil Ministry:               <ul style="list-style-type: none"> <li>□ Marketing</li> <li>□ Approval of annual field development plans and budgets</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>■ KROC is a subsidiary of the MNR.</li> <li>■ KROC administers all KRG oil/gas operations except marketing.</li> </ul>
<b>KRG debt</b>	Baghdad assumes current remaining trade debt (\$1–3 billion).	Baghdad assumes a broad body of debt caused by the interruptions of Baghdad budget transfers since 2012 (\$5–10 billion, if not more).

## Win-Win Outcomes

The following proposed steps would constitute an interim arrangement to implement the FSC ruling for an initial two years. During this period, the two sides would work on legislation such as a federal hydrocarbons framework law, a federal revenue-sharing law, and other issues. If, after two years, the necessary legislation has not been passed, both sides would have the right to terminate the interim agreement or else extend it by a further year. The initial agreement would be authorized by the Iraqi and KRG heads of government.

On the tricky issue of marketing, one innovative solution might be to have SOMO create a new subsidiary called "SOMO North." This would be registered in Baghdad and have an Iraqi-appointed director-general (who would control only Iraqi-operated exports via the ITP) joined by a KRG-appointed deputy director-general (who would control Kurdistan-operated exports via the ITP). The director-general of SOMO North would have oversight access (i.e., transparency) into KRG oil sales and trading agreements. As a reciprocal gesture, a KRG appointee would join the board of the main SOMO organization. Baghdad would not absorb remaining trader debts, and the KRG would retain direct access to oil traders. However, coordination on pricing, specifications, and pipeline tariffs would tighten considerably for mutual benefit. Against the background of a general agreement on the Kurdistan oil sector, per-barrel netback prices could improve regardless of who markets the crude. Commonsense per-capita sharing of the OPEC quota between Baghdad and Kurdistan could also be settled and trialed for the interim period.

On banking and escrow payment of KRG oil receipts, the way forward is relatively clear. Baghdad should invite a major international bank to set up an account to receive KRG oil and gas sales receipts. Iraq would own the account but only with oversight access (i.e., transparency). Baghdad would not be permitted to close the account or alter its operating rules without

signatures from both the federal government prime minister and the KRG prime minister. At the start of each month, the account would release the KRG's oil revenues to the KRG Ministry of Finance and Economy unless stopped by signatures from both the federal government prime minister and the KRG prime minister.

Under this model deal, KROC would be registered in Baghdad and Erbil simultaneously, but would operate under Kurdistan law with its main headquarters in Erbil and a representative office in Baghdad. It would take over many functions and much staff of the MNR, leaving it as a smaller pure regulator with ministry-level status. Within the Kurdistan Region, KROC would be the equivalent of INOC, with its director-general KRG-appointed and its deputy Baghdad-appointed. Institutionalized coordination (monthly meetings) would occur between MNR/KROC and the Oil Ministry/INOC, and Baghdad would gain oversight access into (i.e., transparency) but not control over the execution of Kurdistan-operated field development plans. Joint seminars on technical issues would be held quarterly, alternating between Baghdad/Basra and Erbil, to exchange data, develop expertise, and arrange secondments.

A careful and extended process of reviewing KRG oil contracts could begin with a committee that comprises one Baghdad-nominated consultant, one KRG-appointed consultant, and one consultant selected and paid by an international contact group (e.g., U.S., UK, and UAE) or a nongovernmental agency (e.g., IMF, International Energy Agency). Issuance of the committee's recommendations would only be publicized upon signatures from both the federal government prime minister and the KRG prime minister. Both Baghdad and Kurdistan would be mindful to avoid potential legal disputes with existing investors and to set the guidelines for future investments. At the end of the process, Baghdad would declare the reviewed and potentially amended contracts to be acceptable contractual models and the KRG-issued contracts to be "grandfathered" to their points of inception as valid and legal.

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## The U.S.-Led International Role

In some internal reconciliation processes, international mediators can be a distraction or an overcomplication. In the worst cases, such involvement can even encourage participants to adopt more hardline positions to shake loose aid or other inducements from international players who care more about a positive outcome than the participants do themselves.

This is not the case with Baghdad-KRG negotiations. Both Baghdad and Erbil tend to behave better and engage more fully in dialogue when international players are observing closely and are loosely woven into the process. Left to their own devices, Baghdad and the KRG have a very poor track record in making timely and lasting compromise settlements. Deep multilateral involvement in the Baghdad-KRG energy issue has not yet been fully tested, but it has promise. The current UN Assistance Mission for Iraq (UNAMI) involvement in Kurdistan Region election law redesign and related political dialogue may provide a good example of the model, with both high-level political mediation and technical assistance provided by the UN. Indeed, UNAMI's new mandate includes mediation between parties that could be extended to the energy and economic arenas.

### Political Support

If a similar effort to UNAMI's were undertaken in the Baghdad-KRG energy dispute, it could inject much-needed urgency and pragmatism into the negotiations. A contact group of Iraq-focused international players, led by the United States, would demonstrate that the world is paying sustained attention to the positions taken by both Baghdad and Erbil. A dedicated effort could detect the nuance in each side's words and actions, and thus diagnose what or who is blocking a resolution.

At the very least, an international contact group needs to remind Baghdad and Erbil that their actions can help or hurt the global economy. If 500,000 bpd of oil is taken off the world market, as already noted, that will more than wipe away recent hard-fought increases in OPEC production. President Joe Biden is going to Saudi Arabia in July 2022 to shake Crown Prince Muhammed bin Salman's hand, with reduced oil prices being a significant payoff for this painful compromise on a principled position enunciated clearly by a U.S. president. If Baghdad court injunctions remove Kurdistan's oil from the market, then the president will have gone to Saudi Arabia for nothing.

U.S. interests clearly require oil exports—and later gas exports—out of Kurdistan to displace Russian and Iranian energy supplies to Turkey and Europe. Cutting off Iraq's northern export route will only benefit the petroleum despots of this world—Russia and Iran—and make the United States, Europe, and Asia more vulnerable. There should be a price to pay for willingly inflicting this cost on the West and Asia. Iraq and Kurdistan need to understand clearly that the international community's ability to aid Iraqi and KRG economic recoveries is directly linked to the health of Western and Asian economies. If they suffer, aid flows to Baghdad and other items such as Iran sanctions waivers may also suffer.

International actors need to make something else very clear to Iraq and Kurdistan. The internationally midwived Iraqi constitution arranged for the reintegration of Iraqi Kurdistan into Iraq in 2003–5. It did so on the promise of significant and permanent fiscal and administrative decentralization for a Kurdistan Region of Iraq. As was the case in 2017, when Baghdad threatened to militarily dismember Kurdistan, friends of Iraq now need to stand behind the spirit of the constitution they helped build. International actors need to make clear that the FSC ruling cannot be used as cover to administratively and legally dismember the Kurdistan Region. The KRG is not and never will be a province—until such time as the residents of the region decide themselves to collapse the regional government.

Western and Asian governments have been quite indulgent with the recent politicization of court rulings in Baghdad, which has approached the level of a legal coup. The timing of the FSC ruling on Kurdistan's oil and gas law—suddenly resolved amid a government-formation crisis after being consigned to the doldrums for many years—is suspicious enough, but it might still pass by without serious censure from internationals if the ruling is now implemented sensitively and responsibly. It would *not* be responsible or humane to cut off the income of five million residents and displaced persons and refugees in the Kurdistan Region. It would *not* be responsible to crash the economy of one-fifth of Iraq. And it would definitely *not* be responsible to take 500,000 bpd off the oil market at a moment when oil already costs over \$100 per barrel and new shortfalls could trigger recessions. If the FSC ruling was indeed weaponized as a tool of political warfare—as some Western states know and can prove for a fact—then the architects of the new ruling must tread very carefully before they unleash devastating consequences on the world, and perhaps themselves.

## Technical Assistance

As has occurred with electoral law reforms in Iraq and now Kurdistan, international partners can contribute neutral, specialized technical assistance to resolution of the Baghdad-KRG energy dispute.

- **Marketing.** A range of nations—including other oil producers—could assist the Kurds in developing a SOMO North marketing arm that would equal or even surpass the professionalism and transparency of SOMO's historic operations. Saudi Aramco or the UAE's Abu Dhabi National Oil Company, or even Norway or Indonesia, may be willing to provide such advice.
- **Trader debt.** Many times, the KRG has approached receiving sub-sovereign loans, but each attempt has been stymied by political breakdowns with Baghdad and the high cost of sub-sovereign borrowing. But what if there were an end in sight to the Baghdad-KRG energy dispute and a way ahead to fully authorized KRG oil exports via SOMO North? Under such circumstances, a compelling set of strategic imperatives would favor offering a loan to incentivize KRG acceptance of a package deal. Then perhaps, the International Finance Corporation or other international financial institutions would reapproach a \$1–3 billion loan to clear the KRG's debts and allow more transparency in an entirely “open book” set of new trader deals signed by SOMO North with Baghdad's approval.
- **Bank and escrow arrangement.** Very clearly, the more international attention that goes to the banking arrangement and its initial formalization as a set of written rules, the less chance there is for duplicity at a later stage. Trust building can be an international role in resolving the Baghdad-KRG dispute—especially for those states whose banks are used and whose territory hosts the accounts. The UAE stands out as an option.
- **Contracts review.** The choice of all or some contractor reviewers by an international compact—and potential payment by international actors of the costs of the exercise—might be a way to inject nonpartisan assessors and build trust in the process. It would also encourage fresh thinking, instead of the well-trodden battle lines of Baghdad's and Kurdistan's long-term legal counsels.
- **KROC establishment.** As with marketing, the formation of an efficient, transparent KROC could easily be guided and technically assisted by any number of international advisors—and indeed partially paid for by international donors. This could build trust—with Baghdad and with the Kurdistan public—that oil production, processing, and transportation is largely corruption-free and audited. Capacity building in the MNR and a future KROC is much needed, as presently the Kurdistan Region energy sector creaks along with a very shallow bench of professional talent and very new, underdeveloped institutions.

- **Information sharing and confidence building.** Achieving transparency in marketing, revenue management, and contracts review requires secure information technology solutions that convincingly show exactly how much oil, revenue, and costs are being generated. International partners and donors could quite cheaply create a secure electronic bridge between Baghdad, Erbil, export terminals, banks, and consultants. This kind of transparency could show, for instance, that Kurdistan crude is not being sold to Israel—which is a key propaganda claim of pro-Iran militias.

## Flowing into the Grand Bargain

Even as the first stage (described above) is still being tested, a second stage of support should be planned and scoped. This stage would aim to produce the legislation needed to more permanently secure any gains of an interim two-year arrangement. Key focus areas would include:

- **Iraq-Turkey Pipeline arbitration support.** One of the closest crocodiles to the boat of northern Iraq energy exports is the impending ruling from the International Chamber of Commerce on ITP arbitration in the second half of 2022 or early 2023. This could, in itself, remove 500,000 bpd of oil from the market if Turkey reacts to a decision or award with shock. The United States and Iraq's other friends have every incentive to prod both parties toward settlement either before decision or before award—both of which could very well cause deep shock and diplomatic withdrawal in Turkey. As Iraq is likelier to be successful—especially now with the FSC ruling in hand—then Baghdad must be the party to be compensated in any early settlement. Turkey can easily do this—with water, electricity, trade, and perhaps refurbishment of the ITP. The net gain to U.S. and partner interests is clear: better Turkey-Iraq relations and better Iraq-KRG relations, less drought and more electricity and trade in Iraq, and 500,000 bpd

kept on the market, with additional volumes of oil and gas to follow.

- **Federal hydrocarbons framework law.** This law has been mostly written since 2007 but has sat on the shelf awaiting exactly the kind of settlement that Baghdad and the KRG may be approaching. Clarity on any and all of the issues discussed in this paper can help fill in the gaps in the hydrocarbons framework law. Other issues could also be discussed, such as formulas for sharing the OPEC quota between Baghdad and Kurdistan. The law would cement in place the interim agreement and any needed modifications. Both Iraqi and Kurdish political blocs need to be firmly and insistently prodded by international players to complete this long-overdue legislative project.
- **Support to Kurdistan's regional oil and gas law.** If the Baghdad-KRG energy issues are resolved, the 2007 Kurdistan oil and gas law might be reapproved by the parliament in Erbil with new references to the federal hydrocarbons framework law. This would give Kurdistan energy investors new and stronger authorization of their contracts, which would be based on an undisputed Kurdistan law now supported by Baghdad. The KRG should be pushed by international supporters to fully implement the law, for instance by forming institutions envisaged in it such as the Kurdistan Oil Trust Organization (KOTO), a national fund meant to hold oil revenues in a transparent manner with some withholdings for a strategic reserve.
- **Revenue-sharing law.** As with the above laws, a long-needed revenue-sharing law could replace year-on-year budget arrangements between Baghdad and the KRG. International actors could aid the process with complex accounting and balancing of what is owed to whom over the years, creating a balance sheet and then clearing that sheet with a soft loan that can be repaid equally by the parties over the long term.

## Conclusion

This paper is an appeal—in the form of solid policy options—for the United States and other friends of Iraq to collectively try harder to resolve the Baghdad-KRG energy dispute as quickly as possible. These days, the United States doing nothing or doing less in the Middle East *seems* to increasingly be an option, but in this case it will have very negative effects for U.S. and global interests.

Many avoidable negative outcomes can still be mitigated. If FSC ruling implementation can be stopped or slowed while constructive dialogue is undertaken, then all may be well. If not, then the future will likely include higher oil prices, windfalls for Russia and Iran and a deeper, longer global recession, the collapse of relations between Baghdad and Erbil, if not Ankara as well, and an economic crisis affecting five million people on Europe's doorstep, within easy reach of numerous terrorist groups and their recruiters.

One may ask whether external partners should want a Baghdad-KRG deal more than the Iraqis and Kurds seem to want it themselves. The answer is an emphatic yes: external states have a responsibility to their own national security interests to try to prevent negative events with global impact. The United States and other friends of Iraq may face far worse outcomes if they do not act sooner rather than later. When a country's friends are fighting, it must try to keep them from hurting each other or doing irreversible wrongs while in the heat of an argument. Looking away is rarely the right course of action. That is the clear lesson of the Kurdistan referendum and Kirkuk crisis of 2017—a disastrous case that showed the value of investing a little policymaker attention to prevent a crisis as opposed to a lot of time to clean up the mess afterward. Given how many challenges U.S. policymakers face, they need to focus on prevention, not the cure, and it seems a little soon for the United States and its partners to have forgotten the stark and painful lessons of 2017. ❖

## NOTES

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## The Author

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**MICHAEL KNIGHTS**, the Jill and Jay Bernstein Fellow of The Washington Institute, has worked on and in Iraq and the Kurdistan Region of Iraq for twenty years. He maintains close ties to both Iraqi and Kurdish policymakers dealing with Baghdad-Kurdistan negotiations and the energy sector. He has visited Iraq and Kurdistan on three occasions this year to undertake research for this and other papers.

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