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United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Report of Inspection

A Review of U.S. Policy Relative to Petroleum-Sector Contracting In Iraq

Report Number ISP-I-09-28A, March 2009

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PURPOSE, SCOPE AND METHODOLOGY OF THE INSPECTION

This inspection was conducted in accordance with the Quality Standards for Inspections, as issued by the President's Council on Integrity and Efficiency, and the Inspector's Handbook, as issued by the Office of Inspector General for the U.S. Department of State (Department) and the Broadcasting Board of Governors (BBG).

PURPOSE

The Office of Inspections provides the Secretary of State, the Chairman of the BBG, and Congress with systematic and independent evaluations of the operations of the Department and the BBG. Inspections cover three broad areas, consistent with Section 209 of the Foreign Service Act of 1980:

Policy Implementation: whether policy goals and objectives are being effectively achieved; whether U.S. interests are being accurately and effectively represented; and whether all elements of an office or mission are being adequately coordinated.

Resource Management: whether resources are being used and managed with maximum efficiency, effectiveness, and economy and whether financial transactions and accounts are properly conducted, maintained, and reported.

Management Controls: whether the administration of activities and operations meets the requirements of applicable laws and regulations; whether internal management controls have been instituted to ensure quality of performance and reduce the likelihood of mismanagement; whether instance of fraud, waste, or abuse exist; and whether adequate steps for detection, correction, and prevention have been taken.

METHODOLOGY

In conducting this inspection, the inspectors: reviewed pertinent records; as appropriate, circulated, reviewed, and compiled the results of survey instruments; conducted on-site interviews; and reviewed the substance of the report and its findings and recommendations with offices, individuals, organizations, and activities affected by this review.

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PREFACE

This report was prepared by the Office of Inspector General (OIG) pursuant to the Inspector General Act of 1978, as amended, Section 209 of the Foreign Service Act of 1980, the Arms Control and Disarmament Amendments Act of 1987, and the Department of State and Related Agencies Appropriations Act, FY 1996. It is one of a series of audit, inspection, investigative, and special reports prepared by OIG periodically as part of its oversight responsibility with respect to the Department of State and the Broadcasting Board of Governors to identify and prevent fraud, waste, abuse, and mismanagement.

This report is the result of an assessment of the strengths and weaknesses of the office, post, or function under review. It is based on interviews with employees and officials of relevant agencies and institutions, direct observation, and a review of applicable documents.

The recommendations therein have been developed on the basis of the best knowledge available to the OIG, and have been discussed in draft with those responsible for implementation. It is my hope that these recommendations will result in more effective, efficient, and/or economical operations.

I express my appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in black ink, appearing to read "H. W. Geisel".

Harold W. Geisel
Acting Inspector General

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EXECUTIVE SUMMARY

On July 16, 2008, Senators Kerry, Levin, McCaskill, and Schumer asked the Department's Acting Inspector General to investigate five interrelated issues on U.S. Government policies relative to the Iraqi petroleum sector.¹ The response was a commitment to initiate a review of the issues raised by the Senators.² This report addresses the sets of inquiry in the order formulated by the Senators.

In brief the Office of Inspector General (OIG) team concludes that:

- There was an ambiguously articulated U.S. Government policy linking passage of Iraqi federal hydrocarbon legislation (HCL) prior to contracting by international oil companies (IOC). This policy evolved over time and does not have the force of law. The U.S. Government cannot prohibit Iraq-related business decisions by private corporations. There is no suggestion or evidence that IOC contracts such as that between Hunt Oil and the Kurdish Regional Government are in contravention of U.S. law or regulations.
- U.S. Government employees³ generally understand the essence of this policy. When disseminated for the Embassy and other U.S. Government agencies to keep in mind in dealing with Iraqis on this issue the guidance was not definitive. Some officials posited that the U.S. Government discourages petroleum-sector contracts, absent passage of Iraqi federal HCL. Others have taken a softer line that the U.S. Government does not encourage such contracts. Yet other interpretations focused on potential legal and political risks inherent in contracts concluded prior to passage of national HCL.⁴

¹Letter from Senators Kerry, Levin, McCaskill, and Schumer to Acting Inspector General Geisel, dated July 16, 2008.

²Acting Inspector General Geisel letter responding to the four inquiring Senators, dated July 22, 2008.

³Department of Defense personnel serving in Iraq under Unified Military Command authority are not encompassed in this review, although the inspectors note that some of those persons are engaged in petroleum-related issues—e.g. the energy fusion cell in Baghdad.

⁴In the absence of national HCL, the Government of Iraq has relied on the Iraqi constitution and Saddam-era laws as a basis for petroleum-sector policy and decisions.

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- Among the highest U.S. Government objectives in Iraq since the ouster of Saddam Hussein is preservation of the country as a single political entity. Equitable distribution of petroleum-generated revenues is perceived to be critical to achieving that end. Hence, passage of a national-HCL package is a benchmark set by both the Government of Iraq and the U.S. Congress.⁵ For an extended time, the HCL issue has been a central focus of political attention by Embassy Baghdad. Members of Congress and U.S. cabinet officers have reinforced the message when visiting Iraq or when ranking Iraqi officials are in Washington. Public diplomacy efforts subsequently clarified the U.S. Government's position. The inspectors conclude that the Government of Iraq's failure or inability to reach agreement on an HCL package should not detract from strong, consistent policy pressure from the U.S. Government.
- Short-term technical services agreements (TSAs)⁶ under negotiation at the time the Senators wrote to the Acting Inspector General were set aside by the Iraqi Government in September 2008. The Government of Iraq's objective was to increase production from existing oil and gas fields (brown fields). On October 13, 2008, Iraqi Minister of Oil (MoO) Shahrستاني announced a bidding process for longer-term brown field TSAs. Seven American IOCs are among firms prequalified to bid for these contracts.

The U.S. Government's posture is to approve of such TSAs. The OIG inspectors concluded that this has not been formalized as policy per se. However, the position has been communicated to the Government of Iraq. Likewise, if and as IOC representatives inquire, the U.S. Government's positive stance is conveyed. The Department of Commerce routinely announced Government of Iraq plans to proceed with brown field TSAs.⁷ The OIG team believes such notification to be in keeping with the long-standing U.S. Government commitment to the concept of a level playing field for American firms bidding on international contracts. Likewise, endorsement of this TSA concept is not contrary to U.S. Government reservations concerning Kurdistan Regional Government production sharing agreements (PSAs).⁸

⁵ The 2006 Iraq Supplemental incorporated benchmark language and mandated reductions in economic assistance if national HCL was not passed. President Bush vetoed the supplemental for other reasons.

⁶ For purposes of his review, usage of the term technical services agreements is considered synonymous with technical service contracts.

⁷ U.S. Department of Commerce announcement of TSA opportunities

⁸ Likewise, usage of production sharing agreements is considered synonymous with production sharing contracts.

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- As of November 2008, the Government of Iraq had not opened any process for IOC involvement in developing new areas (green fields) for exploration or exploitation, whether via TSAs or through PSAs. The inspectors found no articulated U.S. Government policy position on such potential contracts. However, there is a shared Iraqi-American perception that eventual, optimal development of Iraq's vast petroleum potential will necessitate sizeable foreign involvement in terms of both capital investment and technical assistance. The U.S. Government and major IOCs believe that such foreign participation will emerge only after a clear legal regime (namely, passage of a national HCL package) is in place.

Notwithstanding the latter point, smaller IOCs have moved ahead in the absence of national HCL. At the time of this review, the Kurdistan Regional Government had signed PSAs with 20 IOCs, which involved at least six American companies.⁹ Even major IOCs are eager to become engaged in Iraq; i.e., the TSA process. Based on this review, the OIG inspectors perceive that IOC executives will make decisions based on their frequently reviewed risk analysis. U.S. Government policies are but one factor in such analyses and not necessarily the most important consideration.

- Discussion of relevant U.S. Government policies and positions has taken place with both the Government of Iraq and with the Kurdistan Regional Government. The dialogue with the Federal Government in Baghdad has been more frequent. Discussion with the Kurdistan Regional Government—based in Erbil—is less vibrant. High-ranking American officials spend more time in Baghdad than in the Kurdish region, and implementation of oil policy related to the Kurdistan Regional Government is normally undertaken by officers from Embassy Baghdad. Nonetheless, U.S. officials consistently stress the criticality of agreement on a national HCL package in Baghdad and Erbil.

⁹Table of information on production sharing agreements contracted with the Kurdistan Regional Government.

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The primary, relevant U.S. Government objective is passage of national HCL. Actions that detract from this objective are unwelcome. Hence, the dialogue has been more accommodating with the Government of Iraq and more critical of Kurdistan Regional Government actions to include PSAs such as that with Hunt Oil.

- Overall, dissemination of policy information across the spectrum of the U.S. Government has not been systematic.

The Senators did not request and the OIG team did not evaluate of the respective policies.

METHODOLOGY

The four Senators whose request resulted in this review asked OIG to determine the existence of policies, the dissemination and communication thereof, the consistency among relevant policies, and how these have been conveyed to national and regional officials in Iraq.

The Acting Inspector General agreed to initiate a review of the issues raised by the Senators. Accordingly, this review was conducted by Ambassador David E. Zweifel and Senior Inspector Matthew Koch between September 22 and November 25, 2008.

The inspectors examined voluminous pertinent documents and interviewed a wide range of U.S. Government employees, private sector representatives, and the Washington-based representative of the Kurdistan Regional Government. In keeping with due diligence, the OIG inspectors reached out to additional organizations and people that have an interest in, or knowledge of, relevant policy formulation and communication. Some of them declined to participate in this review.

There are deficiencies in the written record. Much information was exchanged via e-mail, only retrievable if the originator or addressees retain electronic or paper copies. Some e-mail messages available to the OIG inspectors (not limited to those internal to the Department) are reconstructions of events and conversations that may have taken place weeks earlier. Likewise, since some informal messages inevitably are deleted, there is no assurance that OIG inspectors perused all such pertinent exchanges. The old adage applies: we do not know what we do not know.

Another factor emerged during the analysis of written materials. Very often the exchanges between U.S. Government employees and others document only one side of the conversation: what the non-U.S. Government participant said. This is not unique to the issues under review. Busy personnel assume that readers who follow events know the U.S. Government's side of the dialogue. However, this complicates assessment (in this case, sometimes several years after the fact) of the way in which policies have communicated.

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CONTEXT

More than 90 percent of the Government of Iraq's revenues are generated from crude oil exports. The country has either the second or third largest global proven petroleum reserves, as well as massive gas resources. It is axiomatic that exploitation of these natural resources is the key to Iraq's future development. Under the Iraqi constitution, petroleum resources belong to the Iraqi people. Equitable sharing of the petroleum-generated revenues thus is perceived as basic to preserving a single Iraqi political entity. Assuring that end is the underlying rationale for passage of a national HCL package.

The policy dialogue between the U.S. Government, the Government of Iraq, and Kurdistan Regional Government is conducted at various levels and venues. Frequent, direct involvement of high-level officials takes place both in Iraq and when Government of Iraq or Kurdistan Regional Government officials visit Washington.

Nonetheless, the OIG team concludes that policy dissemination and communication at different levels is not always consistent. Several factors are critical in assessing the process.

- Most U.S. Government American employees serving in Iraq are assigned for one-year tours. Their effective time in country is further reduced by the pattern of rest and recreation breaks. The working assumption is that about one-third of the American cadre is away from their post of assignment at any one time. Continuity of interpersonal dialogue thus is problematic—in a society where establishing comfortable interaction usually takes longer than in American culture.
- By extension, Iraqis place great value on the element of personal trust in the candor with which such issues are discussed. This does not detract from a common, shared propensity to hear what is most favorable to their positions—especially if they discern nuanced differences in discussions of a particular topic.

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- Although authoritative statement and explanation of policy is appropriately carried out at very high levels in both governments, lower-ranking officers or employees have more numerous interchanges with Iraqis. In evaluating issues under this review, discussions that touch on policies are of particular relevance for Americans serving in Erbil, the capital of the Kurdish region.
- U.S. policies are dynamic, reflecting changes and developments in Iraq and in Washington. Many policies are also interrelated. For example, security concerns are of constant and continuing importance to all aspects of American involvement in Iraq; restricted movements have a negative impact on the ease of dialogue. Similarly, the number, location, and responsibilities of U.S. Government civilian employees are subject to change, linked to U.S. military presence and availability of security personnel. Economic developments also shape policies. Such factors underscore the need to update policy guidance from time to time. Relaying shifts in policy to personnel on the front lines has not been as precise and timely as desirable.

The OIG inspectors concluded that the dissemination of policy information across the spectrum of the U.S. Government has not been systematic. As noted, the key bilateral policy dialogue must take place in capitals and at high levels. However, the widely dispersed U.S. Government presence in the country means that Iraqi regional and provincial official levels frequently rely on persons serving in regional embassy offices (REOs) and provincial or regional reconstruction teams (PRTs or RRTs) for information on U.S. policies and positions. As an example, illustrated in the table below, such information is not always conveyed or perceived in a uniform manner.

U.S. government employees' interpretation of The policy linking passage of HCL to oil contracts ¹⁰			
<u>Unaware or unsure of such a policy</u>	<u>Policy actively discourages contracts before HCL enacted</u>	<u>Policy does not encourage such contracts</u>	<u>Variations on such contracts are unhelpful or legally dubious</u>
6	15	6	13

¹⁰This table reflects the OIG team's review of documents and a combination of individual and group interviews carried out by inspectors.

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Prior to departing for Iraq, U.S. Government civilian employees assigned to the REOs and RRTs/PRTs attend a one-week, specially tailored course offered at the Foreign Service Institute. During that short course, 1^{1/2} hours is scheduled for an unclassified review of policy issues. The syllabus for the course does not elucidate further. Once in Iraq, personnel assigned to the REOs or PRTs/RRTs are given a two-day orientation conducted by Embassy Baghdad's Office of Provincial Affairs. This "is a general orientation that is meant to acquaint them with the resources available in this huge bureaucracy."¹¹ The agenda for the briefings includes a late afternoon 45-minute review of unspecified economic issues. These factors underscore the OIG team's conclusion that the process of disseminating policy guidance is imperfect at best.

At present, there is supposed to be overlap among American employees who serve under chief of mission authority in Iraq. Each incumbent is expected to brief his/her successor, in situ. This briefing and weekly telephone conference calls with personnel at Embassy Baghdad, ameliorate the problem. However, specific policy guidance can be (and apparently is) overlooked on occasion. Policy also can be attenuated or distorted as passed from one employee to another.

The classified version of this report (ISP-S-09-28A) makes a recommendation that the Bureau of Near Eastern Affairs, in coordination with the Bureau of Economic, Energy, and Business Affairs and Embassy Baghdad develop a brief summation or checklist of key bilateral issues and corresponding U.S. Government policies or positions and establish a schedule to review and update the information.

The classified version of this report (ISP-S-09-28A) also makes a recommendation that Embassy Baghdad disseminate the summarized policy guidance to all U.S. Government employees under ambassadorial authority, if it is unclassified, or assure it is reviewed by all appropriately cleared American employees, if it is classified.

¹¹E-mail exchange between OIG and Embassy Baghdad.

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RESPONSE TO INQUIRY 1

Was there a clear U.S. policy discouraging oil contracts between private companies and regional governments in Iraq prior to the signing of the production sharing contract between Hunt Oil and the Kurdistan Regional Government on September 8, 2007? If so, was this policy adequately communicated, understood, and disseminated by State Department employees?

The OIG inspectors concluded there is such a U.S. Government policy. However, this policy was ambiguously articulated; when subsequently disseminated, the policy guidance was not definitive, and interpretation and communication of the policy varied. Like others that relate to IOC contracting in the Iraqi petroleum sector, this policy evolved over time. This is hardly unique. Policy formulation must be a dynamic process, reflecting changing developments and events. Thus, on September 19, 2003, the Coalition Provisional Authority nullified all Saddam-era foreign investment law. Direct foreign ownership of natural resources was prohibited, but the clear intent was to encourage across-the-board private investment—including that by foreign enterprises.¹² There was consensus among those consulted during this review that the U.S. Government initially favored the prospect of IOC contracts in Iraq without further defining the form such contracts might take.¹³ However, it was essentially a hands-off approach. Department press guidance from early December 2005 illuminates the point:

Q: Has the U.S. conveyed any concerns to the Iraq Kurds regarding their oil agreement with Norway...?

A: This is an internal matter that should be directed to Iraqi authorities...

A primary U.S. Government goal in post-Saddam Iraq has been to assure cohesion of the country as a political unit. Equitable distribution of revenues is perceived as critical to achieving that objective. This logic is behind the strong U.S. Government efforts for passage of national HCL. As Iraqi deliberations languished,

¹² Coalition Provisional Authority Order Number 39, subsequently rescinded.

¹³ In fact, prior to 2007 IOCs' involvement in Iraq was limited to memoranda of understanding (MOUs) under which the companies provided technical advice—usually pro bono—to the MoO Shahrastani.

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Washington policymakers sought to forestall any actions that might further complicate internal Iraqi deliberations on an HCL package. This led to formulation of a desired sequence: passage of national HCL prior to signing of oil contracts.

Although the OIG inspectors believe that the linkage is generally understood across the spectrum of U.S. Government employees, communication of this policy to the Government of Iraq, Kurdistan Regional Government, IOCs, and coalition partners in Iraq has not been uniform. A few of those consulted during the review stated that they either did not know of the policy or were unsure of its intent. Among the majority of sources (both documentary and in conversation with the OIG inspectors), the policy was interpreted as (1) actively discouraging premature contracting; (2) suggesting that the U.S. Government “does not encourage” such contracts; or (3) frequently asserting that signing such contracts would be unhelpful in the context of achieving a national HCL. A number of those involved focused on potential negative legal or political risks—the possibility that such contracts might be nullified by subsequent action on HCL.¹⁴

The OIG inspectors were not provided with documentation or other information on how or when the policy formally was communicated to the Government of Iraq or Kurdistan Regional Government. However, at some point Iraqi and Kurdish officials clearly were sensitized to the U.S. Government view that passage of national HCL should precede contracting.

Some formulations used in communicating policy were very clear. For example, in May 2007, in response to a complaint from Senator Allard that the Department was directly discouraging IOC investment in Kurdistan, the Department’s Assistant Secretary for Legislative Affairs responded:

The President has also clearly stated the strategic importance that the United States places in ensuring that Iraq passes a hydrocarbon law which reinforces Iraq’s unity and territorial integrity... We have conveyed our view to all parties, the Kurdish Regional Government, the central Iraqi Government, and international oil companies, that signing deals before such a law is passed will complicate efforts of the parties to pass a good law.¹⁵

¹⁴MoO Shahrstani has bluntly asserted that IOCs that have contracted with the Kurdistan Regional Government after 2006 will be blacklisted for consideration of Government of Iraq TSAs. Baghdad 3071, “Hunt Oil signs Agreement with Kurdistan Regional Government under KRG Oil Law,” dated September 12, 2007.

¹⁵Interestingly, Senator Allard wrote Secretary Rice to complain about “direct discouragement by the U.S. State Department” of IOCs seeking contracts with the Kurdistan Regional Government. Letter from Senator Allard to Secretary Rice, dated May 1, 2007.

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Belatedly, the Department used public diplomacy to engage on this policy issue. After Hunt Oil signed the PSA with the Kurdistan Regional Government on September 8, 2007, the Department's press guidance was blunt:

These contracts have needlessly elevated tensions between the Kurdistan Regional Government and the Government of Iraq, who share a common interest in passage of national hydrocarbon framework and revenue sharing laws....

The OIG inspectors believe that overall, communicating this policy linkage was more muted in fact than in hindsight.¹⁶ The inspectors concluded that with the notable exception of August 2006 briefings by the Assistant Secretary for Economic, Energy, and Business Affairs given to representatives from five major IOCs and select Washington-based foreign diplomats, communication of this policy to the petroleum industry and coalition governments was essentially passive.¹⁷ After the Hunt contract was signed on September 8, 2007, a number of IOCs contacted the Department and the Department of Energy to seek clarification of the U.S. Government's position on contracting. The responses ranged the spectrum described above, but generally assigned with established policy.¹⁸

Hunt Oil officials declined repeated requests to be interviewed during this review. One document asserted, "Hunt understands our position from its recent contacts with state officers in Iraq and EEB's clear message to a senior Hunt consultant" The inspectors determined that the message to Hunt was less direct than portrayed. According to information provided to the OIG team, the only face-to-face interaction between Hunt Oil and U.S. Government officials—prior to signing of the firm's PSA with the Kurdistan Regional Government—took place during three meetings at the RRT in Erbil. At none of those meetings did the Hunt representatives ask about the U.S. Government's position relative to the IOC's intention to sign the PSA with the Kurdistan Regional Government.

¹⁶This exchange of correspondence between National Security Adviser Hadley and Senator Levin was downloaded from Senator Levin's Web site. The National Security Council did not approve OIG's request for participation in this review.

¹⁷By contrast to responding if and as questions were raised by industry representatives, proactive communication of the policy could have taken the form of an authoritative letter sent to IOC executives.

¹⁸Based on documents and interviews, the OIG team concludes that IOCs are eager to become involved in developing Iraq's petroleum resources. IOCs will act accordingly based on their internal risk analyses in which the U.S. Government's positions will be but one of several factors.

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RESPONSE TO INQUIRY 2

Is there a clear U.S. policy with regard to the need for the Iraqi Government to pass national hydrocarbon legislation?

In sum, the OIG inspectors determined that:

- There is a clear U.S. Government policy to press for Government of Iraq enactment of national HCL.
- This policy has been consistently and repeatedly pursued at all appropriate levels with both the Government of Iraq and the Kurdistan Regional Government.
- Iraqi failure thus far to achieve the goal of HCL enactment does not detract from the fact that the U.S. Government's policy has been clear and effectively communicated.

Before the first post-Saddam, elected Iraqi Government took office on May 20, 2006, the U.S. Government identified the need for national legislation to regulate the petroleum sector. For example, December 2005 Department of State talking points directed Embassy Baghdad to engage both Iraqi Transitional Government and Kurdistan Regional Government officials to “work together after elections to draft a petroleum law....”

Thereafter, enactment of national HCL emerged as a benchmark endorsed by the Government of Iraq, the Kurdistan Regional Government, and the U.S. Government. Attention to this issue in Washington encompassed the Congress as well as the Administration. By U.S. law,

the United States strategy in Iraq, hereafter, shall be conditioned on the Iraqi Government meeting benchmarks...including: Enacting and implementing legislation to ensure the equitable distribution of hydrocarbon resources of the people of Iraq without regard to the sect or ethnicity of recipients, and enacting and implementing legislation to ensure that the energy resources of Iraq benefit Sunni Arabs, Shia Arabs, Kurds, and other Iraqi citizens in an equitable manner.¹⁹

¹⁹PL 110-28 May 25, 2007, 121 Stat. 123.

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The inspectors are convinced that this U.S. Government policy has been consistently pressed in discussions at both the national and Kurdistan Regional Government levels. The need for an HCL package²⁰ has been raised repeatedly, including conversations at the highest levels of governments. Administration cabinet officials have pressed for action, both when in Iraq and on occasions when Iraqi counterparts are in Washington. The Under Secretary for Economic, Energy, and Agricultural Affairs became the lead exponent of the continuing effort. The Under Secretary traveled to Baghdad and Erbil on four occasions to urge Iraqi national passage of an HCL package. Similarly, when visiting Iraq, members of Congress have pursued this objective. Attention to HCL issues has been a central political focus on Embassy Baghdad's agenda.

²⁰ The desired HCL package should encompass laws and regulations to assure equitable sharing of petroleum-generated revenues, a hydrocarbon framework law, reconstitution of the Iraqi National Oil Company, and reorganization of the Government of Iraq Ministry of Oil.

RESPONSE TO INQUIRY 3

Is there a clear U.S. policy with regard to the technical service contracts currently under negotiation by the Iraqi Government? If so, is this policy consistent with the U.S. policy under 2.) above?

Although there is a U.S. Government position favoring TSAs, it is not clear this has been effectively disseminated and communicated to all relevant parties. Most individuals with whom the OIG team spoke—both inside and outside of government—had a vague understanding that the U.S. Government is not opposed to TSAs, but they had no knowledge or information regarding a formal policy. Private sector representatives were not particularly concerned. They emphasized that, in the absence of any relevant U.S. legislation, for example, the Iran-Libya Sanctions Act, governing involvement in such agreements, IOC decisions will be based on assessment of the company's bottom line and best interests rather than all the basis of what the U.S. Government believes to be the right thing to do.

At the time the Senators wrote to the Acting Inspector General on these issues, the Government of Iraq was negotiating a number of short-term TSAs with IOCs. These essentially would have monetized technical assistance provided, pro bono, by IOCs under previously existing MOUs. In September 2008, the Government of Iraq announced that it had cancelled plans to move forward with these agreements. The following month, Minister of Oil Shahrastani opened bidding for longer-term, brown field TSAs. Seven major American IOCs are among firms prequalified to bid on these new contracts. Obviously, U.S. Government policies with regard to TSAs remain a valid subject for discussion and definition.

The body of evidence reviewed by OIG inspectors suggests that, from the outset, the U.S. Government was not opposed to the concept of TSAs designed to develop Iraq's petroleum sector. This U.S. posture has broadened and deepened over time.

With Department approval, the Department of Commerce routinely announced Government of Iraq plans to proceed with brown field TSAs.²¹ The OIG team believes such notification to be in keeping with the long-standing U.S. Government commitment to the concept of a level playing field for American firms bidding on international contracts.

²¹ U.S. Department of Commerce, op.cit.

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As the Government of Iraq sought to move forward with short-term TSAs in the spring of 2008, the U.S. Government engaged actively on the issue of how such agreements should be structured, particularly with regard to payments. In an April 2008 cable entitled “What is the U.S. View of the Proposed In-Kind Elements of Iraqi Oil Technical Service Agreements with Oil Majors” (08 Baghdad 1021), the U.S. Embassy in Baghdad specifically requested a coordinated view on whether the U.S. Government would support IOCs being paid in kind (crude oil) for their work under TSAs. The Department response, coordinated with other Washington entities, was:

While the U.S. Government strongly supports the Government of Iraq’s efforts to develop its hydrocarbon resources, which will likely include TSAs with companies, our policy is to discourage the Government of Iraq from paying companies in-kind. Accordingly, U.S. Government policy is to advocate Government of Iraq payments to companies in cash. (08 State 36481)

That position prevailed, and the Minister of Oil conceded that payments should be in cash, channeled through the UN-administered Development Fund for Iraq.

Perhaps the clearest indication of active U.S. Government support for the TSA concept—regardless of term length—came at a meeting on July 30, 2008, during which officials at the deputy secretary level approved a document entitled “Economic Way Ahead: Transitioning Iraq to Self-Sufficiency.” One of the areas addressed in that document was how to “Enact Energy Reform.” In that section, the desired “Iraqi accomplishment” is that the Government of Iraq should sign short-term TSAs with IOCs, with an open bidding process for longer term contracts; the U.S. Government definition of success in this area is that the “Ministry of Oil signs TSAs that adhere to UNSCR (UN Security Council Resolution) requirements and/or conducts competitive and transparent bidding process for long-term contracts by end-08.” Thus, the question was not whether the U.S. Government supports TSAs, but rather how such TSAs ought to be structured.

The “Economic Way Ahead” clearly envisioned active U.S. Government support for TSAs with the Government of Iraq. The approved document defines “U.S. Government supportive actions” with regard to TSAs as to “highlight to senior Government of Iraq officials that contracts must be transparent, follow international guidelines, and meet UNSCR requirements,” and offered “technical advisors to assist the Government of Iraq with setting up the open bidding process.”

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As to whether the U.S. Government position with regard to TSAs is consistent with the U.S. Government's emphasis on the need for the Government of Iraq to pass national HCL, none of those interviewed by the OIG inspectors perceived that support for TSAs undermines the broader objective. There was consensus that the U.S. Government will continue to oppose any actions that might potentially damage the prospects for passage of national HCL.

Those interviewed contended that the very characteristics of the since-cancelled short-term TSAs (i.e., fee-for-service agreements that would in effect monetize technical assistance already being provided by IOCs under existing MOUs, would not involve foreign ownership, exploration, or presence in Iraq) made such agreements unlikely to undercut passage of national HCL. It was also noted that each TSA requires approval by the Council of Ministers, and thus the agreements would require acceptance by all major Iraqi factions. Many officials saw the TSAs as an interim step or stopgap measure that would permit some limited IOC participation in the sector while slowing the deterioration of Iraq's crumbling operations. This would be consistent with the vision of enactment of national HCL, the only viable long term solution for Iraq's oil sector development.

Senior Department officials stated on record their assessment that support for TSAs is not inconsistent with support for HCL passage. One letter from the Assistant Secretary of State for Legislative Affairs noted that "...de facto revenue sharing is taking place in Iraq, even in the absence of an enacted law...the technical service agreements do not circumvent the national HCL currently under consideration."

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RESPONSE TO INQUIRY 4

Is there a clear U.S. policy with regard to the oil field development contracts being considered by the Iraqi Government? If so, is this policy consistent with the U.S. policy under 2.) above?

Based on the OIG inspectors' discussions with Department personnel, other U.S. Government agency representatives, and individuals from the private sector, it is clear that there is no formal U.S. policy in place with regard to new green field development in Iraq. The OIG team likewise concluded that this has not been the subject of serious policy discussions within interagency working groups.

This is not to say, however, that U.S. Government officials are oblivious to the issue. An April 2008 Department cable to Embassy Baghdad noted that the U.S. preference for cash payments for brown field TSAs "...should not be interpreted as U.S. Government discouragement of in-kind payment arrangements in future contracts such as PSAs. Passage of Iraq's framework hydrocarbon law will help create the environment under which PSAs would be more appropriately considered."

While there is no officially announced U.S. Government policy position on green field contracting in Iraq at this time, the OIG team's discussions nevertheless revealed considerable common ground on a number of issues directly relevant to future development of policy. First, there is consensus among the U.S. Government, Government of Iraq, Kurdistan Regional Government, and the private sector that development of the oil sector in Iraq is a good thing. Second, there is realization that Iraq will be unable to develop its oil sector absent significant long-term IOC investment. Therefore, IOC investment in Iraq's oil sector is important for Iraq's long-term oil sector development and political stability. Development of new fields will require substantial capital and technology from major IOCs.

Although the Government of Iraq clearly prefers TSAs as a vehicle for both brown field and green field operations, the IOCs favor PSAs under which they can book reserves. As one senior Department official said to the OIG team, "global experience has shown that PSAs are the most successful venue for development, and are the sensible way to encourage foreign investment of significant scale and with modern technology."

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The OIG inspectors are persuaded that, without national HCL in place, PSAs are unlikely. In order to undertake the long-term investment required under a PSA, IOCs will need the necessary legal and regulatory framework to be in place; without such a framework, PSAs are too risky a proposition. That said, however, Embassy Baghdad reporting has suggested that some IOCs are anxious to invest in Iraq “preferably, but not necessarily,” under national HCL. Based on conversations during this review, the inspectors believe that major IOCs are inclined to be more cautious in their approach.

Lastly, there is consensus that for PSAs to be a viable alternative, there will need to be a level playing field for American IOCs. This is a long-standing position favored by the U.S. Government.

The OIG team notes the interest and concern of the four Senators with regard to U.S. Government policy on oilfield development in Iraq and believes that more formal interagency policy discussion, leading to a policy position, should be devoted to this issue. Whether or not Iraq is ultimately able to enact national HCL, PSAs may be a vehicle actively pursued by the Government of Iraq in the future as it seeks to develop nonproducing fields. The U.S. Government would be well served to take steps now to develop, disseminate, and communicate a unified policy position on this issue.

RESPONSE TO INQUIRY 5

Has U.S. policy been consistently applied with regard to oil contracts at both the national and regional levels in Iraq?

The OIG team is satisfied that U.S. policy with regard to oil contracts has been applied persistently, if not consistently, at both the national and regional levels in Iraq. In cases where oil contract policy has not been applied with consistency, however, it has been done in support of a Washington-approved and defensible rationale.

In general terms, the body of relevant Department reporting messages and other communications make clear that actions undertaken relative to implementation or U.S. oil policy were in accordance with oil policy guidance approved by Washington agencies and conveyed to Embassy Baghdad. However, the OIG team notes that the multiplicity of policy actors comprising the U.S. Government presence in Iraq could foster an environment conducive to unequal application of policy messages across the various levels of Government in Iraq. An ambassadorial-rank Coordinator for Economic Transition in Iraq oversees economic policy implementation for the entire mission, importantly to encompass oil policies.

With regard to the specific U.S. Government policy supporting passage on national HCL, the record is clear that U.S. Government officials, to include the Under Secretary of State, have stressed with firmness and vigor the need to achieve this goal. Department and other U.S. officials have engaged forcefully and repeatedly with the Government of Iraq and Kurdistan Regional Government on the need to enact such HCL.

One potential weakness the OIG team observed that could contribute to inconsistency in communicating U.S. policy on oil contracting, is the fact that personnel assigned to the RRT in Erbil play only a marginal role. Policy-related discussions normally involve officers from Embassy Baghdad, whether in the capital or in Erbil. Nevertheless, those serving at the RRT are in more frequent dialogue with Kurdistan Regional Government officials. They should be empowered to speak more authoritatively on policy issues.²²

²²The current American staff population at RRT/Erbil is approximately 130.

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Perhaps the one single area where there has been the appearance of inconsistency of message is U.S. policy relative to concluding oil agreements. This difference, however, relates not to any breakdown in policy communication, but rather reflects that supporting a single policy objective may entail delivering differing messages to the Government of Iraq and the Kurdistan Regional Government.

Both the Government of Iraq and Kurdistan Regional Government are well aware of U.S. views that enactment of national HCL is necessary, and that agreements concluded by regional entities may undermine that objective. Given this, it is not surprising that the U.S. Government would take a generally supportive view of TSAs concluded by the central government, while at the same time making clear U.S. displeasure with PSAs concluded with the Kurdistan Regional Government. As one interlocutor stated to the OIG team, “the Kurdistan Regional Government received the same basic message from the United States as the Government of Iraq did—plus strong criticism for signing 20 oil deals” that impacted negatively on getting an HCL in place.

Throughout this review, interlocutors repeatedly stressed to the OIG team that comparing TSAs with the Government of Iraq to PSAs with the Kurdistan Regional Government was like comparing “apples and oranges.” Various contrasts between the two types of agreements were repeatedly noted: for example, federal vs. regional; transparent vs. nontransparent; nonequity vs. equity arrangements; short-term vs. long-term; Government of Iraq agreements were subject to revenue sharing requirements while Kurdistan Regional Government agreements were not; or legal vs. “illegal” (according to the Iraqi Minister of Oil).

Based on this analysis, the OIG team believes that the body of available information supports a conclusion that U.S. oil contract policy in Iraq has been consistently applied at both the national and regional levels of government.

LIST OF ABBREVIATIONS

HCL	hydrocarbon legislation
IOC	international oil companies
MoO	Minister of Oil
MOU	memorandum of understanding
OIG	Office of Inspector General
PRT	provincial reconstruction team
PSA	production sharing agreement
REO	regional embassy office
RRT	regional reconstruction team
TSA	technical service agreement
UNSCR	United Nations Security Council Resolution

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