

IRAQ

The biggest U.S. oil company's deal with Iraqi Kurdistan was a boon, not just financially but also politically.

How Exxon helped make Iraqi Kurdistan

BY DMITRY ZHDANNIKOV, ISABEL COLES AND NED PARKER





DIPLOMAT: Ali Khedery, above, was an adviser to U.S. ambassadors in Baghdad before joining Exxon and urging the firm to look to Iraqi Kurdistan. The region's oil wealth – the cover photo shows the Taq Taq oil field near Arbil – is only just starting to be exploited. **REUTERS/AHMED JADALLAH; AZAD LASHKARI**

ARBIL/LONDON, DECEMBER 3, 2014

In January 2011, Exxon hired one of the best connected men in Iraq: Ali Khedery, an American of Iraqi descent who had served in Baghdad as a special assistant to five U.S. ambassadors and a senior adviser to three U.S. generals.

At a meeting with Exxon a few months later to analyse Iraq's future, Khedery laid out his thoughts.

Iraq under Prime Minister Nouri al-Maliki was moving towards dictatorship and civil war, he said he told the session. "We will see a rise in violence and a total paralysis in Baghdad," he recalled saying.

Iraq was likely to align itself more closely with Iran, which will "have an adverse impact on U.S. companies."

The gloomy scenario grabbed the attention of Exxon executives. Just two years earlier, they had signed a \$25 billion deal with Iraq to develop West Qurna, one of the largest oil fields in the country.

“If you want to manage risk, then the last place you want to be is in Baghdad or southern Iraq.

Ali Khedery

Former Exxon official

"No one wanted to hear that they had negotiated a multi-billion dollar deal in a country which will soon implode," said Khedery, who has detailed to Reuters the meeting and subsequent events for the first time.

He suggested an alternative: Kurdistan, a semi-autonomous region in northern Iraq that was politically stable, far from the chaos in the south, and had, by some estimates, oil reserves of 45 billion barrels.

Less than a year later, Exxon signed a deal with Kurdistan. The story of how that happened explains much about the would-be nation's growing power.

Interviews with key players in the secret

IRAQ HOW EXXON HELPED MAKE KURDISTAN

2011 negotiations – the talks involved not just Exxon but also fellow Western oil giant Royal Dutch Shell – show how Exxon's decision to invest infuriated both Washington and Baghdad, and helped propel Kurdistan closer to its long-held goal of independence.

Kurds like to say they are the world's largest ethnic group without a state. Numbering some 35 million, they inhabit a band that stretches from Syria across southern Turkey and northern Iraq and into Iran. Most follow Sunni Islam and speak their own distinct languages.

The Exxon deal fueled Kurdish self-belief. The presence of the biggest U.S. oil company has helped not just financially but also politically and even psychologically.

"Part of the process of building our region has to do, of course, with dealing with oil, signing contracts, negotiations with various countries," Fuad Hussein, chief of staff to Kurdistan's president, told Reuters. The Exxon deal validated smaller oil deals Kurdistan had already signed and was "a big victory for us."

Exxon declined to comment.

Despite the deal, Kurdistan's path to nationhood is far from certain. Independence is opposed by Washington, Baghdad, neighbouring Turkey and Iran. It also remains unclear whether the Kurds have the strength to stand alone in this volatile region. As militant group Islamic State (IS) advanced through Iraq this summer, Baghdad's troops melted away, leaving the Kurdish fighters known as peshmerga to halt the extremists. When IS threatened to take Arbil, Iraqi Kurdistan's capital, the United States bailed out the Kurds with a bombing campaign. On Tuesday, a temporary agreement between Baghdad and Arbil to end their dispute over oil exports and budget payments looked, at first glance, like Kurdistan returning to the Iraqi capital's control.

But the deal does nothing to resolve the issues between Arbil and Baghdad, while forcing the Iraqi capital to effectively



SAFE LANDING: U.S. Secretary of State John Kerry (above) with Fuad Hussein, chief of staff to the president of Iraqi Kurdistan and a key player in the oil deal, at Arbil International Airport in June.

Washington's anger with Arbil over its Exxon deal has eased. Rex Tillerson, below, is the oil giant's chairman and CEO. **REUTERS/BRENDAN SMIALOWSKI/POOL; JOSHUA ROBERTS**

“They wanted to know how my president is thinking, what is his vision.”

Fuad Hussein

Kurdish President's chief of staff (above, with Kerry)



acknowledge Arbil's development of its energy resources with Exxon, other foreign companies and Turkey. Arbil has compromised, but it has also locked in the progress of the past three years.

A CHANGE OF THINKING

Oil companies have been interested in Kurdistan for years. But after the United States toppled Iraqi strongman Saddam Hussein in 2003, a series of governments in Baghdad made clear that to get a slice

of the biggest prize – the huge reserves in Iraq's south – firms should not cut separate deals with the Kurds.

The fear: Letting the Kurds control the oil would rob central government of billions of dollars in revenue and bring a breakup of the country closer.

Western firms' reluctance began to melt after Kurdistan passed more business-friendly oil legislation in 2007. Mid-sized firms began to invest, though the biggest players remained on the sidelines.

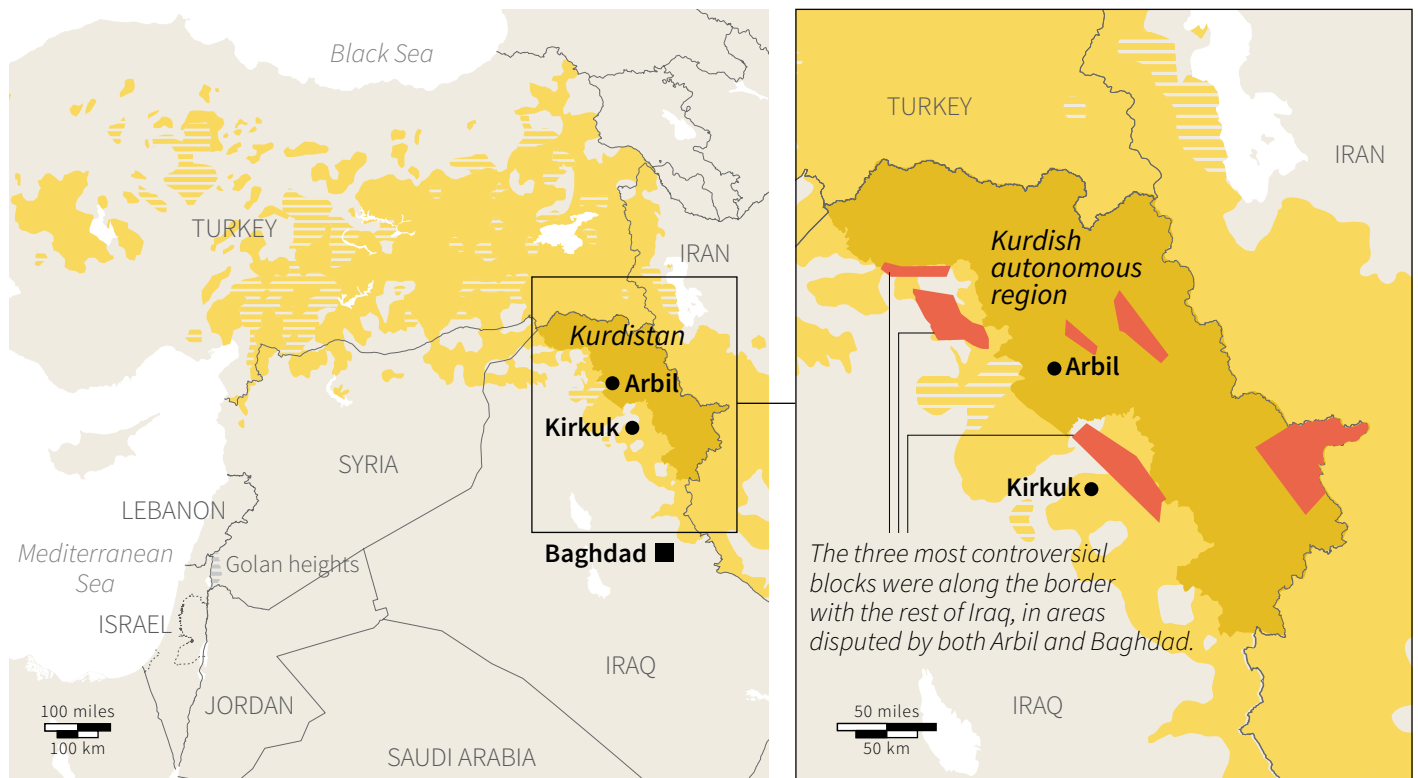
The Exxon deal

Kurdistan has operated independently of Baghdad for years, but its deal with Exxon provided economic legitimacy.

Kurds number some 35 million and inhabit a band that stretches from Syria across southern Turkey and northern Iraq into Iran.

In 2011, Exxon signed a deal with Kurdistan for six oil blocks scattered around the Kurdish autonomous region.

● Kurdish majority areas ■ Mixed population areas ● Exxon oil blocks



Sources: Gulf Keystone Petroleum; M. Izady - Gulf/2000 Project; Columbia University

Baghdad finally divvied up the oil concessions in Iraq's south in 2009 and 2010, and oil majors rushed to sign. But terms were tough and many firms, including Exxon, were soon frustrated.

Quietly, in late 2010, Exxon began putting out feelers to the Kurdish regional government. Proper talks began in early 2011, according to Hussein, the Kurdish

president's chief of staff. Khedery had resigned from the U.S. administration the previous year to protest against U.S. policies in Iraq, which he thought were hurting Washington's interests in the region.

In the oil world, filled with Texas oilmen and former U.S. military types, Khedery stood out. Young, rail thin and with the bearing of an academic, he appeared

confident and well connected. He had been privy to many of the backroom political deals in Iraq since 2003, and had a direct channel to the president of Kurdistan.

"He knew almost every official from the American side in Baghdad and he used to know every Iraqi leader," said Hussein, who had befriended Khedery when they worked together as advisers to the U.S. occupation

IRAQ HOW EXXON HELPED MAKE KURDISTAN

authorities in Baghdad.

Exxon began to rethink its approach to Kurdistan when a small group of company officials met long-time CEO Rex Tillerson and his deputies a few times in the spring of 2011.

The first meeting took place at Exxon's headquarters near Dallas. The small Exxon team briefed Tillerson in his huge conference room. The oil boss listened quietly to the presentations, most of which focused on technology and geology, with a brief talk on Iraqi politics. Afterwards, most of Tillerson's questions were about politics. That's when Khedery spoke up.

"I told him everything I thought would happen in Iraq," Khedery said. "I said that if you want to manage risk, then the last place you want to be is in Baghdad or southern Iraq." Those zones, he warned, were filled with Shi'ite militias, who had killed and maimed thousands of American troops, as well as "neo-Baathist insurgents, al Qaeda sleeper cells, and Iranian Revolutionary Guards."

He pointed instead to Kurdistan, which was "more peaceful, more predictable, and overwhelmingly pro-American."

NEAR FAILURE

Serious talks with the Kurds began soon after, with a call from Khedery to Hussein, according to the presidential chief of staff. The two sides met secretly in London, Dubai and Arbil.

On the Kurdish side, the main negotiator was Oil and Gas Minister Ashti Hawrami. But Kurdistan President Massoud Barzani also tapped Hussein to attend discussions. Unusually, the president even joined some meetings himself. Exxon was represented by senior executives from Texas.

But it was not just Exxon and the Kurds talking. Europe's biggest oil major, Shell, was also involved, according to Hussein. Shell was Exxon's junior partner in the West Qurna field and had a separate deal with Baghdad to invest tens of billions of



LEADER: Kurdish Regional Government President Masoud Barzani during an interview with Reuters soon after signing the deal with Exxon in 2011. **REUTERS/AZAD LASHKARI**

“The more the Kurds have an independent source of income the more it feeds their desire to establish greater autonomy from Baghdad.”

Robert Ford

Former U.S. diplomat

dollars in southern Iraq's Majnoon field. Exxon and Shell believed that teaming up – they had a combined market capitalisation of more than \$600 billion – would make it hard for Baghdad to throw them out of the south even if they cut a deal with Kurdistan.

The first meeting was in Arbil, which is dominated by a central citadel that is one of the oldest continuously inhabited settlements in the world. The Exxon team, concerned about Kurdistan's relationship with Baghdad, and longterm stability, quizzed Barzani on his views of Iraq.

"They wanted to know how my president is thinking, what is his vision," Hussein

said. The chief of staff said Barzani called Prime Minister Maliki's policies damaging to Iraq. "(Barzani said) that if it will continue this is bad for the country, this is dangerous, the path must be changed."

Barzani and Maliki both declined to comment.

In the summer of 2011, as negotiations continued, Kurdistan sold two oil blocks to Hess, a U.S. company. Exxon and Shell had been keen to get the blocks, and the surprise sale nearly ended the talks, according to Hussein. To show Arbil was still serious, Barzani promised more attractive terms, according to both Khedery and Hussein.

A signing ceremony in Arbil was planned for mid-October, but another complication arose. Shell was in the final stages of talks with Baghdad to obtain exclusive rights to process all natural gas produced in Iraq's south, a deal worth \$17 billion. If Shell signed with Arbil, Baghdad might scuttle the gas deal.

At a meeting with Barzani in the Imperial hotel in Vienna, where the

Kurdish president was on holiday, Exxon executives said they were committed to signing. Shell's executives, though, seemed less sure.

What Barzani and Exxon did not know was that Shell's CEO Peter Voser was in Baghdad, meeting Maliki to clinch the gas deal in southern Iraq. Just three days before the Kurdish deal was to be signed, Shell told Exxon it was no longer interested.

A Shell spokesman declined to answer questions about the Kurdistan deal. "Today our focus is on delivering the Basrah Gas Company project and the Majnoon Oil Field development, both of which are projects of critical importance to the reconstruction and economic development of (Iraq)," the spokesman said.

TERRITORIAL AMBITIONS?

Exxon pushed ahead. The firm believed that rivals such as Chevron and Total would follow suit.

The Texans kept things low key, though. An Exxon delegation flew to Arbil to sign the deal. Tillerson stayed in Dallas.

The six blocks Exxon won were scattered around the autonomous region. One block was near Turkey and another near the border with Iran. The three most controversial were along the line that divides Kurdistan and the rest of Iraq, straddling areas whose control is disputed between Arbil and Baghdad. The Kurds included the blocks in the deal and later managed to bring the governor of Nineveh, one of the provinces affected, on board.

To some, it looked as if Arbil was using Exxon to consolidate its borders. Hussein said Arbil already controlled the disputed territories and did not need Big Oil's legitimacy. Barzani, though, has since described the presence of companies such as Exxon as a form of insurance for Kurdistan.

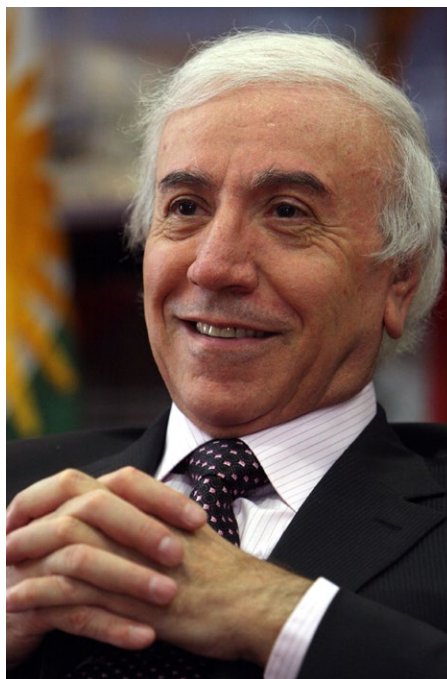
"A FEW F-BOMBS"

When news of the deal leaked in early November 2011, both Baghdad and

“The opposition from Maliki was seen as something that could be managed and eventually mitigated.

Ali Khedery

Former Exxon official



POINT MAN: Ashti Hawrami, Iraqi Kurdistan's Oil and Gas Minister, during a 2010 interview with Reuters in Arbil. Hawrami has likened the Exxon deal to working with "the giant and magnificent".

REUTERS/AZAD LASHKARI

Washington were furious. Maliki wrote a letter to President Barack Obama demanding he push Exxon to scrap the deal. Iraq's deputy prime minister for energy affairs summoned Exxon executives to explain.

To Washington, the deal was an embarrassment. The U.S. strategy was built on support for Maliki and its 'one Iraq' policy of a unified nation under a strong central government. Now one of America's most powerful corporations had undermined that approach.

A former U.S. diplomat told Reuters

the U.S. government had less than a day's notice of Exxon's deal. U.S. Ambassador to Iraq James Jeffrey was livid, said the former diplomat. "My understanding is that (Jeffrey) dropped a few F-bombs," he said. "He was less than amused."

Hussein remembers a tense meeting he and the Kurdish oil minister, Ashti Hawrami, had with Jeffrey in Baghdad soon after the deal. "He was very angry," Hussein said. "We were trying to explain that what we are doing is in the interest of Iraq, what we are doing is in the interest of Kurds, what we are doing is legal."

Hawrami declined to comment. Jeffrey has since left the State Department. He is reported to be a consultant to Exxon, but declined to comment for this story.

Despite the anger, the deal was a political triumph for the Kurds. Exxon had shown Arbil could attract oil majors regardless of what Baghdad thought. Hawrami unveiled the deal at an Arbil energy conference in late 2011. Kurdistan had initially signed contracts with "small and beautiful" companies, he said. Now it was working with "the giant and magnificent."

Within a few months, both Chevron and Total signed deals, further strengthening Kurdistan. A pact with Russia's Gazprom followed.

"What really binds Kurdistan to Baghdad is money," said Robert Ford, who retired from his post as U.S. ambassador to Syria in February and previously served three stints for the State Department in Iraq. "The more the Kurds have an independent source of income, especially from energy, the more it feeds into their desire to establish greater autonomy if not independence from Baghdad."

In January 2013, Exxon CEO Tillerson made his first and so far only visit to Iraq, travelling to Baghdad to mend fences with the central government. It isn't clear what happened in that meeting, but Baghdad has not cancelled its own contract with the Texas firm. Arbil has even built a pipeline



BLAST: This year's offensive by militant group Islamic State threatened Arbil but also reminded Washington and Baghdad of the importance of Iraqi Kurdistan. Here, a Kurdish Peshmerga fighter fires mortar shells towards Zummar, near Mosul, in September. **REUTERS/AHMED JADALLAH**

to Turkey, which makes it easier to export its oil.

The Iraqi capital remains riven by strife, but things are looking up for Exxon. The firm's main Iraqi critics – Maliki and two other senior politicians – were pushed from power this year in elections. The men who replaced them are more amenable to a compromise, as this week's agreement with Arbil shows.

Khedery, who has since set up his own consultancy, is not surprised. "I think for Exxon," he said, "with their 125 years in

business, the opposition from Maliki was simply seen as something that could be managed and eventually mitigated."

Zhdannikov reported from London, Coles from Arbil, Parker from Baghdad; Edited by Simon Robinson

FOR MORE INFORMATION

Dmitry Zhdannikov, Chief EMEA Oil and Gas Specialist

dmitry.zhdannikov@thomsonreuters.com

Isabel Coles, Correspondent

isabel.coles@thomsonreuters.com

Ned Parker, Iraq Bureau Chief

ned.parker@thomsonreuters.com

Simon Robinson, Enterprise Editor, Europe, Middle East and Africa

simon.robinson@thomsonreuters.com

Michael Williams, Global Enterprise Editor

michael.j.williams@thomsonreuters.com