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# Kurdistan's natural gas resources may become a game-changer over the longer term

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**If a firm manages to create a dominant position in the Kurdistan Region of Iraq (KRG) oil business this could, in the long term, open a door to the gas business, as it did in the Caspian zones in the 1990s, when the Baku-Tbilisi-Ceyhan oil pipeline prepared the ground for the South Caspian gas pipeline and TANAP, the Trans-Anatolian gas pipeline. A similar future may be possible for the KRG and the firms working within it. The KRG's proven gas reserves are estimated at 2.8-5.7 trillion cubic meters. That is about four times more than Azerbaijan's reserves. In the perspective of the southern energy corridor projects, KRG's natural gas sources may become a game-changer over the longer term.**

Up till now Azerbaijan's offshore gas fields remain the sole source for the southern energy corridor. A gas pipeline running from the KRG to Turkey might create competition between the KRG and Azerbaijani gas for European and Turkish markets. As BP is the leader of the Azeri offshore consortium, a firm that ended up driving KRG gas to Turkey could eventually find itself competing with BP on the global market.

***Construction of South Stream pipeline***
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The Southern Energy Corridor Project (SECP) is a gas transit infrastructure project running from the Caspian Sea to Europe via Turkey and the Balkans. The SECP is at the top of Eurasian energy security concerns, since the Russia-Ukraine gas crisis of 2005. European countries affected by the crisis diagnosed their gas supply system as overly dependent on Russia and, by consequence, highly vulnerable. This is reason enough for European energy companies to compete in order to become a part of the SECP.

## Azerbaijan as the sole source for the SECP

Today, Azerbaijan's offshore gas fields appear to be the sole source for the SECP. However, the initial project targeted the entire Caspian area's resources, but some economical, political, and legal challenges jeopardized full access to all Caspian sources. Economically, the exploration and production costs for oil and gas in the Caspian Sea Basin ($5 per barrel) are seen as relatively high compared to costs in the Middle East ($1 per barrel). As the region has no direct access to navigable international waterways, all littoral states are dependent on each other for trade and transportation of oil and gas. This challenge creates high transit fees and a complex legal aspect. The Caspian Basin has neither legal status nor regime – i.e., it is unclear if the body of water is a lake or a sea. The qualification of the Caspian as a sea or a lake directly affects the delimitation of territorial waters and sovereignty for exploring and exploiting natural resources. In the absence of a legal framework, littoral states cannot make separate agreements or envision a trans-Caspian pipeline project.

Therefore, Western investors have excluded Kazakhstan and Turkmenistan gas sources from the SECP. Turkmenistan has chosen to direct its energies towards Eastern markets, in particular China. All in all, Azerbaijan's gas fields remain the only reliable Caspian sources. But in the future Azerbaijan may not be longer the sole Caspian gas source for the SECP. Located 1000 km away from Baku, the Kurdistan Region of Iraq (KRG) holds 2.8 trillion cubic meters of gas reserves – some five times more than Azerbaijani reserves, and may at some point be able to supply its gas to Europe. Considering the KRG's current challenges for oil and gas exploration and exportation, it is worth applying Azerbaijan's rising star model to the KRG.

## How Azerbaijan's star rose in the energy industry

Since the collapse of the Soviet Union, Azerbaijan has made substantial progress in developing its hydrocarbon resources. The State Oil Company of Azerbaijan Republic (SOCAR) participates in Azerbaijan's international hydrocarbon export projects. Besides SOCAR, a second main player of Azerbaijan energy is BP, which is been involved in the region since 1992, is the largest foreign investor. BP leads the Azerbaijan International Operating Company (AIOC), which operates Shah Deniz fields, which are the main supply sources for the SECP.

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BP and SOCAR's partnership dates back to 1993, when Abulfaz Elchibey, Azerbaijan's president at the time, attempted to sign an agreement with a BP-led international consortium to develop Azerbaijan's offshore oil reserves. After his overthrow, his successor, Hayrdar Aliyev, followed his initiative and furthered the cooperation with BP interest. However, to equalize relations, he also launched a new partnership with Gazprom.

On September 20, 1994, Baku signed the first production sharing agreement (PSA) for the Azeri-Chirag-Gunashli oil field (ACG) with a consortium of nine Western oil companies from six different countries under the AIOC. These were the UK's BP and Ramco; the US' Amoco, Unocal, Exxon, and Pennzoil; Russia's LUKoil; Norway's Statoil; Turkey' TPAO; Japan's ITOCHU; and Saudi Arabia's Delta Nimir Khazar. BP, as the main shareholder, became leader of the consortium.

## Transport to markets is as important as sharing fields

Studies on route options for a regional export pipeline to transport the oil began shortly after the agreement. Controlling the oil reserves' transport to markets was as important as sharing fields. Without a safe and secure route out of the landlocked Caspian Sea, the reserves could not secure their values. Russia proposed to pump Azerbaijan's oil reserves via existing Russian networks built during the Soviet period, thereby maintaining its main point of leverage over Azerbaijan's economy. The US backed new southern roads, planned to run from the south via Georgia and Turkey. The EU remained distant. Finally three pipelines have been established, each of which fulfilled different functions. The Baku-Novorossiysk and Baku-Supsa pipelines export the early oil to the north and the Baku-Tbilisi-Ceyhan pipeline (BTC) exports oil to the Mediterranean Sea.

## BP and the "project of the century" – the BTC oil pipeline

Azerbaijan, Georgia, and Turkey signed the BTC's intergovernmental agreement on November 18, 1999, calling it "the project of the century". Eleven shareholders from eleven different companies established the BTC Companyto build and operate the pipeline, and as had happened with the AIOC, BP was the largest shareholder and become the operation's leader. While building the BTC, BP hired thousands of employees in the region and became the international energy company with the most important experience in the area.

Azerbaijan, in turn, had also become a star in the energy industry as a consequence of a 13-year long battle for independence from Russia (1993-2006). Baku had to overcome Russia's efforts to maintain its political power, fights over the legal status of the Caspian sea, the legacy of a state-owned energy industry, and its ongoing conflict with Armenia. BP became the main partner of SOCAR during this process. With all this experience in the region due to oil contracts, when Azerbaijan's natural gas exportation began in 2007 with the Shah Deniz field, BP became the natural leader of the gas exploration and export projects. BP, the leader of AIOC and the operator of BTC, also soon became the leader of the Shah Deniz consortium.

***BP's growing power may lead to a monopoly in the SECP.***

As the result of these experiences and by virtue of being the Shah Deniz Consortium's leader, when Azeri resources became a top destination for the SECP supply, BP had the power to select among the gas pipeline projects proposals for building the SECP. BP announced in summer 2012 the Shah Deniz consortium's decision – the Azeri-Turkish joint project TANAP was officially selected as the main leg for the SECP.

In January 2013, BP (now the leader of the AIOC, the operator of BTC and the leader of Shah Deniz Consortium), signed a framework accord to take over 12% of TANAP. Within this partnership BP is expected to become the decisive company for gas transport in the SECP. BP's growing power may lead to a monopoly in the SECP. This is unless KRG resources begin to penetrate the European market.

## The emergence of KRG oil and gas

Despite its abundant oil and gas resources (45 billions barrels of oil and 2.8-5.7 trillion cubic meters of gas), the KRG's hydrocarbon industry only dates back to 2007. While the natural gas sector remains largely undeveloped, the oil production objective for 2015 is 1 million barrels of oil per day, equivalent to Qatar's oil production numbers for 2010. An independent oil pipeline running from the KRG to Turkey is also on the agenda. Until 2011, interest in Erbil's upstream oil sector largely came from medium-sized foreign oil companies, i.e. Norway's DNO, Turkey's Genel Enerji and Petoil, Canada's Addax Petroleum and Western Zagros, US' Prime Natural Resources and A& T Energy. Today, Four medium-sized companies and five international oil companies (IOCs) – Exxon Mobile, France's Total, Russia's Gazprom Nefyt, and the US' Chevron – have begun operations in the region.

Beside these ambitious objectives and its attractiveness as an energy investment destination, the KRG has been dealing with political and jurisdictional challenges. Erbil and Baghdad have had an ongoing dispute since 2005 on an oil and gas revenue sharing formula and how authority is divided between the federal government and regional authorities – i.e., on how to interpret the relevant sections of the Iraqi constitution. In 2007, when the KRG's parliament approved the Kurdistan region's oil and gas investment law and prepared a model production sharing contract (PSC) to standardize agreements with foreigners, the problem was further complicated. Baghdad immediately condemned the KRG's agreements with international companies, declaring them illegal.

Another crisis started when the KRG begun exporting crude oil directly to Turkey. A Turkish-British joint venture under Genel Energy delivered the first crude oil from the KRG's Taq Taq oil field to Turkey's Ceyhan port on the Mediterranean Sea via truck, where it was shipped to be sold on the international market, instead of using the Kirkuk-Yumuratlik oil pipeline (which is controlled by Baghdad). This oil transport has prompted concerns to Baghdad about the KRG's intention to bypass Baghdad in its energy exports and making a symbolic step towards economical independence.

## Major foreign companies joined the forces

Business has kept increasing. "There is nowhere in the world where such a big volume of oil will be stopped because pore politicians did not solve their problems," said Tony Hayward, the CEO of Genel Energy. His company, Exxon Mobile and Gazprom Neft are making major investments in the KRG.

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Genel Enerji from Turkey was one the first oil company penetrating the KRG and today Turkish energy group is moving towards being the largest investor in the region, with its investments in Taq taq and Tawke fields. ExxonMobil, the first IOC to make an agreement with the KRG, signed product sharing agreements for six oil licences in KRG. Its Qara Hanjeer licence in southwest is also close to KRG's main gas fields, with this relations the US energy giant is also interested in Khor Mor gas field. Russia's fifth largest oil producer, Gazprom Neft, has been recently awarded its 3rd PSC in the Halabja block. Gazprom Neft holds 40% stake in the Garmian block and an 80% in the Shakal block.

Today, as the KRG's oil and gas business emerges, international energy companies are willing to explore and invest in the region. New oil production will require new export roads and Turkey appears the most reliable destination. This investment strategy is crucial not just for the oil sector, but also for gas. The firm that manages to create a dominant position in the KRG oil business might in the long term open a door to the gas business, as BP did in the Caspian zone in the 1990s.

## KRG's gas supply to Europe

In the old maps of the original Nabucco gas pipeline plan, a southern gas supply leg to Northern Iraqi gas sources was represented by a dotted line. But with domestic tensions in Iraq and the Shah Deniz

Consortium's strategic politics, this second leg disappeared. In the context of Turkish and European growing gas demands and Azerbaijan's growing power as the sole provider of gas resources, it may seem prudent to redraw this line. Genel Energy, Gazprom Neft, and Exxon Mobil appear to be main competitors for this project.

BP seems to have noted this possibility, as it has decided to join forces with Baghdad in Iraq's domestic oil and gas revenue sharing dispute. In January 2013 BP signed a deal with Iraq's central government to develop the Kirkuk oil field's production capacities, located on the KRG's border. The KRG called this deal an "illegal" step as part of the autonomous region's feud with the central government. Kurdish authorities argue the management of the Kirkuk field must be undertaken not by the central government but by the regional governorate, saying this is part of the process outlined under the country's constitution.

The potential of Kurdistan in terms of fuel reserves is there. So is the interest of major energy companies. Until yesterday we could consider Kurdistan to be a sleeping giant, but not anymore. The awakening is a fact.