

B-6

JC66

To: Cunningham, James B USUN  
Subject: RE: 06-25 USUN - UKUN Discussions

certainly as a 661 Committee document, which would seem more appropriate, but I defer to your judgment.

-----Original Message-----  
From: Cunningham, James B USUN  
Sent: Thursday, June 27, 2002 6:48 PM  
To: [redacted]  
Subject: RE: 06-25 USUN - UKUN Discussions

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B-6

Circulate that energy intelligence group article as a council document?

-----Original Message-----  
From: [redacted]  
Sent: Thursday, June 27, 2002 1:27 PM  
To: [redacted]

Cunningham, James B USUN

Subject: RE: 06-25 USUN - UKUN Discussions

Just returned from leave and realize that this is at least a day late, but for what it's worth:

I wouldn't separate the obligation to lift from the pricing issue: it is key to the surcharge. [redacted] is right that Iraq is trying to set its prices too low, but an absence of an obligation to lift makes the trade risk-free for the middlemen, i.e., if the market moves against them, they simply don't lift their nominated volumes. The obligation to lift increases the commercial risk the middlemen take, which puts pressure on their ability and willingness to accept surcharge payment demands.

There is also another option available, and that is to sell Iraqi oil "spot." In essence, auctioning off each cargo. The overseers have also considered this, albeit in a modest way: in the plan they devised for "pre-payment" buyers would nominate cargos during a two-week period. If the entire lifting schedule wasn't obligated at that time, additional cargos would have to be priced somehow, and one of the options the overseers looked at was auctioning off the cargos. That approach was rejected by the Russians, but auctions may have a place in the UK proposal for a two-tier system. The "pre-approved buyers" (which I suggest should ONLY include companies with their own refining assets, regardless of other factors) would get pro-active pricing, and others could purchase prices of Iraqi oil on the spot market. Doubt the Russians would go for this one, either.

P.S. Energy Intelligence Group (publishers of Petroleum Intelligence Weekly) is putting out a story tomorrow showing that Iraqi oil exports actually expanded under retroactive pricing. Puts all the blame squarely on the surcharge. I should get an advance copy on the unclass system, and can forward it to you all when it arrives.

-----Original Message-----  
From: [redacted]  
Sent: Tuesday, June 25, 2002 7:15 PM  
To: [redacted]

Cunningham, James B USUN

Subject: RE: 06-25 USUN - UKUN Discussions

[redacted] my thoughts for what they're worth:

**Oil Pricing:** Revising the list of companies per the French proposal is not going to be of any use unless the criteria are stiff enough to get rid of a lot of Russian middlemen, which seems unlikely. We need to know the criteria for selecting companies before supporting the French proposal. As far as the Saudi model and mandatory lift, it's a bit inapposite and it's not really pricing per se. The Saudis want to sell their oil at a price that makes a profit. The Iraqis do not; they want a surcharge. As a result they sell their oil for the lowest price they can get away with in order to leave room for buyers to pay a surcharge (bigger the better) and still make a profit. 15-day advance pricing with mandatory lift would be better than the previous 30-day pricing, but it wouldn't be as effective as the current retroactive pricing. Only way to get rid of surcharge is to deal only with reliable companies (a likely very small number), get the overseers to really insist on market rates for Iraqi oil (which they've been unwilling or unable to do in the past), or stick with retroactive pricing. My recollection out of us-uk consults was that both sides agreed retroactive pricing was working and had led to a reduction in the surcharge to as low as 10 to 15 cents per barrel. That reduction has led to a notable and continuing increase in Iraqi exports despite continuing retroactive

Dept. of State, RPS/IPS, Margaret P. Grafeld, Dir.  
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pricing (from around 370,000 b/per day average for the first week of June to over 1 million barrels per day average last week). instead of backing off retroactive pricing, we should be pointing out that iraq's surcharge, not retroactive pricing, is the key to oil exports. agree we should listen to the french proposal and take it under consideration, but not express support until we have got and gone over all the details.

Kickbacks on OFF Contracts: should coordinate with Uk to see if we can come up with something salable at UN; past efforts on this have failed.

Border Controls: same as above.

-----Original Message-----

From: [redacted] B6  
Sent: Tuesday, June 25, 2002 6:13 PM  
To: [redacted]

Subject: RE: 06-25 USUN - UKUN Discussions B6

-----Original Message-----

From: [redacted] B6  
Sent: Tuesday, June 25, 2002 5:40 PM  
To: [redacted] Cunningham, James;

Subject: 06-25 USUN - UKUN Discussions ] 11

I met this afternoon (06-25) with UKUN poloff [redacted] to review a number of Iraq-related issues. B6

Oil Pricing: [redacted] I agree that the French proposal calling for a revision of the list of companies authorized to ship Iraqi crude oil merits support, but only as part of a larger approach that would commit the "legitimate," well-capitalized oil shippers to mandatory lifting obligations at a set price for a set period, an approach similar to the one use in the case of Saudi Arabia. Unless Washington advises to the contrary, we and the British will not support the French idea for 15-day, "pro-active" pricing without a lift obligation. The 661 Committee is scheduled to meet the morning of June 26 to discuss the French proposal and to renew consideration of alternate strategies on oil pricing. Please don't lock us in to specifics until our oil experts have more time to analyze French paper. See suggested talking points for meeting tomorrow on separate email. Intent is to lay some markers similar to what you say here without committing. A

Iraqi 10% Surcharge on OFF Contracts: [redacted] proposes that we coordinate a U.S.-UK strategy to combat the Iraqi Government's unauthorized imposition of a 10% surcharge on most Oil-for-Food contracts. The idea would be initially to raise the issue in a formal 661 Committee meeting, with possible follow-up in the Council if we encountered resistance from the usual suspects. Support. B6

Tightening Border Controls / Possible U.S.-UK Monitoring Mechanism: Following up on an issue discussed at the recent U.S.-UK bilats, I raised the issue of improving border controls, including the idea of some type of monitoring mechanism. I would welcome Washington views on this. We have to think carefully about this. Suggest we keep conversations bilateral with UK for now.

USUN - Sanctions Unit B6

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