



R

SECURITY COUNCIL COMMITTEE ESTABLISHED
BY RESOLUTION 661 (1990) CONCERNING THE
SITUATION BETWEEN IRAQ AND KUWAIT

S/AC.25/2001/OIL/COMM.06
13 February 2001
ORIGINAL: ENGLISH

Letter dated 13 February 2001 from the Overseers addressed to the Chairman
of the Security Council Committee established by resolution 661 (1990)
concerning the situation between Iraq and Kuwait

***** S/AC.25/2001/OIL/1330/OC.10

13 February 2001

Sir,

With reference to the attached communication dated 13 February 2001 from the State Oil Marketing Organization (SOMO) of Iraq, submitting for the approval of the Security Council Committee established by resolution 661 (1990) concerning the situation between Iraq and Kuwait the revised pricing mechanisms for loadings of crude oil during 13-28 February 2001 in accordance with paragraphs 5 and 6 of the Procedures to be employed by the Committee in the discharge of its responsibilities as required by paragraph 12 of Security Council resolution 986 (1995), the Overseers have the following assessment:

On 6 February the Committee endorsed the revised prices (OSP's) for February loading crude oil that is destined for the European and US markets. Since then the attractiveness of Iraqi crude oil in these markets has deteriorated further.

Notwithstanding this deterioration, end-users have been confronted with fob offers of Iraqi crude oil which reflect in general a substantial premium over OSP's: say between 20 and 70 cents a barrel. In an essentially risk-free environment these premia should be considered as excessive. Although many end-users have shied away from paying high premia for legal reasons, there have been temporary market conditions under which these could be justified economically. There have also been moments however, at which the economics should have dictated a smaller premium or even a discount, as could be expected at this moment. However, no such reduced premia or discounts have occurred for some months.

Export levels seem to have been negatively affected under those conditions in which, for legal or commercial reasons, end-users were not prepared to pay a substantial premium.

The current situation can be summarized as follows:

- By far the largest part of Iraqi crude oil is nowadays sold via middlemen and traders rather than directly to end-users (refiners). The former have a very short term profit perspective and often look at this issue on a cargo-by-cargo basis.

Dept. of State, RPS/IPS, Margaret P. Grafeld, Dir.
 Release () Excise () Deny () Declassify
 Date 6/17/05 Exemption _____

- The markets have moved in such a way that the OSP's for Europe and the US are currently too high to allow any sales to end-users to take place without the middlemen/traders accepting negative or zero premia.

- In absence of end-users paying premia of at least around 20-25 cents per barrel the oil is apparently not exported.

In the context of the foregoing, the Oil Overseers would like to make the following observations:

- The need for price revisions more than once a month is mostly a direct consequence of the nature of the contractual structures between SOMO and the end-users.

- SOMO's contract holders' requests for excessive premia in combination with the erratic nature of the exports has been damaging for the income into the UN-Iraq account.

- The Oil Overseers recommendation is motivated by their objective of maximizing oil exports and income into the UN Iraq account within the contractual structure as has been chosen by SOMO.

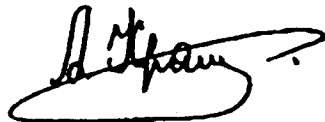
- This contractual structure asks for market responsive pricing and, as the Oil Overseers do not allow a substantial built-in "profit cushion", price revisions may occur more often if markets are volatile.

- The Oil Overseers are concerned that, under the current arrangement, price revisions can only go in one direction (i.e. downwards) since there is no mechanism, apart from SOMO's request, to increase prices.

Notwithstanding the observations above, given the current situation, the Oil Overseers would like to recommend to the Committee the proposed SOMO adjustments of the pricing mechanisms for US and European destinations for loadings during 13-28 February.

Accept, Sir, the assurances of our highest consideration.

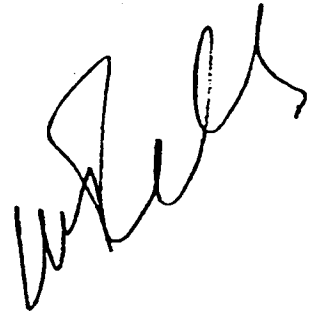
The Overseers



Alexandre Kramar



Morten Buur Jensen



Michel Tellings