
Oil & Gas Contracts in the Gulf of Guinea

History and Trends

Seminar of Petroleum Contracts



Luanda, Angola
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Contents

▮ History of oil & gas contracts

- Supplements development of oil & gas industry
- Shows an increasing and more sophisticated participation of the State
- Main focus remains a fair allocation of management and revenues

▮ Two main forms

- Concession
- Production sharing contract

▮ Four mains stages

- Initial concessions
- Introduction of production sharing contracts
- Implementation of NOC
- Return to concession regime, transformation of NOC into IOC and implementation of regulatory agencies ?

Middle East initial experience

▮ 1901 – Shah of Persia

- Concession to William D'Arcy
- 500,000 sqm for 66 years
- US\$100,000 share in company
- US\$100,000 bonus
- 16% royalty

▮ 1933 – King of Saudi Arabia

- Concession to Standard Oil of California
- 500,000 sqm for 66 years
- Pounds 50,000 gold bonus
- Royalty US\$0.21 per barrel >US\$2

Concession

▮ Total transfer of mining rights to the IOC

- Formal mining title
 - Administrative title
 - Official publication
- No additional contractual arrangement

▮ Regime

- Legal and administrative
- Initially based on mining law



Concession

▮ The IOC has

- Total mineral resources ownership
 - Is entitled to 100% of production
- Total management control
 - Operates in its own name
 - Takes all decisions
 - Owns its own assets
- No requirement to produce

Concession

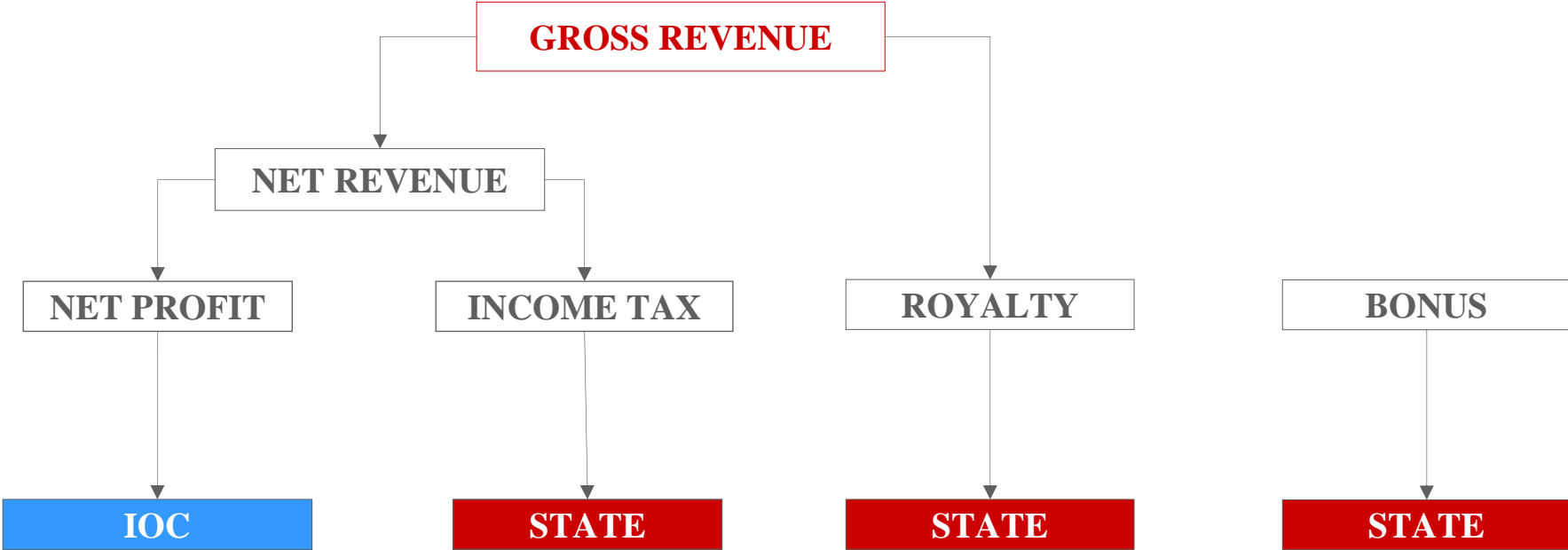
▮ The IOC (Seven Sisters)

- Exported all production abroad
- Generated all profits abroad
- Developed foreign technical expertise

▮ The State is only entitled to

- Bonus (immediately)
- Production royalty (in the event of production)
- Corporate tax (in the event of net profits)

Concession



Resources nationalism

▮ Initial limited renegotiation 1950's

- Saudi Arabia, Iran, Irak
- Increased financial stake

▮ Foundation of OPEC in 1960

- Saudi Arabia, Iran, Irak, Kuweit and Venezuela

▮ Massive renegotiation in Middle East 1970's

- Increased financial stake
- Increased management control
- Access to technical expertise



Production sharing contracts

▮ Introduction of production sharing contract in Indonesia

- First country
- Most attractive
 - First generation considered industry model PSC
 - Flexibility : three generations

▮ Initial production sharing contract

- IIAPCO 1966
- Phillips Petroleum 1968

IIAPCO 1966

▮ Main features

- No transfer of mining rights to IIAPCO
- Permina retains management control
 - IIAPCO acts as a service provider
 - Works programs are approved by Permina
 - Assets are the property of Permina
- Only part of production is allocated to IIAPCO
 - 40% of production to recover costs
 - 35% of the remainder to generate profits
 - Split inclusive of income tax
 - No royalty

Production sharing contract

▮ The State retains

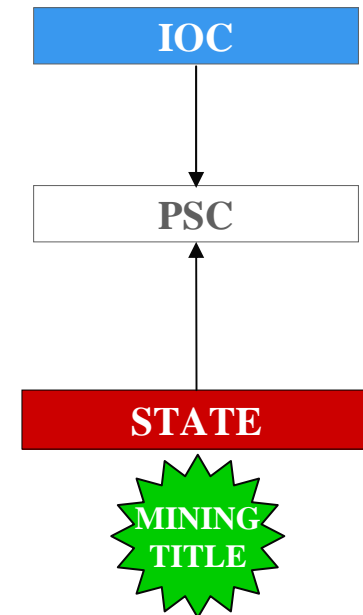
- Title to mineral resources
- Management control

▮ The IOC

- Performs services on behalf of the State
- Is compensated in kind by the State in the event of a discovery only

▮ Regime

- Mainly contractual
- Legal framework



Production sharing contract

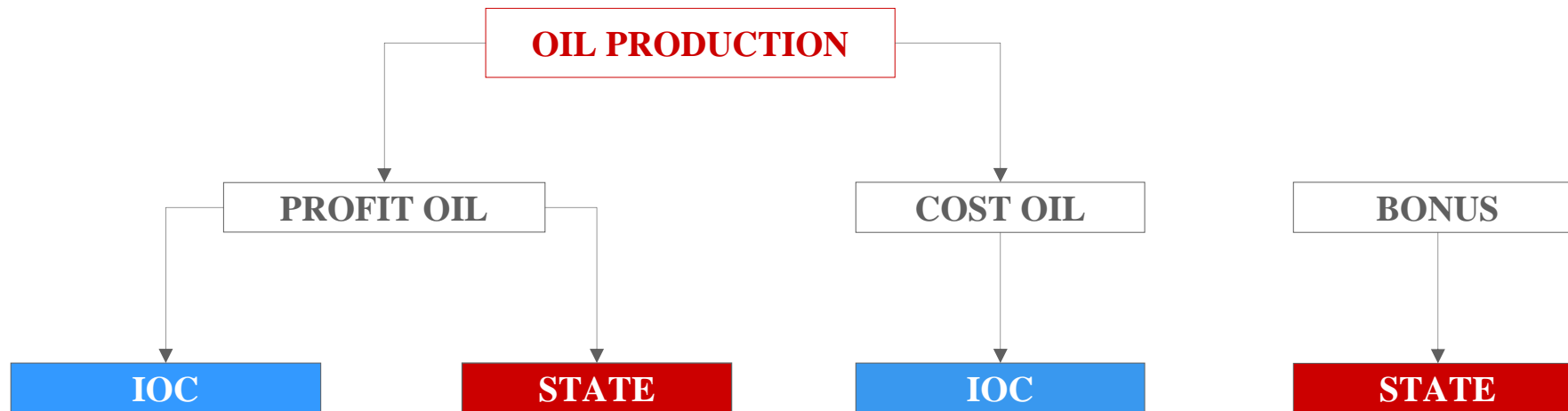
▮ The IOC does not have

- Title to mineral resources ownership
 - Is only entitled to part of production : cost oil & profit oil
- Management control
 - Operates in the name of the State
 - Performs works programs as approved by the State
 - Assets are owned by the State

▮ The State

- Is entitled to a bonus (immediately)
- Keeps the remainder of production after cost oil & profit oil
- Is not entitled to royalty and additional income tax

Production Sharing Contract



Resources nationalism

- ▮ **Production sharing contracts have allowed the States to**
 - Shift mineral resources ownership back to the State
 - Shift management control back to the State
 - Participation in petroleum operations
 - Access to and development of technical expertise
 - Accelerate financial stake
 - Invert flow of payment
 - Share of production as soon as production starts (cost stop)
 - No need to wait for tax profits

Implementation

▮ Several generations of production sharing contracts in Indonesia

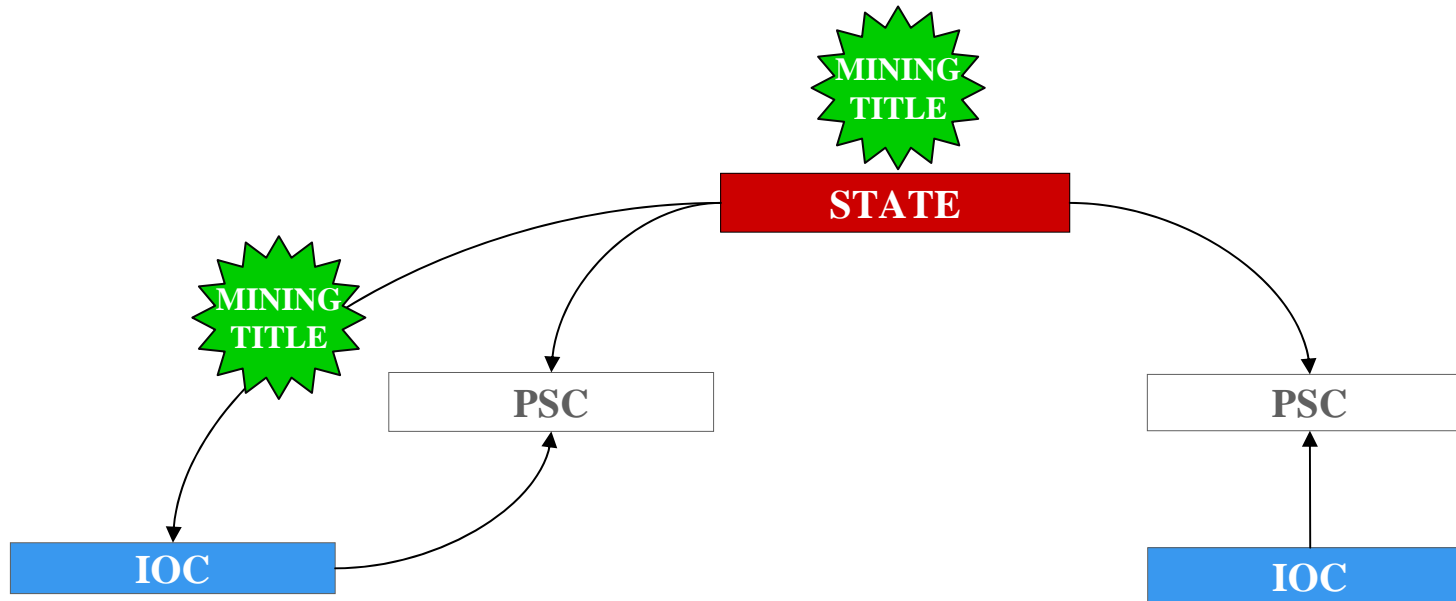
- To improve general terms and fix initial deficiencies
 - Taylor rights and obligations of the IOC
 - Reintroduction of income tax for tax credit issues
- To adapt to a changing environment from time to time
 - Reintroduction of initial petroleum share for the State (royalty)
 - Improved commercial terms and incentives for the IOC

▮ Most of APPA countries have implemented production sharing contracts

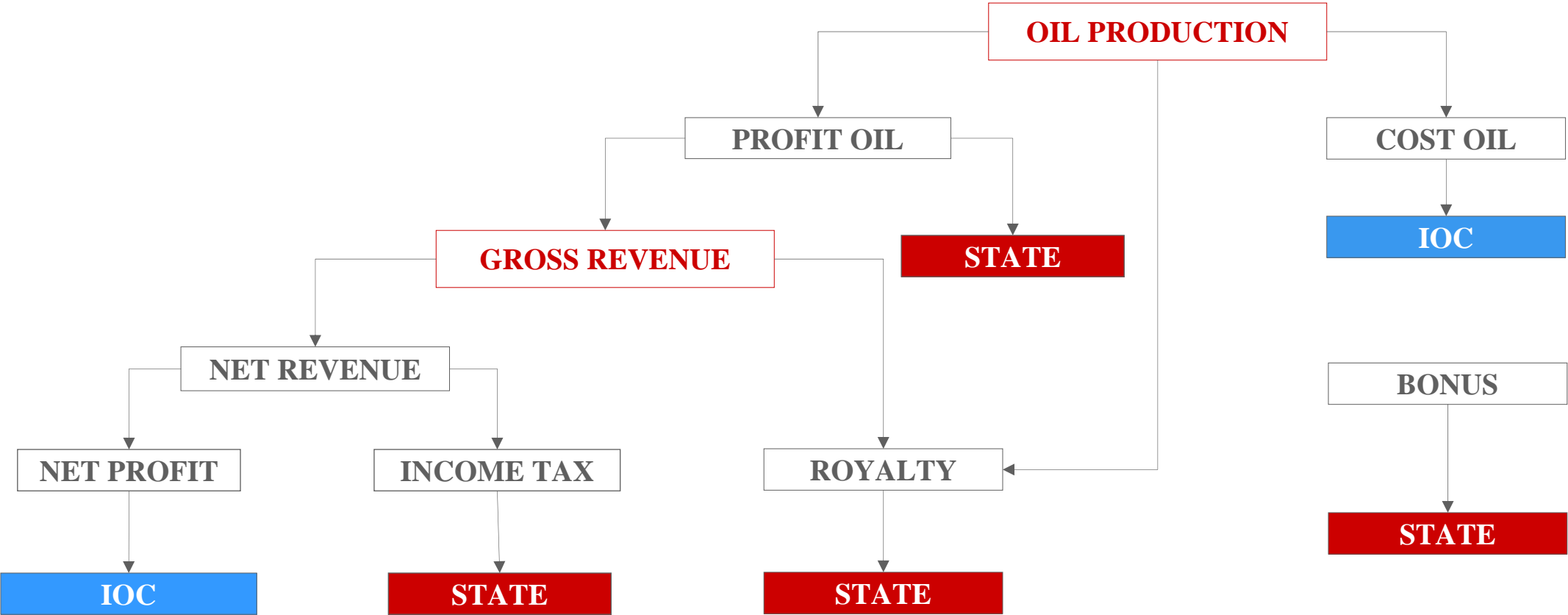
- Immediately, or further to change of regime or conversion,
- However with alterations to the initial model
 - Mining title to address foreign investors concerns
 - Income tax and royalty

▮ Production sharing contracts have therefore become hybrids

Hybrid contracts



Hybrid contracts



Hybrid contracts

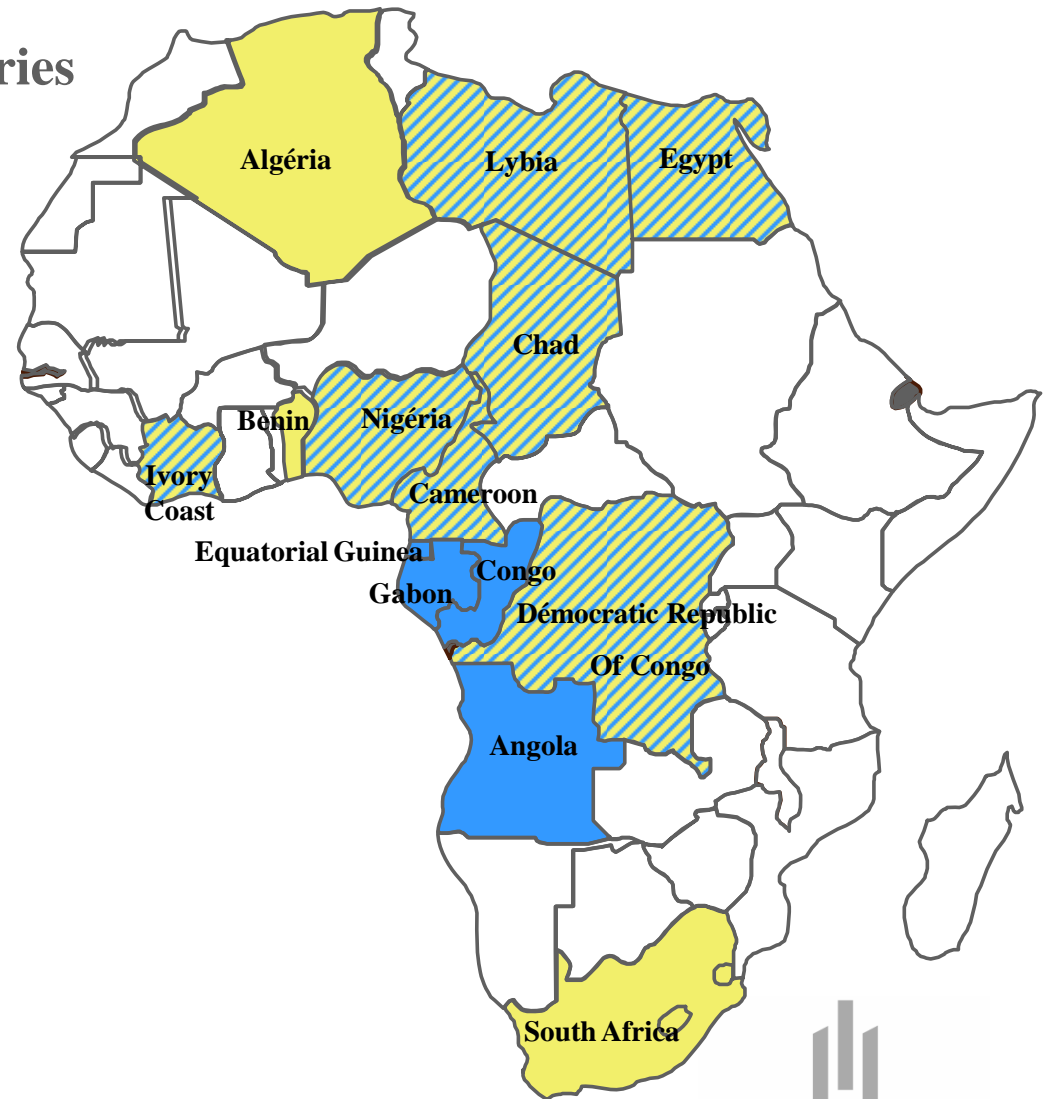
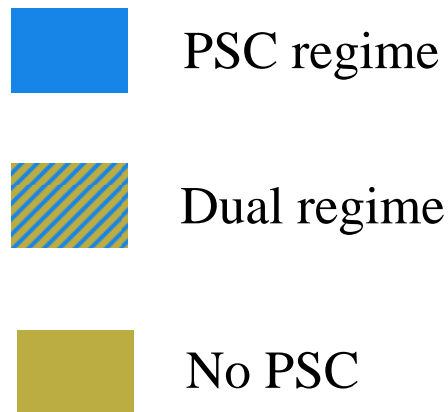
- ▮ **Have proved difficult to manage in practice**
 - **Complicated both for IOC and Ministry of hydrocarbons**
 - **Not necessarily compliant with industry practices**
 - **May vary from country to country**

- ▮ **Have entailed significant legal issues and dispute**
 - Mining title in particular
 - Assignments
 - Force Majeure
 - Renewals

Dual regime

At the same time, most of APPA countries have maintained a dual regime

- Concession
- Production sharing contract



Dual regime

- ▮ **Have proved difficult to manage in practice**
 - Complicated both for IOC and Ministry of hydrocarbons
- ▮ **Lack of justification & interest ?**
 - Based on contracts history
 - Current resources nationalism

State participation

▮ Most of APPA countries have implemented an increasing State participation

- Management
- Revenues

▮ Management of petroleum operations

- Information & decision purposes
- Management and technical committees
 - PSC
- Participation as State contractor
 - JOA

State participation

▮ Revenues

- Participation as State contractor
 - Cost oil
 - Additional profit oil
- Introduction of sophisticated mechanisms to allocate revenues
 - Hydrocarbons production
 - Rate of return
 - Profitability
 - Crude oil prices

State participation

▮ The State however

- Has budgetary constraints
 - No segregation of petroleum operations budget
 - No specific expense procedure to meet cash calls on time
- Has management constraints
 - Not necessarily adapted to PSC/JOA management
- Does not have transparency requirements
 - Pressure from financial institutions and IOC

▮ The State participation has therefore naturally shifted to NOC

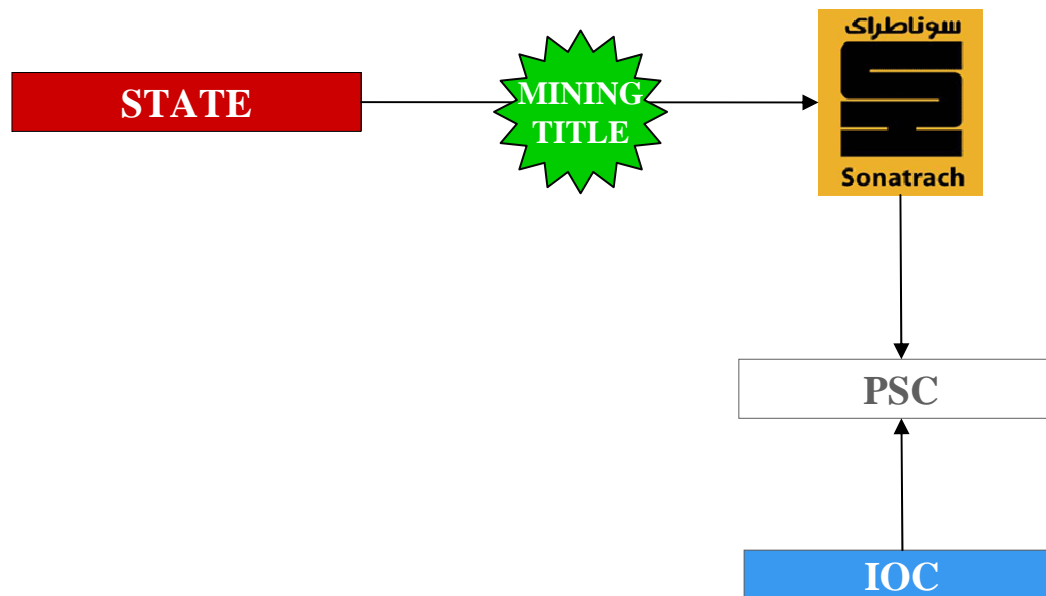
- Initially to hold and manage the State participation only
- Progressively to manage the hydrocarbons industry on behalf of the State



NOC

Algeria – 1986 regime

- State monopoly
- Mining titles exclusively granted to Sonatrach
- IOC to enter into production sharing contract with Sonatrach



Regulatory agencies

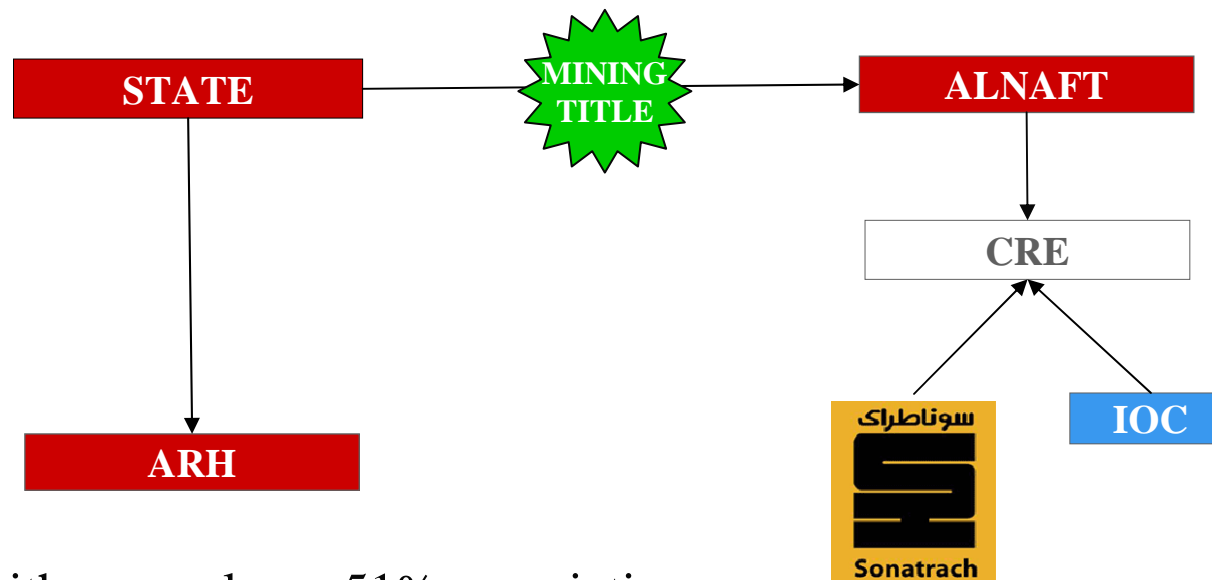
▮ Ultimate stage of development ?

- Transformation NOC into IOC
 - Full maturity: knowledge, technical expertise, financial wealth
 - Competitor to IOC in country and abroad
- Return to a concession regime
 - No more production sharing regime
- Implementation of regulatory agencies
 - Administrative authority
 - Independent from Ministry of Hydrocarbons
 - Separate budget
 - Necessary credibility for regulation and supervision of hydrocarbons industry

Regulatory agencies

Algeria – 2005 regime

- Mining titles exclusively granted to ALNAFT
- Return to concession regime, no more production sharing contract
- IOC to enter into CRE contract with ALNAFT
- Implementation of a regulatory authority ARH



- However, with compulsory 51% association with Sonatrach (2006)

Conclusion

▮ History of oil & gas contracts

- Supplements development of oil & gas industry
- Shows an increasing and more sophisticated participation of the State

▮ Main focus remains a fair allocation of

- Management
- Revenues

Conclusion

▮ Allocation of revenues must be flexible

- **Allocation of revenues is initially based on expectations**
 - Risk: early movers are rewarded
 - Exploration costs and discovery
 - Development & production costs
 - Profits generated
- **Allocation of revenues is however subsequently impacted by actuals**
 - Exploration, development & production costs
 - Discovery
 - Profits, mainly based on crude oil prices

Conclusion

▮ Production sharing contracts allow the necessary flexibility

- For the allocation to be and remain fair
- For the contract to be performed in the long term

▮ Flexibility lies in

- Stability provisions
 - Not to stabilise terms and conditions
 - But to maintain a fair allocation
- Allocation provisions
 - Hydrocarbons production
 - Rate of return
 - Profitability
 - And especially, crude oil prices

Nicolas Bonnefoy
Avocat à la Cour
Mining, Oil & Gas practice

Direct +44 20 7382 5713
Mobile +44 78 7576 1566
bonnefoy@gide.com



Gide Loyrette Nouel LLP
125 Old Broad Street
London EC2N 1AR
United Kingdom
www.gide.com



Gide Loyrette Nouel

A.A.R.P.I.