

# Petroleum legal regimes in the Gulf of Guinea

By Nicolas Bonnefoy, Gide Loyrette Nouel

**The Gulf of Guinea, an area located broadly from the Ivory Coast down to Nigeria and Angola, is one of the most significant petroleum producing areas in the world. With more than 4% of the world's proven oil reserves, the Gulf of Guinea supplied approximately 5% of the world's daily oil consumption, including respectively 15% and 25% of the daily oil consumption for the US and China in 2004. The importance of this region is predicted to grow in the near future as the oil consumption of the US and China is increasing significantly and the world is running shorter of conventional oil. As a result, the Gulf of Guinea has become a major focus of interest for international oil & gas companies (hereinafter referred to as 'IOCs') for the past years.**

However, the Gulf of Guinea is very diverse, and such diversity may appear tricky to IOCs willing to either purchase participating interests in existing ventures or looking to acquire new ventures. Indeed, from a cultural perspective, it comprises four major languages (French, Spanish, Portuguese and English, not to mention tribal languages) and two major religious groups (Catholics and Muslims, not to mention tribal rites). From a legal perspective, it comprises two systems of law (Common Law and Civil Law) and two major contractual systems (concession contracts and production sharing contracts), the focus of which is the purpose of this article.

Therefore, investing in the Gulf of Guinea requires IOCs to investigate the main principles of each

contractual system so as to better understand petroleum model contracts currently in force in the Gulf of Guinea.

In the late nineteenth and early twentieth centuries, petroleum exploration and exploitation activities were governed by concessions granted to IOCs. In the 1950s and 1960s, most of the oil producing countries shifted towards production sharing contracts. However, the shift from one system to the other was not implemented in the same way in the Gulf of Guinea. Therefore, each petroleum model contract currently in force in the Gulf of Guinea is a unique hybrid of both systems.

## Concession contracts

Petroleum ownership systems are based on the state sovereignty principle. The sovereign (typically a state) of a delimited area (typically a country) has exclusive legal dominion over this area, including all natural mineral resources, such as petroleum. This sovereign may recognise either private or public ownership of mineral resources and authorise development of state-owned mineral resources either by public entities and/or private companies, such as IOCs.

IOCs were initially granted concessions in order to undertake petroleum exploration, production and marketing activities on a specific territory for a specific period of time. Initial concessions covered rather huge territories and lasted as long as 75 years. In such concessions, the state transferred ownership of mineral resources to IOCs as well as all managerial and decision-making rights over petroleum exploration and production activities. IOCs had to secure the entire financing and technological capabilities and bear all risks pertaining to exploration and production activities. IOCs were therefore necessarily vested with full management

---

control: the exploration work programme and oil-well locations were left to the entire discretion of the IOC holding the concession. As a compensation for the concession grant, the state was only allocated a portion of petroleum production as royalty, which could be based either on the surface area granted to the IOC (surface royalty) and/or on petroleum production (proportional royalty).

IOCs undertaking exploration and production activities under a concession system operated under their own name, owned and depreciated their assets and were liable to corporate tax, although they were also able to negotiate privileged tax conditions with the state. Finally, IOCs holding concessions were also vested with full rights to the whole petroleum production, the ownership of which was transferred directly at well-head.

## Production sharing contracts

Not surprisingly, concessions granting full powers to IOCs over what might be a state's most valuable asset, rarely remain unscathed for the originally agreed duration. Ownership and control of the world's major petroleum reserves therefore progressively shifted from IOCs back to the states.

Indeed, the states decided not to transfer ownership of mineral resources as well as all managerial and decision-making rights over petroleum exploration and production activities to the IOCs anymore: from that stage onwards, the states retained ownership of mineral resources as well as management control. IOCs continued to be responsible for providing all financing and technological capabilities and to bear all the risks related to exploration and production activities. However, all decisions regarding exploration and production activities were made together with the state and, in the case of a commercial discovery, IOCs were not given full rights to the whole petroleum production but were only allocated a share of the petroleum production as a compensation, in accordance with a production sharing contract (hereinafter referred to as 'PSC'). Part of this allocation was meant to cover all costs incurred by the IOC during exploration and production activities (usually referred to as 'cost oil') and the remainder was meant to be their profit (usually referred to as 'profit oil').

Whereas the concession system was based on the Anglo-Saxon legal tradition, the PSC system is rooted in the legal principle of the French Napoleonic era,

whereby mineral resources are owned by the state only and for the benefit and welfare of all citizens. This same legal principle was embodied in the constitution of the state of Indonesia, which was the first state to enter into PSCs in the mid-1960s. As a result, Indonesian PSCs still serve as the main standard of reference and comparison in the international petroleum industry. Initial Indonesian PSCs are reported below.

Since the state of Indonesia does not grant concessions over a specified territory to IOCs and retains ownership of mineral resources:

- IOCs are not liable for any related compensation, such as surface and/or proportional royalties;
- IOCs do not own petroleum production but are only allocated cost oil and profit oil at an agreed location point, usually the connection point between storage and loading facilities (commonly referred to as 'delivery point'); and
- IOCs are not liable for additional corporate tax, i.e. Indonesian PSCs are tax free. Indeed, the state of Indonesia is already allocated the difference between the total petroleum production and cost oil / profit oil allocated to IOCs.

Since Indonesia retains full management capacity:

- all operations are performed in the state's name; and
- all assets financed by IOCs are the state's property, i.e. IOCs shall therefore not depreciate those assets, but may use the state's assets free of charge instead.

This initial version of Indonesian PSCs, which is commonly referred to as the "*First Generation of Indonesian PSCs*" in the international petroleum industry, has changed over the years but still remains the main standard of reference and comparison in the international petroleum industry.

The main differences between concessions and PSCs are highlighted in Table 1.

## West Africa hybrid contracts

The shift from the concession system to the PSC system was implemented in the Gulf of Guinea in the late 1970s and 1980s. It was not only implemented in different ways around the world and in the Gulf of Guinea, but it was also implemented differently in each country in the Gulf of Guinea.

As a result, the legal environment governing petroleum exploration and production activities in the Gulf of Guinea is very diverse and each petroleum model contract currently in force in the Gulf of Guinea is

**Table 1: Concessions V PSCs**

	<b>Initial concessions</b>	<b>First Generation of Indonesian PSCs</b>
Mineral resources ownership	IOC	State
Royalties (Surface / Proportional)	Yes	No
Operations management	IOC	State
Assets ownership	IOC	State
Assets depreciation	Yes	No
Production ownership	IOC	State
Transfer of production ownership to IOC	Wellhead	Delivery Point
IOC share of production	All production	Cost Oil & Profit Oil only
Additional corporate tax	Yes	No

actually a unique hybrid of both systems, as follows:

1. A few countries in the Gulf of Guinea have still not shifted to PSCs, such as Congo-Kinshasa and Chad, whose petroleum exploration and production activities are still governed by concessions. Other countries in the Gulf of Guinea shifted to PSCs in 1978 (Angola), 1983 (Gabon), 1995 (Congo-Brazzaville) and 1999 (Cameroon). Others, such as Equatorial Guinea and in the Sao Tome & Principe – Nigeria Joint Development Zone, whose petroleum exploration and production activities developed later, immediately implemented a PSC system.
2. For those countries that shifted to a PSC system, implementation of the same was conducted by three major means:
  - Gabon implemented an exclusive PSC system from 1983 onwards: the state would not enter into concessions anymore but former concessions still remained valid and enforceable up to their initial duration;
  - Congo-Brazzaville implemented an exclusive PSC system from 1995 onwards, as well: the state would not enter into concessions anymore, and former concessions were converted into PSCs;
  - Cameroon implemented a dual concession / PSC system from 1999 onwards: IOC may choose to enter into either one.

In spite of the main principles reported above:

1. Some states, which shifted to PSC systems, actually transfer ownership of natural resources to some extent, such as Nigeria, Congo-Brazzaville and Cameroon, whereas some others fully retain

ownership of natural resources, such as Angola, Gabon and Equatorial Guinea.

2. Whether states transfer or retain ownership of natural resources, most of PSCs in force in the Gulf of Guinea actually include royalties : either surface royalty only, such as Angola and Cameroon, or surface and proportional royalties, such as Gabon, Congo-Brazzaville and Equatorial Guinea.
3. Most of PSCs in force in the Gulf of Guinea include a liability to corporate tax, whether to be paid in addition to cost oil and profit oil, such as Angola, Cameroon and Equatorial Guinea, or considered to be already included in the share of production of the state, such as Gabon and Congo.

## Conclusion

As a conclusion, we are of the opinion that reference to 'concessions' and 'production sharing contracts' in the Gulf of Guinea context may be misleading for IOCs willing to either purchase participating interests in existing ventures or acquire new ventures in that region. Indeed, none of the concessions and PSCs in force in the Gulf of Guinea respectively perfectly match the actual definition, standards and concepts of regular concessions and PSCs: each of the same are a unique hybrid of both systems.

Therefore, we would strongly recommend that IOCs intending to invest in the Gulf of Guinea handle concessions and PSC issues with care and should not necessarily assume that definitions, standards and concepts of concessions and PSCs in force in the Gulf of Guinea must be the same as in the international

---

petroleum industry. There are unfortunately too many examples of unsuccessful acquisitions and contract negotiations due to a misunderstanding of the specificities of concessions and PSCs in force in the Gulf of Guinea. Indeed, not taking into account corporate tax in Equatorial Guinea for instance, assuming corporate tax is to be paid out of the petroleum share allocated to the state, may actually significantly reduce the profitability of a transaction. Similarly, not taking into account surface and proportional royalties in Gabon for instance, assuming there are no royalties in PSCs, may also significantly and adversely impact the profitability of a transaction. Even worse, putting in place security

over the IOC assets and/or share of oil & gas production, assuming the same actually belong to the IOC, could not be implemented and enforced in Gabon for instance.

**Nicolas Bonnefoy, Avocat, Gide Loyrette Nouel,  
26, cours Albert 1er, 75008 Paris, France.**

**Tel: +33 1 40 75 29 93**

**City Point, 1 Ropemaker Street,**

**London EC2Y 9HT, UK**

**Tel: +44 20 7826 9737**

**Email: [bonnefoy@gide.com](mailto:bonnefoy@gide.com)**

**[www.gide.com](http://www.gide.com)**