EXTRACTIVE INDUSTRIES  
IMPROVING EXTRACTIVE INDUSTRIES BENEFITS FOR THE POOR

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International Petroleum Acreage Allocation Processes and Petroleum Fiscal Systems  
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Agenda: Allocation Processes and Fiscal Systems Design

Agenda

 Governments’ objectives, boundary conditions, concerns

 Allocation Processes
   Open door policies
   Administrative procedures
   Auctions

 Fiscal Systems
   Legal vs. economic distinctions
   Royalty Tax Systems (Concessions)
   Production Sharing Contracts (PSCs)
   Service Agreements

 Design Considerations
   How Governments protect themselves
   Transparency issues
Governments have many objectives, but maximizing the ‘Take’ is often the primary objective.

- **Optimize**
  - Government Take, early money, ultimate recovery

- **Encourage**
  - investment, resource development & infrastructure

- **Develop**
  - indigenous industry, capacity, & sustainable environment

- **Balance**
  - stability & consistency

- **Alignment**
  - stakeholder interests

- **Flexibility**
  - adapt to changing circumstances
Investors look for an opportunity to recover their investments and share in the profits.
Acreage is not all the same. Attractiveness is a function of geology and risks.

Geology is the key consideration in determining prospectivity but other considerations include:

- Country risk - political
- Project risks – technology and infrastructure requirements
- Market risks – oil and gas prices and market availability

Other key considerations include:

- Fiscal systems and or fiscal terms

Each investor will have its own assessment of prospectivity
Open door systems are typically used when prospectivity is poor, or investor interest is low.

Open door systems, or direct negotiations occur primarily in two situations:
1. Governments that can’t demonstrate good prospectivity rely on direct negotiations.
2. Governments that receive single (or no) applicants during tenders or auctions opt to negotiate directly.

Advantages:
- Provides the Government an option.

Disadvantages:
- Governments are usually at a negotiating disadvantage.
- Negotiations are often not transparent.
- Government may not get most efficient investor.
Administrative procedures allocate licenses based on criteria defined by the Government.

Administrative procedures or discretionary systems allocate acreage based on bids submitted during a tender.

Advantages
- Can offer Government greater share of rent
- More transparent than open door systems
- Governments select investor/investors*

Disadvantages
- Not always transparent
- Provides Government (agency) discretionary selection

* New blood, forced marriages
Auctions award licenses to the highest bidder.

Auctions or tenders, typically award acreage to winning bidders.

Advantages
  More transparent
  Can provide Governments with the most ‘rent’.

Disadvantages
  Not always transparent
  Failed auctions can be costly
  Requires significant ‘capacity’
  Investors are faced with ‘head-on’ competition
Allocation strategies vary widely, in terms of bid requirements, transparency, and competition.

**Negotiated Deals:**
- Columbia, T&T, Indonesia

**Fixed Terms + Work Program Bidding:**
- UK, Norway, Australia, New Zealand

**Fixed Terms + Bonus Bidding:**
- US, Nigeria, Myanmar

**Sealed Bid Round with Terms Bid:**
- Venezuela, Libya

**Allocation Strategies**

- Less Pain
- IOC Attitude
- Greater Pain
- Less Transparency
- More
In the 1990s roughly 50 countries were offering acreage - by 2006 that number had doubled.

Acreage has become a “commodity”.

Governments must take a more proactive approach to allocating acreage.

• Employ advanced marketing strategies
• Improve perceptions about prospectivity
• Develop capacity to manage acreage and licenses
Trends in allocation strategy and design are many, some have worked others haven’t:

• Oil-for-infrastructure
• Downstream equity swaps
• Indigenous participation
• Government participation
• Capacity building
• Out-of-round negotiations
• First-right-of-refusals
• Environmental, health, and safety
• Domestic market requirements
• Forced marriages
• Incentives and credits
• Marginal field development & EOR
Fiscal system classification is based on legal distinctions:

When, where and if hydrocarbon title transfers to the investor, and who has title to facilities.

Classification of Petroleum Fiscal Regimes

- Royalty/Tax Systems
- Contractual Based Systems
  - Service Agreements
  - Production Sharing Contracts
Fiscal system design must address numerous considerations:

- If profits are generated how much does the Government “Take”?  
- “Effective royalty rate”?
- How much incentive does the Contractor have to keep costs down?  
- Relinquishment?
- Is it ringfenced? and “how”?
- Domestic Market Obligation?
- Are there many “Crypto” Taxes?  
- Bonuses?
- How efficient is the system?  
- What percentage of the production is the contractor “entitled” to lift?  
- How stable is the regime?  
- Government Participation?
- If oil prices increase, what percentage goes to the Government?
From an economic standpoint, there are few differences among the fiscal systems.

Although terminology differs among the various fiscal systems, economically they can be identical. Fiscal system evaluation focuses on:

- Division of profits: Take or Internal rate of return
- Effective royalty rate - timing
- Incentives to keep costs down
- Progressivity
- Stability or sustainability

There is however a big difference when it comes to lifting entitlement.
R/T system and PSC Take comparisons.

**Typical PSC:**
- 10% Royalty
- 50% Cost Recovery Limit
- 60% Government P/O Share
- 30% Corporate Income Tax (CIT)

**Typical R/T System:**
- 10% Royalty
- No Cost Recovery Limit
- 60% Tax (1st Layer)
- 30% Tax (2nd Layer)

Where Gvt. Take exceeds 100% it is set at 101%
Royalty/Tax systems (concessions) used to be the only option available to Governments.

Hydrocarbon title transfer - if a discovery is made and deemed commercial, the investor will gain title to hydrocarbons at the well head.

Title to facilities - remains with the investor.

R/T Systems offer Governments little control of their own resources.
Production sharing contracts (PSC) were introduced by Indonesia in 1968.

PSCs offered Governments greater control of their resources.

Hydrocarbon title transfer - if a discovery is made and deemed commercial, the investor will gain title to hydrocarbons somewhere downstream of the well head.

Title to facilities - transfers to the Government, with some exceptions.

*PSCs are often misunderstood - they do not guarantee investors will get their investment back!*
Service agreements (SA) provide Governments with the greatest control over resources.

Hydrocarbon title transfer - there is no title transfer to investors.

Title to facilities - Governments own facilities.

SAs are usually the choice of Governments with financial independence or nationalistic attitudes.
There are numerous ways Governments can protect themselves in allocation and fiscal system design:

Choice of block size  
Ringfencing  
Participation  
Adequate effective royalty rates  
Progressive fiscal systems  
Flexible, efficient fiscal system design  
Relinquishment requirements  
Work program guarantees  
Minimum acceptable bid criteria
Allocation processes and Fiscal System designs must match prospectivity.

If prospectivity is low, auctions and or high Government Take won’t work.

That does not mean Governments must forgo transparency. Transparency can be improved, for example by:

- Defining clear criteria for awarding licenses
- Publishing outcomes
- Use of external oversight bodies