Summary of the Annual Meeting of the New Producers Group

Accra, Ghana, 4–5 December 2018

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International meeting, 4–5 December

The meeting opened with welcome addresses from the chief executives of the Ghana National Petroleum Corporation (GNPC) and the Petroleum Commission (PC), who expressed their pleasure to be hosting this meeting and reiterated their commitment to the New Producers Group (NPG). They expressed appreciation for the companies that are working in partnership with governments in the upstream and downstream sectors of the industry and indicated the need for joint strategies to counteract challenges, especially around issues such as local content.

The host organizations indicated that it was critical to form long-term partnerships for research, information sharing and best practices. They pledged Ghana's readiness to participate in this learning and collaboration effort.

The participants praised the arrival of Malawi and Somalia as new members of the NPG, which promises to improve the exchange of information and deepen relations. It was emphasized that peer-to-peer exchanges enrich partnerships and foster increased learning. As such, attendees were urged to pay attention to the experiences shared around the room, to continue to network and share ideas and experiences after the meeting.

Format of the meeting

The meeting brought together officials from the member countries of the NPG for focused discussions over two days, followed by a National Seminar for Ghana.[1] The discussions were organized in the form of short presentations from government and national oil company (NOC) officials from producer countries as well as executives from oil and gas companies. The presentations were followed by working group discussions with recommendations that were presented and interrogated further.

The discussions were held under the Chatham House Rule, which states that 'participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed.'

Day one focused on bringing together representatives of governments and industry, while day two was only for those from government. Day one focused on the short- to long-term context for investment in oil and gas, highlighting the impact of capital availability, competing jurisdictions in licensing and the energy transition.

Industry outlook

The introductory sessions provided a high-level overview of the current sector – specifically in exploration.

First, the group heard predictions from industry analysts Wood Mackenzie and the International Energy Agency. Wood Mackenzie expects most oil companies will be cautious regarding exploration and that the number of wells will remain stubbornly low. The International Energy Agency expects shale exploration to thrive, while conventional offshore exploration stays low. Many companies remain focused on lower

[1] Publications by the New Producers Group can be found here.

risk, quick pay-out shale and fracking. Cuts in investment and staff by oil companies and oil field services companies could have a knock-on effect in the future with rising costs. In the long-term, oil companies expect global oil demand to decline. The key questions are when and how quickly this decline will occur.

Against this backdrop, Shell's Sky scenario was presented. It outlines what the company believes to be a possible route forward to limit the global average temperature rise to well below 2°C from pre-industrial levels. This is predicated on the following changes by 2070:

- A change in consumer mindset where people choose low-carbon, high-efficiency options to meet their energy service needs.
- A step-change in the efficiency of energy use.
- Carbon-pricing mechanisms are adopted by governments globally over the 2020s.
- The rate of electrification of final energy more than triples, with global electricity generation reaching nearly five times today's level.
- New energy sources grow by up to 50-fold, with primary energy from renewables eclipsing fossil fuels in the 2050s.
- Some 10,000 large carbon capture and storage (CCS) facilities are built, compared to fewer than 50 operating in 2020.
- Net-zero deforestation is achieved. In addition, reforesting an area the size of Brazil offers the possibility of limiting warming to 1.5°C

Against this short- and long-term industry outlook, oil company participants emphasized the continuing need for petroleum. They highlighted that there continue to be opportunities for upstream investments, while smaller explorers are searching for resources beyond conventional areas.

Some government participants also highlighted the continued need for investment in oil exploration, with the natural decline rate for oil reserves around 6–8 per cent. They also challenged the assumption that renewables would grow to meet energy demand in the future, questioning their availability and affordability. Others mentioned the potential role of natural gas as a transition fuel and the potential for technology to enable them to transform their energy-use systems. Countries with limited electricity grids, for instance, could leapfrog the centralized utility model in favour of smaller energy producing units closer to users. There was also a strong recognition of the urgent need for new and emerging producers to diversify their energy mix.

Licensing and negotiation to attract investment and maximize benefits

The group heard about Ghana's competitive processes and the experience from the recent bidding round for licences.[2]

Key messages from the session:

- Ghana has an open, transparent bidding system but relied on direct negotiation when it awarded a licence to ExxonMobil for deep offshore exploration;

[2] Further information is available via www.ghanalr2018.com.

- Petroleum agreements have an additional provision to allow for state participation post-discovery. It is negotiable and is on the basis of a full working interest (i.e. the NOC must contribute to its share of costs); and
- Parliament must ratify each petroleum agreement.

Representatives from Lebanon followed with a presentation sharing the country's first experience with licensing, detailing the relevant laws and decrees, the bid process, weighting of bids on technical and commercial terms, bid bond and legal documentation on the applicants and pre-qualification systems. The process started in 2013 and concluded in January 2017 with the award of a licence. The competitive licensing system is being tested and lessons are being learned for the second round of bids. The public, private sector, civil society and government all contributed their views on the licensing process.

Key lessons:

- The existence of a consistent progressive and stable legislative framework was important;
- The licensing outcome shows the value of having strong pre-qualification criteria and including criteria for work programmes among biddable items;
- Transparency helped the process – the government published its Tender Protocol and model Exploration and Production Agreement (EPA), and their licensing strategy was guided by clearly defined objectives; and
- It was important to have strong technical knowledge in the sector in order to be able to design the licensing framework and vet the bids.

Discussion:

The attendees discussed Ghana's progress. The country's bidding process purposely excluded some exploration blocks, as the government wished to test the provisions of Act 919 – legislation on the petroleum exploration and production sector. The government also wanted to attract companies that had expertise in deep-water exploration.

While increasing geological data is important, one participant commented that over reliance on multi-client studies was unwise. They argued that countries can do a number of things independently to increase geological data, including studying core sampling and engaging further with industry.

Participants raised the importance of block size, and stated that it should be balanced to give governments manoeuvring space, while being large enough to incentivize companies.

The impact of energy transition on investments in the oil and gas industry

This session highlighted that while the timing and speed of the energy transition are uncertain, there will be a point at which demand for oil will peak and the value of oil for export will decline. It was noted that new producers should consider the implications of an energy transition. A key takeaway is that while demand for oil and gas continues to grow, deep changes will come to the supply and demand picture, impacting investment and government policies.

Against this uncertain outlook, a strategic use of revenues is important to avoid squandering the opportunity of finite oil and gas resources. Care is necessary on the part of the government to manage revenues for long-term sustainable outcomes and to avoid the resource curse – and, in the case of countries yet to produce, the 'pre-source' curse. Another issue highlighted was that of creating sovereign wealth buffers as one potential measure to mitigate against resource curse risks and create financial resilience. The importance of resource diversification was also stressed: countries can lock in more value from oil resources through refining/processing and participating in the provision of services through the value chain, and endeavouring to stimulate other sectors of the economy.

Belize and Guyana were highlighted as cases where policymakers have struck a balance between extracting fossil fuels for immediate and long-term developmental needs and mitigating the effects of climate change.

Key messages from the session:

- There is a need to take a broader sector-wide approach to the issue of resource management and the role of the oil and gas sector. New producers have the opportunity to minimize their dependence on the petroleum sector when setting their development path.
- A policy outcome of energy transition could be that it is more feasible to consider other more sustainable alternatives to oil and gas.

Discussion:

- Some countries, especially poor countries, have limited options to generate benefits for their citizens. The petroleum sector offers one such possibility that can benefit the population.
- The energy transition does cause some concern for new producers, which could translate into a race to the bottom among new producers with each competing to attract risk capital for quicker resource exploitation.
- The importance of resource and revenue diversification was emphasized.
- Subsidies on petroleum consumption should be avoided.
- Political will and government coordination for better governance is very important.

Breakout sessions on increasing in-country value creation

Breakout sessions were held on three topics: maximizing benefits from natural gas domestically; gathering information to improve local content policies; and effective tax auditing processes for resource mobilization.

Group 1: Options for maximizing benefits from natural gas

This group discussed how countries with offshore gas resources tend to plan to use these resources onshore to increase domestic and industrial access to energy, and sometimes to feed into regional markets. Assessing the potential demand for gas in a country with an immature market and limited infrastructure can be challenging for governments and companies alike. It was noted that international oil companies (IOCs) may be reluctant to sell larger shares of gas to domestic markets due to factors such as project economics, unreliable local market demands, late payment, and volatility in the value of local currency.

Two main issues were identified and deliberated:

- Price dilemma: domestic supply obligation, and attendant consequences of agreeing to too low a price; and
- Volumes/Quantity dilemma: volumes produced being lower or higher than domestic requirements.

Discussions led to the agreement that there is an absolute necessity to have a gas masterplan to support policy decisions regarding pricing, volumes and standards.

Key takeaways:

- When LNG exports are part of the gas development, the issue of local supply may impact export revenue generation for the country and local economic development;
- It is critical to have a broad public consultation to align expectations and to agree on the requirements of the country;
- New producers are encouraged to seek advice on a realistic future outlook for the natural gas market in the country and region, for both the short and long term;
- Integrated economic planning can better inform such market demand studies;
- New producers are also encouraged to consider adopting a phased approach – to determine the market, appropriate quantity and price; and
- Where possible, ensure market-based pricing. The advice from Nigeria strongly emphasized that gas should both be purchased and sold locally at market prices. It should not be purchased at a price that is too low to attract investment or sold at such a low price that it requires government subsidies to be viable.

Group 2: Opportunities for increasing in-country value: How to gather early information on project demand and support for surveys

This group considered optimal ways to gather information early in the project life cycle for the purpose of stimulating in-country value from oil and gas operations, given limited resources. Industry and government perspectives were shared.

Key takeaways from the discussion:

- An industrial baseline survey is an important first step before elaborating a local content policy. It supports policy planning. It is also useful for managing public expectations because its results clarify the types of opportunities that will arise at the discovery, development and production phases. However, some participants felt such results could be unhelpful at the exploration stage, by creating expectations about discoveries.

- If the resource base is uncertain and governments are reluctant to invest in a full baseline survey, they can work with scenarios to support planning and policy setting. They can identify strategic sectors that could supply the petroleum sector, and develop plans to support the ramp up of skills and finance that can be triggered upon a discovery. At the exploration stage, oil companies are reluctant to give governments estimated information on demand for goods, services and skills because it could be perceived as a promise of exploration success and specific project development decisions. That said, oil companies can provide standard profiles of demand for skills, goods and services based on project scenarios. This would support government planning.
- Timing is crucial to ensure national capacity (supply) is available when demand emerges. Governments should start the process of analysing the supply and demand picture early. They can adopt a phased approach to building local capacity, to invest the right amount and in the right place for each phase of the project life cycle.
- It is also important to have a local content plan that reflects the development priorities of the country.

Group 3: Resource mobilization: Effective tax auditing processes

This group tackled auditing for tax and cost recovery, taking into consideration practices and challenges with regards to ensuring fair and effective capture of revenue by the state.

Key takeaways from the discussion:

- Cost auditing will likely always result in disputes. These disputes can drag on and affect the main task of exploration. Governments should allow room for dispute resolution without disturbing the production process. The group looked at various countries that had done this successfully and agreed there should be a simplified system to do this.
- New producers are encouraged to design systems that do not require too much in terms of auditing – e.g. Colombia. Frontloading fiscal instruments, for example, ensures less worry about calculating for and auditing cost recovery.
- Clarity of roles is very important. It should be clear who is doing what, as regards auditing. These tasks can sometimes be confused between the regulator and the auditor general. Capacity questions can also arise, particularly in cases where the auditor general's office would typically not have specific oil and gas expertise. Capacity measures to bridge this gap are thus very important.
- Capacity-building was emphasized for all agencies. Where there is a gap government should not hesitate to get in experts to assist.
- Trying to build capacity internally while auditing in a timely manner can be challenging. An encouraged solution is to bring in specialists to do the audit and at the same time build capacity.
- Cost control – there is a need for work programmes and budgets to be approved to guide programme implementation.

Government discussions, 5 December

The government participants were divided into three break out groups for the morning session. Each reviewed the progress made by the three working groups that were established at the 2017 New Producers Group meeting in Suriname: group 1 examined 'sticky' clauses in oil contracts and how to navigate them; group 2 looked into understanding exploration costs and how to benchmark them;

and group 3 examined information required from operators at exploration and discovery phases. The working groups were created to address policy implementation challenges. They are standing groups that will continue working on the various themes on an ongoing basis.

Oil Contracts: Unsticking the ‘sticky’ clauses

The first working group focused on an initial topic that had been prepared for the meeting. This was used as a jumping off point for a detailed discussion of how participants could most effectively share their areas of interest and experiences with regards to oil negotiations and contracting. They also had an initial discussion of a second work product that will serve as the basis for bigger-picture thinking over the longer term.

The group spent most of the session reviewing a contractual provisions spreadsheet developed by the working group with support from Clyde & Co. and the Natural Resources Governance Institute (NRGI). The sheet was designed to enable participants to test the working group’s proposed approach to sharing information on contract clauses among participants and prompting discussion and analysis. The spreadsheet focused on two kinds of provisions that had previously been identified by working group members as posing challenges for new producer governments. For each of these topics, the spreadsheet provided examples of contractual language drawn largely from the open www.resourcecontracts.org platform, and a discussion of the implications and pros and cons of each approach for new producers.

The worksheet stimulated a rich discussion among the participants of the two issues being discussed. Participants shared their experiences around the table and there was a detailed back and forth about the implications of different approaches that had been taken. The two issues were:

- Stabilization clauses. These clauses serve to ‘lock in’ certain provisions of oil and gas projects, i.e. to guard against the rules changing in a way that negatively impacts one of the parties after the contract has been signed. Country examples were shared from Ghana, Liberia and Namibia (which does not have stabilization clauses in petroleum agreements).
- Dispute resolution clauses. The working group began a discussion of the importance and challenges associated with dispute resolution clauses.

Key observations included:

- Overly restrictive stabilization clauses – which obstruct a government’s ability to change even fundamentally important provisions of law – can serve to limit the exercise of national sovereignty and operate to the long-term detriment of the contract.
- Some countries have opted not to include stabilization clauses at all, but several participants remarked that in order for such an approach to be successful, the country needs to demonstrate in other ways that it has a stable legal system and that investors are unlikely to be subject to severe and unpredictable shifts in the legal regime.
- Several countries have taken a middle ground approach, whereby they have stabilization clauses that are limited in scope or time period.
- It is important to provide a clear explanation – to investors and to citizens – of the rationale for, and the implications of, stabilization clauses.

- New producer governments should have a strong understanding of the implications of different venues and rules associated with arbitration at the moment that such clauses are being negotiated, to ensure that the dispute resolution clauses included in the final contract operate in the national interest.
- The group also discussed the interplay between dispute resolution provisions and stabilization clauses, which should operate together to simultaneously protect investor interest and the national interest.

The group also briefly discussed a second topic, a report on the *Petroleum Contract of the Future* by Pedro Van Meurs. He shared thoughts on the suitability of a new type of contract, Petroleum Exploration Agreements (PEAs), that he foresees developing countries moving towards in the future.

Next steps

The working group agreed next steps to be followed in 2019. First, it agreed to build on the initial work product on contract clauses by continuing to develop a spreadsheet for sharing approaches. Two specific steps were discussed:

- For the two subjects already developed (stabilization clauses and dispute resolution clauses), participants agreed to add to the spreadsheet with example language from their own contracts, in order to enrich the examples available to consult.
- Participants agreed that the working group should repeat the exercise for additional clauses that have posed challenges. The group suggested tackling force majeure clauses and clauses for the use of associated natural gas.

In addition, the working group agreed to convene a video conference in the New Year to discuss the Pedro van Meurs report.

Understanding exploration costs

The experiences of Kenya and Uganda with regards to tracking, benchmarking and auditing exploration costs were shared with the group, along with strategies employed and measures taken to reduce costs. The working group on benchmarking exploration costs also shared the work it has done so far, which included the preparation of draft guidelines for benchmarking exploration costs and the development of a web-based platform for benchmarking costs, which would be accessible to the NPG members.

Key takeaways:

- Roughly 70 per cent of exploration costs can be attributed to drilling. These costs have gone up by about 250 per cent since 2007, due to high rig and equipment costs. Challenges in this regard, especially based on the Kenyan experience, include:
    - Costs associated with managing affiliates, demobilization, facilities, camps, and drilling;
    - Lack of capacity in that new producer governments typically do not have the team sizes required to actively monitor costs.

- Ways of reducing these costs include:
  - Proper planning – having standardized toolkits;
  - Procurement and supply chain management;
  - Simplifying well specification and design;
  - Lean drilling execution;
  - Rigorous performance management; and
  - A sound rig release strategy.
- The Kenyan representatives noted that there is merit in conducting technical studies to understand these costs as well as their structures and risks.
- A suggestion made by the group was to consider the possibility of also benchmarking other exploration costs.
- Other suggestions included the possibility of adding costs outside of drilling to the software to enable more detailed comparison by new producers, and the creation of a WhatsApp group to support direct exchange between users.
- The broad consensus was that there is value in continuing with the working group.

Information required from operators at exploration and discovery

The main purpose of this working group was to consider measures to bridge the gap in information between licence holders and government regulators of the oil and gas sector. The main questions for the purpose of analysis were, what information should the oil company provide to the government? And, how can the information be used?

Two areas were identified for work in this group: due diligence on prospective investors and legislative and contractual provisions to support the retrieval of information. To this end, two process tools were introduced to the group, namely:

- Due diligence checklist, detailing what it means to provide the various information needed and where it can be obtained.
- Petroleum legal framework and agreement provisions that enable governments to obtain key information.

The objective of the group discussion was to check if these tools were useful and served the purposes of countries in determining information needs and sources.

Key takeaways:

- Government information requirements may be in conflict with company practices.
- There are many areas where governments are encouraged to obtain information from operators. If such information is not made available, they should find alternative sources, such as investment advisories, stock exchange reports and end of year returns. Ultimately, however, governments should not shy away from simply asking the companies to provide the needed information.
- The needs of government and their power to obtain and utilize data to influence decisions will vary over the different upstream phases. The post-discovery phase is especially important. Great emphasis must be placed on reviewing the appraisal and development work plans. For

example, governments should not subject themselves to an obligation to review the field development plans in short timeframes, such as 30 days; however, in such cases governments can legitimately slow the process down by requesting supplemental information from operators. In addition, critical reviews of company plans prior to development approval can help obtain more optimal costs and production decline rates, in the best interests of the country.
- Entities within the government must not be set against each other during the field development or work programme approval phase – it is important for all relevant entities within government to be aligned. The group discussed whether it might be useful to develop a framework to guide country strategy reviews, especially post-discovery, to avoid problems of interagency conflicts and lobbying by the companies.
- A suggested focus for the working group was to organize a course on reviewing field development plans led by both the Society of Petroleum Engineers, providing a review of technical engineering issues, and the New Producers Group, providing the experience of regulators in putting the principles into practice from the standpoint of broader country impacts. Another suggestion was to ask a body with technical and commercial experience, such as Wood Mackenzie, to show the group how it assesses a field development plan or a work programme.

Plenary – Virtual agency services concept for the NPG

A presentation was given on how regulators in different countries could work towards achieving shared repositories for data and procedures. Discussions touched on issues of safety, storage, cost, confidentiality and sovereignty of data. The key takeaway from the discussions was on the efficiency gains that could be made from cross-border information sharing by regulators, and a recognition that the regulatory landscape could change significantly due to technological improvement.

Breakout sessions: Sharing experiences on engaging with different types of companies

Discussions were held in three separate groups on shared experiences in dealing with three categories of companies namely: supermajors, independents and NOCs. The essence of the group discussions was to identify useful engagement strategies from a regulatory standpoint.

Supermajors

The general objectives and strategies of supermajors were discussed, with examples of dealings in countries such as Nigeria and Ghana. Discussions touched on matters such as early payback on investment, pace of production of one field versus development of all economically viable reserves, risk aversion, corporate social responsibility, and technical operational standards.

Key takeaways:

- Supermajors dominate partnerships and will optimize their own portfolio across countries worldwide. This could easily have negative cost consequences for individual projects. A possible way to mitigate this is to have more than one supermajor oil company in the joint venture (JV), which acts as a counterweight and looks after its own business interests.

Government should ensure there are balanced voting rules in the JV and it should approve transfer of equity of petroleum assets, and any proposed changes of voting rules in the JV.

- Supermajors fully comply with laws, regulations and production sharing agreement (PSA) provisions in each specific country. However, they may not share information if not obliged to by the laws and regulations of the partner country unless it is in their own interest. Therefore, government should ensure laws are in place that align oil company behaviour with the country's goals. It is of paramount importance that the PSA caters for information sharing with the JV partners and with the government, not only when it comes to important decisions along the value chain, but also throughout the many years of production where there may be a lack of defined decision milestones.
- Supermajor oil companies are centrally managed, meaning important decisions are not made by local staff. Should there be misalignment between the company and the country, the latter should engage the company at the headquarter level.
- Supermajors are cash driven. Their high discount rate will determine the results of investment decisions towards early pay-back projects. Cash flow is also important in follow up, which means they value cash incentive mechanisms higher than other companies. Utilizing this behaviour in dealings with them will probably make it easier to negotiate with the company. The country should have legislation that sets the standard of efficiency in resource management, including maximum commercial oil and gas production. It is important that incentives are in place, for instance in the PSAs or in tax provisions, which will align oil companies' behaviour with what is desired by the government.

Independents

This group shared experiences engaging with independents and touched on issues such as limited capital, technical capacity, relationships with the NOC, consistency in meeting obligations, and communication.

Key takeaways:

- Independents tend to work well with NOCs at the beginning of the project life cycle but less so at the production phase.
- Independents are reluctant to accept secondments before discoveries are made.
- They tend to rely on consultants more than larger companies because they have a smaller staff. As a result, regulators and NOCs find they interact with different people on different issues, which can be a challenge for continuity.
- Before licensing to smaller independents, it is important for governments to get credit reports to ensure they have the financial capabilities to invest.
- Governments should be aware that independents will communicate more aggressively to emphasize to markets the value of their acreage, and this can result in inflated public expectations.

NOCs

This group focused on regulating NOCs operating internationally. They addressed how, for example, Chinese NOCs undertake business and implement projects in host countries. Issues considered included the nature of relationships between NOCs and governments and how they differ from supermajors or independents; mobilization challenges; flexibility; delivery times; local content issues; wider strategic international relationships between governments; and stringency of regulations.

Key takeaways:

- It is better to have a competitive operating environment – such as a JV – as this helps governments achieve higher standards in operations.
- Useful tools to consider in managing the risks that manifest from dealing with NOCs include: due diligence, competitive bidding, compliance with application/licensing process, adhering to quality standards, ensuring local content.
- Governments stated that Chinese NOCs are reluctant to train non-Chinese secondees.
- New producers are encouraged to clearly articulate and protect their national interests when dealing with NOCs (and IOCs alike).
- It is also important to ensure the establishment of appropriate governance frameworks of rules and regulations, while maintaining a degree of flexibility in policymaking.

Norad GOGIG GHANA OIL AND GAS FOR INCLUSIVE GROWTH

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