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## Meeting Summary

# New Petroleum Producers Discussion Group: 2019 Annual Meeting

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## Introduction

The 7th Annual Meeting of the New Petroleum Producers Discussion Group (New Producers Group) was held in Kampala on 11–15 November 2019 and hosted by Uganda’s Ministry of Energy and Mineral Development, the Petroleum Authority of Uganda and the Uganda National Oil Company. The meeting convened officials from 21 countries who represented agencies (at the national and sub-national level) that administer laws relating to the petroleum industry, revenue, finance and the environment. It included two days of specialized training covering topics such as risks relating to the development of the petroleum sector, revenue management, contract negotiation, communications in the natural resource sector, national oil company performance drivers, and oil metering, valuation and marketing. The remainder of the meeting consisted of discussions and exchanges between the participating countries. The theme of the discussions was ‘Building Capacity and Institutions’. The last day of the Annual Meeting, 15 November, was dedicated to Uganda and its preparation for oil production.

The 2019 discussions showed a heightened concern for the impact of the global energy transition on emerging petroleum producers and their pursuit of long-term economic benefits from oil and gas production. The uncertainties surrounding the transition permeated discussions throughout the week, including a dedicated training session on navigating emerging risks in the sector, a plenary discussion examining various market scenarios and a discussion of the intersection between Uganda’s oil ambitions and climate commitments as part of the national seminar organized by the host government. These discussions provided an opportunity for a nuanced and detailed sharing of perspectives as governments seek to manage risk.<sup>1</sup>

The week’s informal and plenary discussions also demonstrated the growing maturity of the network and the interest of participating countries in deeper cooperation.

A summary of the international discussions and the national seminar for Uganda follows. Discussions were held under the Chatham House Rule and comments are not attributed.

## International discussion group meeting, 13–14 November 2019

### Building capacity and institutions

The first day of the international discussions brought together governments and industry, while the second day was reserved for governments only.

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<sup>1</sup> For an analysis of the treatment of this topic please read: Heller, P. (2019), ‘Energy Transition Brings New Challenges for New Petroleum Producers’, *NRGI blog*, 22 November 2019, <https://resourcegovernance.org/blog/energy-transition-new-petroleum-producers> (accessed 19 December 2019).

## Day 1: Government–company discussions, 13 November 2019

### Shifting global market dynamics

The session presentation showed that the global energy mix has largely remained unchanged between 2000 and 2019, with oil, gas and coal dominating. Gas and coal account for 64 per cent of power production, though solar and wind have been displacing nuclear as a source of energy. However, forecasts point to big shifts ahead. Coal use is likely to drop quickly, oil will slowly peak and gas will stand firm.

Future oil exploration and production are at risk. Energy operating costs and asset valuations are viewed by the Task Force on Climate-related Financial Disclosures (TCFD)<sup>2</sup> as particularly sensitive to physical, policy or technology changes affecting fossil fuel demand, energy production, emission constraints and water availability. As a result, companies need to explain how they will address transition risks. Reducing production emissions should be the key focus of oil companies (and governments); for instance, by deploying renewables to support oil facilities.

Investment trends presented during the session pointed to national oil companies (NOCs) continuing to increase capital expenditure, while the capital expenditure of international oil companies (IOCs) declines. With a plateau of oil demand expected in 10 years or so, upstream capital expenditure will not return to the 2012–14 level. Exploration investment is down, particularly in frontier acreage. On the other hand, each dollar spent in capital expenditure goes further today than it did in the past. Structural and cyclical factors have driven costs down by 30 per cent, reducing breakeven prices. The target is now for project costs to be below \$40–45 per barrel of Brent oil.

OPEC members are expected to continue to produce as long as they can. Middle East and North Africa producers have a clear advantage because of their low costs. But Russian producers are also expected to continue production as long as possible. Market driven suppliers will be more impacted by changes in price and demand – this includes emerging producers and US shale producers. Shale’s short cycles are beneficial, but their costs are not low enough to survive a downward slope in oil prices. The energy transition will happen within the life cycle of assets in emerging producer countries. Critical factors determining the prospects of projects in emerging producer countries are the costs and the ability to reduce the carbon intensity of production. For instance, in Uganda, the commercial viability of discovered oil would be challenging if market prices fell below \$40 a barrel. Being onshore helps to keep costs lower, but the need to transport crude oil 1,500 km in a heated pipeline increases costs (despite Tanzania’s decision not to take transit fees). A full value chain analysis helps new producers to see where they can offset costs.

As a bridge fuel, gas is key to IOC responses to changes in the energy market against the backdrop of transition. Gas consumption as a source of power is expected to grow across the world. As for liquified natural gas (LNG), any gas that can reach the Asian market at the \$8 per thousand cubic feet band will be competitive. An important point is that emerging producers and companies should fully consider all monetization options of any gas discovered before investing in exploration.

For the ministries of finance in countries post-discovery, the energy transition and the associated uncertainty around oil and gas prices over time present specific risks. Among the participants, there was awareness that oil and gas are finite resources, which, with fiscal discipline and judicious spending, can offer a ‘one-off boom’ to support the wider development of new producer countries. Ministries of finance will also need to manage price volatility; a risk that can be better managed by setting fiscal rules that put a

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<sup>2</sup> The TCFD is developing voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers and other stakeholders.

limit on national debt and require savings. They will also need multi-sectoral teams working on modelling to predict future yields. For some, the timeline to first production is uncertain. For others it will be difficult to manage expectations about the long-term value of the discoveries. In the case of each participant country the global energy transition was driving the need to support non-petroleum sectors of the economy, to protect the economy from a collapse of oil prices.

The discussion also focused on capital availability. Comments indicated that investors no longer favour oil companies. Banks will not finance projects that are exposed to climate risk, such as those planned for the Canadian oil sands and associated export pipelines. Capital is unlikely to dry up, but it will be more expensive, which will lead to higher project costs. One producer suggested that sharing infrastructure regionally (e.g. pipelines, processing facilities, refineries) would reduce costs significantly. This has been the experience of the Gulf of Mexico and the North Sea, where costs are kept low through shared infrastructure.

#### Planning and government coordination for delivery

A realistic time schedule for petroleum projects is certainly important for oil companies, but it is equally, if not more, important for government authorities. For planning purposes, different agencies need to coordinate to prioritize tasks, allow time for the various approval processes, and understand the sequencing of approvals. The government side of projects must align with investor companies' planned exploration and production.

This session examined two case studies in which improved government coordination and planning could have brought about better outcomes.

The first was the challenge of using gas discovered offshore Ghana to supply the domestic market. Gas demand was growing and unmet in Ghana in the 1990s. The Ghanaian government decided to champion the West African Gas Pipeline (WAGP), which enabled gas imports from Nigeria. At the same time, Ghana discovered the Jubilee field, which offered associated gas. On top of Nigerian imports, this gas promised to provide Ghana with energy security and raised hopes of gas-fuelled industrialization. Ghana National Petroleum Company (GNPC) led the commercialization of the Jubilee gas and negotiated with oil companies, Tullow and Kosmos, to obtain the gas for free. GNPC also started investing in a pipeline to bring the gas to shore, while seeking partnerships with companies in the power sector. The timelines were tight, as the government had introduced a no-flaring policy and the process to first oil was fast tracked in a record two years. GNPC needed to have the infrastructure and deals in place to capture, transport and commercialize the associated gas when oil production began. GNPC was in negotiation with the World Bank and other NOCs when a new government came to power in 2009 and the fast-tracking of gas commercialization was derailed. A commission was established to consider the best options for commercialization. It recommended the establishment of a new state-owned enterprise, the Ghana National Gas Company (GNGC), to take responsibility for the commercialization of gas. This delayed existing plans. Ghana then negotiated with China for a \$3-billion funding package for the gas project. First oil was achieved in 2010, but gas commercialization was delayed until 2014.

These delays demonstrate the planning challenges the project faced and involved an estimated cost of \$2.2 billion to the power sector. Gas shortages resulted from both delays in gas supply from the Jubilee field and capped supply from the WAGP, leading the power sector to turn to heavy fuel oil for power generation (which it could not afford).

New discoveries of wet gas were then made at the Sankofa field, which required a \$7 billion investment that would produce gas costing \$9.8 per million BTU for Ghana to purchase (making it more expensive

than importing Nigerian gas). Ghana arranged securities backed by a World Bank guarantee to cover the investment. While arguing about the price of the gas, the country failed to assess its cost and challenge the investment. It committed to pay for gas it could not afford (despite GNPC's later renegotiation of the price to \$4.5 per million BTU). While the government was aware the power sector needed reform, it did not remedy its weaknesses. An additional midstream investment of \$140 million was required to bring the gas to power stations. GNPC was obliged to take and pay for the gas, which it sold on to GNGC and to the power utility. The inability of the utility to pay for the gas has led to a chain of debt. The payment to the operator is also in arrears, leading other operators to decide it would be best to use what gas they find in enhanced oil recovery rather than sell it to the domestic market.

The second case study described Colombia's discovery of unconventional hydrocarbon reserves. Colombia has one of the longest histories of petroleum operations in Latin America, dating back more than a hundred years. Production peaked in 2012 at over 1.2 million barrels of oil equivalent per day and has been declining since then. Its oil reserves have dropped to 12 billion barrels with a reserves-to-production ratio of around seven years at current production levels of 850,000 barrels per day. Remaining gas reserves dropped to 3.8 trillion cubic feet, representing a reserves-to-production ratio of around 11 years at current production levels of 1 million cubic feet per day. Oil and gas production account for about 5 per cent of GDP, a third of exports and 20 per cent of government revenue, and the sector supports about 400,000 direct and indirect jobs. There are concerns about the economic impact of the possible loss of oil and gas production and revenue over the coming years, which represents a high risk to the Colombian economy.

The National Hydrocarbons Agency's regional geological studies and preliminary results of exploration activities by Ecopetrol (Colombia's NOC) and IOCs have indicated that potential unconventional economically recoverable resources stand at 12.5–15.5 billion barrels of oil equivalent in the Middle Magdalena Valley, one of 23 sedimentary basins. This productive district alone has the potential to quadruple the country's current reserves.

However, a strong push back on environmental grounds and local civil society organization (CSO) opposition posed a challenge to the development of these unconventional gas reserves through 'fracking'. Improved government coordination and macro-planning could have anticipated these obstacles. The government sanctioned an assessment of the geological potential in which the upstream regulatory agency was authorized to spend an average of \$200 million per year. It then promoted the acreage, and once discoveries were made, engaged in the permitting process, micro-planning, and first-stage production. Yet, if along with seismic studies, the regulatory agency had assessed the impacts on water resources, biodiversity, and communities the government would be in better situation to resolve the challenges Colombia now faces.

A new government took office in 2018. It stepped back from the development and convened a group of experts to explore best practices and ways forward. The independent expert group conducted studies on environmental and socio-economic risks related to hydraulic fracturing. The studies revealed that the communities in the region with the unconventional reserves felt that the state abandoned them and remained absent, despite a century of oil development. Community representatives felt that the long presence of the industry has left very little lasting benefit. Concerns were also raised about institutional deficiencies and the true capacity of the state to control the long-term environmental and social impacts of petroleum operations.

### Role-playing exercises

The next session provided an opportunity to take a closer look at these planning and coordination issues, with a role-playing exercise based on fictionalized case studies: Guina and Covimbia. Each participant was given a pre-assigned role and, working in small stakeholder groups, had to identify the first and second most important outcomes they wanted to achieve in the process, areas of possible compromise and red lines.

The role play on domestic gas use highlighted common coordination errors. Not enough thought was given to sequencing elements necessary for project delivery. The environment agency was a proxy for all the agencies that required permits. Securing the support of the environment agency was the last consideration of other actors in the role play, who underestimated the delays that can be caused by the process of acquiring permits. A fundamental obstacle to productive use of gas in Guina was that decisions were made politically before price and volumes were studied. This made it very difficult to avoid landing the country with a debt chain. There was no obvious solution to the question of who should pay for the shortfall, consumers, the Ministry of Finance, the NOC, the national gas company or the utility company?

The role-play on unconventional resources also illustrated that getting an agreement is difficult. Compromise is necessary. The team behaviour often mirrored reality: the Regulator acted as if it was omnipotent. The Ministry of Environment and the municipal authorities were ignored. The IOCs were the 'hold-outs'. The CSOs were noisy. The NOC was stuck in the middle. The agreement almost reached involved much tighter restrictions on fracking and money for municipal authorities.

### Break-out sessions: What can be learned from industry processes?

#### *Group 1: Best practice in procurement*

In procurement, governments and operators juggle several objectives, such as the desire to rapidly progress projects, select the right partners, and stimulate local content. The procurement process presents many risks, most notably related to corruption and fronting (disguising the foreign ownership or management of a company as national).

The case of Ghana illustrated some of the steps taken by governments to manage risks related to local content. The government passed laws establishing the Petroleum Commission to oversee the sector. The government also passed a public procurement act and a petroleum local content act. The latter law requires companies in the upstream to seek approval from the Commission for projects above a certain threshold. This enables the Commission to scrutinize the procurement process, ensure its transparency and openness to local and indigenous companies. The law mandates foreign companies to incorporate a joint venture with an indigenous company if it wishes to enter the sector. In practice, challenges arise as Ghanaian companies collude with foreign counterparts to portray the overseas party as indigenous under the law. There are often cases in which companies present themselves as Ghanaian, but close inspection reveals their management is expatriate or the indigenous employees have no access to accounts or are not among senior management. The Petroleum Commission monitors and investigates companies for this fronting. A suggestion was made that companies should have to sign a conflict of interest and code of conduct agreement each year with the regulator, with protections for whistle-blowers and penalties for non-compliance. At the procurement stage, the process could also include a channel for fronting complaints to be heard by the regulator.

The discussion also pointed to the importance of encouraging local companies to operate at higher standards. Poor performing local companies and fronting tend to create problems for petroleum projects.

In Ghana and Belize, local companies must first prequalify by reaching a certain standard before being allowed to work in the hydrocarbons sector. To reduce fronting, Belize requires disclosure of beneficial ownership during the prequalification process. One participant noted that fronting is difficult to establish by reviewing paperwork and often requires an in-house investigation.

The focus on local ownership creates incentives for fronting. It also encourages imports rather than domestic production. The lack of domestic capacity in manufacturing forces operators to import, which increases costs and reduces profits. In Uganda, there is little risk of fronting because local companies are defined as registered and operating in Uganda, rather than owned by Ugandans. This creates value in Uganda because these companies are growing their business locally and mitigates some of the problems related to poor performance.

The discussion also highlighted the ineffective efforts made by some governments. For instance, national procurement agencies are meant to ensure companies follow good procurement processes, but, in fact, their slow bureaucratic processes may end up inviting corruption.

#### *Group 2: Coordination across agencies*

The group discussed the challenges of coordinating across agencies in formulating policies and overseeing the oil and gas sector effectively. A key challenge raised by participants was the fact that different agencies have different mandates, interests, expectations, funding and human resources. It will often be more difficult to mobilize the efforts of agencies whose mandate is not focused on the oil and gas sector. Encouraging non-oil agencies to develop appropriate regulations to govern the oil sector and monitor their implementation requires constant engagement, commented one official responsible for government coordination. In Sudan, the government rotates staff between NOCs and ministries, to build a better understanding and awareness of each organization's perspective.

Resource constraints in various agencies often mean project delays or lack of oversight. The time required for each agency to carry out its oversight duties with respect to the oil and gas sector is often underestimated by the oil authorities, which leads to delays. Additionally, finance ministries need to better understand the responsibilities of each institution in the petroleum sector so that each might be adequately resourced to carry out its role.

In terms of mechanisms for coordination, group 2 discussed the value of inter-ministerial working groups. While these are good in theory, the number of various agencies involved and the required meeting schedule may not realistically improve coordination. Another coordination mechanism discussed was the use of a coordinator. This individual can be a conduit for information-sharing between agencies at the national level, but also between the national and municipal levels. The national planning authority should have a more central coordination role to play in most countries – especially on policy coordination – though in practice such authorities are not consulted when it comes to oil and gas policies.

The group discussed the role of the subnational authorities more broadly and shared experiences of coordinating between national and subnational levels for project delivery and oversight. In Kenya, while the petroleum sector is not part of its mandate, the Turkana county government has a role to play at the project implementation stage, most notably dealing with issues related to land access and use.

Some administrative mechanisms for improving coordination were raised including the introduction of specific software for project planning to plot the deliverables from agencies in sequence and a mechanism for sharing documents across agencies. Finally, succession planning was highlighted as a mechanism that would be invaluable in retaining plans and capacity as human resources change.

Politics and elections were discussed as another obstacle to inter-agency coordination. It seemed important to build public service rules that would allow departments to transcend politics and the changing political leadership.

Some of the coordination challenges come from competition between agencies. The revenue agencies in some countries have fought for responsibility to audit costs of oil and gas projects. The petroleum and finance ministries may be reluctant to share the necessary information to facilitate that. For instance, tax authorities should be a party to discussions on cost approvals, so they can better understand the technical components of projects. Finance ministries and revenue authorities clearly need to better understand the petroleum sector, in order to effectively plan for expected revenues or to understand costs. Increased participation in New Producers Group activities from those agencies would be valuable, according to one participant. It was also suggested that case studies could be developed to track what happens to institutions pre- and post-production (e.g. exodus of trained technical people from the ministry of energy to the regulator and NOC).

### **Day 2 – Government discussions, 14 November 2019**

Three technical working groups were established by the New Producers Group at the 2017 Annual Meeting with the aim of producing practical tools to support policy implementation. The morning consisted of breakout sessions to review different outputs of the working groups.

#### **Group 1 – Relationship with operators**

This group focuses on the government's ability to engage with operators, notably by obtaining information necessary for oversight. The discussion emphasized that governments should work closely with companies throughout a project's decision gates, guided by contractual provisions. It was deemed critical that legislation give governments a right to obtain the necessary information from operators. If the contract or the law does not specifically mention this right, government participants advised each other to still ask for the relevant information.

The discussion focused on legal provisions for accessing information and how to implement these. The relevant legislation should give governments the right to review third-party agreements (to discern whether the oil company is benefiting financially by transferring rights) and allow sufficient time for reviews to take place. The legislation should also give clear guidance on the information governments can and should obtain from operators. Initially when governments are new to this, they may not know what to request, but they soon learn what information matters and become more forceful, explained one official. In Uganda, the old law did not give government sufficient rights to obtain information or the power to dictate the format. The country's new legislation specifies format and timelines for submission of information. As a result, government does not 'even need to ask for it' because submission of data becomes automatic. Consistency of data formatting is important: government participants advised each other to be clear on how the information should be presented and submitted. Governments should seek internal consistency and inter-agency coordination when requesting information. Information mapping is important for coordination.

An adviser recommended that governments introduce documentation and data management systems to track what information is requested and received. Data should be in a standardized electronic format,

with automated submissions processes. Oil companies already do this and require the same from their vendors. It should also be clear who in government looks at the data.

It was suggested that non-petroleum agencies should obtain data from operators by providing companies with one point of contact. In Belize, for instance, one agency is the conduit for all government communication with oil companies. The agency holds quarterly meetings with companies and all other agencies with a role to play in the petroleum sector. It is important to include the requirements (in terms of both content and format) of data from non-petroleum agencies.

The discussion pointed to the need to develop trust with operators. As governments ask for information, greater engagement changes the nature of the interaction, 'You know who to speak to in the company and you become more confident'. A participant noted that at last year's annual meeting, the group discussed the difficulties of dealing with small independents, which tended to hire consultants for several core functions, making the establishment of a relationship over time more difficult.

Governments were encouraged to tap into technical assistance support. In particular, the expertise of ex-oil company personnel, who could contribute to the group.

In terms of the way forward for the working group, the field development plan review was seen as the most important decision gate of projects and one that required governments to be particularly demanding of oil operators. Participants suggested the group looks at these field development plan reviews with an intensive course – possibly allowing members of the group to participate remotely via video conference.

#### Group 2 – Understanding and benchmarking costs

The group of governments participating in this working-group discussion expressed interest in a variety of cost issues. Some were interested in development costs, others in how to monitor and track oil costs.

The session offered an opportunity to review the work done in collaboration with the African Natural Resources Centre to establish a benchmarking platform. The main features of the platform, which will be hosted by the African Development Bank, include an integrated web app, a regional cost database with reference wells, and a user guide and reference manual. The main drivers of cost variance are onshore/offshore, well depth, water depth, rig-load capacity, weather, well complexity, and severe problems such as new spuds and fishing, organizational factors, country and location, global market and economics, environmental and social stewardship. As a rule of thumb, construction (21 per cent) and rig costs (24 per cent) are the largest onshore costs, closely followed by casing and cementing (12 per cent) and services (12 per cent). For offshore, 51 per cent of costs are for rigs, while 16 per cent covers rentals.

Participants suggested that there would be a challenge in populating the platform with reliable benchmark wells. It would be easier for countries with thousands of wells drilled, whereas newer producers will have much fewer. Participants suggested that the working group hire a consultant to conduct a survey and input third-party information for reference wells. The wells used as references on the platform will need to be updated regularly and must mirror the country conditions as closely as possible. Interns may be able to contribute the necessary time to update well data. Feedback also indicated the group should consider a reference by basin as well as development drilling.

### Group 3 – Oil contracts – Unsticking the ‘Sticky’ Clauses

The session focused on two common legal clauses: force majeure and arbitration. Participants contributed with their own experiences and views on these clauses.

#### *Force majeure*

Force majeure can be declared when there is an event outside of the control of the contracted parties that prevents a contract from being fulfilled (e.g. epidemics, earthquakes, war, transboundary hostilities, labour disturbances, unlawful acts of government). This clause prevents the company from being in breach of not fulfilling contractual obligations, such as a work plan. But force majeure clauses need to be tailored to specific contexts.

Examples were given in which force majeure was declared, including in Ghana, due to floods and the border dispute with Côte d’Ivoire, which prohibited further drilling; Tanzania, due to acts of government (2017 legal reforms); Somalia, due to civil war; Colombia, due to acts of government and blockades.

The group discussed what issues may not constitute force majeure, notably risks that the company is responsible for carrying, which are under its control (i.e. labour disputes specific to the activity that the contract relates to). This suggests that it would be better to define force majeure as an event that is ‘outside of the reasonable control of the contracted parties’.

Another area of significant discussion was whether NOCs can declare force majeure against government actions. This affects private companies if they are in a Joint Operating Agreement (JOA) with an NOC. It could be seen as giving government too much power because it can change the law and free its company of any JOA obligations. Based on arbitration judgments in Europe, exemptions can be provided when: an NOC, as a separate legal entity from the state, is capable of making its own business decisions, and can sue and be sued by the state; and there is no evidence of state and NOC colluding to introduce a law and then declare force majeure. Examples of NOCs that could be exempted were Colombia's Ecopetrol and Namibia's NAMCOR. In Namibia, an IOC wanted a clause to prevent NAMCOR from declaring force majeure, but the NOC was deemed legally distinct from the State and had a history of legal disputes with the government, so the latter was able to push back against the IOC's request.

The discussion reviewed the procedure of declaring force majeure. The notice period can be a strictly specified number of days or a ‘reasonable’ period after the event occurs (though what is reasonable is obviously open to interpretation). This is a very important consideration, given that threat of force majeure can be used as leverage (e.g. to reverse a legal reform), so a longer period provides more opportunity for that.

The group reviewed the fallout of a force majeure declaration. Parties are obligated to come together and mitigate the effects of the declaration. A key decision is whether the force majeure period can be tacked on to the end of a contract period to compensate for that lost time. And, critically, who makes that decision? If contracts normally go through parliament, does this imply the contract needs to go back to parliament?

The group discussed the fact that force majeure can be used by weak companies who need an excuse for not performing. It also creates an opportunity for corruption, with government officials accepting force majeure without cause (though this is true for all contractual provisions). Therefore, the process needs oversight, with a clearly defined process for reviewing a declaration of force majeure and determining the outcome (e.g. extension of the contract period).

### *International arbitration*

The first step is to try to resolve disputes amicably. If this is not possible, without a dispute clause, action will then be taken through the courts. To avoid the uncertainty of the location of the court companies tend to push for an arbitration clause. The argument is sometimes made that arbitration is faster and less costly than going to court. But this is often not the case. Companies prefer being able to choose their own court, outside of the country in which they are operating, in front of a body that they have some control over appointing and confidence in its impartiality and capacity.

An arbitration clause will set out the rules of arbitration (e.g. International Chamber of Commerce rules) and the seat of arbitration. The location should demonstrate neutrality (e.g. not in Paris in the case of the French oil company Total). The seat of arbitration has implications for the procedural law that will impact the conduct of the arbitration. Courts are known to have different approaches to arbitration. The decision can be made by a sole arbitrator or a group of three. Some arbitrators are known to be state leaning, others contractor leaning. The selection of arbitrators is therefore a contentious process – it requires agreement between two parties that have been unable to agree; often they resort to another body to appoint arbitrators on their behalf.

In terms of next steps, the aim of the group is to operate like an actual working group rather than only connecting at the annual meeting. It will achieve this by developing a library of sticky issues that members can utilize; periodic, virtual exchanges to discuss specific clauses; and by providing timely assistance to governments when they are grappling with an issue.

### *Establishing new regulatory agencies*

The focus of this session was the time frame for creating an agency to regulate the petroleum sector and strategies for building capacity in the agency. The group heard the experiences of the Mozambican regulator and a case study of how Uganda established its regulatory agency.

#### *Instituto Nacional De Petróleo (INP), Mozambique*

The first gas discovery in Mozambique was made in 1961. The government created the NOC ENH in 1981. When gas production started in 2004, the government established the INP as a corporation under public law and as the regulatory authority responsible for the administration and promotion of petroleum operations. INP organized several licensing rounds. In 2004, INP changed the licensing regime from Production Sharing Agreements (PSAs) to concessions, which were seen as the safest and optimal contractual arrangement, placing as many provisions as possible in the law rather than allowing huge variation from one contract to another. In 2011 and 2012, the country made massive offshore gas discoveries. It then had to manage projects with very large, sophisticated companies.

Its current challenge is to establish an appropriate legal framework and is drawing on the experience of other countries in Africa. It also focused on in-house capacity-building for its staff of 120. Its budget constraints have limited its ability to recruit and train staff.

#### *Petroleum Authority of Uganda (PAU)*

The Ugandan government landscape includes several agencies: the Ministry of Energy and Mineral Development (MEMD), which is responsible for policy formulation, investment promotion, and licensing; the PAU, which regulates and monitors the upstream and midstream sectors, ensures compliance of petroleum operations with Ugandan rules and international best practice; and the Ugandan National Oil Corporation (UNOC), which creates joint ventures across the petroleum value chain to further the country's commercial interests.

When discoveries were made in Uganda in 2006, the MEMD was responsible for all oversight of the sector. In 2008, the national oil and gas policy recommended creating a regulatory body. The government established PAU as a statutory body in 2013, appointed the board in 2015, and recruited its staff in 2016. By June 2019, PAU had a staff of 126 (45 per cent of its mandated personnel). PAU's organizational structure is comprised of eight directorates: exploration, development & production; midstream; technical support services (including social and economic support); legal/corporate affairs; finance/administration; environment; health & safety; and ICT/data management.

The strategic pillars of PAU include institution-building, 'enabling' exploration in order to increase the resource base, facilitating the commercialization of discovered oil and gas resources, and enhancing the impact and sustainability of the petroleum sector (e.g. national content, environmental impact).

The vision of PAU is to be a leading global petroleum regulatory agency, covering key areas:

- Resource management – what resources exist and are they developed for optimal recovery?;
- Management of petroleum data – PAU is the custodian of all petroleum data;
- Health, safety, security, social and environmental management – PAU should ensure the co-existence of oil and biodiversity;
- Cost management – review and approve budgets and monitor the profitability of projects (and the government take);
- National content – optimal employment of Ugandans, optimal use of goods and services provided by Ugandan enterprises; and
- Stakeholders – public relations and stakeholder management are very important.

In terms of lessons learned for good governance, it is important to have well-defined and diverse requirements for the composition of the management board. These include ensuring the board's committees are established with clear terms of reference (TORs), building the board's capacity in technical and operational aspects, streamlining items for board approval, and adopting clear procedures for reporting to the board and for implementing the board's actions.

With respect to lessons learned in human-resource development, regulatory agencies need an organizational structure that fits: the activities of the regulator, competitive remuneration packages, a rigorous and transparent recruitment process and the establishment of performance agreements. For major projects, PAU has had staff embedded with companies in order to improve monitoring.

The presenter's assessment was that the establishment of PAU is 50 per cent complete. The achievements of the PAU thus far include:

- Development of a strong regulatory framework;
- Approval and monitoring of the work plans and budgets of licensed oil companies;
- Establishment of a national supplier database and talent register;
- Achieved 80 per cent employment for Ugandans in the structures of the licensed oil companies; and
- Monitoring and evaluation: each week, PAU records all responsibilities and whether obligations have been met and this process has helped ensure that the authority does not leave things undone.

Key questions that should be addressed when establishing a regulatory agency:

- What are the mandate and objectives of the regulator?

- What are the roles and responsibilities?
- What is the legislative authority? Is it adequate?
- What capacity is required to enable delivery?
- How does the agency attract and retain the right people?
- How does it develop and keep a desirable culture?
- How does it ensure transparency?
- How does it ensure alignment across organizations, for the greater national good? Is there a good landscape map?
- What are the risk management approach and procedures?
- How does government ensure its accountability?
- What are the communication strategies?
- What is the relationship management strategy?
- How is the regulator funded? An independent regulator needs an independent source of funding.
- How do they adapt and keep current?

The discussions highlighted further lessons learned through the development of human resources. During the first phase of the establishment of PAU the focus was on recruitment but once the agency's core staff was in place, it became much more focused on capacity-development. The main avenues for building skills comprised overseas training, bringing experts to Uganda for training in specific areas, secondment of staff to overseas projects, training sessions offered by the Norwegian government as well as involvement in the New Producers Group's activities. As for Mozambique's INP, it faced challenges in its early days in 2006 when it signed contracts with oil companies ENI and Anadarko. It needed 100 technicians, but the country only had two. INP realized it needed to invest significantly in capacity-building. They sent personnel for secondments in companies and trained a number of nationals but found staff retention challenging (sitting at approximately 50 per cent). The INP decided it was beneficial for the country even if trained nationals did not return to INP but remained in the sector. They plan to introduce improved incentives to retain staff. In Sudan, where retention has also been an issue, more people than needed are trained in order to end up with enough trained staff. In South Sudan, the government has punitive measures in place for students who receive training but do not return to work for the organization.

INP faces budgetary constraints, but is supporting capacity-development through training, secondments with oil companies, sending students to universities abroad for petroleum degrees, and plans to invest in technologies that allow INP to improve cost control and monitor petroleum activities in real time. Similarly, in Uganda, the PAU is trying to bring in software and systems to improve oversight and have vendors come to Uganda to support their application.

Two participants underlined the potential value of joint regional training and exchange of skills. While others recognized a potential value in this sharing and bridging of teaching resources, they also pointed out that East Africa did not yet possess regional centres of excellence for oil and gas. Furthermore, regional cooperation in that sector has been difficult thus far. When resources were discovered, it became more difficult to collaborate and exchange.

#### [Building-capacity across government](#)

While sector specialization is necessary in relevant ministries, capacity across various disciplines is also required to:

- Implement petroleum policy;
- Administer petroleum legislation and regulations; and
- Implement and monitor contracts.

This session reviewed the level of responsibility (and, by implication, capacity) required to carry out essential sector governance functions (including national versus sub-national authorities).

Coordination across agencies is a complex issue, particularly due to their independent mandates and wide differences in funding. Inter-agency working groups have been set up to achieve coordination across agencies, for example in the form of a sub-committee for the oil and gas sector. Such a group coordinates operations at both the cabinet and the technical levels. These working groups ensure constant engagement to coordinate oil and gas-related projects and the issues arising.

The session highlighted some obstacles to effective coordination:

- The complex government–industry relationship and the lack of expertise in government;
- Aligning various priorities and policies of local governments in a de-centralized system;
- Security;
- Environmental licensing; and
- Community consultations.

The group discussed oil discoveries in Turkana county, Kenya, which has historically been politically marginalized and poor. Participants from other countries shared their own experience in these discussions. Turkana’s land tenure system is one of communal land held in trust by the county for the people. The legal and regulatory frameworks for water access and utilization – of critical importance to Turkana’s pastoralist communities – are weak and the public consultation processes for land acquisition have not always been optimal. The Kenyan central government has devolved several administrative functions to counties, but not the oversight and management of the extractives sector. The county receives funds for education, vocational training and business incubation initiatives, which all have links with the extractives sector. Counties also benefit from support from the Norwegian government and the World Bank programme in Kenya.

In Colombia, for instance, devolved functions relate to land planning, but not environmental management. Royalties are distributed to subnational authorities, but they have little capacity to manage these revenues or to administer public programmes. However, plans are afoot to strengthen this capacity, notably to allow oversight of unconventional resource development at the local level.

Kenya’s non-petroleum agencies at the national level are adequately resourced, with ongoing support from a range of international partners. However, the level of cooperation between different regulators with a role in the petroleum sector was characterized as poor. The relationship between the Ministry of Petroleum and the revenue authority, for instance, is not very cordial or cooperative. The Kenya Revenue Authority is sometimes seen as a ‘bully’, while it suffers from the reluctance of the Ministry of Petroleum to share information (e.g. the PSCs). Both argue over which organization should collect royalties for oil and mining.

It is common to have competition between the regulator and the ministry of energy for skilled personnel and resources. In Uganda, there was an exodus of technical persons from the Ministry of Energy and Mineral Development to the PAU and UNOC once those institutions were established. A participant noted it would be beneficial to maintain similar terms and conditions of employment across institutions as a means of managing such movements and potential loss of talent. This is the approach taken in Mozambique: if one moves from the ministry to the regulator, one retains the original employment terms. In Sudan, the NOC, ministry and regulator have separate salary structures, but they have employed a rotational system under which the minister can move staff from one agency to another. In Colombia, the petroleum regulator, ANH, has the flexibility to collaborate with and fund other agencies with limited capacity for tasks of importance to the oversight of the petroleum sector (for instance, by funding the Ministry of Environment to carry out biodiversity studies). Inter-agency training was cited by a

participant as an important mechanism for building skills across government and promoting coordination. Another was the New Producers Group's plan to organize secondments between agencies of member countries.

The case of Guyana was also described to the group. A participant explained that the country had not anticipated the success it would have in exploration and the government has still not sufficiently prepared itself for the production phase. The Ministry of Finance is now seeking to ramp up its capacity and preparations. The assessment was made that, while they don't need great depths of technical knowledge, they need to grasp the basic concepts to support effective decision-making. For instance, they need to better understand when revenues from oil production will come on stream and at what pace, in order to plan. They need to understand how to value crude. They also need to play a role in approving field development plans and have worked with the IMF to build capacity in financial and fiscal modelling. A participant noted that a challenge in building capacity in Guyana had been in the government's inability to attract members of its diaspora with the required expertise.

In Somalia, the war has had a devastating impact on government capacity, data and institutional memory. The government benefits from the assistance offered by partners such as Norway's Oil for Development programme. Capacity-building programmes are in place and the diaspora is gradually returning. The government is recovering some of its lost data from the companies.

### **Concluding remarks**

The NPG organizers explained that the group is evolving to a governance structure with greater direction from and accountability to the member countries. To this end, an advisory board was established, and the inaugural meeting was held during this annual meeting.

As it is the group's tradition, the meeting ended with participants sharing one thing they learned at the annual meeting and one thing they would have liked to discuss.

Things learned:

- Procurement process of Sudan (breaking the whole contract to a series of small contracts);
- Strategically preparing for shorter timelines resulting from the energy transition;
- Understanding risks pertaining to climate change and how it affects planning for the petroleum sector;
- The model of the PAU, particularly their staffing strategy;
- The need for clarity on the format of information one requests from oil companies;
- How to value crude oil; and
- The importance of information sharing.

Would like to hear more about:

- Topics related to taxation;
- Managing public expectations;
- Concerted effort to help members define minimal incentives in regulatory frameworks to remain competitive but not lose value;
- Include topics related to political risk;
- A repeat of communication training in other countries;
- Contract negotiation training; and
- Receive reading material ahead of next meeting(s).

## National seminar, 15 November 2019

### Preparing for oil production in Uganda

As Uganda prepares for oil production, this seminar provided an opportunity for its government agencies to harmonize public policies that affect or are affected by the oil sector, coordinate across government for improved information flow and planning, and identify investments through which Uganda can leverage the oil sector and achieve its sustainable development goals. The meeting was attended primarily by Ugandan officials, but also included officials from producing or near-producing countries to share their experience, as well as oil company executives. Discussions were held under the Chatham House Rule.

### Managing the timeline to development and production

The Ugandan petroleum sector development plans are comprehensive and include the development of several fields, processing plants, an oil export pipeline, storage terminals and a refinery to process 60,000 barrels of oil per day, as well as the infrastructure required to support and connect each segment of the value chain. The plans will affect both Uganda and Tanzania where a major part of the pipeline and an export terminal will be located. There are many parties involved in the development including governments, authorities, the field licence holders, contractors, banks and landowners. Due to the complexity of such a development there are many important dependencies in the project development. Such dependencies include the sequence for completion of host government agreements, investment decisions for the field developments and the East Africa Crude Oil Pipeline (EACOP), transportation agreements, engineering, production and construction (EPC) and finance agreements, which are all prerequisites for the upstream-field development. The various authorities have an important role to play in the evaluation and approval of agreements and plans. In order for all involved parties to coordinate and plan their respective contributions, careful planning of all activities and milestones is critical. The seminar gave the participating agencies an opportunity to review decision gates, the overall development schedule and any associated challenges.

The participants heard about the Norwegian Petroleum Directorate's approach to managing the project timelines from discovery to development and production, which first ensures the authority has the knowledge and expertise to match those in the industry and is able to create wealth for society in the process. The critical period following exploration drilling and appraisal, during the concept studies for the development and the concept selection itself is the most important phase of any project. A lack of maturity during this phase can result in project delays and loss of value for the country. A lot depends also on the contractor strategy and pre-qualification phase.

Uganda is in the development phase. The requirements for companies to reach a final investment decision (FID) fall into two categories: commercial and contractual. Most of the work currently falls in the latter. The key remaining tasks include:

- Resettlement plans for industrial areas and access roads;
- Alignment in the commercial sphere is needed on the EACOP business model, financing structures, and shareholder commitments to allow Tullow to farm down a share of its equity in the project; and
- Contractual obligations to finalize EACOP host country and shareholder agreements, off-take and transport agreements, UNOC back in agreement and financing arrangements.

As one participant noted, the timeline to first oil in Uganda (13 years) has been longer than many of its peers for a number of reasons. First, the initial discoveries were modest. By the time Uganda put its regulatory framework in place, the value of the oil stood at \$300 million. Assuming operators were able to generate profits of \$100 million, the scale was insufficient to justify building a heated pipeline to carry

that volume to the coast. The government therefore analyzed the potential for domestic use of the oil. Meanwhile further discoveries consolidated the resource base until they were able to confirm 6 billion barrels in place and the development and export of the crude made sense.

Despite the long delays before achieving first oil, the presentations made on the current pace of preparations and the list of tasks remaining highlighted that time is still short. A participant noted how difficult some of the outstanding issues would be to resolve within the set, 'aggressive' timelines and asked whether prioritization was necessary, with the acceptance that some objectives would need to be dealt with at a later stage. According to one participant, the main bottleneck was an agreement on the business model, which, if agreed, would bring more clarity to the commercial terms and an agreement on roles and responsibilities.

An important part of the discussion between Ugandan government agencies and international participants focused on the process for land acquisition. Concerns were raised about compensation schemes and the ability of communities to manage the payments received. Responses indicated that financial literacy programmes and vocational training programmes were offered to give relocated communities new skills for improved livelihoods. A participant asked whether women had been included in the consultations. Ugandan society remains patrilineal, but the discussion indicated that special care had been taken to give local women control of payments (e.g. payments are made to joint family accounts) and to include them in information sessions at the community level.

### Role play

The participants engaged in a role-playing exercise based on a fictionalized Ugandan oil project. The objective was for each government agency and investor group to identify their desired outcome, and to encourage them to negotiate with other parties to reach bilateral agreements on financial terms and delivery volumes. They also had to obtain assurances from government agencies that they would receive the relevant environmental permits. In this context, a successful outcome is one where agreements enable a final investment decision to be taken within the set timelines. The session highlighted several important stages in the process, mainly agreements with host governments and for transportation, which were prerequisites for the fictional pipeline project and upstream field development to proceed. If approval processes are delayed, the operation start-up date will be delayed. The game was challenging because a common agreement required compromises from most parties and an awareness of sequencing and timelines.

In the role play the ministry of environment was a proxy for all the government agencies that are involved in the permitting process (e.g. land, water, biodiversity, labour, etc.) and its given resources were insufficient to carry out its duties. One of the 'short-cuts' taken by some parties in the role play involved obtaining funds from oil companies and private investors to shore up the capacity at the environment agency. It is important to caution against this, as private funding for regulatory bodies creates risks of regulatory capture.

### Leveraging the expansion of the oil sector

Uganda has focused on how to maximize the value retained from the upstream development. It has also sought to refine and improve its regulatory and legislative frameworks as the sector evolves. The approach to licensing is similar. The Ministry of Energy and Mineral Development adopted a phased licensing strategy, offering exploration acreage in stages, which has allowed government to build its capacity for oversight while it builds on existing reserves to ensure steady production. The second licensing round was launched in May 2019.

One participant noted that Uganda had the potential to build significant supply for the integrated oil project. Specifically, it could build, own and operate drilling rigs. It could conduct its own seismic surveys. Uganda could potentially be a gas hub, if there is an agreement with Tanzania to import gas, along the pipeline used to export Ugandan oil to Tanzania. In light of the transition risks, it is indeed important to focus on goods and services that can be used outside the petroleum sector. It is also important to link petroleum planning to national development planning. There is also potential for Uganda and its neighbours to conduct joint research and development around common basins and share ancillary infrastructure.

The NOC can capture additional value for the country through its investments, though these also carry risks for public funds. The energy transition means that some carbon-intensive investments will not bear fruit. This was a concern for UNOC, which wants to build a diversified portfolio. However, the projects pursued are currently in carbon-intensive activities. UNOC is expected to take 'back-in' rights to upstream assets and is pursuing a number of projects through the value chain that it deems commercially justified. It views the downstream and the industrial park around the refinery site as low hanging fruits that will enable it to generate profits. UNOC may also venture into marketing and trading through a joint venture with a qualified company. So far, UNOC has been constrained by finance. It needs a budgetary allocation and Ministry of Finance guarantees to pursue these investments.

#### [Aligning oil sector planning with sustainable development and climate goals](#)

The government of Uganda developed a green growth development strategy for 2017–30, which focuses on five core catalytic investment areas: agriculture, natural capital management, green cities, transport, and energy. Sustainable development is also a basic principle that runs through Uganda's Vision 2040 policy. Thus far, the impact of the energy sector on the country's greenhouse gas (GHG) emissions has been small and a participant noted it was necessary to establish an emissions baseline and have an evaluation and reporting system for emissions in place before production starts. The government has created an MRV (measurement, reporting and verification) system for the petroleum sector, which will be applied to emissions, mitigation actions and support activities undertaken by donors. A participant commented that petroleum sector contracts should include a provision for investors to support Uganda in the disclosure of carbon and GHG emissions. Another participant commented that petroleum projects should consider infrastructure resilience and climate change impacts.

There was extensive discussion of the options available to Uganda to replace biomass with other forms of energy, notably gas-fired power and liquid propane gas (LPG). The use of biomass is causing deforestation and carries health risks, but substitutions are difficult because of the high cost of gas infrastructure and of LPG delivery to remote areas. There was discussion of the potential for government to subsidize gas consumption to reduce emissions. The case of Guyana was mentioned, where the government applied to donors for carbon offset funding to protect its forests and was expected to use its petroleum revenues to further reduce its carbon emissions. There was substantial interest in tackling the issue of the domestic energy mix from an integrated perspective of sector planning and development and environment goals in a future seminar.