Energy, Environment and Resources Department
Meeting Summary

New Petroleum Producers Discussion Group

12-13 May 2014

Under Chatham House Rule

10 St James's Square, London SW1Y 4LE T +44 (0)20 7957 5700 F +44 (0)20 7957 5710
www.chathamhouse.org
Patron: Her Majesty The Queen Chairman: Stuart Popham QC Director: Dr Robin Niblett Charity Registration Number: 208223

Introduction

The New Petroleum Producers Discussion Group convened for its second meeting May 12-13 at Chatham House. The meeting brought together national oil company (NOC) executives, government officials and civil society representatives from 18 different emerging producer countries, key governance advisory groups, and some large and smaller oil companies for a rich and open conversation about the challenges faced in the early stages of development of petroleum resources. This provided a unique opportunity for producers to learn from their peers.

These Summary Notes will review the following key issues, which were discussed at the meeting:

- Meaningful involvement of communities in decisions about the petroleum sector
- Ensuring investor accountability for operational risk in a low-capacity setting
- Allowing contracts to change with the rapidly changing environment of emerging producers
- Can emerging producers afford an "operator" NOC?
- Should NOCs take on a state agency role?
- Problems with coordinating foreign technical advice; and what one official called "advice fatigue"

The goals of these Summary Notes are to (1) memorialize the key themes of the discussion (2) provide a prompt for participants to follow up with one another, with additional ideas and questions, and (3) assemble key learnings from our discussion to input into the project's Guidelines for Good Governance in Emerging Oil and Gas Producers.

Involving communities in petroleum resource governance

What is community engagement?

Misunderstandings between the communities and government or industry are common. It is important that communication with concerned stakeholders be consistent and regular, and that government and industry follow through and communicate final outcomes. When communities don't see their words reflected in documents and final decisions after consultations, they feel that they were not really consulted.

The government needs a strategy for "communicating about communication," as a way to convey to community groups and other stakeholders how their views will be taken into account.

For some, not having a veto on projects means they are not really involved in decision-making about the sector. It is unrealistic in many scenarios to give every possible stakeholder a de facto veto, and the government needs a strategy for managing expectations about how consultation processes will feed into decisions.

Real engagement at an early stage will likely give communities a greater voice and will allow them to have greater impact on the project. Our discussions warned against symbolic engagement or consultations.

One participant from a new producer country warned another from a country with good hopes of commercial discoveries:

“Don’t wait. You need a clear, proactive plan before discoveries about how to engage. Send an advance team to the ground before the seismic studies are carried out, to explain to the communities who these people are and exactly what they will be doing.”

Discussions pointed to the usefulness of formalizing local engagement and consultation in agreements with oil companies and petroleum sector legislation, to increase the chance of real and early engagement. Beyond the scope of one project, there is value too for oil companies to engage in what may be long negotiations to draw up a *global* Memorandum of Understanding for community engagement. This framework sets expectations more clearly and lessens the chance of being pulled into reactive expenditure.

The interests of communities surrounding the project site and other interest groups involved may not always be aligned, and the communication strategy should include a concerted effort to engage with all, and to justify how competing interests were balanced.

Effective communication is not just a question of broad principles. It is also a question of resources, and it is important to devote sufficient staff and financial resources to sustain a regular engagement.

Trust

Communities with low education levels, that are economically and politically marginalized, or geographically isolated, may not trust the messages that are being conveyed. Communities such as the Turkana in Kenya think that outsiders will come to take their land. It is important to be on the ground, to meet communities and speak with them. The tone of this conversation is important.

A government participant proposed that one should see trust on a scale, rather than in absolute terms. If you have low trust from communities, you must go **on the ground** to meet with them and **earn the trust**.

The following comments were made by government participants:
“We issued press releases from the capital – meanwhile locally there was gossip. We should have been on the ground, managing that message.”

“It is a difficult task to meet someone who doesn’t trust you. But you can’t escape this responsibility. And besides, it will improve, and trust will be built as you meet.”

Community engagement should be about really listening. Hearing and seeing the core values of communities, and how these shape their interests.

Government and industry must be aware of how they are perceived by communities. For instance, when they come to the community with suits, while the local counterparts have only the clothes on their backs, it exacerbates the perception that the ‘messenger’ is extremely wealthy.

Community engagement is also about providing information. Helping communities access information about the project – and the very process of consultation itself – builds capacity, which is helpful in terms of managing expectations. It may be costly and may take time, but the outcome is stronger.

Who communicates?

- Ultimately, government holds most responsibility for community engagement. Government sets the tone from the top, but is not the only actor involved in conveying information.
- The media need training to better understand the industry.
- Oil companies have been learning that sending in engineers is not the right way to engage. “Community engagement must be done by professionals,” as one industry participant pointed out.
- Trusted messenger: it is an asset to use a trusted messenger to engage with communities. Sometimes this may be someone external to government and industry, like academics, advisors, independent people who can say “uncomfortable truths”, and members of professional associations, who can provide information. But the absence of a trusted messenger should not halt community engagement efforts.

From the government’s perspective, it can be difficult to distinguish community issues and national issues.

Expectations

Politicians and civil servants (and industry) must coordinate their message. When politicians deliver inflated messages about the transformational potential of the industry, “people wonder where is the impact, where are the results?” One civil servant participant referred to an attempt he made to sell his country’s President on a public narrative centred on building a governance legacy so that the foundation was laid for future success, rather than one built upon the idea that they had reason to believe that oil would bring prosperity to all. Other participants liked this idea, but had varying views on how successful such an approach would be within their political context.

Ensuring investor accountability for operational risks

“We are just lucky that nothing has happened,” said one participant.

Risks are high. Governments need more capacity to effectively regulate operators. In practice it appears that many governments must rely on foreign oil company operators to self-regulate. In this context, a rules-based ‘check box’ regulatory framework was perceived by participants as high risk, given that setting the right regulations requires a high degree of technical knowledge, which many emerging producers don’t have. A ‘goals-based’ performance-based regime encourages operators to aim for the higher standards of operations. Moreover, if an accident occurs, the operator cannot blame the failure on the regulatory standards set by government (as could happen under a rules based regime).

An issue that was flagged for further discussion was what sorts of implications a reliance on a goals-based system would have on the liability regime a country put in place to pursue damages in the event of an accident. One participant suggested that without clearly-defined rules, it may be difficult to hold a company liable for damages, unless there is a regime in place that holds the entity strictly liable for any damages regardless of whether a specific rule was violated.

It should be noted too that in a frontier context it is often difficult to attract experienced, highly technically competent companies and this poses a particular challenge for countries relying on an individual company’s ability to self-regulate.

Other means of increasing investor accountability

- Invest in capacity building. While our discussion suggested various means of working around low capacity to ensure operator accountability, increasing the regulators' ability to understand the technical risks involved in operations remains key.
- Create a network of regulators for greater exchange of ideas and information.
- An industry representative suggested that governments ask oil companies for their advice on regulations and opportunities for secondment of staff.
- Support from consultants to oversee regulatory regime. Concern was expressed that a minimal amount of technical knowledge was necessary to oversee consultants.
- Map out the ecosystem of technical capabilities, and share and swap these experts across a continent.
- Draw on international standards, such as the International Finance Corporation's Performance Standards, which define the investor's responsibility for managing their social and environmental risks, or IPIECA's 19 good practice documents on oil spill preparedness and response, known as the Oil spill report series.
- Provisions in legislation and contracts requiring investors to contribute to decommissioning at the end of the project, and to put up performance guarantees to ensure that funds are available when the time comes.
- Performance bonds and mandatory insurance payments were seen as expensive when designed to cover a wide array of risk and thus risked excluding smaller players. But insurers and banks could nonetheless offer some guidance in assessing risk.

We identified a gap in ensuring the accountability of contractors and sub-contractors and assessing whether they were meeting high standards of operations in terms of Health, Safety, Security and the Environment (HSSE). There was some debate about whether foreign oil company operators were willing to take on the responsibility for these contractors, but a company representative said that this was clearly the responsibility of the license holder.

A participant from a technical advisory group flagged the importance of having an oil spill response plan.

Renegotiations and changing investments terms: when and how?

The consensus was clear: emerging producers need progressive fiscal terms at the outset, in order to capture maximum windfalls as the geological and price contexts evolve.

But over the course of 25-30 years, circumstances may change too much for pre-existing contracts and broader legislation, and government may want to change the investment terms, just as companies do. The group debated the legitimacy of renegotiating an existing agreement. A near consensus emerged that renegotiation was sometimes necessary in order to maintain a long-term partnership between oil companies and governments because the refusal to review terms could be destabilizing and unfair to some countries. It is also in the long-term interest of companies engaged in the country, to ensure the deal is viable.

In this session, we heard from a country in the exploration phase, explaining how far their situation had changed since signing a contract in 2005, when there was little or no interest in exploration there. It proved impossible to bring the company concerned back to the negotiation table – until they failed to meet their work timescales from the original package. This offered an opportunity to force the company back to the table to renegotiate the original terms.

We discussed whether it would be good practice to include a renegotiation clause in contracts from the outset, which would allow renegotiation when specific triggers were activated. The views expressed by industry represented at the meeting – which included an exploration company, an independent and a major - were supportive of a renegotiation clause, provided:

- It was phrased very carefully
- It specified which terms could be renegotiated (local content, fiscal, environmental, financial terms)
- It specified what triggers would lead to renegotiation (political, cost, commodity price changes)

An emerging producer expressed relief:
"Renegotiation has been such a taboo topic. It's good to have a forum where we can actually discuss this… and in which there is enough trust between us to tackle this."

Another point was made by a participant from a technical advisory group about governments failing to communicate well about renegotiation - "governments are losing the communication battle." As a result, it looks like the renegotiation is illegitimate and detrimental to the industry when this might not be the case.

Participants pointed to the following groups, which can support governments in contract negotiations:

- The World Bank's EI-TAF
- The African Development Bank's African Legal Support Facility
- The International Senior Lawyers Project (which has provided a lot of support in negotiations in Liberia, Sierra Leone and Guinea).

Participants expressed a keen interest in the discussion on mechanisms for renegotiating contracts and wanted to discuss this topic further in future discussion group meetings.

Assigning NOC Roles and Financing these Roles

Sequencing is key to assigning roles in an emerging producer context. Roles can change with circumstances (geology, production revenues, state or NOC capacity levels).

Governments and NOCs should be realistic about assigning upstream operational responsibilities to an NOC. We heard from several emerging NOCs whose aim is to develop operational capability.

Financing an operator mandate

Finance is a challenge for these companies. Pre-discovery, it is particularly difficult to raise finance to develop technical competence. We heard from NOCs in the pre-production phase that finance their activities through data sales, operator payments, government capitalization, downstream activities and other non-petroleum industries (e.g. mining). The amount of capital required to develop into an operator would be significantly greater than these sources of finance allow. Moreover, the drain on the country's human and financial resources is likely not justified until discoveries promise a reserve lifespan that is at least as long as the time needed to develop operator capabilities.

"Resources should drive the timing of ambition," as one participant pointed out.

Once in the production phase, NOCs can retain revenues from their stakes in producing fields, which gives access to a significantly more reliable source of capital. But even then, as we heard from a national oil company embarking on a strategy to become a standalone operator, the financial requirements are daunting. The company estimates total expenditure for the first eight years of an aggressive growth strategy of US$11.4bn, US$8.6bn for an accelerated growth strategy and $4.5bn for a business as usual strategy. Retained earnings from petroleum production can meet approximately one quarter to half of these capital requirements (depending on the strategy chosen), which means the company will need to secure finance from international capital markets.

Participants expressed an interest in the following resource:

- A catalogue of various NOC finance models

In addition to financial obstacles, NOCs may face bureaucratic hurdles. An NOC participant explained the importance of streamlining decision-making and approval processes to allow the NOC to operate more competitively, notably with regards to procurement. Recruiting challenges are also very common and a serious obstacle for developing technical skills in many NOCs.

An independent oil company participant pointed to its own experience, explaining it took 25 years to develop sufficient industry skill and credibility to get to the head of the queue to access drilling rigs. Partnerships with strong companies were key to developing capacity and success.

Governance role

Governments must be realistic about the NOC mandate in the pre-production and pre-discovery phases. If a governance role is given during these phases (data sales, data management, promotion, regulation, monitoring of performance), this must be clearly delineated by government, with a plan for transfer of responsibility back to the state at the appropriate time. The NOC's financing model should also be clearly mapped out (one government participant pointed to the importance of explaining to the finance ministries the financial requirements of NOCs).

Data management was identified as an important mechanism for NOCs to develop upstream technical competence and a good understanding of their country's resource base. Revenues from data sales can also meet a large proportion of the NOC's budgetary requirement (although this revenue stream fluctuates, it can represent half of the NOC's budget).

While participants acknowledged that it may make sense for NOCs to take on a governance role at certain stages, giving a significant governance role to the NOC comes with a risk of entrenching interests that need to be accounted for. Once a power has been granted or taken, a transition to another set-up can be challenging from a political economy perspective, and may create financial inefficiencies during the transition phase.

Coordinating advice and assistance

A key message that came out of our discussions was that some governments – especially post-discovery – received too much unsolicited advice. This results in "advice fatigue" and confusion. The following problems were highlighted:

Time

Each development stakeholder (assistance provider) wants individual attention from senior civil servants, which puts a heavy time and administrative burden on these individuals. They must field repeat questions from multiple providers. Some participants from African countries also expressed frustration that providers took advantage of their cultural rules of hospitality, which prevent them from declining a request to meet. "There are cultural issues that mean I can't say, 'I can't listen to you today.'"

Confusion

Assistance providers meet with multiple officials and receive different responses throughout the public service. Different institutions will be interested in different types of assistance: the Ministry of Finance will be concerned about the fiscal regime, the Ministry of Energy about technical questions, and the Central Bank about macroeconomic issues. Each institution receives advice, which is not coordinated or coherent. This prompted the following comment from a senior civil servant: “We in government need time to caucus internally, to think through what we want to do and what we need.”

This problem of lack of coordination is compounded by the fact that multiple assistance providers are offering their services simultaneously, or in succession, without acknowledging or building on the assistance already offered.

While there is a need for assistance providers to better coordinate in country, especially in cases where the government has not coordinated its own assistance requirements, the incentives are not really there. As a participant noted, assistance providers act according to their organisational logic, which drives them to secure more agreements for technical assistance with governments.

Good advice?

A participant suggested that technical advice suffers from complacency and is too academic, which officials are too busy to read. Not all advisors are real experts and it is necessary (though admittedly culturally difficult) to question the qualifications of those offering services. But more significantly, the type of advice given isn’t what is really required. “Governments can write laws, contracts, policies… they don’t need that help. They need comparative *data* and deep analytical thinking,” that help them choose the right type of contracts or legal disposition. Producers also expressed a real need for mentoring.

The Rush

There is a rush to assist governments with recent discoveries. But in response to the above-mentioned problems, many advisors around the table felt that, indeed, less advice might be better. It would be better to allow governments space and time to reflect on their national strategy and to formulate what their needs were.

Some conclusions and recommendations

- Move from supply-led advice to demand-led advice.
- Governments need to say ‘Time out!’ and think through their vision for the petroleum sector, the policies that follow from that, and their needs in terms of technical information, capacity building, and advice.
- To ensure that assistance is demand driven, governments should draft a ‘Terms of Reference’ document that defines exact needs, and require assistance providers to bid, outlining their ability to meet these needs.
- Governments have to speak with one voice. They could establish a Secretariat which houses all relevant government competences and receives high level political support, whose responsibility will be to coordinate assistance, in line with a coherent vision for the sector.

- With or without this coherent approach to demand for assistance, our discussion clearly pointed to the need for assistance providers to listen better.

- Before any assistance is offered, providers should ask what other organisations are providing (or have provided) assistance and what activities they are carrying out, in view of avoiding duplication of efforts and contradictory advice.

- Emerging producers want technical advice from, and to share experience with, more established producers.

- They can participate in regional forums whose objective is to promote the sharing of technical competence in the petroleum sector between peers, like the Association of African Petroleum Producers and OLADE, the Latin American Energy Organization.

- Individuals in emerging producer countries can also benefit from joining technical associations, such as the Association of International Petroleum Negotiators (AIPN) or the American Association of Petroleum Geologists (AAPG).