Production Agreements, Oil Service Contracts & Joint Ventures

Production Sharing Agreement

Production sharing agreement is a contract between an oil company and government of a country stipulating the oil company bear responsibility for exploration and production. On successful production, the oil company would be expected to take the cost oil (for equity and operational expenditure), while the remaining would be identified as profit oil (for sharing between government and oil company at a specified ratio). The oil company shall bear the investment risk.

“Production-Sharing Agreements (PSAs) are among the most common types of contractual arrangements for petroleum exploration and development. Under a PSA the state as the owner of mineral resources engages a foreign oil company (FOC) as a contractor to provide technical and financial services for exploration and development operations. The state is traditionally represented by the government or one of its agencies such as the national oil company (NOC). The FOC acquires an entitlement to a stipulated share of the oil produced as a reward for the risk taken and services rendered. The state, however, remains the owner of the petroleum produced subject only to the contractor's entitlement to its share of production. The government or its NOC usually has the option to participate in different aspects of the exploration and development process. In addition, PSAs frequently provide for the establishment of a joint committee where both parties are represented and which monitors the operations.”

Source: Kirsten Bindemann, Production Sharing Agreements: An Economic Analysis

Total Produced Oil

Total Produced oil should be systematically apportioned in accordance with tenets and stipulations of production sharing contract.

Format A

Total Produced Oil = Cost Oil (To Oil Company For Expenditure)

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Profit Oil (To be Shared btw Govt and Oil Company)

Format B

Total Produced Oil = Cost Oil (To Oil Company For Operation Cost)

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Equity Oil (To Oil Company For ROI)

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Profit Oil (To be Shared btw Govt and Oil Company)

History of Simple Oil Mining Agreements

1901
- Basic Concession
- Between Shah of Persia and William D'Arcy

1933
- Basic Concession
- Between King of Saudi Arabia and Standard Oil of California

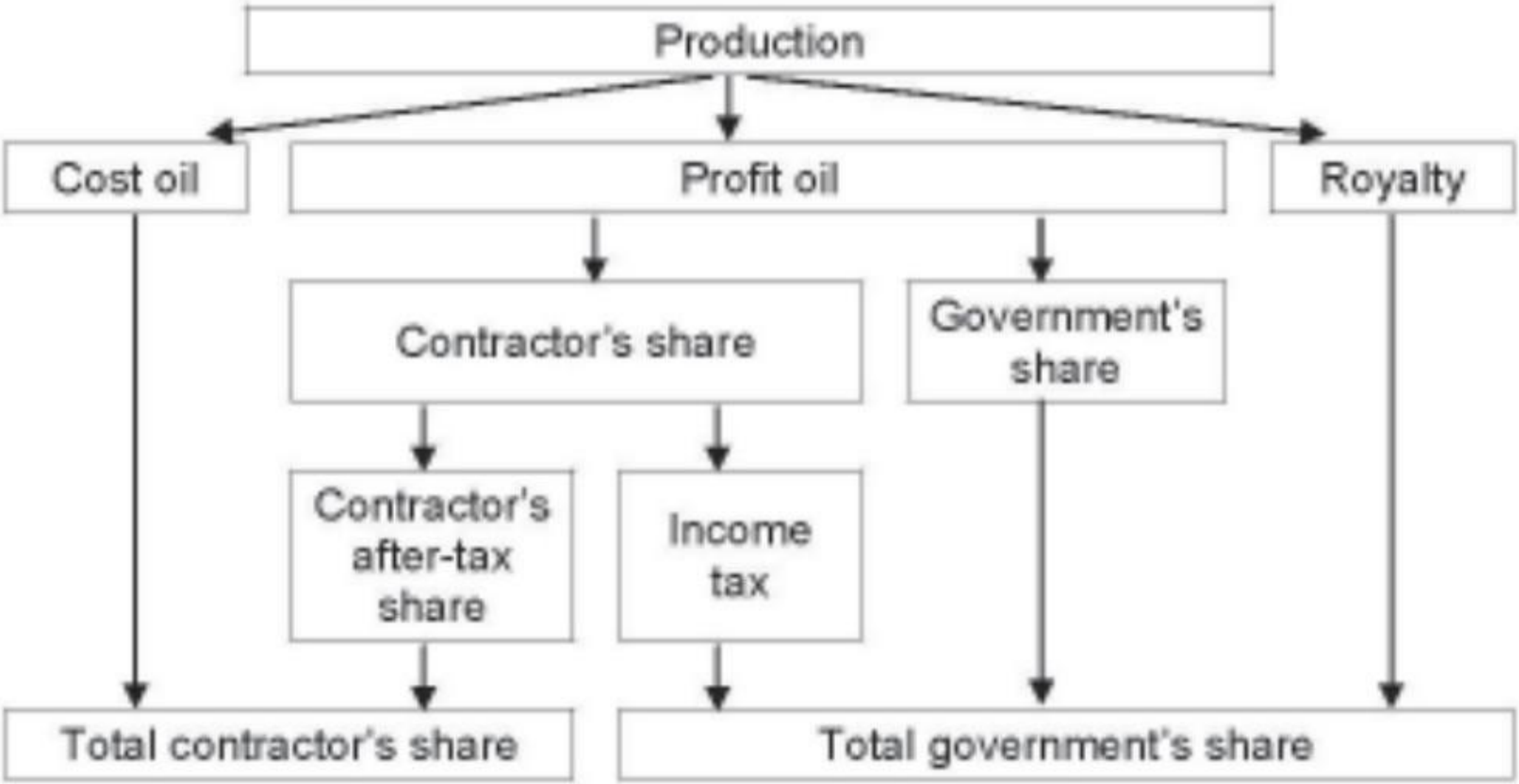
1939
- Basic Concession
- Between Government of Abu Dhabi and Consortium of Five IOC

1930 – 1950's
- Robust Concession Featuring Production & Forfeiture Clauses
- In United States of America

Early 1950's
- Production Sharing Agreement
- Between Government of Bolivia and IOC

Mid 1960's
- Robust Production Sharing Agreement
- Between Government of Indonesia and IOC

Production Sharing Revenue Flow



Source: World Bank, Contracts for Petroleum Development

Elements of Production Sharing Contract

- Royalty
- Tax
- Cost Oil
- Bonus
- Profit Oil
- Validation of Commerciality
- Domestic Market Obligation
- Work Programme
- Local Content
- Participation
- Duration of Contract

Royalty

- Royalty
- No Royalty
- Sliding Scale Royalty

Tax

- No Tax
- Progressive Tax
- Fixed Tax

Cost Oil

- No Cost Oil
- Low Cost Oil
- Fixed Cost Oil
- R-Factor Based Cost Oil
- Unlimited Cost Oil

R-Factor refers to Ratio of Cumulative Receipts to Cumulative Expenditure

$$\text{R-Factor} = \frac{\text{Cumulative Receipts}}{\text{Cumulative Expenditure}}$$

Bonus

- Fixed Production Bonus
- Sliding Scale Production Bonus
- Signature Bonus
- No Signature Bonus
- Discovery Bonus
- No Discovery Bonus

Profit Oil

- Low Profit Oil
- Fixed Profit Oil
- Volume Based Profit Oil
- R-Factor Based Profit Oil

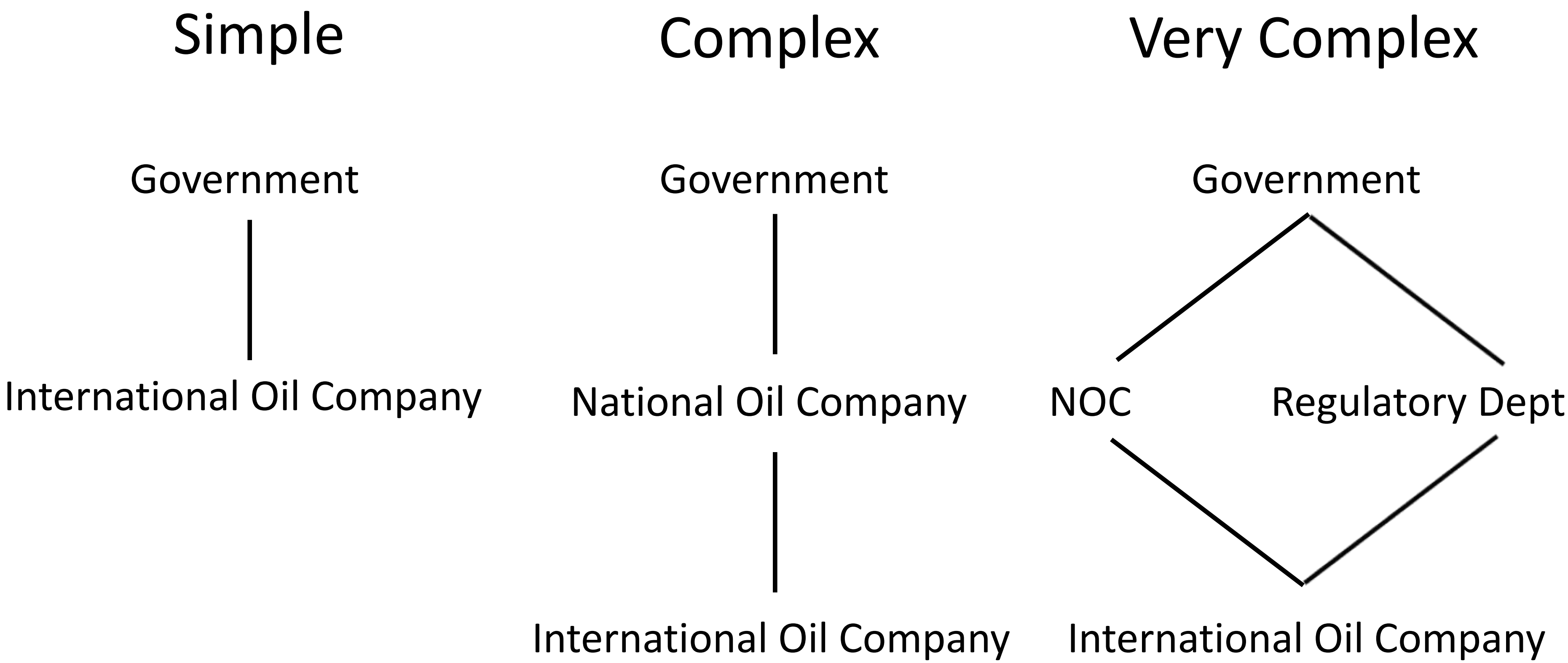
Factors that Affect Scope of Incentives, Risk & Reward

- Influence
- Negotiation Competence
- Brand Value
- Bilateral Intergovernmental Treaties
- Bargaining Power
- National Legal Provision
- Former Relationship Leverage

General Risk & Uncertainty in Oil and Gas Exploration, Development & Production

- Size of Resource at Site
- Commercial Feasibility
- Status of Deposit as Oil or Gas
- Finding Additional Fields
- Change in Local Law
- Political Instability
- Technology Required
- Disenfranchisement of Operating Community
- Price Fluctuation

Models of Principal-Agent Relationships Between IOC and Government



Service Contracts

Service Contracts provide for a Host Government to have greatest control of the oil and only assign work to contracting firm.

The Host Government must have the following:

- Technological know-how and do-how
- Financial Capacity

Types of Service Contracts

Technical Assistance Contract

- Provision of Technical Service Without Bearing Any Risk
- Lean Scope
- Contracting Firm cannot have interest in the oil

Pure Service Contract (PSC)

- Provision of Service Without Bearing Risk
- Can have Broad Scope
- Compensation to Contractor can be Cash or Oil

Risk Service Contract (RSC) aka BOOT

- Provision of Service with Great Risk: Failure to Get Exploitable Discovery Imply Lost Fund while Positive Discovery Means Compensation & Possibility of Equity Option.
- Can have Broad Scope
- Provision of Great Flexibility to Host Government

“Alliances are institutional arrangements that combine resources and governance forms of several partnering organizations, making them mutually interdependent.”

Source: Inkpen

Rationale for Alliance

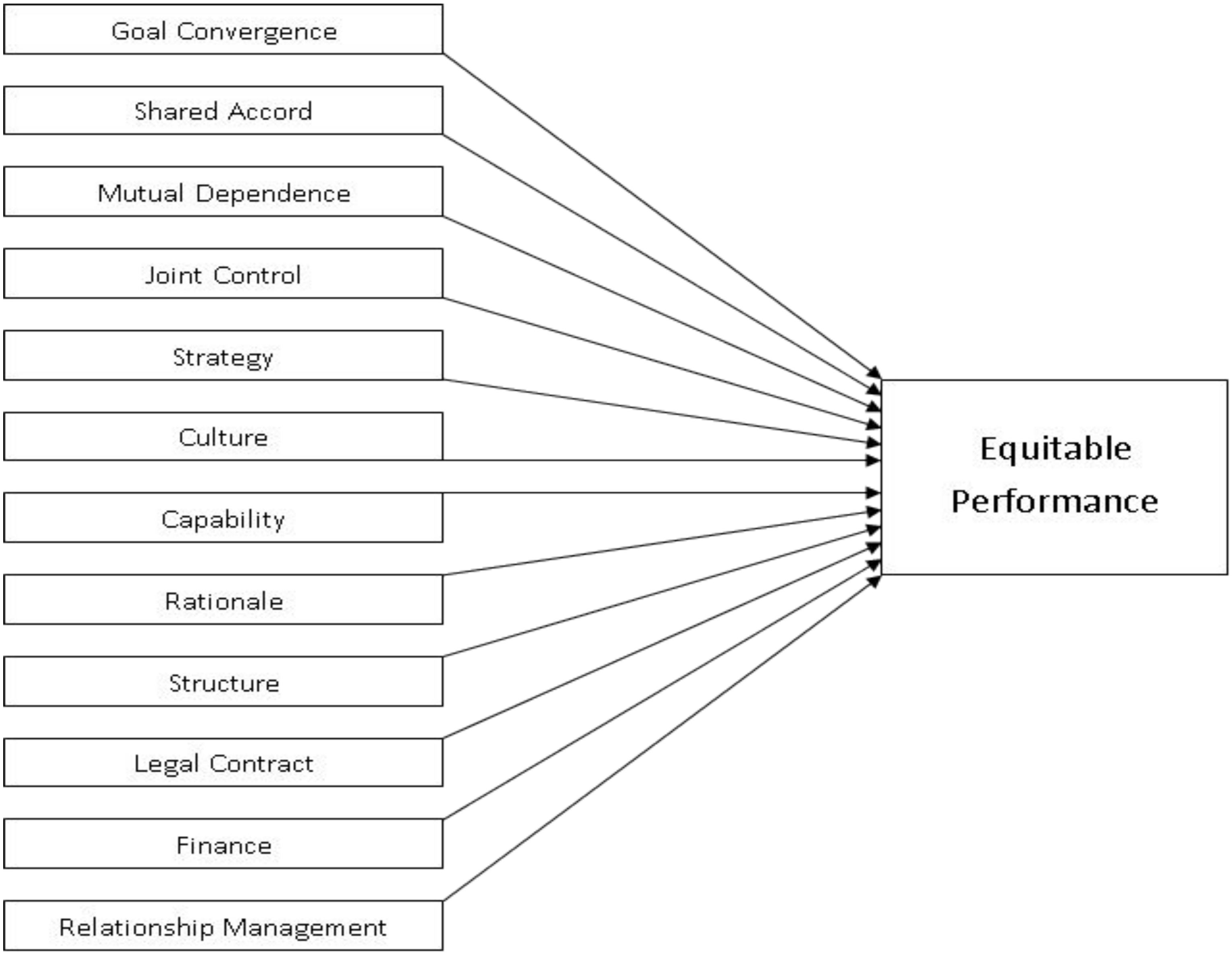
Operational

- Resource Efficiency
- Mitigate against Performance Gap
- Cost Management
- Improve Asset Utilization
- Boost Core Competence

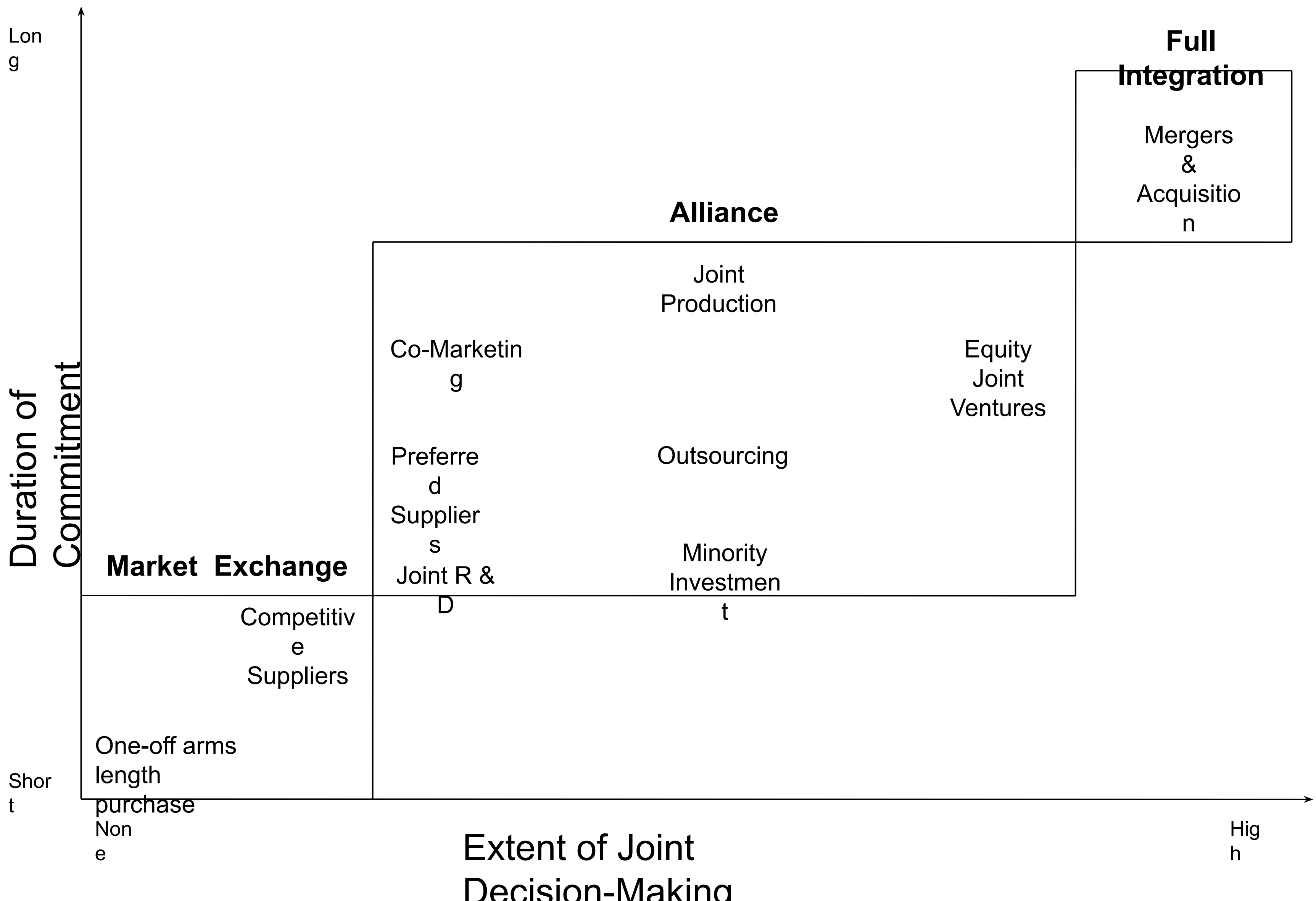
Strategic

- Protection
- Strategic Intent
- Opportunities for Growth
- Diversification
- Visionary Stride

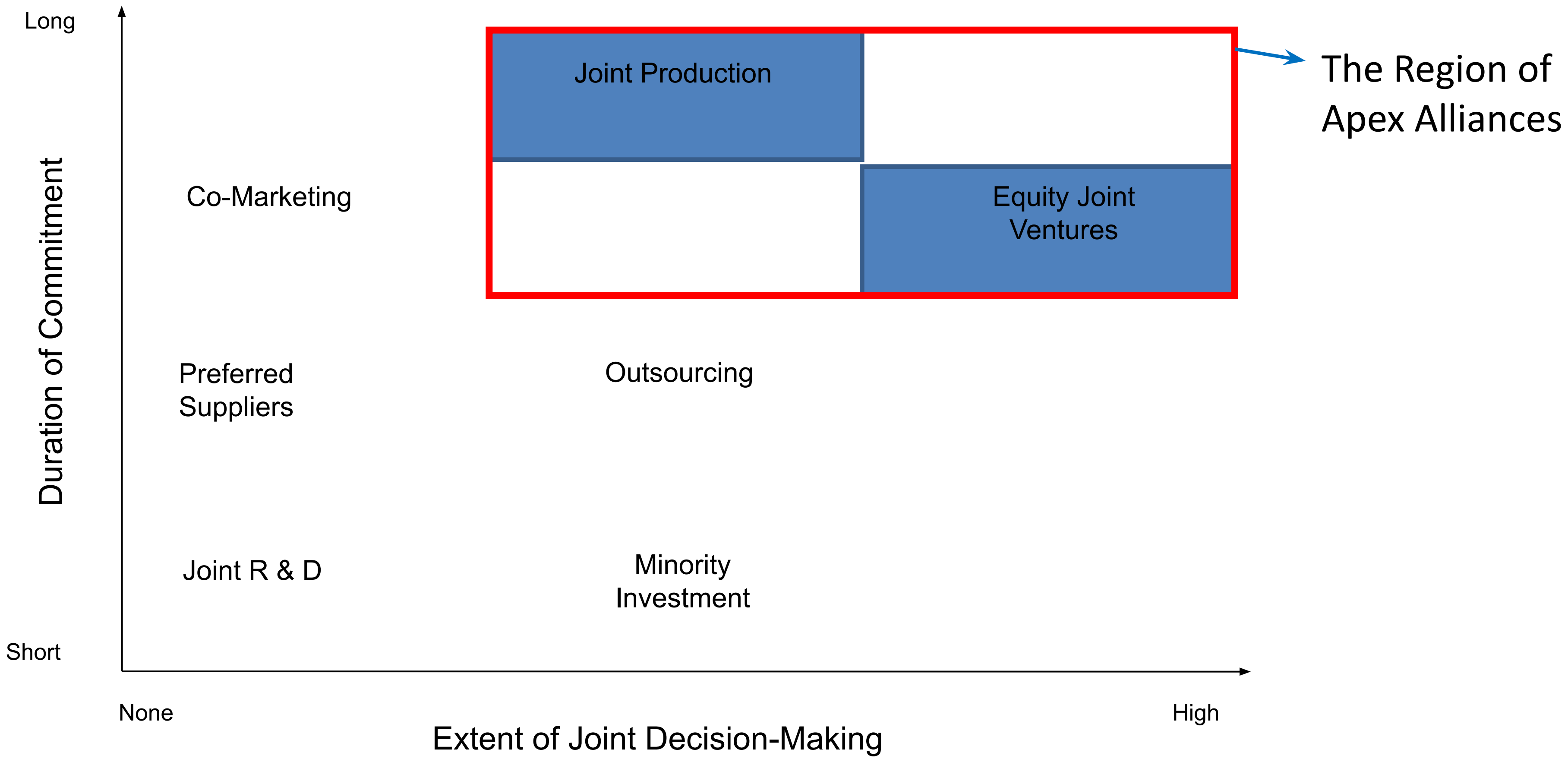
Alliance Stability Model by Elijah Ezendu



Types of Inter-Firm Relationships



Equity Joint Venture & Joint Production as Apex Alliances

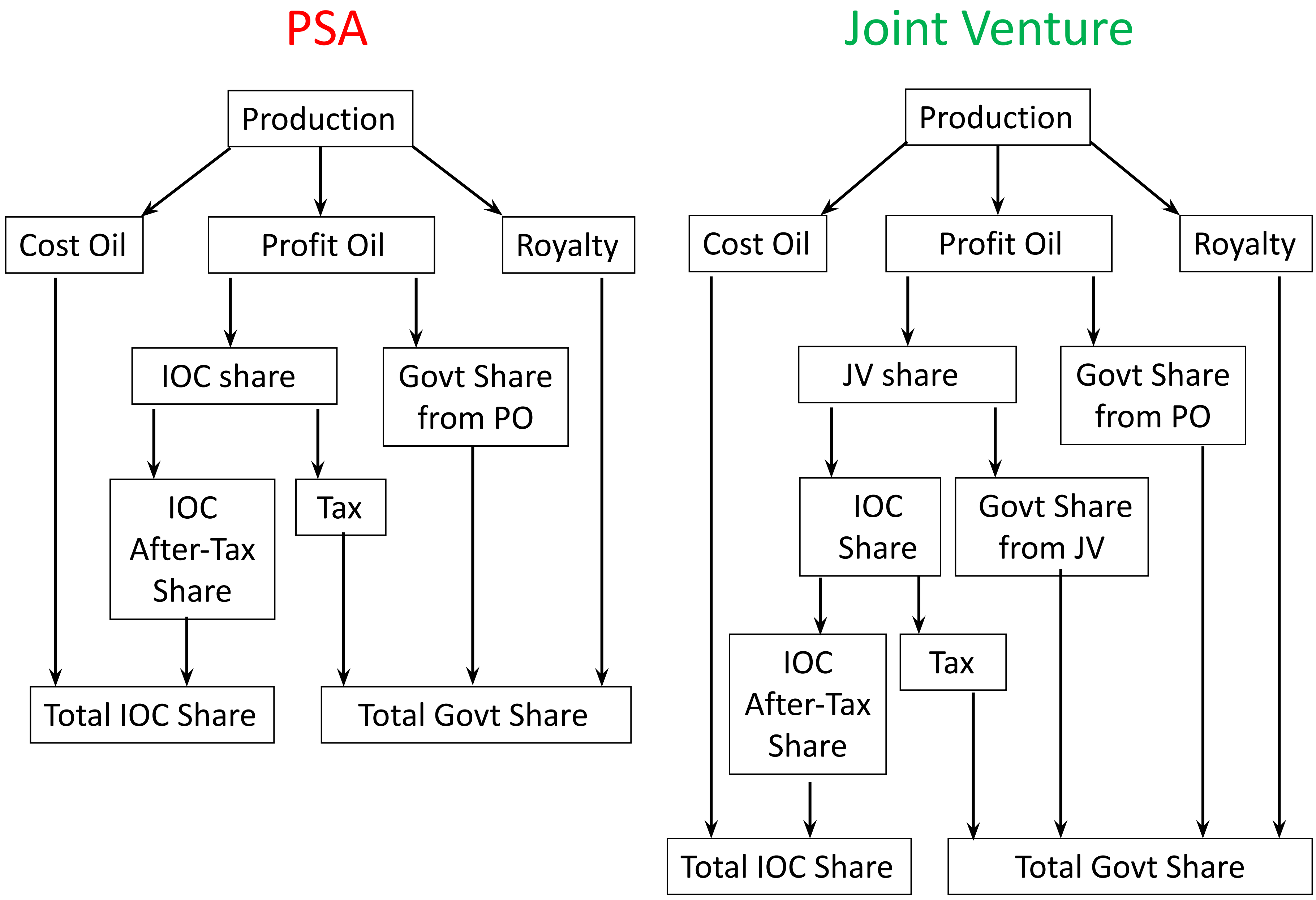


Source: Elijah Ezendu, Alliance Development

Joint Ventures in Oil & Gas

1. Primary Form of Joint Venture:
   This involves venturing parties (namely Government and IOC) working together by means of Joint Operating Agreement wherein each shall be entitled to production share.
2. Secondary Form of Joint Venture:
   Herein, the Government and IOC shall be held together in that venture by equity. Today's global practices show Governments prefer to hold majority instead of equal share.

Differentiating PSA from Joint Venture



Regional Governments

The search for revenue centres in local communities spurred regional governments to take action with the intent of controlling available mineral resources including oil and gas.

“The entry of ExxonMobil into the Kurdish oil market has sent shock waves throughout Iraq's energy sector and its political classes. The presence of one of the world's largest international oil companies (IOCs) in the Kurdistan Region not only challenges central government authority but gives the Kurdistan Regional Government (KRG) greater leverage in developing its own oil market. More super-major IOCs are likely to follow, which will further enhance the recognition and financial rewards for the KRG and its business partners.”

Source: Denise Natali, The Politics of Kurdish Crude, Middle East Policy Council

Exercise

Compare and Contrast Highlighting Pros and Cons to Host Government and International Oil Company.

- Production Sharing Agreements
- Joint Venture
- Pure Service Contracts

Dr. Elijah Ezendu is Award-Winning Business Expert & Certified Management Consultant with expertise in HR, OD, Competitive Intelligence, Strategy, Restructuring, Business Development, Sales & Marketing, Interim Management, CSR, Leadership, Project & Programme Management, Cost Management, Outsourcing, Franchising, Intellectual Capital, eBusiness, Social Media, Software Architecture, Cloud Computing, eLearning & International Business. He holds proprietary rights of various systems. He is currently CEO, Rubiini (UAE); Hon. President, Worldwide Independent Inventors Association; Special Advisor, RTEAN; Director, MMNA Investments Limited. He had functioned as Chair, International Board of GCC Business Council (UAE); Senior Partner, Shevach Consulting; Chairman (Certification & Training), Coordinator (Board of Fellows), Lead Assessor & Governing Council Member, Institute of Management Consultants, Nigeria; Lead Resource, Centre for Competitive Intelligence Development; Turnaround Project Director, Consolidated Business Holdings Limited; Lead Consultant/ Partner, JK Michaels; Technical Director, Gestalt; Chief Operating Officer, Rohan Group; Executive Director (Various Roles), Fortuna, Gambia & Malta; Director, The Greens; Chief Advisor/Partner, D & E; Vice Chairman, Refined Shipping; Director of Programmes & Governing Council Member, Institute of Business Development, Nigeria; Member of TDD Committee, International Association of Software Architects, USA; Member of Strategic Planning and Implementation Committee, Chartered Institute of Personnel Management of Nigeria; Adjunct Faculty, Regent Business School, South Africa; Adjunct Faculty, Ladoke Akintola University of Technology, Nigeria; Editor-in-Chief & Chairman of Editorial Board, Cost Management Journal; National Executive Council Member, Institute of Internal Auditors of Nigeria; Member, Board of Directors (Several Organizations). He holds Doctoral Degree in Management, Master of Business Administration and Fellowship of Several Professional Institutes in North America, UK & Nigeria. He is an author & widely featured speaker in workshops, conferences & retreats. He was involved in developing Specialist Master's Degree Course Content for Ladoke Akintola University of Technology (Nigeria) and Jones International University (USA). He holds Interim Management Assignments on Boards of Companies as Non-Executive Director.