INTRODUCTION TO FISCAL REGIMES

Buford Boyd Pollett, J.D.
Genave King Rogers
Assistant Professor of Energy Law and Commerce
The University of Tulsa
Agenda

- Types of fiscal regimes
- Structure of the Agreements
- Benefits and disadvantages to different fiscal regimes
- Takeaways
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Types of Agreements

• Royalty/Tax Systems
  o Leases (e.g. USA)
  o Concession Agreements (e.g. Egypt)

• Contractual
  o Production Sharing Agreements (PSA) (e.g. Qatar)
  o Risk Service Contracts (e.g. Iraq)
## Types of Agreements – Who has Title?

<table>
<thead>
<tr>
<th>Royalty/Tax</th>
<th>PSA</th>
<th>Service Contract</th>
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</table>
| • Title transfer at wellhead | • Cash or Kind  
  • Kind > Title transfer at export point  
  • Profit oil  
  • Gross Production | • No transfer of title  
  • Compensation  
  • Flat fee – pure service contract  
  • Profit – risk service contract |
Leases

• Grants to oil and gas company (lessee) right and obligation to operate a property
• Bonus payments to Lessor
• Royalty payments (e.g. lessor)
• Lessee responsible for most costs
• In effect indefinitely with production
Leases: Interest Created from working interest (WI)

- Joint working interest
- Overriding royalty interest (ORI)
- Production payment interest (PPI)
- Net profits interest
- Pooled or unitized working interest
Leases

• Grants to oil and gas company (lessee) right and obligation to operate a property
• Generally term with limited duration
• Requires specific activities to extend term of lease
  o Drilling
  o Production in paying quantities
• Limited area and formations
• **Subject to conservation measures**
Concessions

- Bonus
- Royalty or in-kind payment
- Contractor responsible for all costs without reimbursement
- In effect indefinitely with production
- Ownership of minerals transferred to contractor
Concessions

- Generally a long time given to develop
- Autonomy given over time and manner
- Large area and exclusivity often granted
PSCs

- Government (through state oil company) has option to become WI owner in development and production.
- Contractor may be required to build country infrastructure.
- Contracting company (contractor) can recoup costs through future production.
- Some elements of the contract may be negotiated but others are determined by legislation.
Service Contract

- Flat fee for services provided
- Specific criteria for measuring performance
- Purely providing a service
Risk Service Contract

• Expressly requires capital investment
• Defined cost recovery process
• Fee based service agreement based on an R-factor rate or an average profit factor that varies based on the production ranges expressed in the contract
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PSCs

• Maximum term for production.
• Asset retirement obligations – past and present.
• **Common elements of a PSC are outlined.**
PSCs: Purchase of Data

• The contractor may be required to purchase a data package of geological and geophysical data.

• The cost of the package is often not recoverable under cost recovery provisions.
PSCs: Work Commitment

• May be based on kilometers of seismic data and number of wells. Some have extensive drilling obligations.

• May also be defined as a minimum amount of investment during a specified period or periods.
PSCs: Bonuses

• Cash signature bonus is common.
• Other bonuses may be paid when milestones are reached.
PSCs – Valuation of Petroleum

- May be defined as an international market price or based on a specified basket of crudes.
- Often different than actual selling prices.
PSCs: Royalties

- Based on gross production.
- May be based on a sliding scale.
PSCs: Example of Sliding Scale Royalties

- Tranche 1 – Up to 8,000 bopd - 5%
- Tranche 2 – 8,001 – 15,000 bopd - 10%
- **Tranche 3 – Above 15,000 bopd** - 15%
PSCs: Overhead

- May be on a sliding scale and may vary between exploration, development and production phases.
- Example for direct costs in exploration activities:
  - Up to $6,000,000: 6%
  - $6,000,001 to $12,000,000: 5%
  - $12,000,001 to $25,000,000: 4%
  - Over $25,000,000: 3%
PSCs: Cost Recovery

- Mechanism through which the contractor recoups exploration, development and operating costs.
- Cost oil is normally limited, usually 20%-60%.
- Once original exploration and development costs are recovered, cost oil limits may decrease, usually to between 15 to 30% of production.
- Recoverable costs are identified in the PSC.
PSCs: Cost Recovery Order

- Usually specified. Could be as follows:
  - 1. Current period operating costs.
  - 2. Unrecovered explorations costs.
  - 3. Unrecovered development costs.
  - 4. Interest in financing (if allowed).
  - 5. Investment credit (uplift).
  - 6. Abandonment cost recovery fund.
PSCs: Profit Oil

- Shared between contractor and government.
- Contractor’s share of profit is usually subject to taxation.
- In most countries, contractor receives between 15 and 55 percent.
PSCs: Capital Uplift

• Encourages contractor to increase capital spending.

• With a 10% capital uplift, the contractor can recover 110% of actual capital expenditures. If the contractor incurs $10,000,000 in capital costs, $11,000,000 can be recovered.

• Also known as investment credit.
PSCs: Commerciality

- Specifies which party will determine economic feasibility.
PSCs: Government Participation

- Many contracts provide an option for the national oil company to become a working interest partner in the development phase.
- **Participating shares run from 10 to 51 percent.**
PSCs: Domestic Obligation

• The contract may specify that a percentage of the contractor’s share of profit oil be sold to the government, usually at a discounted price.

• Proceeds from these sales are generally taxable.
PSCs: Ringfencing

• If all costs associated with a block must be recovered from revenues within that block, then the block is ringfenced.

• Some countries allow certain types of costs to be recovered from revenues from other blocks the contractor operates in that country.
PSCs: Reinvestment Obligations

• Some contracts require that a percentage of contractor income be reinvested in further exploratory work in the license area.
PSCs: Tax and Royalty Holidays

• For a given period, royalty and taxes may not be payable.
PSCs: Accounting Issues

• Tranches may occur several times during the life of a PSC. They may occur at times when the total risk of the contractor is reduced, such as once exploration costs have been recovered. They also may occur when specified levels of cumulative production, or daily production are met. The percentage of profit oil allocated to the government normally increases when a tranche is reached.
Risk Service

- Bonus
- Royalty (may be in-kind)
- Government retains ownership of minerals
- All costs initially paid by contractor, but recoverable from government
- Government (through state oil company) has option to be WI owner in operations
Risk Service: Accounting Issues

- After contract term, state oil company takes over
- Ownership of reserves by contractor is not permitted
- Fee based on operating costs, capital costs, and a profit factor
- **Non-risk service agreements are possible but are rare.**
Rate of Return Contracts

• Modest royalty and tax with state receiving no other funds until the contractor has recovered the initial investment plus a predetermined return.
• Government take flexes upward with increased profitability.
• Most based on production rates.
• May have progressive tax rates.
• **Sharing arrangements may be based on rates of return.**
Technical Assistance
Contracts

• Phase 1: Feasibility
• Phase 2: Pilot program
• Phase 3: Commercial Development – production is shared through use of a PSC or joint venture
Strategic Co-operation Agreement

- Joint participation including sharing of technical expertise
- Example: ExxonMobil and Rosneft – to evaluate the development of tight oil reserves in Western Siberia and establish a joint arctic research center
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<tbody>
<tr>
<td>Title/ownership</td>
<td>Transfer at wellhead</td>
<td>Transfer at delivery point</td>
<td>No transfer</td>
</tr>
<tr>
<td>State control</td>
<td>Limited</td>
<td>Moderate</td>
<td>High</td>
</tr>
<tr>
<td>IOC control</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
</tr>
<tr>
<td>Limits on cost recovery</td>
<td>None</td>
<td>Generally yes</td>
<td>Contractually no but practically yes</td>
</tr>
<tr>
<td>Ownership of facilities</td>
<td>IOC</td>
<td>State</td>
<td>State</td>
</tr>
<tr>
<td>Limits IOC profits</td>
<td>Only with increasing royalty/tax rates</td>
<td>Substantial</td>
<td>Nearly complete</td>
</tr>
</tbody>
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Modified from Inkpen & Moffet 2011
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• Balance of local interests versus interest of IOC
• Timing and scope of cost recoverability as well as development
• Return on invested capital meeting stakeholder expectations while maintaining safe and environmentally responsible operations
• Taking ownership in stakeholder interest through efficient and disciplined management