Summary
March 2022

Natural Resource Governance Institute

Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

New Producer Contract Terms and Uncertainty: Lessons From the Recent Past

Patrick R.P. Heller, Perrine Toledano, Tehtena Mebratu-Tsegaye and David Mihalyi

The petroleum industry is volatile, and governments in "new producer" countries have operated at a significant information disadvantage when negotiating with international oil companies. This challenge is growing today; new producer countries face intensifying questions around whether to offer fiscal incentives to maintain investment in the face of 1) the pandemic-induced volatility in oil prices and 2) long-term questions about the future of the industry in the face of the climate crisis and the global energy transition.

This confluence of short-term and long-term uncertainty is prompting a reexamination of the narrative that once took hold in many new producer countries. The traditional story was one of linear progression from being non-producers to small levels of production to ultimately having oil and gas become a major economic contributor over the long term.

This notion of progression was associated with a commonly held theory: After a country's first major discovery, the geological risk that wells will be dry was expected to decrease. Countries could therefore shift from a position of having to grant tax breaks (and other concessions) to international investors, to taking a tougher stance in laws and negotiations for new projects going forward.

In this paper we examine whether this theory has been borne out in practice and make recommendations to support new producers in their navigation of the uncertainty associated with the energy transition.

Among the eight "new producer" countries, for which we analyzed a total of 26 contracts signed before and 25 contracts signed after discovery events (all occurring between 2001 and 2014), the evidence is mixed.

Only three of the eight countries in our sample—Ghana, Mozambique and Uganda—demonstrated a clear pattern in the direction of more stringent terms in post-discovery contracts. They featured definitive steps to increase some of the obligations of contractors to the state, and no significant terms that became less stringent. Five out of eight countries did not meaningfully alter their approach to gain greater concessions from their company partners.

Category: operational/ fiscal	Term type	Countries where terms became clearly more stringent	Countries where terms became clearly less stringent
Operational	Relinquishment of portions of the oil block back to the state		Guyana, Senegal
	Duration of first "exploration period"	Uganda, Mozambique (Rovuma and PT), Kenya	Senegal
	Minimum expenditure for first period of exploration	Ghana, Mauritania, Liberia, Senegal	Kenya
	Stabilization clause	Ghana, Mozambique (Rovuma and PT)	
Fiscal	Income tax	Ghana (additional oil entitlement)	
	Exemptions from income tax	Mozambique (Rovuma and PT)	
	Royalty	Ghana, Uganda, Mozambique (Rovuma and PT)	
	Profit oil	Mozambique (Rovuma and PT); Guyana, Liberia	Mauritania, Senegal
	Cost oil	Mozambique (Rovuma and PT); Mauritania	Kenya
	Bonus (signature and production)	Uganda, Mozambique (PT), Mauritania, Liberia, Kenya	
	State equity	Ghana, Kenya	Mauritania
	Contribution to community	Kenya	
	Local content	Mozambique (Rovuma), Uganda (1 of 2 contracts), Senegal, Kenya	Guyana, Liberia

In some cases, this could be because governments did not take advantage of their newfound post-discovery leverage. In others, it could be because the leverage did not materialize: geology may have proven disappointing after a flurry of excitement, global market shifts impacted investor confidence, or internal political dynamics steered the government toward other priorities. Today, the evolution of the global energy transition are surely factors further dampening the leverage of these governments.

Experience from the recent past offers some valuable lessons for government officials when it comes to making decisions about whether and when to conduct licensing exercises and on how to structure government demands on any new projects going forward. We recommend that new producer governments:

- *Undertake sober analysis of market scenarios* when deciding whether to pursue new projects, and internally coordinate to align petroleum, finance, energy and climate objectives.
- *Set clear priorities and objectives* and integrate them coherently into planning processes; a strategic vision for decisions about negotiations, informed by public consultation, will be more important than ever as profit margins shrink going forward.
- *Communicate regularly and openly with industry counterparts.* This is important for understanding the market's perceptions of the country, its geology and its fiscal terms, as well as broader market trends.

- *Award contracts by competitive bidding (where governments decide to pursue licensing or to negotiate new contracts).* This is the surest way for government officials to understand the market, select partners effectively, and maximize company contributions.
- *Standardize terms in legislation* to the maximum degree possible, and reduce the scope of terms that are up for negotiation on individual contracts. This can help the government set the terms for deals according to a coherent strategy that takes account of emerging realities.
- *Build the institutional memory of the government and learn from the performance of past contract bidding, negotiation and implementation.* This can strengthen sector management and help to avoid past mistakes.
- *Stress-test contract terms, fiscal regimes and the country's overall approach to the sector with an eye to where the country's resources sit on the cost curve.* This can enable governments to manage national risk across a variety of energy transition scenarios.

At a broader level, governments of new producer countries must seek opportunities to innovate, including by working within government and with prospective partners. Government should:

- *Systematically adopt built-in terms within extractive contracts* that better protect governments and companies against long-term volatility and uncertainty (e.g., periodic review, progressive fiscal terms).
- *Coordinate closely across government*, to align objectives across the bodies responsible for petroleum, finance, energy and climate and ensure a coherent strategy that keeps expectations in check and enables citizens to thrive in a low-carbon future.
- *Develop new kinds of terms that provide for minimizing the carbon footprint* in operations that remain cost competitive (through zero routine flaring and the use of renewable energies to power the needs of the operations).
- *Apply the skills and practices developed in the hydrocarbons sector to new areas of potential growth*, including climate smart mining and agriculture, renewable energy technology and/or green hydrogen.