



Mongolia:  
Enhancing Resource  
Management through  
Institutional Transformation

## **PETROLEUM EXPLORATION AND PRODUCTION AGREEMENTS**

### **NEGOTIATION ISSUES**

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# OUTLINE

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- 1. Introduction**
- 2. Oil and Gas Agreements**
- 3. Key Issues of Oil and Gas Agreements**
- 4. Joint Operating Agreements**
- 5. Key Issues of Joint Operating Agreements**
- 6. Other Upstream Industry Agreements**
- 7. Current Trends**



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# PETROLEUM EXPLORATION AND PRODUCTION AGREEMENTS

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## 1. INTRODUCTION

# OIL AND GAS LAW

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- Oil and gas law is basic instrument used by governments to regulate oil and gas exploration, appraisal, development and production
- Current laws tend:
  - to be short
  - to establish major principles
  - to assign oil and gas rights to the state
  - to authorize government agencies to negotiate oil and gas agreements

# OIL AND GAS LAW

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- Current laws allow governments to adjust terms to meet changing conditions
- Today, modern oil and gas law not the exclusive legal instrument governing oil and gas operations
- Oil and Gas Agreement is now main instrument for regulating specific oil and gas activities

# OIL AND GAS AGREEMENT

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- Oil and gas agreement constitutes hard core of the legal regime applicable to oil and gas upstream activities
- Primary purpose of oil and gas agreement is to establish **IN ADVANCE** terms and conditions which will govern exploration and (in event of discovery) appraisal, development and production

# OIL AND GAS AGREEMENT

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- Thus, oil and gas agreement provides single legal title for all phases of oil and gas development
- Company is therefore assured of its rights from beginning of exploration up to end of commercial production
- This is necessary because costs of oil and gas exploration, appraisal, and development programs are very high

# OIL AND GAS AGREEMENT

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- Companies unwilling to commit to such expenditures without having first reached agreement with government on contract terms covering all aspects of project
- Remember! Investments in exploration, appraisal and development incurred **BEFORE** commencement of commercial production but not reimbursed until **AFTER** commercial production has begun



# OIL AND GAS PROJECT PHASES

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- Phases of activity leading to commercial production of oil and gas:

Exploration

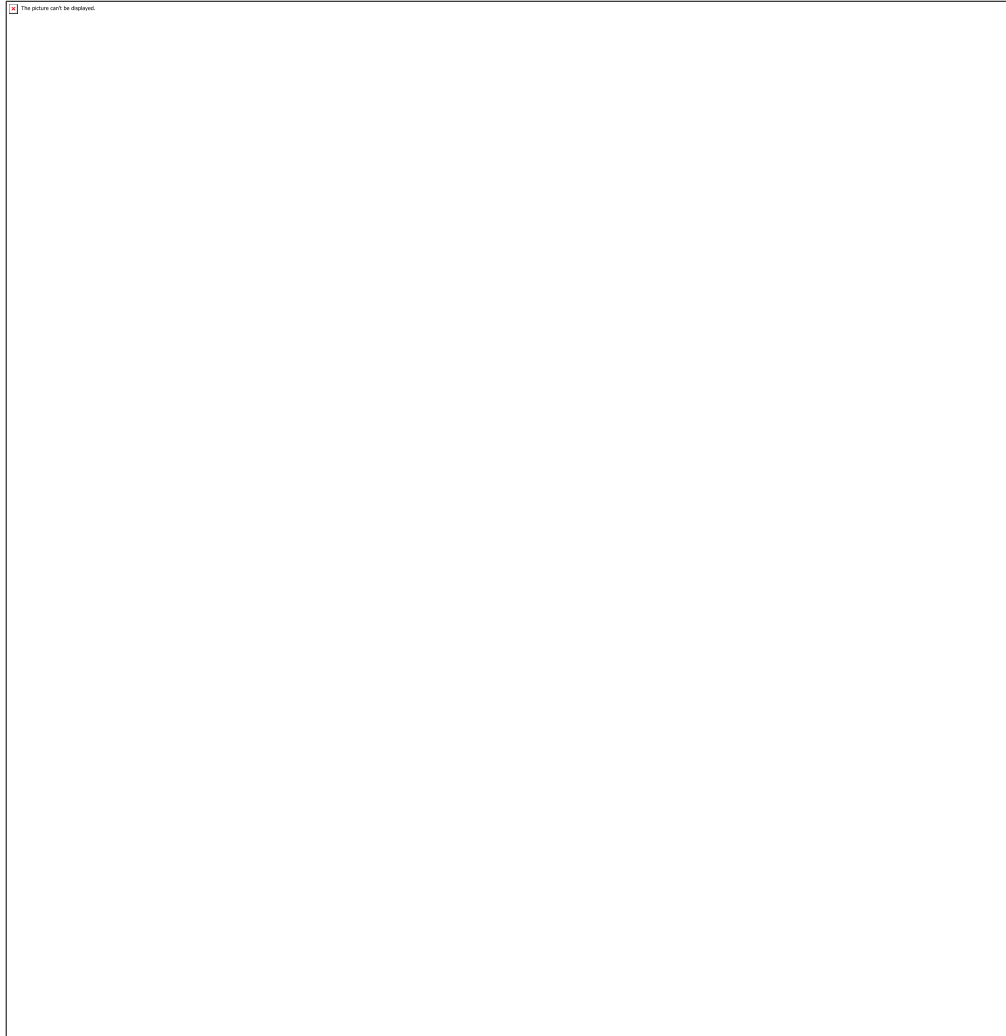
Appraisal

Development

Production

# OIL AND GAS PROJECT PHASES

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# OIL AND GAS PROJECT PHASES

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PHASE	DURATION (YEARS)	GEOLOGICAL RISK	INVESTMENT LEVEL
EXPLORATION	3 – 6	VERY HIGH	HIGH
APPRAISAL	1 – 3	MODERATE/ LOW	HIGH
DEVELOPMENT	3 – 7	LOW	VERY HIGH
PRODUCTION	15 - 30	VERY LOW	OP. COSTS

# OIL AND GAS AGREEMENT

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## DEFINITION

Arrangements which government of host country and oil and gas company(ies) make to allow company(ies) to carry out oil and gas exploration, appraisal, development, and production activities in the country

# JOINT OPERATING AGREEMENT

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## DEFINITION

Arrangements which oil and gas companies which are party to an **OIL AND GAS AGREEMENT** make between themselves

(NB: National Oil Company of country may sometimes be party to Joint Operating Agreement)

# AGREEMENT FRAMEWORK

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# OIL AND GAS AGREEMENTS

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- Prior to World War II, international exploration carried out by small number of large, powerful companies under Concession-type agreements
- After World War II, many independent companies began to explore internationally and different types of agreement developed

# OIL AND GAS AGREEMENTS

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## PRINCIPAL TYPES

- Concession (Royalty-Tax) Contract
- Production Sharing Contract
- Service Contract
  - Pure Service Contract
  - Risk Service Contract



# OIL AND GAS AGREEMENTS

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## GLOBAL OCCURRENCE

- Concession (Royalty-Tax) Contract  
45% of countries (approx.)
- Production Sharing Contract  
50% of countries (approx.)
- Service Contract (both types)  
5% of countries (approx.)  
(Some countries offer more than one contract type)

# OIL AND GAS AGREEMENTS

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## DIFFERENCES

- Differences stem from different attitudes towards ownership of oil and gas resources:
  - Concession (Royalty-Tax) contracts derive from Anglo-Saxon legal tradition which allows private ownership of mineral wealth
  - Production Sharing/Service contracts derive from Napoleonic legal tradition which believes ownership of mineral wealth should rest with State for benefit of all citizens

# OIL AND GAS AGREEMENTS

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- For practical purposes, ownership less important than economics
- Economically, few material differences between Concessions and Production Sharing/Service Contracts
- Possible to achieve the same economic results under all contract systems



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# **PETROLEUM EXPLORATION AND PRODUCTION AGREEMENTS**

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## **2. OIL AND GAS AGREEMENTS**

# CONCESSION (ROYALTY TAX) CONTRACT

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- Concession acquired by company via payment of cash bonus or commitment to work program
- Company has exclusive rights to explore/produce within Concession
- Company undertakes exploration and production activities at its own risk and expense



# CONCESSION (ROYALTY TAX) CONTRACT

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- Company owns any production from Concession and free to dispose of it as it wishes
- Company owns equipment and installations used in its operations
- Company receives revenues from commercial production



# CONCESSION (ROYALTY TAX) CONTRACT

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- Company pays surface rentals
- Company pays royalty on production (either cash or in kind) and pays taxes to the government on its profits
- Exploration/development capital costs and operating costs written off:
  - Capital costs depreciated
  - Operating costs expensed



# CONCESSION (ROYALTY TAX) CONTRACT

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# PRODUCTION SHARING CONTRACT

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- All exploration/production conducted by State, usually represented by the National Oil Company
- National Oil Company appoints foreign company as “contractor” for Contract area
- Foreign company operates at its sole risk and expense under control of National Oil Company

# PRODUCTION SHARING CONTRACT

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- Production belongs to host country
- A royalty may be paid to the government
- Company recovers capital & operating costs out of production (“cost oil”)
  - Capital costs reimbursed according to schedule (possible “cap” on “cost oil”)
  - Operating costs usually expensed

# PRODUCTION SHARING CONTRACT

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- After cost recovery, production shared between National Oil Company and foreign company (“profit oil”)
- Income of foreign company from “profit oil” portion of production usually subject to taxation
- Equipment and installations become property of National Oil Company

# PRODUCTION SHARING CONTRACT

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# SERVICE CONTRACT

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## BASIC PRINCIPLE

Host country contracts with foreign oil company (or service company) to undertake certain specified tasks

# SERVICE CONTRACT

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## TWO TYPES

- Pure Service Contract
  - Risk Service Contract
- (hybrids of the two also exist)

# SERVICE CONTRACT

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# PURE SERVICE CONTRACT

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- Typical services provided by contracted company:
  - Management of oil and gas production operations for host government
  - Provision of technical advice and trained personnel to host government
  - Training of citizens of host country in operation and management of oil and gas production



# PURE SERVICE CONTRACT

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- In return for providing such services, foreign company receives:
  - Set fee in US\$ for each barrel of oil and/or oil-equivalent gas produced
  - Sometimes foreign company may have right to receive part/all of its fee in kind
  - Sometimes foreign company may also have additional right to purchase some of the oil it produces

# RISK SERVICE CONTRACT

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- Foreign oil company assumes all technical/financial risks of exploration, development (and production)
- If exploration unsuccessful, contract is terminated without reimbursement to company
- If exploration successful, company develops field and places it on production

# RISK SERVICE CONTRACT

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- Capital invested by foreign company is reimbursed with interest, together with per barrel fee in US\$
- Management of production operations may then be:
  - carried out by foreign company, or
  - taken over by the National Oil Company

# RISK SERVICE CONTRACT

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- If foreign company manages operation of the field, its operating costs are reimbursed via a per barrel fee in US\$
- As with Pure Service Contract, company may have the right to purchase some of the oil which it produces

# OTHER TYPES OF ARRANGEMENT

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- Government Participation Contract  
(Government/Company Joint Venture)
- Technical Assistance Contract  
(EOR/Rehabilitation/Redevelopment)
- Profitability Contract  
(Rate of Return/"R" Factor Contract)

# GOVERNMENT PARTICIPATION CONTRACT

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- Can be a feature of both Concessions and Production Sharing Contracts
- Arrangements vary:
  - from pure joint ventures in which government and foreign company share equally in all costs and risks (rare)
  - to joint ventures in which government is carried by the foreign company through the exploration and development phases

# GOVERNMENT PARTICIPATION CONTRACT

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- Foreign company recovers government's share of exploration and development costs through direct reimbursement or cost recovery deductions
- Typically, government is carried through exploration and development and company recovers government's share of costs from production

# GOVERNMENT PARTICIPATION CONTRACT

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- Company Perspective:
  - Government participation reduces potential rewards of exploration but exposes company to full exploration risks
- Government Perspective:
  - Popular with governments as they are not exposed to exploration risks



# GOVERNMENT PARTICIPATION CONTRACT

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# TECHNICAL ASSISTANCE CONTRACT

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- Can be a feature of both Concessions and Production Sharing Contracts
- Normally involves proved reserves beyond primary recovery stage
- Used for EOR (Enhanced Oil Recovery) projects and rehabilitation/redevelopment schemes
- There is no exploration risk

# TECHNICAL ASSISTANCE CONTRACT

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- Company takes over existing operations, equipment and personnel
- Government and company may sometimes jointly manage project
- “Assistance” usually includes capital commitment related to application of special technology

# TECHNICAL ASSISTANCE CONTRACT

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- If there is existing production, decline curve negotiated by government and company
- Company does not share in production below curve
- Incremental production above curve is:
  - subject to royalty and tax (Concession), or
  - shared between government and company (Production Sharing Contract)

# TECHNICAL ASSISTANCE CONTRACT

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# PROFITABILITY CONTRACT

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- Can be feature of both Concessions and Production Sharing Contracts
- Government take a function of true profitability (measured by ROR/Return on Investment-not pseudo profitability as measured by production rate)
- Government take increases as profitability increases

# PROFITABILITY CONTRACT

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- Take into account all factors which influence profitability (costs, timing, production rates, product prices)
- Profitability systems characterized by initially modest royalty and tax
- Government receives nothing further until company has recovered initial investment plus pre-determined threshold ROR/ Return on Investment

# PROFITABILITY CONTRACT

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- Above threshold ROR/Return on Investment, additional royalties and/or taxes paid to government
- However, company still receives share of “excess” profits
- Profitability Contracts are flexible and progressive
- Becoming more popular throughout world



# PROFITABILITY CONTRACT EXAMPLE

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# PROFITABILITY CONTRACT EXAMPLE

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# MIDSTREAM/DOWNSTREAM AGREEMENTS

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- Oil and Gas Agreement governs relationship between oil and gas rights holder and company for activities in upstream sector (exploration, appraisal, development, and production)
- Activities in midstream/downstream sectors (transportation, refining, marketing, and petrochemical operations) governed by separate agreements



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# PETROLEUM EXPLORATION AND PRODUCTION AGREEMENTS

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## 3. KEY ISSUES OF OIL AND GAS AGREEMENTS

# INTRODUCTION

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- Use of model agreements allows standardization of contract provisions in oil and gas agreements
- But each individual agreement must be negotiated separately
- During negotiations, much attention given to fiscal matters
- But must also address number of other key, mainly operational, issues

# KEY ISSUES IN OIL AND GAS AGREEMENTS

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- Principal key issues include:
  - Agreement Area
  - Exploration Period
  - Relinquishment
  - Work Program
  - Bonuses
  - Discovery and Appraisal
  - Declaration of Commerciality
  - Development
  - Planning, Budgets, and Forecasts
  - Government Participation
  - Gas Clause
  - Abandonment
  - Arbitration (Dispute Resolution)

# AGREEMENT AREA

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- Governments generally prefer to keep agreement areas small
- This allows more companies to participate in exploration
- Companies prefer large agreement areas
- This allows them to have more control over pace of exploration
- Size of agreement areas related to perceived prospectivity (greater the risk, larger the agreement area)

# EXPLORATION PERIOD

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- Variation in length of exploration period
- But aggregate period (initial phase plus extensions) usually not less than 6 years
- Often, greater the risk, longer the period
- Exploration period often divided into number of phases
- Advantages of phased exploration period:
  - Minimum work program/expenditure for each phase
  - At end of each phase, company:
    - has option to proceed to next phase or terminate contract
    - usually required to relinquish part of agreement area



# EXPLORATION PERIOD

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- Company needs sufficient time to explore agreement area thoroughly
- Agreements usually allow for extension if activities in progress near end of a phase
- If discovery made near end of phase, time allowed for appraisal

# RELINQUISHMENT

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- Mandatory relinquishment of part of agreement area at end of each phase
- Relinquishment provisions related to work program and duration of exploration period
- Typical relinquishment schedule:
  - End of first phase: 25%\*
  - End of second phase: 25%\*
  - End of final phase: 50%\*(\* of original area)

# RELINQUISHMENT

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- Usual to specify size and configuration of areas to be relinquished
- Government needs to be able to offer relinquished areas to other companies
- If relinquishment provisions too severe, company will tend to apply for large agreement area
- If discovery being appraised or developed, usual to exempt discovery area from relinquishment obligation

# WORK PROGRAM

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- Work program usually requires company to acquire specified number of kilometres of seismic and to drill one or more exploration wells
- Sometimes wells must be drilled to specified depth or geological formation
- If a well abandoned prematurely for technical reasons, substitute well usually required

# WORK PROGRAM

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- Sometimes, company's obligation may be expressed in terms of expenditure, or of both work and expenditure
- But work program may be reduced through inflation (unless index-linked) or through high start-up costs
- Also cost-effective company should not be penalized for fulfilling its work program with lower expenditure

# BONUSES

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- In addition to work program, company may be required to pay cash bonuses to government:
  - Signature bonus
  - Discovery bonus
  - Production bonus
- Cash bonuses required by countries with great potential can be very large

# DISCOVERY AND APPRAISAL

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- Company usually required to report discovery to Government
- Company must then undertake approved appraisal program
- After appraisal, company usually required to consult with Government prior to making development decision
- If company fails to make decision within specified time period, Government may have right to develop at own risk and cost

# DECLARATION OF COMMERCIALITY

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- After appraisal, company must decide if discovery capable of commercial development
- Decision normally left up to company
- Government approval of commerciality decision may be required
- Government approval definitely required if Government has right to participate.
- Commerciality can be controversial



# DEVELOPMENT

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- Company to submit development plan to Government for approval
- Key issues in development plan:
  - Estimates of recoverable reserves
  - Development well pattern
  - Production profile
  - Economic analysis
  - Schedule of operations
  - Employment and training of national staff
  - Purchase of local goods and services

# PLANNING, BUDGETS AND FORECASTS

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- Company usually required to provide its proposed plans and activities during various stages of project life
- Also necessary to provide budget required to implement these plans
- Company may also provide forecasts of:
  - Production levels
  - Technologies to be used
  - Training and technology transfer
  - Numbers of nationals to be employed

# GOVERNMENT PARTICIPATION

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- Government may have right to participate in operations
- Numerous ways for Government to do so
- Not popular with companies
- Key issues:
  - Options to participate
  - Carried interests
  - Working interests
  - Documenting Government participation

# DOCUMENTING GOVERNMENT PARTICIPATION

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- Terms and conditions of Government participation may be incorporated in main Oil and Gas Agreement
- But often documented in a Joint Operating Agreement or Participation Agreement
- Government may have special rights on operating committee
- It may even have right to assume operatorship regardless of % interest

# GAS CLAUSE

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- Many Oil and Gas Agreements were negotiated assuming oil (not gas) would be discovered
- These Agreements vague or silent on terms and conditions relating to gas
- Thus, if gas discovered, company may have no right to exploit it
- Issue of natural gas must be addressed when negotiating Agreement

# ABANDONMENT

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- Most Oil and Gas Agreements now address issues which arise when field finally abandoned
- Costs to undertake abandonment, removal and reclamation occur after production and revenues have ceased
- Parties to Agreement make periodic contributions to trust fund or escrow account before abandonment

# ABANDONMENT

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- Various mechanisms for recovery of abandonment costs:
  - Companies prefer to treat them as current operating costs and to recover them in same way
  - Not all Governments will accept this
  - Instead, Government may provide subsidies or may allow tax relief

# ARBITRATION (DISPUTE RESOLUTION)

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- In Oil and Gas Agreements, normal to settle disputes via arbitration not litigation
- Arbitration faster and less expensive than litigation
- Agreements now contain arbitration clauses
- Norm is for arbitration to be conducted under rules of some international body (ICC, ICSID, UNCITRAL, etc.)



# SUBSIDIARY AGREEMENTS

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- Several subsidiary agreements form attachments to Oil and Gas Agreement:
  - Accounting Procedure
    - Documents all accounting procedures
  - Lifting Agreement
    - Documents procedures to be used when production exported by ship
  - Joint Operating Agreement
    - Documents rights and obligations of Government and company when Government has right to participate



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## 4. JOINT OPERATING AGREEMENTS

# JOINT VENTURES

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- Exploration and exploitation characterized by risk and large capital expenditures
- Thus, few companies undertake these activities alone
- Companies usually “team up” with other partners to undertake these activities as a **JOINT VENTURE**
- Partners may be other companies and/or Governments and National Oil Companies

# JOINT VENTURES

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- Joint venture **not** an Oil and Gas Agreement
- Joint venture **is** form of association or “partnership” for the purpose of jointly operating and oil and gas venture
- Difficult to distinguish between joint ventures and true partnerships because relationship of parties in both is similar
- However, significant legal differences between the two

# JOINT OPERATING AGREEMENT

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- Rights and obligations of all parties in joint venture must be agreed and documented
- Agreement negotiated and signed by joint venture partners termed Joint Operating Agreement (“JOA”)
- The JOA is subsidiary to (and must be consistent with) principal Oil and Gas Agreement

# JOINT OPERATING AGREEMENT

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# JOINT OPERATING AGREEMENT

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- JOA has four main functions:
  - To identify and address interests of all joint venture partners
  - To provide for all aspects of joint exploration and exploitation
  - To provide for sharing of costs and revenues of joint operations among partners
  - To designate operator and define operator's powers, duties, compensation and (if necessary) replacement

# MODEL JOINT OPERATING AGREEMENTS

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- Various model JOA's in use
- Model JOA prepared by Association of International Petroleum Negotiators ("AIPN") now commonly used internationally
- Model JOA's provide convenient format to facilitate negotiation of actual contract
- But actual contract requires skilled and experienced negotiators and legal advisors to ensure it accurately reflects agreement between the parties





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## 5. KEY ISSUES OF JOINT OPERATING AGREEMENTS

# KEY ISSUES

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- In any JOA there are number of key issues with potential to be contentious:
  - Pre-Emption Rights
  - Voting Procedures
  - Sole Risk and Non-Consent
  - Overhead Allocation
  - Parent Company Overhead
  - Independent Experts
  - Government Participation

# PRE-EMPTION RIGHTS

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- Pre-emption clause requires any party to JOA who wishes to sell part or all of its interest in the JOA to first offer interest to other JOA partners
- If any partner agrees to match best offer received by seller from company not party to JOA, then partner has right to buy interest
- Thus, partner has right to pre-empt sale to outside company

# PRE-EMPTION RIGHTS

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- Pre-emption clauses still included in many JOA's, but recent trend has been to exclude them
- Pre-emption rights can avoid possibility of interest being sold to outside company other partners may not want
- But many companies wishing to purchase an interests in JOA reluctant to make offer if JOA contains pre-emption clause

# VOTING PROCEDURES

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- Partners in JOA hope always to have unanimous consent to any decisions
- if unanimity not possible, necessary for parties to vote with each party voting in proportion to its interest in JOA
- Thus, JOA must include provisions for voting “passmark”
- “Passmark” may take form of “y%” or may take form of “y%” and at least “n” partners

# VOTING PROCEDURES

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- Whichever system used, decision is approved if “passmark” equalled or exceeded
- Those partners who voted against obligated to accept decision
- Some JOA’s require different passmarks for different decisions
- Voting “passmark” a serious issue usually involving serious consideration and negotiation by all partners

# SOLE RISK AND NON-CONSENT

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- Rights of “sole risk” and “non-consent” related but quite different
- Most JOA’s contain provision for “sole risk” but many do not include right of “non-consent”
- Rights of “sole risk” and “non-consent” usually relate to drilling or deepening of discretionary well
- Distinction hinges on whether voting “passmark” has been reached

# SOLE RISK AND NON-CONSENT

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- If voting “passmark” not reached, partners who want to drill well can do so at their own cost and risk (i.e. at their “sole risk”)
- If “passmark” reached, “non-consent” provision gives them right not to participate (i.e. to go “non-consent”)
- “Sole risking” and “non-consenting” are aggressive actions and may damage spirit of cooperation necessary for JOA to work
- For this reason, provision often not included



# OVERHEAD ALLOCATION

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- Operator may be responsible for managing number of joint ventures in same country from same office
- Joint ventures may have different partners
- Some of costs associated with this office will be entirely for operator's own account
- But much (probably most) of office costs have to be allocated among various joint ventures in an equitable way

# OVERHEAD ALLOCATION

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- Number of problems associated with allocating these costs
- Most common method involves preparation of time sheets by operator's professional staff who work directly on joint venture activities ("time writing")
- Non-operators prefer this method
- Governments monitor cost allocation to ensure operator does not unfairly allocate costs to ventures with high tax obligations

# PARENT COMPANY OVERHEAD

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- Operator often subsidiary of parent company with head office in another country
- Parent company head office usually provides support to operator's office
- Joint venture partners usually accept that operator has right to collect contribution towards those "overhead" costs
- Most common and easiest method is to mark up operator's expenditures

# PARENT COMPANY OVERHEAD

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- Using this method, typical fee structure could be as follows:
  - 5% on first \$2 million of expenditures
  - 3% on next \$1 million of expenditures
  - 1% on any remaining expenditures
- Operator may try to apply this formula to **annual** expenditures
- Non-operators will prefer to apply formula to **cumulative** expenditures

# INDEPENDENT EXPERTS

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- Most JOA's contain provision for use of independent expert to resolve differences of technical opinion among partners
- Expert's decision usually binding
- Often, expert has complete freedom to study opposing positions and to issue binding decision
- Expert will tend to select compromise between rival opinions

# INDEPENDENT EXPERTS

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- Most companies believe expert should not have freedom to compromise and should be forced to decide in favour of one or other of opposing positions
- Most companies believe costs of expert determination should be paid by loser(s)
- Such arrangements are believed to put pressure on parties to resolve differences without having to go to trouble and expense of bringing in independent expert

# GOVERNMENT PARTICIPATION

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- In oil and gas agreements where Government has right to participate, terms and conditions of participation may simply be documented within body of principal oil and gas agreement
- However, often those terms and conditions are documented in JOA
- One of issues to be addressed when Government has right to participate involves question of control

# GOVERNMENT PARTICIPATION

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- Governments would prefer ultimate operational control and management to rest with national oil company
- But unless Government shares in exploration risk, most companies will insist on having control during exploration phase
- Once commercial production established and Government begins to pay its share of costs, companies willing to consider joint arrangements for control and management





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## 6. OTHER UPSTREAM INDUSTRY AGREEMENTS

# OTHER AGREEMENTS

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- Several other types of agreement commonly used in upstream oil and gas industry, in particular:
  - Farmout Agreement
  - Unitization Agreement
  - Service Agreement

# FARMOUT AGREEMENT

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- An agreement whereby company with rights to explore and produce in given area assigns all or a portion of those rights to another company in return for undertaking a work program in subject area

# UNITIZATION AGREEMENT

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- Unitization Agreement allows field which underlies two or more blocks held by different companies to be exploited as single unit under single authority
- Unitization Agreement similar to Joint Operating Agreement as it provides for joint exploitation of field
- However, latter negotiated before joint operations begin whereas former is negotiated after field discovered

# SERVICE AGREEMENT

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- Service Agreements (Contracts) used in various forms in oil and gas industry
- Used between governments and oil companies as form of Oil and Gas Agreement (two types):
  - Pure Service Agreement
  - Risk Service Agreement
- But Service Contract most commonly used between oil companies and contractors

# SERVICE AGREEMENT

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- Service Agreements most commonly used in upstream industry when oil companies require seismic, drilling or other specialized services performed
- In such cases contracts are typically Pure Service Contracts in which company performs specified services for fixed fee



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## 7. CURRENT TRENDS

# CURRENT TRENDS

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- International exploration and production industry is undergoing profound changes
- Privileged position which major oil and gas companies have enjoyed for so long being eroded and reduced
- Independent oil companies, national oil companies (“NOC’s”), and service companies now competing aggressively with major companies



# CURRENT TRENDS

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- NOC's in particular now increasingly important players not only in their own countries but internationally
- Many NOC's now extensions of their nations' foreign policy (position once held by many of major companies)
- NOC's working internationally also enjoy advantage of being preferred by other governments in preference to Western oil companies

# CURRENT TRENDS

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# CURRENT TRENDS

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- Governments have always wanted to have control of their natural resources
- In the past, governments and NOC's had to invite international oil companies to undertake E & P activities in their countries because they:
  - did not have capital, technology, and skilled people to undertake these activities
  - did not want to take risk associated with these activities

# CURRENT TRENDS

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- But financial strength and technical competence of NOC's has changed dramatically
- *Remember:*
  - *Almost 80% of world's proved oil reserves are under control of NOC's*
  - *There are 13 NOC's with more reserves than Exxon Mobil, world's largest international oil company*

# CURRENT TRENDS

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- Situation today is that governments and their NOC's:
  - have access to off-the-shelf technology just like international oil companies
  - often have a skilled workforce
  - do not always need to look for outside capital
- Now well-developed trend towards increasing government participation in oil and gas sector

# CURRENT TRENDS

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- This is driven by strong desire by governments to:
  - Gain control of strategic industry and enhance national security
  - Enjoy greater financial returns
  - Develop skilled workforce
- High oil price has effect of accelerating all these trends

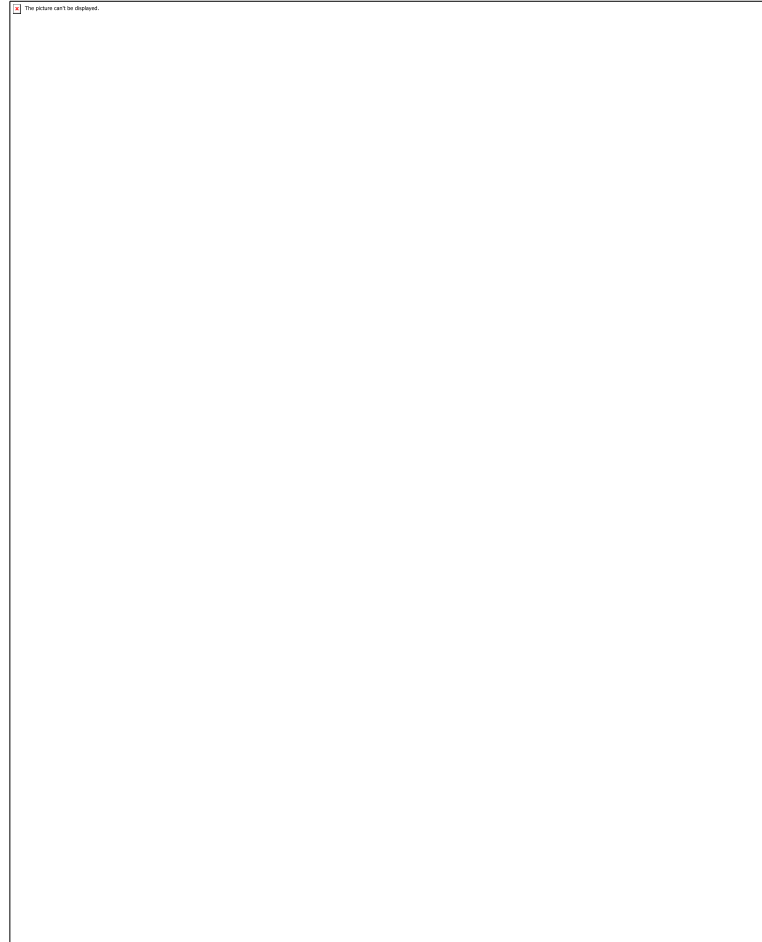
# CURRENT TRENDS

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- High oil price also put great pressure on relationships between governments and international oil companies
- International fiscal and contractual terms underwent dramatic changes
- New terms and conditions were imposed on companies which have existing agreements
- Many disputes resulted via renegotiation, arbitration, mediation, and litigation

# CURRENT TRENDS

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Recent Fiscal Changes  
Johnston, 2008



# CURRENT TRENDS

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- In response to changes imposed by many countries, companies pressed governments for more stable agreements
- Trend now to attempt to include one or both of following in oil and gas agreements:
  - Stabilization clause
  - Adaptation clause

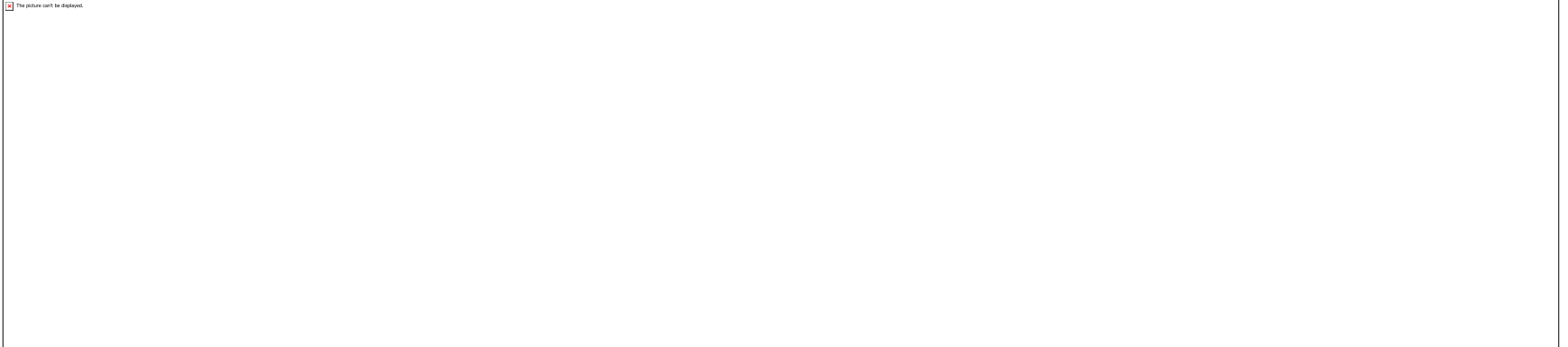
# CURRENT TRENDS

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- Stabilization clause “freezes” rights and obligations of parties so that State cannot modify terms to oil company’s detriment
- Adaptation clause provides for renegotiation if circumstances beyond control of parties negatively affect economic equilibrium
- Stabilization and adaptation clauses can co-exist within same agreement
- Two clauses both aim to achieve objective of fair allocation of risk over long life of oil and gas agreement

# THANK YOU!

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Thank You!

