

SESSION A: LAW AND ENERGY ECONOMICS

“The Role of Law and Energy Investment”

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Background to Law and Energy Investment

A. Host Countries Objectives to Attract Foreign Energy Investment

- Develop Hydrocarbons
- Generate Revenues
- Spur Economic Potential
- Develop Expertise
- Promote Investment Incentives

Background to Law and Energy Investment

B. Objectives of Company Investment

- Discover & Develop Hydrocarbons
- Reward Appropriate to Risk
- Stable Political and Fiscal Environment
- Manage Operations on Commercial Basis
- Stability of Contract
- Impartial Dispute Resolution

Framework of Law in the Petroleum Agreement

A. Fixed Regime/Award of Licenses

- Determined by Host Country Laws & Legislation
- Terms and Condition under Legislation not Subject to Negotiation
- Terms such as Tax, Royalty, Rentals & Relinquishment Set in Legislation of Country
- Competitive Bidding Based on Work Program, Budget, Work & Financial Commitments

Framework of Law in the Petroleum Agreement

A. Fixed Regime/Award of Licenses (cont'd)

- Law & Legislation Determine Criteria for Award
- Criteria Based on Expertise, Experience, Financial Capabilities, Record of Exploration & Production
- Examples: UK, Norway, France, Spain, Italy, the Netherlands
- Assessment: Rigid Framework Determined Under General Considerations

Framework of Law in the Petroleum Agreement

B. Contractual System

- No Specific Detailed Legislation
- Each License Separately Negotiated
- Terms & Conditions for Both Parties Often Require Extensive Negotiation
- Final Agreement may be either a Tax/Royalty Agreement (Concession), Production Sharing Contract (PSC) or Risk Service Agreement
- Final Agreement will be subject often to the Law of the Host Country and Principles of International Law

Framework of Law in the Petroleum Agreement

B. Contractual System (cont'd)

- Final Agreement may be Subject to the Petroleum Law or may be Structured to incorporate the Petroleum Law
- Final Agreement may be Assessed as a Private International Treaty between the Sovereign & Foreign Party
- Parties often provide for International Arbitration in a Neutral Jurisdiction to settle Disputes & Disagreements

The Investment Decision by a Company to Invest in a Host Country

A. Why Will Company Invest in Petroleum Exploration in Host Country?

- Discover & Develop Hydrocarbon Resources
- Obtain Reward Appropriate to Risks and Investment
- Provide for Asset Growth
- Need to Achieve Success in Discovery of Hydrocarbons

The Investment Decision by a Company to Invest in a Host Country

A. Why Will Company Invest in Petroleum Exploration in Host Country? (cont'd)

- Increase Attraction to Investors as a Publicly Traded Company
- Judgment of Ability to Manage Political and Economic Risks in the Investment
- Ability to Negotiate Agreement to Provide for Stability in Terms and Conditions of Agreement

The Investment Decision by a Company to Invest in a Host Country

B. Why Will Host Government Welcome Foreign Company Investment?

- Develop Hydrocarbon Resources
- Generate Cash Flow to Government
- Spur Economic Growth & Infrastructure Development
- Develop Expertise & Experience for Nationals
- Lessen Balance of Payments Deficits in Importing of Hydrocarbons

The Investment Decision by a Company to Invest in a Host Country

B. Why Will Host Government Welcome Foreign Company Investment? (cont'd)

- Transfer of Technology from Investing Company
- Provide for Training Programs to Develop Expertise
- Maintain Control in Company Exploration & Production Ventures
- Impetus to Enter into Other Joint Venture Projects
- Provide for Potential in Economic Growth

Law and the Investment Decision under International Petroleum Agreements

A. Tax/Royalty (Concession)

- Traditional Petroleum Agreement Between Host Governments & Companies
- License Awarded Based On Legislation Criteria or Host Government Evaluation
- Company has Equity Interest in Hydrocarbons at Wellhead

Law and the Investment Decision under International Petroleum Agreements

A. Tax/Royalty (Concession) cont'd

- Government “Take” Often Measured by Royalty, Tax, Rentals, State Participation, Signature or Production Bonuses
- Terms and Conditions may include Production Split, Rate of Return Cap or Excess Profits Tax
- Often no restrictions on Cost Deductions except as Limited by Legislation or Depreciation

Law and the Investment Decision under International Petroleum Agreements

B. Production Sharing Contract (PSC)

- Developed in late 1960s to emphasize Sovereign Control over Natural Resources
- Company enters into PSC with State as a Contractor
- Company responsible for all costs and expenditures of exploration
- In the event of commercial production, the State and Company share in agreed percentages the available production

Law and the Investment Decision under International Petroleum Agreements

B. Production Sharing Contract (PSC) cont'd

- The State is owner of all oil & gas subsurface; the Company does not acquire an equity interest in oil & gas
- The facilities used by the Company in oil & gas operations will belong to the State
- The PSC will impose terms and conditions similar to those under Tax/Royalty Agreements; one of the main exceptions is a cost recovery limitation provision for a PSC

Law and the Investment Decision under International Petroleum Agreements

C. Risk Service Agreement

- Risk Service Agreement is comparable to the PSC except that the Company's share may be payable either in monetary compensation or in kind
- Used in Host Countries that want to emphasize the "service" basis of the agreement with a Company
- Formerly popular in Latin American and some Middle East Countries; not frequently used in today's petroleum investments

Assessment of Law in the Investment Decision

- A Host Country that has a Policy to Welcome Foreign Petroleum Investment will provide the Legal Foundation in Support of such Policy
- Such Legal Foundations would require a Stability of Contract Provision
- A Stability Provision in a Contract with a Foreign Investor would Protect against Unilateral Changes by the Host Government which change the terms and conditions of the Contract to the detriment of the Company

Assessment of Law in the Investment Decision (cont'd)

- Thus by Legal Safeguards the Company can provide for Investment in the expectation that there will be no changes in the Fiscal or Contractual provisions to its detriment
- The Host Country by Law may also provide incentives to investing Companies to encourage and support their investments

Assessment of Law in the Investment Decision (cont'd)

- A Balance will always be desirable in respect of the interests of the Host Country and the Investing Company so that there is an acceptable Reward to Risk basis for the Investment
- Finally the function of Law as an incentive to Investment will provide for a Mutuality of Interests principle to result in a “Win-Win” conclusion to Investments between the Host Country and the Investing Company