# STATE PARTICIPATION AND FISCAL ELEMENTS IN PSAs

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# Intended Learning Outcomes

- ❑ Gain an understanding of state participation in Petroleum Operations and common issues arising from the participation.
- ❑ Gain an understanding of the concept of cost recovery including the common cost recovery mechanisms applied in PSAs.
- ❑ Gain an understanding of the concept of production sharing including the various profit petroleum sharing mechanisms
- ❑ To enable participants develop a production sharing flow chart for their country based on their PSA

# State participation

- Government or its nominee elect to enter into a Joint Venture agreement with Licensee. Usually National Oil Companies (NOCs) like in  Uganda, Nigeria, Indonesia, Kenya, Angola etc.

- **Carried equity participation**

Most PSAs require the IOC to carry the state, which means that the IOC bears all the exploration costs. If the field is declared commercial, the state then has the option to participate in the production activities. The IOC carries the exploration risks.

- **Participating Interest:**

The state participating interest usually ranges from 10-20% For example: Uganda-15%,Indonesia-10%,Kenya-20%

# State participation

**Common issues arising from state participation:**

- **Governance-** tendency of resource wealth to undermine governance in resource–rich countries or to exacerbate pre-existing weaknesses in governance.
- **Funding of NOCs-** Funding significant participation draws resources away from other urgent budget priorities, jeopardizing overall development objectives, and creating social and political tensions.
- **Macro economic management-**Financing off budget activities
- ***Commercial Efficiency-*** Pervasive government interference, lack of transparency and accountability, and the extensive assignment of non-commercial tasks are systemic factors.
- **Institutional capacity deficiencies**-Mainly man power expertise

# Fiscal Elements in the PSA

- Bonuses (Signature, Discovery, Production etc)
- Royalties
- Cost petroleum
- Profit petroleum
- Rental fees i.e Surface rent
- Taxes i.e corporation tax

# Cost Petroleum

- **Recoverable costs**

These constitute costs incurred in the production of petroleum. They are determined as per the criteria described in the PSA or regulations. (***Necessary ,Appropriate and Economical.).***

- **Recovery of Expenditure**

  - All permitted expenditure are treated as an expense for the purpose of cost recovery.
  - Contractor recovers qualifying expenditure (Accounting Procedure) in respect of all Petroleum Operations.

# Cost recovery Mechanisms

- Full cost recovery

Recovery of accrued costs with no limits. (100% recovery)

Share of remaining Profit petroleum in agreed ratios.

# Cost recovery Mechanisms

- **Full cost recovery, with first tranche hydrocarbons:** *For example in Indonesia*

**Deduction of pre-agreed first tranche oil.**

**Recovery of accrued costs with no limits. (100% recovery)**

**Share of profit petroleum in agreed ratios.**

# Cost recovery Mechanisms

- **Capped cost recovery**:Usually capped (50-70%) e.g Uganda, Kenya.

Recovery of accrued costs subject to cap in the PSA.

Share of remaining Profit petroleum in agreed ratios.

Accrued but unrecovered costs are carried forward to successive periods

# Cost recovery Mechanisms

- First tranche hydrocarbons, capped cost recovery

Deduction of pre-agreed first tranche oil

Recovery of accrued costs subject to cap in the PSA.

**Share of profit petroleum in agreed ratios.**

Accrued but unrecovered costs are carried forward to successive periods

# Cost recovery

**Some of the key issues to watch out for:**

- ❑ **Ring fencing**

In the event that a licensee/operator has more than one contract area, the calculations are done on a contract area by contract area basis. No consolidation of costs.

- ❑ **Classification of Capital and non Capital costs**
- ➢ Depreciation-year's allowable cost of recovery
- ➢ Depreciation method and rates applicable

- ❑ **Cost categories whether exploration, development or production or by petroleum value chain**

# Production sharing

**Profit petroleum**

- Oil/Gas remaining after the deduction of Cost Oil/Gas is considered Profit Oil/Gas.
- Profit Oil/Gas is shared between IOC & government on agreed ratio.
- Allocated on a daily/monthly/annual basis between IOC and the state (NOC) on basis of sliding or fixed scale

# Production sharing

## Profit Petroleum Sharing Mechanisms

- Production Volume based

Progressive (or upwardly increasing) scale designed to increase the state's participation levels as the underlying project attains greater levels of daily production.

- *Level of daily production from each field (Sudan,Uganda,Trinidad and Tobago etc)*
- *Cumulative production per year from the contract area* ***i.e Nigeria***

| Barrels per day | % for government |
|---|---|
| Up to 25,000 bpd | 61.5% |
| 25,000-50,000 bpd | 71% |
| > 50,000bpd | 80% |

| Million barrels | % for government |
|---|---|
| <350 | 20 |
| 351-750 | 35 |
| 751-1,000 | 45 |
| 1,001-1500 | 50 |
| 1,500-2000 | 60 |
| >2,000 | To be negotiated |

# Production sharing

## Profit Petroleum Sharing Mechanisms

- ❑ **R-factor (Profit based)-** This is the ratio of cumulative receipts from the sale of petroleum to cumulative expenditures.

- ➢ It is the commonly used method. For example in Uganda, Azerbaijan, Kenya,Ghana etc.

$$R = \frac{Cost\ recovery + Profit\ oil - Income\ tax}{Costs}$$

| R-Factor | Licensee's Share of Profit Petroleum (in percentage) | Government's Share of Profit Petroleum (in percentage) |
|---|---|---|
| $R \leq 1.000$ | 50 | 50 |
| $1 < R \leq 3.000$ | $Z = 50 - [25*(R-1)/2]$ | 100-Z |
| $R > 3.000$ | 25 | 75 |

# Production sharing

## Profit Petroleum Sharing Mechanisms

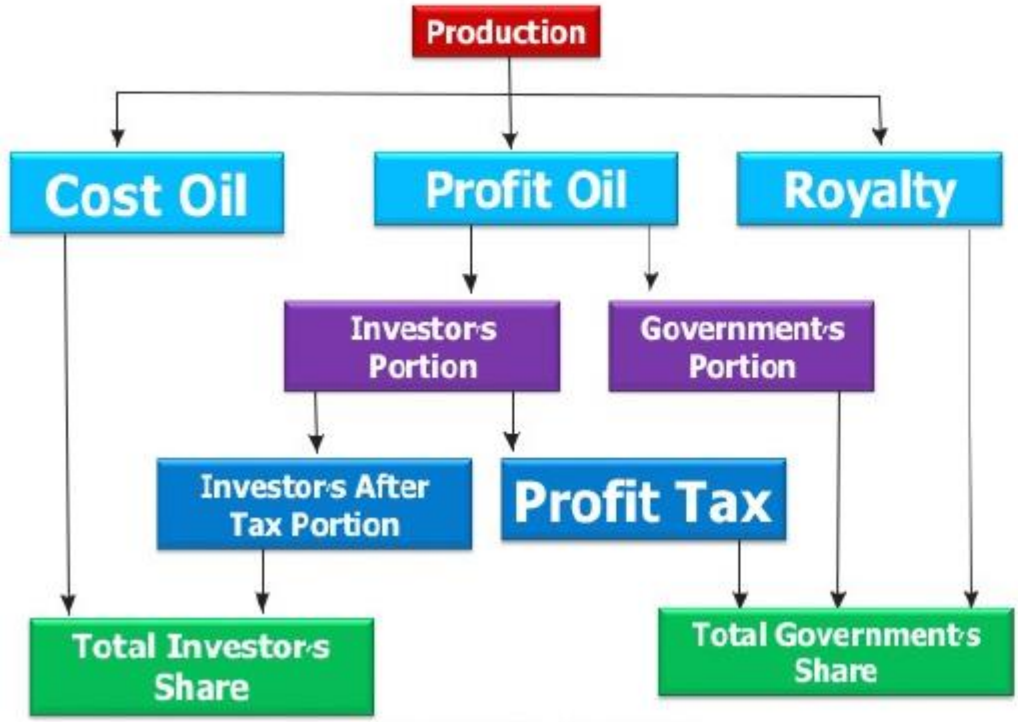
- **Fixed Allocation**

Fixed percentages for the lifetime of the PSA. For example in Indonesia

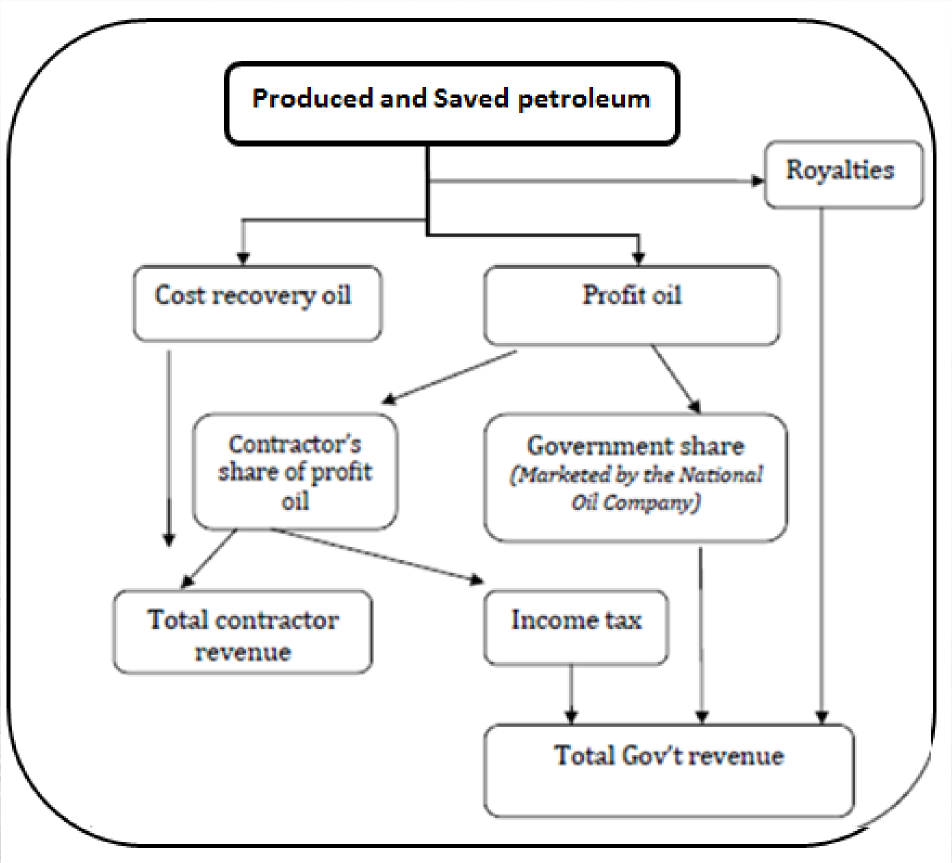
6.1.3 Of the Crude Oil remaining after deducting Operating Costs, the Parties shall be entitled to take and receive each Year, respectively thirty seven point five zero zero zero percent (37.5000 %) for **PERTAMINA** and sixty two point five zero zero zero percent (62.5000 %) for **CONTRACTOR**.

# Production sharing illustration

Source: IMF



# How production is shared in Uganda



# Exercise

- Develop a flow chart for your country’s PSA fiscal regime.

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