

ALLEN & OVERY



Guide to Extractive Industries Documents – Oil & Gas

World Bank Institute Governance for
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1_Introduction¹

1.1_Background

The notion of the state sharing production of oil and gas with companies as part of a commercial enterprise was first developed in Bolivia in the 1950s. The Production Sharing Contract (**PSC**) was introduced in Indonesia in 1966 and PSCs are now used widely to record arrangements for oil and gas exploration and production, particularly in developing countries; today, they are used in over 40 countries, including in Africa, Central Asia and South-East Asia.

The PSC is not the only manner by which a state may grant oil and gas exploration and production rights to commercial investors. Prior to the development of the PSC, exploration and production of oil and gas was typically governed by way of a licence or a concession, and these regimes remain in many jurisdictions (see paragraph 1.4 below). However, in developing nations, the PSC is now the most common means by which a state permits commercial involvement in the oil and gas industry and in many jurisdictions there are political reasons for their adoption. For example, following Indonesian independence in 1945, the concessions regime came under attack by nationalist groups. This eventually led to the Indonesian government refusing to grant new concessions, which inevitably led to a decline in foreign investment in Indonesia's oil and gas sector. To halt this decline, the government introduced new legislation which provided for production sharing arrangements; such arrangements were widely considered to be less controversial than the previous concessions system, as they enabled the government to maintain formal ownership of the resources in question, while permitting the private sector to exploit them.

1.2_What is a PSC?

Under a PSC, a state (the **State**) contracts with an international (and in some cases a domestic or another state's national) oil company (**IOC**) for the IOC to provide the requisite finance and technical skills in order to explore for (and hopefully produce) oil and/or gas. The State will usually be represented by the government or a government body, such as the national oil company (**NOC**), who will take delivery of the State's share of production. The IOC is granted an exclusive right to explore and produce oil and gas within a defined area (generally known as the **contract area**) and, in doing so, bears the entire risk of the project, financial and otherwise. Should a commercial discovery be declared, the IOC becomes entitled to a portion of any oil produced as 'payment' for its efforts (generally at the end of the quarter in which the oil is produced), in addition to recouping its costs out of production; conversely, if no discoveries are made, the IOC receives nothing. The State retains ownership of all oil and/or gas produced (subject only to the IOC's entitlement to a portion of any oil produced on a successful discovery). The extent to which the NOC is involved with the exploration and production process varies from country to country.

1. Allen & Overy are very grateful to Professor Terence Daintith for his contributions to this guide.

There are commonly four key financial aspects to a PSC:

- (a) *Royalty*: Firstly, the IOC is often expected to pay a royalty on gross production to the State. The royalty is often, at the State's election, taken 'in kind' (that is, a share of production) or by way of a payment equivalent to the sale price of the State's royalty share of production.
- (b) *Cost oil*: Following payment of any royalty, the IOC is entitled to a pre-determined percentage of production from which it may recover its costs (with any costs not recovered carried forward to the next period). Such production is known as **cost oil**.
- (c) *Profit oil*: The oil remaining after the royalty and cost oil (known as **profit oil**) is divided between the IOC and the State in accordance with the production sharing provisions in the PSC. It is often the case that the State's share of profit oil increases as production increases.
- (d) *Income tax*: Finally, the IOC usually has to pay income tax on its share of profit oil. However, this income tax is often paid by the NOC or State on behalf of the IOC, such that there is no financial impact on the IOC.

In terms of the respective parties' objectives in negotiating a PSC, generally an IOC will want to negotiate for itself as much control as possible over operations, and it will want any State intervention in the running of the project kept to a minimum. Naturally, it will be keen to keep its costs low, by negotiating favourable tax provisions and the ability to recover some (if not all) of its costs. The State's primary interests are financial; it wants to make the maximum profit possible and have access to an IOC's resources and relevant expertise, by expending minimal time and money. It will also want to ensure that the IOC is undertaking a sufficient work program (including meeting a minimum level of expenditure) and that the land is being used efficiently. The State may also have national economic considerations that it wishes to address; for example, it may want to ensure that domestic supply is met from any production of oil and/or gas. In addition, the State will typically be concerned to secure as many rights and benefits for the local community as possible, for example, jobs and training for local workers and access to medical care.

1.3 Why the PSC model?

The obvious advantage of the PSC model for the State is the minimal risk on its part; it is able to reap the benefits of its natural resources without having to spend its own time and money. In many cases, the State may not have the technology needed to explore for and produce oil and/or gas and so enlisting the help of an IOC who has the requisite technology is usually necessary in order for the State to exploit its natural resources.

Should exploration prove successful, the State can secure a long-term supply of oil and/or gas. The long term nature of PSCs enables States to predict future levels of oil and gas for domestic use and budget accordingly. Alternatively, the PSC model can be very financially lucrative for the State; it is often the case that it has the option of taking its share of production as a payment, rather than in kind. It is also very common for PSCs to provide that as production increases, the proportion attributable to the State also increases, meaning that a significant proportion of the value of profit oil is paid to it.

It is clear that the IOC, at least in the initial stages of an oil and/or gas project, is the party who bears substantially all of the financial risk. However, should exploration prove successful, the IOC should be able to recover its costs through cost oil (see paragraph 2.9) and share in the profits of the remaining quantity of oil and/or gas. In this regard, in theory at least, the PSC model is more favourable to the State than to IOCs in contrast to the concessions system. However, this of course depends entirely on the financial terms negotiated; it may be possible for an IOC to negotiate a PSC with more financially attractive terms for it than a concession may offer in neighbouring countries.

One possible negative aspect of the PSC model is that it is contractual; under the PSC model, the State always remains the owner of the resources, with the contract establishing the applicable compensation arrangements and level of NOC or State involvement in the asset. PSCs can allow States to provide a more extensive framework in respect of the relevant asset and, in general, they tend to afford IOCs less freedom to run an asset, with Contractors being subject to restrictions and required approvals in addition to those contained in the applicable legislation and regulation.

1.4 Alternatives

There are a number of alternatives to the PSC model. The differences in these alternatives lie mainly in relation to the level of control granted to the IOC, the level of involvement of the NOC, and the compensatory arrangements.

- (a) *Licence:* Under this arrangement, there is little scope for an IOC to negotiate tailored arrangements in relation to its exploration and production rights. Licensing regimes are typically standardised and embedded in legislation, such that the terms of each licence are near identical. This regime is most common in developed countries e.g. UK, Norway, the Netherlands, Australia. The IOC is typically granted complete control over the contract area and complete ownership over any oil and gas it successfully produces. Unlike PSCs, where ownership of the resources always remains with the State, in licence regimes ownership generally passes at the wellhead, with profits subject to general tax legislation.
- (b) *Concession:* A concession arrangement is generally subject to a greater level of negotiation than a licence. The IOC is typically granted proprietary rights over the contract area and complete ownership over any oil and gas it successfully produces, subject to the payment of a royalty and income tax (each of which may vary in rate depending on the level of production).
- (c) *Service contract:* Under a service contract, the IOC provides its technical services to the State to explore and develop oil and gas resources and so in many ways it is similar to a PSC. However, remuneration to the IOC is usually by way of a service fee or payments based on the value of oil produced. The term of a services contract is often very short, leaving an IOC with considerable risk and no guarantee of a long production period (although we note that services contracts may also be on a non-risk basis). Services contracts are common in Iran, Iraq and Kuwait and have also been used from time to time in Indonesia.

(d) *Joint venture:* This is not strictly an ‘alternative’ to the PSC model, but such an arrangement may be used in conjunction with a PSC, a concession or a service contract. In a joint venture, the IOC and the State jointly participate in the exploration and development of the resources. The State is therefore entitled to a share of the profits as a participant, in addition to the other financial benefits it would expect to receive (e.g. profit oil, royalties, taxes); accordingly, the State is required to contribute to the costs of operating and development, unless it takes a ‘carried’ interest (see paragraph 2.13 below for further detail). It has become common for the interests in such joint ventures to be split 51:49 in favour of the State.

2_Key terms review

A high degree of standardisation across PSCs is evident and a large number of model form agreements exist across jurisdictions in Africa, Central Asia and South-East Asia. Where this is the case, the model form has been used as a starting point or precedent, with modifications resulting from negotiations between the IOC and state concerned noted. The jurisdictions reviewed are set out in the ‘Key terms table’ on pages 22 to 25, which provides an indication, at a high level, of which key terms apply by jurisdiction.

This section provides a high level summary of the key terms common to PSCs, and an overview of the key legal issues arising from such provisions. When reviewing a PSC, it is important to consider not only the language in which the terms themselves have been framed, but also to consider what material terms might have been omitted.

Many of the key words and phrases are defined in detail in the ‘Glossary’ section beginning on page 26. For your reference, we have also included a number of sample clauses in Schedule 1 beginning on page 31. Please note that the sample clauses are taken from existing PSCs reviewed for the purpose of preparing this guide; as such, they are illustrative only and not recommended for use as precedent clauses or for use in any particular agreement.

2.1_Parties

The parties to a PSC will invariably be a NOC, a government or a Minister representing the State, on the one hand, and an IOC, as defined in paragraph 1.2 above, on the other. It is common for there to be a consortium of IOCs, who are collectively defined in the contract as “the Contractor”. In some countries, the State is also a party to the PSC in addition to the NOC.

For the avoidance of doubt, throughout this section we will refer to an IOC and a consortium of IOCs collectively as “the **Contractor**”, and the state entity or entities, whether the NOC, government or Minister representing the state as “the **State**”. The relationship between Contractors (typically governed by a joint operating agreement) is beyond the scope of this guide.

2.2_Start date

The parties’ obligations under a PSC generally commence on the “effective date”. This can be a fixed date, and in many jurisdictions it is defined as the date of execution of the agreement (e.g. Burma, Sudan); it can also be determined by the occurrence of a particular event, such as the date on which the contract is ratified by the State (e.g. Equatorial Guinea, Indonesia).

The effective date signifies the beginning of the exploration phase, and therefore indicates when the Contractor’s exploration obligations commence.

2.3 Term

The term of a PSC is divided into two consecutive phases: the “exploration phase” and the “production phase” (alternatively known as the “exploitation” or “development” phase). The Contractor undertakes exploration activities (including, for example, drilling and seismic surveys) and, should it discover any oil or gas that can be commercially exploited, it proceeds to the production phase, i.e. extraction of the discovered resources. The exploration phase commences on the effective date and the production phase commonly begins from the date of the declaration of a ‘commercial discovery’ (see paragraph 2.8).

The length of time for the initial exploration phase is usually around 10-12 years, which generally consists of an ‘initial’ exploration phase, followed by one or more extensions. To extend, the Contractor generally has to have fulfilled its contractual obligations up to that point and may be required to obtain approval from the State.

The production phase generally ranges from 20-30 years in duration, and there is usually an option to extend for a further period of 5-10 years. Sometimes further extensions are permitted, for example where the Contractor can demonstrate that commercial production is still possible (e.g. Mauritania).

An extension is generally permitted if the Contractor has been forced to suspend its activities, such extension being equal to the period of suspension.

The long life of the agreement reflects the substantial capital investment required to facilitate the operation of the project. There may be a degree of flexibility with respect to the contract duration to reflect the bargaining power of the Contractor party or parties (as the case may be). However, from our review of both model PSCs and negotiated PSCs, the duration tends to be of a similar length.

2.4 Minimum work obligations

The prescription of minimum work and expenditure commitments is a crucial element of a PSC. Given that it is possible that only a small number of commercial discoveries may be made, such obligations are key to ensuring that the Contractor invests time and money in exploring the relevant area and defining the extent of the Contractor’s exploration risk. The Contractor is generally obligated to perform a specific program of works, for example drilling a certain number of wells, and in doing so, to incur a minimum level of expenditure (which will be set out in the contract).

The Contractor is given a time period in which to fulfil these obligations. Where the Contractor fails to do so, it is usually required to pay the State the difference between the amount actually expended and the minimum expenditure commitment and such failure may give rise to termination rights (although where failure to comply occurs due to an event of force majeure, this is generally excluded). Conversely, if the Contractor exceeds its minimum work obligations during the ‘initial’ exploration phase, such excess work/expenditure can usually be credited against that required in any extended exploration phase (e.g. Angola, Vietnam).

2.5 Operations and control

Generally, the Contractor will be in charge of operations under the agreement; however, where the Contractor is a consortium of IOCs, one of the IOCs is usually appointed as the operator and carries out this role on behalf of itself and the other Contractor parties. The operator may be appointed by the Ministry (e.g. Angola), or the Contractor may have the right to appoint the operator subject to the State's prior approval (e.g. Timor-Leste). The remit of the operator is often set out in a separate agreement, known as a joint operating agreement (which will also govern the relationship more generally between the Contractor and the operator), which may be annexed to the contract. The operator's remit is generally very wide, and includes responsibility for the preparation of work programs and budgets, conducting research, appraisal and development operations, and maintaining the necessary insurance.

Another common feature of a PSC is a management committee (also known as an operating committee or a joint operating committee), which has responsibility for, amongst other things, coordinating and supervising the operations, reviewing and approving all work programs and budgets, and reviewing and approving proposals for surrender and relinquishment. Management committees are usually composed of representatives from the State and Contractor parties, with a chairman (typically a representative of the State) who may hold a casting vote (e.g. Angola, Timor- Leste).

The division of management and control between the Contractor, the operator and the management committee varies between countries, with the majority utilising all or a combination of the above. Of the contracts reviewed, some did not make reference to an operator or a management committee (e.g. Indonesia, Liberia, Mauritania); in these agreements, the Contractor retained responsibility for the conduct of the operations, subject to the approval of the State.

2.6 Work program and budgets

All operations carried out by the Contractor in relation to exploration and production will be in accordance with approved work programs and budgets. The Contractor (or operator, as the case may be) is usually obliged to prepare and submit such documents to the management committee and/or the State on an annual basis, which set out the minimum work program and expenditure commitments. Where a managing committee has been established it may have responsibility for approving the work programs and budgets instead of the operator.

An approved work program and budget can be revised by agreement between the State and the Contractor. In particular, it is common for a certain level of excess expenditure to be permitted without prior approval of the State. The Contractor may, if in any contract year it performs less work than required in that year, have the ability to carry forward any work not performed and add it to the work to be performed in future years, without prejudice to its rights and obligations under the contract (e.g. Indonesia).

2.7 Relinquishment

PSCs generally contain a relinquishment obligation, which requires the Contractor to surrender certain parts of the contract area to the State after a given period of time; these are typically areas that have not been exploited (and are not expected to be exploited). The time frame for relinquishment usually coincides with the end of the exploration phase and the area to be surrendered is defined as a percentage of the original contract area. In addition, there is often a requirement to relinquish the entire contract area by the end of the exploration phase; this excludes any areas on which a discovery has been declared or which are under appraisal. The rationale behind such a provision is efficiency; if there is little interest for petroleum exploration on a particular area, the Contractor should ‘discard’ that area and concentrate on those where there are such interests. In addition, it provides the Contractor with a powerful incentive to undertake preliminary work on the entire contract area. The Contractor is generally given the right to determine which areas it will relinquish.

The proportion subject to compulsory relinquishment varies across jurisdictions. Generally, of the contracts reviewed, if the Contractor extends the exploration period it must relinquish a minimum of 25 percent of the original contract area by the end of any ‘initial’ exploration phase, which increases to 50 percent by the end of the exploration phase. Throughout this period, the Contractor will continue to carry out the specified work program. In one sample (Indonesian) contract, relinquishment was compulsory if the Contractor did not conduct (and did not intend to conduct) exploration for a period of two consecutive years on any unexplored area.

An option usually exists for the Contractor to voluntarily relinquish any part of the contract area, which usually contributes to any mandatory relinquishment requirements. To exercise such a right, generally the Contractor must fulfil its obligations under the contract, for example, any minimum expenditure requirements (and if not, it may be required to pay any difference to the State (e.g. Angola, Burma)).

Following relinquishment, the Contractor will usually be obliged to remove its equipment, plant and machinery, and installations from the relinquished area.

2.8 Commercial discovery

Generally, the Contractor is obliged to inform the State promptly following any discovery of oil and/or gas. If the Contractor considers the discovery to be significant and worthy of appraisal, it will typically submit an appraisal work program to the State. Following completion of the appraisal program, which typically has to be completed within a set time frame, either the State or the Contractor determines whether the discovery is commercial. If a commercial discovery is declared, the Contractor will prepare a development plan and, once the management committee and/or the State has approved the plan, commence work on the area in question. In some jurisdictions, if commerciality cannot be established by the given deadline, the Contractor may be able to extend this period, either for a distinct period of time (e.g. in Libya, two years) or for such time as is sufficient for the Contractor to carry out the necessary appraisal work (e.g. Burma). If, following a discovery, the Contractor considers that it will not merit appraisal or, after appraisal, considers that it is not commercially viable, it may be required to relinquish the area concerned (e.g. Ghana, Sao Tome).

2.9_Cost recovery

Typically, the Contractor is entitled to recover its exploration and production costs from available oil production or gross revenues (known as **cost oil**). Recoverable costs are usually determined in accordance with ‘accounting procedures’ (which are generally annexed to the contract), and are deductible expenses for the purposes of calculating the Contractor’s taxable income.

The percentage of costs that can be recovered varies from country to country; it may extend to full recovery or, more commonly, will be restricted to a certain level. Of the contracts reviewed, typically the limit was between 40 percent (e.g. Tunisia) and 80 percent (e.g. Angola, Sao Tome) of available oil/gas per annum, with most at approximately 70-75 percent. In Burma and India, however, the recovery was as high as 100 percent (although subject to certain restrictions, e.g. quarterly caps, in Burma). However, variations were noticed within countries, which may reflect the bargaining power of the Contractor involved.

2.10_Production sharing

Profit oil is the predetermined allocation of oil remaining after payment of royalties and cost oil, which is shared between the State and the Contractor as detailed in the PSC. It is generally calculated quarterly based on the production of oil in barrels per day. Methods of calculation adopt typical valuation metrics, including rate of return (e.g. Angola, Sao Tome) and investment multiples (e.g. India). Commonly, the State’s allocation increases with the amount of oil or gas produced. The Contractor’s share of profit oil is usually subject to income tax.

2.11_Bonus/Taxation/Royalty

The Contractor is obliged to make a number of payments to the State during the contractual term, including those set out below. Generally, such payments are not recoverable from cost oil and are in addition to the Contractor’s minimum expenditure commitments.

(a) Bonus

A number of bonuses are typically required to be paid by a Contractor under a PSC. A signature bonus is a one-off lump sum paid by the Contractor upon signing of the PSC. In the contracts examined, this ranged from US\$200,000 in Cambodia, to US\$15 million in Burma. A production bonus is a sum the Contractor must pay when production reaches a certain level of output. Commonly the contract specifies a series of production bonuses to be paid on a sliding scale. For example, in Equatorial Guinea, the production bonus increased from US\$1 million at the beginning of production to US\$15 million when production reached 100,000 barrels per day for 60 consecutive working days. Other jurisdictions (e.g. Indonesia, Liberia) took a similar approach.

Please see paragraph 1 of Schedule 1 for sample bonus clauses taken from an existing PSC reviewed.

(b) Taxation

The Contractor is typically required to pay various taxes in accordance with the applicable laws of the jurisdiction, including income tax, export tax and duties, import duties, and stamp duty.

The basis upon which income tax is calculated varies between jurisdictions, depending on the domestic income tax regime. In some contracts specific reference is made to the percentage of tax payable (e.g. Cambodia, Mauritania), and some have extensive tax provisions (e.g. Liberia). In some jurisdictions, the Contractor is given the benefit of certain exemptions from the tax regime, for example, the salaries and benefits of expatriate employees of the Contractor being exempt from personal income tax (e.g. Ethiopia), the Contractor being exempt from income tax for its share of production sharing oil (provided it reports annually to the tax authorities regarding its gross revenues) (e.g. Mongolia) and tax ‘holidays’ (i.e. exemptions from payment of certain taxes for three years starting with the year of commencement of production) (e.g. Burma).

Please see paragraphs 2 and 3 of Schedule 1 for sample tax clauses taken from existing PSCs reviewed.

(c) Royalty

Royalties are payable by the Contractor to reflect its usage and exploitation of the State’s property and are typically agreed upon as a percentage of the amount or value of available oil and/or gas from the contract area. Adjustments may be made to the percentage to account for any transportation costs from the delivery point to the point of export (e.g. Burma). The State may also have an option to take payment in kind (e.g. Burma, Equatorial Guinea).

The rate may be dependent upon a number of factors such as the contract area, the size of the project, and the bargaining power of the Contractor. Our review reflected a range of between 7 and 17 percent levied on the total production of oil and/or gas. Variations are evident in some jurisdictions; for example, royalties only payable when production exceeds a certain output (e.g. Morocco), or a sliding scale of royalties based on daily total disposable production (e.g. Equatorial Guinea).

Royalties are generally allowed as a deductible expense in calculating the Contractor’s income for tax purposes.

Please see paragraph 4 of Schedule 1 for a sample royalty clause taken from an existing PSC reviewed.

2.12 Valuation

Valuation methods in relation to sales of the oil/gas by the Contractor (on its own and the State’s behalf) to third parties differ depending on whether the sale is on arms’ length commercial terms. In the case of arms’ length transactions, the market price is generally the free on board (the **FOB**) market price at the delivery point or the actual price received by each party during a particular quarter for sales

of similar oil. This is usually adjusted to accommodate differences in quality, terms of delivery, transportation and payment (e.g. China), and may exclude certain kinds of transactions, for example, sales to the State (e.g. Mauritania). In the case of non-arms' length transactions, the market price is generally the 'fair and reasonable' market price (e.g. Timor-Leste), the prevailing market price (e.g. Cambodia), or the world market price (e.g. Ghana, Libya). In calculating such price, the State may be required to consult industry publications such as Platts Crude Oil Market Wire. The market price is generally calculated on a quarterly basis. If the market prices fluctuates within a quarter, the State and the Contractor may have the right to negotiate a new market price (e.g. China).

The calculations for gas are generally divided in a similar way; however, in the case of non-arms' length transactions, we saw many examples of the price being set by the State in accordance with the applicable law.

2.13_Participating interests

These are the interests held by the respective participants in the venture. The State will generally have an option to participate as a contractor within the framework of the overall PSC; however, generally the Contractor 'carries' the State's interest, which means that it bears all of the exploration costs. Should a field be declared commercial, the State can typically elect to convert its carried participation interest into a full working interest. In return, the State agrees to reimburse the Contractor for the costs it has incurred up to that point in operations, in proportion to the State's acquired percentage. Any bonuses paid up to that point may also be reimbursed in proportion to the State's acquired percentage (e.g. Burma). From the sample of documents reviewed, the largest carried interest was 25 percent (e.g. Tanzania). In Equatorial Guinea, the State has the right to acquire an additional 25 percent interest if a commercial discovery is made (in addition to its 20 percent carried participation interest), bringing its total participation interest in the field concerned to 45 percent.

2.14_Community development

Such provisions can be quite extensive, and usually provide for the Contractor to employ local citizens and contractors where possible and to provide and/or contribute financially to various training schemes and schooling for local workers. Expenditures vary from one-off lump sums to annual payments and in general such costs are classified as recoverable expenditures and are tax deductible. The Contractor can typically only employ foreign personnel, contractors or materials if it has exhausted all local possibilities and there are no adequate local equivalents or if foreign personnel, contractors or materials are significantly cheaper.

In terms of employment, most jurisdictions require the Contractor to make the employment of local personnel 'top priority' (e.g. Equatorial Guinea). In terms of training, the Burmese model PSC is extensive, requiring minimum expenditure on sending qualified nationals to selected universities and others to higher learning courses. In Equatorial Guinea and India, the Contractor is required to provide access to medical attention and nursing care to local personnel, as well as other accommodation and living allowances.

Given the lengthy duration of PSCs, these obligations can be significant. As they appeared in all contracts reviewed, inclusion is likely non-negotiable. However, there may be scope for negotiation in terms of the level of obligation required.

2.15_National economic interest

Many PSCs oblige the Contractor to give preference to local suppliers, provided the local services and materials are competitive in performance, price, quality, and availability, to foreign equivalents. In Liberia, the Contractor is obliged to give preference to goods from Liberia when the value of such goods is less than US\$200,000. If the value is greater, the Contractor does not have to give preference to a Liberian contractor; however, if it chooses not to, the non-Liberian contractor is obliged to enter into a partnership arrangement with a Liberian company to perform the relevant services.

The majority of PSCs also contain an obligation for the Contractor to supply oil and/or gas to the domestic market, subject to existing sales commitments. In certain cases this obligation only arises when the State is unable meet demand itself (e.g. Mauritania); however, often the provision is drafted in such a way that the State has the flexibility to order the Contractor to supply it (e.g. Cambodia). Such clauses vary as to the amount of oil and/or gas that the Contractor is obliged to supply; either a defined proportion, or until domestic demand is satisfied. The clause will normally provide for the Contractor to be compensated for the oil and/or gas at the market price (see section 2.12), although there may be provision for the Contractor to be compensated at a specified discount to market price (e.g. Burma).

2.16_Currency exchange control

Around half of the contracts reviewed contained currency exchange control provisions. These provisions generally grant the Contractor a number of rights in relation to payments and currency exchange, including a right to make a payment in the currency of the State concerned or any foreign currency, to freely convert funds, to pay foreign employees in foreign currency, and to remit proceeds from petroleum sales abroad. It is often a prerequisite that the Contractor complies with all applicable exchange control laws or has met all of its payment and tax obligations. A number of countries provide that foreign exchange costs are not recoverable under the contract (e.g. Cambodia, Libya, Timor-Leste).

2.17_Stabilisation

Stabilisation clauses address the Contractor's concerns that the State may, following signing, implement measures that adversely affect the Contractor's commercial and/or financial position under the contract, for example, amending the tax regime, by seeking to maintain the stability of the terms originally agreed. The inclusion of a stabilisation clause seeks to protect the Contractor, as it controls the State's ability to materially alter the original terms agreed upon and may also ensure that where the State does do so, the Contractor is adequately compensated.

Such clauses generally take one of two forms: in the event that any change in the laws, regulations or policies of the State adversely affect the Contractor's rights, obligations and/or benefits under the contract, either:

- the parties must agree to amend the contract to ensure the Contractor is in no worse a position than before (e.g. Angola, Cambodia); or
- the new laws, regulations or policies do not apply to the contract and so the Contractor's position in relation to those areas does not change, i.e. an automatic disapplication of the new laws to the agreement (e.g. Tunisia). This is generally much less common than the alternative detailed above.

However, if the Contractor benefits from such a change, for example, from a more favourable tax regime, the Contractor is generally permitted to take advantage of such benefit (e.g. Equatorial Guinea, Vietnam).

2.18 Title to assets

It is usual for title to all movable and fixed assets acquired by the Contractor during the course of the operations to vest in the State, with the Contractor only retaining the right to use the assets in the course of operations. In some jurisdictions, the Contractor is not required to pay for this privilege (e.g. Ghana); in others there may be a further charge for use of the assets going forward (e.g. Equatorial Guinea). The Contractor is generally permitted to recover the costs expended in acquiring such assets.

There are a variety of ways in which title to such assets can pass to the State. The most common methods appear to be:

- title passing automatically upon purchase in, or importation into, the country (e.g. Angola, Indonesia);
- title passing by the Contractor notifying the State that it no longer requires the assets, and the State electing to acquire the assets at no cost (e.g. Cambodia);
- title passing when the Contractor fully recovers the costs of acquiring such assets (e.g. Tunisia, Vietnam);
- title passing on the State requesting the Contractor to transfer the title (e.g. India); and
- title passing on the termination of the agreement and the State requesting such transfer (e.g. Timor-Leste).

Any income from the sale of such assets also usually belongs to the State.

To avoid such a pitfall, Contractors often use subcontractors to carry out various activities and, where possible, lease, rather than purchase, equipment and installation.

In addition, all data and technical information is generally considered to be the sole property of the State. In some jurisdictions, the Contractor is required to pay a fee for use of certain data (e.g. Burma).

2.19_Force majeure risk

Force majeure provisions are often included in PSCs to provide for events or circumstances beyond the control of either party, which cause a party to fail to meet its obligations (other than a payment obligation) under the PSC. In such circumstances, the party concerned is relieved from liability. The party claiming an event of force majeure is often required to use reasonable efforts to remove the causes of non-performance and to complete performance as promptly as possible.

The term “force majeure” is an area of key negotiation between the parties, and as such it is important for the term to be defined with accuracy and detail. Having said that, force majeure provisions usually include common features, such as:

- a detailed definition of a force majeure event;
- the obligations surrounding a force majeure event: these usually require the party claiming force majeure to serve notice to the other party and use all reasonable efforts to correct the situation as promptly as possible;
- examples of events which constitute a force majeure event: this is usually a standard list and may be exhaustive or non-exhaustive; however, some jurisdictions have a broader list of examples than others; and
- a specific list of events which will not constitute a force majeure event: for example, in the majority of the contracts reviewed, an obligation to pay money under the contract was excluded from the definition of a force majeure event.

Another common feature of force majeure clauses is provision for the term of the agreement to be extended by the length of time that the force majeure event delays the operations.

Please see paragraph 5 of Schedule 1 for a sample force majeure clause taken from an existing PSC reviewed.

2.20_Indemnities and liabilities

A PSC may not explicitly outline the allocation of liability between parties with respect to loss or damage to each party's personal property or interests arising from activities contemplated under the PSC. Where this is the case, liability will be allocated according to the laws governing the agreement. In the PSCs reviewed, the regimes set out in the indemnities and/or liability provisions are fairly standard. Generally, the indemnity provisions reflect a “fault based” approach, providing for the Contractor to indemnify the State against all loss, damages, claims or legal action caused by or resulting from the operations conducted by the Contractor. Variations on this provision include disapplying the benefit of an indemnity where the Contractor commits gross negligence or wilful misconduct (e.g. Ghana, Sao Tome) and restricting its application to the exploration phase (e.g. Libya). In some PSCs, the State may indemnify the Contractor against loss (e.g. Angola), although this is less common.

Similarly, in the PSCs that include liability provisions, such clauses generally provide that the Contractor is liable for loss and damage caused during the conduct of operations to the State and/or third parties. The variations on this centre around whether the Contractor must have committed gross negligence or wilful misconduct for liability to arise; in some jurisdictions, it does (e.g. Libya and Vietnam), whereas others do not specify such a requirement (e.g. Angola, Equatorial Guinea).

We note that a number of contracts provide for joint and several liability as between the entities constituting the Contractor, where applicable (e.g. Cambodia, Morocco, Sudan).

2.21 Assignment

Typically, PSCs permit the Contractor to assign part or all of its rights and obligations under the agreement to an affiliate or non-affiliate, with or without prior authorisation of the State. Assignment to an affiliate can be made without obtaining the State's consent in a number of jurisdictions (e.g. Angola, Liberia, Tanzania). The State is generally permitted to assign its rights and obligations under the agreement without obtaining prior consent of the Contractor (e.g. China, Libya). In addition, the State is commonly granted a pre-emptive right to acquire any participating interest being transferred by the Contractor (e.g. Equatorial Guinea, Vietnam).

Conditions may be attached to an assignment; the extent of such conditions vary across jurisdictions. Typically, the assignment clause sets out criteria an assignee must meet (for example, having adequate technical and financial capability), as well as stipulating that the Contractor must have met its obligations under the contract prior to the date of assignment (e.g. Morocco). In some countries, an assignment is subject to the payment of a bonus by the Contractor (e.g. Equatorial Guinea, Sudan).

The rationale for such provisions is the concern of states to minimise disruption to operations and ensure that the assignee is of the same financial standing and/or technical ability as the assigning Contractor party.

2.22 Security

The Contractor's performance of its minimum work obligations and payment of its minimum expenditure commitments may be secured by way of a guarantee. The guarantee is generally adjusted on an annual basis to account for monies expended by the Contractor during that year, or may be increased if the exploration phase is extended. The form of the guarantee the Contractor is required to enter into is often appended to the contract.

In India, in addition to a guarantee, a legal opinion is required to the effect that the guarantee has been duly signed and delivered on behalf of the guarantor(s).

One sample (Chinese) PSC enabled the Contractor to use its entitlement to its share of oil and gas production under the contract as security for finance, provided that the Contractor's application for the loan in question was provided to the State in advance of the application being submitted to the relevant financial institution.

2.23 Environment

Another common provision is to require the Contractor to take necessary and adequate steps to ensure operations are conducted in compliance with environmental laws and regulations. The extent of this obligation varies across jurisdictions; however, the Contractor is generally required to:

- abide by all laws, regulations etc to protect the environment;
- take reasonable measures to protect and minimise damage to the environment;
- produce an environmental impact assessment plan;
- clean up following any damage caused (in general, costs associated with this are not recoverable; however, in some jurisdictions this is only the case where pollution results directly from gross negligence and/or wilful misconduct (e.g. Cambodia, Ghana)); and
- take reasonable efforts to restore the area upon relinquishment and/or abandonment.

Certain PSCs provide for the State to take actions to clean up or make good any damage caused where the Contractor fails to do so. In this situation, the costs are ultimately borne by the Contractor (e.g. Tanzania, Timor-Leste). New and changing legislation in this area in many jurisdictions means that environmental issues are likely to be increasingly important for states and Contractors in the future.

2.24 Termination

A PSC will generally end as a consequence of the natural expiry of the contract term or because an event has arisen which entitles a party to terminate under the PSC and the party has exercised that right.

In addition to natural expiry, the contract will set out several events or circumstances giving rise to a termination right, which are usually in favour of the State. Such events may include:

- failure of the Contractor to discover any oil or gas within the contract area prior to expiration of the exploration phase;
- default of the Contractor in the performance of its obligations under the agreement (this may be restricted to material obligations);
- failure to make any payment required under the contract;
- an insolvency event;
- failure to fulfil minimum work obligations; or
- interruption of production for a defined number of consecutive days.

The Contractor is usually given a period in which to remedy the default. If a termination event is caused by force majeure, neither occurrence of the termination event nor its unremedied continuance (for a specified period) will result in termination.

The Contractor's powers to terminate are commonly much less extensive than the above. Such rights usually enable the Contractor to terminate at the end of the 'initial' exploration phase or any subsequent extension phases. In some contracts, the Contractor can terminate upon giving notice to the State (e.g. Ethiopia, India); however, this is usually conditional upon the Contractor having satisfied its minimum expenditure requirements.

It is common to find provision for automatic termination at end of the 'initial' exploration phase or extensions thereof if no commercial discovery has been made, or where the Contractor has relinquished the entirety of the contract area; this again is usually conditional upon the Contractor having satisfied its minimum expenditure requirements.

2.25 Confidentiality

A typical confidentiality clause in a PSC provides for a party to obtain prior consent of the other before it can disclose "confidential information" to a third party; this is generally defined to include all data, information and reports relating to petroleum operations. The clause will then provide for a list of permitted disclosees, to whom a party can disclose confidential information without the need to obtain prior consent. This varies between jurisdictions but usually includes affiliates, potential assignees, banks, consultants and employees, who generally must also undertake to maintain confidentiality of the information.

In some countries, the standard is lower, with the Contractor only required to use its best endeavours to ensure affiliates observe confidentiality (e.g. Sao Tome); others require formal confidentiality agreements to be signed between the party seeking to disclose and the permitted disclosee (e.g. Libya).

The provision will generally contain a long-stop date, after which the confidentiality obligations will cease to exist. In the sample of documents reviewed, these range from two years following termination of the contract (e.g. Cambodia, Equatorial Guinea) to ten years (e.g. Angola, Sudan).

In the majority of contracts reviewed, the definition of "confidential information" does not include the contract itself; however, in a number of jurisdictions it is expressly stated that the contract itself is a confidential document (e.g. Angola, Cambodia, China, Equatorial Guinea, Vietnam) and therefore it cannot be disclosed by a party without prior consent of the other party.

Please see paragraph 6 of Schedule 1 for a sample confidentiality clause taken from an existing PSC reviewed.

2.26 Governing law and dispute resolution

The governing law is typically the law of the jurisdiction concerned, although some jurisdictions adopt the laws of England and Wales as an international standard (eg Timor-Leste).

In the case of a dispute arising between the parties, generally the contracts provide for the parties to attempt to amicably resolve the dispute between themselves, with arbitration or expert determination as a last resort when such discussions have failed. In around half of the contracts

reviewed, the parties are required to attempt to amicably resolve the dispute for a certain period of time (typically three months) before they resort to arbitration or expert determination (eg Equatorial Guinea, Liberia, Vietnam).

Arbitration is a proceeding whereby a dispute is resolved by one or more impartial adjudicators and a legally binding and enforceable decision is imposed upon the parties to the dispute, although a concern for a Contractor could be whether it will receive a fair hearing where the counterparty to an arbitration is a state. Arbitration is commonly used for the resolution of commercial disputes, and a number of international bodies, for example, the International Chamber of Commerce (**ICC**) and the United Nations Commission on International Trade Law (**UNCITRAL**), have established rules governing arbitration procedures and established institutions to administer and oversee arbitration matters. The contracts reviewed typically contemplate using an international arbitration forum, such as the International Court of Arbitration, the London Court of International Arbitration or the Singapore International Arbitration Centre. An issue for a Contractor to consider in relation to arbitration are the rules relating to enforcement of arbitral awards. The 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the **New York Convention**) is one of the key instruments in international arbitration which, broadly, requires courts of contracting states to give effect to private agreements to arbitrate and to recognize and enforce arbitration awards made in other contracting states. A large number of countries in Africa, Central Asia and South-East Asia have adopted the New York Convention.

In contrast, in expert determination the parties agree to be bound by the decision of an independent third party (i.e. an expert). It is often the quickest and most effective way of solving disputes of a technical nature or disputes which are relatively simple in terms of content. The parties will generally agree the remit of the expert and the procedures that are to be followed.

An issue to consider in relation to dispute resolution more generally is the enforceability of orders made against a state. In some jurisdictions the state may have sovereign immunity, which may make it difficult for a Contractor to bring a suit against it or to enforce an award granted in the Contractor's favour. In some jurisdictions, such immunity is expressly waived in respect of the enforcement and execution of any award rendered by an arbitral tribunal under the contract (e.g. Angola, Ghana, Libya, Timor-Leste).

Please see paragraph 7 of Schedule 1 for a sample dispute resolution clause taken from an existing PSC reviewed.

2.27_Anti-bribery/corruption

Provisions relating to anti-bribery and/or corruption are not commonly seen in PSCs, although we note that this is a developing body of law internationally, with extensive and far-reaching legislation being introduced relatively recently, for example in the UK and the US. Where such provisions are included, these are generally quite extensive, requiring the Contractor to warrant that it has not made and will not make any gift or reward to any officials or employees of the State to induce or reward such persons for any acts taken in accordance with their duties.



3_Key terms table

The following table provides an indication, at a high level, of which key terms apply in PSCs by jurisdiction.

Country/ Clause	Term	Financial obligations (Contractor)	Work programme and budget	Relinquishment	Operator	Cost recovery	Commercial discovery	Participating interests	Environment	Stabilisation	Assignment/ withdrawal
1. Angola	✓	Royalty ✓ Bonus ✓ Taxation ✗	✓	✓	✓	✓	✓	✓	✗	✗	✓
2. Burma	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✗	✓	✓	✓	✓	✗	✓
3. Cambodia	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✗	✓	✓	✓
4. China	✓	Royalty ✓ Bonus ✗ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
5. Equatorial Guinea	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
6. Ethiopia	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✗	✓
7. Ghana	✓	Royalty ✓ Bonus ✗ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
8. India	✓	Royalty ✓ Bonus ✗ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
9. Indonesia	✓	Royalty ✗ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
10. Liberia	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✗	✓	✓	✓	✓	✓	✓
11. Libya	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✗	✓	✓	✓	✓	✓	✗	✓

	Change of control																																						
	Termination			Expropriation			Liability			Force majeure			Indemnities			Currency exchange control			National economic interest			Community development			Valuation			Security			Confidentiality			Governing law/ dispute resolution			Anti-bribery/ corruption		
x	✓	x	x	✓	x	✓	✓	x	✓	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x												
x	✓	x	x	x	x	✓	✓	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓												
x	✓	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x													
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✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x													
x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x													
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x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x													
x	✓	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	x													

Country/ Clause	Term	Financial obligations (Contractor)	Work programme and budget	Relinquishment	Operator	Cost recovery	Commercial discovery	Participating interests	Environment	Stabilisation	Assignment/ withdrawal
12. Mauritania	✓	Royalty ✗ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
13. Mongolia	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✗	✓	✓	✗	✓	✗	✓
14. Morocco	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✗	✗	✗	✓	✓	✓	✓
15. Mozambique	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
16. Sao Tome and Principe	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
17. Sudan	✓	Royalty ✗ Bonus ✓ Taxation ✗	✓	✓	✗	✓	✓	✗	✓	✓	✓
18. Tanzania	✓	Royalty ✓ Bonus ✗ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✗	✓
19. Timor-Leste	✓	Royalty ✗ Bonus ✗ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✗	✓
20. Tunisia	✓	Royalty ✗ Bonus ✗ Taxation ✗	✓	✓	✓	✓	✓	✓	✓	✓	✓
21. Vietnam	✓	Royalty ✓ Bonus ✓ Taxation ✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Change of control	Termination	Expropriation	Liability	Force majeure	Indemnities	Currency exchange Control	National economic interest	Community development	Valuation	Security	Confidentiality	Governing law/ dispute resolution	Anti-bribery/ corruption
✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗
✗	✓	✗	✗	✓	✓	✓	✓	✓	✓	✗	✓	✓	✗
✗	✓	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✗
✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✗
✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗
✗	✓	✗	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	✗
✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
✗	✓	✗	✓	✓	✗	✓	✓	✓	✓	✗	✓	✓	✗
✗	✓	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✗
✗	✓	✗	✓	✓	✗	✓	✓	✓	✓	✗	✓	✓	✗

4_Glossary

Affiliate: two parties are affiliates if either party has the power to control the other, or a third party controls both. Affiliates may be subject to more strenuous legal requirements than two unconnected parties.

Alternative Dispute Resolution: a process for resolving disputes between parties, often in lieu of or prior to litigation. Often the initial step involves elevating the dispute to senior management to negotiate a resolution and, if that fails, with an arbitration or expert determination mechanism to follow. Parties include a dispute resolution clause in contracts to define how a disagreement is to be resolved. Arbitration is more common than other forms of dispute resolution in an oil and gas context. See also: Arbitration, ICC.

Arbitration: a proceeding often held in an attempt to avoid litigation and conducted by a person or panel of people, who are not judges, in a neutral forum. Arbitration awards are generally enforceable internationally and parties can draft arbitration clauses into their contracts to specify the rules of the proceeding.

Arms' Length Transaction: a transaction where a willing (but not anxious) seller and buyer, with no prior relationship, act independently to reach an agreement. It is important for a transaction to be at arms' length to demonstrate that price and other requirements are fair and representative of transactions of a similar type in the market and are not 'friendly' transactions to, for example, avoid tax.

Assignment: the transfer of one party's rights or property to another (in order for obligations to be transferred, the consent of the other contracting party may be required).

Capital Expenditure: the amount of money required to purchase the plant and equipment required for the project, for preliminary development and for working capital.

Change of Control: where one company is acquired by another, or when an existing or new shareholder acquires a majority shareholding.

Commercial Discovery: the discovery of oil or gas of a sufficient quantity to make any potential production potentially profitable.

Concession: the grant of exclusive privileges by the state or a controlling authority. In the context of oil and gas contracts, it specifically refers to a grant of the rights to the oil and gas resources themselves, together with a right to enter the land or offshore area to obtain them, on which the oil and gas company carries out a commercial undertaking and pays rent and usually a royalty to the granting authority.

Contractor: the person or company who signs the contract to perform specified obligations. In the oil and gas industry, the contractor is typically an experienced oil and gas company, who may then sub-contract to others certain aspects of the work.

Cost Oil: a proportion of product or revenue from which the Contractor can recover its costs.

Delivery Point: the location where the commodity will be delivered. Due to transportation costs, the chosen location will have an effect on the net cost. Thus, in order to specify a single contractual price, the delivery point is an essential detail.

Downstream: the oil and gas industry is divided broadly into upstream and downstream sectors. Downstream refers to the refining and sale of hydrocarbon products. Participants in the downstream sector include refineries, petrochemical plants, retail outlets and gas distribution companies. See also: Upstream.

Exploration: the search to identify areas that may warrant examination of areas for oil and gas discoveries, including geological, geophysical and topographical surveys and drilling exploratory wells. The aim of exploration is the discovery of commercial deposits.

Expropriation: compulsory seizure of private property by, or compulsory surrender of private property to, a government authority, ostensibly for the public benefit.

Fair Market Value: the price a willing buyer would pay a willing seller for a given property or asset, provided both parties are unrelated, know the relevant facts and are under no compulsion to participate in the transaction. Given these conditions, fair market value should be an accurate representation of an asset's worth.

FOB Price: the free on board price. The FOB Price means the costs associated with delivery, inspection and loading involved in putting crude oil, refined products or LNG on a tanker at a seller's facilities which are included in the agreed price. The buyer pays all additional costs to transport and unload the cargo.

Force Majeure: a force majeure clause removes liability for unavoidable catastrophes that occur without default of either party and produce a fundamentally different situation to that contemplated by the parties when entering the contract, rendering obligations incapable of being performed. For example, natural disasters, war, blockades and riots are often considered force majeure events, and liability is suspended for the duration of the event.

Governing Law: the law chosen by the parties to apply to the contract and any dispute arising from it.

Guarantee: a written promise to pay another party's debt or perform their contractual obligations if that party fails to pay or perform.

Hydrocarbons: all natural organic substances composed of carbon and hydrogen, regardless of composition. This includes crude oil and natural gas.

ICC: the International Chamber of Commerce. The ICC's International Court of Arbitration (the **Court**) is one institution administering arbitration, and parties may elect to have disputes governed by it, the ICC Rules of Arbitration (the **Rules**) or both. Originally established in Paris, the Court primarily ensures the Rules are correctly applied. The Court also has oversight powers, including appointment of arbitrators, review of awards and fixing tribunal fees. Other well known arbitral bodies include the London Court of International Arbitration and the Singapore International Arbitration Centre.

Indemnity: an undertaking to compensate for or provide protection against damage, loss or liability. In a contractual relationship, the concept of indemnity can arise where one party agrees to pay for the potential losses of the other, or to protect themselves from liability arising from such losses.

Insolvency/Act of Insolvency: insolvency means being unable to pay debts when they are due. Acts of insolvency sufficient to enable termination of a contract generally include compulsory or voluntary liquidation, arrangements with creditors for assignment and the appointment of an administrator.

IOC: an International Oil Company. An IOC is a company contracted by a state under a PSC to provide the finance and technical skills necessary to explore for and produce oil and gas.

Joint Operating Agreement: an agreement entered into between two or more participants to share the risk and expense of oil and gas exploration and production and to govern the operation of the oil and gas asset(s).

Liability: legal responsibility for the consequences of one's acts or omissions, enforceable by civil remedy or criminal punishment.

Management/Operating Committee: a committee of representatives of the participants under a PSC or a Joint Operating Agreement formed to supervise management and/or operation of the project.

Material Breach: a substantial failure in the performance of a contract, typically a breach of a material term. An insignificant divergence from the terms of the contract will generally not be considered a material breach. See also: Material Term.

Material Term: an essential term of a contract. A term may be expressly designated as 'material' by the parties or such intention may be objectively inferred by a court, considering whether the promise is of such importance that the relevant party would not have entered the contract unless assured of its substantial performance. Material terms often include a description of the product, the price, the quantity and the delivery date.

Natural Gas: any hydrocarbon substance which is in a gaseous form at atmospheric temperature and pressure. The exact composition varies with locality.

NOC: a National Oil Company. A NOC is a company that represents the relevant state or government body, and may take delivery of the state's share of production.

OPEC: the Organization of Petroleum Exporting Countries. OPEC is an intergovernmental organisation comprising twelve oil-producing countries, predominantly Middle Eastern and South American countries, who currently control 79 percent of global crude oil reserves. It aims to ensure the stabilisation of international oil prices, giving regard to the interests of producing nations, and at one point effectively controlled oil production and prices. Its ability to determine the price of oil has relatively diminished, due to discovery and development of large oil reserves in Alaska, the North Sea, Canada, the Gulf of Mexico and Russia.

Operator: the entity responsible for managing the day to day operation of the oil and gas exploration and development.

Petroleum: a generic term applying to liquid petroleum (crude oil) and all other hydrocarbons that may be found in a solid, liquid or gaseous state.

Platts Crude Oil Market Wire: a daily online intelligence report containing information on crude oil price spreads, crude oil forwards, trade updates, industry commentary and futures settlement prices.

Possible Reserve: a possible oil and gas reserve has a 10 percent chance of being recoverable under existing technical and economic conditions. Also referred to as “3p”, meaning “proven plus probable plus possible”.

Probable Reserve: a probable oil and gas reserve typically has a 50 percent chance of being recoverable under existing technical and economic conditions. Also referred to as “2p”, meaning “proven plus probable”.

Production: the commercial exploitation of oil and gas found in an authorised contract area, specifically the operation that brings hydrocarbons to the surface and prepares them for processing, but more generally may be considered to include all incidental activities, including the design, construction, installation, operation and maintenance of any plant and infrastructure and the processing, stockpiling, transportation, export and sale of products. This phase may also be referred to as exploitation or development.

Profit Oil: the amount of product remaining after a pre-determined percentage has been deducted for cost recovery. This amount is then divided between the participating parties under the production sharing contract.

Proven Reserve: a proven oil and gas reserve has a reasonable certainty (generally at least 90 percent certainty) of being recoverable under existing technical and economic conditions. Also known as “1p”.

PSC: a Production Sharing Contract. A PSC is a widely-used agreement between a state and an oil company, which enables the company to explore and develop oil and gas reservoirs within a specified area in return for performance of specific obligations, including payment of royalties and tax.

Reporting Standards: these are minimum standards for classification and reporting of petroleum deposits based on their geologic certainty and economic value. Petroleum deposits are generally classified as Proven Reserves (1p), Probable Reserves (2p) and Possible Reserves (3p). The most widely used international standard is the Society of Petroleum Engineers’ (**SPE**) Petroleum Resources Management System (**SPE-PRMS**). In the last two decades there has been a consolidation of reserve standards; for example, the PMRS is now sponsored by the SPE, the World Petroleum Council, the Society Of Petroleum Evaluation Engineers and the American Association of Petroleum Geologists. From 2010, the Securities and Exchange Commission in the USA has adopted the SPE-PRMS principles within its regulatory framework.

Royalty: a payment by an oil and gas company to the state to reflect the grant of the rights to the oil and gas resources. It is commonly a fractional share of the amount or value of available oil and/or gas from the contract area. In the oil and gas context, a royalty is often, at the state’s election, taken ‘in kind’ (that is, a share of production) or by way of a payment equivalent to the sale price of the state’s royalty share of production.

Sovereign Immunity: the legal doctrine that a state cannot be sued without its consent. The extent a state is immune within its own jurisdiction varies according to country, while principles of international law exempt states from legal proceedings in another country. However, if states are acting as contracting bodies, sovereign immunity may not be available in an international or foreign court. In addition, a state may elect to waive this immunity when negotiating a contract.

Stabilisation: in the context of resources contracts, a stabilisation clause seeks to address a party's concerns that the state may, in future, reverse policies upon which the agreement was entered into; for example, the petroleum laws or taxation regime. The clause attempts to maintain the original contract equilibrium.

Subsidiary: an enterprise controlled by another (called the parent). Generally this relationship exists where one company can appoint or remove another company's directors, where one company can cast more than 50 percent of the maximum number of votes at a general meeting of another company or where one company holds more than 50 percent of the issued capital of another company.

Upstream: refers to the exploration, recovery and production of hydrocarbon products. It includes the search for potential reservoirs and drilling and operating exploratory wells. See also: Downstream.

UNCITRAL: the United Nations Commission on International Trade Law. A commission sponsored by the UN and established in 1966, UNCITRAL meets annually to discuss issues regarding international trade law. It published the 1985 Model Law on International Commercial Arbitration and adopted its Arbitration Rules (the **Rules**) in 1976. The Rules provide for ad hoc arbitration, as UNCITRAL does not provide administrative services. Parties should therefore consider designating an arbitral institution to act as an administering authority when electing to have the Rules apply in the event of a dispute.

Waiver: the expressed or implied intentional and voluntary giving up of a legal advantage, claim, requirement or right. In essence, a waiver removes a real or potential liability for a party under the agreement.

Withholding Tax: income tax deductions on dividends and salaries. Withholding taxes are collected at the point of income disbursement and are paid directly to the state by the collecting entity.

Work Program and Budget: means a work program and budget for the conduct of operations, including the minimum work obligations and details of any proposed wells, which may be subject to approval by the Management/Operating Committee.

Schedule 1 – Example clauses

1_Bonus (Equatorial Guinea)

Model Production Sharing Contract between the Republic of Equatorial Guinea, Guinea Ecuatorial de Petroleos (the NOC) and the Contractor

11.1_Signature Bonus

The Contractor shall pay to the State a signature bonus of [●] Dollars (\$[●]) within thirty (30) days of the Effective Date.

11.2_Discovery Bonus

On the date the Contractor notifies the Ministry for the first time that it deems a Discovery to be a Commercial Discovery in compliance with the provisions of Article [●], the Contractor shall pay to the State the sum of [●] Dollars (\$[●]).

11.3_Production Bonuses

The Contractor shall pay to the State the following sums as Production bonuses:

- (a) on the start date of Production of Crude Oil from a Development and Production Area, [●] Dollars (\$[●]);
- (b) [●] Dollars (\$[●]) after daily Production from a Development and Production Area first averages [●] Barrels per day for a period of sixty (60) consecutive days;
- (c) [●] Dollars (\$[●]) after daily Production from a Development and Production Area first averages [●] Barrels per day for a period of sixty (60) consecutive days;
- (d) [●] Dollars (\$[●]) after daily Production from a Development and Production Area first averages [●] Barrels per day for a period of sixty (60) consecutive days; and
- (e) [●] Dollars (\$[●]) after daily Production from a Development and Production Area first averages [●] Barrels per day for a period of sixty (60) consecutive days.

Such payments shall be made within thirty (30) days of the date that the liability accrues.

2_Tax (General) (Equatorial Guinea)

Model Production Sharing Contract between the Republic of Equatorial Guinea, Guinea Ecuatorial de Petroleos (the NOC) and the Contractor

Payment of Taxes

Except as otherwise provided in this Contract, the Contractor, its subcontractors and their respective employees, agents, consultants and other personnel shall be subject to the Tax Law and all regulations passed pursuant thereto, as well as UDEAC (Central African Economic and Monetary Union) and fiscal and customs laws of Equatorial Guinea.

3_Tax (Income Tax) (Vietnam)

Petroleum Production Sharing Contract between Vietnam Oil and Gas Group (the NOC) and the Contractors dated 12 February 2007

Each Contractor Party shall be individually liable for and pay its corporate income tax at the rate of thirty-two percent (32%) of their net taxable income in accordance with the Petroleum Law and regulations providing implementation thereof.

The corporate income tax is payable in US Dollar or Dong, paid temporarily on a quarterly basis in arrears and finally reconciled on a Yearly basis in accordance with the applicable tax laws of Vietnam.

4_Royalty (Equatorial Guinea)

Model Production Sharing Contract between the Republic of Equatorial Guinea, Guinea Ecuatorial de Petroleos (the NOC) and the Contractor

The Contractor shall pay Royalties to the State from the first day of Production based on the daily Total Disposable Production from a Development and Production Area. The calculation shall be determined according to the following table applicable for each tranche:

Daily Total Disposable Production (Barrels per day)	Royalty (%)
From 0 to •	13
From • to •	•
From • to •	•
From • to •	•

5_Force Majeure (Equatorial Guinea)

Model Production Sharing Contract between the Republic of Equatorial Guinea, Guinea Ecuatorial de Petroleos (the NOC) and the Contractor

Non-fulfilment of Obligations

Any obligation or condition arising or derived from this Contract which any Party is unable to perform, whether in whole or in part, shall not be considered as a breach or non-fulfilment of its obligations under this Contract if such breach or non-performance is caused by an event of Force Majeure, provided that there is a direct cause-and-effect relationship between the non-performance and the event of Force Majeure. Notwithstanding the foregoing, all payment obligations owed by any Party to another must be made when due.

Definition of Force Majeure

For the purposes of this Contract, an event shall be considered an event of Force Majeure if it meets the following conditions:

- (a) it has the effect of temporarily or permanently preventing a Party from performing its obligations under this Contract;
- (b) it is unforeseeable, unavoidable and beyond the control of the Party which declares Force Majeure; and
- (c) it is not a result of the negligence or wilful misconduct of the Party which declares Force Majeure.

Such an event shall include acts of God, earthquake, strike, riot, insurrection, civil unrest, blockade, sabotage and acts of war (whether declared or not). The Parties intend for the term of Force Majeure to be construed in accordance with the principles and practice of the international petroleum industry.

6_Confidentiality (Morocco)

Petroleum Agreement between the Office National de Recherches et d'Exploitations Petrolières (the NOC) and the Contractors dated 19 March 2004

20.1_Each of the Parties shall treat as confidential the terms of this Agreement, and information gathered by it as a result of the operations described in this Agreement (“Confidential Information”), and shall not divulge Confidential Information to a person who is not a Party. Provided that a Party may divulge Confidential Information:

- (a) to the extent such Confidential Information is required to be furnished pursuant to any arbitration or legal proceedings, or by virtue of any law applicable to such Party;
- (b) to any of its Affiliates, provided any such Affiliate maintains confidentiality as provided in this Article;
- (c) to its employees or those of its Affiliates for the purposes of conducting operations hereunder, subject to each Party taking customary precautions to ensure Confidential Information is kept confidential;
- (d) subject to Article 20.2, to a contractor, subcontractor, professional adviser or auditor employed or potentially to be employed by any Party in relation to the operations described in this Agreement, where such disclosure is required for the effective performance of the recipient's duties;
- (e) subject to Article 20.2, to a credit establishment or any other financial institution in connection with the prospective funding of a loan or other financial agreement to be entered into for financing operations described in this Agreement;
- (f) subject to Article 20.2, to a bona fide prospective transferee of the whole or part of a Percentage Interest in this Agreement, including an entity with which such Party is conducting bona fide negotiations directed toward a merger, consolidation or the sale of a majority of the shares in such Party or any of its Affiliates which control such Party directly or indirectly;
- (g) to the extent Confidential Information must be disclosed by the Party as a public communiqué for the purpose of complying with laws, regulations and requirements of the [State] or pursuant to any rules or requirements of any other government or stock exchange having jurisdiction over such Party, or its Affiliates;
- (h) if, before such disclosure, the Confidential Information had become public knowledge or had been legally obtained by the Party or any Affiliate from a source other than under this Agreement; or
- (i) if such disclosure is approved in writing by all of the Parties.

20.2_Disclosure pursuant to [paragraphs] (d), (e) and (f) shall not be made unless prior to such disclosure the disclosing Party has obtained a written undertaking from the recipient to keep the data and information strictly confidential and not to use or disclose the data and information except for the express purpose for which disclosure is to be made.

20.3_The Parties agree under all circumstances to honour the provisions of this Article 20 throughout the entire term of this Agreement, and with regard to [the Contractors], for a duration of three (3) years after the expiry of the Exploration Permit in respect of which the Confidential Information was obtained.

7_Dispute Resolution (Equatorial Guinea)

Model Production Sharing Contract between the Republic of Equatorial Guinea, Guinea Ecuatorial de Petroleos (the NOC) and the Contractor

26.1_Dispute Resolution and Notification

26.1.1_In the event of any dispute, claim, conflict or controversy (a “Dispute”) between any of the Parties arising out of, or in relation to, this Contract, including any question regarding its breach, existence, validity or termination, the Parties shall take all reasonable measures to resolve such Dispute amicably.

26.1.2_If the relevant Parties have not reached an amicable agreement after three (3) months of the date of the notice of a Dispute by one Party to another, unless the Parties to the Dispute mutually agree to an extension, any Party to the Dispute may refer the Dispute for resolution by final and binding arbitration:

- (a) to the International Centre for the Settlement of Investment Disputes (the “Centre”) established by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, done at Washington, March 18, 1965 (the “ICSID Convention”);
- (b) to the Additional Facility of the Centre, if the Centre is not available; or
- (c) in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”), if neither the Centre or the Additional Facility are available.

26.2_Seat and Language of Arbitration

The seat of the arbitration shall be agreed by the Parties to the Dispute and, in case of a disagreement, shall be determined by the arbitrators. The languages of the arbitration proceedings, and of all orders, decisions, and the award, shall be Spanish and English.

26.3 Number and Identity of Arbitrators

The arbitral tribunal shall be constituted by three (3) arbitrators selected according to the following procedure:

- (a) The claimant and the respondent shall, within thirty (30) days from the day on which a request for arbitration has been submitted, appoint an arbitrator each (and if there is more than one claimant or more than one (1) respondent, then the claimants and/or the respondents collectively shall each appoint a single arbitrator), by giving notice in writing of such appointment to the Secretary-General of ICSID and the other Party or Parties to the Dispute.
- (b) If either the claimant or the respondent fails to comply with the time limit in the preceding paragraph, the Chairman of the Administrative Council of ICSID shall appoint the arbitrator or arbitrators that have not yet been appointed, at the request of either the claimant or the respondent and after consulting the claimant and the respondent as far as possible. The Chairman of the Administrative Council of ICSID shall give notice in writing of such appointment or appointments to the Secretary-General of ICSID and the claimant and the respondent.
- (c) The two (2) arbitrators so appointed shall, within thirty (30) days of their appointment agree upon the person to be appointed as the President of the tribunal, and give notice of such appointment to the Secretary-General of ICSID and the claimant and the respondent.
- (d) If the two (2) arbitrators fail to agree upon the person of the President of the tribunal, the Chairman of the Administrative Council of ICSID shall appoint the President, at the request of either the claimant or the respondent, and after consulting the claimant and the respondent as far as possible. The Chairman of the Administrative Council of ICSID shall give notice in writing of such appointment to the Secretary-General of ICSID and the claimant and the respondent.

None of the arbitrators shall be a citizen of the countries of any of the Parties to the Dispute (or in the case where the Party is a company or another entity, any country or countries of nationality of such Party, including the country of its ultimate parent).

26.4_Rules of Arbitration

The arbitration procedures initiated under this Contract shall operate under the arbitration rules in effect for ICSID, the Additional Facility or UNCITRAL, as the case may be, at the time of the filing of the request for arbitration, which rules are deemed to be incorporated herein by reference in this Article 26.

26.5_Binding Nature of Arbitration

The arbitration award shall be final and binding on the Parties and shall be immediately enforceable, subject to the remedies provided for in the ICSID Convention and Arbitration Rules, in the Arbitration Rules of the Additional Facility of the Centre, or in the UNCITRAL Arbitration Rules, as appropriate. The Parties waive any right to refer any question of law, and any right of appeal on the law and/or merits to any court. It is expressly agreed that the arbitrators shall have no authority to award aggravated, exemplary or punitive damages.

26.6_Costs of Arbitration

The costs of arbitration shall be charged in accordance with the directions of the arbitration tribunal, failing which shall be borne proportionally by the Parties to the Dispute on a per capita basis. The costs of the Parties comprising the Contactor shall not be recoverable.

26.7_Payment of Awards

Any monetary award issued shall be expressed and payable in Dollars.

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