Energy, Environment and Resources Department
Meeting Summary

CHATHAM HOUSE
The Royal Institute of International Affairs

Good Governance: Preparing for First Oil

The Guyana National Seminar of the New Petroleum Producers Discussion Group

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Background

The Good Governance: Preparing for First Oil in Guyana seminar was held in Georgetown on the 17 and 18 November 2016. A high-level discussion on 17 November featured ministers, members of parliament, high-ranking civil servants, and civil society leaders. Following the significant oil discovery made offshore in Guyana, this seminar was designed to help policymakers prepare for first oil production; to review policy options (and the trade-offs involved in pursuing the various options); and to discuss what changes in laws and institutions would be required to best prepare for oil production. On 18 November, members of the legal and accountancy professions were invited to participate in a more focused training session on finance and the legal framework for the petroleum sector. Discussions on both days were enriched by participants from other emerging and established producer countries as well as oil industry representatives.

The New Petroleum Producers Discussion Group ('the Group' or 'the New Producers Group') is a knowledge and experience-sharing network. It provides a platform for new and emerging oil and gas producers to discuss challenges, strategies and governance frameworks for sustainable exploration and development of their oil and gas resources. The New Producers Group is an initiative of Chatham House, the Natural Resource Governance Institute (NRGI) and the Commonwealth Secretariat through its Oceans and Natural Resources Advisory Division (ONR). Guyana has been a member of the group since 2012 and has regularly participated in meetings of new oil and gas producers around the world. This meeting summary was edited by Valerie Marcel, Owen Grafham, Ekpen Omonbude, Matthew Genasci and Laura Robinson.

The Liza discovery in context

ExxonMobil signed an agreement with Guyana in 1999 to explore the offshore Stabroek block, which covers some 26,800 square kilometres.[1] ExxonMobil made a discovery at the deep-water Liza-1 well in May 2015, roughly 120km off the coast of Guyana. This first proved discovery for Guyana is now thought to be the second largest discovery globally in the last five years, with an estimated gross oil resource of between 800 million to 1.4 billion barrels.[2] For Guyana, with a population of around 800,000, this can be roughly converted to around 91 barrels per person per year[3] (before accounting for costs and operator profits). The size of the discovery in relation to the population puts Guyana among a small number of countries whose oil revenues could have a transformative impact. Many other producers have squandered such opportunities to bring economic benefits to the country or have overspent and indebted themselves.

During the early stages of the meeting agenda, much discussion surrounded the low oil-price environment that characterized the previous two years. One speaker highlighted that the oversupply that caused the oil price to collapse in 2014 has persisted and, in broad terms, looked set to continue in both the short and medium term.[4] Private sector participants at the meeting highlighted that this had reduced international oil companies' profits and threatened the viability of many projects around the world. However, it has also led to a reduction – albeit lagged – in operating costs throughout the sector. Overall, participants felt that Guyana's future prospects in this context were favourable because of where the Liza

[1] Esso Exploration and Production Guyana Ltd. holds a 45 per cent interest. Hess Guyana Exploration Limited holds 30 per cent interest and CNOOC Nexen Petroleum Guyana Limited holds a 25 per cent interest in the Stabroek block.
[2] Exploration is ongoing in this and adjacent blocks and also in neighbouring Suriname. Positive results were announced on 12 January 2017 from the Payara-1 well in the Stabroek block.
[3] Assuming 200mbd production (estimate by Keith Myers).
[4] This analysis was made before the December 2016 OPEC and non-OPEC agreement to hold back production. However, many analysts expect that the gains made in balancing markets will be partially offset by growing output in US shale oil and elsewhere in 2017. Refer to the IEA Oil Market Report for current analysis; https://www.iea.org/oilmarketreport/omrpublic/

field was likely located on the cost curve. ExxonMobil's intention to fast-track the project's development is also a testimony to the field's commercial viability in the current price environment.

Fiscal considerations for a new oil producer

Guyana is comparatively one of the poorer countries in the South American–Caribbean region, with a GDP per capita of $4,127 in 2015.[5] The size of the Liza discovery in relation to Guyana's small economy brings particular economic risks of Dutch disease. Participants from larger producer countries highlighted the negative impact that petroleum revenues had had on existing industries and economic activity in their own countries. In order to lessen the likely economic distortion caused by an influx of rent, Minister of Natural Resources Raphael Trotman indicated that the government has plans to establish a sovereign wealth fund to save for the future and reduce spending volatility.

Presentations concentrated on the fundamental features of fiscal regimes for upstream petroleum operations. Discussions centred around the careful policy choices and action steps that the government would need to consider. As the project's major written output, the *Guidelines for Good Governance in Emerging Oil and Gas Producers*, points out,[6] risks are highest for exploration companies in frontier areas where no discovery has been made; while a major discovery significantly de-risks the country. As a result, fiscal regimes for frontier regions tend to be comparatively favourable to investors. The risk profile typically lessens following commercial discovery and accordingly fiscal regimes tend to be more stringent. All participants recognized that the significant discovery offshore Guyana was likely to reduce the risk profile for petroleum operations in the country. This has important implications for the evolution of the fiscal regime for subsequent licences in Guyana, and observations were made in this regard.

In the development of the fiscal regime, the government will be faced with a number of challenges. These challenges will include adjusting current fiscal terms to fairly reflect the change in Guyana's risk profile without upsetting investor confidence; preparing early for the establishment of a robust revenue management mechanism; legislative and regulatory reform to reflect changes at an appropriate speed (balancing urgency with the need for comprehensive reform); optimizing support and assistance from various agencies and service providers; and capacity to design, benchmark, negotiate, implement and audit the petroleum fiscal system.

Capacity challenges

Maximizing the rent transfer to the treasury requires sufficient state capacity to oversee oil company operations and budgets and to collect taxes. Naturally this is a challenge for emerging producers who do not have petroleum sector experience; but lack of capacity in tax authorities is also a common occurrence in established producers. One participant highlighted that Nigeria had around one tax official for every 27,000 citizens while in the Netherlands this figure was around one in 300. Participants highlighted that around 35 per cent of companies in Guyana did not currently pay tax and this lack of capacity to collect taxes would prove problematic for the country. Several participants voiced the view that now is the time for Guyana to invest heavily in developing its capacity to scrutinize company costs, and that if the country waits until production begins, it will be too late to maximize the revenues gained by the government.

[5] The World Bank (2016), 'Guyana Overview', http://www.worldbank.org/en/country/guyana/overview.
[6] See Objective 2 'Attract the most qualified investor for the long-run' in the Guidelines for Good Governance in Emerging Oil and Gas Producers (2016), the discussion of how to both attract investors and to maximize economic returns to the state continues through pages 17–25, https://www.chathamhouse.org/sites/files/chathamhouse/publications/research/2016-07-13-guidelines-good-governance-2016-marcel.pdf.

Discussions also focused on how to efficiently allocate scarce financial and human resources to manage risk and opportunity during the rapid expansion of the oil industry. It is challenging for emerging producers to evaluate the development plans and audit the costs of the high-tech and capital-intensive oil industry. Creating the right incentives for operators – through the legal and contractual framework and bolstered by rigorous systems for oversight and cost recovery audits – can help compensate for lower levels of petroleum audit experience. The selection of an operator with strong internal controls is also a critical success factor to cost effectively manage financial risk.

In the public administration, a risk management framework is needed to monitor risks. This framework involves setting and communicating clear objectives, understanding the uncertainties in the oil sector in Guyana, response planning for events that pose significant risk or opportunity, and establishing controls to attain the desired outcome where possible.

The opportunities for the local accountancy industry to work with the operators, their subcontractors, and supporting industries will depend on their ability to meet their specialized requirements. The timing of Guyanese capacity development is critical. The training and compliance programs for accounting are expensive and must be in place before Guyanese accountancy firms can qualify for selection by an international company.

Contract negotiation

Presentations focused on a few pitfalls commonly observed in oil contract negotiations within new producing states. These include: excessive discretion, 'policymaking' at the negotiating table, challenges of internal consensus building, and mismatches between contract terms and administrative capacities and practices.

The discussion also focused on the legitimacy (or lack thereof) of governments modifying existing terms to reflect changing circumstances or to address significant imbalance in benefits to one party. This discussion highlighted the importance of respecting existing contracts to avoid being labelled as investor-unfriendly and possibly be exposed to litigation. In this view, only future deals and relinquished acreage (proportions of licensed areas that companies must relinquish after specified deadlines) offered opportunities to change terms. Conversely, some participants felt that unfair deals needed to be changed, and cited that there are a number of countries across the world who have attempted to renegotiate, and that companies also press for renegotiations of terms of contracts as economic circumstances evolve. Clearly, the best moment to request a return to the negotiating table arises when companies make requests for changes or delays in existing contracts.[7] But the concept of how risk changes throughout the project lifecycle is also crucial to this discussion. This change in attractiveness to oil companies would normally prompt the government to set more competitive terms for future deals – and sometimes makes them eager to change existing deals. The legitimacy of contractual terms depends on how well both parties are satisfied that changing risks are reflected in the terms.

A session designed specifically for participants from private law offices in Guyana highlighted the importance of developing negotiation capacities – and related professional and technical skills – not only among government staff, but also among local firms as a key component of local content development strategies.

[7] For recommendations related to renegotiation, please refer to the Guidelines for Good Governance in Emerging Oil and Gas Producers (2016), Chatham House, pp. 23–25.

Defining a national vision and ensuring good governance

Speakers during this session raised a number of policy priorities that new producers should develop following discoveries: elaborate a national vision that would guide the development of the sector, carefully manage public spending, preventing corruption before it takes root, and design new institutions with increased administrative and technical capacity. Guyana has been committed to a green growth agenda and there are questions now about how that agenda will sit with the country becoming an oil producer.[8] The risk of environmental incidents also rises with petroleum activities. Speakers emphasized that most new producers want to 'do it all', since they have multiple policy priorities and a new source of revenue that offers an opportunity to fund these. But in practice they face difficult choices. For example, an ambitious local content policy could potentially increase recoverable costs for the oil companies and reduce the amount of revenue transferred to the treasury. There is also the temptation to introduce fuel subsidies to provide cheap petrol to citizens, but this locks countries into growing domestic fuel consumption trends, which are difficult to reverse once introduced. In practice, the national vision of a new producer should be clear about whether it prioritizes revenue maximization (to maximize the public funds available for specific development targets), in-country value addition through local skills and businesses (the creation of supply chains and local jobs) or the use of petroleum produced as a factor input for industrialization or development. National visions can also be driven by values, which can inspire the efforts to develop the sector and the economy. These might include technical competence and professionalism, transparency and good governance or inclusiveness, for instance.[9]

While participants were optimistic about the economic development that the oil sector could bring, they were also very cognizant of the governance risks involved for a country already struggling to improve government effectiveness, rule of law and control of corruption. One Guyanese speaker suggested that the oil discovery would provide an 'amplification of governance issues' and others stated, 'an inefficient petroleum sector can quickly become a liability.'[10]

Among other countries represented at the session were Uganda, Liberia, Suriname and Trinidad and Tobago. Participants from these countries emphasized the value of building public administrative capacity in stages and making clear choices in accordance with a transparent overarching strategy.[11] In the public session that launched the seminar, Minister of Natural Resources Raphael Trotman explained the government's plans to present a set of new policies and legislation to the public for consultation and review. The documents being drafted address the governance and institutional frameworks for overseeing the new sector, as well as the conditions for investment in the sector. Minister Trotman highlighted the important role he expected a visiting delegation of senior Ugandan oil officials to play in this process.[12] Uganda is indeed paired with Guyana in a mentoring exchange organized by the New Producers Group. Uganda discovered oil 10 years ago and has built significant national capacity during this time and recently completed preparations for oil production.

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[8] Since 2009 Guyana has been engaged in a bi-lateral agreement with Norway to provide large financial incentives (US$250 million initially agreed) in order to protect the country's rainforest and promote low carbon development. These came in the form of performance based payments dependent on national rates of deforestation.

[9] For discussion see Guidelines for Good Governance in Emerging Oil and Gas Producers, pp. 14–15.

[10] NRGI highlighted research that suggested that corruption control was significantly worse in resource rich developing countries when compared to non-resource rich developing countries.

[11] Patrick Heller, Large Oil Discovery Generates Hope, Challenges in Guyana, NRGI, 29 November 2016; http://www.resourcegovernance.org/blog/large-oil-discovery-generates-hope-challenges-guyana

[12] Guyana Chronicle, 18 November 2016.

A Guyanese national oil company

Speakers in this session focused on what is often a preoccupation of new oil and gas producers – namely the formation of a national oil company (NOC). NOCs are important to emerging producers because they can be vehicles for developing technical and commercial skills in the petroleum sector, enabling countries to participate in the production of their natural resources. Through state participation (equity stakes in licences that are held by the state or its representative agency) the NOC can potentially transfer benefits beyond petroleum revenues to the state. However, the net financial gain to the state depends very much on the efficiency of the NOC and the soundness of its commercial strategy. Many Guyanese in our discussions were positive about the idea of having an NOC and felt the prospect of such an institution was an attractive one, which contained a powerful symbolic message regarding national ownership of the resource.

However, several external speakers during this session urged Guyana to consider some of the negative considerations. Firstly, there is an opportunity cost to financing an NOC: indeed, are those funds better spent on other budgetary priorities such as vocational education to train Guyanese for jobs in the oil sector, for example? Secondly, financing an NOC can be difficult when it does not have equity stakes in producing licences that generate revenue. In Guyana's case the offshore acreage has already been awarded (with no provision for an NOC stake) but minority equity stakes could feasibly be reserved for the NOC in acreage that is relinquished. Finally, other producers in the room also suggested that Guyana would need to be ready to confront the likely rush of requests and favours that would follow the establishment of an NOC. In this respect, other producers were clear that it would be sensible to establish careful governance mechanisms to reduce the opportunity for nepotism and corruption. One speaker suggested that should the government decide to create an NOC, it should include the right of an NOC to minority equity stakes in future licences but work to establish the capacity of the regulator first. Also, when establishing an NOC it is important to carefully delineate its mandates and ensure that it is affordable.[13]

Conclusion

As is the case in any country without a history of oil and gas production, Guyana faces challenges in ramping up its rules, institutions and skills to prepare for first oil. Over the course of 2015–16 the government worked to make these preparations in a very short time. The next step involves public consultations and parliamentary review of proposed plans. The country will also need to build capacity to oversee and participate in the petroleum sector. A key to future success lies in building the right capacity, to focus resources where they are most needed.

[13] For an analysis of the human and financial resources needed to establish an NOC, see Marcel, V. (2016), *The Cost of an Emerging National Oil Company*, Research Paper, London : Royal Institute of International Affairs, https://www.chathamhouse.org/publication/cost-emerging-national-oil-company.