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International Negotiations

**The Type of Petroleum Agreements , Negotiations and Techniques
2014**

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Agenda

1. Main Petroleum Contracts
2. Contractual / fiscal system classification and main topics of each Contract:
 - » **Concession Agreement**
 - » **Production Sharing Agreement**
 - » **Service Contract**
3. A focus on the Joint Operating Agreement
4. Type of Negotiations and main tactics

Questions/Answers and Brief Discussion



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1. Main Petroleum Contracts



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Main reasons to conclude a Petroleum Contract

International Oil Company

Why will a **company** invest in petroleum exploration in host country?

- ✓ Discover hydrocarbon resources and book relevant reserves
- ✓ Obtain reward appropriate to risks incurred and investment made
- ✓ Provide for asset growth

cooperation

Host Country

Why will a **host country** welcome foreign company investment?

- ✓ Share risks associated with petroleum activities and develop hydrocarbon resources
- ✓ Generate cash flow to Government and spur economic growth & infrastructure development in the country
- ✓ Develop expertise & experience for nationals through training programs etc.
- ✓ Transfer of technology from investing company



Concluding a Petroleum Contract

- Petroleum Contracts regulate the relationship between the Government of a country and the International Oil Company(ies) ("IOCs"), being the hydrocarbons a property of the country/Government (except in USA);
- Petroleum laws of a country regulate all the basic terms like the type of Petroleum Contracts to be concluded, the duration of the various phases of the activities (exploration, development / production), the procedures and rules for the award of a Contract Area and relevant petroleum rights (international bidding rounds or private negotiations...), the conduct of activities carried out by financially-sound, technically-skilled international companies etc. ;
- Fiscal issues are generally described in the relevant Tax Code / Fiscal Regime
- Grant of rights, governance of activities and commitments are disciplined within such Contracts between the Government (often through National Oil Companies "NOC") and IOCs.
Provisions concern minimum work/financial commitment, bonus, decision-making process, procedures to declare a commercial discovery, development plan, title to production and sharing/disposal, WP&B, Operator, Participations, Valuation of Oil, Accounting rules, duration and term, applicable law, arbitration etc....



Main Petroleum Contracts



- The main Agreements which establish the rules/relationships between Authorities/Host Governments and International Oil Companies are :
 - Concession Agreement
 - Production Sharing Agreement
 - Service Contract

- The main Agreement governing the relationship among two or more IOCs for conducting petroleum operations within a certain area is the
 - Joint Operating Agreement



2. Contractual / Fiscal system classification and main topics of each contract



Basic Contractual Schemes

Three main types of Petroleum Contracts:

- **Concession Agreement:** direct title (property) to produced resources is granted to an IOC (*Concessionaire*);
- **Production Sharing Agreement:** Government maintains title to production, IOC (Contractor) is paid out and remunerated from a portion of produced hydrocarbon;
- **Service Agreement:** Government maintains title to production, IOC (Service Contractor) is paid out and remunerated in cash or kind by a fee per barrel.

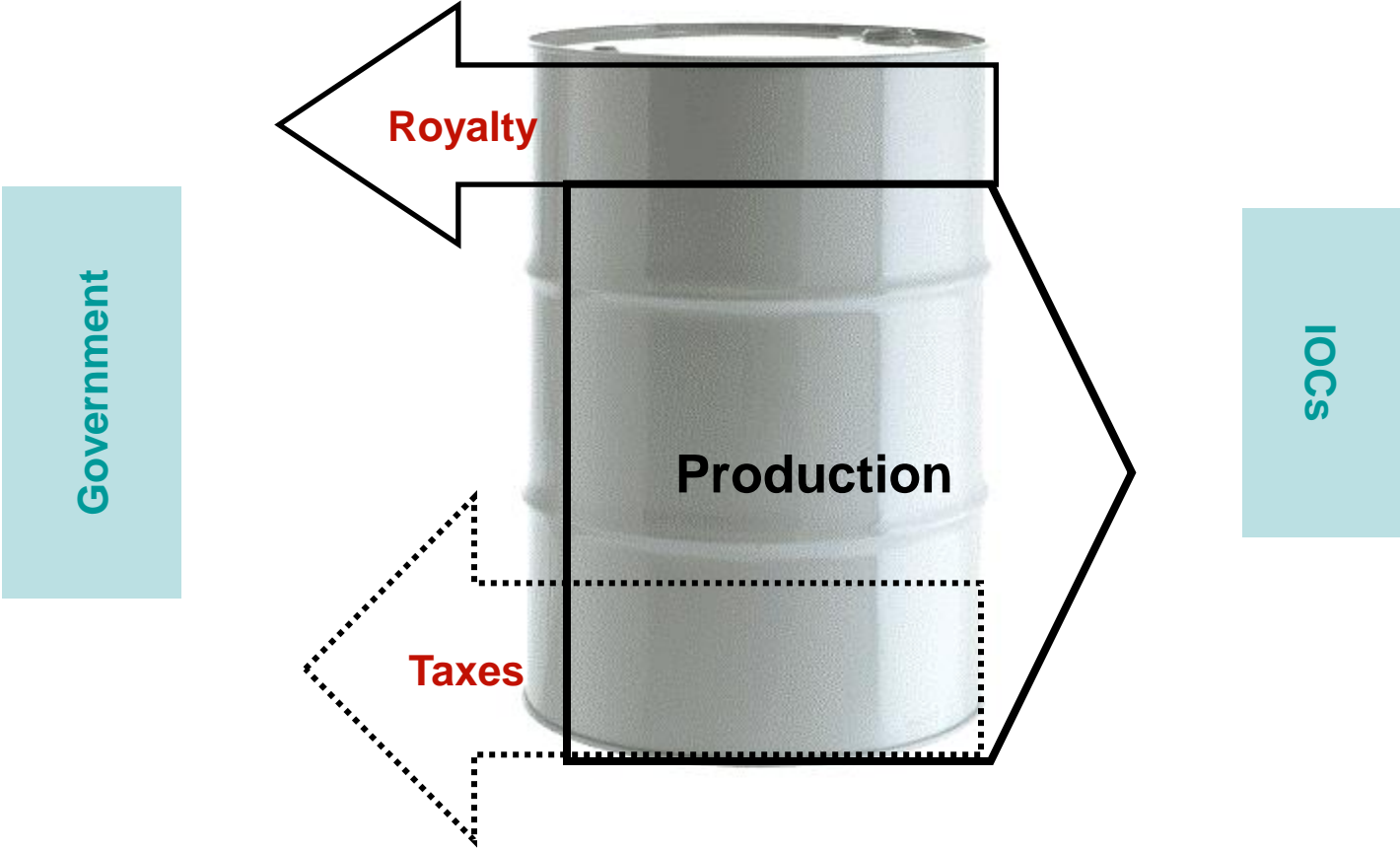


Concession Agreement: Key Features

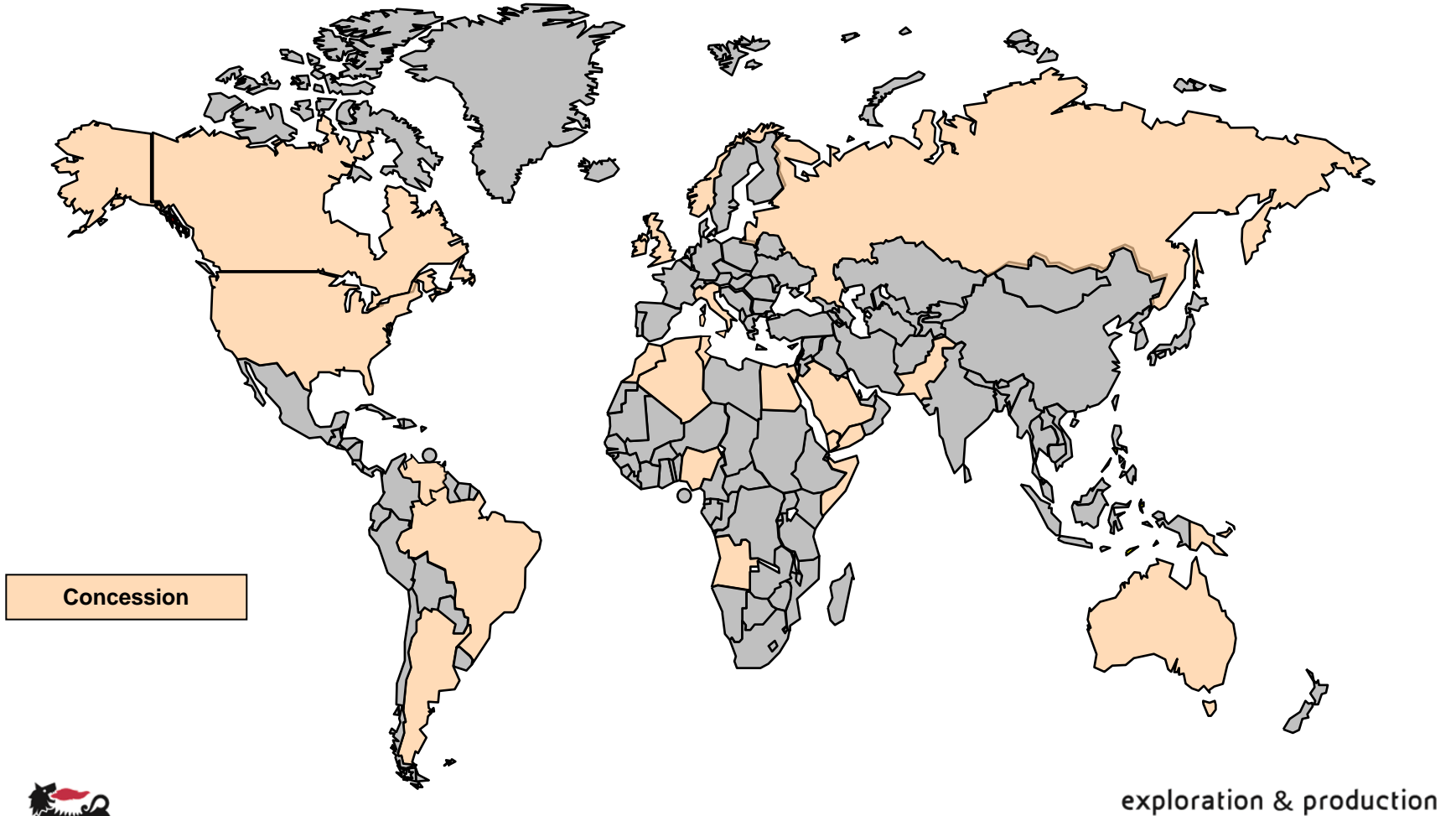
- The **Concession Agreement** is the oldest type of Contract;
- The Government grants a Concessionaire the rights to conduct petroleum operations and direct (equity) title to hydrocarbons found and produced.
- Concessionaire is normally subject to the payment of:
 - **Annual Rental Fee** in cash, based on the size of the Concession area;
 - **Royalty** in cash or in kind, as a fixed or variable percentage of gross production; and
 - **Profit Tax** and possibly other taxes on income, at rates often depending on the degree of risk.
- The NOC sometimes elects to participate with IOC to the investment; NOC is often “carried” during Exploration and repays its share of exploration investments during Development / Production.



Concession Agreement - TAX and ROYALTY



Eni's Concession Agreements



Production Sharing Agreement: Key Features

- **Production Sharing Agreement/Contract** (PSA/PSC) first PSA was concluded in Indonesia in early 1960's and then became popular in the world during the following decades;
- Under PSA/PSCs Government retains title to produced hydrocarbons.
- Contractor receives, in case of discovery, a share of gross production:
 - **Cost Oil**
(*in order for the IOCs to recover the investments made*, "Cost Oil" is generally capped with a fixed percentage of production);
 - **Profit Oil**
(*in order to remunerate IOCs for the investments made*)
- The NOC sometimes elects to participate with IOC to the investment. NOC is often "carried" during exploration period and repays its share of exploration investments during the production period, giving to the IOC part of its share of petroleum produced.



Production Sharing Agreement: Latest generation

- More recent PSAs have seen the introduction of new contractual and fiscal terms:
 - Income Taxes and, in some cases, Royalties;
 - Windfall Profits tax;
 - Ring fence;
 - Different mechanism of production sharing.



PSA: Profit Sharing Mechanism



- **Production (cumulative or daily)**

- **Rate of Return** $IRR = \text{investment profitability}$

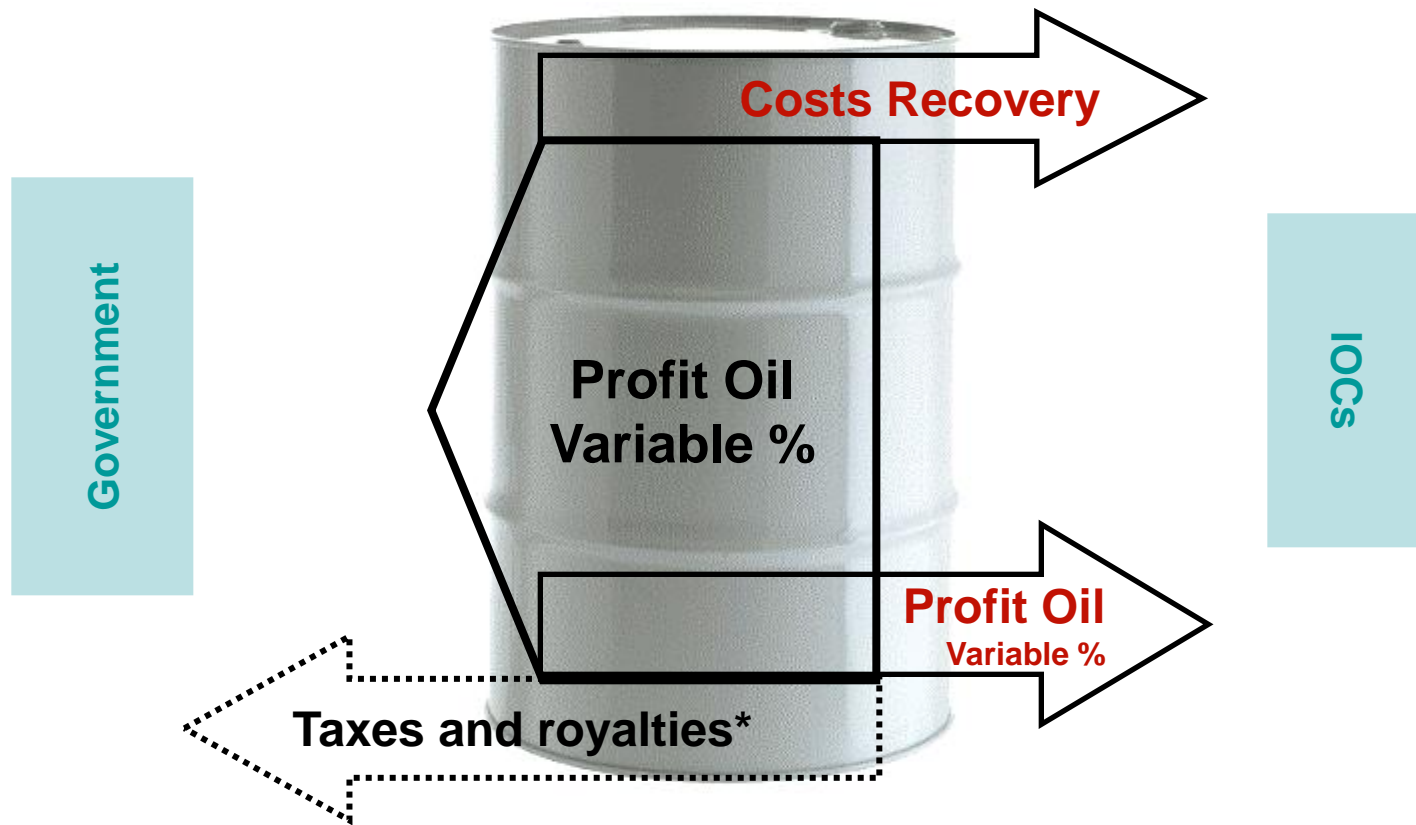
- **R-Factor** $\frac{\text{Revenues}}{\text{Cumulative Investments}} = \text{investment profitability}$

- **Hybrids**

The diagram shows the word 'Hybrids' at the top left. Two arrows originate from it. The first arrow points down and to the right, ending at a percentage sign (%). The second arrow points down and to the right, ending at the text 'IRR'. Below the first arrow, the text 'Revenues' is written above a horizontal line, which is then followed by 'Cumulative Investments'.



PRODUCTION SHARING CONTRACT MECHANISM



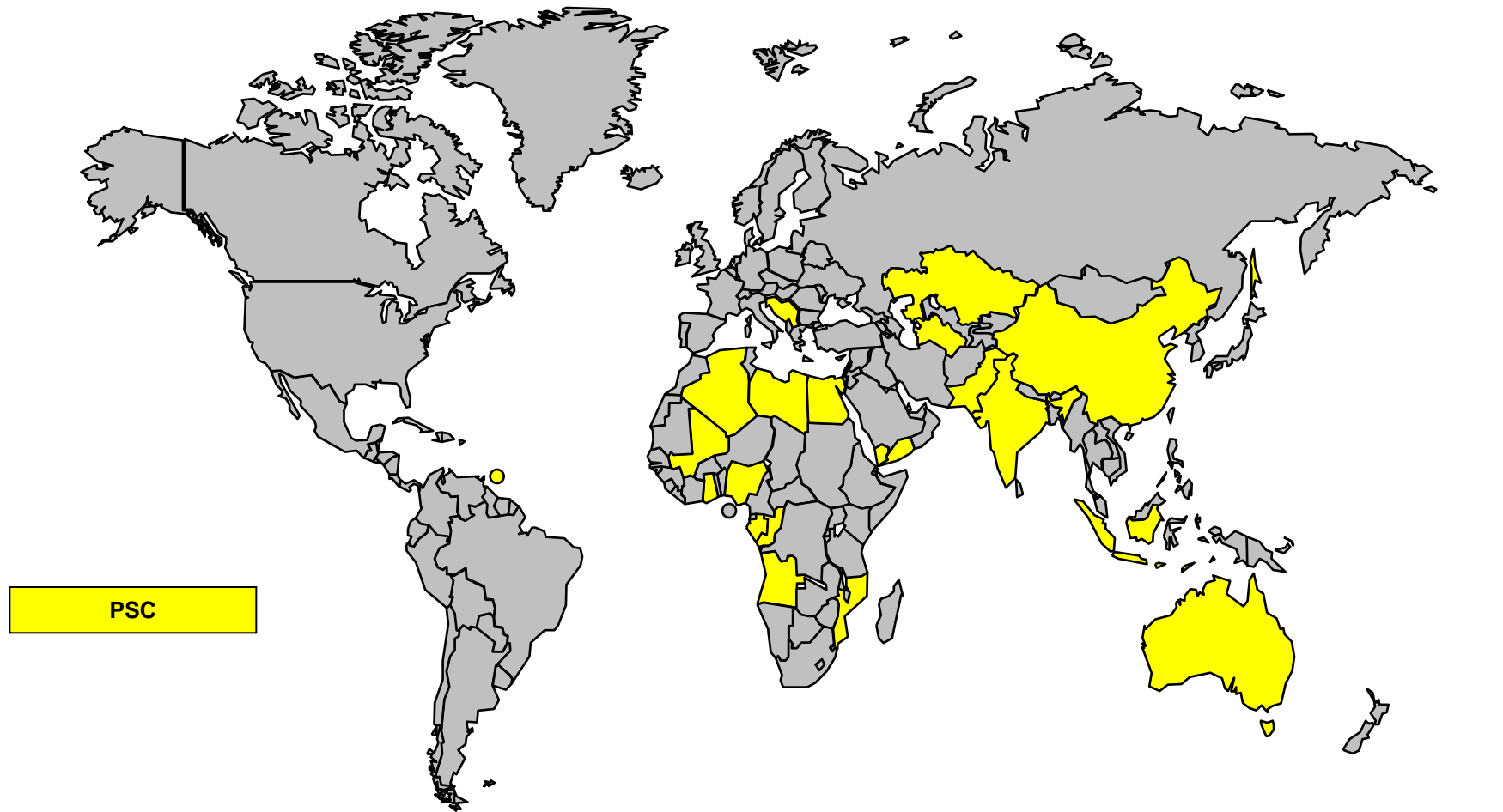
*Taxes and royalties are features of second generation PSC

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Eni's Production Sharing Agreements



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Service Agreement: Key Features

- First ***Service Contracts*** were introduced in the late 1960's;
- IOC ("Service Contractor") is charged with funding and conducting activities and bears (in case of risk service contracts) the exploration risk;
- The Government maintains title to hydrocarbons.



Service Contract: Key Features

- IOC's investments are repaid in cash (in accordance with an amortisation plan), with buyback clauses;
- Unpaid balance of investments generate interests.
- Remuneration consists of an agreed "Service Fee", paid in cash or in kind; taking the form of a per barrel fee or a percentage of profits;
- In more recent cases Contractor is granted repayment of investments and payment of the Service Fee directly from production (in these cases differences from PSAs are minimal);
- Generally, Profit Taxes are applied on the Service Fee and may be reduced if profits are re-invested in the Host Country.



Eni's Service Contract



Service Contract



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Basic issues for Oil Companies when deciding to invest

- **Contract Stability:** terms of (or applicable to) the Contract to remain stable throughout its entire duration;
- **Full Cost Recovery Principle:** all costs approved and incurred to be repaid/recovered;
- **Risk/Reward Balance:** remuneration proportional to risk taken;
- **Booking reserves;**
- **Right to Export Production:** for sale on international markets;
- **Oil Valuation:** valued at realised market prices;
- **International Arbitration:** disputes to be settled by international courts/arbitration, in neutral venue and under international rules.



New Trends in the Contractual Practices

- **Recent trend of the international Petroleum Contracts** is the request of the Government of a Country to negotiate and finalise at the same time, together with the Petroleum Contract, other Agreement(s) concerning Initiatives or Projects in various fields of interest of the Country

Elaborate a package of Agreements with the basic elements defined in a “Cooperation Agreement” during the first steps of the negotiation

- **Scope:** cooperation may so involve a variety of different areas, and a wide number of initiatives, such as :
 - developing industrial projects in return for upstream business opportunities
 - social programs for local communities
 - training for local personnel and/or building of a training center
 - studying an area
 - developing technologies / grant use of an exclusive technology
 - developing common facilities
 - etc...



A specific request for Procurement Issues under a Petroleum Contract

Local content / procurement

- Increasing attention and requests from the Authorities at the local content issues
- Generally a Contract provides that the Contractor / Operator must give preference to local contractors for the award of a certain contract if the local contractors can offer same or substantially same terms and conditions, with reference to price, quality, performance, reliability etc offered by other contractors
- The above general rule often is detailed through certain provisions in the Petroleum Contract or in the Law, such as, typically
 - (i) An allowed “spread” in price – in the order of 10%; or
 - (ii) A minimum quota/percentage of contracts must be assigned to local contractors



- Growing consciousness that preventing HSE risks is a very sensible way of avoiding unacceptable possible damages
- Political and Social Groups exert growing influence at local, regional, state level for the adoption of appropriate laws on HSE issues
- Dedicated legislation (laws and decrees) and specific contractual provisions (provide periodic surveys, reports process/procedures for risk assessment / mitigation etc....)
- Stringent Supervision and Control by Authorities/NOCs
- Parent Co. Guarantees to be delivered at the finalization of Petroleum Agreements



3. A focus on the Joint Operating Agreement

Joint Venture and Joint Operating Agreement (JOA)

- Whereas the Petroleum Contract (e.g. Concession, PSC etc) set forth the rights and obligations of the parties towards the “First Party” (Government/NOC), the scope of the JOA is to set out the rights and obligations of the parties among themselves and cover the relevant activities

- The JOA formally creates the...

...**JOINT VENTURE**

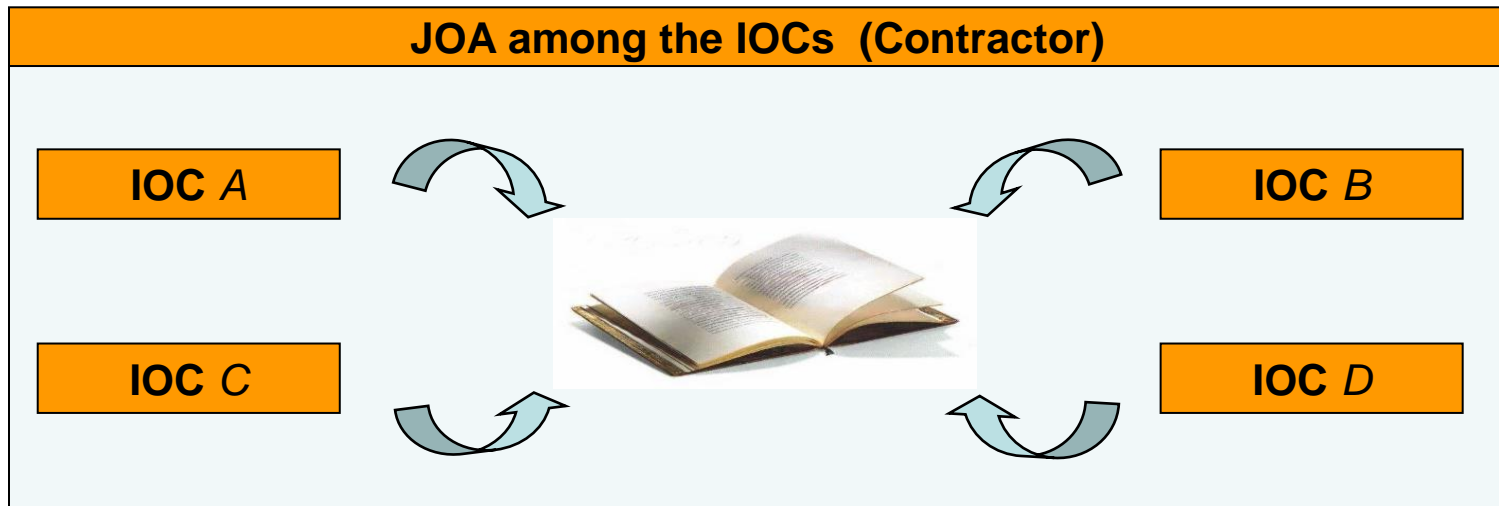
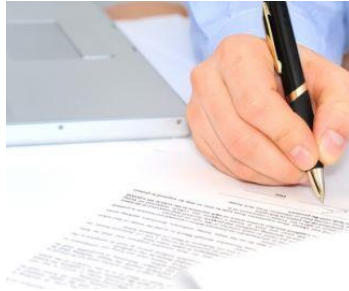


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Joint Operating Agreement (JOA)

Petroleum Contract with Government / NOC



Reasons for establishing Joint Ventures

- Even the largest companies do not have the capital, skills or market access necessary to achieve their commercial objectives entirely through their own resources.
- Commercial objectives driving joint ventures:
 - Costs savings
 - Risk sharing
 - Financing large-scale projects
 - Access to technology
 - Entry into various countries and emerging economies



The Operator under the JOA

- In order to run the Joint Venture efficiently, the Parties appoint one Party as the “Operator” to conduct Petroleum Operations on their behalf.
- The Operator responsibilities include:
 - The preparation of Annual Work Programme and Budget;
 - The implementation of such Work Programmes and Budgets once they have been approved by the Operating Committee (and subsequently by Management Committee under the Petroleum Contract)
 - The preparation of lists of contractors and submission of such lists to Operating Committee, conduct of the tenders, award the contracts etc.
- The Operator provides periodically to the Non-Operators all data and information (as agreed), which include a copy of all seismic data, other geophysical acquisitions; daily progress drilling reports, including estimated costs to date etc. ;
- Other Operator’s main responsibilities include the payment obligations under the Petroleum Contract (tax, fees, bonuses etc., obtain all necessary approvals, permits for implementation and conduct of Petroleum Operations; implementation of Training plans for the development of local resources and of Social Projects;



The Operating Committee

- The Operating Committee (OPCOM):
 - provide for the overall supervision and direction of Joint Operations
 - define the common policies of the Parties as regards their relations with the Government
- The OPCOM is comprised of members from each of the Parties
- All decisions of the OPCOM shall be made by the affirmative vote of the representatives of two or more Parties having an aggregate Participating Interest of at least%.



The Operating Committee

The main powers and duties of OPCOM include:

- Review, approval/disapproval of the proposed Programmes and Budgets;
- Decisions regarding entry into the Extension of the different periods of the Petroleum Contracts;
- The approval of any proposed Appraisal Work Programme to determine if a Discovery is a Commercial Discovery.
- Approval of timing and location of the wells and any suspension of drilling;
- Review and approval of all contracts (for which OPCOM approval is required);
- Any proposal to seek amendment to terms of the Petroleum Contract;
- The approval of any public announcement (press release) regarding JOA or Petroleum Operations.



The Operating Committee

- For certain decisions the unanimous vote may be required, like :
 - voluntary relinquishment of the Contract Area
 - declaration of Commercial Discovery
 - location of certain wells
 - Amendment of the Contract

- The OPCOM can appoint sub-committees to deal with specific subject areas:
 - Technical
 - Financial
 - Legal
 - etc.



The knowledge of the main principles/content of the Petroleum Contracts (Concessions, PSCs, SCs, JOA etc) helps the "technical" people to better conduct the day by day activities, enabling also the understanding of the impact of their "working products" on the other IOC areas of activity (e.g. contracts and negotiations)



4 . Type of Negotiations and main Tactics

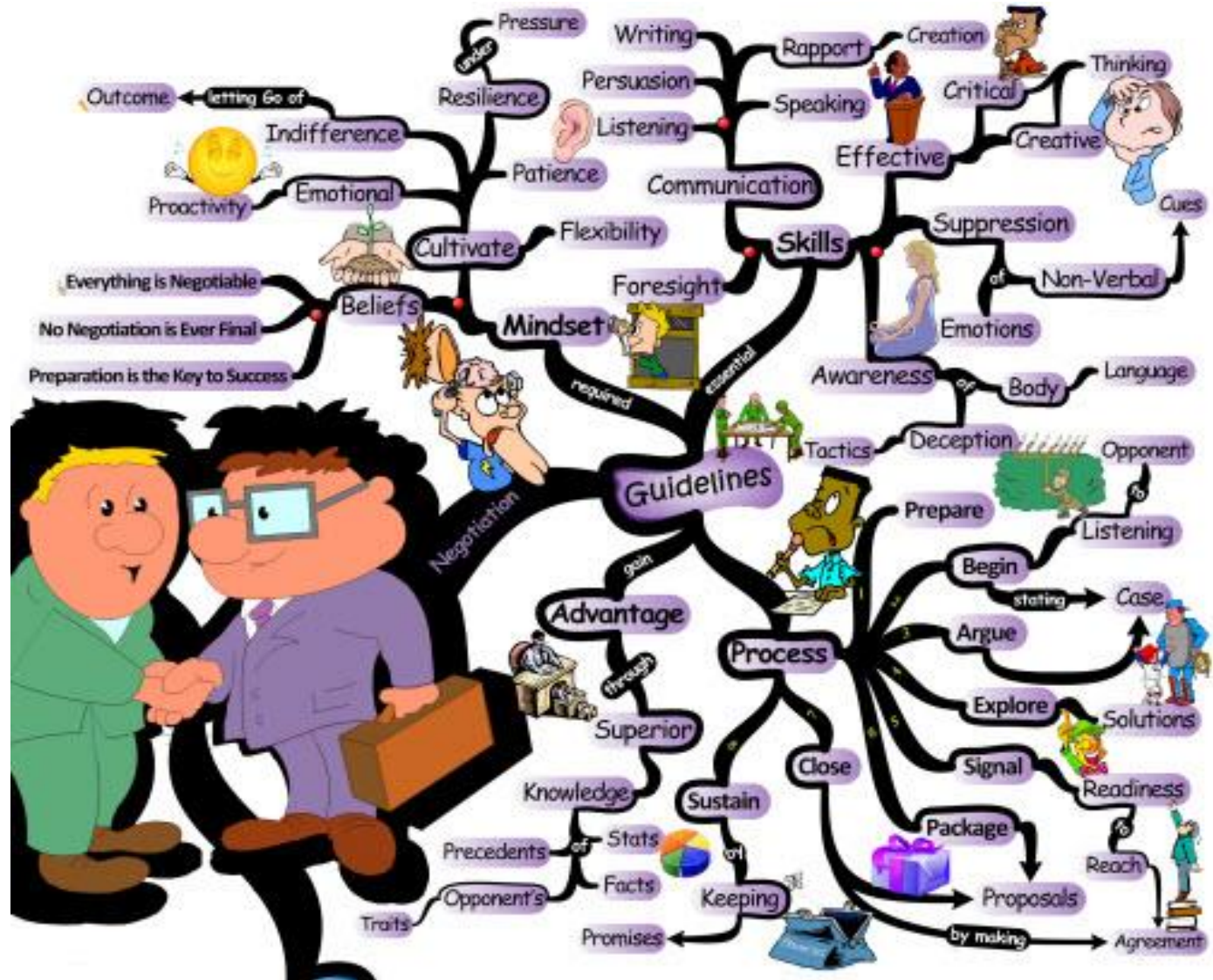


Negotiation - Definition

The negotiation is an interactive process between two or more parties seeking to find common ground on an issue or issues of mutual interest or dispute where the involved parties seek to make or find a mutually acceptable agreement that will be honored by all the parties concerned.



The Negotiation and the Negotiator's Mindset



Basic Types of Negotiation

■ **Distributive Negotiations**

These negotiations involve competitive approaches and lead to win-lose situations

- a dollar more to one side is a dollar less to the other
- “carpet sale” situation where buyer and seller have no relationship

■ **Integrative Negotiations**

These negotiations involve cooperative approaches and lead to win-win situations

- the counterparts work to increase the value of the solution
- target is to create as much value for the parties (and also claim for yourself)



Two Simple Examples

Integrative Negotiation

One party uses the fruit pulp and the other the peel



Distributive Negotiation



Negotiator's Dilemma



Your Counterpart

Cooperate

Defect

You

Cooperate

Fairly Good

Reward for mutual cooperation

Very Bad

Your opponent defects while you cooperate

Defect

Very Good

You defect while your opponent cooperates

Fairly Bad

Both of you defect



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Negotiation on Positions

- A negotiation where the counterparts tend to lock themselves into certain positions
- In such a case the negotiators bargain over positions and each negotiator tries to clarify its position and defend it from remarks etc. from the counterpart
- In case you insist to defend the position, the more you insist the more it is difficult to change later such position
- Often the result of such type of negotiation is the conclusion of an agreement that is less satisfactory to each of the counterparts in respect to the agreement that could have been finalized

Value creation in an integrative negotiation

- Creation of the appropriate atmosphere, open body language, cooperative attitude and relationship among negotiators at the table, begin with openness to the other side concerns, in order to build constructive discussions
- A key point to be understood by the negotiators is the value one party confers to a specific issue
- One of the targets is to trade issues that you value less than others issues and try to get the issues that are significant to you
- Look to find various options instead of one solution and look for benefit of all interested parties (“enlarge the pie”)
- Important is to investigate soon the possible reservation price of your counterpart and then the area of possible agreement (difference between the reservation prices)



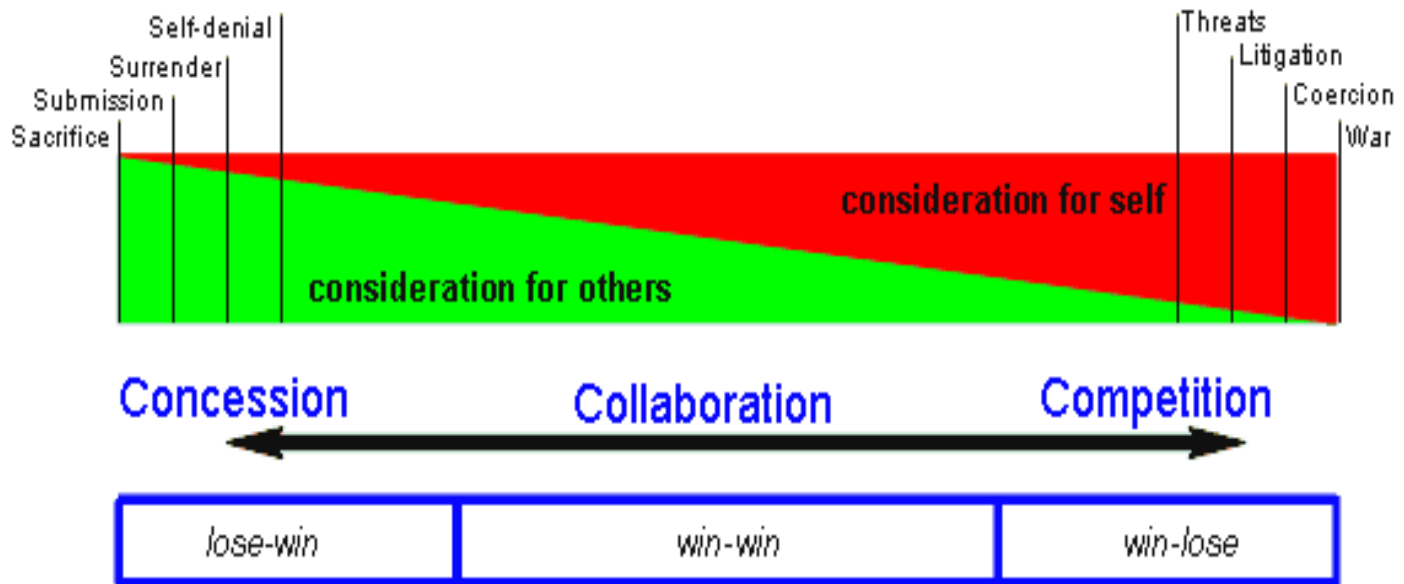
Few examples of a cooperative attitude vs. the counterpart / persons

- Opening and sustaining the conversation with the colleagues of the counterpart, encourage two-way conversation
- Ask them easy and short questions, be interested about themselves and their country....
- Remember their name and use it during the discussions
- Building the relationship
- Active care, encouraging the exchange of ideas and thinking, listening
- Ask their opinion, try to create good atmosphere



Negotiators attitude

- Simplified outline of a range of styles, based on the degree to which a party thinks about itself / its targets or thinks about the counterpart /its targets



An interesting principle

My father said: “You must never try to make all the money that’s in a deal. Let the other fellow make some money too, because if you have a reputation for always making all the money, you won’t have many deals”

J. Paul Getty



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Negotiations Tactics

- Tactics and technique could be understood as a sort of “guarantee” that “if you do this you will get that”
- On the contrary tactics and techniques are negotiations’ tools that if you use, you may get something of what you want...
- Negotiation is also a practice, that means that the more you try, the better you will get, soit is an interesting job.....and...
-the best suggestion is continue to try and learn from your experiences to improve your capabilities.....



Frequent negotiations with the same counterpart



Lets be subtle about this, we want to do business with them in the future.



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Examples of Negotiation Tactics – 1/4

- **Good Guy / Bad Guy:** tactics to make easier the discussion for the negotiator and the finalization of a specific issue, for example one colleague of the team makes things difficult, he is so contrary to such item about to be agreed but you intervene as good guy to solve the situation.....
- **Competition:** the counterpart “informs” that they have received a more competitive offer and we must meet such terms.....
- **Have a more informal contact:** when the discussion is becoming tough, have a simple chat with your counterpart, have a walk or a coffee in informal way
- **Last minute request / “nibbling”:** ask for concession just a while before finalizing the agreement
- **Discontinuity:** you do not continue unless the counterpart offers a goodwill move, like concede an issue or give real clarification on an item
- **Interruption of the discussion:** threaten extreme action like abandon the discussions and cause discomfort in the counterpart
- **Call an expert:** during the discussions make reference to an expert and use such advice in the appropriate way to convince the counterpart



Examples of Negotiation Tactics – 2/4

- **Bring a new item:** Introduce a new issue during the negotiation when you need that the counterpart thinks to something else in respect to the issue under discussion and also in order to obtain delay because you need to think again on a specific issue
- **Weight of items:** underline the importance of an item (that for you is not important) and then concede it
- **Fragmentation:** the aim is to divide important items, raising difficult discussions, into smaller ones and try to get each of them separately
- **Cherry Picking :** a party tries to take , step by step, the most desirable offerings from each of the proposals made by the other party.
- **Deadlines:** set a deadline can create tension and push to find a solution
- **Delays:** use of time in order to avoid negotiation until a clear decision on a issue is taken or to rethink on a specific issue without pressure



Examples of Negotiation Tactics – 3/4

- **Find an agent for you:** try to find the right person of the counterpart to act on your behalf, giving him certain information to help him to convince some of his colleagues
- **Persuasion at various steps:** Persuade one individual at a time, understanding also their different needs, they could convince their colleagues about your ideas
- **Retreat:** make physical reactions like expressions of great surprise, shock...
- **New negotiator:** certain issues already deeply discussed could be reset if you introduce a new negotiator, in extreme cases the negotiation can start again from the beginning.....
- **New data:** you bring at the table new information you have recently received....so you can update the status of the discussions or rethink on a certain issue you are not convinced about



Examples of Negotiation Tactics – 4/4

Pre-meeting conditioning:

- before the meeting you can start negotiations with the counterpart ! This applies, for example, when a party wishes to deliver a clear message that things are not going well.....
- Which location ? Where do we meet ? When ? Which is the agenda ? May we review the agenda...?
- When you arrive, the other party keeps you waiting for a while.....
- the room is not so comfortable and..... no coffee / tea



The meeting room is not so nice.....



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Body Language

- It is important for the negotiator to understand the “ body language” and non-verbal communication of his counterpart.
- We have to be aware that we emit signals that may appear to be unperceivable, but in reality they can reveal something about what we're thinking, during a negotiation
- Few examples
 - * Crossed Arms - in general, this gesture can indicate defensiveness
 - * Hand Supporting the Chin - This gesture shows boredom
 - * Chin Stroking - Here the person is making a decision. Don't interrupt!
- Non-verbal communication differs across cultures, and how easy it is to misinterpret.
- If the voice states that the offer is the final one but the body does not reflect such statement and seems to give availability for further discussion, the addressee of the message will note such attitude and will continue to negotiate.....



Emotions in the negotiation

- In a negotiation emotion arises in the context of a relationship
- Negotiators with a positive mood achieve more integrative results and generally use less aggressive techniques (better problem solving, creative approach, empathy.....)
- Sometimes skilled negotiators try to create negative emotions in the counterpart, manipulate their own emotions to gain.....(example : used car salesperson may show shock towards the price rejection of a customer and)
- Manipulating emotions to gain in negotiations can have a bad effect on long term negotiations.....



Discussion, Further Questions and Answers

