

Key Features of Modern Petroleum Law and International Best Practices in Upstream Petroleum Industry for Stakeholder Sensitization



**Cambodians for Resource Revenue Transparency
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Key Features of Modern Petroleum Law and International Best Practices in Upstream Petroleum Industry for Stakeholder Sensitization

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Summary

This report reviews Cambodia's existing petroleum regulatory regime; including the Petroleum Regulations 1991, the 2004 Model Petroleum Contract and the Environmental Law 1996 and discusses the existing Regulatory Institutional Structure.

An analytical framework for evaluating the new proposed Petroleum Law that currently being prepared by Cambodian National Petroleum Authority and the Government is provided in the context of international best practices in petroleum regulation, taxation and petroleum agreements.

There is discussion of the international best practices prevailing in upstream petroleum regulation and examination of the provisions of the proposed new Petroleum Law and changes being proposed to Taxation Law in relation to petroleum operations and the developments in the upstream regulatory regimes in three selected countries namely Timor Leste, Indonesia and Ghana. The report sets out its findings and recommendations.

The report identifies the weaknesses of the current petroleum regulatory regime and highlights the areas where the current regime could be improved. It concludes that the existing petroleum legal regime could be made to work well in combination with licensing through petroleum agreement provided appropriate modifications and improvements are made in the existing regulatory and contractual arrangements.

The key features of a modern petroleum law are discussed to assist in the evaluation of the new petroleum law when the same is available for public review.

Key Features of Modern Petroleum Law

Introduction

There should be a comprehensive national petroleum policy developed in consultation with civil society and national stakeholders to guide and form the basis of the formulation and development of new petroleum laws.

This document consists of two themes on Key Features of Modern Petroleum Law and the International Best Practices in Upstream Petroleum Industry for Stakeholder Sensitization.

Legal Framework

The legal framework should: (1) provide for ownership and control of petroleum existing in its natural state in the country should be vested in the State on behalf of the people, (2) provide for effective management and supervision of petroleum operations by the State for the maximum benefit of the people of the country, (3) provide for appropriate licensing and petroleum agreement scheme to regulate petroleum operations, (4) create an enabling environment and a good climate for efficient operations and investment by oil industry, (5) ensure thorough and prompt exploration and timely development of petroleum discoveries and efficient production and conservation of petroleum, (6) provide level playing field and effective implementation of the petroleum laws and fair treatment accorded to all industry participants and stakeholders; and (7) deal with basic legitimate concerns of the investors including security of tenure, ability to recover investment and service financing arrangements, repatriation of profits to shareholders, effective operational arrangements, efficient enabling business environment to conduct petroleum operations without undue delays in securing requisite ancillary consents and authorizations, stability of legal and contract terms and provision of international arbitration and enforcement rights.

Institutional Regulatory Arrangements

Institutional regulatory arrangements should: (1) provide for a single petroleum regulatory authority with operational independence and good internal corporate governance and transparent decision making based on objective criteria, (2) reduce administrative discretion in decision making and provide accountability to Parliament and the nation, (3) provide review and appeal procedures for contesting decisions by aggrieved parties; and (4) provide for effective coordination between petroleum regulator and other ministries and agencies involved in petroleum sectors such environmental agency and others.

Publication of Model Petroleum Agreement and of the Licence Terms

There should be publication of model petroleum agreement and of the licence terms being offered by Government and of the competitive bidding procedures for submission of bids and the qualifying criteria for evaluation of bids and for selection.

Financial and Technical Resources and Experience

There should be procedures to ensure that companies selected for award have and demonstrate adequate financial and technical resources and experience in petroleum operations and a good track record of operatorship in the case of proposed operators of petroleum operations.

There should a screening process of pre-qualification of companies to ensure that rights are only allocated or assigned to petroleum companies with adequate resources and experience and track record.

Bidding Procedures for Award of Licences and Petroleum Agreement

There should be utilisation of open licence rounds and competitive bidding procedures for the invitation and evaluation of bids and the selection of the winning bidders and the award of licences. There should be published bidding procedures for award of licences and petroleum agreement. These should provide for public bidding procedures and evaluation criteria, bidding by consortium including qualified operator party, the system for pre-qualification of bidders, and ensuring qualifications required from ad hoc applicants or bidders namely technical and financial resources and experience of operatorship are met.

Conduct of Negotiations with Companies

There should be in place procedures for the conduct of negotiations with selected companies elaborating as to the agency with primary responsibility for negotiations and the role of other ministries or an inter-ministerial negotiating team, the approval of negotiated agreement by Cabinet, Council of Ministers and the ratification of agreement by Parliament.

Licence Area

There should be clear delineation of the contract area i.e. the licence block which constitutes the exploration area granted. Graticular system of blocks should be utilized as basic unit of area for orderly identification, delineation and relinquishment of licence area.

Exploration Phase

There should be defined and divided into the initial and extensions period. It is common to have exploration period of 7 to 10 years and development and production period of 25 to 30 years subject to life of field.

Exploration Work Program

The minimum exploration work programs and expenditures stipulated in licenses should be obligatory and designed to ensure thorough and effective exploration. There should be minimum exploration work programme and expenditure for each exploration period. This would comprise seismic surveys and processing and interpretation of data and exploration drilling. The appraisal work programme and drilling for evaluation and appraisal of the discovery is distinguished from minimum exploration drilling and there is no set off of appraisal against minimum exploration work programme. An environmental impact assessment would be required for exploration operations including seismic and drilling operations.

Compulsory Relinquishment

There should be compulsory relinquishment of specified percentage of the exploration area at end of each exploration period.

Approval of Programs

There should be an effective scheme of approval of all the key petroleum operational plans such as exploration plans, appraisal plans and development and production plans at all stages of operations. This would include the approval of exploration work programs and budgets, approval of appraisal plans and approval of development plan by the regulator.

Discovery of Petroleum

There should be an effective discovery scheme setting out the procedures to be followed upon discovery to ensure that oil and gas discoveries are promptly notified, appraised and developed expeditiously or otherwise relinquished. In terms of the discovery of oil and gas there should be an

immediate reporting requirement and an obligation to carry out further production tests and assessment of flow of petroleum. It could be a decision of the company whether the discovery is of potential commercial interest or it is not but the procedures would set out the consequences of each type of decision by the company. If the discovery is of potential commercial interest it would be the duty of company to appraise discovery and submit development plan within defined period. The appraisal period may be 2-4 years for crude oil and up to 8 years for natural gas discoveries. If it is not of potential commercial interest then there would be an option of government to require company to relinquish discovery area. The appraisal of gas discovery would include the feasibility of gas market for the gas discoveries.

Retention Period

There is provision for retention period of up to 4 years for marginal discoveries of crude oil not regarded as of potential commercial interest but which require further exploration work to establish commerciality provided company commits to doing adequate and requisite work programme during this retention period .

Development Plan

There should be a submission to regulatory agency of detailed appraisal and application for developing the petroleum discovery and proposed development plan. There should provision for formulation and submission of decommissioning plan as part of development plan for commercial petroleum operations and the setting up of decommissioning fund to provide financial backing and assurance for its implementation. The development plan should include proposals for construction and commissioning of production and other facilities and development of the field, financing plan, production plan and profiles, decommissioning plan and proposals for the

decommissioning fund and, in the case of gas development, the proposed gas sale agreements and proposals for training and employment of nationals, proposals for procurement of local goods and services and environmental impact studies and mitigation proposals.

Gas Discovery

In the case of associated gas discovery the Government should be able to take and utilise the gas for domestic projects if the contractor cannot or does not use the gas. In the case of non associated gas the company must either appraise and develop the gas discovery within defined period allowed for that or relinquish the gas discovery area. There would be a retention period for gas discoveries to establish the gas market and viability of gas project. After retention period the obligation would be to appraise the gas discovery or to relinquish discovery area.

Flaring or Venting of Gas

The flaring or venting of gas should be prohibited except in operational emergencies.

Regulation of Petroleum Operations

The law should also have provisions relating to the regulation of petroleum operations by the licensing or regulatory authority including reporting requirements, approval process, environmental impact assessment process, decommissioning plan and fund, security for performance and insurance cover of operations, the coordination between the regulatory body and the environmental agency in respect of their respective roles and the control of assignment of licence and the unitisation of operations to develop straddling oil and gas fields.

Monitoring and Oversight of Petroleum Operations

There should be regular monitoring and oversight of petroleum operations carried out by licensees such as seismic shootings, drilling and installation of structures and facilities, procedures for accidents, health and safety at work, observance of good oilfield practices and compliance with international petroleum industry standards.

Health and Safety

There should be provision for ensuring that the petroleum operations are subject to application of all prevailing health, safety, technical operational petroleum industry requirements, human rights standards and environmental standards prescribed in applicable legislation as may be amended and in force from time to time and the frozen law provisions which seek to limit the applicable law and standards to that in effect on the date of signature of agreement should be avoided.

Reporting by Licensee

There should be a comprehensive scheme of proper and comprehensive reporting by licensees reporting at each phase of petroleum operations to the Petroleum Regulator. The reporting requirements would include regular monthly, quarterly, and annually reports on petroleum operations, submission of core samples and drill well cuttings, seismic and well data and interpretation and evaluation thereof.

Ownership of all Data

The ownership of all data would remain in the State.

Reporting and Audit of Petroleum Costs and Revenues

The reporting of petroleum costs and revenues to the regulator on periodic basis i.e. monthly, quarterly, six

monthly and annually is very important. The accounting procedures attached to the petroleum agreement would provide detailed guidelines as to what constitute recoverable and non recoverable costs. There should be at the expense of the company auditing of accounts and costs and revenues and the inspection of petroleum operations by regulator. To minimize misreporting and transfer pricing abuse, there are rules and procedures put in place to ensure that companies make sale commitments to and transactions with affiliated purchasers only at prices based on or equivalent to arms length sales to non-affiliated purchasers, and in accordance with comparable terms and conditions between non affiliated arms length parties. This also applies to procurement of goods and services. There should be coordination and cooperation between the relevant national institutions to achieve development goals and objectives, optimal revenue collection, the highest possible local value addition.

Measurement and Inspection of Petroleum at the Metering Point

The procedures for measurement of petroleum at the metering point and the regular inspection of the same and the procedures for adjustment to revenues in case of defects discovered in the metering device are very important operational provisions and can have huge substantial financial impacts on the parties.

Assignments of Licences

In relation to assignments there should be requirement of approval in relation to assignment to third parties and the requirement that previous obligations remain with assignor in case of an assignment within related companies or same corporate group. The assignee should be pre qualified company. There should also be provisions for the imposition of capital gains tax on any assignment premiums or windfall gained by assignor company.

Unit Development of Oil and Gas Fields Straddling across Licences or National Boundaries

There should be provision for unitization and joint development of petroleum fields straddling across licence boundaries both within the country and also those straddling across boundaries of adjoining countries. The unitized development of petroleum fields provides for the situation of oil and gas fields straddling licence or agreement boundaries within a country or fields straddling national boundaries among adjoining countries. Where this takes place within a country the usual provision is that the joint unit development of the straddling field is left in the first instance to be formulated and worked out between the licensees involved within the same jurisdiction by negotiation subject however to approval of the State to the unit agreement. Failing agreement between the licensees Government retains the power to determine the terms and conditions and impose a reasonable unit scheme in accordance good oil field practices in the international industry. Where the straddling is across national boundaries then there will need to be an agreed joint development agreement between the adjoining states involved and this would have to be implemented by the states concerned by directions given by them to the respective licenses involved within each jurisdiction.

Land Access Rights to Licence Areas

There should be fair and transparent procedures for securing access rights to licence areas especially in onshore areas in relation to land, in the procedures for compulsory acquisition of land and payment of compensation, and for resolving disputes arising there from.

Environmental Protection and Pollution

There should be adequate provisions for mitigating, minimizing and managing adverse impacts of petroleum

operations on the environment and social and economic wellbeing of the people affected thereby through environmental permitting and environmental impact assessment and management plans. This would include effective protection of the environment to prevent and mitigate risks of environmental pollution on land and sea, conservation of petroleum resources and environment, preventative measures to prevent spillage and dealing with spillage incidents at sea and on land, proper decommissioning measures and restoration of discovery areas after cessation of operations, provision of decommissioning fund to secure performance of decommissioning obligations, effective system of environmental permitting and carrying out of and approval of environmental impact assessment studies. The principle of strict and joint and several liability for pollution caused by petroleum operations should be embedded in the petroleum and related environmental laws.

Role of the Environmental Regulatory Agency

The role of the environmental agency in granting environmental permits and in the oversight of environmental monitoring and inspection is important. These provisions should identify the respective roles of the petroleum regulator and environmental regulator on environmental matters and the coordination between the various other agencies involved. There should be provisions on environmental legal regime and procedures, procedures for dealing with escape of oil, mud and effluents and pollution of land and sea and water resources. There should be provision for adequate contingency plans for oil spills and related emergencies and the establishment of a oil spillage fund financed by the oil companies and linkage with national oil spill plan.

Decommissioning Plan and Fund

The decommissioning plan backed by a decommissioning fund for decommissioning facilities and operations would be required as part of the development plan for a commercial discovery. The decommissioning fund would be built up by annual contributions from the contractor in accordance with approved decommissioning plan. The annual contributions would be deductible for income tax. The funds would be held in ring fenced escrow bank account under joint control of Government and contractor and used only for decommissioning. Any excess in the fund would be taken by the company but would be treated as income for tax purposes and any shortfall in the fund would be met by the contractor.

Guarantees and Performance Security Instruments

The performance of the contractual and statutory obligations of the contractor would be secured through bank guarantee and bonds, parent company guarantee, sufficient insurance from international insurance companies of repute to cover all operational liabilities of operator and consortium members including insurance for accidents, blowout, spillage.

Fiscal Terms

The fiscal terms would usually include signature and production bonuses, area rentals, royalty, income tax, state participation and terms of carried interest provisions , cost petroleum and profit petroleum splits under PSA, international pricing for crude oil and determination of market prices for gas, loss carry forward and accelerated depreciation for income tax. There should be provision for a progressive resource tax element in taxation such as additional profits tax to provide higher government share in cases of high profitability and windfalls. There should be clarity and certainty of licence terms and conditions to allow

adequate return to investors and a fair share of project profits to the State through a progressive fiscal regime which gives higher share to State with higher profitability and but yet does not deter development of marginal fields. There should be provision for carried interest terms for participation or other appropriate terms for state participation to ensure that exploration and appraisal risks are borne by the oil companies.

Collection and Accounting for Taxation and Fiscal Imposts

There should be in place appropriate and effective procedures for proper collection and accounting for taxation and fiscal imposts namely bonuses; area rentals, royalty, income tax and progressive windfall tax and profit oil split, import duties and minor taxes; ensuring transparent recording and reporting of costs and transaction prices by companies and revenues and measures against abuse of transfer pricing.

Petroleum Revenue Management Fund

There should be provision for petroleum revenue management fund to regulate the utilization, management and allocation of petroleum revenues for budget needs in key priority areas, stability for economic shocks and oil price volatility and intergenerational fund for future generations. The objectives of Fund would be to provide for developmental budget expenditures, stabilisation of revenue flows, savings for future generations and to provide for post petroleum era with minimum economic distress. There would need to be procedures for its management and investment of moneys of the Fund; integration of Fund into budgetary control and Government financial management system, avoiding Dutch disease and curse of resource phenomenon; procedures to ensure that these funds work effectively and that they are integrated into the overall national budgetary process; ensuring resource blessing and

ensuring proper management and avoiding negative impact of petroleum revenues.

Local Content

The local content provisions would include utilisation of local goods and services, the employment nationals; training of nationals, the training fund for employees and the contribution to national training fund to build up capacity in petroleum sector.

Title in Assets

The title in assets and equipment is vested in the State on being brought into the country or upon cost recovery. There should be provision giving the State the power to require contractor to decommission the assets that have no further useful life notwithstanding transfer of title to the State.

Domestic Market Supply

There should be provision requiring contractor to provide pro rata share of production of crude oil and gas under licence or PSA for domestic market requirements.

Contractual and Legal Provisions

The contractual and legal provisions that should be provided for in the regulatory framework comprises the settlement of disputes, contract review clauses, contract stability provisions, contract transparency and other legal provisions such as Force majeure and the governing law. These provisions would include provisions for Independent expert determination for technical matters and International arbitration for other disputes. Oil companies would want to see fiscal stability provision and contract stability provision.

Grandfathering Provisions

It is common practice to provide appropriate grandfathering provisions for existing subsisting licences and petroleum agreements when new petroleum law is enacted. These involve appropriate transitional arrangements for saving of existing petroleum rights and providing appropriate mechanisms for transitioning existing petroleum agreements to the scheme of the new law on a consensual basis agreed by the parties. Such transitional grandfathering clauses should be provided for in the new law.

Contract Review

There should be provisions for periodic review of overall contract performance and terms and conditions of the agreements and the procedures and modalities for agreeing changes in the light of changed circumstances.

Contract Transparency and Confidentiality

As regards the confidentiality provisions these typically have provided for confidentiality of agreement, confidentiality of technical data and information supplied under agreement and confidentiality of commercially sensitive information of companies. There is however need for contract transparency in the publication of contracts while at the same time protecting commercially sensitive information. Such transparency could include information on decommissioning fund build up for benefit of stakeholders. There should be provisions for publication of information on petroleum contracts entered into, summary of terms and conditions, publishing of current model petroleum agreements used in negotiations. Provision for such contract transparency would require restructuring of contract confidentiality provisions to permit disclosure of information other than technical and proprietary and commercially sensitive information and data.

Transparency Measures

There should be good governance provisions in the administration of the petroleum laws to ensure that conflicts of interest are avoided and addressed appropriately including the prohibition on public officers holding interests in the licences or petroleum operations and other measures such as code of conduct for public officials. There should be a scheme of transparency measures for all stakeholders and parties involved in the sector. These would include good corporate governance code for listed and public companies, disclosure of details of payments made to host governments on a contract by contract basis, mandatory revenue disclosures, publication of contracts and their terms. There should be procedures for public disclosure of information to stakeholders and regular publication of information on petroleum operations and developments by companies and government for benefit of stakeholders and civil society.

Consultations with Stakeholders

There should be adequate modalities for stakeholder consultations for obtaining their inputs and enabling their effective participation in the process of development of Petroleum and other extractive industry laws and policy. This would include procedures for consultations with national and international stakeholders on petroleum developments and policy and regulatory measures and initiatives. The role of civil society should be recognized and assisted in the development of petroleum laws and policy and interacting with Government, private sector and public, raising awareness of petroleum operations and their implications for the nationals and management of public expectations by flow of reliable accurate information and understanding true meaning and implications of the information made available.

International Best Practices in Upstream Petroleum Industry for Stakeholder Sensitization

This paper summarizes the key international best practices in upstream petroleum industry for stakeholder sensitization.

Development of Petroleum Sector

The development of the petroleum sector includes carrying out petroleum operations namely exploration, development and production operations, finding and developing and producing commercial deposits of oil and gas. The petroleum operations could be onshore, shallow offshore or deep offshore petroleum operations. This needs specialist technology, capital and technical resources, and experience in conducting petroleum operations as an international oil operator. The petroleum exploration activities are a risky business with high risks and high returns and the abortive costs are borne by oil companies themselves.

Petroleum activity is a highly regulated business and controlled by Government under petroleum laws. It has significant and substantial environmental impact and implications such as oil spillage and environmental pollution and degradation. It needs specialist and qualified oil companies to be operators and Joint Venture partners companies. The main mechanism of control used internationally in petroleum industry is the licensing mechanism to regulate petroleum operations.

The petroleum operations could be upstream and downstream operations. Upstream operations would consist of the exploration phase comprising seismic and exploration drilling; the appraisal phase involving the assessment and investigation of oil and gas discoveries to determine extent and volume of oil and gas fields; the development phase involving the construction and installation and commissioning of production equipment, structures and facilities; and the production phase involving commercial production and export and other sale. The downstream operations consist of processing, refining of petroleum and storage and transportation of petroleum product.

National Petroleum Policy

Many countries undertaking reform and improvement of the regulatory framework of the petroleum sector have found it useful and necessary to formulate and issue a national policy for the petroleum sector e.g. recently Uganda 2008, Sierra Leone in 2010, Namibia 1998. This process also provides a valuable opportunity for holding consultations with relevant national and international stakeholders and civil society organizations on the proposed policy framework and obtaining their views on the same to ensure that there is broad consensus on the petroleum policy and regulatory framework. A national oil and gas policy framework seeks to provide for the exploitation and utilization of the oil and gas non renewable resources to be managed in a manner that creates durable and sustainable social and economic development of a country. A key objective would be to provide benefits to the country and its people through creation of employment, developing local technical skills and capacity in petroleum services and activities, generation of revenues, local content in goods and services, diversification of the economy and development of infrastructure and subsequently accelerated social and economic transformation of the country. The petroleum reform process involves enactment of new modern petroleum law or revision and updating of existing petroleum law which would implement the national oil and gas policy framework transparently and effectively.

Role of Civil Society Stakeholders

The civil society stakeholders have a very important role in the development of the petroleum sector and the petroleum reform process. Their key contribution through advocacy, sensitization, mobilization and dialogue with the communities is recognized in the consultation process.

Ownership and Control of Petroleum

Ownership and control of petroleum existing in its natural state within the jurisdiction of country is vested in the State to be exploited and managed for the maximum benefit of

the people as a whole. The objective is to ensure effective management of the petroleum sector and that petroleum activities are conducted with due diligence and efficiency. The legal framework supporting the petroleum industry seeks to protect the rights of all stakeholder and participants in the industry and the citizens of the country and to provide predictability, stability and profitability and a fair return to both investors and the nation.

Institutional Arrangements

In terms of institutional arrangements it is common practice to have a single petroleum regulatory authority with transparent decision making process based on objective criteria and accountability to regulate and promote petroleum sector activities. It is vested with exclusive mandate to implement petroleum sector policy and to represent Government in negotiations with investor companies. With respect to regulation making powers the authority of the regulatory body would need to be subject to Governmental Cabinet or inter- ministerial review and approval process. There would also need to be appropriate exchange of information and coordination to ensure close working and collaboration with other concerned governmental agencies and to ensure that the grant of environmental permits and other ancillary rights and consents required for the petroleum operations are made upon full compliance with all regulatory requirements applicable.

It is a good practice to keep the role of the regulatory authority with monitoring and oversight responsibilities over the petroleum sector separate and distinct from that of a national oil company managing the State's participation share in petroleum operations of the oil companies and to ensure that these roles are handled separately through separate entities to avoid conflicts of interests.

Host Country Concerns

The prime concerns of the host country are to generate comprehensive geological data on the country's acreage, ensure full and prompt exploration of all prospective areas, prompt and effective development of oil and gas commercial discoveries, fair division of revenues between the nation and the oil companies, proper treatment of residents and communities affected by petroleum operations, protection of the environment, training and education and development and upgrading of skills of nationals, institutional capacity building of regulatory authority and relevant government agencies and local content and purchase of local goods and services.

Concerns of the Investor Companies

The main concerns of the investor companies are to have security of tenure and exclusive rights, expeditious recovery of the investment costs and an adequate return on the investment, stability of fiscal and legal terms over life of the project, enforceable international arbitration, freedom to remit funds to service project loans and distribute dividends to their shareholders.

Regulation of Petroleum Operations

The conduct of petroleum operations is regulated through laws, regulations and petroleum agreements and contracts. The legal framework should be transparent and seek to provide predictability for the industry while at the same time being flexible enough to adjust for important changes in prevailing circumstances in key areas of concern to both the State and investors.

Design of Petroleum Law

The types of legislative design could be enabling, comprehensive and hybrid. In terms of the design of petroleum law, some countries prefer to keep principal

petroleum law at a general conceptual level reflecting key principles and provide the details of the regime in governmental regulations made under the principal law. This facilitates the updating and revision of the regulatory provisions over time in response to changing circumstances without having to go through the parliamentary process of amending the principal law. Many countries also have parliamentary process of laying of petroleum regulations before parliament for negative or positive resolution for validity or enforcement of the regulations. This approach assumes that all requisite regulations are in fact promulgated upfront to make the scheme fully operational. Some countries like Russia, China and Azerbaijan do not have a comprehensive petroleum law as such but rely upon contractual frameworks like petroleum agreement supplemented with petroleum regulations to oversee the industry. China for example has offshore and onshore petroleum regulations 1982 and 1993.

Other countries like Papua New Guinea (PNG), Ghana and Sierra Leone attach considerable importance to fixing key minimum terms and conditions (albeit with appropriate measure of flexibility) in the main principal law as non negotiable to reduce transaction time and costs during negotiations, to minimize the scope for exercise of administrative discretion by incorporating objective criteria in the administration of the law and for greater negotiating leverage and protection from pressures of oil companies in negotiations. Accordingly there are considerable advantages for countries seeking to develop their natural resources in taking this proactive approach of fixing key minimum terms in the principal law.

Licensing Instruments

Different types of petroleum licences and petroleum agreements are used in the petroleum industry. The type of licensing used could be a two tier exploration and

production licences or a single tier joint exploration and production licence or a petroleum agreement covering all phases of upstream petroleum operations. A common practice in the industry is to use two tier licensing scheme for exploration and development phases of the operations by grant of exploration licences and development or production licences although some countries do use a single tier licence namely a joint exploration production licence for both phases. The Petroleum agreements could be the form of production sharing contracts, concession licence agreements or risk bearing service contracts. There could also be a hybrid form of petroleum agreement combining some features from the various types of petroleum agreements.

As regards the type of petroleum agreement much depends on the familiarity of the country with the type of agreement used but within each type of agreement namely the royalty/tax type, PSA or service agreements the structure and elements of the fiscal package is more important than the type of arrangement. The development of various forms of hybrid agreements enables the preferred fiscal terms to be accommodated to a considerable extent under any type of agreement.

The key agreements involved in the project would comprise the main petroleum agreement, joint venture agreement, operatorship agreement, financing agreements, marketing agreements, crude oil lifting agreements between joint venture partners. Speculative seismic agreements and reconnaissance permits are used to carry out geological and geophysical surveys to obtain technical data and sell data packages to the industry in conjunction with international bidding rounds. Pipeline licences for used for authorizing the construction and operation of oil and gas pipelines.

In many countries petroleum licences are used in conjunction with a petroleum agreement entered into with

oil companies which seeks to deal with matters that may have to be agreed on a project basis such as specific financing arrangements and rights of lenders and natural gas development arrangement or to provide for flexibility in appropriate matters critical to investors such as security of tenure and contract stability.

Some countries such as Indonesia do not have such statutory licences but rely on the contractual instrument of the petroleum agreement which serves as the licence under their legal scheme. It is common practice to have a model agreement which is sometimes prescribed and which sets out the minimum standards and terms and conditions for grant of exploration and development rights indicating the areas where there may be negotiations.

Laws Involved in Petroleum Sector and their Respective Roles

The Petroleum law is the principal law which reflects national petroleum policy. The Petroleum regulations set out detailed implementing provisions and procedures such as detailed reporting requirements, inspection of operations, investigation of accidents, regulating conduct of seismic and drilling operations, health and safety at work.

The Petroleum taxation laws provide for taxation of petroleum revenues, determination of taxable income, deductions and capital depreciation allowed in calculating taxable income, treatment of capital expenditures, amortization and revenue expenditures.

The Environmental law regulates environmental permitting and environmental impact assessment and mitigation process. There are also special measures to provide for response to environmental incidences and rehabilitation of discovery areas such as spillage fund, decommissioning or abandonment funds.

The Petroleum agreement is a key legal contractual instrument and deals with work programmes during exploration, appraisal and development and production phases and approval processes, security of tenure of investors, right to extension and right to develop and exploit discoveries subject to not being in default, recovery of investment and adequate return on investment, legal assurances such as sole expert determination and arbitration of disputes, force majeure and termination of agreement process; The other licences required for production may include licences such as the production permit.

Petroleum Licensing

The regulatory framework should lay down the objective criteria to be adopted for licensing ie allocating the rights to conduct petroleum activities in the country to ensure grant of rights to well qualified and resourced companies and guarding against speculators. Licensing is based on a transparent published competitive bidding procedures and process to get the best returns for the country and attract well qualified partners. The holding of bid rounds is announced as and when they are considered necessary. Recourse to licensing outside bidding rounds is only permitted in exceptional circumstances such as where the bidding round has failed to produce suitable companies and even then under defined parameters in accordance with the prescribed model petroleum agreement.

A process of pre-qualification under which only pre-qualified companies that meet the objective criteria for pre-qualification are permitted to bid as part of the bidding round or for the exceptional out of round licensing assists in ensuring credentials of the bidders. For transparency and equity, the allocation criteria is published in order to inform petroleum companies and stakeholders of the basis for allocation and the award of licences made public. The contractual blocks to be awarded are prescribed. Any

transfer of licence or operatorship is subject to approval of the regulatory authority.

Graticular System of Blocks

It is common practice for the regulatory scheme to provide for a graticular system of blocks to facilitate orderly identification and management of licence area and the relinquishment scheme (for example Tanzania, PNG). This graticular block should be distinguished from the concept of a contract block which would indeed contain a specified number of such basic graticular blocks.

Exploration and Development Periods

It is common to have an exploration period of about 7-10 years and the development production period of 25-30 years subject to field life. The licence areas are subject to progressive compulsory area relinquishment requirements at various specified times during the exploration period to ensure expeditious and vigorous exploration of the licence area. The licensing scheme recognizes that following discovery of petroleum of potential commercial interest an appraisal phase is required for the proper appraisal of the oil and gas discoveries. This may comprise about 2-4 years for oil discoveries and up to 8 years for natural gas discoveries. There is also a provision for retention period of up to 4 years of specific small marginal discoveries for specified periods to permit commercialization of such discoveries in conjunction with other similar discoveries in the licence area subject however to appropriate work commitments during the permitted retention period.

Discovery Provisions

The discovery scheme sets out procedures to ensure that companies do not sit on discoveries that can be developed and either assess and develop or relinquish the petroleum

discoveries concerned. In relation to natural gas discoveries of both associated and non associated natural gas there are specific provisions to facilitate the development of gas markets and establishment of the gas project.

Sole Risk Provisions

There should be sole risk provisions in petroleum agreements allowing government at its own cost to develop oil and gas discoveries that the contractor does not find commercial or does not wish to develop.

Fiscal Regime

The fiscal regime seeks to provide transparency and predictability to the Government, investors, the citizens of the country and those regulating the petroleum industry. To ensure fiscal progressivity, the fiscal regime in many countries includes in addition to royalty and income tax, an explicit progressive revenue sharing mechanism. For predictability, transparency and stability, the key elements of the fiscal terms such as royalty rate, income tax rate and some element of the progressive revenue sharing mechanism to the greatest degree possible is not left to be determined by negotiations of individual contracts but established in laws and regulations.

The various elements of the fiscal terms may comprise bonuses on signature and production milestone, royalty, taxes including corporate income tax, profit oil splits in case of PSA arrangement, state participation, and a progressive revenue sharing mechanism (such as resource rent or additional profits tax) . There would also be administrative fees and area rentals. There may also be a substantive assignment fee for transfer of licence interests between oil companies.

The precise structure and elements of the fiscal package is influenced and shaped, in the context of the type of

arrangement adopted, by the need of investor to have an adequate rate of return on investment and the concern of government to have a reasonable government take and progressive fiscal system and with the timing of government revenues and the level of government revenues in each accounting period of the project.

Collection, Verification and Utilization of Petroleum Revenues

It is common practice to put in place a transparent and predictable system for the collection, verification and utilization of petroleum revenues for the benefit of current and future generation and to deal with commercial tax evasion and mispricing of transactions. There should be fiscal discipline to ensure that correct petroleum revenues are collected and accounted for, and measures put in place to establish mechanisms to facilitate and simplify fiscal administration.

To minimize misreporting and transfer pricing abuse, there are rules and procedures put in place to ensure that companies make sale commitments to and transactions with affiliated purchasers only at prices based on or equivalent to arms length sales to non-affiliated purchasers, and in accordance with comparable terms and conditions between non affiliated arms length parties. This also applies to procurement of goods and services. There should be coordination and cooperation between the relevant national institutions to achieve development goals and objectives, optimal revenue collection, the highest possible local value addition and maximum environmental protection.

Management of Petroleum Revenues

The development of the petroleum sector and the use of revenues generated by it should be coordinated closely with the country's National Development Plan and development

of other sectors of the economy. Measures should be taken to prevent excessive volatility of the national budget or key macro-economic variables. The petroleum revenues should be properly managed and utilized to create new wealth and to boost balanced growth and sustainable development of the economy.

An important measure adopted in many countries is the establishment of a Petroleum Revenue Management Fund to ensure effective petroleum revenue management and to serve as a source of future funding to sustain the economy after the oil boom has ended. In addition, such fund contributes to overall price stabilization of shocks from fluctuating oil prices. This measure involves the enactment of revenue management law which specifies how oil revenues can be used, the percentage that can be used for current and development expenditure of government and what percentage is allocated for savings to be used by future generations and the procedures for accessing these funds. These arrangements seek to assist the countries to face post petroleum era with minimum economic distress. Such petroleum revenue management laws assist in ensuring accountability and transparency in the management of oil resources by providing transparent rules to govern relationship between oil companies, government revenue and public spending.

The arrangements in essential terms set up a single destination such as a specific national oil account for payment and management of oil revenues with annual specified limit on funds which can be transferred to the annual state budget and a permanent fund which is restricted for future generations and constitutes inter-generational capital and secures a flow of funds for economic development after oil resources are exhausted. The management and investment of the permanent fund is assigned to an investment committee appointed under and in accordance with the law. There are rules for auditing, transparency and oversight. The oversight procedures may

comprise a parliamentary or other high level oversight commission to oversee compliance of law with investigatory and sanctioning powers. The law also creates a public registration and information office to keep and make publicly available all acts and documents related to oil activities, petroleum fund transactions and related matters which should be public knowledge.

International Accounting and Reporting Standards

The fiscal regime should be commensurate with the EITI principles and other international best practices. All companies/entities operating in the country should be required to comply with International Financial reporting and Audit Standards consistent with international best practices and General Accepted Accounting, Auditing and Reporting Standards.

Work Practices

A key objective of the regulatory framework is to ensure that the petroleum resources of the country are effectively and thoroughly explored under the agreed work programmes and developed efficiently in accordance with approved plans. Petroleum operators are required to establish an office and physical presence in the country under its law and jurisdiction so as to ensure effective oversight of petroleum operations. Operators are required to conduct their operations diligently and efficiently in accordance with best international techniques and practices in the petroleum industry and with due regard to safety and environment. Effective systems for monitoring and auditing petroleum operations and for inspection and access to the sites and areas of operations to ensure compliance with laws, regulations and contract terms are established.

The companies are required to maintain and keep complete records of petroleum operations with all data collected and stored in proper manner for use and access by the

regulatory body. Changes to key plans and programmes including exploration work programmes, appraisal plans, field development plan, annual and other production plans, phase out and decommissioning plans require submission to and approval by the petroleum regulatory authority. Operators are required to provide periodic reports on the operations to the regulatory authority and to notify it immediately of any discovery. It is standard practice to have provisions in the law or the regulations to specify the frequency and the content of the periodic reports that the licensee must make regularly to the regulatory authority. Ownership of data vests in the State.

Decommissioning Regime

The upfront decommissioning regime is a key feature of modern petroleum legal framework in many countries. It is important to deal with and address the decommissioning of petroleum field installations at the end of field life reflecting the modern trends and international best practices in the petroleum activity. The petroleum company is obliged to decommission field installations at the end of field life in accordance with the approved decommissioning plan. The decommissioning plan is included and approved as part of the development plan for the petroleum discovery and is reviewed and updated from time to time during field life as set out in the decommissioning plan in the light of the petroleum operations carried out in the field.

The company is obliged to contribute funds into a decommissioning fund established for the exclusive purpose of funding decommissioning operations in accordance with the approved decommissioning plan. Funds contributed to the decommissioning fund are cost recoverable. Appropriate provisions are reflected in the income tax law to allow the funds required to be contributed to a decommissioning fund to be treated as an operating cost of the company for the purposes of determination of taxable income and make related consequential provisions

to deal with withdrawals from the decommissioning fund, additional moneys contributed to meet any shortfall and surplus amounts remaining in the decommissioning fund.

Local Content and Training

It is common practice to require petroleum operators to contribute to the building up of national competence in the petroleum industry and include nationals on their staff and help achieve desired levels of national expertise and know how over time. The local content component and utilization of local goods and services to the extent possible in the petroleum operations is a matter of key importance to host countries. It is important to set up agreed mandatory specific and realistic targets over a specified period to achieve specified percentages of local content in terms of local contracts and labour and capacity of its local staff in various skills categories.

Governments seek to facilitate a structured collaboration among the petroleum industry and local universities, business associations and communities. These objectives are facilitated by the establishment of petroleum training and education funds. Such funds provide for scholarships in the various technical fields of engineering, geosciences, mathematics, and related technology in the petroleum industry to pave way for nationals to fill important professions and areas where the country lacks adequate manpower and skills and expertise and foster awareness.

It promotes knowledge of these technical fields over a broad spectrum of the population by exposing them to selected promotional activities in the relevant fields and enhancing education and training in these fields in the country by improving the quality of teaching staff in these subjects at various higher educational establishments in the country. The funds are financed by agreed annual contributions made by petroleum companies operating in the country under the petroleum agreement towards

training. The contributions are cost recoverable and treated as deductible expenses for determining taxable income for income tax purposes.

Good Governance Measures

It is common practice to require good governance measures to apply in the petroleum sector to promote transparency and accountability, establish credibility, predictability and integrity in all activities of petroleum industry, including licensing, procurement, exploration, development, and production operations; and also, in the management of the petroleum revenues. These measures seek to promote provision of accurate and timely information through Government and other information media and other appropriate channels to key stakeholders and the public, their participation in decision making, and consultation process and engagement of all stakeholders in the process. A common good governance provision is the restriction on public officers holding petroleum rights or having personal interest in the licences directly or through their family members and requiring the Public officers to provide the listing and particulars of personal assets.

International trend is towards provisions for publication of information on petroleum contracts entered into, summary of terms and conditions, publishing of model petroleum agreements used in negotiations. There is a trend towards publication of signed agreements for transparency and public accountability, publication of petroleum revenues received from oil companies, development of revenue transparency measures in USA, Europe and other countries, EITI initiatives, petroleum revenue collection transparency, revenue management transparency and revenue accountability. Countries like Timor Leste and Ghana publish their petroleum agreements and Congo's recent transparency law provides for publication of oil, mining and forestry contracts to be published within two months of entering into them. In some countries like Ghana

and Sierra Leone signed contracts have to be ratified by national parliaments before they become effective. In countries such as Liberia, Peru, Ecuador, Sao Tome Principe there is contract disclosure and the contracts can be downloaded from websites. Niger's 2010 constitution requires disclosure of extractive industry contracts.

Extractive Industries Transparency Initiative

The Extractive Industries Transparency Initiative in the petroleum industry promotes publication and submission of information on petroleum revenues according to the principles, criteria and procedures established by the EITI. These principles require regular publication and independent audit of all financial transactions between oil companies and governments. To achieve EITI status a country has to meet the specified EITI indicators and thereafter EITI implementation requires measures to strengthen resource revenue transparency. EITI compliance is achieved when the country passes an independent assessment of the progress achieved and EITI validation in a two year period. There are presently 11 EITI compliant countries as of 2011.

The EITI initiative has been given supported by transparency legislation aimed at improved corporate financial transparency such as the US financial reporting requirements in the Dodd Frank Act that require all extractive companies listed on the US stock markets to report payments to the governments in countries where they operate. Similar transparency laws are planned in Europe. The EU has announced its plans to introduce country by country reporting for the extractive and forestry sectors. Other legislative measures include anti corruption legislation in USA and UK with criminal sanctions. Listed petroleum companies are also subject to stock exchange disclosure requirements.

EITI seeks to strengthen governance by improving transparency and accountability through independent audit and public reconciliation of payments made by companies and revenues received by governments. EITI envisages a multi stakeholder role and approach including governments, companies, investors and civil society in this process.

Health, Safety and Environment

The integration of health and safety matters and the process of environmental permitting for the protection of environment in accordance with bench marked prevailing international environmental standards in the planning and development of the petroleum sector is a key feature of modern practice. This involves the prior evaluation and approval of environmental impact studies at key stages of petroleum operations and the proposals for the mitigation of adverse environmental impact of operations on the environment by the appropriate national regulatory entity before commencement of operations. The principle of strict and joint and several liability for pollution caused by the petroleum operations is an established practice. In furtherance to national and global efforts to reduce emissions of greenhouse gases, protect the environment and considering the fact that natural gas is a valuable resource, the international practice is for government to maintain a policy of no flaring or venting of natural gas, except for testing, emergencies and for safety reasons.

Oil Spillage and Environmental Pollution

In respect of oil spillage and environmental pollution in some countries there is consideration of establishment of an environment management fund which seeks to provide last resort funding for spills and other significant environmental pollution caused by petroleum operations of oil companies operating in the country. Such fund is a last resort mechanism as it does not replace in any way the strict and absolute liability of polluter for the environmental

damage but seeks to come into play at the instance of the government when the company concerned (which may be mainly either small or medium oil companies) is not able to fulfill its liability because of insolvency. The financing of such environment management fund would be by an annual levy imposed on all the operating producing oil companies in the country which would constitute recoverable operating costs of the companies concerned. There would also be replenishments as required to restore the fund to previous level after an environmental incidence has necessitated access to the fund. In terms of international precedents the spillage fund contributions during the exploration phase are funded through a levy on companies on exploration drilling per well drilled e.g. New Zealand. In Australia the National Offshore Safety Authority established in 2003 is funded through fees and levies on industry by safety levies which comprise safety investigation levies, safety assessment of a facility, and annual pipeline safety management plan levy. In other countries the environment management fund is financed by a levy on producing oil companies production.

Domestic Market Requirement

It is common practice to require petroleum companies to make available pro rata portion of oil and gas produced by them to meet the national domestic market requirements at the market price.

Grandfathering Provisions

It is common practice to provide appropriate grandfathering provisions for existing subsisting licences and petroleum agreements when new petroleum law is enacted. These involve appropriate transitional arrangements for saving of existing petroleum rights and providing appropriate mechanisms for transitioning existing petroleum agreements to the scheme of the new law on a consensual basis agreed by the parties.

Public Expectation Management

The international experience of many producing countries has been that the discovery and production of petroleum resources raise significant expectations in the public as to the perceived importance and immediate benefits of petroleum activities in the country. In order to manage the public expectations Government provides the public with accurate and timely information about the activities in the sector thus addressing and dealing with false expectations and pre-empting the dissemination of false and/or unfounded information about petroleum operations.

Education of stakeholders at all levels as to the actual impact of the petroleum discovery and the flow of revenues to the Government and the nature and timing of the specific realized benefits to the members of the public from petroleum production needs to be provided in a comprehensive and effective manner. It is important that in this process the Government engages with all stakeholders and civil society organizations to address matters of concerns to the stakeholders.

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