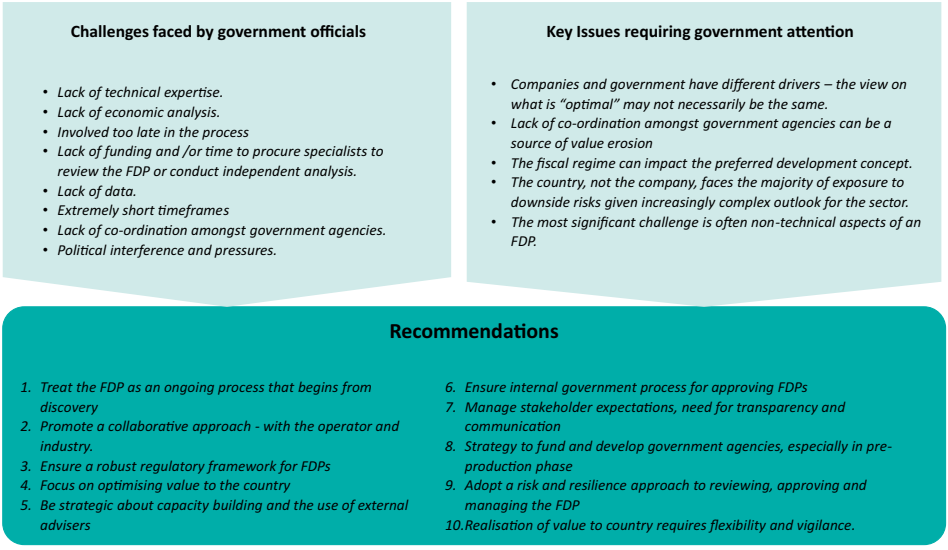
Chapter 3

Recommendations to Government Officials for Effective Review, Approval and Oversight of FDPs

This chapter is intended to provide guidance to government officials on the FDP process and stakeholder interactions to avoid regulatory capture, and ensure the country's best interests are served in the development of petroleum resources.

Adoption of the recommendations Figure 3.1 should ensure all aspects of the project – strategic, technical, economic, social and environmental have been identified and that mutually agreeable solutions have been included in the FDP. They should also produce a collaborative and constructive environment (intra-government and government-operator) which should result in timely approval of the FDP and avoid delays for first production.

Figure 3.1 Key Challenges and Issues facing the Government and Recommendations



1. Treat the FDP as an ongoing process that begins from discovery

The government, as owner[1] and regulator of the nation's valuable and finite petroleum resources, should not be a passive participant in its development.

1 Petroleum resources are vested in the state on behalf of its citizens

The greatest ability to influence a project – and hence the opportunity for preserving or creating value for the country – occurs in the Appraise and Select phases. Early and ongoing engagement with the operator will help to safeguard the country's interests. The government's interaction with the FDP must be well in advance of the regulatory point of submission.

This requires a paradigm shift from a reactionary mode (waiting for the government to receive the FDP) to proactive engagement with the operator to ensure the country's interests are best served.

2. Promote a collaborative approach – with the operator and industry

An oil and gas field's life cycle spans decades. The FDP is therefore the starting point of a long-term relationship between the government and company.

It is inevitable that differences on elements of the FDP will arise as the government and company are not dealing with the same strategies, time horizon, constraints, objectives and pressures. Such differences will continue to present themselves after the FDP is approved. A positive constructive environment would be conducive to quick and timely resolution of issues over a project's life span.

In the first instance, building a partnership based on a shared understanding of the project's risks, opportunities and expected outcomes under various scenarios is important. This is fundamental to the development of the FDP and requires ongoing communication and information sharing by both the company and government.

The government should also promote collaboration among companies within the sector as it can yield substantial benefits. Industry collaboration, where appropriate, can re-orient efforts from an individual company's focus on cost reduction towards value creation.

This was highlighted in reviews of the UK's oil and gas sector. Following an independent review on how to maximise economic recovery from the UK Continental Shelf (UKCS), the government stated in 2015 that "*To effectively respond to the challenges posed to the UKCS, a significant shift in regulatory culture is needed, with a focus on catalysing, encouraging and facilitating collaborative partnerships throughout the sector*[2]". A 2020 review of the upstream supply chain indicated that "*companies are able to reduce costs, share knowledge and maximize the economic recovery from the basin*[3]". There is thus growing evidence supporting the policy assertion that successful collaboration creates value for all – government, operators and suppliers.

2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/414444/Call_for_Evidence_Govt_Response-FINAL_120315.pdf

3 Collaboration becoming new reality as oil and gas industry index returns highest score of 7.1 | Deloitte UK

3. Ensure a robust regulatory framework

It is important for a country to have clear rules for FDPs given the far-reaching impacts on the economy, environment and society. These should be effectively addressed as part of the regulatory framework.

The regulatory framework refers to the combination of policies, laws, regulations, contractual arrangements and institutions that govern the petroleum sector, and by extension the FDP. This includes principles and commitments (obligatory and voluntary), at the national, regional and international level.

An effective regulatory framework will cover all aspects of the industry – operational, legal, fiscal, social, health, safety, environmental etc. Thus, it will sit across several sectors – for example petroleum, environmental, and finance. Effectiveness depends on the consistency and coherence between the regulatory frameworks across these sectors, as well as with broader economic development policies and related implementation tools.

The government's policy positions and international obligations should, as far as reasonably possible, be written in law. This provides clarity to companies and a basis for government agencies to plan ahead. It also allows for a non-discriminatory approach towards investors and avoids a situation where a contract (the petroleum agreement) serves as the primary legal instrument regulating the sector. This increases the complexity of administering the sector with each petroleum agreement, in effect having its own regulatory framework operating under separate rules. This is especially difficult for low-capacitated countries to manage and increases the probability of sub-optimal outcomes for the country.

The regulatory framework should minimize administrative burden and avoid inefficiencies. The use of standard definitions and reporting templates improves transparency, ease of administering and lends itself to effective monitoring and benchmarking of implementation across companies. The government can contribute to this by providing clear guidelines on timeframes and content of an FDP submission. Please see Appendix A for a Model Template for developing National FDP Submission Guidelines.

Each country's regulatory framework must be reflective of its own national context, objectives, laws, institutional framework and capacities. The formulation of national policy and legal framework must be carried out in a comprehensive manner which requires specialists to diagnose elements of the existing framework and make recommendations that reflect international best practice and are context appropriate.

Revising the regulatory framework is a complex matter that takes considerable time, but is essential for effective management of petroleum resources. It is the key tool to empower government officials facing challenges associated with the political economy and large asymmetries with operators.

Please see Chapter 4 for an overview of an effective regulatory framework for FDPs and Appendix C for a checklist and Appendix D for model FDP provisons.

4. Focus on optimising value to the country

Government officials should be conversant with governing laws and contractual terms for the project and seek to optimise value to the country as decisions are made throughout the FDP process. Value from a project will be the combination of the net direct (government revenues) and indirect benefits associated with it. Optimisation recognises that trade-offs are an inherent part of decision-making where there are multiple objectives limited by time and resources.

The indirect benefits from the project will be dependent on country and project specific factors. However, there should be a shared understanding between the operator and the government on the potential benefits, especially on local content. In addition it is important to ensure that the negative aspects from a project will be effectively managed. It is therefore critical that effective environmental and social impact assessments are conducted with clear action plans in place to manage the risks.

The project economics should be one of the focus areas of government's FDP review as it provides the assessment of the direct benefits from an oil and gas project i.e. the revenue streams to government. Decisions made throughout the FDP process will impact the project economics and how value is shared between the investors and country. Performing economic simulations using different assumptions for key variables would provide a picture of the amount and timing of government revenues.

Scenario-based analysis is critical to understanding the direct benefits in light of the project risks and should inform the development concept for an oil and gas field. This would enable an understanding of the overall value from different development concepts and how it is shared between the company and government. In light of the growing downside risks to the country from the energy transition and stranded assets these should also be considered in assessing the project value and government revenues.

Ideally governments should have their own economic models and analysts to support the FDP review and approval process.

The economic analysis of FDPs should therefore be a core element of the government's approval process and should be given greater prominence and scrutiny.

5. Be strategic about capacity building and the use of external advisers

Policy and legislation can provide an effective framework for FDPs, but effective implementation requires that government institutions are adequately resourced to be able to execute their duties. The government should take a holistic approach to ensuring the right combination of people and tools are in place across the relevant

institutions. Attention should be placed on non-petroleum agencies, for example environment and finance.

Capacity building is a long-term endeavour and the country will need to consider the balance of immediate expertise required versus longer-term management of the sector.

Investment into human and technical capacity should be carried out as early as possible, but should be informed by a strategy that balances short-term needs with sustainable national development of talent. A skills-gap analysis would be a critical step to identify areas where the government may need expertise, alongside the requirement for technical models to effectively review FDPs. It will be important to identify and prioritise filling the capacity gaps considering the outlook for the sector (e.g. 1 FDP vs 4 FDPs, resource prospectivity) and develop a resourcing plan to build national capacity. This should include actions in the short term to address pressing FDP needs.

Hiring talent can be an effective way to source experienced individuals to be able to pinpoint the points of greatest value for the country in the FDP process – both from value "creation" and "protection". When experts are hired, the contractual terms should include specific actions and timeframes for documentation, mentoring/coaching to faciltate knowledge transfer.

The government should also seek to leverage seasoned professionals with transferable skills from other sectors. For example, engineers from mining or construction sectors and accountants from financial services. Targeted training of such individuals can be an effective way to accelerate the building of national expertise.

6. Ensure internal government process for approving FDPs

Management of the petroleum sector is a complex web of inter-related and competing demands and interests across many government agencies. An integrated approach is needed to coordinate across sectors and leverage scarce financial resources/technical experts to support the attainment of the nation's development goals.

It is important to recognise that as a single project, the FDP cannot simultaneously satisfy all of the government's objectives. Especially if it is the country's first petroleum development.

Misalignments among government agencies can be exploited to the disadvantage of the country. This is exacerbated in jurisdictions with weak regulatory frameworks and low capacity.

An optimal outcome for the country can only be achieved if there is a "whole of government" position. As per recommendation 1 – this should be viewed from the lens of not simply "FDP approval", but at a minimum cover the "discovery to first production". This requires early involvement from a broad range of stakeholders.

Given the multiple government objectives, it is important the government understands the trade-offs for a particular petroleum project and works with the operator to ensure the FDP is based on mutually accepted solutions. This should be carried out through an integrated, interdisciplinary and inter-sectoral approach

Chapter 5 outlines a step-by-step guide on how to establish an integrated government process for the FDP.

7. Recognise importance of managing stakeholder expectations, need for transparency and communication

Unrealistic expectations about the potential benefits from a particular project can easily occur. It is vital that the government recognises this can delay FDP approval and first production and hence should be carefully managed. Provision of information to communities and the public on projects in a timely and effective manner can hep temper expectations. It is important that the company's FDP submission includes a stakeholder engagement plan to effectively identify stakeholders and ensure they are consulted in a meaningful way over the life of the project.

8. Strategy to fund and develop government agencies, especially in pre-production phase

One of the key contributing factors of regulatory capture is the government's limited access to finance. This is a common barrier that limits the use of external expertise and the development of strong national institutions (e.g. inability to hire or retain experts within the public sector, procurement of specialist software or hardware). These challenges are especially acute prior to production as there is little or no government revenue from the sector.

This situation has worsened in the aftermath of the COVID-19 pandemic as government finances have been severely depleted and available resources have been prioritised towards recovery efforts. Furthermore, as a consequence of the climate crisis and the energy transition, many development agencies and donors are withdrawing support to the oil and gas sector. This is both in terms of technical and financial assistance.

In light of such circumstances, it is vital for Governments that are dealing with significant technical gaps to develop funding strategies to address them in the short and long term.

In the short term this could include prioritising the areas that can have the greatest impact. For example, is the greatest need in the environmental agencies who are tasked with reviewing ESIAs? Or is it in the agency providing economic analysis or reviewing the subsurface plans?

One area that could provide benefits indirectly is clarity on roles and responsibilities among agencies. This would avoid duplication of efforts and ease pressures on building similar capacity across multiple agencies.

In the longer term, the government may want to consider how the legal framework can support the use and funding of external experts for reviewing FDPs and more broadly government capacity building efforts. For example, provisions that expressly outline a clear transparent process for third party reviews (including treatment of such costs e.g. tax deductibility) can provide some assurance and comfort to both companies and Governments. Legal provisions can also specifically earmark a certain portion of annual training and development contributions towards government needs.

9. Adopt a risk and resilience approach to reviewing, approving and managing the FDP.

Given the significant risks associated with a petroleum project, a resilience approach can supplement the traditional risk management practices to ensure the country benefits from the development of the project.

Risk management involves (1) the identification of sources of uncertainty, which can be either positive (upside or opportunities) or negative (downside or threats) (2) the assessment of likelihood and impact of occurance (3) putting measures in place to deal with the risk e.g. eliminating, reducing, transfering or mitigating. Resilience on the other hand, refers to the ability to anticipate, prepare, adapt and recover from adverse events and disruptions. Whilst both concepts are related, resilence is broader and geared towards ensuring that projects can "withstand" and "cope" with shocks.

Given the growing challenges facing the petroleum sector it is prudent for governments to understand how resilient new oil and gas projects are to potential future shocks. For example, the energy transition introduces several new uncertainties. How would project value and government take be impacted if oil or gas exports were subject to carbon border-adjustment taxes? How resilient is the project design? Are facilities built with additional buffers in anticipation of worsening climate change impacts? (e.g. storm surges, frequency of floods).

A 'risk and resilience' approach to approving the FDP would focus both company and government agencies on the longer-term horizon, anticipating disruptions and testing the project robustness to potential disruptions, especially in the longer-term (where the company may not be focussed on but the government should be).

10. Realisation of value to country requires flexibility and vigilance

The approval of the FDP is only the first step towards realisation of benefits from an oil and gas project to a country. As noted earlier, the FDP is subject to large uncertainty and there could be significant changes after it is approved. The legal framework should ensure the government is aware of these risks and the FDP processes are flexible to accommodate such events. Ongoing interactions between the operator and the regulator should enable efficient handling in such instances.

It is also important that there is effective communication to all relevant arms of government on changes to the FDP. This is especially so for the Ministry of Finance if there are changes to government revenue forecasts.

Approval of an FDP does not constitute the approval to engage in drilling, installation of facilities etc. as there would be separate approval processes for such activities. For benefits to flow, it requires firstly that petroleum activities are executed on time and budget as per the project plan (construction of facilities, drilling wells etc.). The regulator should ensure all project activity is in accordance with the FDP which requires ongoing monitoring and engagement with the operator.

The scale and consequences of disasters (environmental, lives, livelihoods) can easily exceed any economic benefits of petroleum projects. Extreme vigilance is required to ensure the operator is effectively managing risks and that mitigation measures are in place.

Please see Appendix B for a Summary Recommendation Checklist.