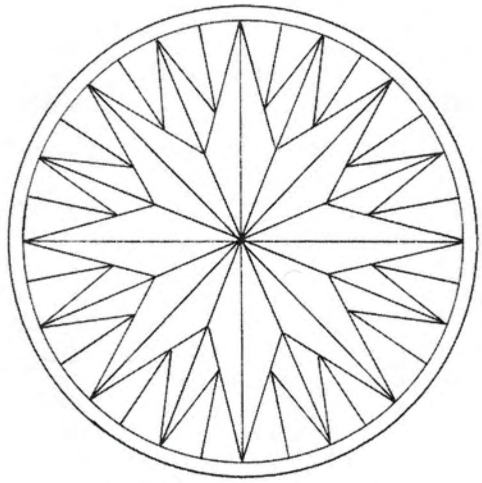

International Primer

First Edition

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ipaa
America's Oil & Gas Producers

Independent Petroleum Association of America

Why Go International?

Growth – The primary reason for initiating an international effort is to gain exposure to longer term and higher impact projects. These opportunities tend to be limited in the traditional producing basins in North America.

Niche Opportunities - Many countries have few, if any, indigenous oil and gas companies. This can translate into less competition for the type of opportunity that would fit an independent company's risk appetite and capital exposure target.

Exposure - The concessions or acreage positions that are available internationally generally are far more extensive than domestic offerings. It is possible to acquire acreage with multiple prospects and multiple play types.

Government Attitude - Foreign governments tend to be very encouraging towards the exploration for and development of oil and gas.

International Issues To Consider

Deal Flow - As in the domestic arena, deal flow can be limited. Quality deal flow and the best opportunities can be competitive.

Fiscal Terms - Fiscal regimes are much more complex than in the U.S. A general guideline is "small doesn't work".

Legal Issues - Petroleum laws vary dramatically from country to country and often can be ambiguous and part of immature legal systems. Doing your legal homework can offset much of this.

Politics - Relationships and politics are critical in conducting business and will require a considerable investment of time and effort.

Commitment - Patience and trust are an absolute must.

The First Steps

1. Develop A Clear Mission Statement and Business Plan

It is very important in the early stages of an international start-up effort to develop a mission statement and define the company's objectives.

- What type of opportunities will be pursued – High risk? High potential exploration? Available contracts/bid blocks? Producing property acquisitions or a balanced portfolio? Oil versus gas?
- Where are these types of opportunities likely to be found?
- What level of exposure is targeted? (net reserves, net daily production)
- What technical criteria are important – subsurface factors, production characteristics, field (or basin) maturity, etc.?

Among other factors to consider are fiscal terms, entry costs, business environment (access to markets, product pricing, corruption), political risk (both host country and unilateral actions by the U.S.), and financing options for project development.

The business plan should outline financial and reserve/production targets for each focus area. This should include, but is not limited to, an estimate of resources required (personnel and capital), measurable intermediate goals, and time frames for achieving these goals.

It is important to ensure that the required resources are available within the organization and that the time frame is consistent with overall corporate needs and goals. The company should anticipate that it might take as many as seven to ten years from start-up to revenue. To fast track the revenue stream, focus on specific types of opportunities. Examples would be producing property acquisitions, field revitalization projects, and drill-ready exploration prospects. For these types of opportunities, there generally will be some type of entry cost. Once a revenue stream is established in an area, a traditional regional exploration program may be pursued.

2. Assess Political Risk

In the context of an international oil and gas venture, political risk can be defined as any factor outside the technical aspects of exploration, development and production operations (drilling, facilities engineering, etc.), other than Acts of God, which may reduce or destroy the value of the oil and gas assets.

At its most extreme, political risk could be the chance of nationalization or expropriation of the assets by a host government. More common examples of political risk are acts of terrorism (blowing up pipelines, etc.) or kidnapping of key employees. Less extreme, but potentially devastating is "creeping expropriation": the chance that cash flows will be postponed by government-induced delays or that cash flows will be reduced by retroactive changes to production sharing or license agreements or to taxation regimes.

An additional element of political risk may be the problem of bribery. This can occur at a high level, involving requests for large sums of cash to smooth the way to obtain acreage, but also can be common at lower levels. The issue of bribery varies considerably from country to country.

Unfortunately, one of the general rules of international exploration seems to be that the largest reserve potential lies in regions with high political risks and large entry costs. Companies involved in international exploration and production should be careful not to invest too heavily in a single country or region with high political risk. If the quality of the potential is considered to be so great as to justify "putting all your eggs in one basket", there are a number of strategies to reduced these risks:

- Expropriation insurance can be obtained, although this is probably the lowest of the political risks at the present time.
- You may be required to open a local office and hire staff such as local counsel. Ensure that this person is well respected and well connected. Your local staff can be very influential in ensuring that timetables are met and operational issues resolved.
- To reduce the risk of bribery, consider bringing in a local partner who is well respected in business. This strategy runs the risk that the local partner may attempt to gain a larger interest if a discovery is made.
- One potential for government-induced delays occurs with civil servants, who may lose or misplace permit applications. Treat everybody with respect and acknowledge those who are involved in the day-to-day business. Cultivate professional relationships with all levels of staff to ensure that they feel they have an important role to play. Opening a local office can facilitate this critical dynamic.
- Be a good corporate citizen. Consider investing in small local infrastructure projects, commensurate with the size of the overall oil and gas investment the company is making in the region. This may involve setting up clinics, installing water systems, or providing basic electricity generation services.
- It is common for companies to take out insurance against kidnapping. Note that most policies state that employees must not be told that they are covered by such insurance, since kidnappers demand much higher sums if they discover its existence.

Bribery has been endemic in many countries and it is not unusual for companies applying for acreage to be informed, usually through a middleman, that payments will be required. The combined efforts of Transparency International, the Foreign Corrupt Practices Act (FCPA) (www.usdoj.gov/criminal/fraud/fcpa.html) and the recently introduced European equivalents appear to be taking effect. It is now much less likely that a competing "western" oil company will be willing to pay a bribe to take the acreage.

- Any company should take the risk that management, staff or local representatives may succumb to the temptation to bribe very seriously, particularly since the FCPA is likely to hold the chief executive responsible. Ensure at an early stage with all parties that your company will not pay bribes.
- When taking a deal from another company in a country known to have problems with bribery, it is normal practice to include a clause in the agreement to the effect that the selling company warrants that neither it nor its local representatives have made any payments that might be prohibited under the FCPA, or its equivalents in other relevant countries. It is recommended that this clause be insisted on to provide a measure of protection against prosecution for the acquiring company.
- Note that there are firms that offer companies assistance in dealing with these issues including corporate responses to terrorism (lessons learned and moving forward), international money laundering (what is it, and how to avoid it), and kidnapping and extortion trends worldwide.

3. Determine A Strategy for Entry

In any area, there is an entry cost. Whether you enter by farm-in, acquisition, partnership or as a startup, you will have to invest something to get established.

- A farm-in or partnership, as discussed below, will almost certainly require some form of promotion, whether dealing with another oil company or a NOC.
- An acquisition in a target basin is another entry strategy. This would bring acreage, production and revenue, a database, possibly a technical staff and establish you as a player in an area. This would demonstrate your commitment and allow you to get into the deal flow.
- A "starter project", a deal that provides entry in a promising area at a low rate of return, may be a strategy for an exploitation opportunity or acquisition. Doing such a project also would demonstrate a regional commitment, establish a base of operations, garner local expertise and enhance access to other opportunities in the same area.
- Going forward, it is necessary to recognize that each means of entry will be effective only in certain basins. While means of entry are not mutually exclusive in a program, they may be in a certain area. It is important to apply the right strategy in the right country, and dedicate the appropriate resources for data and manpower in order to be successful. You also need to determine if you have the resources to pursue more than one path.
- Equally important in all these cases is the time required to climb the learning curve and begin to compete for your own concessions in an area. Without your own representative in country, this endeavor can be difficult.

There are a number of different strategies for entry.

- Joint Study Group - Knowledge of local hydrocarbon systems, regulatory regimes and application procedures form a very important aspect of the initial entry decision and may take significant time and expense to develop.
  - Many companies prefer to form a study group, which may develop into a bidding group, to cover this first stage. The partner operating the study group will either be a locally based company or one with more knowledge of the area than the other partners.
  - Bear in mind that the partners in an exploration and production license or a Production Sharing Contract (PSC) are normally held jointly and severally liable for the obligations, irrespective of the individual obligations under an eventual Joint Operating Agreement (JOA). It is therefore important to be comfortable with the partnership group from a financial as well as a technical point of view if the intend is to make acreage applications. Many countries also require the posting of a bond to cover the value of the committed work program, which can present problems for small companies.
  - The operations of the group will normally be governed by a JOA, which should include:
    - Definition of the partners and their interests
    - Definition of the study area
    - Definition of the term of the agreement
    - Designation of Operator and his duties
    - Procedures for changing the Operator
    - Procedures for applying for acreage and agreeing a work program, including applications by less than all the parties
    - Procedures for assignment of interests (prior to award of any acreage)
    - Default procedures
    - Applicable law
    - Accounting procedures, including:
      - Operator's overhead charges
      - Cash calling and billing procedures
  - An agreement among the parties also may establish an Area of Mutual Interest (AMI), and it may indeed be called an AMI agreement. The parties will normally be bound by the agreement not to submit an application within the AMI other than under its terms. If acreage within the AMI is acquired by one or more of the parties by farm-in or purchase during the term of the agreement, they will normally be bound to offer interests to the

other parties on the same terms, such that the acreage is shared according to the interests of the parties as set out in the agreement.

- Farmout Agreements - Although most independents prefer to generate their own prospects, a farm-in to existing acreage has several advantages in the international arena.
  - One of the drawbacks of international work is the length of time it can take to progress from the initial idea to acquiring the acreage and generating a drillable prospect.
  - Farming-in to acreage with a prospect already in place can save as much as five years work. The standard international farm-in terms have tended to be "pay 100 percent to earn 50 percent", but the area earned normally encompasses far more than the single prospect to be drilled.
  - Be aware that many countries will not allow an assignment of interest in a license agreement or PSC until the initial work program commitments have been completed. Most countries will still allow an "earning-in" agreement to be entered into, with the understanding that the interest will be assigned when the obligations have been fulfilled. The agreements usually have a clause to protect the company farming-in in the event that the host government does not ultimately approve the assignment.
  - Note that most international JOAs give the partners the right of first refusal and right to refuse assignment of interest to a new party on a number of grounds, especially on the basis of lack of financial strength. Although very rarely invoked, this relates to the problem that most licenses stipulate that the parties are jointly and severally liable for the obligations.
- Direct Application to Government - Most international governments regulate the award of new acreage, either for licensing or for PSC's, through offerings in "bid rounds".
  - In these rounds, the acreage available for bid is published in advance and a date is fixed for the submission of applications. There is sometimes an opportunity to nominate areas for inclusion in bid rounds and lobbying for acreage to be included can be successful.
  - In considering the applications submitted, the government will take into account a number of factors including:
    - Technical competence of the companies applying
    - Financial strength of the companies applying
    - Do the applicants have new ideas? Ultimately, are they more likely to find hydrocarbons than their competitors?
    - What work program are they proposing?
    - Kilometers of seismic (2D vs. 3D)
    - Number of wells
    - Timing of program
  - Note that most countries require a minimum expenditure commitment and minimum work obligation
    - Can the applicants pay for the work program? If not, how do they intend to raise the capital? Note that most governments dislike the idea of promotion, although most will accept it if you are bringing new technical ideas to the table.
    - Does the proposed Operator have the necessary experience? It is often possible to obtain a license with a stipulation that the Operatorship is only valid during the initial exploration period. In order to move to either drilling or development work, it will be necessary either for the Operator to satisfy the government that he is taking sufficient steps to strengthen his team or for the group to find a new Operator.
    - Do the applicants have the ability to develop oil and gas if they find it? Note that evidence of financial strength normally takes the form of audited accounts of the parent company. This can present problems for private companies and partnerships, although many governments are now accustomed to dealing with such entities.
  - In some countries (e.g. the United Kingdom), there are additional considerations:
    - Does the Operator have established health and safety policies?

- Is the Operator's environmental policy satisfactory? It is often necessary to produce an outline of an environmental impact statement when making the initial application.
    - Has the Operator agreed to abide by industry-wide agreements made with local trade unions?
- Other countries have a system of bonuses and other payments as part of the application process
    - What is the level of signature bonus offered?
    - What other bonuses are being offered?
    - There are often bonuses to be paid in stages as stipulated production targets are reached (normally [x],000 bopd for a sustained period of [y] days)
    - Many countries require training of local personnel as part of the bid, normally stipulated in dollars per year.
- Many countries stipulate that license awards be made only to locally registered companies to ensure that taxes can be collected.
- Many countries require successful applicants to post a bond or parent company guarantee in favor of the government to cover the cost of outstanding work obligations. In case of non-performance, the government can cash the bond.
- There are still countries (for example, Tunisia, Libya, France, Italy, and Spain) that are willing to entertain applications for acreage outside any formal bid round. Some of these countries will make a public announcement of applications received and allow competitive bids from other companies. Others will allow the process to go forward without competition. In either case, the parameters used to consider the application will be similar to those outlined above.

4. Initial Contacts

Directly With Foreign Government – The Ministry of Energy or the National Oil Company (NOC) often will be your first visit in a new country, especially in the case of a "cold call".

Through Other Companies and Consultants – Useful sources of contacts include multinational service companies, large accounting and financial services firms, and international law firms.

It is likely that independents already have some relationship in the U.S. with one or more of these types of companies. Their local offices are usually very helpful in providing not only contacts, but also insight into the operating, business, and political environment in specific countries.

Through Chambers of Commerce and U.S. Embassies – Many countries sponsor local chambers of commerce in various cities that meet on a regular basis. Many of the U.S. Embassies in the oil producing areas of the world have energy specialists on staff.

5. Qualities To Convey to Foreign Governments

Differentiation is the key to gaining access to opportunities. It is critical to communicate the particular specialty that your company can provide that sets it apart from the competition. International programs should be tailored to identify projects that play to a company's strengths.

- Experience/Expertise
- Financial Capabilities

- Ability to Make Quick and Efficient Decisions
- Particular Specialty
- Team Player
- Good Corporate Citizenship

6. Know The Playing Field

Know Your Primary Competitors

- **International Oil Companies (IOC's) or Multinational Oil Companies (MNOC's)**. These can be subdivided as follows:
    - Global Companies - the household names. Those companies that have core areas around the world.
    - International Companies - both majors and independents, with a significant area or two outside their home country.
    - Emergent Companies - the newcomers.
- **National Oil Companies (NOC's)**. These are the state-owned companies that carry out oil and gas activities on behalf of the state. Many have recently or will shortly be dealing with some type of privatization in their home country or with a public offering in international stock markets.
- **International Service Companies and Integrated Gas/Power Companies**. These are relatively new competitors to the upstream side of the business and will in some cases take equity positions in E&P deals.
- **Indigenous Companies**. These are in-country companies not owned by the state, which may or may not have the technical expertise or financial resources to carry on a viable business. Often they have connections within the NOC's or governments and therefore access to licenses, acreage, and local networks.

Know the Host Country Needs

Realize that the primary objective of the host country is to discover, develop, and produce its oil and gas resources to meet the economic needs of the country.

Understand the host country's development priorities – jobs, infrastructure, capital, etc.

Know the Restrictions That May Be Imposed by the U.S.

- Export license restrictions
- Sanctions (www.usaengage.org/resources/map.html)
- Trade policies

Know Market Conditions and Infrastructure

Knowledge of the commercial arrangements, markets, and infrastructure will be important in determining the economic viability of investments in that country.

Knowledge of funding sources and financing also is important.

Know the Local Deal Flow

The ability to structure innovative deals with creative financing, the ability to act quickly, and to make timely decisions is important. As with any new venture, a key element is exposure to opportunities. The word needs to get out that your company is in the market for international prospects. You need to be knowledgeable about deal flow to develop a realistic perspective of the types of deals that are available, and which ones are completed.

To demonstrate interest, build a contact base and accumulate the "data points" needed to develop a ranking system. Allow for some inefficiency in the early stages. You cannot arbitrarily select appropriate focus areas from afar.

Do not preclude looking at an attractive proposal, one that may be a good fit for your strengths, by imposing rigid filtering criteria. Although you need a degree of flexibility while narrowing the search for International focus areas, you also should exercise discipline so as to not get sidetracked and lose sight of the objectives.

Know How To Differentiate Risk

Although most independents are well equipped to cope with "below ground" risks, new skills are required to handle "above ground" risks. Skill sets include international negotiation, crude oil and/or gas marketing, infrastructure development and developing local markets.

- Above Ground Risks
  - Domestic political attitudes about industry
  - Labor union issues
  - Environmental sensitivities
  - Civil strife
  - Transportation routes, boundary disputes
  - Exposure to taxation
  - Currency risk
- Below Ground Risks
  - Exploration risk
  - Reservoir performance
  - Operational difficulties

Know the Difference Between Oil versus Gas Opportunities

There is a big difference in the oil versus gas markets in the world. While oil has a world market, gas is still geographically constrained. If you find commercial amounts of oil, it is comparatively easy to get to market at internationally priced terms.

On the other hand, the prices paid at the wellhead for natural gas vary widely. There is no international market for gas and the price is based on what can be negotiated or what the government is willing to pay. Companies need commercial skills to develop these markets for gas, either through LNG or power generation projects.

Gas-to-liquids technology may be a new breakthrough that will create additional markets for the gas.

Know the Rules for International Reserve Reporting

With the exception of the Former Soviet Union, reserve definitions in areas outside North America generally follow guidelines similar to those of the Society of Professional Engineers (www.spe.org)

The definition of Proved reserves was broadened for the North Sea because it would have been impossible to arrange development financing for large offshore fields on the basis of Proved reserves defined in terms of a limited area around each appraisal well. In the North Sea and many other international areas, seismic information has long been used in conjunction with widely spaced wells to determine the Proved reserves. In addition, reserves in the U.K., and in many other international areas, are normally reported as Proved plus Probable, since companies tend to have large stakes in the acreage containing big offshore fields but the number of delineation wells is limited until a platform has been installed.

Canadian companies report their reserves on the basis of Proved plus half Probable.

A term in common international usage is "technical" reserves. These are reserves which would normally be defined in the Proved and Probable categories but for which no means of economic development have yet been determined.

Dealing with Host Governments

In almost all international areas, acreage is held by the national government. Therefore, applications to explore for and produce oil and gas are generally made to a single central government body. This normally is the oil and gas directorate or ministry, in cases where exploration and production licenses are awarded, or the NOC in cases PSC's are awarded.

1. Key Points

- Do not underestimate the importance of proactive government relations.
- Be mindful that some countries may have a reputation for difficult negotiations. In these instances, gather as much information up front as possible about players and positions.
- Realize that host governments may have a different definition than your company of risk and reward.
- Be aware that what you consider to be satisfactory deal terms may be outside the scope of what the host government considers acceptable.
- Understand International Petroleum Customs and Practices.

2. Create Positive Relationships

Steps in Building Relationships

- Understand and respect cultural differences
- Understand business, legal, and political climate
- Always be respectful to host country
- Extend invitations to home country
- Exercise personal and company integrity
- Offer training to host country
- Use local service providers if available and competitive

Importance of Establishing Local Staff and Office

- To be an effective competitor in the targeted focus areas, it is important to have some form of local representation. This will provide access to deal flow and allow you to develop a local expertise. Former employees of oil companies who live in a particular area are often good local representatives and having them on staff may ease operational and governmental challenges.
- Local representation can take many forms in the early stages. Partnering with the state oil company, an indigenous company, or another International company that may already be established in an area is not unusual. International service companies also have a good network of contacts and may provide technical strengths that an independent operator could utilize.
- A consultant that is familiar with the oil industry, the customs and the people that you need to know to conduct business can be retained as a representative. Compensation for this individual can be as a retainer or as a success fee for helping to identify and close deals.
- Alternatively, you can open your own office or purchase or merge with an existing company that is set up in the country of interest.

3. Reporting Obligations to Host Governments

Each country will have its own set of reporting requirements to various agencies. It is important that you have a checklist for each country of what is due and when. Keeping the National Oil Company or Ministry well informed, even beyond the contractual requirements, will typically serve you well. Expect to encounter:

Work Programs

- Detailed work programs are usually required to be submitted on an annual basis, often by the anniversary date of the license.
- The work commitment is often stated in terms of a minimum dollar contribution or an amount of minimum activity.
- At the completion of a year, an audited report showing that the work commitment has been met may be required.

Joint Management Committee

- Most PSC's provide for a Joint Management Committee (JMC) to review and supervise the work program.
- Generally, it will be composed of 50 percent government representation and 50 percent company representation.
- Approvals usually require unanimity even though the government is not paying for the work program.

Other Special Obligations under a Production Sharing Contract

- Under PSC terms, there is generally a cost recovery pool for pre-production expenses. This usually must be consistent with approved budgets and work programs.
- Tax pools for future deductibility against profits accumulate during the pre-production phase. Often these costs must be approved by different government bodies and are subject to audit and exception.

Financial Capability Requirements

- Many host governments require proof of financial capability before licenses will be awarded.
- Proof may take the form of detailed financial information, letters of support from U.S. parent companies, bank and/or professional references.

Contracts

1. Common International Contracts

Production Sharing Contracts

- PSC's are one of the most widely used forms of contract in international oil and gas ventures.
- The host country grants to the foreign oil company a contractual right to explore in a specified area in exchange for the company's opportunity to recover its costs and a specified profit. In return, the country contributes the acreage and receives a share of production.
- The management clause of the agreement may give the state oil company significant involvement in the operation of the enterprise since the ultimate goal of the host country is to assume operatorship of developed, producing fields.
- Each contract will address how the foreign oil company's costs will be recovered and whether any bonus, interest, or other costs will be added to such cost recovery.
- The foreign oil company is considered a contractor to the government. The contractor takes a percentage of the production to recover costs and a profit split with the host government from production of oil.
- As low cost operators, independents have an advantage in certain countries, especially those with a tax-royalty fiscal system. Being a low cost operator, however, is generally not an advantage in a country with a PSC system, since most of the money that is saved goes to the government.
- Another consideration in a PSC environment is the relative exploration maturity of the project. Because exploration costs are fully deductible from production revenues, the tendency for the foreign oil company operator has been to over explore rather than under explore because the government is, in effect, picking up 65 percent to 85 percent of the costs.

Risk Service Contracts

- Risk service contracts are used most often in Latin America, but are not limited to that region.
- These types of contracts allow the foreign oil company to explore, develop, and produce reserves, while the host country/state-owned oil company avoids constitutional and statutory restraints on foreign ownership of oil and production.
- The foreign oil company contracts to explore all or part of a concession granted to the host country/state-owned oil company. The foreign oil company is reimbursed for its investment and paid for its services only if there is commercial production. The contract usually provides for payment in cash but the foreign oil company may have the right to purchase a portion of the oil produced, frequently at a discounted price. If no oil is discovered, the contract terminates without compensation to the company.

Concession Tax/Royalty Agreements

These familiar arrangements are used in many countries, such as the U.K., Australia, and Brazil and apply to about 50 percent of total worldwide production. While a system of Government taxation is familiar to all U.S. producers, a government-imposed royalty is only familiar if production is on federally held lands.

Joint Operating Agreements

- As discussed above with respect to Joint Study Groups, the operations of the partners group will be controlled by a JOA (to a greater degree than is usually found in domestic operations).
- The JOA will include:
    - Definition of the partners and their interests

- Designation of Operator and his duties
- Procedures for changing the Operator
- Procedures for approving the annual work program
- Procedures for approving budgets and AFE's
- Provisions for operations by less than all the parties ("Exclusive Operations")
- Default procedures
- Applicable law
- Accounting procedures, including:
  - Operator's overhead charges
  - Cash call and billing procedures
  - Equipment procurement and disposition procedures
  - Audit requirements

- The AIPN Model Agreement is often the starting point for these agreements. (order from aipn@aol.com).

Confidentiality Agreements

- Most independents are intimately familiar with Confidentiality Agreements (CA's) in North America. CA's can be quite different in other countries.
  - Check term of CA – it should not exceed term of license.
  - Check liability provisions for breach – make sure these are acceptable prior to executing agreement.
- The AIPN standard form is a good reference.

2. Fiscal Considerations of Various Types of Contracts

Production Sharing Contracts

- Most contracts divide the production stream into two components: cost recovery oil and profit sharing oil.
- Under cost recovery, all expenditures are eligible for recovery in the year they are incurred, but the amount recoverable may be limited to a certain percentage of production. Cost recovery oil that is not claimed generally is shared between the company and the government as profit oil.
- The contract will specify a certain portion of production to be shared between the company and the government. Revenue also is usually subjected to a royalty and income tax. Some oil may be required to be sold in the domestic market at a discount from the market price. Production bonuses may be required at first production as well as at threshold production levels.

Risk Service Contracts

- The company may be paid in cash or kind at a fixed fee for its services rendered to the host government.
- Exploration and production costs are reimbursed from production.
- The company has the right to buy a portion of the production at world market prices that is equal to its payment.

Concession Tax/Royalty Agreements

A royalty is applied to gross revenue and a tax (or taxes) is applied to the profits from remaining revenue, after deduction of the royalty, operating costs, and depreciated capital investment costs.

Alternative Taxes May Be Imposed

- Annual License Fees –similar to annual surface rentals
- Taxes Specific to the Petroleum Industry (for example, the PRT in the UK or PRRT in Australia)

Fiscal Incentives May Be Offered

- Lower Tax and Royalty

- Royalty Exemption
- Lower Production Share to Host Government
- No “Ring Fence” – For tax purposes, investments made on any acreage in a country may be recovered against income from production from anywhere within the country.
- Removal of Export Controls
- Removal of Exchange Controls
- No Carried Interest
- No State Participation – To promote a joint venture, the state company is structured as a true commercial entity, with a reasonable participating percentage, which pays its way in exploration and assumes all risks in the joint venture.
- No Signature Bonus

Business Practices and Dispute Resolution

1. Practices Under the JOA

Operating Committee Meeting (OCM)

- The management committee, as directed by the JOA, exercises supervisory control over operations. Each participant has one representative on the committee with a vote weighted in accordance with the participant’s interest in the project. The powers of the Operating Committee may be specifically listed or stated in general terms. The Operator then has a general responsibility to manage and conduct the joint operations, as authorized by the Operating Committee.
- The JOA will provide what percentage of votes (and possibly how many parties) is necessary for approval of a recommended work program, budget or AFE.

Work Program and Budget

- The work program and budget generally must be submitted to the partners for approval by a certain day of the preceding year.
- The work program will detail the operations to be performed in the permit area for the following calendar year. Within a certain number of days following its submission, the Operating Committee will meet to consider and approve the Work Program and Budget.

2. Dispute Resolution

Arbitration

Advantages of arbitration compared to litigation:

- Cost and delay, resulting partly from the lengthy American discovery process and the necessity to educate the Court with the complexities of the international business transactions.
- Adversarial nature of litigation damages the relationship between the parties involved (many international transactions are structured with an ongoing relationship of 10-30 years).
- Litigation often exposes the parties agreement (which often times are kept very confidential) to the public.

The following should be addressed in the arbitration clause of the operating agreement between the parties:

- Description of issues that can be arbitrated

- Governing law provision
- Place of hearing
- Set of administrative rules
- Procedures for appointment of arbitrators
- Determining the number of arbitrators
- Appropriate language of the hearing
- Any applicable time limits
- How costs are to be shared
- Currency in which the award is to be paid
- Need for an award enforcement provision

Mediation

Under the new standard JOA, mediation will assume more prominence. The parties will agree to mediate disputes, although often the decision is not binding.

Mediation generally involves the selection by the parties of one mediator who renders a decision that the parties have the option to but are not compelled to accept.

Litigation

In international operations, this option usually is not the favored method of dispute resolution since winning in a foreign court in the host company's home country is difficult.

Information Appendix

1. Applicable U.S. Accounting Principles

- Generally Accepted Accounting Principles (www.investopedia.com/terms/g/gaap.asp)
- FASB Summaries (www.FASB.org, http://accounting.rutgers.edu/raw/fasb/stpg.html)
- Accounting for Income Taxes (http://accounting.rutgers.edu/raw/fasb/st/summary/stsum109.html)
- Disclosure of Proved Reserves (http://accounting.rutgers.edu/raw/fasb/st/summary/stsum69.html)
- Reserve Writedown Rules – FAS 121 (http://accounting.rutgers.edu/raw/fasb)
- Permanent Reinvestment Rules – APB 23 (http://accounting.rutgers.edu/raw/fasb)
- Determining the Functional Currency – FAS 52, Appendix A (http://accounting.rutgers.edu/raw/fasb)
- Recording Exchange Gains/Losses – FAS 52 (http://accounting.rutgers.edu/raw/fasb)
- Council of Petroleum Accountants Societies (COPAS) (www.copas.org)

* Note that the government of the host company also may require statutory audits under different accounting principles.

2. Checklist of Tax Considerations

In-country Taxation

- Corporate Income Tax
- Computation of Taxable Income (including timing of deductions, deductibility of overhead)

- Capital Gains Taxes
- Capital Taxes
- Custom Duties
- Treaty Network (withholding and permanent establishment)
- Formal Audit Requirements
- Consolidation Relief (Tax Unity)
- Taxation of Foreign Corporations & Non-Residents
- Foreign Ownership Restrictions
- Individual Tax Filing Requirements
- Value Added Tax
- Petroleum Industry Specific Taxes
- Registration Taxes
- Ad Valorem Taxes
- Withholding Taxes
- Stamp Taxes
- Transfer Pricing
- Exchange Gain/Loss Issues

Tax-efficient Worldwide Structure

- Branch versus corporation
- Flow through entity versus nonflow through entity (Note U.S. "Check-the-Box" rules)
- Repatriation
- Exit Strategies (e.g., liquidation)

U.S. Tax Filing Requirements (www.irs.gov)

- Form 5471, 8265, Information Reporting by CFC's and Partnerships
- Form 99-1, Signatory of Bank Accounts Form
- Form 1116, 1118, Foreign Tax Credit Calculation
- Form 926, Return by US Transferor to Foreign Corporation
- Form 8832, Entity Classification

3. Funding Sources and Financing

Capital Providers

- World Bank (www.worldbank.org)
    - Provides loans and assistance to the governments of developing countries for development (not exploration) projects
    - Includes Africa, Asia, Latin America, the Caribbean, and Europe
    - Finance lending from capital market borrowings, retained earnings, and cash flow
    - Cooperates with International Finance Corporation (IFC) (www.ifc.org) for technical assistance, lending and loan guarantees
        - IFC finances private sector projects, assists developing countries to secure financing in international markets, and provides advice and technical assistance
        - IFC investments typically range from $1-100 million
        - IFC limits total debt and equity financing to 25 percent of any single project
        - IFC may provide up to 35 percent of equity capital if it is not the largest shareholder
- U.S. Government Agencies
    - **Export/Import (Ex-Im) Bank** - Mission is to create jobs through exports. It provides guarantees of working capital loans for U.S. exporters, guarantees the repayment of loans or makes loans to foreign purchasers of U.S. goods and services. Ex-Im Bank also provides credit insurance that protects U.S. exporters against the risks of non-payment by foreign buyers for political or commercial reasons. Ex-Im Bank does not compete with commercial lenders, but assumes the risks they cannot accept. It must always conclude

that there is reasonable assurance of repayment on every transaction financed. (www.exim.gov)

- **OPIC** - Assists U.S. investors through four principal activities designed to promote overseas investment and reduce the associated risks (www.opic.gov).
    - Insuring investments overseas against a broad range of political risk including currency inconvertibility, expropriations and political violence;
    - Financing of businesses overseas through loans and loan guaranties; typically range from $100K up to $200 million, need 25 percent ownership in project, 3-15 year term;
    - Financing private investment firms that provide equity to businesses overseas;
    - Advocating the interests of the American business community overseas.

- Commercial Banks and Institutions

  Borrower will need:
    - Large equity stake
    - Political risk insurance
    - Environmental risk insurance
    - Reliable engineering
    - Usually more than one lender

Industry Joint Ventures and Strategic Alliances

- Types of Strategic Alliances
    - Horizontal – two or more companies with the same capabilities and expertise; combined expertise of similar disciplines
    - Vertical – two or more companies with differing capabilities and expertise; integrates different but synergistic disciplines
- Advantages
    - Spread the risk and increase competitive position
    - Combine or integrate talent and share similar objectives
    - Maximize operational efficiency

Creative Financing Deals

4. Scouting Services and Databases

- Alberta Resource Development (www.energy.gov.ab.ca)
- American Association of Petroleum Geologists (www.aapg.org)
- American Association of Petroleum Landmen (www.landman.org)
- Australian Geologic Survey Organization/Geoscience Australia (www.agso.gov.au)
- Australian Institute of Mining and Metallurgy (www.ausimm.com.au)
- British Geological Survey (www.bgs.ac.uk)
- Canadian Energy Research Institute (www.ceri.ca)
- Canadian Society of Exploration Geophysicists (www.cseg.org/resources)
- Canadian Associate of Petroleum Landmen (www.landman.ca)
- Canadian Associate of Petroleum Land Administrators (www.caplacanada.org)
- Canadian Association of Petroleum Producers (www.capp.ca)
- Canadian Institute of Resources Law (www.ucalgary.ca/~cirl)
- Commission for Environmental Cooperation (www.cec.org)
- Directory of Geoscience Organizations of the World (www.aist.go.jp/GSJ/EXT/GsOWDir.html)
- Energy Council of Canada (www.energy.ca)
- Energy and Mineral Law Foundation (www.emlf.org)
- Fossil Energy International (www.fe.doe.gov/international)

- GEO Petroleum Internet Resources (www1.slb.com/Petr.dir)
- Global Legal Information Network (www.loc.gov/law/glin/GLINv1)
- GTR for Energy and Economic Development
- Heritage Foundation, Index of Economic Freedom (www.heritage.org/index)
- Indonesian Petroleum Association (www.ipa.or.id)
- Institute of Petroleum (www.petroleum.co.uk)
- International Association of Oil and Gas Producers (www.ogp.org.uk)
- International Association of Geophysical Contractors (www.iagc.org)
- International Center for Gas Technology Information (www.gtionline.org/gti/main/main.cfm)
- International Chambers of Commerce, various cities (www.iccwbo.org)
- International Development Research Center (www.idrc.ca)
- International Union of Geological Sciences (www.iugs.org)
- International Resources Research Information Pages (www4.ncsu.edu/~leung/nrrips)
- International Right of Way Association (www.irwaonline.org)
- International Oil Scouts Association (www.oilscouts.org)
- Latin America Industry resource (www.petronoticias.com)
- Mediterranean, Middle East, and African Scout Group, London
- Mining Association of Canada (www.mining.ca/english)
- Mining Laws of Asian Countries (www.mmaj.go.jp/mmaj-c/asianlaw/asianlaw.html)
- Natural Resources Forum (www.natural-resources.org/minerals)
- Natural Resources Canada (www.nrcan.gc.ca)
- Nigerian Oil and Gas Online (www.nigeriaoil-gas.com)
- North Africa resource (www.northafrica.de)
- Norwegian Petroleum Directorate (www.npd.no)
- Ocean Drilling Program (www.oceandrilling.org)
- Office of Legal Advisors, US Department of State (www.state.gov/s/l)
- Offshore Oil Scouts Association (www.oilscouts.org/oosa.html)
- Oil Patch Directory (Europe) (www.gasandoil.com/opd)
- Petroleum Exploration Society of Australia (www.pesa.com.au)
- Regional Associate of Oil and Natural Gas Companies in Latin America and the Caribbean (www.arpel.org)
- Regional Scout Meetings of Active Operators
- Rocky Mountain Mineral Law Foundation (www.rmmlf.org)
- Russian resource (www.neftegaz.rv/english)
- Small Explorers and Producers Association of Canada (www.sepac.ca)
- Society of Exploration Geophysicists (www.seg.org)
- Society of Petroleum Engineers (www.spe.org)
- Southeast Asia Petroleum Exploration Society (www.seapex.org)
- Transparency International (www.transparency.org)
- UK Department of Trade and Industry (www.dti.gov.uk)
- UK Offshore Operators Association (www.ukooa.co.uk)
- UK Oil and Gas Directorate (www.og.dti.gov.uk)
- UK Petroleum Industry Association (www.ukpia.com)
- US Department of Energy (www.eia.doe.gov/emeu/international/contents.html)
- US Geological Survey (www.usgs.gov)
- US Department of State Background Notes (www.state.gov/r/pa/bgn)
- US Department of State (www.state.gov)
- United Nations (www.unsystem.org)
- World Factbook (www.cia.gov/cia/publications/factbook/index.html)
- World Resources Institute (www.wri.org)

5. Other Websites

- Association of International Petroleum Negotiators (www.aipn.org)
- Cambridge Energy Research Associates (www.cera.com)
- Export-Import Bank of the U.S. (www.exim.gov)
- European Bank of Reconstruction and Development (www.ebrd.com)
- Independent Petroleum Association of America (www.ipaa.org)
- Inter-American Development Bank (www.iadb.org)
- International Association of Drilling Contractors (www.iadc.org)
- International Energy Agency (www.iea.org)
- Overseas Private Investment Corporation (www.opic.gov)
- Petroleum Equipment and Suppliers Association (www.pesa.org)
- State Department-The Bureau of Consular Affairs (www.travel.state.gov)
- United States Trade Representative Office (www.ustr.gov)
- USA Engage for sanctions accountability (www.usaengage.org)

6. Reference Material

- International Petroleum Transactions, Rocky Mountain Mineral Law Foundation
- Financing Energy Projects In Emerging Countries, Hoessein Razavi
- The Management of International Oil Operations, Richard Barry
- Oil and Gas Journal
- PennWell's (OGJ) International Petroleum Encyclopedia
- Petroleum Accounting, PDI
- Petroleum Economist
- Production Sharing Contracts, Daniel Johnson
- Summary of International Taxes, PricewaterhouseCoopers
- World Oil