Fiscal & Commercial Negotiations

Achieving Strong Negotiating Positions through Balanced Modelling

At Indeva, we believe the best approach to strategy and decision analysis is one that provides a balance between quantitative analysis and qualitative knowledge capture. Indeva consultants have strong technical capabilities in the areas of fiscal and commercial modeling. We can deliver the realistic, representative and balanced models that are key to establishing strong negotiating positions for contracting, tariffs & pricing and integrated project evaluation.

Indeva also has extensive expertise in modeling and negotiating fiscal regimes and production sharing contract structures worldwide. We maintain in-house models of over 60 existing fiscal regimes for different countries and have advised both governments and energy companies on fiscal strategies.

Our approach to both fiscal and commercial negotiations is to provide support in the area of modeling and to ensure that models used to evaluate the situation include alternative viewpoints to achieve optimal returns for both parties and reach consensus quickly. We have modeling experience in a variety of areas related to fiscal and commercial negotiating strategy such as:

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- Technical and commercial valuations to quantify expected returns on an asset or group of assets
- Economic modeling for integrated projects (IPP, LNG, refining) from reservoir through to delivery point
- Deterministic and probabilistic risk analysis and post-tax project economics to quantify project risks and rewards

- Technical reviews and models of third-party pipeline tariff and gas transportation contracts.

The following case studies illustrate how our consultants have helped clients establish effective negotiating strategies and strong positions through a balanced approach incorporating alternative viewpoints and objective quantitative analysis.

CASE 1 – FISCAL TERMS TO ENCOURAGE EXPLORATION & MAXIMIZE GOVERNMENT REVENUE SHARE:

Indeva was first involved with the Nova Scotia Department of Natural Resources at the early stage of developing their offshore basin. Significant gas reserves had been identified but there were limited oil reserves and a low probability of future oil discovery. Our basin assessment helped the government to identify a development and infrastructure strategy that made development of the gas reserves attractive to the oil companies in a cooperative development scenario.

Subsequent to this analysis, Indeva was engaged to examine negotiation strategy for the first development and to advise on a generic fiscal regime for the rest of the basin.

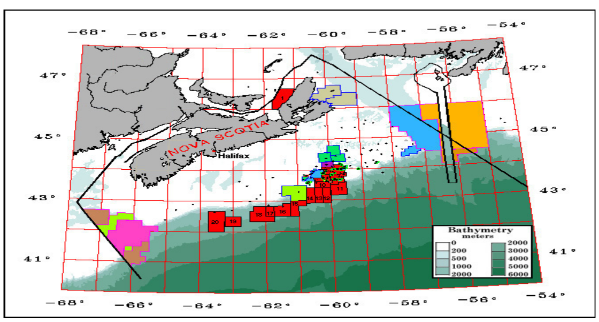
Requirements

The government required a progressive fiscal regime that would successfully attract development commitment whilst simultaneously delivering an acceptable return to the government. They were keen to establish the first development and associated infrastructure and also wanted to encourage future exploration and development for both low and high risk licenses. They had to balance these requirements against those of the oil companies looking for competitive return, stability for future planning and recognition of the varying degrees of risk.

Approach
We worked very closely with government personnel on this project to ensure their local knowledge was reflected and we engaged technical and market experts as well as other governments and industry representatives.

We then commenced development of royalty models based on the models already built as part of the basin analysis to test fiscal policy and illustrate results incorporating uncertainty from the point of view of both the government and the oil companies. Our model incorporated representative project costs and revenues as well as exploration chance of success and allowed us to develop and illustrate alternative royalty regimes.

The principles that guided our royalty strategy development were that the oil company's cost of capital was higher than the Nova Scotia social cost of capital and the oil company would prefer early cash flows while Nova Scotia would accept later cash flows provided a minimum level of early cash flow was achieved. We evaluated several alternatives including flat rate, production and reserves related, multi-tier profit related and multi-tier price related.



Deliverables
The deliverable in this project was a recommended royalty regime for the first development offshore Nova Scotia and a generic regime for subsequent developments. Both regimes were revenue based and stressed price protection and special provisions in high risk areas for the oil companies whilst limiting government exposure by basing thresholds on simple interest payout to limit government exposure. The needs of both parties in this case were balanced and the result was successful negotiation of the first development and an exploration round with over $1 billion in committed work programs.

CASE 2 – PSC RENEGOTIATION TO MEET NEEDS OF DEVELOPING COUNTRY

Politics and global issues often affect oil company policy, particularly in developing countries. This case

involved an existing development in a poor, third world West African country. The oil company was asked to renegotiate a production sharing contract when the government's early cash flow requirements were not being met. The government was under increasing pressure to develop the economy but the original PSC was progressive based on rate of return and did not provide any government profit oil until a 30% ROR threshold was reached. The oil company was willing to negotiate for political reasons but required advice to minimise erosion of their investment.

Requirements
The oil company's requirements in this case were to maintain their economics whilst providing the required cash flow to the government. This particular development was not yet producing so there was still significant uncertainty around reserves and production potential.

Approach
Our approach in this case was to develop a fully probabilistic model of the royalty regime to ensure the downside risk was reflected as adjustments were made to reflect the government's requirements. Indeva supported the oil company throughout the negotiations, running a live model during the meetings to ensure revised terms met both parties' objectives across the full range of probably outcomes as the negotiations proceeded.

Deliverables
The deliverable in this case was the live model which allowed for successful renegotiation of the contract to meet the government's needs during the early stages of production.

For more information on our consulting services and to discuss how we can help your company make better decisions, contact us at decisions@indeva.com