

Tanzania and Statoil: What Does the Leaked Agreement Mean for Citizens?



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Executive summary

The leak in July 2014 of an [important addendum](#) to a production sharing agreement (PSA) between Norwegian national oil company Statoil and the government of Tanzania has ignited a debate on whether Tanzania “got a good deal” from granting these extraction rights for a block now expected to produce large amounts of commercial natural gas. The debate demonstrates a public appetite for explanations from the government on the country’s management of its nascent oil and gas industry. Potentially at stake are billions of dollars of potential revenues that could boost socio-economic development in Tanzania if it becomes possible to extract these gas resources.

An NRGi financial analysis suggests that the deal is not out of line with international standards for a country that had no proven offshore reserves of natural gas at the time when the original contract was signed. Thus [claims that the addendum is on its face grossly unfair](#) to Tanzania appear to be premature. The outgoing managing director of Tanzania’s national oil company TPDC gave an estimate of the government’s take of 61 percent, a figure that our own model determined to be plausible under a reasonable set of assumptions. There are some caveats to this result which we explain in the body of the main briefing.

Still, the Statoil addendum diverges meaningfully from the model natural gas addendum that the Tanzanian government had established in 2010 as a benchmark for its future natural gas negotiations, and it is only reasonable for Tanzania’s citizens and their representatives to ask the government why such deviations were accepted.

There are several possible elements of an answer to this question. When Statoil and the government signed the original PSA in 2007, geological uncertainty surrounding Tanzania was huge; this may have led public officials to believe that they needed to make concessions in order to incentivize companies to take investment risk. Statoil received the contract as a result of a competitive bidding process, which, if conducted effectively and according to transparent rules with genuine

competition, would have provided strong data on what the market would bear and would have made a fair deal more likely. That original agreement established a set of understandings on which Statoil and its partners based their activities or financial arrangements; it may be that in negotiating the addendum after gas had been discovered, the government found the model addendum to be unrealistic in retrospect.

The debate illustrates the value to Tanzania of more systematic disclosure of its natural resource contracts, a step recommended by the 2013 Extractive Industries Transparency Initiative (EITI) Standard and which is under consideration by Tanzania's own national EITI group. More systematic disclosure particularly on contracts, negotiation and bidding processes provides the government and extractive companies with an opportunity to show a firm commitment to transparency; put all projects on a level playing field; manage citizen expectations and guard against unrealistic assumptions about the nature of extraction projects; facilitate consistent public monitoring of implementation of project; and, ultimately, improve public trust and the stability of the operating environment for businesses.

Introduction

The leak in July 2014 of an important addendum to a production sharing agreement (PSA) between Statoil and the government of Tanzania has ignited a debate on whether Tanzania “got a good deal” from granting these extraction rights for a block now expected to produce large amounts of commercial natural gas. The debate demonstrates a public appetite for explanations from the government on the country’s management of its nascent oil and gas industry. Potentially at stake are billions of dollars of potential revenues that could boost socio-economic development in Tanzania if it becomes possible to extract these gas resources.

Our analysis indicates that it is premature to say whether the Statoil PSA and addendum represent a good deal for Tanzania. Given the limited information available, the deal does not seem out of line with international standards for a country that had no proven offshore reserves of natural gas at the time when the original contract was signed. More detailed elements and explanations from the national oil company TPDC or the government could confirm for Tanzanian citizens that this is the case. The fact that Statoil won its rights through a competitive process should also indicate what market information was available to the government at the time, and should also help the government to explain its assessment that the deal was the best possible option at the time.

However, the differences between the 2010 model PSA addendum and the leaked Statoil addendum have led to legitimate questions about the reliability of model PSAs to assess the legal environment of the emerging gas sector, and the actual content of signed PSAs. These questions underscore the need for contract transparency. Publication of all contracts would support informed debates within Tanzania on the management of extractive resources, which is necessary to build trust and manage expectations around what these new resources could mean for the future of the country.

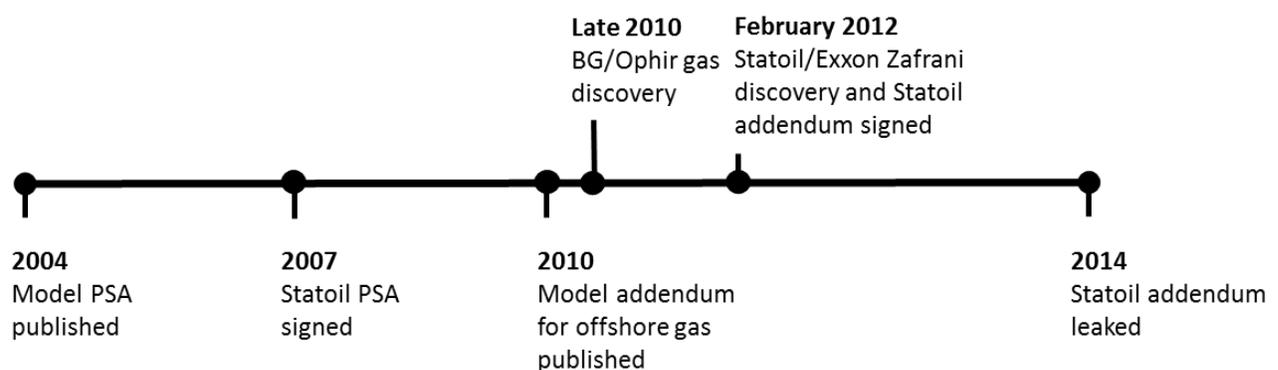
What is a model PSA? What is the significance of the addendum?

The [addendum](#) establishes some changes to a production sharing agreement (PSA) that had been signed between Norwegian oil company Statoil, the Tanzania Petroleum Development Corporation (TPDC) and the government of Tanzania, through the Ministry of Energy and Minerals (MEM) in 2007. The PSA concerns a license for Statoil to explore and produce in Block 2, off the coast of Tanzania. The date of the leaked addendum (which we will refer to as the Statoil addendum) is February 22, 2012, following the [first discovery of natural gas in substantial quantities by the company](#). The original PSA (which we call the Statoil PSA) has never been disclosed to the public (and was not part of the recent addendum leak). ExxonMobil is also a party to this contract, as stated in the Statoil addendum, with a 35 percent participating interest in Block 2, bought from Statoil

through an agreement in 2010. [The government has signed PSAs with companies for a total of 12 blocks off the coast of Tanzania since 2002](#); none of the PSAs are publicly available.

Since petroleum contracts frequently span 25 years or more, it is not uncommon for the parties to agree to adjustments as the contract progresses, particularly when the original contract is signed in an environment of uncertainty, or when unexpected events change the assumptions that accompanied the original deal (e.g., reassessment of reserves, particularly favorable or unfavorable market conditions). Such adjustments are generally made in order to render projects viable, while stabilization clauses often protect investors against unilateral revision of the initially agreed financial balance.

Timeline of events with respect to key contractual agreements



When Statoil started exploring in 2007, the likelihood that the block would produce significant quantities of natural gas was low. The sea floors off the coast of East Africa had not been discovered to hold significant petroleum deposits, and the hopes the industry did have for the area were focused on oil, not gas. Further, the combination of a heavy supply of liquified natural gas (LNG) on the market and concerns over weakening Asian demand was putting downward pressure on LNG prices. This meant that there was a high hurdle for an LNG project off the coast of Tanzania to clear in order to be commercially viable. At the time that the Statoil PSA was signed, there were clearly sufficiently interesting prospects to warrant exploration by the company, but the level of geological uncertainty created significant risks. This presented Tanzania with a challenge faced by [many emerging countries](#) seen as “frontier zones” by the oil and gas industry. It first needed to negotiate a contract that created enough incentives for an oil company to invest the huge sums necessary to conduct exploration in a risky environment. But it also had to ensure that a project, if it ever led to extraction, would deliver appreciable benefits to citizens.

In the years since the original Statoil PSA was signed, the prospects for natural gas production, both in Tanzania and globally, have risen significantly. Most important for Tanzania was the [significant](#)

[2010 discovery](#) of natural gas off the country's coast by a consortium led by Ophir energy and BG, as well as a major discovery in neighboring Mozambique. The shutdown of Japanese nuclear reactors following the Fukushima disaster in 2011 prompted significant shifts away from nuclear power into gas. This increased global demand and further enhanced the viability of bringing Tanzanian gas to market. Finding non-associated natural gas instead of oil under these new market conditions was probably the trigger that prompted the parties to get together in 2012 to amend Statoil's original PSA.

A lot of the public discussion about the published document has centered on divergences between the addendum and Tanzania's 2010 model production sharing agreement addendum for natural gas (which we refer to as the 2010 model addendum). Governments sometimes use model contracts to guide the formation of actual PSAs with companies. The government of Tanzania has issued these "model PSAs" four times: in [2004](#) (focused on oil exploration and production), [2008](#) (a full model PSA for onshore/shelf oil and gas areas), [2010](#) (a model PSA addendum for offshore natural gas), and [2013](#) (applicable to both onshore and offshore oil and gas).

the 2010 [model addendum](#) was established after the first discoveries of offshore natural gas, to guide the adjustment of existing contracts with respect to gas. The specificities of gas mean that new terms often need to be agreed with investors in order to account for the project components necessary to monetize these finds (accounting for cost, structure/terms of gas sales, financing etc.).

Model PSAs are used as a complement to petroleum laws to set standard terms to guide agreements with companies interested in developing a project in a country. Though not the case in the Tanzanian model PSAs, it is common for some fiscal terms to be left blank in the model, to be subject to competing bids in the allocation of petroleum blocks in a bidding round. As its name suggests, a model contract represents a guide or reference point, designed to help the government standardize its relationships with various companies, increase its leverage in negotiation, and enhance its ability to monitor compliance. International experience has demonstrated that governments [tend to get the best deals for their citizens when negotiations are limited to only a small number of contract terms](#). In most countries though, including Tanzania, the government retains legal discretion to deviate from a model contract during the course of an individual negotiation.

As well as guiding government decisions, citizens and watchdogs can use model PSAs as a benchmark with which to hold decision makers to account. Oversight actors both within and outside of the government can compare the terms set in the models with those in actual PSAs to legitimately ask whether and why the state agreed to terms that fall outside the parameters set by a model PSA. Whether or not it was intended as such, the disclosure of the Statoil addendum in Tanzania provides a good opportunity to take stock and to have a constructive discussion about public decision-making in the oil and gas sector.

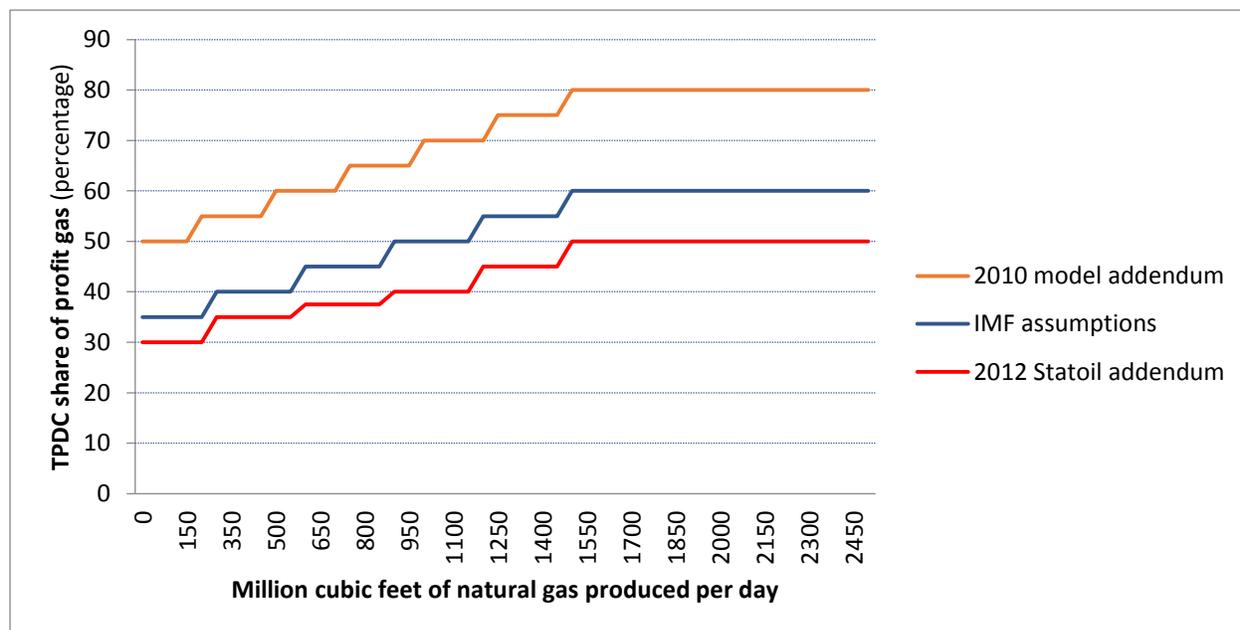
What are the differences between the model and Statoil addenda?

The recent debates in Tanzania have emphasized a comparison between the Statoil addendum and the 2010 model addendum. A fuller analysis would compare all of Statoil's legal rights (outlined in Statoil's PSA in 2007 and the Statoil addendum in 2012 and any other legal amendment that may have been agreed on) with the generally applicable legislation and model PSAs, but we do not know the terms of Statoil's 2007 PSA. As far as the addenda alone are concerned, the differences between the Statoil addendum and the model addendum relate to the split between government and company of "profit gas" and the obligations of the company to supply a given percentage of gas production to the domestic market.

The profit gas split determines how gas is shared between TPDC and the contracting company after an initial tranche of gas has been used to pay costs incurred by the contractor (the "cost gas"). The state's profit gas share is received by the government or its national company, which usually sells the gas onward to realize government revenue. Like in many PSAs worldwide, the split between how much profit gas TPDC collects and how much Statoil and its partners collect changes according to how much gas is produced each day. So for example, according to the Statoil addendum, if the project produces 500 million cubic feet of gas in a day, Statoil and other equity partners would first keep enough gas to pay costs, then keep 65 percent of the remaining gas (profit gas), while giving 35 percent to TPDC. If production rises to a billion cubic feet of gas per day, TPDC's share of profit gas would rise to 40 percent. The idea behind this sliding scale is to allow the government to capture a greater share as the project becomes more and more profitable. The structure here is based on an assumption that higher production means higher profitability and a higher chance that the investor can realize a reasonable return on investment.

The graph below shows TPDC's shares in profit gas that feature in the Statoil addendum and the model 2010 addendum, as well as the assumptions used by [the IMF in a recent report](#) on fiscal regimes and fiscal frameworks for natural gas in Tanzania. At every level of production, the Statoil addendum delivers a lower share of profit gas to TPDC than the models or the IMF's assumptions.

Comparison of profit gas shares



Source: TPDC website, IMF May 2014 report on Selected Issues, Statoil PSA Addendum 2012, and NRGi computations.
 Notes: the IMF assumptions of fiscal terms were made in the IMF May 2014 report based on the actual contracts, as stated in the report: “fiscal regime applied reflects broadly the existing fiscal regime, although this is only approximately so given that each signed PSA differs in important aspects.”

As with all tax analysis one must not focus on a selection of terms, but consider the whole tax regime, to assess the total share of the revenues collected by the state, and the returns to the investor. The table below shows the other tax terms gathered from the 2004 model PSA and model addendum and what we understand are the terms in the Statoil PSA.

	Model PSA 2004 (offshore)	Model PSA addendum 2010 for natural gas	Statoil PSA (as adjusted by addendum)
Corporate income tax	30%	30%	30%*
Royalty	5%	5%	5%*
Cost gas limit	70%	70%	70%
Additional profit tax	No	No	No
Royalty paid out of TPDC profit share	Yes	Yes	Yes
TPDC equity share	5%-20% depending on daily production	5%-20% depending on daily production	10%*
Dividend and interest withholding tax	Generally applicable law (10%)	Generally applicable law (10%)	Unknown
Capital gains tax	Exempt	Exempt	Unknown

Source: [model PSA 2004](#), [model PSA addendum 2010](#), [Statoil addendum](#).

* From TPDC's statements in [Daily News](#)

Did Tanzanians get a good deal?

The fundamental question that has surfaced in the recent debates is: “is this a good deal for Tanzania?” This is a legitimate question from Tanzanian citizens who need to hold their government to account, particularly given the deviations between the Statoil addendum and the model, and the realization that the actual terms of this contract may result in lower revenues than those assumed by the IMF and others. As they decide how to answer that question, we recommend that Tanzania’s citizens analyze the deal in two ways. First, they should analyze it with respect to the options available to the government at the time it was signed. Second, they should analyze it with respect to the results the deal appears likely to generate based on information available today.

Our analysis of the Statoil addendum and other publicly available information about the deal suggests that it is not out of line with international standards for a country that had no proven offshore reserves of natural gas at the time when the original contract was signed. Thus, [claims that the addendum is on its face grossly unfair](#) to Tanzania appear to be premature. The outgoing managing [director of TPDC stated](#) that its internal financial models estimated the government’s take (i.e., the share of the total revenues generated by the project, over and beyond all development, operating and financing costs, collected by the state) at 61 percent. If accurate, such a take would indicate a reasonable deal for a country in Tanzania’s situation at the time the deal was made, comparing with international benchmarks. We modeled the likely results of the contract using a wide range of assumptions on key features (prices, costs, productions, LNG downstream

processing), under a 10 percent discount rate and also taking into account the possibility of an exemption of dividend withholding tax. This exercise yielded a government take of 61 percent or higher under most of the likely scenarios, which leads us to a preliminary assessment that the official government take computation from TPDC is reasonable.

However, the basic financial model we constructed is subject to several limitations—most notably the continued secrecy around the full PSA itself, but also information about the parties’ assumptions on the production profile, investment and operating costs, pricing mechanisms relating to the arrangement for transport, processing, and exports of LNG. Without this information it is impossible to model to a high degree of accuracy the likeliest financial results for Tanzania and Statoil. The debate would be significantly enriched if TPDC were to share and discuss the hypotheses on which its calculations are based.

Given the fundamental shortcomings of modeling using only information that is publicly available, it is important to consider, and for the government to further discuss, what may have been the reasons that TPDC’s profit gas share was lower than what is called for in the model addendum.

One possible reason for this difference in profit gas share is that there was great uncertainty that may not have been adequately reflected in the model contract, so lower terms in an addendum could be reasonably expected. In particular, there may have been uncertainty over the relative [costs and value of extracting natural gas relative to oil](#). As outgoing TPDC managing director Yona Kilagane said, a reason for the difference in the Statoil and model addenda was that the project considered was “the first deep sea exploration in the region, incurring huge costs compared with onshore exploration ...[there is] no ready market, infrastructure and pricing mechanism in case natural gas is discovered.”

Another possible reason for the difference is that Statoil’s PSA may contain terms that are more favorable than we assume and makes up for the lower profit share for the government. If it does, it committed the state to a certain profit oil split, and negotiation of an addendum to the original contract five years into the project, after tens of millions of dollars had already been invested, would not include any substantial modification of the fiscal terms, even if fiscal terms more favorable to the state had been established for new projects in the meantime. Until the full PSA is disclosed we are only looking at half the picture.

A third possible reason for the difference lies in the fact that the Statoil 2007 PSA as agreed was as a result of Tanzania’s third offshore licensing round. Typically such processes are useful at obtaining the best terms possible for the government as companies will compete against each other to obtain the license. This could suggest that despite the seemingly low profit share, Tanzania got the best it could hope for given the circumstances. However, what needs to hold for this to be true is that there

was sufficient competition amongst companies to bid up the terms. This information is not publicly available.

All these factors together indicate a possible justification for a lower government share from the Statoil addendum than might be expected when comparing with the model addendum.

On the other hand, it is also possible that the new resource prospects of the country led to an upward revision of the terms compared with the 2007 PSA. Having sunk possibly millions of dollars into finding the gas, Statoil and ExxonMobil would have been keen to make a return on their investments. By the time they drew up the Statoil addendum in 2012 the government could have used this as a bargaining tool against the companies.

How can better disclosure lead to better deals for Tanzania?

With more information, better analysis of fiscal terms and prospective revenues become possible. More information can also support good deals in the future by creating stronger accountability in negotiating processes. One key lesson from the ongoing debates is that there is appetite, within Tanzania, for discussions around mineral and hydrocarbon contracts. Citizens and the media want to hear how the government justifies the deals it signs with extractive companies. This is a good sign for democracy and accountability, and responding to this demand by systematically publishing contracts signed with investors, as well as explaining the terms negotiated, would be the most sensible reaction. The initial reactions by the government to the concerns raised by Tanzanian media and political commentators indicate a willingness to have a constructive dialogue around these issues, and further elaboration of the state's views will serve to enhance public trust.

The next step in the evolution of this issue in Tanzania is a more thorough effort to disclose petroleum (and eventually mining) contracts systematically, rather than through ad hoc and sometimes unreliable informal disclosures. When a contract like this is leaked—without the formal blessing of the government and without citizens having an opportunity to access other related documents (such as the original PSA in this case) or to compare the terms agreed with one company to those in other contracts—the population will react with suspicion and assumptions of a terrible deal. More systematic disclosure provides the government and extractive companies with an opportunity to show a firm commitment to transparency; to put all projects on a level playing field; to manage citizen expectations and guard against unrealistic assumptions about the nature of extraction projects; to facilitate consistent public monitoring of implementation of projects; and, ultimately, to improve public trust and improve the stability of the operating environment for businesses.

It is for this reason that a growing number of petroleum- and mineral-rich countries, including several in Africa—Ghana, Guinea, Liberia and Mozambique among them—have begun to disclose their extractive industry contracts more systematically. And a growing number of international institutions and initiatives, including the Extractive Industries Transparency Initiative (EITI), are formally encouraging contract disclosure. The latest Tanzania Open Government Partnership Action Plan also provides for the publication of all newly signed extractive contracts from 2014 onwards, which would ideally extend to previous contracts, so as to put investors on a level-playing field. As an EITI-implementing country, Tanzania has a ready platform by which it can disclose its extractive contracts in a systematic way, and satisfy the hunger for public discussion that this incident has exposed.

Questions for the Tanzanian government

Our initial analysis of the contract with a standard set of assumptions about the project does not indicate that it is grossly out of step with international standards at the time it was signed. As noted above, the unknown terms and project-specific assumptions make it impossible to look at a document like this in isolation and say definitively whether it represented the best possible deal for Tanzania at the moment it was signed. The disclosure does, however, provide an opportunity for Tanzania's citizens to better understand their government's strategies, and for the government to explain the basis for its specific decisions and what Tanzanians can expect from the contract moving forward.

We recommend that the country's citizens and public officials address the following questions in the ongoing discussion around the PSA Addendum:

- What are the other fiscal terms applicable to this contract but not included in the published addendum and not yet publicly available? To what extent does the 2007 Statoil PSA deviate from the generally applicable law?
- Did the negotiation of the Statoil addendum in 2012 lead to (i) a downward adjustment of the government take from the original Statoil PSA (to take into account the different economics of a gas discover rather than an oil discovery); (ii) an upward adjustment of the government take from the original PSA (to take into account different leverage given new geological reality); or, (iii) a mix of the above?
- Are there additional features of the contract, such as local content requirements, which the government expects will deliver meaningful economic benefits to the country and which have not yet been disclosed?
- How did the government calculate its estimated government take figure of 61 percent? Under what assumptions of fiscal terms, prices, investment costs, operating costs, LNG plant tolling fees, domestic market obligations?

- How does the government take estimate of the Statoil contract compare with the estimated government take in Tanzania's other PSAs?

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