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The Financial Governance Committee (#FGC) has issued a damning advisory note concerning the #FGS Ministry of Petroleum and Mineral Resources' (MPMR's) oil & gas licensing efforts.

Current approach provides "poor value for money...that may last for 40 years or more."

(thread)

FGC ADVISORY NOTE		
Review of recent developments with the 2020 oil and gas licensing round and the 2021 proposed direct award of petroleum contracts		
Date: 12th January 2021	**Reference:** 2021/001	**Authors:** [redacted] World Bank Delegate [redacted] FGC Concessions Adviser [redacted] Donor Delegate

The two main concerns identified in FGS's current approach to oil and gas contracting are incomplete compliance with the FGS legal framework, and inadequate protection of FGS's financial interests. Incomplete compliance significantly raises the risk of future legal and/or compensation claims against FGS, while inadequate protection of FGS's financial interests risks poor value for money over the lifetime of awards that may last for 40 years or more.

The FGC raises concerns over "incomplete compliance with the FGS legal framework, and inadequate protection of FGS's financial interests." Current MPMR approach risks "future legal and/or compensation claims against FGS."

The FGS makes seven principal recommendations. #7: "PSA negotiations do not prioritise short-term revenue (i.e. signature bonuses) at the expense of longer-term value."

The <u>seven principal recommendations</u> set out in this note are for FGS to ensure that:

1. *The petroleum licensing round is fully compliant with the requirements of the Procurement Act (i.e. IMCC approval of: the PSA and tender protocol, the evaluation report, appointment of the negotiation team, and negotiating benchmarks; and, consistency between licensing round rules and procedures and Procurement Act requirements).*
2. *Direct negotiations outside the licensing round are properly justified and approved by the IMCC, and comply fully with the Procurement Act (i.e. IMCC approval of: the PSA to be used in the direct negotiations, the evaluation report, negotiation team, and negotiating benchmarks).*
3. *Consultations with the FMS are held prior to the issuance of any PSAs, and FMS rights are appropriately captured in the PSA as required by the Petroleum Law.*
4. *All PSAs are aligned with the provisions of the EIIT Bill, including any PSAs being used in direct negotiations (key areas for alignment include royalties, tax exemptions and stabilisation provisions).*
5. *No PSAs are signed until after the EIIT Bill has been enacted, so that they are fully consistent with the provisions of the enacted Law.*
6. *The tender protocol is revised, to reduce bidders' scope for negotiation of PSA terms and to allow awards only where at least two bids have been submitted for a block.*
7. *PSA negotiations do not prioritise short-term revenue (i.e. signature bonuses) at the expense of longer-term value.*

The note confirms that Coastline Exploration (https://t.co/YztVl7wCZi) -- a company formed in 2018 and based in the Cayman Islands -- is in fact a rebranding of the discredited Soma Oil & Gas.

- In January 2021, the MPMR made preparations for the award of PSAs to two firms, Coastline (formerly Soma Oil and Gas) and Liberty Petroleum, following direct negotiations. The basis for directly negotiating these PSA had not been established by MPMR or approved by the IMCC. The Procurement Act stipulates that direct negotiations should only be conducted with the prior approval of the IMCC, which is consistent with the 2020 Petroleum Law requirement that the direct negotiation of PSAs requires justification and government approval beyond MPMR[6]. The form and content of the PSA should also have been reviewed and approved by the IMCC before the commencement of negotiations. While Coastline may have the right to apply for PSAs under the terms of Soma Oil and Gas' 2013 Seismic Option Agreement with FGS, Liberty's rights to direct negotiations are not known.

This note summarises findings from a review of the oil and gas licensing round tender documentation posted online by the Ministry of Petroleum and Mineral Resources (MPMR) in November 2020. It also addresses the Ministry's recent move to make direct awards of PSAs to two firms. The two main concerns identified are incomplete compliance with the FGS legal framework and inadequate protection of FGS's financial interests. Incomplete compliance significantly raises the risk of future legal or compensation claims, while inadequate protection of FGS's financial interests risks poor value for money over the lifetime of awards that may last for forty years. It makes recommendations on the way forward both for the bid round and the proposed direct awards.

"Minimum bidder qualifications are set at relatively low thresholds... By comparison, the 2019 tender protocol required that a bidder include at least one party who has drilled multiple offshore exploration wells."

Grandfathering in "Coastline"? ■

- Minimum bidder qualifications are set at relatively low thresholds. For example, with respect to the drilling of exploration wells, the minimum technical requirements specify that a bidder has to have participated in at least one offshore exploration well, in unspecified water depth. By comparison, the 2019 tender protocol required that a bidder include at least one party who has drilled multiple offshore exploration wells in water depths exceeding 500 meters and was the operator of production at this depth, not merely a participant. It is also understood that the minimum financial qualification of a net worth of at least $50M is not likely sufficient to support the type of operations anticipated under the PSA.

"...certain provisions seem to allow the award of PSAs even where a single, potentially incomplete or otherwise non-compliant, bid is received."

It is understandable that a licensing round being conducted during one of the worst economic downturns in recent years must make adjustments to attract competition and to provide flexibility in the tendering process. Competition is a key driver of value for money in government contracting and ensuring that there is competition in the licensing round is of vital importance. However, the adjustments that have been made potentially place value for money at risk and may have far reaching consequences, given that the PSAs signed may govern the exploitation of sovereign resources of considerable value for over forty years. These risks are further increased by the wide scope for further adjustment to PSA terms, either through amendments submitted with bids or as a result of post-bid negotiations. It is also not clear that the flexibility provided by the tender protocol is designed to ensure competition, as certain provisions seem to allow the award of PSAs even where a single, potentially incomplete or otherwise non-compliant, bid is received.

"The PSA and the tender protocol issued in November 2020 offer considerably more attractive terms to oil companies than previously contemplated."

3. Protection of FGS financial interests

The PSA and the tender protocol issued in November 2020 offer considerably more attractive terms to oil companies than previously contemplated under either the 2019 licensing round or in the model documentation developed with the support of development partners in 2017.

Notable features include:

- Lower royalty rates;
- Reduced work requirements during initial the exploration period;
- A wide range of tax exemptions;
- Protection from changes to the economic balance of the contract over the full term of the contract.

Per FGC, no stakeholder consultation appears to have occurred. "A group claiming to represent one clan has recently expressed their rejection of petroleum operations in areas inhabited by their clan."

- Stakeholder consultation – due to the far-reaching impacts of many concession agreements, stakeholder consultations are required to be held for all concession projects[22] to inform the public of the strategic importance of the project, the extent to which there will be private investment into the needs of the community and measures that may be instituted to mitigate environmental impact, among other things. This is particularly important for the exploitation of a natural resource, which has economic and environmental implications for a wide range of stakeholders, and the potential to generate conflict between communities[23]. MPMR does not appear to have held such consultations. A group claiming to represent one clan has recently expressed their rejection of petroleum operations in areas inhabited by their clan[24] .

The FGC also recommends that Federal Member States be properly included in the process.

b. The Petroleum Act

The 2020 Draft PSA issued to bidders makes no reference to the right of the relevant Federal Member State to acquire a 10% interest in an oil development area as required by the 2020 Petroleum Law[28]. The FGC has previously recommended[29] that MPMR should hold consultations with the FMS prior to the issuance of a PSA given that they are key stakeholders in oil production. It should also ensure that FMS rights are appropriately reflected in the PSA.

Recommendations: MPMR should hold consultations with the FMS prior to the issuance of a PSA given that they are key stakeholders in oil production. It should also ensure that FMS rights are appropriately captured in the PSA as required by the Petroleum Law.

Conclusion: "...there is a significant risk that any contracts awarded under the license round or through direct negotiations will not protect the interests of the FGS and oil-producing FMS or extract appropriate value for #Somalia's oil over the lifetime of the PSA."

4. Conclusion

Although considerable progress has been made to improve the preparedness of the legal, regulatory and institutional framework relevant for oil and gas exploitation, additional work is required to ensure that any PSAs signed by the FGS deliver value for money and also protect its interests, and the interests of the FMS.

Unless the concerns identified in this note are appropriately addressed, there is a significant risk that any contracts awarded under the license round or through direct negotiations will not protect the interests of the FGS and oil-producing FMS or extract appropriate value for Somalia's oil over the lifetime of the PSA. Moreover, deficiencies in the legal compliance of any award process could expose FGS to legal claims, while inconsistencies in contractual terms and legal requirements could expose FGS to compensation claims. These risks should be avoided at any cost, by ensuring that all awards adhere to the requirements of the Procurement Act and are compliant with the broader Somali legal framework, which will include the EIIT Bill once it becomes law.