Understanding Upstream Host Government Contracts

Series no. 4 **- Types of Host Government Upstream Contracts**

As mentioned in the previous article, the Host Government Upstream Contracts (HGUC's are classically grouped into three (3) types, namely;

(1) Concessions or Licenses
(2) Production Sharing Contracts
(3) Risk Service Contracts.

In this article we are going to elaborate more on Risk Service Contracts

Risk service contracts (RSC)

Risk service contracts (RSC) falls under an umbrella of service contracts, the other one being pure service contracts.

The former entailing an undertaking by a contractor to carry out exploration and production activities at its own costs and risks while the host government reserves the right to exclusive ownership of hydrocarbon reserves developed or not if any, the contractor may in exceptional cases be paid the fee in kind by being entitled to a share of oil/gas or have a preferential right to purchase the production from the host government; and in cases where the exploration does not materialize to commercial production, the agreement is terminated without any legal obligations on any party to the said contract.

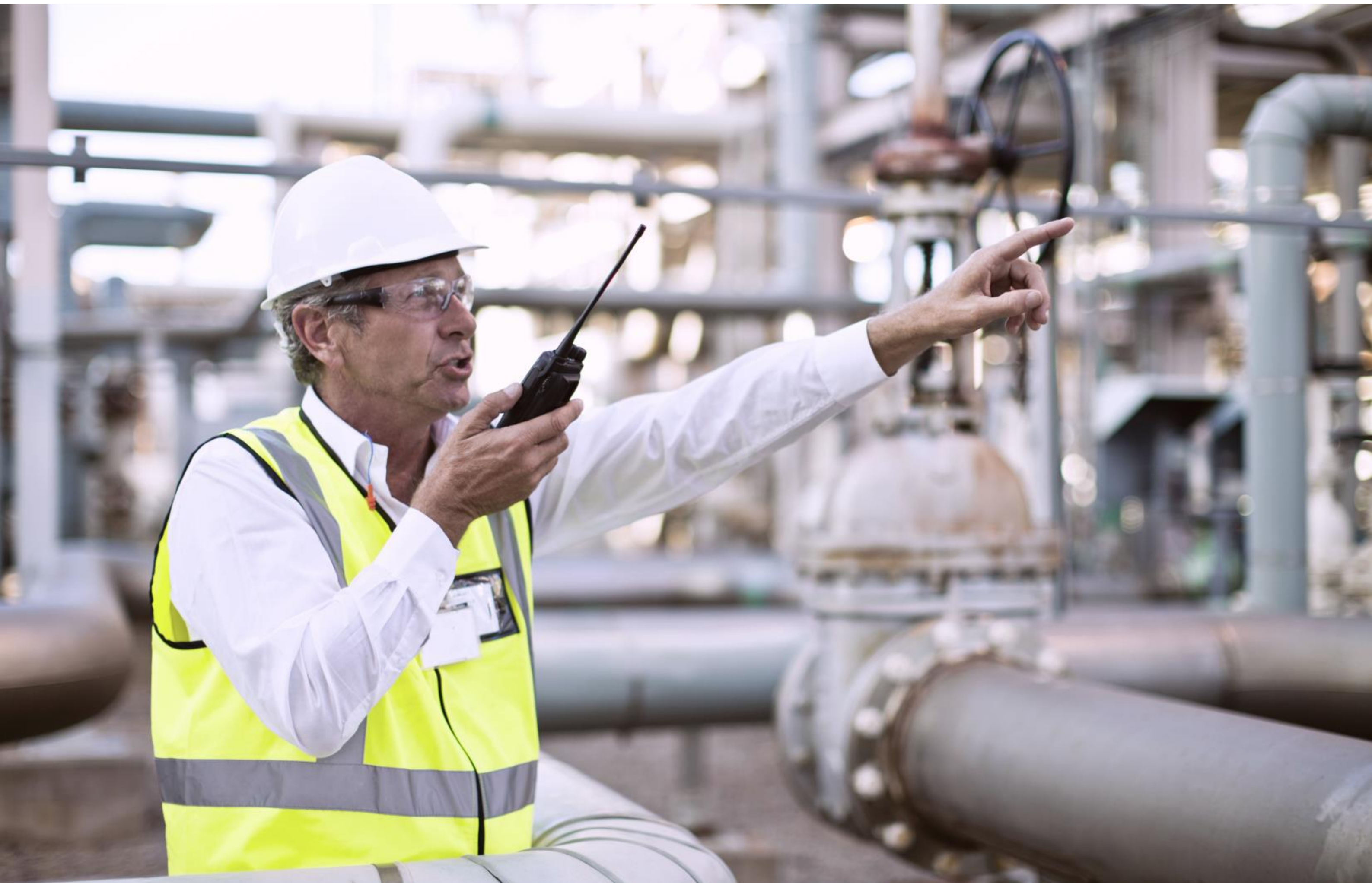
While a pure service contract is basically one that the host government bears all the risks associated with the investment and just engages a contractor to carry out the exploration and production activities for a consideration usually in terms of an agreed flat fee. In this regard, the contractor assumes the role of a mere service provider and does not have any interests or benefits whatsoever in the investment.

Generally, in service contracts, the contractor is least incentivized as the government retains highest level of control, management and supervision of its reserves including activities in their exploration and production. As already hinted out, in risk service contract key rights of the contractor are limited to just being a service provider under an identified contract area whose right to receive fee is in most cases subject to commercial discovery thereof.

Contrary, main duties and obligations of the contractor include the task of carrying out stipulated work programs with very little or no control at all since every work to be done is regulated by the host government. And even when there is a successful exploration, the development and production program must be approved by the government.

Ownership and allocation of production in the strictest form of risk service contracts vests with the host government, the contractor does not acquire any ownership rights in the hydrocarbon production. All output therefore goes to the government.

In reality, service contracts are not very common in today's oil and gas industry; they may only be traced in some countries with previous political tensions, and communist governments where private participation in the oil and gas sector is constitutionally prohibited. Mexico provided a good example of this, Brazil, Algeria, Argentina also had experimented with Risk service contracts.



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