

THIRD IEF NOC-IOC FORUM

CO-OPERATION, CHALLENGES AND INVESTMENT



EXECUTIVE SUMMARY

IEF Ministers have welcomed the idea that on-going co-operation and open communication among NOCs and IOCs holds significant potential to address major challenges facing the industry and to promote energy security through dialogue. The IEF NOC-IOC Forum has gained recognition as an important platform to help build trust among key actors and to facilitate an informal exchange of ideas and insights among stakeholders.

In light of the recent shifts in the energy landscape, the IEF convened a wider selection of voices and viewpoints for the 3rd Forum than in years past. Roughly 90 thought-leaders with experience and expertise representative of the diverse yet interconnected nature of contemporary energy markets gathered in New Delhi for a day and a half of informal discussions. CEOs and top government policymakers joined seasoned professionals representing industry, academia, investment banking, think tanks, management consultancies, private equity funds, information technology firms and the legal profession, among others.

Participants in the 3rd IEF NOC-IOC Forum discussed the broad themes of challenges, investment and cooperation, as well as four major shifts in the tectonic plates of today's energy world: shifts in the geography of energy, driven by unconvensionals in North America; shifts in gas prices, linked to the spot versus oil-linked contract debate; shifts in the direction of trade, centred around the Middle East and Asia Pacific; and shifts in geopolitics, which are on-going.

The 3rd IEF NOC-IOC Forum was generously hosted by India's Oil and Natural Gas Corporation (ONGC) and co-hosted by Shell, and was supported by knowledge partner Ernst and Young.

THE NOC-IOC DICHOTOMY: AN OUT-DATED LABEL?

Discussions at the NOC-IOC Forum confirmed that the name of the event itself is out-dated. Up until around 2010 the NOC-IOC concept remained relevant, but more recently the range of players and potential partners has expanded beyond the confines of that simplified label. Today we talk of co-operation between NOCs and independents, NOCs and services companies, interaction among the so-called INOCs (International National Oil Companies) and NOCs or IOCs, and other combinations.

Technology and economics explain the shift. The new frontier in oil and gas production involves two very different sets of projects: massive ones, which tend to be complex, expensive and located offshore; and small- to medium-sized projects, normally located onshore and involving markedly different fundamentals.

For large offshore projects it is uncommon that a single company can absorb the costs, manage the risks, and generate the technology requires to produce. A more likely outcome is a pooling of resources among IOCs or between NOCs and IOCs, depending on the rules of the game established by the host government.

For onshore projects, the company size tends to be smaller--at least thus far--but the costs are still larger in comparison to the financial muscle of the firms involved. Thus, a partnership with an NOC or an independent would make sense, especially where IOCs might have less room than NOCs to manoeuvre.

The need to manage country risk in many regions is also increasing, as production becomes more transnational. This is especially the case for INOCs, which will have to learn to partner with both the private and public sectors to better manage risks. This is an area where IOCs have developed an advantage.

In a highly-stylised way, the table below illustrates what each company will contribute to new projects:

	IOCs (Expensive/Difficult)	NOCs (Mainstream)	Independents & Service Companies (Frontier)
Risk advantage	+	0	+
Technological innovation	+	0	+
Human capital	+	+	+
Financial resources	+	+	–
Reserve growth	–	+	+
New project advantage	<ul style="list-style-type: none"> Upstream, offshore Deep water Complex LNG 	<ul style="list-style-type: none"> Upstream and downstream, onshore Conventional Oil and Gas Unconventional gas in North America Conventional in the Arctic 	<ul style="list-style-type: none"> Upstream onshore Unconventional oil and gas Arctic
Regional strength	<ul style="list-style-type: none"> Arctic West Africa 	<ul style="list-style-type: none"> Home country, except for Norwegian and Chinese companies 	<ul style="list-style-type: none"> North America Brazil East Africa West Africa
Price environment	High (lower end)	Low	High (high end)

** The +, 0, and – signs refer to advantage, neutral or disadvantage in each category. An overlap may apply to companies in any of the above categories, as some work in three environments. This table is only suggestive and subject to revision.*

All this is not to say that the notion of NOC-IOC co-operation has become a complete anachronism. Much to the contrary, as this co-operation remains quite relevant. The themes of NOC-IOC co-operation on health, safety and environment (HSE), technology transfer and research and development initiatives were highlighted at the Forum as holding great promise. Yet the rising prominence of additional actors and nuances within the categories (new NOCs versus more mature NOCs or majors versus supermajors) call for a new approach to understanding a new paradigm with more actors, which is striking in that it at once entails more competition and a need for more co-operation.

CHALLENGES

- A lack of transparency and understanding between stakeholders and IOCs or NOCs can engender a scenario in which industry's motives and actions are treated with prejudice. This so-called "perception problem" presents challenges for industry, which range from realising investments to attracting and developing human capital. As one example, if an IOC engages in a partnership with an NOC, the first reaction by citizens of the home country may be that they have lost a valuable national asset to the private sector. The burden is then upon the IOC to explain the value it will bring to the partnership, which may come in the form of implementing good HSE practices or investing in education to support local supply chain development.
- The energy industry's activities are highly visible to US regulators with regard to the Foreign Corrupt Practices Act (FCPA) for at least three main reasons: (1) energy companies do business in markets widely considered to be "at risk" from a compliance perspective; (2) energy companies have been known to use agents or consultants who handle matters "on the ground"; (3) energy firms routinely move products, equipment and employees across national borders.
- Companies that may fall under the reach of the FCPA include those not headquartered in the US but listed on exchanges there, companies traded through American Depositary Receipts, or companies doing business with other companies that are headquartered in the US. Performing "extensive" due diligence is advised prior to making an acquisition.
- Regarding the threat of cyber attacks, it is not a matter of if, but when a breach will occur. Executives should assume that their firms will be breached at some point and must have a system and protocol in place to take action. The practice of companies co-operating in sharing analysis, rather than data, holds great promise.

INVESTMENT

- Today, NOCs appear more driven by international portfolio diversification and access to technology than in the past, when they used to seek capital from the deep pockets of the IOCs. Asian NOCs appear to be following investment practices that know no geographical limitation.
- Talk of moving away from oil-linked gas contracts towards spot prices raises the question of how companies will obtain project financing for gas projects if the underlying contracts are not linked to oil prices.
- Asset swaps are a simple tool that help to provide a balance in the upstream/downstream investment mix and can help guarantee contract fulfilment over a 20-30 year timeframe.



CO-OPERATION

- With roughly 90% of global reserves under the control of the NOCs, it appears safe to say that NOCs will be "calling the shots" for the foreseeable future. In light of the NOCs' bargaining power, there is a need for IOCs to offer unique value propositions to the host countries.
- Enablers for the success of IOC operations include sharing technology, making significant contributions to improve the domestic economy of the host country, and stressing transparency in the procurement process.
- Over the next few years, we may see an increase in the conditionality imposed on investments made by Asian NOCs in the exploration and production segment in the Gulf region.
- The future for IOCs and NOCs is likely one in which they will both compete and co-operate.



ROUNDTABLE BREAKOUT SESSION: FRAMEWORK AND FINDINGS

Part One: Participants in the 3rd IEF NOC-IOC Forum split up into small groups to identify and rank the top five opportunities or risks for the oil and gas industry, using findings from the latest Ernst and Young global survey as a reference. Selected results from this exercise are:

Notable Risks Identified by Roundtable Groups

- Commodity price volatility
- Negative public perception about the industry
- Uncertainties regarding energy policies
- HSE incidents or regulatory compliance issues
- Human capital constraints

Notable Opportunities Identified by Roundtable Groups

- New markets for natural gas
- Rising energy demand from emerging markets
- Investing in innovation and research and developments
- Acquisitions or alliances to gain new capabilities
- Focussed recruitment, training and retention programs

Part Two: Each group chose one opportunity or risk from its list and crafted related policy recommendations. The recommendations were then discussed through a moderated discussion.

Selected Recommendations to Policymakers

- Governments can and should serve as a credible interlocutor between industry and the public.
- NOCs should be given the flexibility to frame decisions based on business motives. The role of politics in their decision-making process should be minimised, and policymakers should endeavour to “let businesses behave like businesses”. Acquisition policies should be simplified, and NOCs should have greater autonomy over those processes.
- Governments should set frameworks to increase all transparency of NOCs, especially with regard to their revenue structure and retail pricing formulas, as this would help allay stakeholder concerns that the public may not be enjoying the full financial benefits from NOC revenues.
- Development initiatives should be undertaken directly by the government; NOCs should not be used as conduits for advancing a government’s development agenda. Social mechanisms, such as non-governmental organisations, should be used for such purposes.
- Frequent changes in fiscal regimes should be avoided at all costs. Transparent and fiscal-friendly policies will attract investment from IOCs.