Production sharing
Oil and Gas

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In my first article I discussed the role of Government and the Exploration and Production (E&P) company in oil and gas resource development. I mentioned that the relationship between the Government and an E&P company is governed by a Production Sharing Contract (PSC).

The PSC has a few key clauses that I wish to mention. The PSC stipulates that the E&P company gets a share of the oil and gas produced and its share is in the form of oil barrels. The E&P does not own the oil or gas but rather the Government retains title to the oil or gas produced.

Should the E&P company not find any oil then the cost of exploration is borne solely by the E&P company (and its partners). The Government does not participant in meeting any exploration costs that do not result in any oil revenue. Should oil be produced, then the E&P company can recover that cost against the oil produced.

It is important to note that the E&P company commits to a certain level of investment, a certain level of work obligation over a fixed period of time normally three years. The work obligation ensures that the Government gets investors who are serious and not speculators.

If an E&P company does not meet the work commitment, then Government can terminate the PSC and is entitled to call on the bank guarantee and obtain a cash amount from the bank of the defaulting E&P company. The work commitments includes, amongst others, the expected level of seismic data acquisition. The PSC will normally provides for the shooting of seismic data – where and when.

The PSC obliges the E&P company to process or interpret the seismic data and provide that data to the Government. The work commitment also provides for certain drilling obligations including the number of exploratory wells and/or the minimum expenditure for such an activity. A PSC also provides the basis on which an E&P company can recover costs of exploration and development, against oil or gas production. This is known as "cost oil".

Typically the E&P company is normally allowed to recover the cost of exploration and development of the oil and gas resource on the commencement of commercial production. Thereafter, the E&P company is allowed to share in the oil and gas produced after recovering its operating costs.

The PSC typically provides that Government can participate in the equity holding of an oil block once a discovery has been made for which the E&P would have to cede some interest. This will ensure that the Government enjoys an additional share of the oil revenues directly..

It is the role of Government to come up with the oil and gas policy. With the latest development in the oil and gas sector in Kenya and its neighbouring countries, it is important that Government reviews the overall legal and regulatory framework as it appertains to oil and gas.

This would impact both policy and legislation including the 1986 Petroleum (E&P) Act, the Ninth Schedule to the Income Tax Act to ensure that the people of Kenya maximize the value of the oil and gas resources. It is important that the petroleum policy and legislation help promote, license, monitor and manage the impact of oil and gas with regards to the pillars identified in Vision 2030.

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