

## MEMORANDUM

Date: 17 August 2015

To: Robert Sheppard  
Philip Wolfe  
Soma Oil and Gas

From: John LaMaster

**Re: Capacity Building in the Oil & Gas Industry**

### 1. Background

1.1 Soma Oil & Gas (**Soma**) has entered into a letter agreement dated 25 April 2014 with the Minister of Petroleum and Mineral Resources (the **Ministry**) of the Government of the Federal Republic of Somalia (the **Government**) regarding Capacity Building Arrangements, and a letter agreement dated 28 April 2015 with the Government regarding Additional Capacity Building Arrangements (collectively, the **Capacity Building Arrangements**).

1.2 Under the Capacity Building Arrangements, Soma agrees to pay the “salary costs” of certain “staff, consultants and advisors” of the Ministry, together with the “cost of office equipment, transportation and other working tools” needed by the Ministry. These payments are to be set-off against the obligations to pay rent and training fees under the terms of Production Sharing Agreements to be entered into by Soma in the future.

1.3 The UN Somalia and Eritrean Monitoring Group and the Serious Fraud Office have alleged that the payments contemplated by the Capacity Building Arrangements are improper. You have asked our advice regarding the usual and customary practice regarding capacity building arrangements in the oil & gas industry.

1.4 Akin Gump Strauss Hauer & Feld LLP (**Akin Gump**) has represented clients in the oil & gas industry for 70 years. Our clients include independent producers, major multinational and state-owned oil companies, national governments, lenders, investment banks, private equity funds, underwriters, issuers, energy service companies, processing, operations, transportation and pipeline companies and refining and petrochemical companies. We have represented these clients throughout the entire oil & gas value chain, from exploration and production activity through pipelines, LNG, refining and petrochemicals. This memorandum draws on the collective experience of the 198 lawyers at Akin Gump who have experience in the oil & gas industry.

### 2. Summary Conclusion

2.1 Capacity building is typically defined as the development and strengthening of human and institutional resources.

2.2 Capacity building has been a long-standing feature of the oil & gas industry. One of the characteristics of the industry is that significant quantities of the world’s oil & gas reserves are located in developing countries and emerging markets. In order to explore for and develop these

reserves, it has typically been necessary for international oil companies (**IOCs**) to engage in capacity building of local persons and governments.

2.3 To build capacity effectively, it is first essential to understand what capacity is already in place, which is typically a function of the stage of development of the relevant country's oil & gas industry. An early stage oil & gas jurisdiction is likely to place more extensive capacity building requirements on IOCs than a more developed oil & gas producing jurisdiction. As a result, an aspect of capacity building that may look unusual or unconventional in one jurisdiction may be necessary in another jurisdiction.

2.4 Capacity building by IOCs is typically mandated by legislation and/or by contract.

2.5 Depending on the existing capacity already in place, capacity building in the oil & gas industry can take many forms, ranging from training and education, to technology transfer, to the building of legal and institutional frameworks.

2.6 Paragraph 3.9 of this memorandum sets forth a variety of examples of capacity building provisions in various jurisdictions under legislation and in contracts. These include mandated payments directly to governmental institutions for specified purposes, such as development of government institutions and logistics for the oil and gas industry, which can often be spent at the government's discretion. There are also examples of capacity payments directed towards training of government personnel, which is a nearly universal requirement in the oil & gas industry.

2.7 The pervasiveness of capacity building in the oil & gas industry, and the commonality of the goals of such capacity building, can be demonstrated by two recent World Bank projects that are described in paragraph 3.12.

### 3. Discussion

*What is 'capacity building'?*

3.1 Capacity building is typically defined as the development and strengthening of human and institutional resources. It involves an analysis of what is preventing people and governments from realizing their development goals, and implementing processes to help them achieve those development goals.

3.2 The United Nations Conference on Environment and Development held in Rio de Janeiro in June 1992 adopted two conventions regarding sustainable development. One of those Conventions, Agenda 21 (the **Agenda 21 Convention**), adopted the following definition of "capacity building":

"The ability of a country to follow sustainable development paths is determined to a large extent by the capacity of its people and its institutions as well as by its ecological and geographical conditions. Specifically, capacity-building encompasses the country's human, scientific, technological, organizational, institutional and resource capabilities. A fundamental goal of capacity-building is to enhance the ability to evaluate and address the crucial questions related to policy choices and modes of implementation among development options, based on an understanding of environmental potentials and limits and of needs as perceived by the people of the

country concerned. As a result, the need to strengthen national capacities is shared by all countries.”<sup>1</sup>

### *Capacity building in the oil & gas industry generally*

3.3 Capacity building has been a long-standing feature of the oil & gas industry. One of the characteristics of the industry is that significant quantities of the world’s oil & gas reserves are located in developing countries and emerging markets. In order to explore for and develop these reserves, it has often been incumbent upon **IOCs** to engage in capacity building of local persons and governments. Oftentimes this capacity building is carried out in parallel with public entities such as the United Nations and the World Bank.

3.4 To build capacity effectively, it is first essential to understand what capacity is already in place. This will obviously vary widely from jurisdiction to jurisdiction.

3.4.1 At one end of the spectrum, developed countries with long-standing oil & gas industries such as the United States, the United Kingdom and Norway, will already have fully-developed oil & gas capacity across the full spectrum of technical, legal, institutional and other relevant capabilities.

3.4.2 On the other end of the spectrum, developing countries without established oil & gas industries may have little or no capacity. Countries such as Kenya, Tanzania and Mozambique have recently had their first material oil & gas discoveries, and they are rapidly developing the necessary technical, legal, institutional and other relevant capabilities.

3.4.3 Somalia sits at the far end of this spectrum because as a result of the civil war there has been no oil & gas exploration activity for over a decade. Most of the technical, legal, institutional and other relevant capabilities that existed prior to the civil war have dissipated. As a result, Somalia can be viewed as a country with minimal existing capability.

3.4.4 In summary, it is never enough to say “this is how it is done everywhere else” because no two jurisdictions are exactly the same. An aspect of capacity building that would look unusual or unconventional in one jurisdiction may be necessary in another jurisdiction.

3.5 Capacity building in the oil & gas industry has benefits for both host countries and IOCs. Host countries will seek capacity building in order to develop their domestic oil & gas industry and otherwise develop their wider economy. From the perspective of the IOCs, capacity building will give the host country the ability to perform more efficiently its interfaces with the IOC. In host countries with a national oil company (**NOC**), capacity building can also enable the NOC to perform more capably its interfaces with the IOC, whether as a regulator or a co-venturer or both.<sup>2</sup> Ultimately, from an IOC perspective capacity building is a form of sustainable development that leads to a more stable investment environment and reduces the IOC’s political risk.<sup>3</sup>

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<sup>1</sup> Chapter 37.1, Agenda 21, United Nations Conference on Environment and Development, Rio de Janeiro, June 1992.

<sup>2</sup> Martyn David, *Upstream Oil and Gas Agreements*, at 75 (1996).

<sup>3</sup> Claude Duval, et al, *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects*, at 407 (2<sup>nd</sup> ed. 2009).

## *Specific types of capacity building in the oil & gas industry*

3.6 Depending on the existing capacity already in place, capacity building in the oil & gas industry can take many forms, including the following:

3.6.1 The most common type of capacity building is the provision of training and education. Petroleum laws and upstream petroleum agreements in most host countries include provisions requiring IOCs to provide training for nationals of the host country. Oil & gas exploration and exploitation requires highly skilled technical workers, such as geologists and geophysicists, as well as legal and financial specialists. The purpose of the training is two-fold. First, the IOC is typically obligated under the petroleum laws or upstream petroleum agreements to employ nationals of the host country, and it is necessary to train persons for these positions. Second, it is often necessary to train the staff of the local ministry of oil & gas and/or the NOC in order that they can perform their regulatory, oversight and other functions, which the IOC needs to have performed in a competent manner.<sup>4</sup> Although training may be the most common form of capacity building, there are many other aspects of capacity building in the oil & gas industry.

3.6.2 Another common aspect of capacity building in the oil & gas industry is the transfer of technology. The oil & gas industry is a highly technical and complex industry, involving a range of technologies from geo-sciences such as geology, geophysics, geochemical, gravity and magnetic work and interpretations, to oilfield services such as drilling wells, laying pipelines and general operations and maintenance. An example of a technology transfer is the transfer to the Ministry of the seismic data acquired and processed by Soma and the establishment of a data room repository to accept and retain that data. Of course, the transfer of this technology to the host country is not useful without the training of host country nationals as described above. The Agenda 21 Convention described technology transfer as follows:

“There is a need for favourable access to and transfer of environmentally sound technologies, in particular to developing countries, through supportive measures that promote technology cooperation and that should enable transfer of necessary technological know-how as well as building up of economic, technical, and managerial capabilities for the efficient use and further development of transferred technology. Technology cooperation involves joint efforts by enterprises and Governments, both suppliers of technology and its recipients. Therefore, such cooperation entails an iterative process involving government, the private sector, and research and development facilities to ensure the best possible results from transfer of technology. Successful long-term partnerships in technology cooperation necessarily require continuing systematic training and capacity-building at all levels over an extended period of time.”<sup>5</sup>

3.6.3 A further aspect of capacity building is the fostering of an appropriate legal and institutional framework by which the host country may best achieve successful exploration and exploitation. This includes a regulatory body such as the Ministry to manage, oversee and regulate

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<sup>4</sup> Id. At 382.

<sup>5</sup> Chapter 34.4, Agenda 21, United Nations Conference on Environment and Development, Rio de Janeiro, June 1992.

the oil & gas industry. This requires a wide range of skillsets. On the technical side, the regulatory body will need geoscientific capabilities in order to assess exploration activities such as minimum work programs and development programs. On the legal side, the regulatory body will need to administer the relevant petroleum law, prepare and enforce oil & gas regulations, and work with IOCs with respect to upstream petroleum agreements such as production sharing contracts and concessions. On the financial side, the regulatory body will need to be able to collect and distribute oil & gas revenues. Strengthening the regulatory institutions can also improve transparency by creating standard policies and procedures that should be followed in specified circumstances. In a country like Somalia, which has minimal existing capabilities, the development of these capabilities requires more than just the training and technology transfers referred to above. In this context, in our experience it is appropriate that these additional forms of support include payment of salaries at a time when the regulatory body has no revenue from oil & gas activities, as well as providing office space and office equipment.

### *How is capacity building implemented in the oil & gas industry?*

3.7 Capacity building by IOCs is typically mandated by legislation and/or by contract. In some host countries, the petroleum law or the petroleum regulations will provide for capacity building. This is particularly seen in developed petroleum jurisdictions, such as Nigeria and Angola. Alternatively, or in addition to legislative requirements, capacity building may also be required under the contractual provisions of a host country's model production sharing contract (**PSC**), concession or equivalent upstream petroleum agreement (collectively referred to as a **UPA**). The model form of the UPA will be prescribed by the government. Examples of capacity building provisions under legislation and in UPAs are detailed in paragraph 3.9 below.

3.8 The implementation of the types of capacity building described at paragraph 3.6 take several forms under the relevant legislative and contractual provisions. Capacity building will require active engagement by IOCs for purposes of training, technological transfer and knowledge sharing. Very commonly, there is an additional requirement for the IOC to provide monetary funds to the host government in order that the government may implement its own capacity building programs. This is typically structured as the payment of a specific monetary amount either at the outset of IOC operations and/or on an annual basis for the duration of operations. The payment may be stipulated as for a particular purpose, such as a contribution to a training fund. In other cases, it is described broadly as for purposes of development, or as financial assistance. In the vast majority of cases, this is payment directly to a government, a ministry or other government-affiliated body, via a bank account controlled by that government party. It is at the discretion of the government to then apportion funds. In some, but not all, cases, the IOC may be notified of, and may have audit rights regarding, this process. In our view, it is not unusual that the government of an early-stage oil and gas jurisdiction without an institutional or logistical infrastructure may require an IOC to make monetary contributions for the purpose of it putting this infrastructure in place.

### *Examples of capacity building payments for institutional / logistical development*

3.9 The examples included in this paragraph detail specifically the use of capacity building payments for the development of government institutions and logistics for the oil and gas industry.

#### *Kurdistan Region, Iraq*

3.9.1 The Kurdistan model PSC requires an IOC to provide multiple capacity building payments to the government, which are in addition to other provisions which deal with expenditure for purposes of training of personnel. The following three provisions, in particular,

exemplify the wide scope of capacity building payments. Notably, the capacity building bonus is a up-front capacity building payment to the government without a defined purpose:

Recruitment of personnel: “For the first [ ] ([ ]) Contract Years, the CONTRACTOR shall provide up to [ ] Dollars (US\$[ ]) in advance each Contract Year to the GOVERNMENT for the recruitment or secondment of personnel, whether from the Kurdistan Region other parts of Iraq or Abroad, to the Ministry of Natural Resources. The selection of such personnel shall be at the discretion of the Minister of Natural Resources. Such costs shall be considered as Petroleum Costs and shall be recovered in accordance with the provisions of Articles 1 and 25.”

Logistical assistance: “Before the end of the first Contract Year, the CONTRACTOR shall provide to the GOVERNMENT in kind technological and logistical assistance to the Kurdistan Region petroleum sector, including geological computing hardware and software and such other equipment as the Minister of Natural Resources may require, up to the value of [ ] Dollars (US\$[ ]). The form of such assistance shall be mutually agreed by the Parties and any costs associated therewith shall be considered Petroleum Costs and shall be recovered by the CONTRACTOR in accordance with the provisions of Articles 1 and 25.”

Capacity building bonus: “A capacity building bonus of [ ] Dollars (US\$[ ]) (“Capacity Building Bonus”) shall be payable to the GOVERNMENT by the CONTRACTOR within thirty (30) days of the Effective Date.”<sup>6</sup>

## *Tanzania*

3.9.2 The Tanzanian model PSC requires the IOC to make annual payments to the government for capacity building. The PSC specifically provides for capacity building in terms of both the training of government and NOC (TPDC) personnel and also the development of government resources. For example, the payment may be used to “purchase for the Government and TPDC advanced technical books, professional publications, technical software, scientific instruments, technical software or other equipment required by the Government and TPDC.”<sup>7</sup>

## *Liberia*

3.9.3 The Liberian model PSC includes detailed provisions in relation to capacity building, which include annual payments by the IOC for training, social and welfare programs, and the development of university programs. These payments are required to be paid by an IOC into a general revenue account maintained by the ministry of finance.<sup>8</sup>

*Examples of capacity building payments specifically for training of government personnel*

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<sup>6</sup> Kurdistan model Production Sharing Contract, articles 23.4, 23.11 & 32.2.

<sup>7</sup> Republic of Tanzania Model Production Sharing Agreement 2013, article 21.

<sup>8</sup> Republic of Liberia Model Production Sharing Contract 2013, article 13.

3.10 Capacity building payments for the purposes of training of local, government and/or NOC personnel are a feature of most, if not all, African jurisdictions.

## *Kenya*

3.10.1 In Kenya, an IOC must, pursuant to law and the model PSC, make annual capacity building payments to a government ministry training fund. This requirement is mandatory, with the quantum being a negotiable aspect of a PSC.<sup>9</sup>

## *Equatorial Guinea*

3.10.2 By law and under the terms of the model PSC, an IOC operating in Equatorial Guinea must provide the petroleum ministry with funds for the training of Equatoguinean personnel.<sup>10</sup>

## *Ghana*

3.10.3 The Ghanaian model PSC requires an IOC to pay the NOC an annual sum for purposes of training and development of local personnel.<sup>11</sup>

## *Cameroon*

3.10.4 Under the Cameroonian model PSC an IOC has been required to pay into a government bank account an annual sum for purposes of the professional training of Cameroonian personnel.<sup>12</sup>

## *Eritrea*

3.10.5 Under an Eritrean PSC an IOC has been required to pay into a ministerial bank account an annual sum for purposes of the training and employment of local personnel.<sup>13</sup>

## *Examples of capacity building payments in developed African jurisdictions*

3.11 The examples below indicate that capacity building payments to governments are commonplace even in the most developed African petroleum jurisdictions, where the institutional and logistical framework for the oil and gas industry is already in place.

## *Nigeria*

3.11.1 The Nigerian Content Development Fund was established for the purpose of funding local capacity building in the oil and gas industry. Under Nigerian legislation, 1% of the contract value of every contract awarded to any IOC in the upstream sector is deducted at source

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<sup>9</sup> Petroleum (Exploration and Production) Act (Chapter 308), section 11, and Republic of Kenya Model Production Sharing Contract, article 13.

<sup>10</sup> Petroleum Regulations of the Republic of Equatorial Guinea, article 157.

<sup>11</sup> Ghanaian Production Sharing Contract, article 21.

<sup>12</sup> Example Cameroon Production Sharing Contract, article 19.

<sup>13</sup> Example Eritrean Production Sharing Contract, article 3.5.



and paid into the fund. The fund is managed by a Nigerian government body, the Nigerian Content Development and Monitoring Board.<sup>14</sup> The fund primarily supports working capital and loan requirements to the local supply chain.

## *Angola*

3.11.2 Any IOC operating in Angola is required under Angolan legislation to make annual payments to a centralized government petroleum training and development fund, in accordance with specified criteria.<sup>15</sup>

## *Analogous capacity building by the World Bank*

3.12 The pervasiveness of capacity building in the oil & gas industry, and the commonality of the goals of such capacity building, can be demonstrated by two recent World Bank projects:

3.12.1 On 20 December 2010, the World Bank announced its approval of a credit of US\$38 million to the Government of Ghana for implementation of an Oil and Gas Capacity Building Project. Oil and gas was discovered in Ghana in 2007, after which it was determined that institutional development for management of the oil & gas sector and development of individual skills faced significant challenges. The Project has two main objectives: “first, to help improve public management and regulatory capacity and enhance sector transparency by strengthening the institutions managing and monitoring the sector; and second, support the development of indigenous technical and professional skills need by the petroleum sector through support educational institutions.” In particular, “the Project will provide institutional support to the Ministry of Energy and the soon-to-be-established petroleum regulatory body to enable them [to] play their oversight, coordination, policy planning and implementation as well as monitoring and evaluation roles effectively.”<sup>16</sup>

3.12.2 On 24 July 2014, the World Bank announced its approval of US\$50 million for the Government of Kenya to “strengthen its capacity to manage the oil and gas sector and the distribution of its revenues to create sustainable growth across all areas of the country’s economy.” The project followed the first discoveries of significant quantities of oil & gas in Kenya. The project is intended to foster “transparency and good governance in oil contracts and revenue” and “capacity building among existing government institutions and clarification of their roles and responsibilities.”<sup>17</sup>

Please let me know if you need anything further or if you have any questions.

JCL

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<sup>14</sup> Nigerian Oil and Gas Industry Content Development Act 2010, s.104.

<sup>15</sup> Angola Decree-Law 17/09, articles 12 & 13.

<sup>16</sup> Building Capacity to Manage Ghana’s Oil – World Bank Assists with \$38 Million, World Bank press release no. 2011/272/AFR dated 20 December 2010.

<sup>17</sup> Kenya: New World Bank project will support country efforts to better manage oil and gas developments and revenues to invest in lasting growth and development, World Bank press release no. 2015/045/AFR dated 24 July 2014.