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Summary of IEEFA Report Findings: 2016 Petroleum Agreement Between Guyana, ExxonMobil, et. al.

IEEFA Analysis Finds Guyana Contract Is One-Sided Deal Favoring Oil Companies

Executive Summary

Guyana government officials face an upcoming decision on a request to renew an environmental permit for offshore oil operations in the Liza 1 field, an extensive area of seabed owned by Guyana. ExxonMobil has requested that the government weaken the environmental protections contained in the prior permit. Although Guyana and ExxonMobil had previously agreed to a policy of zero routine air emissions, the company is now asking Guyana to approve a system of "incremental non-routine" flaring. The change, if adopted, would effectively allow the company to rely on faulty equipment for natural gas emissions management and to provide a backup system in case of further system failure.

If Guyana grants this new concession to ExxonMobil, it will become part of a long line of one-sided decisions that have given ExxonMobil substantial financial benefits at the expense of Guyana's taxpayers.

Recent reports show that the existing agreement is already a bad deal for Guyana. The oil companies receive an unfair revenue split, and Guyana is having to borrow money to pay for new spending. Guyana cannot close its budget deficits because it is receiving too little revenue from the Liza project. At the same time, Guyana has provided substantial tax giveaways to the oil companies and handed them a lucrative decommissioning deal that allows the companies to pocket $3.2 billion.

Recent reports show that the existing agreement is already a bad deal for Guyana.

Specifically:

- ExxonMobil, Hess and the China National Offshore Oil Company (CNOOC) have received approximately G$752.4 billion (USD$3.6 billion) from the project, while Guyana has received G$127 billion (USD$607 million) through

2021—a 6-to-1 revenue gap that gives the oil companies an 85.5 percent split of revenue and only 14.5 percent to Guyana.[1]

- IEEFA estimates that by 2027, Guyana will carry a hidden liability of more than G$6.27 trillion (USD$34 billion) owed to the oil companies. This assumes all development costs related to Liza 1,2,3,4 and Payara; decommissioning costs and tax giveaways. It does not include undisclosed pre-contract costs and undisclosed development costs for additional oil discoveries. IEEFA estimates these costs mean that Guyana's per capita cost for the oil development is G$9.4 million (USD$44,000).

- Guyana will have to increase borrowing over the next five years. Since December 2019 the commencement of commercial operations Guyana's total public debt has increased. In its first year of using its G$127 billion (USD$607 million) in revenues, the country borrowed G$87.8 billion ($420 million).

- Guyana will give away additional tax breaks to the oil companies amounting to approximately G$335.3 billion (USD$1.7 billion) over the next five years.

- Guyana will advance more than G$666.1 billion (USD$3.2 billion) in additional cash to the oil companies, purportedly to cover future costs of decommissioning. The government does not require the companies to set the money aside to make sure it is there when needed.

- IEEFA has identified at least four more areas of risk under which the contract's provisions are likely to short-change Guyana. Those areas include project costs related to insurance, interest rates and borrowing, parent company charges and potential charges due to contract changes.

Background

This report summarizes three IEEFA studies and several analytical commentaries on the 2016 petroleum agreement (the "contract") entered into between the government of Guyana and Esso Exploration and Production Guyana Limited (a subsidiary of ExxonMobil), CNOOC Nexen Petroleum Guyana Limited and Hess Guyana Exploration Limited.[2] The agreement governs oil exploration, production and profit sharing between the companies and the government of Guyana in the

[1] All USD$ to G$ conversions equal USD$209 to G$1. See appendix.
[2] IEEFA. Guyana's Tax Giveaway: Guyana pays ExxonMobil, Hess and CNOOC's annual income taxes, September 28, 2021. (IEEFA-Tax Giveaway). Also see: IEEFA. Lack of Ring-Fencing Provision Means Guyana Won't Realize Oil Gains by 2030's, If at All. July 2021. Also see: IEEFA. Guyana's Oil Deal: Promise of Quick Cash Will Leave Country Shortchanged. October 2020. "IEEFA-Quick Cash"). Also see: IEEFA. IEEFA: Exxon Led Consortium Tramples Zero Gas Flaring Goals in Guyana, February 2022.

Stabroek Block, an area of 26,800 square kilometers off the coast of Guyana. Esso is the party responsible for conducting day-to-day operations under the contract.[3]

The petroleum agreement establishes the mechanism for sharing the profits of oil sales with the government of Guyana. Specifically, the agreement provides that 25 percent of the monthly revenue from oil and natural gas shares be split evenly between the companies and the government of Guyana. From the remaining 75 percent, "recoverable contract costs" are to be deducted, and the remaining revenue (if any) split evenly between the companies and the government. If recoverable contract costs exceed 75 percent of oil and gas revenues, excess costs are to be carried over into future months for recovery. Recoverable costs include all costs related to petroleum exploration and development, including total development costs and abandonment costs.

There is an inherent conflict in the contract between the oil companies and Guyana. Guyana needs as few costs as possible to be included in recoverable costs. The sooner it can pay off these costs, the sooner it can claim an equal share of total revenues. And it is in the oil companies' interests to put as many costs as possible into recoverable costs, including the total development costs as well as other cost factors, since this pushes off the day when Guyana can claim an equal share of the revenue. Any additional project costs advanced by Guyana are to the benefit of ExxonMobil and its partners.

There is an inherent conflict in the contract between the oil companies and Guyana.

The category of total development costs, as a component of all recoverable costs, is particularly important since it includes all the capital expenditures made to explore, drill and extract oil from the Stabroek reserves. Total development costs have risen into the billions of dollars.

Prior IEEFA reports on the 2016 agreement have examined details of the costs and revenue-sharing agreement—including the lack of ring-fencing provisions and the substantial tax relief provided to the companies.[4] The costs collectively result in

[3] Petroleum Agreement Between Government of the Cooperative Republic of Guyana and Esso Exploration and Production Guyana, Limited, et. al., dated July 10, 2016 ("Agreement"), Section 2.2(a).

[4] Ring fencing in this context refers to the establishment of a geographic area (*e.g.*, Liza 1) as an accounting domain. A ring-fenced domain requires that all income statements, balance sheets and cash flow analysis that result from activities in the area are cordoned off and separated from activities that occur in other areas (*e.g.*, Liza 2 and Yellowtail and the 17 other oil discoveries). Each would become their own financial unit. The lack of ring fencing in this instance refers to the fact that the area defined in the 2016 petroleum agreement as the Stabroek is essentially one accounting unit. All expenditures made and all revenue received are applied as if this were one unit. Therefore, the revenues from Liza 1 pay for the costs of Liza 2, 3, and Payara, for example, until those wells become operational. The lack of ring fencing eliminates basic standards of accountability for the financial output of each well. The consequences are highly significant since

billions in hidden liabilities for Guyana and less revenue available to the country. IEEFA's reports show the various ways in which the contract is front-loaded in favor of ExxonMobil, Hess and CNOOC.

IEEFA has estimated that when all known development costs, tax giveaways, and decommissioning costs are added together over the life of the agreement individual Guyanese residents will take on conservatively G$9.4 million (USD$44,000).[5] This does not include the costs from an outstanding audit of pre-contract costs and development costs associated with additional oil discoveries.

Given declining oil and gas markets over the next couple of decades, additional costs significantly increase the risk that Guyana's oil fields will never produce the revenues promised to the people of Guyana. The agreement has independently been described by IHS Markit as providing Guyana with a below-average take.[6]

The contract is front-loaded, one-sided and riddled with tax, decommissioning and other loopholes that favor the oil companies.

IEEFA's reports issued thus far have been warnings to the Guyanese government and its people that the contract is front-loaded, one-sided and riddled with tax, decommissioning and other loopholes that favor the oil companies. The lack of transparency also hurts the interests of Guyana.

IEEFA's research findings could have been substantially improved if the government and the operator, ExxonMobil, had provided routine reports containing basic operational and financial information. Despite repeated public requests to do so, however, neither the government nor ExxonMobil has made such disclosures.

With the filing of this year's budget, Guyana has entered a new phase of its oil project—its national budget is now fully dependent on the oil project to produce revenues to balance the country's budget. Twenty-nine percent of its revenues come from the proceeds of Liza 1 oil and gas production.

Guyanese government officials have acknowledged the one-sided nature of the agreement and promised reforms to future agreements.[7] A government official, however, recently indicated that Guyana was in no hurry to develop an improved

they provide a proverbial blank check, an incentive for the operator to spend on new development without any regard for the fiscal impact on Guyana. Until further public clarification of the actual accounting on the project, this is IEEFA's interpretation of the agreement.

[5] This figure is derived by taking estimated costs in Table II and dividing it by the population of Guyana of 773,000. According to the budget speech appendix documents, the population of Guyana in 2021 is 773,000. Guyana Budget Speech, 2022 Budget, Appendix I, Population and Vital Statistics Line 4.1 Mid-Year Population.

[6] IHSMarkit. Yellowtail - A Modeling Perspective—Vantage Insights. January 2021.

[7] Reuters. Guyana seeks higher royalties, revamped terms for new oil contracts. August 17, 2021.

policy, claiming that no potential new contracts are pending.[8] Even if the government moved forward with contract provisions that would provide Guyana with a larger take, it would take perhaps a decade to implement them.

The remainder of this report covers the specific findings of prior IEEFA reports and offers additional findings and identifies new areas for future research.

I. Core Findings

A. *Current Revenue Split Is One-sided: Oil Companies Receive G$752.4 billion (USD$3.6 billion) and Guyana Receives G$127 billion (USD$0.6 million)—a 6-to-1 Ratio*

The petroleum agreement divides up revenues received from the extraction, transport and sale of oil according to the following formula:

1. 25 percent of all revenue is taken off the top in the form of profit oil. Profit oil is split 50/50, with the government of Guyana receiving 50 percent and the three companies (ExxonMobil, Hess and CNOOC subsidiaries) splitting the remaining 50 percent. So, off the top, each party receives 12.5 percent of profit oil.

2. The remaining 75 percent is used to satisfy total recoverable costs.

3. Because oil drilling is capital-intensive and the parties have agreed to reimburse the oil companies for 100 percent of expenses, the oil companies are able to include all capital and operating expenses in total recoverable costs.

4. The capital expenditures, referred to as development costs, are part of total recoverable costs and count into the billions of dollars. So, for the first several years, revenues do not cover total recoverable costs. The outstanding balance of total recoverable costs is rolled over into the next month or year. During this period, Guyana's revenue take or profit oil is limited to 12.5 percent, plus a 2 percent royalty, or 14.5 percent.

5. When all development costs are satisfied, the surplus would be split 50/50.

6. Therefore, in the out years, the profit oil split is enhanced, and Guyana's share more closely approximates a 50/50 overall split.

7. Currently, though, Guyana's share of revenue is 14.5 percent, and the oil companies receive 85.5 percent. This is because billions of dollars in outstanding, hidden total development and other costs have yet to be paid off.

[8] Reuters. Guyana in 'no rush' to draft new oil production-sharing pact—minister. May 6, 2022.

From 2019 through the end of 2021, Guyana received G$127 billion (USD$607 million) and the companies received G$752.4 billion (USD$3.6 billion).

Figure 1: Guyana and Oil Company Revenue Split (December 2019 through end of 2021; in USD$ billions)

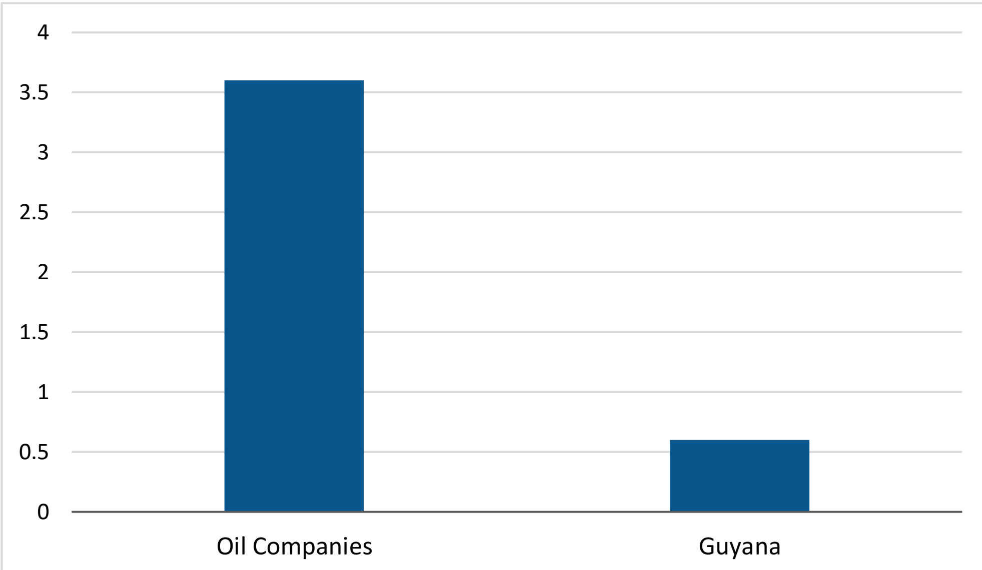

Figure 1 reflects IEEFA's estimate of the oil company revenue from oil extraction using the amounts reported by the Bank of Guyana through 2021. Neither the government nor the oil companies publish an aggregate number that reflects the revenue take of the oil companies, compared to the amount Guyana receives.

The oil companies are responsible for paying expenses incurred in the course of day-to-day operations. Guyana's revenues must also be adjusted for expenses related to tax payments the country makes for the companies, pursuant to the contract, as well as any additional expenses. Since neither party to the agreement makes this information available, the simple representation above of the revenue split provides a reasonable portrayal of the cash apportionment at this time.

B. Billions of Dollars in Hidden Development Costs

A significant portion of the total recoverable costs are the capital expenditures, or total development costs.[9] This represents the cash amounts used to explore and extract the oil. Rystad estimates a total development cost of G$4.5 trillion (USD$21.8 billion) for the Liza field. The Liza Phase 1 capital cost is approximately G$940.5 billion (USD$4.5 billion).

Overall projected total development costs for Liza Phases 1, 2, 3 and Payara amount to G$6.1 trillion (USD$29 billion). The costs are folded into the ongoing cash flows

[9] Rystad. Guyana-Suriname Basin poised for upgrade while oil firms prep to splurge billions on Stabroek. February 2020.

and balance sheet for the project. A disputed amount of pre-contract costs also exists that could add at least another G$96.1 trillion (USD$460 million).[10] Also, it is not clear how much (if any) of the exploration costs associated with the approximately 15 additional announced oil discoveries is added to the costs. (See Section III below)

It is very possible that the hidden liabilities that fall under the contractual category of total development costs could reach upward of G$6.1 trillion (USD$29 billion) by the end of 2027. This amount must be paid back before Guyana can start receiving the enhanced 50/50 oil profit split.

C. Rising Debt Incurred to Pay for Increased Expenditures

The promise of future revenues has whetted Guyana's appetite to increase annual spending on domestic needs. The demand to spend is happening at a pace that is faster than Guyana's revenue take from oil production is actually materializing. In the first year that Guyana used its oil revenues in its budget—2022—the government increased spending by more than the amount of revenue it received from oil production. The country also increased borrowing by G$87.8 billion (USD$460 million).

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Since December 2019 the first month of commercial operation of the Liza field through December 2021 Guyana's Total Public Debt has increased.[11] Debt levels are expected to continue to rise through the end of 2022.

Over the past few years, Guyana has been provided with a number of recommendations on balancing how new resources would be used. The critical fiscal recommendations would require at least 50 percent of profit oil to be contributed into its sovereign wealth fund. An additional recommendation is to not increase spending in any one year more than the amount received in oil revenues.[12] Both of these recommendations have been violated in the first year that Guyana has used oil revenues in its budget. These are bad precedents.

[10] Stabroeknews.com. Audit of Exxon pre contract costs stalled by mix-up. February 2021.
[11] Guyana Budget Speech 2022. 2022 Budget Speech, Appendix VI Actual and Projected Total Public and Publicly Guaranteed Debt, Line 2.0, Total Public Debt.
[12] For a more detailed discussions of these fiscal mechanisms see: IEEFA-Quick Cash.

D. Guyana Provides Large Tax Giveaways to Oil Companies

One provision of the petroleum agreement requires the oil companies to pay income taxes to Guyana,[13] but another provision requires the government of Guyana to pay the actual tax. This provision will cost Guyana. IEEFA estimates Guyana will lose approximately G$355.3 billion (USD$1.7 billion) in tax revenues over five years. The losses just add to the series of provisions in the petroleum agreement that harm Guyana's interest.

E. Decommissioning Liability: Cash Is Advanced to Oil Companies 20 years Before It Is Spent—and Without Any Controls That Require It to Be Set Aside for Decommissioning Expenses

A significant provision in the contract requires Guyana to advance the cost of decommissioning in cost recovery to the oil companies without any requirement that it utilize the money to perform the actual steps needed to secure the wells at the point the wells are fully depleted, and otherwise clean up the site before abandoning it. Industry best practices would allow for the costs to be advanced—but only if the money is put into a trust so that it is secured and available at the point when the site is properly closed and abandoned. One independent estimate puts the decommissioning cost at G$666.1 billion (USD$3.2 billion). The contract calls for a decommissioning and abandonment program and approved budget, but this is not publicly available.

F. Flaring: Strict Environmental Standards to Prevent Greenhouse Gas and Other Emissions Were Agreed Upon by the Parties. ExxonMobil Violated the Standards and Has Requested Weaker Environmental Permits Going Forward.

The Liza One environmental impact assessment and permit call for zero routine emissions.[14] Almost from the beginning of operations in December 2019, however, the project's emissions controls failed to function properly. ExxonMobil acknowledged the failure and has made futile efforts to fix the system.[15] The company agreed to pay a fine to acknowledge the violations of the permit.

Subsequently, ExxonMobil appealed and was awarded a modified permit with weaker standards that allows it to flare, based on an unusual regulatory standard identified by ExxonMobil as "non-routine incremental flaring."[16]

[13] See: IEEFA-Tax Giveaway
[14] Esso Exploration and Production Guyana Ltd. Environmental Impact Assessment for the Liza Phase 1 Development Project, Vol. 1. May 2017.
[15] Stabroek News. ExxonMobil says working fervently to fix compressor issues – in order to cease flaring. June 11, 2020.
[16] Environmental Protection Agency. Environmental permit no. 20160705-EEDPF. September 2020. (The "Liza Phase 1 Permit" or the "modified permit"), issued to Esso Exploration and

The financial structure of the petroleum agreement, like the original permit, included a zero routine flaring standard. ExxonMobil agreed that it could adhere to this standard within the payment structure of the contract. The amended permit that reduced the pollution standard does not contain any financial or other provision that compensates Guyana for this new, less-stringent permit arrangement. Future permits, as outlined in the Yellowtail and Payara environmental impact assessment, contemplate further erosion of environmental protections but similarly maintain the same one-sided financial arrangements.[17]

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Residents of Guyana have brought an action in court that challenges the government's right to reduce environmental protections.[18]

G. Investigation Is Needed of More One-Sided Contract Provisions

Each of these provisions allow ExxonMobil, Hess and CNOOC to receive compensation that is extraordinary. As explained above, each of the findings in IEEFA's prior research would be improved if the government and ExxonMobil provided more frequent and transparent reporting. Further research is also needed to review provisions of the contract that cover insurance,[19] interest charges,[20] the parent company administrative charge,[21] and costs associated with contractual adjustments.[22]

While IEEFA's research can provide some insight into Guyana's interests, all of these analyses point to the need for Guyana to vastly improve its own internal auditing capacity.

Production Guyana Ltd as the "Operator." Also see: *Henry, Nageer and Thorington v Environmental Protection Agency and Esso Exploration and Production Guyana, Ltd.,* No. 2021-HC-DEIV-CIV-FDA-94, in the High Court of the Supreme Court of Judicature of Guyana Civil Jurisdiction (Constitutional and Administrative Division), Proceeding for Judicial Review ("Flaring Case"), Esso Exploration and Production Guyana, Ltd., Affidavit in Defence, (March 28, 2022), paragraph 30.

[17] Esso Exploration and Production Guyana Ltd. Environmental Impact Assessment for the Payara Project, Vol. 1. August 27, 2019. Also see: Esso Exploration and Production Guyana Ltd. Environmental Impact Assessment for the Yellowtail Project. Revised March 2022.

[18] Flaring Case. Fixed Date Application. January 21, 2022.

[19] Petroleum Agreement, Section Accounting, 3.1.

[20] Petroleum Agreement, Section Accounting 3.1(g).

[21] Petroleum Agreement, Annex C, Section 2.5 b.

[22] Petroleum Agreement, Section 15.7.

II. Assessing Long Term Costs of Oil Exploration and Production in Guyana

This section of the report tries to put in summary fashion some of the points made above as a way to assess the current cost structure of the Guyana oil exploration project and to take a long view of the development process.

Table 1: Development/Decommissioning/Tax Adjustment Costs

Cost	Amount G$	Amount USD$
Development Cost- Liza and Payara	$6.1 Trillion	$29.1 billion
Decommissioning Costs Liza Area	$666.1 billion	$3.2 billion
Five Year Value of Tax Adjustments	$355 billion	$1.7 billion
Total Costs	$7.2 Trillion	$34.0 billion
Unspecified Costs		
Pre-Contract Liabilities	Unknown	Unknown
15 New Oil Discoveries	Unknown	Unknown

Source: IEEFA, Rystad.

IEEFA estimates that based on current, final development decisions the Guyanese people are facing at least $34 billion in costs that must be paid prior to it receiving a fair share of the profits. Currently ExxonMobil and its partners have made Final Investment Decisions on Liza and Payara projects. The costs of those projects are estimated at G$6.1 trillion (USD$29.1 billion). The decommissioning costs and tax giveaways additional $4.9 billion.

This figure reflects the current investment decisions that have been already made by ExxonMobil and its partners and some of the cost implications. ExxonMobil and its partners have also been announcing new oil discoveries. The last one put the total amount of oil reserves at 11 billion barrels.[23] IEEFA estimates that those oil discoveries are expected to extend oil development through the late 2050's. The additional amount of development and decommissioning costs could add an additional G$15.8 trillion (USD$75.7 billion).[24]

Although ExxonMobil and its partners have not made Final Investment Decisions on these discoveries it appears that they are positioned to do so. As noted above Guyana's government officials are no longer committed to making sure that financial reforms are instituted that would protect Guyana from the one-sided provisions IEEFA and others have identified.[25] If this level of cost is added to the project, then it is very difficult to predict when—if ever—Guyana will receive a fair share of profits.

[23] Reuters. Exxon makes three new discoveries Guyana increases oil reserves. April 26, 2022.
[24] IEEFA's estimates build upon the Rystad estimates identified above. Those estimates add to approximately G$ 10.4 trillion (USD$50 billion). Those estimates do not include several new discoveries. IEEFA has derived its estimate including Yellowtail, Mako, Uaru, Whiptail 1 and 2, Tanager 1, Ranger, Pinktail, Pluma, Koebi, Snoek 1 and Hammerhead 1. It does not include the recently announced Bareeye-1, Lakanani-1 and Patwa-1.
[25] Reuters. Guyana in 'no rush' to draft new oil production-sharing pact—minister. May 6, 2022.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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Tom Sanzillo, director of financial analysis for IEEFA, is the author of numerous studies on the oil, gas, petrochemical and coal sectors in the U.S. and internationally, including company and credit analyses, facility development, oil and gas reserves, stock and commodity market analysis and public and private financial structures. Sanzillo has experience in public policy and has testified as an expert witness, taught energy industry finance and is quoted frequently in the media. He has 17 years of experience with the City and the State of New York in senior financial and policy management positions. As the first deputy comptroller for the State of New York Sanzillo oversaw the finances of 1,300 units of local government, the annual management of 44,000 government contracts, and over $200 billion in state and local municipal bond programs as well as a $156 billion global pension fund.