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Guyana's Past Debt: Contractual Loose Ends Tangle Path to Profit

Audit Issues Complicate Potential Billion-Dollar Windfall for Guyana

Executive Summary

The contract between Guyana and ExxonMobil, Hess and China National Offshore Oil Company (CNOOC) is being mismanaged. At least $1 billion hangs in the balance, and Guyana's officials are unprepared to defend the public interest.

The current contract requires Guyana to pay ExxonMobil for costs incurred by the company between 1999 and 2015 to develop Guyana's oil resources. ExxonMobil has made claims, the government has conducted an audit, and there has still been no settlement.

A partial claim of $460.2 million that Guyana has agreed to pay has become a source of controversy. The remainder of the costs owed are unknown. Some have estimated the amount at $900 million. The amount is substantial. At the current rate of production, this would equal more than two years of Guyana's oil profits.

If Guyana must accept this future liability, it will mean that its annual profits from the oil project will remain at bare minimum levels until it is paid off. The promise to Guyana is that annual revenue from the oil will help the country: 1) Close Guyana's annual budget deficit; 2) Fund new programs; 3) Build national wealth; and 4) retire Guyana's debt. The overall development is meant to stimulate the country's economy. The inability to settle this important matter means that the date when substantial revenues are available is being pushed back, assuming it is realized at all.

The inability of the Guyanese government to review a claim, start and finish an audit, and negotiate to protect Guyanese interests is an indication of significant and fundamental fiscal distress. The skills to perform these functions are basic. The absence of this talent for Guyana is a fundamental flaw. It means every time Guyana receives payment for an oil lift, it has no way to determine if the payment is accurate. The government has had more than 20 years to prepare for this deal.

The information regarding this issue is in the possession of both the government and ExxonMobil, but no one is sharing it with the public. The failure of both parties to provide regular, ongoing, accurate information harms the credibility of the project and the parties involved.

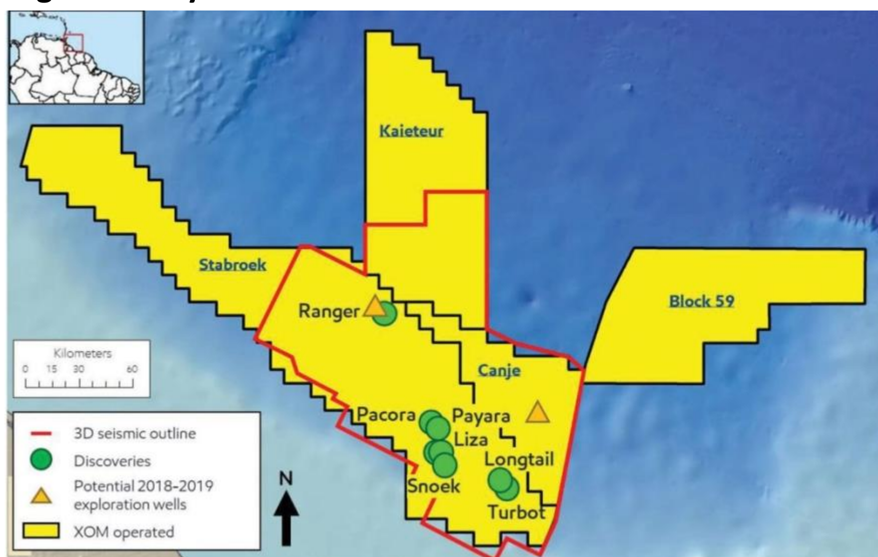
I. Background

On June 27, 2016, the government signed an agreement with ExxonMobil (Esso Exploration and Production Guyana Limited, referred to in the contract as "Esso"), CNOOC Petroleum Guyana Limited (referred to as "Nexen") and Hess Guyana Exploration Limited (referred to as "Hess"),[1] defined in the contract as "the contractor." The contract is drawn between the three parties and the government of Guyana.

Esso is the operator charged with the day-to-day activities of the contractor.[2] The contract sets forth the terms and conditions of a production-sharing agreement. The agreement details how oil production

will take place, how costs are calculated and how "profit oil" is divided among the parties. "Profit oil" is the amount of oil remaining after the oil is extracted and sold, and recoverable contract costs have been satisfied.[3]

Figure 1: Guyana's Identified Oil Reserves



Source: Stabroek News.

[1] Petroleum Agreement (the "Agreement") Between the Government of the Cooperation of Republic of Guyana and Esso Exploration and Production Guyana Limited (for purposes of this paper, "Esso"), an ExxonMobil affiliate; CNOOC Petroleum Guyana Limited (China National Offshore Oil Company), for the purposes of this paper "CNOOC"); and Hess Guyana Exploration Limited (for the purposes of this paper, "Hess"). They are identified individually in the contract as the "Contractor." (See: Agreement, Article 1.1, Definitions). The contractor also will be referred to as "ENH" for the purposes of this paper., The companies will be identified individually as they are in the contract when being discussed individually. The Guyanese government and the three companies will be referred to as "the parties" to the agreement.

[2] Agreement, Liabilities and Indemnities, Article 2.2 (a).

[3] Agreement, Cost Recovery and Production Sharing, Article 11.4.

The contract area is 26,800 square kilometers and extends over 300 kilometers, all the way from the border with Venezuela to the Suriname border.[4] This is a contract area of extraordinary size. For example: As of 2019, there were 159 million acres under lease in 2,451 leases, which equates to 53,000 acres each, or 214 square kilometers for each block in the U.S. federal waters in the Outer Continental Shelf of the Gulf of Mexico.[5] If you compare that to the ExxonMobil acreage in Stabroek of 26,800 square kilometers for one lease, it means the Guyana lease is more than 125 times the size of the average Gulf of Mexico lease.

Successful execution of the project is meant to bring substantial, long-term financial benefits to Guyana in the form of annual profit payments from oil development. The drilling and extraction are meant to bolster Guyana's economy. The revenues are meant to: 1) Close Guyana's annual budget deficit; 2) Fund new programs; 3) Build national wealth; and 4) retire Guyana's debt. Government officials are confident these goals can be achieved, even as they warn the public that the future of oil and gas development is risky.[6]

A. General Terms and Conditions

The agreement continues in full force and effect as long as the contractor holds a petroleum prospecting license or a petroleum production license. Each petroleum production license is granted for 20 years. The agreement comes to an end when the last petroleum production license expires.

The basic formula is:

Figure 2: Contract Formula to Establish Level of Profit Oil From Development

Oil Price x Gross Production (barrels of oil) = Gross Revenue – Total Recoverable Costs = Profit Oil [7]

Gross Revenue is the cash amount received for the sale of gross production. The first 75% of gross revenue goes to pay for Total Recoverable Costs. The remaining 25% of gross revenue is considered the dollar value of "profit oil." The contractor and Guyana share "profit oil" on the basis of a 50-50 split. Each party receives a minimum 12.5% of gross revenue as their share of the profits. This is the floor, or minimum amount each party receives from the sale of oil. Guyana also receives a 2% royalty on gross production and sale.[8]

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[4] ExxonMobil. ExxonMobil announces Redtail discovery offshore Guyana. September 17, 2021.
[5] U.S. Bureau of Ocean Energy Management. BOEM Gulf of Mexico OCS Region Blocks and Active Leases by Planning Area, September 1, 2020. September 17, 2021.
[6] Ashni K. Singh. Budget Speech. February 12, 2021.
[7] Agreement, Cost Recovery and Production Sharing, Article 11.9 – gross production is minus any oil used by the operator for project needs which are determined by the operator.
[8] Agreement, Taxation and Royalty, Article 15.6. The focus of this paper is on Guyana's profit oil and does not discuss the royalty payment in any depth. The Royalty payment will be the subject of future IEEFA commentary.

Recoverable costs include 100% of all exploration and development costs, pre-contract costs, operating expenses, estimated cost of future abandonment, interest and parent company expenses. Annual recoverable costs are capped at 75% of revenues, and any balance in recoverable costs is carried over until the next month.[9]

Since recoverable costs include 100% of all development costs (initially $33 billion over the first five years),10 the project carries a substantial balance that accrues to the contractor through at least 2028 (see Appendix I). The substantial balance of outstanding development costs could take even longer to satisfy, since new investments, pre-contract costs, operational delays and volatile oil prices can disrupt financial plans. Repayment of the development and other recoverable costs diminishes the size of Guyana's annual cash receipts from profit oil. Until Total Recoverable Costs are paid in full, Guyana receives only the minimum payment, 12.5% of gross revenues (see Appendix I).

B. The Pre-Contract Cost Provision

In 1999, Esso and Guyana entered into a production sharing agreement.[11,12] The 1999 agreement required the contractor to pay all costs and for those costs to be reimbursed from the oil that was identified and extracted by Esso. Over time, the parties agreed to enter into a new agreement that included Hess and CNOOC, and altered some of the other terms and conditions from the 1999 agreement.

The new agreement, signed in 2016, contained a "pre-contract cost" provision. The actual costs incurred under the 1999 agreement that remained unpaid are the basis for the pre-contract costs in the new 2016 agreement. This provision allowed Esso to grandfather the costs incurred under the 1999 agreement into the new 2016 contract. Those costs now would be factored into the cost structure going forward as part of the Total Recoverable Costs of the project.

The 2016 pre-contract provisions read as follows:

> Costs incurred by Contractor in connection with petroleum operations carried out pursuant to the 1999 Petroleum Agreement, which shall include: (1) four hundred and sixty million, two hundred and thirty seven hundred thousand and nine hundred and eighteen United States Dollars (US$ 460,237,918) in respect of all such costs incurred under the 1999 Petroleum Agreement prior to year-end 2015, and (2) such costs as are incurred under the 1999 Petroleum Agreement between January 1, 2016 and the Effective Date which shall be provided to the Minister on or before October 31, 2016 and such number agreed on or before April 30, 2017. For purposes of this paragraph, the term Pre-Contract Costs include contract costs, exploration costs, operating costs, service costs and general and administrative costs

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[9] Agreement, Cost Recovery and Production Sharing, Article 11.3.
[10] Appendix I: The $33 billion comprises of the total Pre-Effective Date Costs, Exploration Cost and Total Development Costs (Pre-2020 through 2024) identified on the spreadsheet.
[11] This original agreement in 1999 was between Esso and Guyana. CNOOC and Hess were brought in as part of the 2016 agreement.
[12] World Bank. Esso Exploration and Production Guyana Lt., Liza Well, PSA. January 1, 1999.

and annual overhead charge as those terms are defined in the 1999 Petroleum Agreement.13

II. Why Are the Pre-contract Costs Important to Guyana's Fiscal Health?

For Guyana to plan its fiscal future, it needs to maintain control over the size of Total Recoverable Costs. When new costs are added to Total Recoverable Costs, Guyana's share of production is limited to the minimum 12.5% of gross revenue. In IEEFA's last report, we noted that several new discoveries would add to these costs, and those costs have not been disclosed to the public.[14] The longer these costs remain out of control or unknown, the longer it will take for Guyana to receive anything other than the bare minimum payment.

Table 1: Size and Status of Pre-Contract Costs (1999-2017)

Costs	Amount ($ millions)	Status of Claim	Source	3rd Party Verify
Pre-Contract Costs thru 2015	$460.2	Parties Agree	Unknown	None
Pre-Contract Costs Post 2015	Unspecified	Unknown	Audit	Unreleased

Table 1 shows that the current agreement on pre-contract costs requires Guyana to reimburse the contractor for $460.2 million in partial settlement for pre-contract costs incurred through 2015. Although this is agreed under the contract, neither the government nor the contractor have provided details that justify the amount. The lack of any formal presentation allowed the local press and commentators to raise questions about the validity of the $460.2 million. The local challengers contend that based upon limited public information, Guyana appears to have agreed to a figure that is too high. The concerns regarding the validity of the $460.2 million claim were raised in 2018. Neither the government nor the contractor has responded.[15]

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[13] Agreement. Annex C, Section 3, Costs, Expenses, Expenditures and Credits to the Contractor.
[14] IEEFA. Lack of Ring-Fencing Provision Means Guyana Won't Realize Oil Gains Before 2030s, if at All. July 2021.
[15] Stabroek News. The 1999 and 2016 Petroleum Agreements Compared – Annexes. March 16, 2018.
Christopher Ram, a Guyanese attorney and accountant reviewed the contract and is monitoring the process as a private citizen. Ram publishes his research findings regularly. To support his conclusion that the amount of the claim was too high, Ram relied on the annual financial statements filed by each of the three oil companies. The audits are sparse. Although each audit is different, they do not provide a reasonable amount of information regarding the contract or the accounting categories. There are very few notes that clarify values attached to the categories. Since ExxonMobil made the expenditures prior to the partnership with Hess and CNOOC, its financial statement is most important. It is the audit with the least information of the three. Ram reviewed outstanding balances from financial statements owed each company and compared it to the $460 million. The total costs were well below the $460 million, indicating that Guyana agreed to pay too much. The method is sound but the limitations on the audit make the conclusion necessarily qualified. This matter clearly needs additional review.

With regard to the pre-contract costs that were incurred after 2015, local commenters made assumptions because there is no formal public accounting. Local estimates put the total pre-contract costs at approximately $900 million (including the $460.2 million). While neither the government nor the contractor has formally agreed to the higher amount, an Exxon spokesperson has confirmed that the claim was in the range of $900 million.[16]

To move the matter toward settlement (and to its credit), the government of Guyana commenced an audit in 2019.[17] The audit has been the subject of considerable controversy. The status of the audit is unknown. Its completion and final disposition are unknown. The full scope of the audit, findings and any final settlement have not been released.[18]

According to published reports, IHS Markit has completed an audit. It is unclear what responses have been made to the audit by either the contractor or the government. IHS Markit has not commented on the any aspect of the audit to date. An IHS Markit analyst commenting broadly on the development process concluded that Guyana is receiving a below-average share of the take.[19]

III. What Is the Significance of Allowing the Pre-Contract Cost Claims To Languish?

The pre-contract cost provision is part of the 2016 agreement. In theory, it creates an orderly mechanism for Guyana to repay the costs incurred by ExxonMobil (Esso) under the 1999 agreement. To date, the parties have not reached a settlement on the amount.

The overarching problem is that this oil project is being mismanaged.

First, the inability to complete an audit of costs that were incurred more than 20 years ago demonstrates that the Guyanese government is not capable of assessing a claim for payment. The implications go far beyond the audit and effects the ability of Guyana to protect its interests. As an administrative matter, the inability to carry an audit project to completion is evidence of poor project management skills. These skills are imperative if Guyana is to secure its interests over the course of the agreement.

The government still lacks the skill bank necessary to perform these functions. The government is in the process of securing an audit team to assess the seven oil lifts thus far and future transactions under the agreement.[20] It still lacks the capability to

[16] Stabroek News. GRA begins audit of US$460M pre-oil costs. September 19, 2018.
[17] Stabroek News. Audit of Exxon pre-contract costs stalled by mix-up. February 11, 2021.
[18] *Ibid*.
[19] IHS Markit. Yellowtail: A Modelling Perspective. January 7, 2021.
[20] Guyana Chronicle. Gov't pursuing cost recovery audit of oil share. April 6, 2021.

determine if the shipments are being carried out according to the terms of the contract.[21]

Second, the inability of Guyana to complete an audit of claims from 1999 to 2017 and then advance its interests leaves it subject to having to accept 100% of the contractor's back claims. While the amount may be $900 million, it may be higher. The longer an unknown cost remains, the greater the likelihood that Guyana is faced with a future substantial financial liability.

Third—and quite paradoxically—if the contractor has made a claim for $900 million and Guyana is not taking steps to expeditiously resolve the matter, the contractor can pursue its right to the money through litigation. Why the contractor is refraining from taking these steps may be evidence of its mismanagement of the project as well.

For example, Esso's 2020 financial statement lacks a line item for pre-contract costs. According to the contract this category covers "contract costs, exploration costs, operating costs, service costs and general and administrative costs and annual overhead charge," suggesting that it would be treated as an accounting matter as a single line in subsequent documents. The financial statement offers very little information. There is no indication from Esso that this matter is an outstanding issue.[22]

IV. The Need for Transparency

Multiple levels of mismanagement at the outset of the project left unaddressed are only likely to intensify. One way to take steps to address the problem is for Guyana to assemble a professional team to represent its interests. Although the government is in the process of assembling such a team through a contract process, the competency issue remains outstanding.

Another way to address the matter is with more and better disclosure.

While this report reflects only the information that is publicly available, it is plain that both the contractor and the government possess more information that would clarify the actual business arrangement between the government and the contractor.

The International Monetary Fund has praised the country for its willingness to tighten its fiscal controls and improve transparency.[23] The IMF findings are now two years old and more work needs to be done here. ExxonMobil, facing a long period of

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[21] *Ibid*.
[22] Esso Exploration and Production Guyana Limited, Financial Statement for the period ending December 31, 2020. April 26, 2021.
[23] International Monetary Fund. Guyana: 2019 Article IV Consultation – Press Release, Staff Report and Statement by the Executive Director for Guyana. September 2019.

financial distress, is encountering questions about its financial presentations from a whistleblower, regulators and shareholders.[24,25]

According to the contract Annex C, Sections 4 through 9, ExxonMobil must submit regular reports on production, costs, profit calculations and other basic information to the Guyanese government. The public release of these reports would go a long way to resolving how these issues are being handled. The information is available, can be made accessible with little effort and should have little need for redactions. It's not clear why neither ExxonMobil nor Guyana wants the information released to the public.

The failure to disclose key information is harming public confidence in the oil project itself. Information that surfaces only in a piecemeal fashion will further harm both the government of Guyana and ExxonMobil.[26]

V. Conclusion

As this report was being completed, Guyana received payment from the seventh oil lift.[27] Given that no plans are available, the Guyanese public does not know whether this lift is on time, on budget, late or short of revenue targets.

We do know that this lift completed in July comes after an April lift. Eighty-one days have now passed since that lift was consummated. The fifth and sixth lift occurred in less time—an average of 55 days. Even if oil prices are higher, production volume should not be slower. This fact may be evidence of a problem with ExxonMobil's project execution. This is not known, either.

This is the third in a series of papers that will address the flawed contract arrangement between Guyana and ExxonMobil and its partners. The inability to settle the value of costs that are 20 years old is inexcusable and is a significant red flag warning of financial distress.

[24] Wall Street Journal. Exxon Draws SEC Probe over Permian Basin Asset Valuation. January 15, 2021.
[25] U.S. District Court for the Northern District of Texas. *Ramirez v. Exxon*. November 7, 2016. Also see: Coalition United for a Responsible Exxon. Coalition for a Responsible Exxon, Coalition United for a Responsible Exxon CURE Representing Stakeholders with $2.2 Trillion in Assets Calls for New Leadership and Strategy at Exxon. February 2, 2021. Also see: Engine No. 1. Engine No. 1 Issues Message to ExxonMobil Shareholders. May 19, 2021.
[26] The Guardian. Exxon's oil drilling gamble off Guyana coast 'poses major environmental risk.' August 17, 2021.
[27] Department of Public Information. Government of Guyana, Government of Guyana receives payment for the seventh oil lift. August 9, 2021.

Appendix I: IEEFA Profit Oil Projections for Guyana, 2020-2024

		pre-2020	2020	2021	2022	2023	2024	
Gross Production	MM Bbls.	3	40	44	79	157	233	555
Price	$/Bbl.	50.00	44.00	43.00	46.00	48.00	48.00	
Gross Revenues	$Millions	152	1,767	1,883	3,613	7,544	11,167	26,126
Recoverable Costs:								-
Annual Operating Expense	$Millions	18	241	263	471	943	1,396	3,332
Pre-Effective Date Costs to Recover	$Millions	460	-	-				460
Exploration Costs: Eff. Date to 2019	$Millions	4,100	1,000	800	800	700	200	7,600
Amortized Abandonment Costs	$Millions	1	16	18	32	64	95	227
Total Development Costs	$Millions	3,400	2,200	2,800	4,000	4,700	7,600	24,700
Interest on Loans	$Millions	143	229	336	488	661	946	2,803
Parent Company Overhead (PCO)	$Millions	76	35	39	53	64	93	360
Total Recoverable Costs	$Millions	8,198	3,721	4,256	5,845	7,132	10,329	39,482
		pre-2020	**2020**	**2021**	**2022**	**2023**	**2024**	
Cost Recovery Cap	$Millions	114	1,325	1,413	2,710	5,658	8,375	
Current Year Costs Recovered	$Millions	114	1,325	1,413	2,710	5,658	8,375	
Unrecovered From Current Year	$Millions	8,084	2,396	2,844	3,135	1,474	1,954	
Total Cost Recovery	$Millions	114	1,325	1,413	2,710	5,658	8,375	
Cumulative Unrecovered Costs	$Millions	8,107	10,503	13,347	16,482	17,956	19,911	
Profit Oil	$Millions	38	442	471	903	1,886	2,792	6,531
Government Share	$Millions	19	221	235	452	943	1,396	3,266
Contractor Share	$Millions	19	221	235	452	943	1,396	3,266
Royalty	$Millions	3	35	38	72	151	223	523
Income Taxes Owed by Contractor	$Millions	4	44	47	90	189	279	653
(assumes 20% of Profit Oil)								
		pre-2020	**2020**	**2021**	**2022**	**2023**	**2024**	
Government Share	$Millions	22	256	273	524	1,094	1,619	3,788
Minus Taxes Paid by Guyana		4	44	47	90	189	279	653
Total Available Revenue to Guyana		18	212	226	434	905	1,340	3,135
Shares of Gross Revenue								
Government % of Gross	Percentage	14.5%	14.5%	14.5%	14.5%	14.5%	14.5%	
Contractor % of Gross	Percentage	85.5%	85.5%	85.5%	85.5%	85.5%	85.5%	

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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.

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