Local content and procurement requirements in oil and gas contracts: trends in the MENA region

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- Legal risks posed by diversity of approaches to LCRs
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Local content requirements (LCRs)

- LCRs- *i.e* contractual provisions, laws and policies that require extractive companies to give priority to nationals, indigenous communities, domestic companies and locally produced material, in the procurement of goods and services used for petroleum and mining operations
- Some LCRs mandate the procurement of raw materials/ goods from certain suppliers; some mandate the use of technologies and methods of work that are within the capability of local contractors; while others adopt the use of pre-qualification and local registers to ensure that local contractors with the right experience are awarded work
- The aim is to deliver maximum local benefits at all stages of procurement, beyond what it would be in the absence of such policies, through the promotion of local employment, skills development, and national industry participation

- For example, in Canada, especially in the provinces of Saskatchewan, Newfoundland and Nova Scotia, LCRs have included contractual obligations that thirty five (35) per cent of all goods and services are to be sourced from aboriginal-owned businesses

- ILUAs in Australia have also stipulated that at least 40% of workforce at the Mine will at all times be comprised of Local Aboriginal People. Also the ‘Buy America’ Act of 1933 requires US government entities to prefer U.S.-made products in federal procurement

- Targeted economic benefits include: employment of nationals, procurement of goods and services from companies resident in the host country, partnerships with local entities, development of endogenous technology and infrastructure, and the improvement of the skills and capacity of local businesses and the domestic workforce

Rise of LCRs in the MENA region

- LCRs have become even more important in MENA countries following the global fall in oil prices. Since 2014, the price of a barrel of oil has fallen more than 70%, wiping out more than $360 billion of revenue from Gulf countries in 2015 alone, about 21% of GDP in the region
- In 2015, Saudi Arabia’s national oil company, Saudi Aramco, launched its In Kingdom Total Value Add (IKTVA) program: which places an obligation on contractors to achieve 70 percent (50%) local content by the year 2021 (70 by 21 threshold)
- Similarly, the ultimate goal of Oman’s In Country Value Strategy (ICV), launched in December 2013, is to increase the country’s total spend retained in order to benefit business development, contribute to human capability development and stimulate productivity in Oman’s economy

- Like the Saudi IKTVA Programme, the Oman ICV Programme introduces a joint supplier registration system as a single window system for registering suppliers in a ‘common pool’.
- The aim is to provide equal opportunities for local industries to participate in oil and gas activities.
- The other drivers of LCRs are the need to:
  - create a level playing field for indigenous workforce and local businesses -especially businesses owned and controlled by traditional owners (TOs) or aboriginal communities (AC)- to participate in oil and gas exploration activities

Drivers

- increase the capabilities and competencies of indigenous workforce over time
- maximize economic benefits to indigenous communities through job and employment opportunities. Virtually all of the surveyed regimes mandate IOCs to give priority to the employment to suitably qualified nationals, and in more specific cases, like Canada and Australia, preferential employment of TOs and ACs are stipulated
- improve endogenous technological capacity
- mitigate and manage social and political risks that may result from rising local expectations for better and more equitable distribution of wealth and authority

Diversity of implementation approaches

- **Definition of Local:** Generally 'local' is defined in terms of nationals, and companies owned, or majority controlled by nationals (Qatar, UAE, Oman, Saudi Arabia, also Jordan)
- However, some MENA countries adopt a more expansive definition of locals that include services by locally-registered firms and entities and the employment of local manpower which will include nationals and residents (Yemen, Algeria, Iran, Lebanon, Iraq (Federal)).
- "Local" in this case is equivalent to domestic entities or local players, meaning goods, services or labour sourced from the national locality or region where the oil and gas activities take place, as opposed to nationality or citizenship of the provider of the goods, services or labour.

- This distinction is indeed very important in MENA countries and could be a legal risk point if not properly clarified and handled.
- **Source of obligation**: Two main approaches have been adopted in codifying LCRs: **contractual** (indigenous-industry contracts, state agreements) vs. **legislative** (legislation, regulations, guidelines, and bidding practices).
- **Local Content threshold:** a mix of flexible and mandatory approaches to specifying timeframes for LCRs. While local content obligation is without mandatory thresholds in Qatar, Jordan, and Syria
- A percentage threshold of local content that must be met, and the timeframe, is expressly set out by Saudi Arabia (70%) Oman (18% to 32% by 2020), Iran and Libya (50%)

- **Role of the State**: Several MENA regimes provide the contractor with the flexibility to design and propose its own procurement processes and procedures, so long as they comply with LCRs and are based on generally accepted standards in the international petroleum industry (for example Jordan, Iraq (Kurdistan Region)
- While in some countries, government must be informed after the fact through yearly statements, audits or mandatory performance standards that demonstrate compliance with LCRs and procurement requirements (Oman, Iran, Saudi Arabia, UAE); in others, procurement plans must be submitted prior to the commencement of petroleum operations (Lebanon, Iraq (Federal)

- A variation arises where the national oil company or a management committee is directly involved in an advisory capacity (Qatar) and, in some countries, government must be informed and may participate in procurement activities above certain financial thresholds (Libya, Egypt).
- It is important for IOCs to clarify, from the outset, the level of government involvement in the process. A common approach in Europe, for example, is to mandate the contractor to submit a LCR compliance and procurement plan within sixty (60) days from the effective date of the petroleum agreement. This allows the IOC to design and develop its own procurement practices, while providing the State an early opportunity to make inputs

- **Monitoring, Reporting and Institutional Coordination:** While some MENA countries such as Jordan, Qatar, Lebanon and Syria establish contractual LCRs, they do not provide clarity on how such requirements are to be implemented or measured, both by an IOC or by the government.
- However, Saudi Arabia, Iran and Oman have established institutions or mechanisms for monitoring and enforcing such requirements. Oman’s ICV Program Management Office is responsible for monitoring and quantifying the total value add by an operator, while Saudi Aramco directly evaluates and monitors the “added value” brought to the Kingdom by a supplier.

Conclusions

- While a number of MENA countries have recognized LCRs in indigenous-industry contracts, state agreements, legislation, regulations, guidelines, and bidding practice, a coherent set of best practices has yet to emerge
- The diverse LCR regimes, and the unclear scope of local content obligations, raises several legal risks and uncertainties for IOCs and procurement practitioners, a very few portion of which can be managed through traditional contractual documentation.
    - *Adopt collaborative contract terms on LCRs:* procurement leaders, local communities, national authorities and IOCs need to define together up front, what constitutes success in terms of local content and “in-nation” value addition

- *Instrument Choice:* It is critical for procurement leaders to choose the most appropriate procurement strategy to deliver the project and the local content objectives. There is a need for a targeted procurement procedure to achieve LCRs
- *Pre-qualification and contractor rosters:* can be used to ensure that local contractors with the right experience are awarded work
- *Procurement strategy:* Breaking contracts into smaller packages; or for example unbundling or separating the purchase of materials from the provision of labour and consultancy services can allow for tailored achievement of goals

- *Simplifying tender procedures:* to create level playing field for local industries; sending targeted emails and SMS to local suppliers
- *Preferencing:* Giving preferences to local tenderers in the award of contracts (for example, if the tender of a local contractor is less than 10% above the lowest tender, the contract can be awarded to the local supplier).
- *Multi-year framework service agreement*: Serial contracts or framework agreements can allow local contractors to get continuous work without having to compete with large players. It will also make it easier for them to plan and expand their business

- *Measure and communicate performance*: establish reporting obligations and mandatory key performance indicators (KPIs) that mandate IOCs to provide quarterly status updates and annual reporting on the scope and level of compliance with LCRs

- *Establish focal unit on local content:* to coordinate and spearhead the development of a standard and accountable approach to local content and product sourcing

- *Establish clear and comprehensive local content laws:* Countries can address the indeterminacy of the contractual approach by establishing robust legislative requirements that mandate oil, gas and mining companies to submit periodic reports and plans in LCRs to designated focal institutions or agencies.

Shukran! Thank you

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