Natural Resource Governance Institute

Precept 3: Exploration, Licensing and Monitoring Operations

The government should encourage efficient exploration and production operations, and allocate rights transparently.

–Precept 3, Natural Resource Charter

So that a country benefits from extraction in the future, the government must take care to attract competent and law-abiding companies to discover and later extract new resources. A well-governed exploration and licensing process will include three tasks for the government. First, the government should develop an understanding of the resource base, manage the resulting data and decide whether to license areas and at what pace (Q3.1). Second, government must choose a process for licensing resource rights to companies (Q3.2). Third, government must monitor operations to ensure companies fulfil their commitments in accordance with law, regulations and best practices (Q3.3).

For the purposes of this guidance note, the term license refers to a range of legal documents—including licenses, leases, contracts and concession agreements—that confer companies the right to carry out exploration and/or production activities in a specific area.

PRIMARY QUESTIONS

3.1 | License planning

Does the government adequately prepare before allocating licenses?

3.2 | Awarding resource licenses

Does the government allocate licenses to competent and law-abiding companies, and in a way that maximizes value for the country?

3.3 | Monitoring operations

Does the government adequately monitor operations across project life cycles?

3.1 | License planning

Does the government prepare before allocating licenses?

To facilitate efficient exploration and attract interest from the best companies, the government should make available accurate and comprehensive information about the resources below the ground and the ownership above the ground to prospective companies. Poor preparation can damage value by licensing inappropriate areas at the wrong time or wrong price. For example, if opening an area for exploration impinges on people's livelihoods.

Secondary question	Guidance
3.1.1 **Pre-licensing survey** Does the government facilitate or fund pre-licensing surveys and make geological information available to companies?	To attract prospective companies, government may invest in geological/geophysical surveys, which reduce uncertainty in frontier regions, where there has been little exploration activity to date. Surveys can be undertaken by the government directly using public funding, or more commonly, by contracting geophysical companies. These companies carry out surveys at the company's expense, under the agreement that the government and the company share any revenues generated from data sales. In addition to commissioning surveys, the government must securely store and share geological data with extractive companies in order for the data to deliver its full value. (See Q3.3.3.) The government may choose to make the data freely available to potential investors, sell it to interested parties, or require its purchase as a condition for participation in the licensing round (EI Sourcebook). *Researchers should consider:* • Does the country have "frontier regions" (in which there is little prior geology information available) where pre-licensing surveys may be appropriate? • If so, have any pre-licensing surveys been carried out, or are any due to be carried out? • Does the government have the necessary staff and technology to sort through geological data? • Does the government have possession of the data from all previous geological surveys conducted in the country?
3.1.2 **Strategic impact assessments** Does the government conduct and publish a strategic impact assessment before allocating licenses?	A strategic impact assessment (SIA), sometimes known as a strategic environmental assessment, provides a process for a government to evaluate the overall benefits and costs of licensing areas. An SIA considers the government's institutional readiness to manage operations, its revenue needs, and compares the expected outcome from licensing with government objectives (UNEP 2004). The government typically conducts an SIA to help formulate its plans. This differs from environmental and social impact assessments (ESIAs) that are specific to a particular project. An SIA should be done before there is the political momentum in favor of extraction, and before companies have committed significant investments. Conducting an SIA merely to justify a political decision does not contribute to a good management of natural resources. This issues is also considered in precept 1 (Q1.1.4) and precept 5 (Q5.2.1). Precept 5 also considers ESIAs (Q5.2.2). *Researchers should consider:* • Has the government conducted an SIA before licensing areas for exploration and production? • What are the main results of any SIAs conducted by the government? • Has there been instances in which the government has decided not to license an area based on the results of an SIA?

3.1.3 **Non-resource property rights** Prior to allocating licenses, does the government clearly establish who holds property rights to the land being licensed and how those rights will be upheld?	Prior to allocating licenses, the government has a responsibility to clearly establish ownership and access rights to the land and other resources that will be affected by extraction. This is important to clarify who will be impacted by exploration and production activities. (See Q5.2 for more on impact assessments.) It is also important to guard against conflicting claims for the surface rights of the land. (See Q1.1.1 for consideration of the ownership of sub-soil assets.) A well-managed land-registry is an important first steps. Establishing such a registry in some countries may require clarification about the status and use of land held though customary and/or communal systems. *Researchers should consider:* • Has the government established all ownership and access rights to land above subsoil assets? Does this include clarification of customary and/or communal land rights? • Has the government created a well-managed land registry? • Where clear land rights have not been established, has the government consulted with local people, particularly in relation to customary or tribal rights? (See also Q5.1 on consulting with citizens in the locality of extraction projects, Q5.1.5 on indigenous peoples' rights, and Q5.2 on assessing the potential impact on local property from exploration and extraction.)
3.1.4 **Resource rights** Does the government organize licenses to ensure that license areas do not overlap or conflict with existing rights to explore and extract resources?	Along with ensuring that the rights to resource exploration and extraction do not impinge on existing rights to use the land for other purposes, government officials should ensure that exploration and production rights not overlap with each other. This is sometimes the case when subnational authorities assign exploration and production rights without carefully managing their subnational boundaries, or where a combination of authorities assign rights to companies. Further, as licenses are allocated, bought and sold, their management can grow increasingly complex. A license registry, such as a cadaster, which contains a list of license holders, license types and expiration dates, helps the government manage this information and maintain company confidence in the licensing process. By making the cadaster open to the public, the government can help ensure a better understanding of license areas by oversight actors and government departments. *Researchers should consider:* • Is data on licenses disaggregated to include the following information for assigned licenses: 1 geographical coordinates 2 license-holder(s) 3 date of application and award 4 duration 5 type of license/contract (i.e., a license for exploration or production) 6 work program commitments 7 names of companies that hold an interest in the license (e.g., joint venture partners). Does the cadaster include details on both assigned and unassigned licenses? • Do license-holders have the freedom to transfer their licenses to eligible companies? • Can license cancellations or denied applications be appealed? (See Resource Governance Index (RGI) 2013, Q1.3.015.) • Can the public access and view the cadaster? See also EITI Standard 2016 requirement 2.3.

3.1.5 **Pace of licensing and size of licenses** Does the government have an effective policy on the pace of licensing and size of license areas?	The government's licensing policy sets the pace of licensing, the size of license areas and the rules for the relinquishment of licenses. Researchers can assess the licensing policy by how well the government has considered: • **Change in risk after a major discovery is made.** The first discovery in a region will typically reduce the risk and increase the expected value of further prospects in the same geological basin. Governments can earn more income if the pace of licensing allows for some terms to be set after the geological risk is reduced. (See Q4.1 on fiscal terms.) In other words, a government shouldn't license too much at once. • **Regulatory agencies capacity.** The licensing policy should reflect the readiness of regulatory agencies to oversee exploration operations. A government does not need to delay licensing until agencies are ready, but licensing at too fast a pace can be problematic when agencies' capacities are weak. • **Prevailing market conditions.** Exploration opportunities are more valuable during periods of higher commodity prices. • **Size of license area.** Large license areas attract bidders, particularly when exploration occurs before commercial resources have been proved. However, the risk then is that just a few companies control large portions of the prospective resources. See also precept 1 on setting overall strategy and establishing institutions for resource governance. *Researchers should consider:* • What guides the government's decision on licensing new areas? • Does the government have a policy over how fast it will license new areas for exploration? • Does this policy recognize constraints such as those listed in the bullets above? • What guides the government's decision over the size of license areas? • Has the size changed as perceived exploration risks have changed?

3.2 | Awarding resource licenses

Does the government award resource rights to competent and law-abiding companies, and in a way that maximizes value for the country?

Competent and law-abiding companies are more likely than incompetent or corrupt companies to make discoveries, maximize income from those discoveries, and avoid accidents and corruption. The government needs a company selection process that screens potential license-holders and prevents licenses awarded for the personal gain of public officials. Governments often use pre-qualification processes for this purpose. They then choose the license recipient from among these qualified companies, typically through one of two methods: direct negotiations (also termed *first-come first-served*) or competitive bidding under *licensing rounds*.

Secondary question	Guidance
3.2.1 **License pre-qualification** Does the government screen license applicants before allowing applicants to enter a licensing round or negotiation?	In order to avoid granting licenses to companies with records of non-compliance in other countries, or that lack the necessary technical and financial abilities, governments can use pre-qualification screening. This helps to focus the selection process, and signals to companies the seriousness and competence of the government's management of the process. Pre-qualification screening should evaluate potential license applicants against technical and financial criteria, and should be done before license applicants enter a negotiation or a licensing round. *Researchers should consider:* • Is pre-qualification of applicants required by law or policy? • Are the criteria for pre-qualification well defined and clear to applicants? • Are the criteria appropriate in the context of geology and potential scale of production? For instance, should only highly competent companies apply for licenses in unconventional or offshore petroleum blocks? • Are the details of the pre-qualification process disclosed? • If the minimum thresholds are not disclosed pre-licensing, are they at least disclosed after the pre-qualification and award process? • Have licenses only been awarded to applicants who have passed pre-qualification? • Are licenses that are transferred by one company to another subject to pre-qualification? • In the case of a joint ventures with multiple companies, does the pre-qualification ensure that the interests of these companies are sufficiently aligned to allow for efficient operations?

3.2.2 **License award method** Does the government use a method of awarding licenses that accounts for the level of competitive interest and the administrative capacity of the government?	A government can choose to award licenses either via direct negotiation (also termed "first come, first served" or "open door negotiation") or via a competitive license round. Direct negotiation is when the government announces the availability of a license and negotiates terms with each company or consortium that approaches the government. In a license round, the government awards licenses by a competitive auction process. General practice has been that most countries allocate petroleum licenses using a competitive process and allocate mining licenses on a first come, first served basis (Ortega-Girona et al. 2009). However, with increasingly better geological data, some mineral countries are now shifting to competitive licensing rounds as well (EI Sourcebook). License rounds are better if there is sufficient competition for licenses and the government has the required administrative capacity to conduct a license round. A license round has the advantage of pushing applicants to bid as high a value as possible for the license, overcomes information deficits between government and companies as company bids help reveal the perceived value of the rights being licensed, and is more transparent than direct negotiations. However, where there is little competitive interest or where the government does not have the capacity to run a license round, direct negotiations may be preferable. *For the latest license award process, researchers should consider:* • What award process has the government chosen? (See RGI 2013, Q1.1.003.) • Does the government use an award process that is suitable given the competitive interest there is for licenses? Has there been a significant amount of competitive interest in previous license rounds? • Is the government capable of administering whatever award process it chooses?

3.2.3 **License terms and post-bid negotiations** Does the government limit the use of negotiable/ biddable terms and resist further negotiations after the bidding process?	Limiting those terms that are subject to bidding or negotiation (often terms on taxation, for example) simplifies an otherwise complex award process, minimizes the opportunities for companies to take advantage of a lack of government capacity and information, and reduces government officials' discretion. There are two ways to limit bidding or negotiable terms. First is to use a model contract that sets out a standard set of terms that applies to all license holders, along with a limited set of terms that companies bid on during an auction, or offer during negotiations. Second is a license regime in which companies bid for a standard license and must follow the terms set out in generally applicable legislation and regulation (NRGI, ISLP, VCC and OpenOil 2014). For those terms that are open for negotiating or bidding, the government should have clear and strategically chosen criteria to evaluate what the companies propose. Where there is more than one bidding term, a government should set and disclose the relative importance of each in terms of how a license will be awarded. After winning a bid, a company may seek to negotiate some of the terms of its license agreement or contract. The company sometimes argues that circumstances have changed and the project is no longer viable under the existing terms of the license. The government should resist pressure to enter additional negotiations as it reduces the value of conducting an auction process in the first place. Transparency of the auction process and agreed terms (Q3.2.4) can help others check whether a government has avoided post-bid negotiation. In some cases, governments enter into barter arrangements, offering licenses to companies in exchange for assets such as infrastructure or credit facilities. These deals warrant caution, as it can be difficult to assess the cash value of such compensation and compare them with other offers. (See Q10.4 on resource sector related infrastructure.) *Researchers should consider:* • Does the government use a model contract? • Does the government limit the number of terms available for negotiation or bidding? • Where there are multiple bidding variables, is the weighted importance of each in the selection process made clear to applicants? • Has the government avoided further negotiations after awarding licenses? • Do any barter deals receive adequate scrutiny, and reflect the national interest?
3.2.4 **License transfers** Does the government submit license transfers to the same checks and balances as an initial license award?	The government must also have an effective process to handle transfer of licenses, including the steps outlined in questions 3.2.1 to 3.2.3. The transfer process should also allow the government to tax the selling company's capital gains where desired. (See precept 4 on taxation.) This requires coordination between the licensing authority and the tax authority, and between the licensing rules and the tax code. *Researchers should consider:* • Is there a record of licenses that have been transferred from one company to another? • Are there examples of transfers done without the checks applied by the authorities?
3.2.5 **License disclosure** Does the government disclose pre- and post-license round information?	Transparency can reduce the governance risks associated with licensing processes. The transparency table in annex 3 details the information that is important that the government disclose, and whether information should be disclosed before or after the allocation of licenses.

3.2.6 **License oversight** Is oversight of the licensing process effective, and are conflicts of interest avoided?	Along with transparency, effective oversight can also reduce governance risks. Legislatures and independent audit institutions can play important oversight roles, if these roles are well designed. Legislatures are not necessarily well placed to approve individual contracts with companies, and requiring this may pose certain risks (among others corruption, a reduced licensing efficiency due to politicization and lack of capacity, and the facilitation of derogations of contracts from law). However, legislatures and auditors can hold the licensing authority to account on how it conducts negotiations or auctions overall, and should receive regular reports from the licensing authority to this effect. To avoid conflicts of interest, it is useful to ensure that the licensing authority is independent, particularly from any state-owned enterprise (SOE) that is itself a commercial participant in resource projects. (See Q6.1.2 on non-commercial roles of SOEs and RGI 2013 1.3.011, 1.3.013 and 1.3.014.) *Researchers should consider:* • What role does the legislature play in licensing processes? • What role do other oversight institutions such as auditors or corruption authorities play in licensing processes? • Do these institutions have sufficient expertise to interrogate these processes? • Have there been examples of these institutions revealing poor practices in licensing?

3.3 | Monitoring operations

Does the government adequately monitor operations across project life cycles?

After assigning rights, government authorities should monitor whether companies adhere to the agreed obligations. Monitoring the project can also help the government learn about the geology and project management when entering into negotiations or license rounds with other companies.

Secondary question	Guidance
3.3.1 **Development plans** Does the government evaluate and approve development plans with appropriate consideration for all stakeholders without undue delay?	Development plans set out how a commercially viable reserve will be developed. Companies must usually get the government to approve these plans before the company can develop the reserve. It is important for the government to evaluate and agree on these plans to ensure that they: are technically sound, cost effective and consistent with its resource depletion policy (Q3.1.5); make appropriate use of infrastructure (Q10.4); and address health, safety and environment concerns (Q5.3). Government officials may also wish to ensure that the plan provides opportunities for local content and employment provisions (Q5.4 and Q10.3). These documents should also provide for abandonment or the closure of the project, including clean up and restoration (Q5.3.5). Such an evaluation requires technical competency and coordination across a range of government departments. This can be difficult to achieve, leading to long delays which deter investments and can risk agreements being accepted by the government without sufficient scrutiny. *Researchers should consider:* • Is there a process to ensure that all relevant government departments are able—within the stated timeframe—to evaluate development plans and feasibility studies? • Is this process coordinated and if so by whom? • Are development plan or feasibility study approvals publicly announced?

3.3.2 **Monitoring capacity** Does the government have the capacity to monitor companies during each stage of the project life cycle?	Once a license is awarded, the government should monitor the company's operations to ensure the company adheres to the license terms. The government's first task is to monitor exploration work programs, which require the license holder to undertake a minimum amount and/or value of exploration within a certain time. Work programs can be stipulated as a license requirement or used as a bidding variable and have been designed to encourage exploration. (Companies may not always have a strong incentive to explore in license areas, preferring to wait for other companies to make a discovery in nearby areas so they can use that information to direct their own exploration efforts.) Failure by a company to realize the demands of the work programs should result in the relinquishment of the license and/or payment of the equivalent cost of the uncompleted work. *Researchers should consider:* • Is the duration of the license period sufficient to execute the work program? • Are minimum values for expenditure included in the work program and are these realistic for the work contemplated? • Does the system allow for periodic relinquishment of parts of the license area in order to incentivize exploration investment and prioritization by the company? • If companies fail to complete their work programs, are they made to relinquish their licenses?
3.3.3 **Data management** Does the government collect and manage geological and operational data?	Both companies and the government will typically hold geological and operational data. Much of these data will be generated by companies, but the government has a responsibility to collect these for monitoring purposes. Along with encouraging companies to explore, governments can use geological and operational data to inform other resource management decisions. For instance, data such as production rates helps the government monitor ongoing operations and set licensing rounds. The government should operate a system to collect and manage this data; in particular, the government should collect production and reserves data disclose these to the public on a field-by-field basis. (See Myers 2014.) *Researchers should consider:* • Are companies required to provide geological and geophysical data to the government? • Is it clear who owns and who can access the data? • Is geological data stored in a well-managed and secure database? • Is a country-wide geological map available to government officials and investors? • Does the government make all the data packages that are necessary to attract investors available in an easy to access manner (whether free or through payment)? • Does the government host a website that describes what national geological information is available? • Does the government manage data on production and reserves over the course of operations for each project?

ANNEX 3. PRECEPT 3: EXPLORATION, LICENSING AND MONITORING OPERATIONS

This transparency table has been designed to assist with Q3.2.5. It summarizes the specific disclosures needed to help build effective accountability around precept exploration, licensing and monitoring operations. (General transparency requirements that support this precept are covered in the transparency table for precept 2.) Unless otherwise stated, disclosures should be made by government in line with the standards of open data outlined in Q2.1.4. Existing country-specific research on some disclosure items may be available in the Resource Governance Index (RGI) country questionnaires using the indicated question numbers.

For each disclosure, researchers should consider the following questions:

- Is *all* latest information available? If not, what are the exceptions?
- Is *all* historical information available? If not, what are the exceptions?
- Is information provided in sufficient time to enable effective monitoring and scrutiny of activity?
- Is information available in a machine-readable format? Are there any other barriers to access to information? (See Q2.1.4 for background.)

Disclosure item	Guidance
Strategic impact assessment (SIAs)	Documents/text. See question 3.1.2 for background. **Related standards:** IFC Performance Standard 1 **Resource Governance Index:** 2013: questions 1.2.006.a, RGI1.2.008.a to 1.2.000.8.d
Blocks/areas available for license allocation	Documents/text listing blocks or areas. **Resource Governance Index:** 2013: question 1.2.006.a
Criteria for license application	Documents/text. See question 3.2.1 for background. **Related standards:** EITI 2016, 2.2.a.i, and 2.2.a.ii **Resource Governance Index:** 2013: question 1.2.006.a
Criteria for license evaluation	Documents/text. See question s 3.2.2 to 3.2.3 for background. **Related standards:** EITI 2016, 2.2.a.i, and 2.2.a.ii **Resource Governance Index:** 2013: question 1.2.006.a
Criteria for license transfers	Documents/text. See question s 3.2.4 for background. **Related standards:** EITI 2016, 2.2.a.iii **Resource Governance Index:** 2013: question 1.2.006.a
Criteria for appealing license decisions	Documents/text. See questions 3.2.1 to 3.2.4 for background. **Related standards:** EITI 2016, 2.2.a.i, and 2.2.a.ii **Resource Governance Index:** 2013: question 1.3.015
Biddable/negotiable terms	Documents/text listing terms that are subject to negotiation or that are used as bidding variables in an auction. In many countries these terms are contained within in model contracts. See question 3.2.3 for background. **Related standards:** EITI 2016, 2.2.a.i, and 2.2.a.ii **Resource Governance Index:** 2013: question 1.2.006.a

Applicant information	Documents/text listing companies that applied for licenses or participated in bid rounds. See questions 3.2.1 to 3.2.4 for background. **Related Standards:** EITI 2016, 2.2.c **Resource Governance Index:** 2013: question 1.2.006.b
Licenses awarded	Register of licenses listing licenses awarded. Should include name of license holder; coordinates of the license area; date of application, date of award and duration of the license; and the commodity being produced. See questions 3.2.1 to 3.2.4 for background **Related Standards:** EITI 2016, 2.3 **Resource Governance Index:** 2013: question 1.2.006.b
Justification of selection	Documents/text providing the rationale for each license allocated. **Resource Governance Index:** 2013: question 1.2.006.b

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ACKNOWLEDGEMENTS

Written by David Manley and Rob Pitman. They wish to thank to Joseph Bell, Jim Cust, Alexandra Gillies, Rebecca Iwerks, Keith Myers and Amir Shafaie for their substantive edits and comments.

Edition: 2016