KPMG

New opportunities with improved joint ventures for LNG organizations

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Opportunity to improve joint ventures

In the wake of the liquefied natural gas (LNG) project experience and heightened by the industry's downside, is an upside opportunity to improve joint ventures (JVs). Benefits include realizing a set of improvements including cost rationalization and overall significant operating and development asset performance improvements, implementing new operating models keyed to sustaining improved performance, applying innovation to update process and practices to achieve better performance and attracting new investors based on the improved performance platform.

Making material step-changes, requires JV engagement and improved joint venture operating agreements (JVOAs) to promote comprehensive cross-functional programs in major assets keyed on performance. This requires companies to focus on the following considerations.

1. **Operating models:** Adapting to fast-changing global business operating models and saving costs by eliminating inconsistent management and operating models, as well as keying on performance standards in areas of reliability and process rationalization and performance excellence.
2. **Contract collaboration and service sharing:** Leveraging and improving cost transparency between unrelated JVs involving, for example, maintenance and logistics.

Operating models

There is no doubt that companies are moving towards global operating models. Primary drivers of the change include:

- development of global centres of excellence (e.g. exploration, project design, contract management and marketing)
- asset and asset portfolio performance
- new technology
- shared services and offshoring processes to low-cost locations
- global partnering between upstream companies and service providers.

New operating models bring new challenges to the management and allocation of costs. In our experience, these include:

- cost allocation processes and systems that fail to fully account for all valid JV costs
- difficulties in identifying cost drivers, and/or transparency of costs
- disputes with non-operator partners on the source and amount of costs.

KPMG firms have provided expert opinions in a number of JV cost disputes. They have found that a primary reason for these disputes has been a disconnect between cost drivers and cost transparency in the operating model and the specified accounting procedures of the JVOA.

To support the implementation of new global operating models, offshoring and incorporate improved cost transparency, KPMG firms recommend updating or rebalancing JV accounting procedures to reflect these changes, and proactively helping JV partners to agree on amended procedures.

The performance improvement prize is large. Based on recent KPMG member firm work in the sector, operating JVs have the opportunity to achieve **21–36 percent** unit operating cost improvement in LNG assets.

Contract collaboration and service sharing

Cost pressures have led to an increasing appetite for more sharing by projects or project JV consortiums of infrastructure and key cost contracts. Opportunities are found in such areas as procurement, logistics, maintenance, finance, human resources, infrastructure sharing and shared offices.

Most JVOAs have provisions that allow for both direct charges and indirect charges to be charged to the joint account. KPMG firms often see JV partners having difficulty agreeing on the definition of direct and indirect costs, in particular where indirect charges are based on a percentage of capital or operating costs (the direct charges). Contract collaboration between independent JV consortiums can add to this challenge because these shared costs may lead to cost recovery if managing the contract on behalf of others, or a source of direct and indirect costs if receiving the service.

The potential cost advantages are obvious, but clearly they need to be well thought out with comprehensive performance, financial and risk analysis. Key issues to be considered are:

— contract structures (is it in a manner where a single company manages the third-party contract, or is there joint management?)

— ownership of intellectual property and technology

— tax structure

— cost management and allocation.

As a final note, most JVOAs have little guidance on how to manage collaborated contracts, account for, and report to JV partners. We recommend review and revision of the JVOA to reflect required amendments.

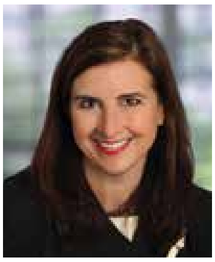
Additional opportunities exist in the following areas.

— **Separation of ownership of infrastructure:** Accessing the most efficient structures and capital providers; learning from evolution and capitalizing on interest in power plants, pipelines and other supporting infrastructure).

— **JV governance:** Achieving the proper level of control (versus more or over-governance) between participants and in attracting investment.

— **Resourcing:** Noting the right transition of capabilities between dealmakers and JV operators.

— **Accounting procedures:** Keeping pace with ever-changing requirements so companies can avoid poor cost allocation, loss of cost transparency, tax issues and cost disputes.



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