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Petroleum Federation of India

Advocating change

Suggestions on Policy for extension of PSC term

Addenda to the presentation on
May 29, 2013

Table of contents

1. Background

About 37 Producing Fields in India operate currently under the PSC regime consisting of 28 "Medium and Small Sized Fields" earlier discovered by ONGC & OIL, and 9 Fields resulting from oil/gas discoveries made in "Pre-NELP" and "NELP" blocks. In addition, there are currently about 185 blocks under PSC, which are in exploration stage and yet to commence commercial production of oil/gas.

PSCs have wide variations regarding provisions for extension of term of PSCs/Mining Leases beyond the Contract period in case the economic life of the field is not over within the stipulated PSC term.

MoPNG has constituted a Committee to suggest a draft policy for grant of extension to Production Sharing Contracts (PSCs) awarded to Private Joint Ventures, where the economic life of the Field is not yet over when the PSC gets due for expiry. PetroFed has been requested by MoPNG to make a presentation of its views in this regard before a Committee constituted vide MoPNG letter no. O-19025/10/2005-ONG.D.V. (Pt. II) dated 22nd March, 2013 comprising Additional Secretary & Financial Advisor, MoPNG; DG,DGH; Joint Secretary (E), MoPNG; JS (P-II), Ministry of Finance; Adviser (Energy), Planning Commission; Dy. Legal Adviser, Ministry of Law & Justice.

Towards this end, PetroFed approached PwC to assist in developing a paper on suggestions to the Committee.

PetroFed obtained views of E&P companies in India on this subject. Based on the industry views and on the basis of research undertaken by PwC to understand practices in other major oil and gas producing countries, PwC assisted PetroFed in developing a background paper for consultation among industry for formulating views to be submitted to DGH/MoPNG by PetroFed. An industry meeting was held on 24th May, 2013 for detailed discussions amongst industry members. In a meeting held with the Committee at MoPNG office on 29th May, 2013 the views of the industry were presented. The Committee received the suggestions well and requested PetroFed for further suggestions in devising the following:

i. Parameters for assessing the past performance of the operator;
ii. A methodology for ensuring that operators abide by the Development Plan submitted along with the extension application; and
iii. A methodology for ensuring that operators do not undertake exploration activities intentionally only during the latter part of the extension period with a purpose to develop a case for further extension.

Now this paper includes suggestions on the above mentioned points after discussion with the Indian E&P operators.

2. Merits of extension to PSC term

The promise of energy security is alluring. For an import-dependent country like India, energy security is no longer just a desire, but a critical necessity for the sustenance of its economy. The dream of energy security is realisable only when the country starts putting in efforts to unlock its hydrocarbon potential. Spin-off benefits from investments and creation of facilities, although difficult to measure, can be substantial and range from increased employment to economic and social upliftment of people in the rural areas.

The Indian oil and gas sector has been tasked with an ambitious target to reduce hydrocarbon imports in stages and eventually achieve self-sufficiency and energy independence for India by 2030. To be able to achieve this target, the industry must collectively embark on a journey of bold initiatives and focused work programmes, which will also require higher investments. Among the numerous policy measures and other enablers required to usher in an era of energy self-sufficiency, the implementation of a forward-looking PSC extension policy will be a key element.

The PSCs for most of the oil and gas producing fields/blocks in India would expire in the next five to ten years. Many of these blocks are likely to retain significant hydrocarbon reserves which remain to be exploited. The primary objective of the Indian Government, ostensibly, is to ensure recovery of remaining reserves within these Contract Areas in an uninterrupted and cost effective manner by extending term of the PSC for which it is undertaking consultation for introducing a policy.

The proposal to develop a policy framework for granting PSC/mining leases extension is a welcome initiative by the Government of India (GoI).

The incumbent operator would have the best knowledge about the field including the challenges associated in developing the field and therefore should be considered favourably for retention for the extended period of the PSC. This is a key requirement for ensuring continuity of safe operations while optimizing on expenditures.

3. Suggested criteria for getting an extension

Fulfillment of Contract Conditions:

Contractual provisions of the operational PSC are the cornerstone of any policy the Government promulgates in regard to PSC term extension. Operators acknowledge the existence of provisions in PSCs for **medium size and small size fields** which allow for:

i. Extension to the contract duration on mutual agreement by the parties; and

ii. Vesting of full title and ownership, free of cost, of any or all assets acquired and owned by the Contractor for use in petroleum operations with the Government or its nominee upon expiry or earlier termination of the Contract.

Operators agree that the extension decision will be subject to the above provisions of the contracts.

Criteria:

It is submitted that, as is practiced internationally, the decision to extend the duration of the PSC ought to be considered on a field by field basis since each case would be unique in parameters like remaining reserves and exploration & development potential. The international practice is to grant extensions based on the estimated recoverable reserves. Some countries also give importance to the past performance of the operator. Therefore it is suggested that PSC extension be granted subject to the following criteria:

I. **Economic recoverable reserves:** The primary criteria should be the presence of economic recoverable reserves and/or prospective resources as the case may be. The operators be asked to submit a Development Plan supporting the above to the extent possible along with the application for extension. As these would be operating fields, exploration or development costs may or may not form a part of the proposed Development Plan. Possibility of further exploration and development costs is in light of recent decision announced on 1st February, 2013 by the Government to allow exploration within Mining Lease Areas. Further exploration ought to be allowed at any point during the extended period also as better information/technology becomes available. Also operators be given opportunity to demonstrate that additional resources are available in the Development Area. Toward this end, the extension application can be accompanied by

   a. A Development Plan based on:

      i. Current production

      ii. Any Commercial Discovery

   b. A case on any resources (either Contingent or Prospective) in the Development Area

The Development Plan submitted at the time of seeking extension must be viewed and recognized with the attendant uncertainties associated with the field at that stage and duly revised as better information and technology becomes available over time.

II. **Capability to operate the block:** Companies believe that the Government would like to ensure that the capability of an operator is established before it is granted a PSC/ mining lease term extension. Indian PSCs provide sufficient governance mechanism for assessing the performance of E&P companies to continue as operators of different blocks. The PSCs also have provisions for curing any defaults of the Operator. Similarly, other Indian laws provide good framework for governance by the Government on operational performance of the operator.

From the context of financial capability of the Contractor, the Government may consider it necessary to ensure that the incumbent company is financially sound to continue during the renewed term of the PSC/mining lease. Using the same methodology as is followed for NELP bidders, for example, the financial capability could be checked by ensuring that the net worth of the company is equal to or more than the participating interest share of the likely investment required under the proposed Exploration Work Programme, if any. Details of how the Development Plan will be funded along with commitments from external funding agencies if the plan is proposed to be financed from other than internal sources could also be asked for at the time of submission of the Development Plan.

4. Proposed application process and approval timelines

A clear and well defined process with definite timelines specified for the evaluation of application for extension of PSC/Mining Lease and approval is desired. The policy ought to also state defined roles and norms for the different entities involved in the PSC extension process. The key entities involved in the approval process for PSC extensions are:

- DGH or a technical advisor who evaluates the technical and commercial details of the request for extension having due and proper regard to the submissions of the contractor party;
- Ministry of Petroleum and Natural Gas (MoPNG) which decides on the extension based on the recommendations given by the regulator/technical advisor; and
- Operator(s) which initiates the application for extension, and undertakes preparation of the recoverable reserves/prospective resources estimate and Development Plan.

In this context, it is noteworthy to consider the examples of Brazil[1] and USA (Gulf of Mexico). Brazil leads by example in the faster approval process for the extension of PSCs/mining leases. The Brazilian National Petroleum Agency (ANP) takes a maximum of 3 months from the submission of request for extension to announce its decision. The request for extension is deemed approved if no decision is announced within 3 months. This clearly reduces uncertainty for the operators and provides them with continuity of production operations in the field, thereby benefiting all stakeholders. In some cases, ANP may itself instruct operators to extend the production period of the field based on ongoing production.

In USA too, oil-producing lands could be owned by federal, state or private institutions. In all cases, the primary term of production is a maximum of 10 years. However, the lease is automatically extended if the production is in paying quantities.

When to apply:

The operators be allowed to make application for extension from 5 years before expiry of PSC/Mining Lease. As the exploration, development and production potential of each field is different, operators will plan timing of application for the extension of PSC term accordingly.

Time for Processing Application:

Operators propose that the Government makes a decision within 120 days of submission of the application. With such timelines, decisions can be taken by the operator regarding continued field development, related projects, capital expenditure, abandonment etc. If the extension application is not

[1] Concessionary contract of Brazil

approved by the Government within the stipulated time-frame, the PSC extension sought by the operator be considered deemed approved.

5. Terms and conditions of extension

Need to agree to an extension of the PSC duration should not be seen as an opportunity to open up other terms and conditions of the contract. Any additional amendments should be kept to an absolute minimum. The Contractor parties need certainty and continuity and a wholesale renegotiation at the cost of a simple and timely agreement would not be in the interests aimed at maximizing economic production for the benefit of all stakeholders.

Tenure of extension

The exact term for PSC extension is clearly defined in some countries based on the remaining economic life of the field. Colombia does not define any ceiling to the extension duration and awards extension based on the economic life of the field. In 2004, the Colombian government agreed to extend Occidental Corp's term for the Caño Limón field till the time the field is no longer commercially viable (estimated to be around 2018). Indonesia and Nigeria are also known to have awarded extensions of 20 years.

The norm of 5 and 10 years' extension based on associated or non-associated gas production under certain pre-NELP PSCs is not aligned with the practice of extension to operator or a contractor till the economic life of a field. The NELP PSC provides for extension for a period of 5 years or such period as may be agreed mutually between the operator and the Indian Government after taking into account balance recoverable reserves and balance economic life of the field/development area. Similarly, the CBM contract also provides extension of period by mutual agreement between Government and the contractor, after taking into account the balance recoverable reserve and balance economic life of the field. The NELP PSC and the CBM contract represent a better way in terms of extension tenure and such criteria should be adopted for all pre-NELP blocks also to maintain a consistent approach. Any commercial discovery made prior to expiry of the Mining Lease which can be produced economically should be allowed to be monetized by the contractor. In this background, the Operators have recommended that rather than limiting by policy, the term of extension be equal to that proposed in the Development Plan submitted by the Operator along with application for extension duly vetted by DGH.

Fiscal terms to be used during the extension period

Generally, development activities in the extension period will involve marginal projects and risks associated with a depleting reservoir. The fiscal terms should represent a fair risk and reward balance for the contractor to ensure maximum recovery of reserves from the license area. Hence, the incumbent could possibly look for better Fiscal Terms. On the contrary, the Government would tend to negotiate terms since the field is proven and operations have been undertaken in past. However, such discussions and negotiations pose a threat of delay and demotivation of the investors.

Hence, Operators believe that the extension should be on the prevailing fiscal terms and conditions. Should the terms not be attractive for the investor(s), they would refrain from applying for extension.

Pre-NELP and NELP PSCs differ in terms of the levies (royalty, cess etc.) payable. Any future extension policy should be clear on the levies payable during the extension period and the Government may wish to move to a consistent ad valorem rate and participating interest share basis for levies payable.

Allowance of exploration activities during the extended period

PSC/Mining Lease extensions should be carried out in a manner which encourages further exploration within the development areas. The costs related to exploration activities should also be made cost recoverable. This will incentivize operators to continuously apply new technologies to add to the Indian oil and gas production. Cost recovery should also be allowed for all unsuccessful efforts in the field.

Steps to ensure that operators abide by Development Plan submitted along with extension application

Operators suggest that the Pre-NELP/NELP PSCs provide a good governance and monitoring framework for ensuring that operators carry out petroleum operations in line with Development Plans as approved from time to time. Hence the proposed policy does not warrant any specific provisions. They feel that a decision to terminate the contract on account of operator's inability to fulfill the Development Plan, in part or in full, would be too harsh a decision on operators.

Steps to ensure that operators do not undertake exploration activities intentionally only during the latter part of the extension period with a purpose to develop a case for further extension

Late exploration is risky especially when exploration is uncertain. It will not be in the operator's interest to delay exploration and add to the risk. Timing of exploration activity can be adequately monitored by the Management Committee through the annual planning and budgeting approval process. For India's energy security through increased hydrocarbon production, it is essential that extension applications be considered on sound justification by the operators in cases of commercial discovery during the latter part of the extension period.

Ownership of assets and equipments

There is a provision in CBM contract that all assets and equipments in the contract area or outside for purposes of CBM operations shall vest with the government at the expiry or earlier termination of the contract. Such a provision should not be applicable in the case of a CBM contract which has no provision for cost recovery. Keeping such a provision in CBM contracts will only deter fresh investments in the operations closer to the expiry date of the Contract. If it is removed, contractors will invest to get the maximum reserves out till the end of the contract as they can then get salvage value of their relatively newly acquired assets.

6. International practices

It is quite prevalent in international practices to extend the tenure of PSCs/mining leases on the basis of remaining economic life of the field. The extensions granted are of the order of years and many times decade. Cited below are extension periods accorded in some countries:

Extension cases in various countries		
Period of extension	i.	5 years (Algeria)
	ii.	10 -25 years (Argentina)
	iii.	Till the economic life of the field (Colombia, UK)
	iv.	10 years with optional re-extension of 5 years (Egypt)
	v.	10 -30 years (Indonesia)
	vi.	10 -35 years (Libya, Norway)
	vii.	20 years (Angola and Nigeria)
	viii.	8 years (Peru)
	ix.	32 years (Oman)
	x.	30 years (Saudi Kuwaiti Neutral Zone, Denmark)
	xi.	10 years (Syria and Thailand)

All above citations are based on atleast one example in the mentioned country