

## THE EMERGING LEBANESE OIL & GAS REGIME

*A presentation given by Fadi B. Nader*

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The regulatory regime of Lebanon's petroleum activities aims to ensure that the exploration and development of petroleum resources are carried out to the benefit of the Lebanese people.

This constitutional principle forms the basis of **Lebanese Offshore Hydrocarbon Law No. 132**.

The Lebanese petroleum regime is characterized by the use of principle-based legislation, as currently reflected in the Law.

The Law sets out framework conditions to guide the formulation of acceptable commercial incentives through authorizations granted to private companies for undertaking the prospection, exploration and extraction of petroleum resources in Lebanon.

Among the matters prescribed by the legislation are the initial duration of a **Reconnaissance License (3 years)**, an **Exploration License (10 years)** and a **Production License (30 years)**.

### **Scope**

The Hydrocarbon Law governs the planning, preparation, installation and execution of all activities related to oil and natural gas or both, and all kinds of gas or other hydrocarbons that are associated with a sub-sea reservoir within the Lebanese territorial waters, the waters of the exclusive economic zone and the Lebanese continental shelf (all these activities are defined by the Law as "**Petroleum Activities**").

The Law is expected to be completed by a number of Decrees covering various regulatory, commercial, taxation and environmental issues.

### **Petroleum Activities**

These activities cover petroleum reconnaissance, exploration, appraisal, production and exploitation, as well as the laying of pipelines, the transportation of petroleum and the development of facilities as well as the cessation of such activities and the decommissioning of facilities.

However, the transportation of petroleum in bulk, by vessel or vehicle, is not considered a Petroleum Activity.

The Hydrocarbon Law grants the Lebanese State the right to carry out or participate in such Petroleum Activities as well as the exclusive ownership of petroleum resources and their management.

The net proceeds collected or received by the Lebanese State arising out of Petroleum Activities shall be placed in a Sovereign Fund, which shall be regulated by a specific law, based on clear and transparent principles for investment and use of proceeds.

Once the existence of promising commercial opportunities has been confirmed, the Hydrocarbon Law grants the Council of Ministers the right to establish a national oil company.

### **Petroleum rights**

The Lebanese State may award a petroleum right, defined as a “right arising out of a petroleum license, an exploration and production agreement or any other authorization”, to right holders, for the performance of Petroleum Activities in accordance with the Hydrocarbon Law (the “**Petroleum Right(s)**”).

The Hydrocarbon Law defines the term “Right Holder” as “any joint stock company which is participating in Petroleum Activities through an Exploration and Production Agreement or a Petroleum License that allows it to work in the petroleum sector” (the “**Right Holder(s)**”).

A Petroleum Right shall not be awarded to a company unless the competent authority has assured itself of the validity of the documentation with regard to the company’s ownership, corporate organization, its financial and fiscal matters as well as its previous experience in conducting various Petroleum Activities.

**The Hydrocarbon Law provides for different types of petroleum rights, depending on the activity to be undertaken by the Right Holder(s):**

#### **1. Reconnaissance License:**

The Minister of Energy and Water (the “**Minister**”) may, upon the opinion of the petroleum administration authority (the “**Petroleum Administration**”), “award a reconnaissance license to carry out activities aiming at defining the existence of one or more petroleum reservoirs, *by means of geological, petro-physical, geophysical, geochemical or geotechnical surveys as well as other activities as stipulated by a petroleum right*”.

General conditions for the award of a Reconnaissance License, its scope and fees shall be defined by a Decree issued by the Council of Ministers, on the basis of a proposal by the Minister upon the opinion of the Petroleum Administration.

The Reconnaissance License shall be granted for a period not exceeding **Three (3) years** and the resulting data shall remain the property of the Lebanese State.

The Reconnaissance License shall not be exclusive and shall not give the Right Holder any preference or privilege with regard to obtaining any other Petroleum Right.

## **2. Exploration & Production Right:**

The Council of Ministers may, on the basis of a proposal by the Minister based upon the opinion of the Petroleum Administration, award “an exclusive Petroleum Right to carry out Petroleum Activities in accordance with an exploration and production agreement” (the “**Exploration and Production Agreement**”).

### ***a. Exploration & Production Stages:***

The Hydrocarbon Law identifies two phases of the Exploration and Production Agreement: an exploration phase and a production phase:

#### ***i. Exploration phase***

The Hydrocarbon Law defines the exploration as the drilling of wells to “explore or assess the content of a reservoir, as well as the operation and use of a facility for the purpose of exploration drilling”.

The exploration phase should not exceed **Ten (10) years**.

#### ***ii. Production phase***

The Hydrocarbon Law defines the production as activities for the extraction of petroleum from a reservoir, *including:*

- *drilling of production wells;*
- *injection into the reservoir;*
- *developing and improving the resources recovered from the reservoir;*
- *processing and conversion of substances extracted from the reservoir (except for the destructive distillation);*
- *storage and shipment of petroleum; and*
- *planning, preparation, construction, placing, operation and use of facilities for the purpose of production.*

The production phase should not exceed **Thirty (30) years**.

The two phases can be extended if they are less than the maximum duration but without exceeding them.

### ***b. Exploration & Production Agreement Award***

The **Exploration and Production Agreement** is defined by the Hydrocarbon Law as an “agreement concluded between the Lebanese state and **at least three (3) Right Holders** and which regulates the relationship between the state and the Right Holders for the performance of exploration and production activities within a defined area subject to Lebanese Law”.

The Council of Ministers decides on the launching of invitations to apply for the pre-qualification phase for participating in the licensing of Petroleum Activities, on the basis of a proposal by the Minister based upon the opinion of the Petroleum Administration.

### ***c. Pre-qualification Criteria***

Decree No. 9882 dated 15/02/2013 governs the Prequalification Phase and sets its criteria.

The main Prequalification criteria are as follows:

- **Legal:**  
Joint Stock Companies (**Lebanese or Foreign**) conducting **Petroleum Activities**.
- **Financial:**  
Right Holder Operator with **minimum total assets of USD 10 Billion**;  
Right Holder Non-Operator with **minimum total assets of USD 500 Million**.
- **Technical:**  
Right Holder Operator: operatorship of at least **one petroleum development in water depths in excess of 500 m**;  
Right Holder Non-Operator: having an **established petroleum production**.
- **Quality Health Safety Environment (QHSE):**  
  
Applicant should submit a satisfactory operational plan covering **health, safety and environmental issues** that comply with Lebanese Law and International Standards

The final version of the Exploration and Production Agreement is subject to the approval of the Council of Ministers prior to the signature by the Minister. The Exploration and Production Agreement shall become effective from the date on which it is approved by the Council of Ministers.

Once the approval has been obtained, the selected applicant shall become a Right Holder of a joint and undivided participating interest in the Exploration and Production Agreement.

The Right Holders of an Exploration and Production Agreement should form an unincorporated joint venture in which each Right Holder has a joint and undivided percentage participation interest.

Each Right Holder of an Exploration and Production Agreement is jointly and severally liable towards third parties and to each other in proportion to its part in the proceeds of the Petroleum Activities, as established in the said Exploration and Production Agreement.

Right Holders are jointly and severally liable towards the Lebanese State for obligations related to or arising out of Petroleum Activities.

#### ***d. Exploration & Production Agreement***

The Exploration and Production Agreement grants “Rights Holders the exclusive joint right to undertake Petroleum Activities, and defines their rights and obligations towards the state and towards each others, *that shall include:*

- *the coordinates of the awarded area;*
- *the allocation of participation interests between the Rights Holders;*
- *the duration of the Exploration and Production Agreement and the duration of each of its phases;*
- *the minimum work obligations and expenditure commitments for the exploration phase;*
- *provisions concerning potential state participation in the Exploration and Production Agreement;*
- *provisions concerning environmental matters;*
- *accounting rules and provisions applicable to the Petroleum Activities subject to an Exploration and Production Agreement and the methods of determining profits;*
- *provisions relating to dispute resolution and arbitration; and*
- *standard minimum guarantees covering the minimum work obligations for the approval of the plan for development and production, and for cessation of Petroleum Activities and the decommissioning of a facility.*

When awarding an Exploration and Production Agreement, the Council of Ministers, based on a proposal by the Minister in consultation with the Petroleum Administration, shall approve the appointment amongst the Right Holders of an operator entrusted with the day to day management of Petroleum Activities (the “**Operator**”).

No change of Operator may take place without the approval of the Council of Ministers.

#### ***e. Plan for Petroleum Production & Transportation***

Following the signature of the Exploration & Production Agreement and not later than 2 years after the last exploration well has been drilled, the Right Holders shall inform the Minister and the Petroleum Administration whether it intends to commence production.

When a discovery of petroleum is made in a reservoir, the Operator shall immediately notify in writing the Minister, with a copy of the notice to the Petroleum Administration. The Operator shall also within six (6) months of the discovery, perform the necessary

tests to appraise the potential commerciality of the reservoir and notify the Minister of the results.

If the Operator decides to develop one reservoir or more, the Operator, on behalf of the Rights Holders, shall submit to the Minister a plan for development and production (the “**Plan for Development and Production**”).

The Minister, after consulting the Petroleum Administration, shall submit the Plan for Development and Production to the Council of Ministers for approval.

#### ***f. Content of Plan for Development & Production***

The Plan for Development and Production shall consist of two (2) parts:

Part I: An environmental impact assessment study.

Part II: Development of reservoir resources and technical and economic aspects of available development solutions.

#### ***g. Petroleum Entitlements & Fees***

##### **a) Area fee**

The Hydrocarbon Law provides that the Right Holders shall pay an “Area fee for the area covered by an Exploration and Production Agreement from the first year following the expiry of the exploration phase.

The “Area fee” shall be ***progressive*** and shall be ***calculated per square kilometer***.

##### **b) Royalty, Cost Petroleum & Profit Petroleum**

Petroleum extracted from a reservoir in an Exploration and Production Agreement shall be split into Royalty, Cost Petroleum and Profit Petroleum.

##### ***i. Royalty***

The Lebanese state, as the exclusive owner of the petroleum resources, is entitled to a **Royalty** representing a percentage of the total petroleum extracted from the reservoirs. The Royalty volumes, rates and payments for liquid and gas petroleum shall be determined by the Council of Ministers based on a joint proposal by the Minister and the Minister of Finance.

The Lebanese state has the option to receive the royalty either in cash or in kind. Royalty taken in kind shall be delivered at no cost to the point of delivery stipulated in the Development & Production Plan.

## ***ii. Cost Petroleum & Profit Petroleum***

The Hydrocarbon Law defines **Cost Petroleum** as the share of each Right Holder in the extracted petroleum to cover the cost and expenses incurred in carrying out Petroleum Activities.

Whereas **Profit Petroleum** is defined as the share of each Right Holder and the state in the extracted petroleum, after deducting the cost petroleum.

## ***h. Taxation***

Petroleum activities and Petroleum Rights are subject to Lebanese tax laws and regulations. Each Right Holder shall be subject to Lebanese Tax laws on all its petroleum activities in Lebanon.

## **Regulatory Authority**

The Law attributes specific powers to each Regulatory Authority:

### **1. The Council of Ministers:**

- Approves the necessary preparations to launch the licensing rounds.
- Sets the petroleum policy of the state, and make a final decision in relation to any conflicting opinions among the concerned parties
- Takes the final decision regarding the negotiations of Exploration and Production Agreements.
- Approves the final text of Exploration and Production Agreements prior to their signature by the Minister.
- Authorizes the Minister to sign the Exploration and Production Agreement.
- Appoints the board of directors of the Petroleum Administration.
- Sets the applicable rules on the functioning of the Petroleum Administration and its internal and employment regulations.
- Sets the content of the license applications and the due fees.
- Extends the duration of the exploration and/or production period based on the opinion of the Petroleum Administration.
- Sets the safety zone for any facility.

### **2. The Minister**

- Signs the Exploration and Production Agreement upon authorization of the Council of Ministers.
- Ensures the implementation of the Petroleum Policy & the Hydrocarbon Law.
- Promotes the State's petroleum potentials and is responsible for the supervision of petroleum operations.
- Takes necessary measures to protect water, health and property and the environment from pollution in case of emergency.

- Most of the decisions taken by the Minister require approval by the Council of Ministers and take into consideration the opinion of the Petroleum Administration.

### 3. The Petroleum Administration Authority

The Petroleum Administration Authority (**PAA**) is granted administrative and financial autonomy, but within the supervisory authority of the Minister.

PAA shall have the following duties and powers:

- Conducts studies to promote the Lebanese petroleum potential.
- Reports to the Minister on the qualifications and capacities of the applicants for Petroleum Rights.
- Prepares drafts for invitations for bids, conditions for applications, Exploration and Production Agreement and any related licenses and/or agreements.
- Assists the Minister in negotiating Exploration and Production Agreements and reports to the Minister the results of such negotiations to enable the Council of Ministers to take the final decision.
- Manages, monitors and supervises Petroleum Activities and the proper implementation of licenses and agreements, and in this regard submit quarterly reports to the Minister for approval.
- Gives its opinion to the Council of Ministers.

*Decree no. 7968 dated 07/04/2012 determines the organization of the PAA, its operational mode, and the qualification of its members.*

The PAA Board is composed of **Six (6) members**, appointed by the Council of Minister for a term of **Six (6) years**, upon the Minister's recommendation.

The Board's term is renewable for a similar period. *The current members of the PAA were designated by the Government on 4<sup>th</sup> December 2012 and their remunerations were determined by a Council of Ministers' Decree dated 6<sup>th</sup> March 2013.*

The chairmanship for the PAA Board shall be for **One (1) year** term and shall rotate among the PAA Board members according to the alphabetical order of their family name.

Members of the PAA BOD should satisfy certain criteria as defined in Art. 2 of the Decree.

They should be Lebanese nationals, holders of a university degree in Law, engineering, economy, business or in any field related to petrol, having expertise in the Petroleum field and not to have directly or indirectly through any of their relatives (up to the fourth degree) any personal interest in the contracts concluded by the PA or with any company working in this field.

Subject to criminal penalties, the members of the BOD of the PA should not occupy, directly or indirectly, during their tenure and for a period of 2 years after the end of their term in the BOD, any position or responsibility in any of the companies conducting petroleum activities in Lebanon or any of their affiliates.

PAA Board members are not authorized to communicate with any company working in the petroleum field without written notification to the PAA Chairman. They cannot make any press/media before obtaining the Minister's approval.

The term of the PAA Chairman and BOD members shall end upon the occurrence of any of the following:

- Term expiry
- Death
- Resignation
- Dismissal (in case of bribery, violation of professional secrecy and serious breach of duties) dismissal shall enter into effect by a decree issued by the Council of Ministers.

The PA is composed of "**Administrative Units**":

- 1- Unit of Strategic Planning
- 2- Unit of Technical & Engineering Affairs
- 3- Unit of Geology and Geophysics
- 4- Unit of Legal Affairs
- 5- Unit of Economical & Financial Affairs
- 6- Unit of Quality, Health, Safety & Environment (QHSE)

*Role of Each Unit:*

**1- Unit of Strategic Planning:**

- *Setting plans related to exploration and the petroleum activities' area*
- *Conducting economical and financial studies related to mining, production and extraction*
- *Conducting studies related to the State's interest in the petroleum activities through the establishment of visions related to the State's share in the exploration and production of petrol.*

**2- Unit of Technical & Engineering Affairs:**

- *Evaluating, from a technical and engineering aspect, the license applicants' application*

- *Evaluating, the development and production plans submitted by the right holders or operators.*
- *Monitoring and following up the operations related to petroleum activities. Following up on technical and engineering matters related to the administration of the reservoir, including the improvement of production and extraction.*
- *Following up, from a technical perspective, on the right implementation of the exploration and production agreements.*

### **3- Unit of Geology and Geophysics:**

- *The administration of Data Room and archiving data related to petroleum activities*
- *Evaluating, from a geological and geophysical perspective, the license applicants' application*
- *Saving digital and physical information related to petroleum activities.*

### **4- Unit of Legal Affairs:**

*All the legal matters related to licenses and exploration and production contracts including and not limited to:*

- *Checking that the operators and right holders are abiding by the provisions of Hydrocarbon Law and its implementing regulations and the exploration and production contracts and regulatory decisions issued by the Minister*
- *Preparing legal studies and projects of laws and regulations related to petroleum field*
- *Preparing files related to differences and PA affairs and following up on arbitration and conciliation matters , subject to the provisions of Law no.440 dated 01/08/2002 (amendment of certain provisions related to arbitration of the Lebanese civil procedure law)*
- *Preparing the wording of the agreements which shall be used in the negotiation process with the contracting companies.*

### **5- Unit of Economical & Financial Affairs:**

*All the economical matters related to petroleum resources including and not limited to:*

- *Evaluating, from an economical and financial perspective, the license applicants' application*
- *Conducting economical and financial studies related to the petroleum field*
- *Proposing policies related to the State's share*

## **6- QHSE (Quality Health Safety Environment) Unit:**

*All the matters related to the quality of the systems of the operators and their compliance with health, safety and environmental conditions including and not limited to:*

- *Monitoring to what extent the operators are abiding with the safety and protection regulations vis a vis their employees and the environment*
- *Monitoring establishments and their efficiency and to what extent the petroleum activities are in line with the environmental, health and safety standards.*

### **Forthcoming Decrees**

**The Hydrocarbon Law prescribes that the Lebanese Government should be issuing a number of decrees and legislations to complete the legal & regulatory framework for conduction Petroleum Activities in the country.**

**The Decrees are expected to address the following issues:**

- Setting the delimitations of the Lebanese Territorial Waters.
- Regulating the Sovereign Fund, its management rules, its investment policy and the use of its proceeds.
- Determining the State's share in Petroleum Activities.
- Defining the scope of the environmental assessment study.
- Setting out Conditions for the invitation to participate in license rounds, terms of reference and conditions of the model EPA and agreements between companies.
- Determining the general conditions for the award of a Reconnaissance License, its scope and fees.
- Publishing the final version of the Exploration and Production Agreement is subject to the approval of the Council of Ministers prior to signature by the Minister.
- Setting standards and Criteria for granting an extension of an Exploration or Production Phase.
- Approving the Plan for Development and Production.
- Setting out procedures, requirements and conditions related to the environmental impact assessment study.
- Stipulating the approval process for a Test Production Application.
- Setting out the procedure and documentation required to apply for and obtain a Production License.

- Establishing criteria for authorizing third parties to use spare capacity of a Facility for Production, Transportation, or storage of Petroleum.
- Regulating the sale of Petroleum or the transfer of related interest.
- Determining the Area Fee.
- Setting out Royalty volumes, rates & payment.
- Determining the method of calculation and allocation of entitlements of Cost Petroleum and Profit Petroleum.
- Setting conditions for the transfer of Facility's rights and documentation to the Lebanese State.
- Setting out rules and regulations related to mortgaging of a Facility.
- Establishing and regulating a Special Register for registering petroleum rights.
- Setting requirements related to health and safety plan.
- Determining the boundaries of safety zones surrounding Production Facilities.
- Determining conditions related to the management, location of companies and other matters relating to Petroleum Activities
- Fixing relevant fees to be levied by the Government for the monitoring, control & verification of Petroleum Activities or Facilities.
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### **TYPES OF OIL & GAS REGIMES**

When a natural resource is found, a comprehensive legal and regulatory regime is needed to ensure its efficient management and development with an aim to maximize the stake belonging to the State whilst creating the right incentives to oil companies who are taking the risk and who expect to obtain credible protection and rewards.

There have been some moves towards a regulatory system in which the roles of promoter, regulator and health and safety are more clearly defined and separated where potential conflicts between these roles may arise.

Consideration should be given to how these issues should be addressed in the Lebanese context. The experiences and best practices of other countries shall be useful to us in this regard.

The differences between the types of oil & gas regimes are of a conceptual nature. These differences are mainly related to the levels of control granted to the contractor, the type of compensation arrangements as well as the degree of the State's involvement.

There are a number of categories of regimes in operation worldwide and typically these regimes differ on the basis under which *rents* are distributed between governments and E&P companies.

Four broad categories of regimes are applied:

- **Concession agreements;**
- **Production sharing contracts;**
- **Service contracts; and**
- **Joint Ventures**

**Concession Agreements** are the oldest and most common type of petroleum agreement and the terms are often fixed by law. The oil company receives the right to explore for, produce and market petroleum in exchange for payment of royalties and taxes. In its simplest form, the oil company will bear all costs but, in many cases, the government retains the right to participate as a partner in development and production and will then usually (but not always) pay its share of development and operating costs. There may also be other payments made to the government, such as signature or production bonuses, but these are relatively uncommon in concession agreements.

A Second Category is the **Production Sharing Contract (PSC)**.

Typically a PSC is agreed between the risk taking Oil Company (normally called the Contractor) and the government, often through a State Oil Company.

The three main elements of a PSC are **Cost Recovery, Production Split** and **Taxation**.

Bonuses are also a common feature of a PSC, whilst royalty and participation are also sometimes seen, although the government is assured of a minimum level of revenue through the production split.

The Third Category is a **Risk Service Contract**, where a contractor receives payment in cash as cost reimbursement and service fee respectively, and is similar to a PSC. A standard **Service Contract** is a contract, whereby the contractor is paid a fee for his technical services in developing and operating a field.

The Fourth Category is the **Joint Venture** model where both the Oil Company and the Government, or one of its agencies, participate actively in the operation of the oilfield and acquire ownership of a specified part of production.

In addition to royalties, taxes, and profit oil, the Government is entitled to a share of profits.

Joint ventures take either the form of equity participations or contractual undertakings.

In the first case, a joint stock company is established and each partner owns a specific equity percentage.

The contractual form is done through a joint operating agreement where each partner owns a share of the production

## **A HYBRID LEBANESE REGIME**

Lebanon's adopts a hybrid regime as its **Production Sharing Model** carries certain features of the **Licensing Regime**.

In other words, the Lebanese Hydrocarbon Law creates:

- A discretionary regime that awards production licenses in dedicated licensing rounds;
- The Minister/PAA announces licensing rounds, considers applications, negotiates with applicants, proposes final award to Government.
- Production licenses are awarded to multiple Right Holders. This ensures plurality of geological and technical findings, it also establishes a transparent checks and balances mechanism.
- Council of Ministers approves the appointment of the Operator who shall execute the day to day management of Petroleum Activities.
- Formal award by Government.
- Companies should form a joint venture and should enter into a model EPA.
- Copies of all data and materials should be submitted to the Government
- Assignments are subject to Government's consent to ensure control.
- Cooperation agreements entered amongst Right Holders shall be submitted to the Minister & the PAA.
- Minister, after consultation with PAA, may at any time require amendments to cooperation agreements to ensure that they comply with Lebanese Laws.

## **ENHANCING LEBANON'S REGIME**

An **ideal petroleum tax and licensing regime** is the one that can achieve the following **3 objectives**:

- Attracts the most efficient companies;
- Ensures that all profitable fields be exploited in an optimal way; and
- Captures the gains received from exploiting the petroleum resource.

At this stage of our oil & gaz exploration journey, Lebanon should invest more in information gathering and monitoring.

Our petroleum policies and expected regulations should be designed to increase incentives for companies to submit complete and accurate information.

The contemplated Licensing/Tax/Royalty systems should be simple, as complex policies reduce transparency & tend to increase the risk premium a company puts on a project.

Therefore, the main policy objective at this stage should be to create an attractive legal and regulatory environment for exploration activities.

It is important that Lebanese Government and policy-makers plan ahead to ensure that Lebanon has the right infrastructure on all levels, in order to be in a position to fully maximize the benefits of any future discoveries.

Lebanon should strengthen its capabilities and seek the necessary technical expertise to help the newly established PAA at the various stages of petroleum exploration and production.

## **CONCLUSION**

Lebanon's petroleum potential is currently unproven. Prospecting such valuable resource is driven by knowledge which can be increased by implementing an efficient exploration process.

Maintaining an attractive legal, regulatory, taxation infrastructure to conduct exploration activities in the designated blocks should be a main policy objective for Lebanon at this stage.