

LEBANON: OFFSHORE BLOCKS, BIDS, AWARDS & ACREAGE POTENTIAL

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INTRODUCTION

According to the most recent geological surveys conducted by the Lebanese Government, covering more than 2/3 of the 22,730 Sq.km Lebanese Offshore Area known as the Exclusive Economic Zone (EEZ), it is being estimated that the Lebanese Hydrocarbon potential ranges from 25 to 35 cubic feet of natural gas and from 440 to 675 million oil barrels.

During the last few years, the Lebanese government was able to assemble 14,012 Sq.Km of 2D seismic data and 15,176 Sq.Km of 3D seismic data, covering the surveyed Offshore Area.

A compilation and modeling of this seismic data provides a reasonable understanding of the serious hydrocarbons potential that could be uncovered under the waters of the Lebanese Offshore Area.

Encouraged by these findings, the Lebanese Authorities have initiated an ambitious plan, amid regional turmoil and local political instability, aiming to put in place the legislative infrastructure required to organize a first licensing round for interested bidders.

The legal infrastructure was founded on a petroleum regime characterized by the use of a principle-based legislation, as currently reflected in Lebanese Offshore Hydrocarbon Law No. 132 issued in August 2010 (the "Hydrocarbon Law").

By adopting a hybrid petroleum regime, combining the Production Sharing Model with the Licensing Regime, the Lebanese Hydrocarbon Law is characterized by the following features:

- It establishes a discretionary regime that awards production licenses in dedicated licensing rounds;
- It gives the Minister of Energy and the Petroleum Administration Authority (PAA) the power to announce licensing rounds, to review applications and to negotiate with applicants before submitting its recommendation on final awards to the Government;
- It awards production licenses to multiple Right Holders, with the aim of ensuring diversity in geological and technical findings and establishing a transparent check and balance mechanism;
- It entrusts the Council of Ministers with the authority of approving the appointment of the Operator responsible for the day to day management of the licensed petroleum activities;
- It gives the Lebanese Government the final authority to award the licenses;

- It requires bidders to form joint ventures among themselves and to enter into a model Exploration and Production Agreement (EPA);
- It requires bidders to submit copies of all data and materials to the Government;
- It makes any assignment of rights or obligations of Right Holders subject to the Government's consent;
- It requires Right Holders to submit their cooperation agreements to the Minister & the PAA, who may at any time, require amendments, to ensure that these agreements conform to Lebanese Laws.

The Hydrocarbon Law defines the **Exploration & Production Agreement** (the “EPA”) 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 EPA determines the exploration and production phases which should not exceed 10 years and 30 years respectively. If an EPA provides for a shorter period, the Right Holders may apply for an extension, provided that the total duration of each of the two phases remains within the set limits. Any extension will also require relinquishment of 50% of the relevant area. Moreover, any area not included in any approved development plan must also be relinquished at the end of the exploration phase.

On 15th February 2013, the Lebanese Government invited interested parties to apply for the pre-qualification phase and announced the main prerequisites for bidders wishing to participate in the Prequalification Phase. These prerequisites are summarized as follows:

1. **The bidder should be a Joint Stock Company (Lebanese or Foreign) engaged in Petroleum Activities.**
2. **The bidder should form a joint venture comprising:**
 - a. A Right Holder Operator with **minimum total assets of USD 10 Billion and who has at least one petroleum development in water depths in excess of 500 m;** and
 - b. A Right Holder Non-Operator with **minimum total assets of USD 500 Million and who has already an established petroleum production.**
3. The bidder should also submit a satisfactory operational plan covering **health, safety and environmental issues** that comply with Lebanese Law and International Standards

Pursuant to the Hydrocarbon Law, the Exploration and Production Agreement becomes effective once it is approved by the Government and signed by the Minister.

Upon obtaining said approval, the selected applicant automatically becomes a Right Holder of a joint and undivided participating interest in the Exploration and Production Agreement.

The Right Holders in an Exploration and Production Agreement should then form an unincorporated joint venture in which each one of them has a joint and undivided percentage of a 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 executed Exploration and Production Agreement.

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

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 other.

The EPA essentially determines:

- *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;*
- *the relevant provisions concerning potential state participation in the Exploration and Production Agreement;*
- *the provisions concerning environmental matters;*
- *the 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*
- *the standard 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 of Energy 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.

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 start production activities.

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

The Plan for Development and Production should be composed 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.

The Hydrocarbon Law provides a framework for environmental safety that complies with the Barcelona Convention which requires all signatory parties to take all appropriate measure to prevent, abate and combat pollution of the Mediterranean Sea resulting from exploration and exploitation of the continental shelf and the seabed and its subsoil.

The Law also complies with Lebanese Environmental Law No. 444 of August 2002 which emphasizes in its Article 4 on the principle of Environmental Impact Assessment as a tool for planning & management and requires in its Article 21 all private and public persons to undertake an environmental assessment for all projects which are likely to affect the environment due to their sizes, nature, impacts or activities.

The Lebanese Offshore Law provides that "the State shall conduct a Strategic Environmental Assessment SEA prior to any petroleum rights being awarded or petroleum activities initiated".

Accordingly, the Lebanese Government has completed in May 2012 a strategic environmental assessment plan in 8 volumes and the Petroleum Administration formed a unit dedicated to quality, health, safety and environment concerns.

The Hydrocarbon Law provides that the Right Holders should 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*. It is anticipated that the first year Area fee shall be 350 US Dollar/ sq.km and 400 USDollar/ sq.km in the second year with the acreage rounded off to the nearest sq.km and paid to the Lebanese Treasury in advance for each year.

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

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 of Energy and the Minister of Finance.

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

The Royalty rate for Crude Oil shall be assessed on the basis of escalating rates linked to the quantity of the extracted oil. The schedule of escalating rates shall be set out in the EPA. The Royalty rate for other Petroleum products other than Crude Oil shall be a fixed percentage to be defined in the EPA.

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 the licensed 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.

The Right Holders in an EPA are subject to Lebanese Tax Law, as each contractor is considered as a taxpayer in respect of its own taxable activities and is subject to Lebanese Tax Law like any joint stock company operating in Lebanon.

Currently, the standard tax rate on distribution of profits is 15% for joint stock companies and 10% on their net profits. However, the Ministry of Finance is reassessing the tax rates applicable to Right Holders in an EPA, with the aim of creating some tax incentives for bidders in line with international market practice.

The Petroleum Administration may at any time audit the Operator and the Right Holder in order to verify the information submitted in relation to measurement, calculation, valuation for the settlement of Area fees, Royalty, cost recovery and profit entitlement or in relation to any other required reporting to the Minister or to the Petroleum Administration.

In November 2012, the Lebanese government appointed the first board members of the PAA.

On 27th December 2012, Lebanon announced that its first tender for oil and gas exploration in the Offshore Area shall take place on the 1st of February 2013. The Lebanese Government also set 21st of March 2013 as the date on which the list of qualified firms shall be published and the 2nd of May 2013 as the final deadline to receive formal applications from qualified bidders.

The results of the first Offshore Licensing pre-qualification process, which had opened on the 15th of February 2013 and closed on 28th March 2013, were published by the Ministry of Energy on 18th of April 2013.

52 companies participated in the pre-qualification process of which 46 were pre-qualified: 12 as Operators and 34 as Non-Operators.

Authorized Operators	
Anadarko International O&G	USA
Chevron EMEP Limited	USA
Eni International BV	Italy
ExxonMobil E&P Lebanon Ltd	USA
Inpex Corporation	Japan
MAERSK Olie og Gas A/5	Denmark
Petrobras Int'l Braspetro BV	Brazil
Petronas Carigali SDN BHD	Malaysia
Repsol Exploracion SA (REXSA)	Spain
Shell E&P (LXV) N.V.	Netherlands
Statoil ASA	Norway
TOTAL S.A.	France

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The formal Licensing Round started on the 2nd of May 2013, and the bidding process was expected to close on the 10th April 2014, with awards expected in March 2014.

However, the Minister of Energy announced on 8th April 2014 that the date to submit the bids under the First Licensing Round has been extended from 10th of April 2014 to 14th of August 2014.

The new extension was made due to the continuing stalemate by the Lebanese Government in issuing the two decrees related to the Delineation of the Offshore Blocks and the approval of the model Exploration and Production Agreement.

The PAA and the Ministry of Energy have opted to divide the Lebanese Offshore Area into 10 blocks covering around 17,900 Sq. Km (excluding a coastal buffer zone of 2 nautical miles). The Minister of Energy submitted this map to the Council of Ministers for its approval; this approval is still pending.

Offshore Blocks	
Block number	Area(SqKm)
Block 1	1,928
Block 2	1,924
Block 3	2,048
Block 4	2,030
Block 5	2,374
Block 6	1,721
Block 7	1,259
Block 8	1,400
Block 9	1,742
Block 10	1,475
Source: Lebanese Petroleum Authority	

The proposed demarcation of the blocks disregards Israeli claims over a portion of the Lebanese Offshore Area situated in the south; and more precisely over a zone overlapping with Blocks 8 and 9 covering an area of more than 854 Sq Km.

The Minister had previously announced that out of the 10 designated blocks, 5 blocks - namely Blocks 1, 4, 5, 6 and 9 - are open for bidding in the First Licensing Round, with the possibility of opening additional blocks for bidding after the Government ratifies the two governmental decrees related to the Delineation of the Offshore Blocks and the approval of the model Exploration and Production Agreement.

In the aftermath of the Eastern Mediterranean hydrocarbon discoveries, specifically in August 2010, the Lebanese government presented a chart of geographical coordinates defining the western, northern and southern limits of its Exclusive Economic Zone to the UN.

Although the Lebanese official view regarding maritime border had acknowledged the Tamar and Leviathan gas fields to be outside its territory, it had argued that other prospective fields in the region may be within the Lebanese territory.

Under the UN Convention on the Law of the Sea (“UNCLOS”), a coastal State has sovereign rights to explore and exploit, conserve and manage the natural resources in its Exclusive Economic Zone (“EEZ”).

Under Article 57, of the Convention, the EEZ extends a maximum of 200 nautical miles from the baseline.

Article 74 provides that States with opposite or adjacent coasts should delimit their EEZs by applying international law to achieve an equitable solution. Accordingly, States must deposit charts and lists of geographical coordinates of the EEZ to the UN Secretary-General.

Lebanon has ratified UNCLOS in January 1995. Although Israel is not a party to UNCLOS, these rules could be considered in principle binding on both Lebanon and Israel by application of the customary International Law.

In July and October 2010, Lebanon submitted to the UN Secretary-General the geographical coordinates of its southern boundary with Israel and its southwestern boundary with Cyprus.

However, these boundaries were different from the boundaries shown in Lebanon's 2007 agreement with Cyprus. It should be noted that the 2007 agreement was ratified by Cyprus but not by the Lebanese Parliament.

The so-called "Point 1" on the map, which was designated as a shared dividing point between Lebanon and Cyprus in 2007, remains a contentious point.

Lebanon's 2010 maritime boundary submission uses a different coordinate ("Point 23"), seventeen kilometers southwest of Point 1 which overlaps with the area claimed by Israel.

From the Lebanese perspective, the coordinates in the Cyprus-Lebanon 2007 agreement were only considered as an interim solution, pending a the resolution of the dispute on maritime boundaries between Lebanon and Israel.

In December 2010, Israel and Cyprus reached an agreement on their maritime boundaries. Cyprus ratified the delimitation of the EEZ with Israel in February 2011.

In June 2011, Lebanon filed a protest against the Israel-Cyprus Maritime Agreement with the United Nations. Lebanon's government complained that the zone defined in the Israel-Cyprus 2010 Agreement takes over parts of Lebanon's EEZ.

The agreement between Israel and Cyprus used similar coordinates to the Lebanon-Cyprus Maritime Agreement. Lebanon reemphasized that Point 1 does not represent the terminal southern end of the median between Lebanon and Cyprus that separates the EEZ of each country.

The coordinate can only be viewed as a point that is shared by Lebanon and Cyprus, but should not be taken as a starting point between Cyprus and any other country. As there is no agreement between Lebanon and Israel, the EEZ of Lebanon could even extend beyond this point.

In July 2011, Israel approved a map of its proposed maritime boundaries based on the 2010 Israel-Cyprus Maritime Agreement and submitted it to the United Nations.

According to international law principles, the non-ratified 2007 Cyprus-Lebanon Maritime Agreement does not bind Lebanon. The agreement requires ratification by Lebanon to enter into force, a final step the Lebanese Parliament has refused to take so far. Therefore, an agreement between Cyprus and Lebanon should ultimately be renegotiated.

Similarly, under international law, Israel's and Lebanon's maritime boundary submissions to the UN are only unilateral proposals. The arrangement must be legitimized by an interim agreement between Lebanon and Israel. As UNCLOS Article 74, paragraph 3, emphasizes, pending a final agreement, the States concerned "shall make every effort to enter into provisional arrangements of a practical nature."

Theoretically, like in other maritime boundary dispute, the conflict could be settled through the International Court of Justice ("ICJ"). As ICJ can only assume jurisdiction on the basis of consent, Israel and Lebanon should accept the Court's jurisdiction.

Israel has invoked the ICJ's jurisdiction only once in 1957 (in *Israel v. Bulgaria case*) and Lebanon has been twice a party before the ICJ (in 2 cases involving *France v. Lebanon* in 1953 and 1959).

Alternatively, the International Tribunal for the Law of the Sea ("ITLOS") could determine the maritime boundary. As Israel is not a member to UNCLOS, Israel should expressly agree to the jurisdiction of the ITLOS, where Lebanon is already a member.

Arbitration between Lebanon and Israel is yet another option that would also require consent by both countries.

Meanwhile, at Lebanon's repeated requests to the UN to protect its maritime boundaries and resources, the UN finally suggested that it could act as a mediator between Lebanon and Israel in demarcating the maritime boundary and in creating a maritime security zone.

UN Commander of UNIFIL troops in South Lebanon, Major General Alberto Asarta, declared in July 2011, that "UNIFIL has the means, funding, and determination to carry out the demarcation, but it only needs an agreement between Lebanon and Israel".

Even if this UN mediation is accepted by the 2 countries, negotiations for marking a temporary or permanent sea boundary would take considerable time. The demarcation of the Blue Line between Israel and Lebanon, indicating the withdrawal line for military forces in Southern Lebanon, took 11 years to finalize.

Although Lebanon and Israel did not engage yet in any direct or indirect negotiations to reconcile their maritime dispute, each of the USA and Cyprus are also trying to engage in a mediation initiative, aiming to clear the way for an understanding that would allow the parties to start developing the discovered fields following agreed-upon guidelines.

I finally hope that the prospects of abundant hydrocarbons resources that could benefit all countries around the Levant Basin would be a good incentive for all parties to put political differences aside and start working towards bringing to their citizens the much needed economic development.