HYDROCARBON EXPLORATION & LICENSING POLICY - 2016

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The paper examines the latest Hydrocarbon Licensing policy in India. The differences between the previous policy and the current one are the key focus of this analysis. The paper also reflects upon the effect of the new policy on all concerned stakeholders which aims to attract foreign investors and boost development of the Oil & Gas exploration & production sector.

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NELP

The **New Exploration License Policy** ("NELP") was given formed by the Union Government with Directorate General of Hydrocarbons ("DGH") as the nodal agency to provide a level playing field to both public and private sector companies in exploration & production ("E&P") of hydrocarbons. DGH has been entrusted with the responsibility of implementation of NELP. Further, issues relating to contracts given in Oil & Natural Gas ("O&NG") companies, environmental clearances, pricing etc. are looked into by the DGH in consonance with the Union Government.

Since 1999, NELP by providing a level playing field for interested parties to compete for award of exploration has amplified the pace of petroleum and natural gas exploration activity. All parties vying for a contract such as state owned oil companies and the private sector compete on equal terms and conditions to secure a production and exploration license ("PEL") through a formal bidding process. Further, in order to encourage E&P in particular, NELP allows for Foreign Direct Investment ("FDI") up to 100 % in E&P activities. Over the past decade, more than 275 blocks were allotted over nine bidding rounds, resulting in discovery of several O&NG fields. One of the benefits of NELP was the seven year corporate tax holiday for the production of mineral oil, exemption from custom duty on imports required for petroleum operations, and biddable cost recovery up to 100%. However, the tax holiday is not available in respect of O&NG blocks awarded post March 31, 2011. Although, before Finance Act 2013, there were speculations that tax holidays will again be granted for E&P in O&NG blocks, in order to attract further investments but nothing was done to affect any changes. The successful bidder enters into a Production Sharing Contract ("PSC") with the Union Government. In terms of the PSC, the successful bidder is granted the requisite license under the Oilfield Act and Petroleum Rules for carrying out E&P activities, as per the Model Contract provided under the policy.

Although the private foreign bids for Indian oil and gas blocks have increased significantly through 19 years of the existence of NELP, the success in attracting foreign capital and technology has been slower than originally anticipated. The effectiveness of NELP was constrained due to design flaws in its bidding process which the policymakers along with industry inputs are seeking to rectify.

NELP – CHALLENGES

Some of the challenges and concerns faced by stakeholders due to NELP are as follows:

1. **Lack of distinction between contracts of varied risks**- There are different kinds of blocks in NELP i.e. offshore (Shallow; Deep Water; Ultra Deep Water; High Pressure/ Temperature Zones) and on-land. NELP doesn't accord a different kind of production sharing contract for different kinds of blocks given that the risk involved in the abovementioned zones is quite different, and all the other procedures are different for each block. Thus, these different requirements, issues, risks cannot be addressed by a model production sharing contract with fixed royalties. This acts as a deterrent to investors undertaking riskier ventures which may be more profitable for the government.

2. **Fiscal Model and Pricing**- the NELP model which is based on sharing of profits implies that no share accrues to the government except for royalties and cess unless there is an actual profit that has been accrued by the contractor. Since the profit has to be measured on the basis of accounting of costs which needs to be audited by the government, the present model requires government approval at various stages of the production process so as to determine the exact costs. The current mechanism of fixing prices is also done administratively at the hands of the government. Thus, the entire process of determining costs and administratively fixing prices leads to inordinate delays due to government accounting processes; litigation and dispute resolution in case there is a disagreement on the correctness of the costs between the government and the contractor.

3. **Exploration Rights-** NELP allows for exploration rights to the contractors to be confined only to blocks which are put on tender by the government. This means that Oil Companies may be aware of other blocks which may be exploited but since such blocks aren't the subject of a tender agreement, they can't be brought on for bidding until a tender for them is floated by the government which is a long and tedious process.

4. **Inefficiency owing to lack of uniformity in hydrocarbon licenses-** NELP envisages separate policies and licenses for different hydrocarbons i.e. Conventional Oil & Gas; Coal Bed Methane; Shale Oil & Gas & Gas Hydrates. There are thus separate terms of allocation of acreages accruing out of different hydrocarbons. This leads to inefficiency as in practice, there is a lot of overlapping of resources in contracts. Further, NELP was framed at a time when unconventional hydrocarbons (shale gas and shale oil) were still not discovered. This fragmented policy framework led to inefficiencies in exploiting natural resources. For example, while exploring for one type of hydrocarbon, if a different one is found, it will need separate licensing, adding to cost, time delay and increased procedural work.

HELP- AN INTRODUCTION

Despite India's resource rich background, we are still very much importers of hydrocarbons and the numbers on imports have been increasing in the wake of stagnating oil prices abroad. Given the overall demand for hydrocarbons in India and abroad, the government decided to take steps to improve the structure of the ailing industry by strong policy. This positive outlook gave way to the new policy called **Hydrocarbon Exploration Licensing Policy** ("HELP") which replaces the old policy NELP. It is a step in direction of "*MINIMUM GOVERNMENT, MAXIMUM GOVERNANCE*". The policy is framed and introduced in order to attract foreign investors and boost development of the O&G E&P sector.

The Union Cabinet under the Prime Minister Shri Narendra Modi led government approved the HELP Policy on **10th March, 2016**.

The salient features as envisaged under HELP are as follows:

1. **Uniform Licensing Regime**– HELP has proposed a single license regime for exploration and production of conventional as well as non-conventional hydrocarbon resources. This policy change is bound to correct the inefficiencies that arise in natural resource exploration due to fragmented norms for different kinds of resources.

2. **Biddable Revenue Sharing Model-** contracts will now be based on "Biddable Revenue Sharing". Winning bids will now be decided on the basis of bidders quoting their revenue share to the government. They will quote a different share at two levels of revenue called "lower revenue point" and "higher revenue point". Revenue share for intermediate points will be calculated by linear interpolation. The bidder giving the highest net present value of revenue share to the Government, as per transparent methodology, will get the maximum marks under this parameter.

3. **Open Acreage Policy-option to select the exploration blocks without waiting for formal bid round-** an open Acreage Licensing Policy, where bidder may apply to government seeking exploration of any block not covered under exploration. This ensures that an opportunity may be created to exploit a block of natural resources even if it is not up for tender. If government agrees with expression and interest, a bid not formally up for tender may be granted.

4. **Revenue Sharing Model-** the revenue sharing model under HELP will be much simpler easy to administer than the one under its predecessor. There is no cost recovery, no micro-management by the Government which will ensure operational freedom to the operator.

5. **Pricing and Marketing Freedom** - the contractor will have freedom for pricing and marketing of gas produced in the domestic market on arms length basis. To safeguard the Government revenue, the Government's share of profit will be calculated based on the higher of prevailing international crude price or actual price. Further, in order to protect user industries from market based imperfections, the price freedoms would come with a market cap based on opportunity cost of fuels coming in the form of imports. This ceiling will be revised and notified periodically by the Ministry of Petroleum and Natural Gas. This ensures that the discretion of the government at pricing will be reduced considerably thereby acting as a positive stimulant to investor sentiment and also safeguarding the interest of all stakeholders concerned. The price ceiling determination will done as follows:

Ceiling Price	*The ceiling price shall be the, lowest of the*

	– Fuel oil import landed price *– Weighted average import landed price of substitute fuels (0.3 x price of imported coal + 0.4 x price of imported fuel oil + 0.3 x price of imported naphtha) and* *– LNG import landed price.*
Time Period	*The ceiling will be calculated once in six months. The price data used shall be the trailing four quarters data with one quarter lag.*
Applicability	*The policy guidelines would be applicable to future and existing discoveries which are yet to commence commercial production as on 1.1.2016.*
Existing Discoveries	*Will be applicable to existing discoveries where arbitration/ litigation exists directly on gas price, only after conclusion/ withdrawal of such arbitration/litigation.*

6. **Risk Recognition-** under the previous regime, there was no recognition of the risks entailed in exploring different kinds of blocks which added to uncertainty and lack of investor incentive. The government under HELP has recognized these risks and distinguished between royalty regimes for exploration in land, deep water, ultra deep water and high pressure/ temperature zones.

7. **Increase in exploration phase**- exploration phase for onshore areas has been increased from 7 years to 8 years and for offshore increased from 8 years to 10 years.

8. **Minimum Regulatory Burden-** no micro-management, no control over budget and expenditure will result in ease of doing business.

9. **Reduced Government Audit-** the government audits will now only be limited to production and revenue and not at different stages of production which will ensure that the time frames for carrying out projects will be reduced considerably. The biggest decision taken by the government has been to free the contractors from the tedious audits of the Comptroller and Auditor General ("CAG") in order to boost freedom and ease of doing business.

10. **Changes in royalty regime**- concessional royalty regime for deep and ultra deep water exploration are proposed under HELP. There will be no royalty for the first 7 years. Concessional royalty 5% (deep water) & 2% (Ultra-deep water) has been reduced significantly. For shallow water areas royalty rates will be reduced from 10% to 7.5%. Revenue sharing for deep water and ultra deep water has been exempted in the new scheme.

11. **Exploration allowed after expiry of the contract period-** the contractors at their own risk may explore any mining lease areas after the expiry of contract. They may be eligible for recovery of costs at a stage where they can prove commercial viability of their exploration. This policy measure has essentially put the ball in the court of the explorer if the latter is given the freedom to explore geographical areas for potential opportunity.

12. **Policy for grant of extension to the Production Sharing Contracts for small, medium sized and discovered fields** - 28 small, medium sized fields discovered by National Oil Companies (ONGC and OIL) were awarded to Private Joint Ventures through Production Sharing Contract (PSC) between 1994-1998 for periods varying from 18 to 25 years. These Contracts are effective from different points of time. The earliest of PSCs were signed in the year 1994. Out of 28 PSCs, two fields in which the duration of the PSC had expired in 2013

had been granted extension up to 2018. The remaining PSCs would start expiring from 2018. The following process and guidelines for extension of contracts for small and medium sized discovered fields is being put in place:

Application	*Contractor application for extension of Contract: at least 2 years in advance of the expiry date, but not more than 6 years in advance.*
Recommendation	*Director General Hydrocarbons (DGH) recommendation: within 6 months of submission of application by the contractor.*
Decision	*Government will take a decision on the request for extension: within 3 months of receipt of the proposal from DGH.*
Revenue Sharing	*The Government share of Profit Petroleum during the extended period of contract: 10% higher than the share as calculated using the normal PSC provisions in any year during the extended period.*
Royalty & Cess	*During the extended period of Contract, the royalty and cess shall be payable at prevailing rates and not at concessional rates stipulated in the contracts.*
Extension	*The extension of these PSCs would be considered for 10 years both for oil and gas fields or economic life of the Field, whichever is earlier.*
Terms	*The policy for PSC extension will lead to production of hydrocarbons beyond the present term of PSC.*

A COMPARATIVE ANALYSIS

PARAMETER	HELP	NELP
Fiscal Model	Revenue sharing	Profit sharing
Cost efficiency	Encouraged	Neutral
Royalty Regime	Different rates depending on the risk undertaken	Standard rate given as per policy
Exploration Phase	On-land and Shallow Water- 8 years; Deepwater- 10 years	On-land and Shallow Water- 7 years; Deepwater & Ultra-Deepwater - 8 years
Licensing Regime	Allowed for all hydrocarbons discovered in the area with a single license	Allowed only for hydrocarbon for which license has been taken
Auditing	No micromanagement, no CAG auditing, no auditing at different stages of production	Technical & financials examination at different stages of production
Sharing agreement	On actual production and estimated revenue basis	Calculation of estimated revenue, calculation of estimated cost, audit of the cost and then sharing of the profit calculated using the above
Exploration after expiry of contracts in Mining Lease (ML) areas	At the contractors own risk	Not allowed
Open Acreage	Open for blocks which are not on tender on the basis of proved opportunity and interest	Only for those blocks on tender
Marketing and Pricing	Contractors have freedom to decide with minimum interference	Decided by the government administratively
Extension Policy	Allowed on sharing 10% more profit with government	Not policy

CONCLUSION

The new HELP policy fits the perfectly into the Prime Minister Shri Narendra Modi's mantra of "MINIMUM GOVERNMENT, MAXIMUM GOVERNANCE" which the Oil Minister Shri Dharmendra Pradhan also pointed out in his tweet on 10th March, 2016 (sic.) "*Besides generating employment, these decisions will also enhance transparency & reduce administrative discretion – Minimum Govt, Max Governance*."

In the recently concluded Budget speech of 2016, Finance Minister Shri Arun Jaitley had pointed to stagnating production and rising demand for petroleum products in the country and had said the government would unveil steps to incentivise gas production. By focussing on two key aspects in the HELP Policy, the first being, to provide calibrated marketing freedom; and second, to do so at a pre-determined ceiling price to be discovered on the principle of landed price of alternative fuels, the government has clearly taken up the challenge to synonymise the O&G E&P industry with ease of doing business. Market experts have already claimed it as a path breaking policy to market India's so far understated Oil Industry to global players. Although there are apprehensions given the low price environment India operates in, the HELP policy is a substantial improvement to the earlier NELP policy both in letter and spirit. It now remains to be seen whether this success on paper can be translated to success on the ground as well.