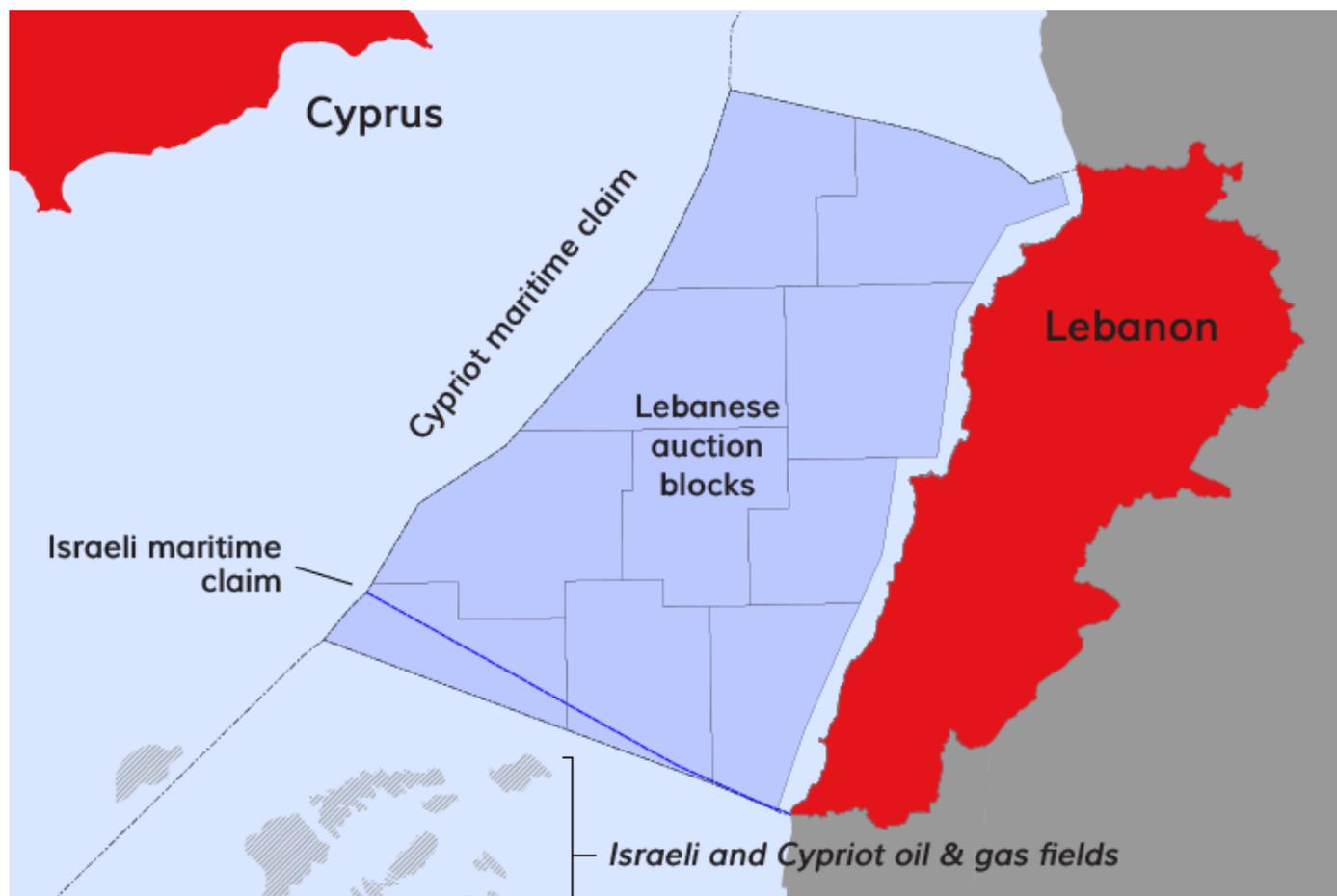


Splitting the spoils

Lebanon and Cyprus discuss their potentially shared oil and gas reserves

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When most people think of oil or gas discoveries, money is the first thing to spring to mind. Industry insiders, however, know that newfound resources often come hand-in-hand with ownership disputes since subsurface deposits predate the lines humankind has drawn above them.

With this in mind, Lebanon and Cyprus are currently in talks aimed at preempting future disagreements over possibly shared underwater hydrocarbon reserves, officials from each country announced in late May.

Neither will know if reserves exist — let alone whether or not said reserves are shared — until drilling begins, but talking now could help boost investor confidence down the road, particularly for Lebanon.

Drilling is still a pipedream in Lebanon as international oil companies cannot bid for rights to explore — and, they hope, produce — until the government approves decrees on block delineation and a model contract. Cyprus, on the other hand, in January signed exploration and production sharing deals with Italy's ENI and South Korea's KOGAS that include block 3, which abuts Lebanon's blocks 1 and 3.

Collective benefit

The early days of the oil and gas industry were governed by what is called the 'rule of capture' — meaning whoever captures the resource owns it. The result of this rule was a mad dash by landowners who thought they might have subsurface resources to drill numerous wells in an effort to capture as much as possible.

While sticking multiple straws in a milkshake works well for lovers, drilling multiple holes into a reserve actually decreases the amount of recoverable oil or gas. The more a reserve's geological seal resembles Swiss cheese, the less will come out of it.

Given the recoverability benefits of poking fewer holes into a reserve — along with lower investment costs — the idea of 'unitization' agreements was born.

"[A] unitization agreement," explains **David Ong**, a professor of international and environmental law at Britain's Nottingham Law School, in an email interview, "involves the prior determination of a single operator to develop the overlapping/transborder deposit according to the prior agreed share of the deposit determined by agreement between the licensees/operators/States concerned." In layman's terms, once a discovery is made, the parties decide how to divvy up the shared resources before exploiting them — thus maximizing the total amount of recoverable hydrocarbons.

It's still too early, lawyers specialized in oil and gas legislation tell Executive, for Lebanon and Cyprus to sign a unitization agreement as there are no known reserves to discuss nor a mutually agreed boundary between the two states.

"It will happen between the operators once there is a discovery," Malek Takieddine, a lawyer specialized in oil and gas, tells Executive.

That said, the two states can hammer out a framework for what a future unitization agreement between companies with rights to drill will look like.

In an email exchange, Ziad Obeid, a lawyer also focused on oil and gas, explains, "there are [two] main levels of agreement for international transboundary unitization: (i) a cross-border agreement/treaty between the relevant states, which regulates or applies unitization of deposits which are in between (straddle) their boundary (which is a sort of 'framework unitization agreement'), and (ii) a cross-border unitization agreement between the relevant [international oil companies] holding [exploration and production] rights in common petroleum reservoirs, by which the reservoirs are commonly exploited (as a single unit)."

Among the issues the two states will be interested in before discoveries — and money —

are made are: whose law applies to offshore installations; which authorities in each country have which powers; what happens if a right holder is qualified to drill in one country but not the other; and, perhaps most importantly, what is the border between them. A unitization framework would ideally cover all of these.

Border complications

Beirut and Nicosia agreed on a maritime boundary back in 2007, but for fear of angering Turkey — which is the sole country that recognizes northern Cyprus as a separate nation — Lebanon's parliament never ratified the agreement.

In addition to not being ratified, the 2007 agreement identified an end-point for the southern edge of the border but stipulated that point could be moved further south upon later agreement among the three parties concerned — namely Lebanon, Israel and Cyprus. In 2010, Cyprus and Israel signed a boundary deal corresponding to the 2007 agreement's border at sea that also extends slightly further north on land than Beirut believes it should — a result of Lebanon and Israel not having a demarcated land border; Lebanon sees this as giving around 850 square kilometers of its waters to Tel Aviv.

This, however, does not mean any unitization deal is off the table. Obeid notes that Lebanon's failure to ratify the agreement with Cyprus "does not necessarily preclude the conclusion of an economic development agreement in which the framework for unitization would be laid out. Of course, such an agreement would need to be without prejudice to Lebanon's position vis-à-vis its border with Israel."

Another issue the two states may address is what happens if one country makes a discovery before the other country has awarded rights to the block with a shared reservoir, Obeid says.

Regardless of what they eventually agree, Obeid adds that the fact the two countries are thinking of resolving disputes before they happen "can provide for a better investment climate by adding certainty and reducing investment risks."



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