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Offshore Oil and Gas Projects: Regulatory & Contractual Issues

The Role of Natural Gas in Lebanon's Future Energy Mix
Third Annual Masri Institute Workshop


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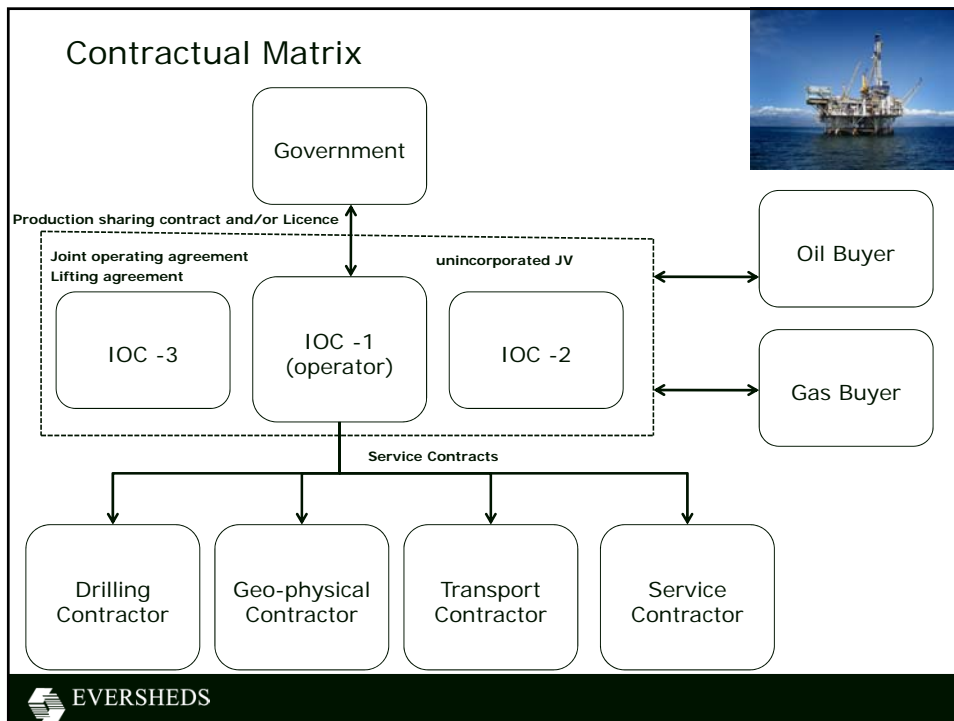
- Introduction
- Contractual Matrix
 - Contractual frame work of an upstream project
 - Focus on Drilling Contracts
- Regulatory structure
 - International Conventions
 - National Regulatory systems



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Contractual Matrix

The frame work of contracts in a typical international upstream oil and gas project

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Production sharing contracts or Licences



- A government has to grant a private party the right to explore and produce petroleum.
 - origin
 - nature
 - sources
- This is done either through a production sharing agreement or a licence (and sometimes confusingly both)
- In August 2010, the Lebanese Parliament ratified a law providing for production sharing contracts
- Another possibility is the service agreements (“buy-back”)
 - where there is a fixed return
- The government gets, for the grant of the right, royalty and other taxes



Licences



- A will contain the grant of the exclusive right to explore, develop and produce petroleum within the area (usually identified by co-ordinates) covered by the licence
- It could be separated into two stages: an exploration licence followed by a production licence
- The licence will incorporate, by reference, conditions that are found in laws and regulations
- The conditions will include:
 - Minimum work
 - Royalties
 - Environmental obligations



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Production sharing agreements




- Under a PSA (or PSC), the government grants exclusive right to explore, develop and produce petroleum
- The Government or the national oil company will be a party to the PSA. If the government itself is not a party to the PSA, the NOC will have some sort of licence from the Government
- The PSA will provide that the government and the counterparty share, in agreed proportions, the petroleum that is produced (after recovery of the counterparty's costs)
- Major issues
 - Profit share
 - cost recovery
 - stabilisation

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Joint Operating Agreements



- Joint operating agreements (JOAs) are the standard basis of upstream developments
- Oil Companies like to mutualise risk by sharing it with other participants, by creating an unincorporated joint venture
- Each party has a “participating interest” – but that does not accord much control.
- The party designated as the “operator” will have most of the control
- Features of JOAs
 - Operator powers – change of operator
 - Operating Committees
 - Budgets and Cash Calls
 - Risk sharing – “gross negligence”

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Service Agreements Generally



- The Operator (on behalf of the participants) will enter into service contracts with service providers
- The service providers provide survey capabilities, engineering services, drilling services, shipping, supply
- The service contracts will identify the service to be provided and the rates that will be charged for the service

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Product sales agreements



- Oil sales agreements are standardised and are relatively simple, the price is based on international price markers
- Gas sales need supporting infrastructure
- Gas sales contracts are complex, long term, and very detailed
- Gas Sales agreements are likely to include:
 - “take-or-pay provisions
 - complex price formulas

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Other agreements




- Pre-contractual agreements
 - Confidentiality agreements
 - Joint Study Agreements
 - Joint Bidding Agreements
- Transfers of interest
 - Farm-in agreements
 - Earn-in agreements
 - Share sales

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Drilling Contracts

All eyes on the drilling contract

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Drilling Contracts




- Drilling contracts are a special kind of service contract, they are very similar to charters
- The drilling company agrees to put at the disposal of the Operator the drilling rig.
- Recently drilling contracts have received a great deal of attention because of the accident in the Gulf of Mexico
- Off-shore drilling rigs are:
 - Jack-ups
 - Semi-submersibles
 - Drill ships
 - submersibles
 - Drilling Barges

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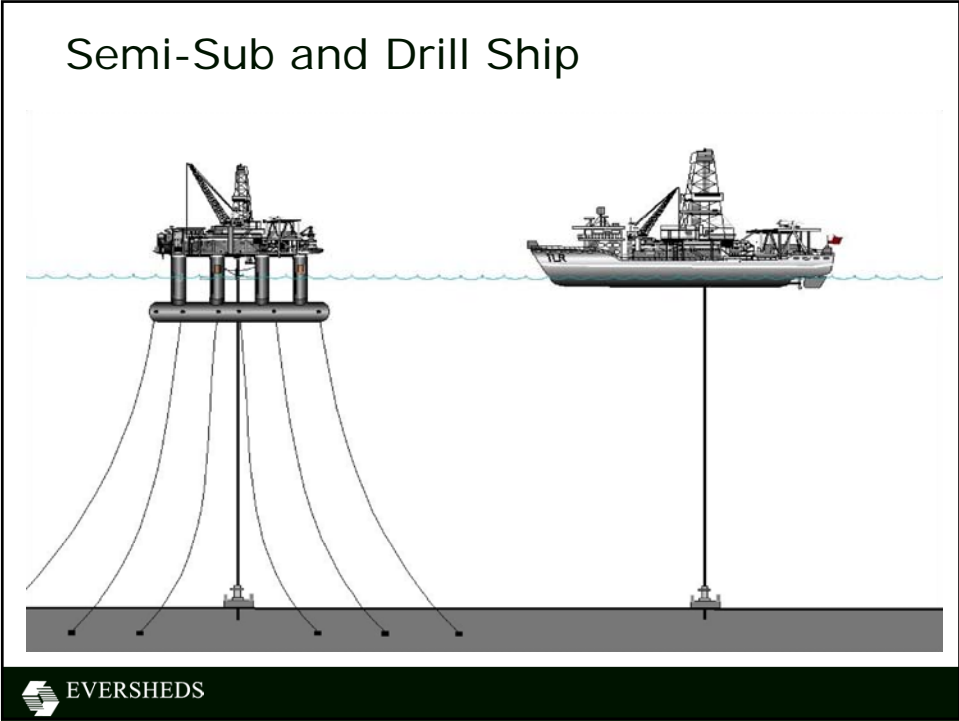
The Market for Drilling Rigs



- The market for drilling rights is dominated by a few suppliers
- The world fleet is about 951 rigs
 - Drillships - 125
 - Semi-submersibles – 223
 - Jack-ups -550
- In Lebanon's case we would probably need either drill ships or semi-submersibles
- Average day rates (for water depths of more than 4000 Ft)
 - Drill ships - \$ 457,000 p/d
 - Semi-subs - \$ 411,000 p/d

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A semi-sub being transported



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This image shows a large, complex semi-submersible platform being transported on the ocean. The platform is supported by several large, cylindrical legs. A tugboat is visible in the background, pulling the platform. The sky is clear and blue.

A working semi-sub



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This image shows a large, complex semi-submersible platform operating in the ocean. The platform is supported by several large, cylindrical legs. A tall derrick is visible on the platform. The sky is clear and blue.



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Dynamic positioning




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Drilling Contracts




- A drilling contract is similar to other service contracts
- Like any hire contract a drilling rig is hired for a number of days and paid a day rate for each day it is on hire
- Hire
 - Mobilization charges
 - Average day rate
 - standby rate
- Contractor warrants that the drill rig can perform the work correctly
- Company agrees to provide access to the site
- The Operator provides/pays for consumables


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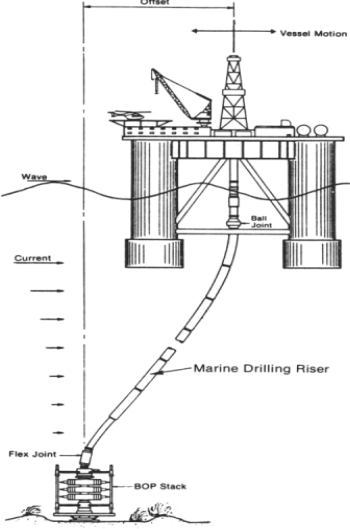
Drilling Contracts: Liability Regime



- The liability regime has been subject to close examination after the Macondo incident
- The liabilities can be huge and both operators and contractors have started to negotiate hard over the liability regime
- The liability regime is closely related to the insurance that the parties take or want to obtain
- Generally the principle has been “knock-for-knock”
 - each party responsible for its loss of or damage to property or personnel
 - each party indemnifies the other for claims with respect its liability
 - Shall be without recourse to the other party

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Drilling Contracts: Liability Regime



Contractor Responsibility


- Pollution
- Normal wear & tear

Operator Responsibility

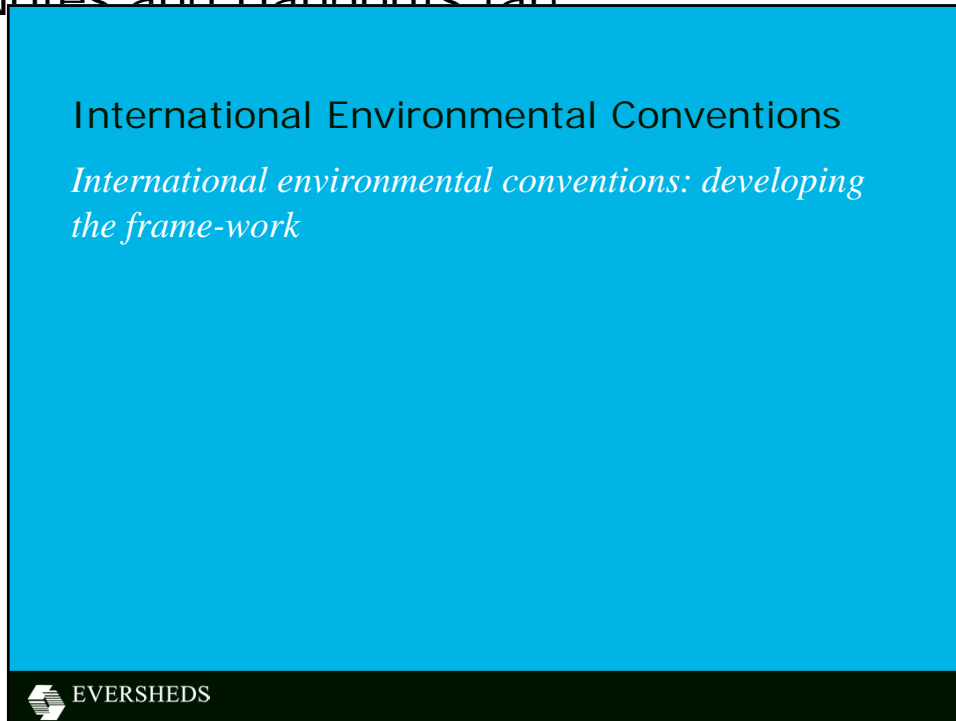
- Pollution
- Down hole equipment
- Wild well

Exception to the rule if there “gross negligence” or wilful misconduct”?

Marine Drilling Rig with Marine Drilling Riser


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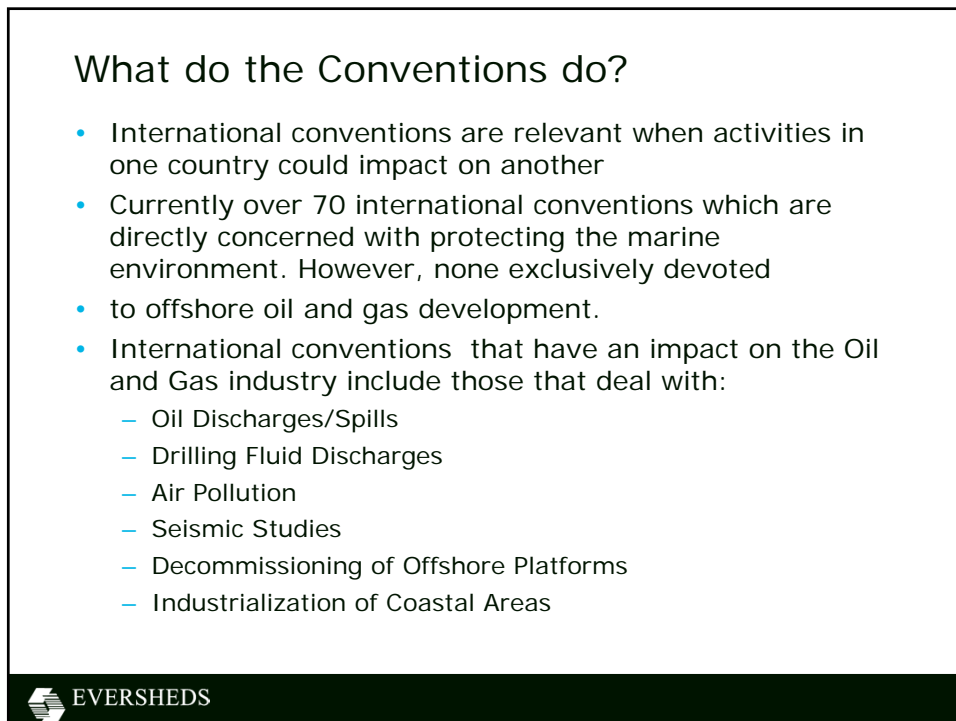
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International Environmental Conventions


International environmental conventions: developing the frame-work

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What do the Conventions do?

- International conventions are relevant when activities in one country could impact on another
- Currently over 70 international conventions which are directly concerned with protecting the marine environment. However, none exclusively devoted
- to offshore oil and gas development.
- International conventions that have an impact on the Oil and Gas industry include those that deal with:
 - Oil Discharges/Spills
 - Drilling Fluid Discharges
 - Air Pollution
 - Seismic Studies
 - Decommissioning of Offshore Platforms
 - Industrialization of Coastal Areas

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UN Convention on the Law of the Sea


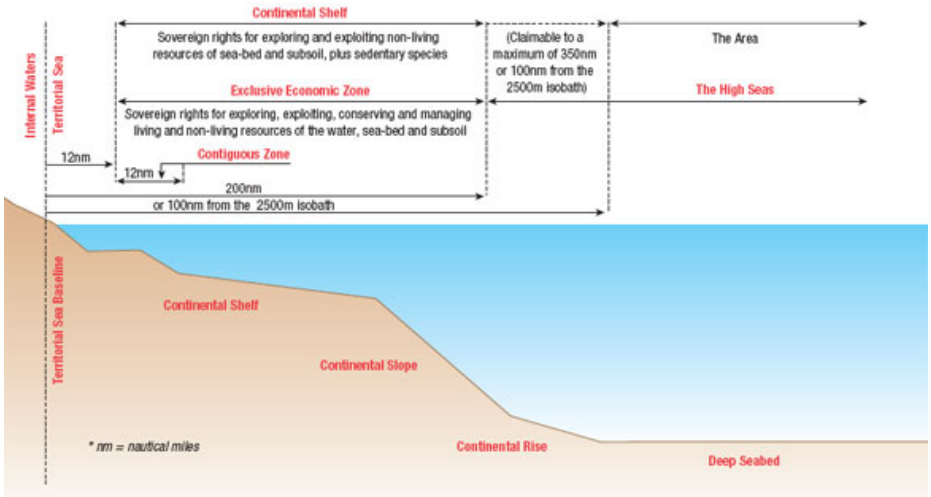


The UN Convention on the Law of the Sea, 1982 ("UNCLOS") provides that a description of maritime zones

- These maritime zones are required under international law to:
 - outline the range of sovereign rights that can be exercised by a coastal state (the rights diminish with distance from the coast); and
 - outline the rights that can be exercised by other countries when they wish to undertake activities in these areas of the sea.
- The zones and associated rights are set out in the UNCLOS



UN Convention on the Law of the Sea





The diagram illustrates the maritime zones and their boundaries from the coast:


- Internal Waters**: The area closest to the coast.
- Territorial Sea**: Extends 12 nautical miles (nm) from the baseline.
- Contiguous Zone**: Extends an additional 12 nm from the territorial sea, for a total of 24 nm from the coast.
- Continental Shelf**: Sovereign rights for exploring and exploiting non-living resources of the sea-bed and subsoil, plus sedentary species. It extends to 200 nm or 100 nm from the 2500m isobath.
- Exclusive Economic Zone (EEZ)**: Sovereign rights for exploring, exploiting, conserving and managing living and non-living resources of the water, sea-bed and subsoil. It extends to 200 nm or 100 nm from the 2500m isobath.
- The Area / High Seas**: The area beyond the EEZ, claimable to a maximum of 350 nm or 100 nm from the 2500m isobath.

The seabed is divided into the **Continental Shelf**, **Continental Slope**, **Continental Rise**, and **Deep Seabed**.


* nm = nautical miles




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UN Convention on the Law of the Sea 

- Internal Waters (all waters landward of a coastal state's jurisdictional coastline)
- Territorial Sea (0–12 nautical miles)
- Contiguous Zone (12–24 nautical miles)
- Exclusive Economic Zone (12–200 nautical miles)
- Continental Shelf (12–200 nautical miles, but can be farther under certain circumstances)
- High Seas (the area beyond the outer limit of a coastal state's continental shelf)

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UN Convention on the Law of the Sea 

UNCLOS provides that:

- Coastal States shall adopt laws and regulations to prevent, reduce and control pollution arising from or in connection with seabed activities;
- That such rules shall be no less effective than international rules and standards; and
- States shall endeavour to harmonize their environmental policies.


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Rio Declaration 

United Nations Rio Declaration on Environment and Development provides:


- States shall enact effective environmental legislation which reflect their environmental and developmental context;
- States shall develop national law regarding liability and compensation;
- The precautionary approach shall be applied;
- The polluter should in principle pay.

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Agenda 21 

Agenda 21 – Adopted by the United Nations Conference on Environment and Development:

- Sets out the rights and obligations of States and provides the international basis to pursue the protection and sustainable development of the marine and coastal environment; and
- Requires new approaches at the national, sub-regional, regional and global levels which are integrated, precautionary and anticipatory.

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Barcelona Convention, 1976



The Barcelona Convention was renamed as the Convention for the Protection of the Marine Environment and the Coastal Region of the Mediterranean:

- Lebanon acceded to the Barcelona Convention in 1995
- Requires that contracting parties take all appropriate measures to prevent abate, combat and to the fullest extent possible eliminate pollution of this area resulting from the exploration and exploitation of the continental shelf and the seabed; and
- Provides that the contracting parties cooperate in producing rules relating to liability and compensation resulting from marine pollution.
- The Barcelona Convention and the Mediterranean Action Plan form part of the UNEP Regional Seas Programme



Mediterranean Action Plan, 1975




MAP involves 21 countries bordering the Mediterranean as well as the European Community.

- The main objectives of the MAP were to:
 - assess and control marine pollution
 - formulate their national environment policies
 - improve the ability of governments to identify better options for alternative patterns of development
 - optimize the choices for allocation of resources
- The focus of MAP gradually shifted to include integrated coastal zone planning and management as the key tool through which solutions are being sought
- Will the MAP have to be re-focused to deal with oil and gas developments in the eastern Mediterranean?




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A new approach needed?




- The general conventions are probably too broad, regional conventions, some times are more effective
- Are the regional conventions in the Mediterranean appropriate for oil and gas developments that are taking place?
- EU-Lebanon Association Council initiative?

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International Pollution Conventions

Effective insurance?

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CLC Convention, 1992



The International Convention on Civil Liability for Oil Pollution Damage ("CLC Convention")

- The CLC ensures adequate compensation would be available where oil pollution damage was caused by maritime casualties involving oil tankers (ie ships that carry oil as cargo)
- The CLC Convention:
 - introduces strict liability for ship-owners when there is fault
 - When the ship-owner is not at fault, the convention caps liability
 - requires ship-owners to maintain insurance or other financial security" sufficient to cover the maximum liability for one oil spill
- Lebanon party to the 1992 Convention?



OPRC, 1990



International Convention of Oil Pollution Preparedness, Response and Cooperation, which entered into force in 1995



- Lebanon acceded to the OPRC in 2005
- The parties undertake, individually or jointly, to take all appropriate measures to prepare for and respond to oil pollution incidents
- A national system for responding to oil pollution incidents, to be established by the competent national authority
- Operators of offshore units are required to have oil pollution emergency plans and reporting procedures




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Action for Lebanon?

- Should Lebanon accede to the 1992 fund?
- Other initiatives?



National Regulation of Offshore Activities
The UK and US: a case in point



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National Regulation - UK

- Key legislation
 - Petroleum Act 1998
 - Environmental Protection Act 1990
 - Food and Environmental Protection Act 1985
- Regulators
 - Department of Energy and Climate Change (“DECC”)
 - Health and Safety Executive (“HSE”)
 - Department of Environment, Food and Rural Affairs (“DEFRA”)
 - Marine and Coastguard Agency (delegated all responsibility for oil spill response planning for offshore oil and gas installations to DECC)



National Regulation - UK

Key features of UK regulation

- Standards v Quality Objectives
- Integrated Pollution Prevention and Control
- Precautionary Principle
- Polluter Pays Principle
- Use of Best Available Techniques
- Separation between the roles of regulator and issuance of oil and gas rights following Piper Alpha Disaster



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National Regulation - US




- Key legislation
 - Outer Continental Shelf Lands Act
 - Oil Pollution Act 1990
 - Clean Water Act 1977 (and associated legislation)
- Regulators
 - US Department of the Interior (delegates responsibility to BOEMRE (as defined below))
 - US Coast Guard
 - Bureau of Ocean Energy Management Regulation and Enforcement (“BOEMRE”)
 - Environmental Protection Agency




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National Regulation - US




Key features of US regulation

- Prescriptive Standards
- Use of industry standards through the incorporation of usually the American Petroleum Institute’s Recommended Practices.
- Polluter Pays Principle
- Moving towards separation of roles between regulation of drilling and the issuance of oil and gas rights following the Mocado incident.




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A Regulatory frame-work for Lebanon? 

- Early this year Lebanon put in place a regulatory authority to supervise drilling activities
- Regulations should, include:
 - Precautionary principles
 - prescriptive standards referring to industry standards
 - polluter pays principle
 - separation between granter of right and regulator
- The regulations must be aimed at attracting investment at the same time protect the interests of Lebanon and its people

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Questions



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