

A Citizen's Guide

to lebanon's petroleum
exploration &
production agreement



What is Lebanon's Petroleum Exploration and Production Agreement (EPA)?

The EPA is contract through which the Lebanese state grants to international oil companies the right to explore and extract Oil and Gas. It follows the internationally common agreement type known as the production sharing contract.

EPA* is a Production Sharing Agreement

* All references to the EPA in this document relate to the EPA of the first licensing round



Execution



The Parties

- Republic of Lebanon represented by MoEW
- At least 3 International Oil Companies (IOC) called Right Holders, including one Operator

Effective Date:
Approval of the CoM

Duration:
It depends

Rights Awarded



Exclusive right to

conduct Petroleum Activities



Non-exclusive right to

construct and operate facilities for processing, transportation and storage of petroleum

EPA
Exploration production Agreement

MoEW
Ministry Of Energy and Water

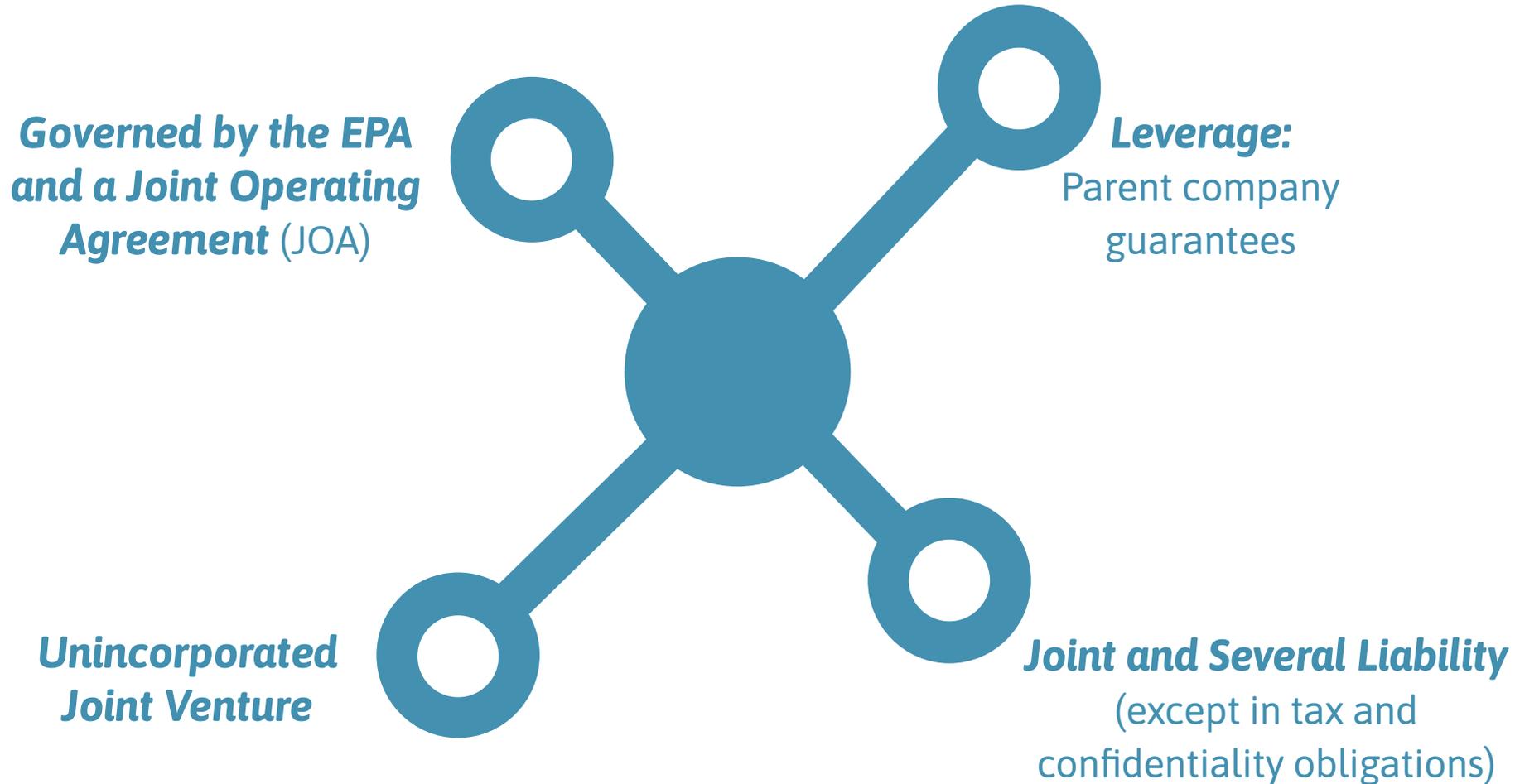
CoM
Council of Ministers

IOC
International Oil Companies

Relationship between Right Holders

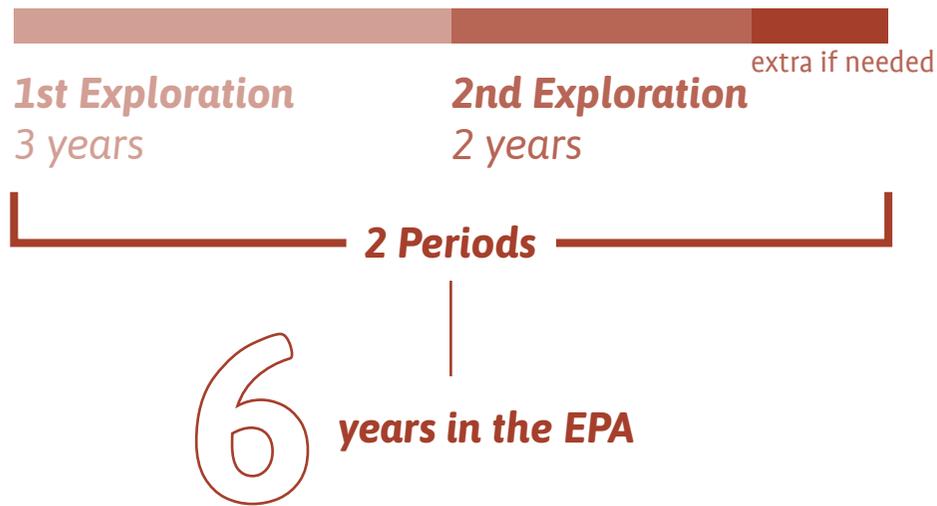
The International Oil Companies (IOCs), being no less than three companies under each EPA, constitute the Right Holders under the EPA. The nature of their relationship is an unincorporated joint venture (ie not established as a separate joint venture company). Such relationship is subject to the EPA and a separate agreement to be entered between the Right Holders themselves called a Joint Operating Agreement (JOA).

It is common that each Right Holder would be formed as a special purpose vehicle (SPV) which normally has no valuable assets and is owned/controlled by the relevant IOC. Hence a parent company guarantee is required to be submitted by the main IOC to guarantee the obligations of the SPV towards the Lebanese state. Furthermore, the liability of the Right Holders towards the Lebanese state is joint and several.



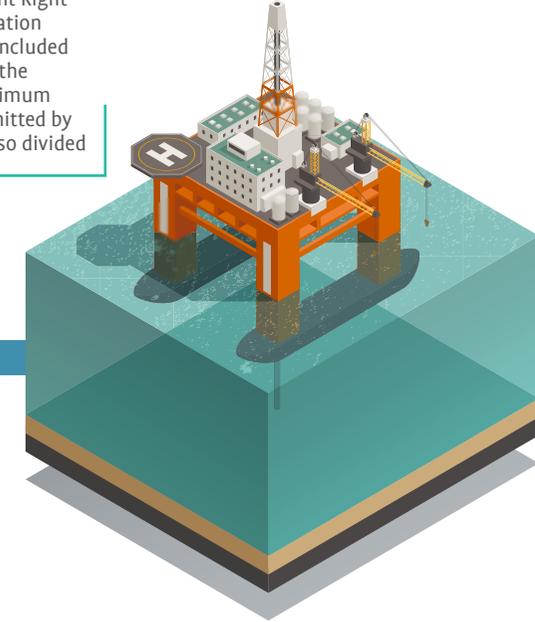
Exploration Phase

up to **10** years in the Lebanese law



The Exploration Phase constitutes the first phase of the EPA. The Right Holders are allowed during this period to carry out activities necessary to determine the existence of a hydrocarbon discovery and to assess the commerciality of such discovery. The Lebanese government has the legal right to grant Right Holders up to 10 years for such Exploration Phase. In the First Licensing Round concluded in 2017, the government decided that the Exploration Phase shall only be a maximum of 6 years (i.e. within the margin permitted by law). The Exploration Phase is itself also divided

into several sub-periods of 3 years and 2 years, each of which shall require separate exploration obligations by the Right Holders. The latter sub-period (2 years) can be also extended for an additional one year if justified by relevant circumstances as per the terms of the EPA.



- Requires approved Exploration Plan
 - Approval by Minister
 - Rejection can be for specific reasons, e.g.
 - MWC related
 - WCG not given
 - Activities not compliant with Lebanese Law or Best International Petroleum Industry Standards, or present HSE risks
- to be given within 60 days
- No answer is a deemed approval

MWC
Minimum Work Commitment

WCG
Minimum Work Commitment guaranteed

HSE
Health and Safety and Environment

Second Exploration Period can be extended to an additional 1 year



Conditions for extension:

- Completed MWC
- Pursuing Appraisal Plan or waiting to receive approval

• **Minister approval required**

Extension of Exploration Phase (beyond 6 years) is possible



Conditions for extension:

- In process of drilling a test well
- Pursuing Appraisal Plan

CoM
Council of Ministers

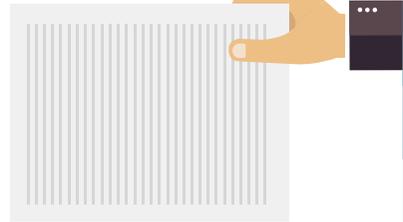
MWC
Minimum Work
Commitment

If no Exploration Plan is submitted/approved for the second Exploration Period, all the block is relinquished (except Appraisal or Development & Production areas)

In case of Force Majeure, Exploration Period can be extended (subject to approvals/limitations)

Minimum Work Commitment (MWC)

Includes technical details approved by the LPA



What happens in case of failure to achieve MWC?

- Financial penalty (e.g. \$40 Million for 1st Period and \$35 Million for 2nd Period)
- Merci et au revoir – above penalty as sole remedy

MWC is a work commitment – not a spending commitment



Petroleum Discovery



A petroleum discovery means nothing if it is not a commercial discovery

Following discovery, RHs must report to Minister in 6 months on results of testing

Testing is based on Appraisal Plan

LPA
Lebanese Petroleum Administration

MWC
Minimum Work Commitment

RH
Right Holders

Appraisal Plan

Must be submitted for approval of Minister within **60** days of discovery



Silence is a deemed approval



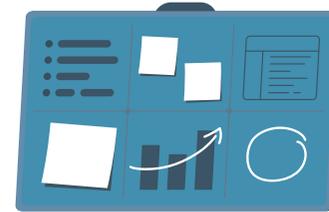
Appraisal Plan can be for a maximum period of 2 years

(or longer if approved by the Minister for technical or economic reasons)

Declaration of Commerciality

60 days is the deadline after completion of works in Appraisal Plan

(unless Minister approves extension)



But no later than **2** years after last exploration.

In case of natural gas discovery, the Declaration of Commerciality can be subject to Gas Infrastructure and Marketing Plan.

Development and Production Plan

Should include:



- Proposed target date and initial production rate

- Preliminary description of decommissioning activities

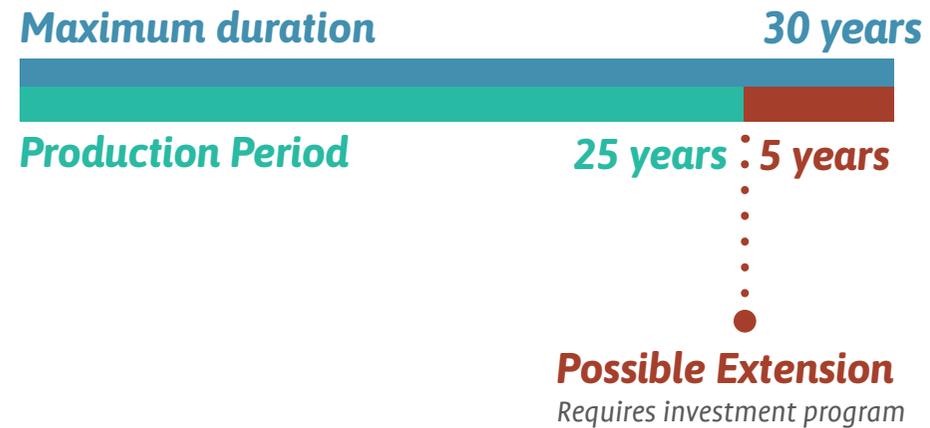
- Requires CoM approval

What happens if no decision by CoM by end of Exploration Phase

- EPA suspended!

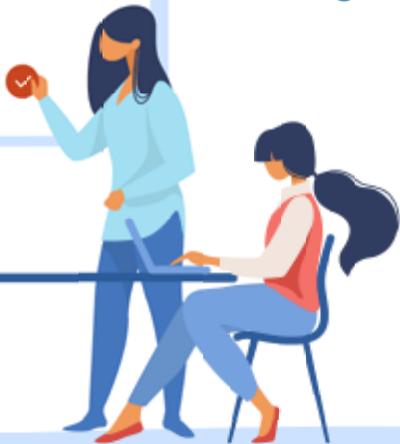
Production Phase

Once a discovery is deemed commercial (i.e. in rough terms, if the value of the hydrocarbons to be extracted can exceed the required capital and operational expenses), the Right Holders would be required to submit for government approval a plan (i) for the development of the infrastructure necessary for the production of the hydrocarbons (e.g. platforms, pipelines, etc.) and (ii) for the actual production (i.e. describing expected production date, quantities, etc.). This is called the Development and Production Plan. It is a key plan, and hence requires high level approval (i.e. by the Council of Ministers). The duration of the Production Period is 25 years, and can be extended for an additional 5 years subject to an investment program to be submitted in due course.



State Privileges

○ **Approval of Work Programs and budgets by LPA**



○ **Access to all RHs Management Committee meetings**

(via observers and access to reports)

○ **Minister can decide to restrict sale of natural gas to local market**



Operatorship

○ **Operator**

(holds no less than 35%):

- Subject to JOA
- Acts on behalf of RHs
- Conducts and manages all Petroleum Activities

○ **Operator receives no separate remuneration for its services**

The structure of the EPA provides important privileges for the Lebanese State which shall ensure proper oversight and transparency over the work of the Right Holders. Furthermore, the Right Holders which include no less than three companies are all jointly liable towards the Lebanese State, although only one of them is considered to be the Operator, i.e. the company that acts on behalf of the Right Holders in conducting the petroleum operations under the EPA. Finally, the Right Holders are required to pay for the costs of removing/ decommissioning the project's infrastructure (which is usually a costly exercise) at the end of the project, and for this purpose the Right Holders are required to create a Decommissioning Fund around half-way the lifetime of the project and to start depositing money into such funds to cover the expected decommissioning costs. This ensures that if the Right Holders are not solvent for any reason at the end of the project, sufficient money have been put aside for the costly decommissioning activities.

LPA
Lebanese Petroleum Administration

RH
Right Holders

JOA
Joint Operating Agreement

Decommissioning Fund

Considered Recoverable Costs



○ **Intended for decommissioning activities**

○ **Fund starts when production hits 50% of recoverable reserves**

Employment and Training

Requirement for staff to include 80% Lebanese citizens
(unless exempted by the Minister)

Yearly training budget
(increased by 5% annually):
\$300K during Exploration Phase
\$500K during Production Phase



Royalty

Different rates for oil and gas



Oil rate varies ——— depending on monthly average of daily production: starts at 5% and reaches 12 %
(for quantities above 100,000 barrels per day)

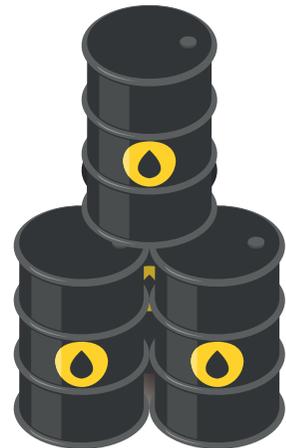
Gas royalty rate fixed ——— at 4%

Production Rate (Barrels/Day)	Royalty Rate
0 to 15,000	5%
15,001 to 25,000	6%
25,001 to 50,000	7%
50,001 to 75,000	8%
75,001 to 100,000	10%
Above 100,000	12%

Cost Petroleum

Capped and paid per quarter

Capped at 65% of Disposable Petroleum
(or less if Recoverable Costs are less)



Paid in cash

OR
Subject to yearly decision



Paid in kind

Profit Petroleum

State share between 30% and 40%

State share increases within the above range depending on **R Factor**



R-Factor	Royalty Rate	Right Holders' Aggregate Portion
$R \leq 1$ Less than or equal to 1	A% ($\geq 30\%$)	100% - A%
$1 < R < R_b$ Greater than or equal to R_b	See formula below	100% less percentage determined in formula below
$R \geq R_b$ Greater than or equal to R_b	B%	100% - B%

$$\text{R Factor} = \frac{\text{cumulative cash inflow}}{\text{cumulative Capex}}$$

When the R-Factor is greater than 1 and less than R_b , the State's portion of Profit Petroleum shall be determined in accordance with the following formula:

$$SP = A + \left[\frac{(B - A) \times (R - 1)}{(R_b - 1)} \right]$$

Where "SP" is the State's portion and "R" is the R-Factor used to determine the State's portion (i.e., the R-factor for the immediately preceding Quarter). "B" shall be forty percent (40%), and R_b shall be equal to 3.



Cash inflow means all receivables less Opex

Capex

Exploration + Development (without operating)

Opex

Operating Cost

The Profit Petroleum entitlement of each Right Holder for any Quarter shall be equal to the product of:

- (i) such Right Holder's Participating interest, and
- (ii) the Profit Petroleum entitlement of all of the Right Holders for such Quarter.

For purposes of the foregoing, the R-Factor for any Quarter shall be calculated in accordance with the following formula:

$$\text{R Factor} = \frac{\text{cumulative cash inflow}}{\text{cumulative Capex}}$$

Where "R" is the R-Factor being determined

Cumulative Cash Inflow for any Quarter is equal to:

- (i) all Profit Petroleum to which the Right Holders are or have been entitled from the beginning of the Production Phase through the end of such Quarter, plus
- (ii) all Cost Petroleum to which the Right Holders are or have been entitled from the beginning of the Production Phase through the end of such Quarter, less
- (iii) all Operating Expenses recorded pursuant to the Accounting and Financial Procedure that constitutes Annex D of this EPA from the beginning of the Production Phase through the end of such Quarter.

Cumulative CAPEX for any Quarter is equal to all Capital Expenditures recorded pursuant to the Accounting and Financial Procedure that constitutes Annex D of this EPA from the Effective Date through the end of such Quarter.

Capex

Exploration +
Development (without
operating)