ACQUISITION OF OIL AND GAS ASSETS

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CERTIFICATE

This is to certify that the research work entitled "***ACQUISITION OF OIL & GAS ASSETS***" is the work done by **Ms. Mahak Garg** under my guidance and supervision for the partial fulfillment of the requirement of the degree of B.B.A., LL.B. (Hons) with Specialization in Corporate Laws at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled ***"ACQUISITION OF OIL & GAS ASSETS"*** is the outcome of my own work conducted under the supervision of **Mr. Rajkumar Narayanan**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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TABLE OF CONTENTS

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- Mahak Garg

LIST OF ABBREVIATIONS

OECD : Organization for Economic Cooperation and Development

OPEC : Organization of Petroleum Exporting Countries

M&A : Mergers and Acquisitions

NOCs : National Oil Companies

OFS : Oilfield Services

VPP : Volumetric Production Payment

ONGC : Oil and Natural Gas Corporation Limited

OVL : ONGC Videsh Limited

OIL : Oil India Limited

LNG : Liquified Natural Gas

KIPs : Key Performance Indicators

SPA : Sale Purchase Agreement

IOC : International Oil Company

JOA : Joint Operating Agreement

JV : Joint Venture

GAIL : Gas Authority of India Limited

CNPC : China National Petroleum Company

NELP : New Exploration Licensing Policy

E&P : Exploration and Production

CHAPTER 1

INTRODUCTION

1.1 SIGNIFICANCE OF OIL AND GAS SECTOR

The Industrial Revolution of the 1800s provided the impetus for unprecedented growth and development of economies of the Europe and the United States, and the global search for sufficient energy to fuel economic growth and ensure national prosperity has intensified. Third world countries are desperate to catch up, creating a demand for even more energy. Most national governments now realize that a nation's ability to fuel its industries and provide its citizens with reasonable (and rising) standard of living is a crucial element of political stability and even national survival. Wars have been lost and political ideologies have disappeared because a nation could not sustain its energy appetite.

Although many alternative energy sources have been evaluated and tested in the last few decades, fossil fuels remain the world's primary energy source and are expected to remain so in years to come. With continued economic growth predicted worldwide and explosive growth expected for the Pacific Rim, the challenge to discover, produce, and deliver economic sources of energy if formidable.

Energy is the lifeline of every economy. It is the prime mover of economic growth. Sustainable development is majorly dependent upon availability of energy with required quality of supply. It has a direct impact and influence on the quality of services in the fields of education, health, food and security. Oil and gas forms a small but significant part of the energy sector. Of all other sources of energy, hydrocarbons are the most critical and will continue to be so in the foreseeable future. Its level of utilization directly asserts the level of economic development. Emerging economies are expected to drive energy usage to still higher levels. For countries like India, access to affordable energy is critical to the economic growth of the nation and enhanced standards of living of its population.

Integrated Energy Policy of the Planning Commission defines Energy Security as under:

> *"We are energy secure when we can supply lifeline energy to all our citizens irrespective of their ability to pay for it as well as meet their effective demand for safe and convenient energy to satisfy their various needs at competitive prices, at all times and with a prescribed confidence level*

considering shocks and disruptions that can be reasonably expected. [1]

Therefore, it is safe to infer that the chief emphasis of energy security policy of India focuses mainly on meeting the energy needs of all citizens and the ability to provide it to all citizens disregarding their capacity to pay.

Securing energy sources is of strategic importance since most of the established hydrocarbon resources in the world are confined to a few countries, while the demand is world-wide. The concerns related to assured supply are threats of supply disruptions, terrorism, and instability in exporting nations, nationalist backlash, geo-political rivalries, speculative trading and business cartels. Energy security remains a concern for India as the country faces challenges in meeting its energy needs. The country depends on imports to meet more than 75% of its hydrocarbon energy requirements. The growth in domestic oil and gas production is not commensurate with the growing consumption of petroleum products in the fast developing economy like India. In order to supplement domestic availability of Crude Oil and Gas, there has been substantial effort on acquisition of assets abroad.

1.1.1 Trends in Global Oil Demand

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1) *Report of the Working Group on Petroleum and Natural Gas Sector for the 12th Five Year Plan (2012 - 17)*, Government of India, Ministry of Petroleum and Natural Gas, November 2011, full text available on http://www.indiaenvironmentportal.org.in/files/file/wgreport.pdf (Last visited on 05th Feb, 2015)

"It is expected that oil will be the slowest growing of the major fuels to 2035, with demand growing at an average of only 0.8% a year. Nevertheless, this will still result in demand for oil and other liquid fuels being almost 19 million barrels a day higher in 2035 as compared to 2012. All the net demand growth is anticipated to come from outside the OECD - demand growth from Middle East, India and China will together account for most of the net demand growth."[2)]

The growth in the supply of oil and other liquids (including biofuels) till 2035 is anticipated to come mostly from the Middle East and Americas. More than half of the growth is expected to come from non-OPEC sources, with rising production from Canadian oil sands, US tight oil, Brazilian deepwater and biofuels more than offsetting mature declines elsewhere.

Increase in the production from new tight oil resources is anticipated to result in the US overtaking Saudi Arabia and become the world's largest producer of liquids. United States oil imports are expected to fall almost 75% between 2012 and 2035.

The share of OPEC's in the oil market is expected to fall early in the period, indicating growing non-OPEC production combined with slowing demand growth because of

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[2)] Oil and Gas Reality Check 2014: A look at the top issues facing the oil and gas sector, by Deloitte high prices and increasingly efficient transport technologies. The market share of OPEC is expected to rebound somewhat after 2020.[3)]

1.2 MERGERS & ACQUISITIONS IN INDIA

The government of India doesn't participate in acquiring equity assets abroad. The public sector units (PSUs) and private sector companies in India go abroad to acquire assets on their own merits. The Public Sector Units do receive support from the government, especially the Ministries of External Affairs and Petroleum and Natural Gas, and the Ministry of Coal for negotiating significant assets. Generally, this support is reactive, however it helps in getting the attention of relevant countries and their national oil companies. Governments are known to provide funds, lines of credit, encouraging setting-up of infrastructure in the country with hydrocarbons, thus actively assisting in acquiring assets. Thus, it doesn't remain a mere commercial deal between host governments and oil companies. It is considered a national activity undertaken through their oil companies.[4)]

"For the duration of the project or operations phases, it is common

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3) BP Energy Outlook 2035 Shows Global Energy Demand Growth Slowing, Despite Increases Driven by Emerging Economies last visited 03-03-2013, See at *http://www.bp.com/en/global/corporate/press/press-releases/energy-outlook-2035.html*

4) William H. Caudill, Zhusong Yang, *Acquisition and Disposition of Oil and Gas Properties*, Texas Journal of Oil, Gas, and Energy Law, 2010-2011

for such governments to support their companies if regulatory, political, social or commercial instability related risks occur. Indian Public Sector Units in some cases suffered from loss of concessions, lack of cooperation by local authorities, tardy responses by host governments on permissions and clearances, undue taxation, and such other challenges with almost no support from the government of India. Hence India needs to acquire energy assets abroad to enhance and improve its energy security. As a component of its energy security strategy, India has entered into cooperative relationships with a number of oil-producing countries in the Middle East and Africa. It has also permitted public sector companies such as Oil India Limited (OIL) and Oil and Natural Gas Corporation (ONGC) to secure ownership of oil and gas fields and overseas companies. The government has also encouraged companies to acquire overseas upstream assets as a means to shield the domestic energy sector from global price volatility. The Indian companies hold huge stakes in Russia's Sakhalin-1 project and Sudan's GNOP block. Lately, Indian firms have also explored assets in Central Asia and the Caspian Sea. For ex, ConocoPhillips announced that it was selling its stake in a north Caspian Sea PSA to ONGC in late 2012. A similar deal was announced by Hess

Corp with ONGC for oil fields in Azerbaijan ."[5]

India has made path breaking agreements with countries such as Russia, Mozambique, Sudan, etc. ONGC Videsh Ltd (OVL) has invested more than 2.5 billion USD in the Greater Nile Petroleum Operating Company (GNPOC) in Sudan in the year 2003. The OVL's blocks provide approximately 2.4 million tonnes of crude oil annually. ONGC Videsh Ltd also acquired Sakhalin-1, a large oil and gas field in Russia in July, 2001. It holds 20% stake in Sakhalin-1 block, with the investment of 1.7 billion USD and Imperial Energy in 2009 at a total cost of 2.1 billion USD. Public sector companies of India have been involved in numerous signature deals. A consortium of Indian PSUs--ONGC Videsh, Indian Oil Corporation and Oil India—has acquired two development blocks sited in Carabobo area of Orinoco Heavy Oil Belt, Venezuela.

Indian private sector companies are also quite active in acquiring oil and assets abroad on consortium or solo basis or both. Videocon Hydrocarbon Holdings, a wholly owned subsidiary of Videocon Industries and Bharat PetroResources Ltd, a unit of BPCL hold 10% each in Rovuma basin in Mozambique. Oil India and ONGC Videsh Ltd recently acquired stake in Mozambique gas field from Videocon Industries. ONGC Videsh Ltd is also close to acquiring stake from Anadarko subject to the consent of other partner. OIL has properties in Gabon, Libya, Yemen, Egypt, Nigeria, Venezuela and Iran. Reliance via its Reliance Exploration and Production DMCC arm, has seven oil and

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5) http://www.eia.gov/countries/cab.cfm?fips=IN visited on 15-01-2015

gas (conventional) blocks overseas. It has assets in Peru (two), Yemen (two), Colombia (two) and Australia (one), besides shale gas assets in the United States.

India has collaborated efficiently with oil-rich countries but still has a long way to go. China has effectively acquired assets almost all over the world. In stipulations of seeking cooperation from energy-rich countries, China, Malaysia and South Korea are far ahead of us. There is a considerably low deal success rate in India as compared to China. The government of China is involved in mostly all deals facilitating it from all the angles.

India should have a sharper strategy to facilitate its companies in acquiring assets abroad. Indian government has to visualize an opportunity sooner than other countries do. India has the potential of acquiring better prospects in the Middle Eastern countries because of its physical proximity, Russia as our old ally, Brazil (member of BRIC), Argentina, Latin America, etc. The Indian government needs to aid both the public and private oil and gas companies at the time of acquiring assets abroad. Government needs to guide them, encourage them and make them think innovative; wherever they see molecules and where production is economic. The Indian oil companies (IOCs) have to connect with other national oil companies (NOCs) of the world. In conclusion, IOCs need to have more autonomy.

CHAPTER 2

OIL AND GAS TRANSACTIONS

Key factors that motivate companies for acquisitions and mergers are accessibility to superior quality, manufacturing assets and reserves worldwide accompanied with infrastructure synergies, capability of rapid growth and economies of scale. On the other hand, materiality shortage, portfolio rationalization and yielding value during unpredictable commodity prices, force the companies to divest assets or at times seek mergers. Mergers, acquisition and divestment in the oil and gas industry require cautious management and a structured approach to maximize values and to complete deals in an efficient way and timeframe. If oil and gas transactions are conducted competently then it encourages faith of investor, growth, returns and efficiency in operations at the time fluctuations are being experienced in the market. The old trends in oil and gas industry specific key performance indicators (KPIs) disclose about the companies that are expected to prosper and likely to decline and hence facilitates acquisition.

2.1 SALE AND PURCHASE AGREEMENTS:

A transaction involving oil and gas property will be treated as a sale or exchange under two general circumstances. First, where the owner of any kind of oil and gas interest assigns all of his interest or a fractional interest (such as an undivided interest) that is identical, except as to quantity, to the fractional interest retained. Second, a sale occurs when the owner of an oil and gas working interest assigns any type of continuing non operating interest in the minerals and retains the working interest. This second class includes primarily those transactions in which the owner carves out an interest from the working interest and disposes of that interest. For example, if the owner of the working interest transfers an overriding royalty or a net profits interest for cash and retains the working interest, a sale has occurred.

This mode of acquisition involves a company already engaging in E&P to sell its interest in that business or operation to new company which eventually resumes the original role of the company for some consideration. The sale may be in terms of both ownership of the original company or even only the ownership of the working interest of the company in the Exploration & Production project.

> *"The purpose of the sale purchase agreement (the SPA) is to record the detailed terms on which the shares in a company are sold and purchased, since we are talking about M&A activities, hence as suggested this sale shall always refer to the purchase of equity shares in company ultimately altering its ownership. Such*

contracts are also known as Purchase and Sale agreements."[6]

The terms of all M&A transactions are set forth in a contract known as the "purchase and sale agreement" between the selling and the acquiring parties. The contract can attain the form of a asset purchase agreement, stock purchase agreement, merger agreement or tender offer document. Irrespective of the form, the contract contains a number of clauses that are alike in all situations. M&A transactions can be structured as stock sales or asset sales. When asset sale is considered, the specific assets and liabilities that are being sold (including everything from office supplies to goodwill) are listed in the sale and purchase agreement. Instead, the purchase and sale agreement may simply include a general description of the assets being sold (e.g. "all assets used in Target's business".[7]

- *Negotiating Leverage in SPA's*

The tone of the transaction documents (that is, how they are biased in favor of the buyer of seller) is dependent on the relative leverage of the parties and the type and kind of transaction. In auctions, the typical case is that the selling party is charged with drafting the transaction documents so that it can more steadily compare the bids that are competing. In case of a negotiated transaction, the buyer usually drafts the

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[6] Joseph R. Dancy, John C. Harrison, "*Environmental Issues Involved in Oil and Gas Acquisition and Divestitures*", Rocky Mountain Mineral Law Special Institute

[7] http://macabacus.com/mechanics/agreements, last visited 01-02-2015

documents. In the prior case, initial tone of these documents shall be determined by the competitiveness of the process of auction.

It is significant to understand which parts of the purchase and sale agreement are normally subject to negotiation and which are less significant or boilerplate clause. Understanding the contract fundaments is helpful in negotiations that surround the contract. The investment bankers frequently act as counterweights to lawyers in deciding which clauses are relevant to a transaction.

2.1.1 Brief Components of a SPA:

2.1.1.1. Execution Provisions

Execution provisions provide for the transfer by the seller of the assets or stock of the target to the acquirer in exchange for the purchase consideration. It may take a number of forms, including stock (common or preferred), cash, warrants and deferred compensation. The execution provisions also involve the definition of any collars or other protection mechanisms.

In an M&A transactions, a portion of the purchase price may be deferred or withheld. This can be accomplished through escrows, hold-backs, earn-outs, or other kind of contingent payments. Such mechanisms are often useful to bridge differences over the price, there are frequently significant hurdles in their implementation form a practical point of view.. This can be due, in part, to the fact these payments may be dependent on future business performances that will be under the control of the buyer.

2.1.1.2. Representatives and Warranties[8)]

Representations and warranties include the statements and assurance that a seller makes regarding its capability to sell the business, the consents necessary to sell the business, and the condition of the business that is concerned. Representations are the statements pertaining to the business, whereas warranties are the business that those statements are true and accurate.

2.1.1.3. Covenants

Covenants regulate the actions that sellers and buyers are permitted to undertake between the period of signing and closing. Covenants also form the basis for closing conditions and indemnification. Fundamentally, breaking a covenant means that a condition to closing has been violated, and the party that is not in breach will be able to claim indemnification from the other party, or perhaps terminate.

2.1.1.4. Indemnification[9)]

[8)] http:macabacus.com/docs/fenwick_deals.pdf, last visited 07-02-2015
[9)] Fenwick and West LLP, M&A Tips and Tricks, 2005

Indemnifications arise in private transactions to protect the buyer against pre- or post-closing breaches of the covenants and/or warranties and reps. Indemnification characteristically involves a payment from the seller to the buyer to compensate the former for losses that occurred because of these type of breaches. Mainly, there is a materiality threshold for such breaches. The acquirer shall only be indemnified for breaches warranties and reps for the "survival period", and that is usually until closing or a defined period of time thereafter.

Indemnifications can be structured in a number of ways. The size and mechanism for the indemnification is often subjected to considerable negotiation and it depends on the situations and the likelihood that they will be made applicable, may be used for negotiation for the purpose of influencing other parts of the deal, for example- overall purchase price.

2.2. FARM OUT AGREEMENTS

The concept farm-out is believed to have originated from the use of the term by ancient Romans to signify the practice of transferring rights of tax collection to a third party for a determined fee which has since been abolished because it led to wide abuses and later at common law where it was described as letting of an estate to another person for a fee.[10)]

"In the oil and gas industry, the term of farm-out evolved from the United States of America in the industry of mining and petroleum due to the structure of oil ownership which resides with private ownership and not with the state ."[11)]

"A farm out is an agreement where Party A, who is the owner of a rights or interest in an oil leasehold or acreage, assigns all or a portion of those rights or interest in the acreage to Party B who agrees in return for the rights or interest to do some drilling work or testing operations to a predetermined extent on that acreage ."[12)]

The owner of the leaseholder is usually referred to as the "farmer" while the Party B who is buying into the leasehold interest is referred to as the "farmee" or The rights or interest earned in the acreage is referred to as a "divided" meaning the farmee receives a part of the farmor's share.[13)]

"The main feature of a farm-out transaction is that the rights or interest to be assigned must be carried out by the farmor.

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10) Hemingway, W.R., The Farmout Agreement: A Story Short But Not Always Sweet, (HeinOnline-1 Nat Resources & Envt, 1985-1986) pg 3

11) Smith, E.E., et al, International Petroleum Transactions, 2nd Edition, (RMMLF 2000) pg 201

12) Lowe, J.S., Analysing Oil and Gas Farmout Agreements 41 Sw. L.J. 759, 763-764 (1987)

13) Stickley, D.C., A Framework Negotiating & Documenting Petroleum Industry Transactions, (New Zealand: Wellington Publishers 2006) pg 23

Another ***distinctive feature of a farm-out*** *a transaction from other transfer of interest such as* ***sale purchase agreement (SPA)*** *is that: an interest is allocated and obtained in the concession in exchange and not directly for consideration in form of cash. Although in some extraordinary instances the farmee pays the cost for the performance of such work obligations ."*[14)]

2.2.1 Motives for "Farm Out"

Generally the reason for venturing into a farm-out arrangement will depend on parties to the arrangement. However the main reason behind most farmout agreement is basically for finance. For example a farmor may assume that the risks exposure innate in the exploration aspect of E & P project is extremely too high for it to assume the financial burden of further exploration then decides to assign (farmout) that part of the

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14) This was illustrated in the case of Mastri v Consolidated Contractors International UK Ltd & Anor; Masri v Khoury & Others)2006) All ER (D) 444 (July) where the defendants "CCIC "entered into a farmout agreement with Pecten Yemen Company (a U.S. oil company controlled by Shell) to acquire half of CCICs' forty percent interest in a concession in return for payment of CCIC s' past and future exploration costs of about $16 million (plus a one payment $500,000)

business to a third party company with expertise on exploration. By this arrangement the farmer, which could be an International Oil Company (IOC), though will be losing a part of its equity share in the concession but will be sharing the workload and risk as well as fresh injection of capital.

> *"On the other hand, the allure for the farm-in party is the opportunity to earn a lease interest under a prospective concession that may not be otherwise available or at discounted fee than normally possible, or the reason may just to keep its human and technical expertise gainfully employed."*[15)]

The substantive provisions as regards this paper of the farm-out agreements may be divided into these following parts for consideration.

2.2.2 Parties

The starting point for any agreement is to state the contracting parties. The names and capacity (whether acting or not) of the farmor as well as the farmee should be clearly stated in the opening paragraph of the agreement.

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15) Blinn, K.W., et al, International Petroleum Exploration and Exploration Agreements, (London: Euromoney Publications 1986) pg 204

2.2.3 Obligation of Parties

a) **Farmor:** The interest and percentage rights of the farmor in the concession or acreage should be identified in the agreement. In addition the interest that is to be assigned and the overall royalty interest or an special interest of the farmor in production should be defined in the farmout agreement.

b) **Farmee:** The earned interest, rights and obligation of farmee is very crucial to the overall transaction and must be should be described sufficiently. Such earned obligation should be exact, for example whether it is to perform some seismic activity or the drilling of a specific well within the concession. What would constitute breach of this obligation may also be described in this provision.

2.2.4 Consents

It is pertinent to check the conditions of a concession/license agreement or a PSC to determine whether approval of host government is required before interest can be assigned or transferred under a farm-out agreement. Such an action is motivated by host government concerns for the selection of IOC that is entrusted with the exploration and development activities. Moreover the HG does not entertain nonchalantly the idea.

That the assigned interest might be used in a speculative manner to attain highest possible consideration for the rights, with no spread or profit for the middleman.[16)]

> *"This apprehension has informed host government decision in some jurisdiction to put in place some form of control over any change, transfer or assignment over the title rights of an acreage.*
>
> *For instance, the Nigerian jurisdiction takes the issue of consent and approval very important before such assignment or transfer of oil exploration rights could be said to be valid. Regulation 14 of the Ist Schedule to the Nigerian Petroleum Act of 1969 provides that ··the holder of a license or lease shall not assign his license or lease or any right, power or interest in it without the prior consent of the Minister.*
>
> *Regulation 16a (1) of ht same Schedule in the amended Act further provides that a the one holding the lease can, with the permission of the Head of State, farm-out an interest in its area of lease. This stance was reflected during the time of writing this*

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16) More details available at The Nigerian Punch Newspaper of July 17th 2008 available at http://www.punchon theweb.com/ (last visited on 27=12-2014); but see Adaralegbe A. Third Party Participation in Exploration Rights: Is it the Regulators Consent a Requirement, Who argues that it is AGIP's PSC partner, the NNPCs' Consent, that is required for this agreement under the Petroleum Act

research when the Nigerian Senate Committee on Petroleum (upstream) nullification of JOA between Agip and three other oil companies for allegedly violating this Act due to the fact that permission of the Petroleum Minister was not obtained in the farm-out arrangement.[17] *"*

2.3. FARM IN AGREEMENTS

A farm-in agreement involves transfer of a part of the shares in an oil or gas company in consideration for an agreement by the transferee to meet certain expenditures that would otherwise have to be taken up, by the user of subsoil rights. Hence, a farm-in agreement is a combination of a typical sale and purchase agreement and an additional investment commitment.[18]

The Farmor and the Farmee, may come to sign a Farm-in-Agreement in the specific context where both want to share costs and risks of drilling to increase capital expenditure in expecting higher gain in return.

This state of affairs usually happen when the owner of the acreage, the Farmor, discovers after few drilling and testing operations that the oil or gas field licensed in the acreage may contain more reserves than expected or will require more technologies.

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17) *Supra* note 24

18) Asset Capital Monitors, Monthly News letter, Moscow, September, 2007

Thus the Farmor may take years to come to production and get the pay back of its capital expenditure. In this context, the added value of the Framee is to provide cash and technology to speed up the oil and gas field development.

The joint operation of the Farmor and the Farmee is expected to leverage capital expenditure for both parties. A successful implementation of a Farm-in-Agreement is based on the two or three steps approach where the Farmor having the utmost expertise of the oil and gas field at the early stage of the development is designated the operator while the Farmee will facilitate and provide support. Then the Farmee takes over the operations in respect with the technologies and resources that he mobilized to enhance exploration and production. Such Farm-in-Agreement may also be used when the rumor about the higher than expected reserve of the oil and gas fields start to spread around and to attract major companies willing to be part of it.

Such major companies will hence offer a premium on the value of the acreage to take that role of Farmee and offering the opportunity to the Farmor to decrease risks and to enhance its return on capital expenditure.[19)]

The various forms of farm-in turn mainly on what is perhaps the most vital provision in a farm-in agreement and that is the nature of the obligation of the party that is farming-in. There exists the "exploration farm-in", which would characteristically

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19) http://www.2b1stconsulting.com/farm-in-agreement/, last visited 14-03-2015

involve the carrying out of seismic work that can be done by a third party or the operator or might be done by each company independently or only one of them. Then pertinent to discussion is the "appraisal farm-in", wherein the obligation to work will aim to establish the nature and size of the indicated deposit and shall include the drilling of an appraisal well/wells. The main feature for the party that is farming-in is to become a party to the Joint Operating Agreement, and also to be able to take part in any eventual development and to be able to influence the development throughout the process of the decision making established in the JOA. Also there is "development farm-in". The commercial dynamics will establish who gets what in this kind of farm-in because it is basically a sharing of reward and risk. The party that farms-out will have established that there are commercial oil and gas deposits and it will be selling some of its interest to the party farming-in where characteristically the obligation of the party farming-in will be to perform all or part of the development work.

Retained interest of the farming-out party's retained interest is usually called the "carried interest" or the development carry".[20)]

2.4. JOINT VENTURES

JVs are a well-established feature of the oil and gas industry. They are less risky and

20) http://www.mondaq.com/x/8501/Why+Do+Oil+Companies+Do+FarmOuts+And+FarmIns, last visited 27-01-2015

are easier to unbundle than the full organizational mergers. Keeping in mind the scale of organizations within the oil and gas industry, the antitrust concerns and the importance of national energy security, Joint Ventures are a beneficial means of gaining the advantages of collaboration without the political and the economic risks associated with a merger or other business combination.

Share purchase agreements in the oil and gas sector

Share purchase agreements (SPAs) may be encountered in various contexts in the oil and gas sector. Like asset purchase agreements, they are used to buy and sell petroleum assets, whether upstream, midstream or downstream. On a share sale it is the shares in the asset-holding company (the target company) that are purchased, rather than the assets directly. A share sale is therefore most appropriate where the target company is a special purpose vehicle, holding only those assets that are the subject of the sale. If the target company holds additional assets which the seller does not wish to sell, or the buyer does not acquire, the seller will need to conduct pre-transaction restructuring to transfer those assets out of the target company.

In the oil and gas sector, given the size, value and complexity of the assets in question, there are often a number of entities holding interests in any one asset or project. Project participants may hold their interests through an incorporated or an unincorporated joint venture. In the former case, a share sale will be required in order to transfer a project participant's interest (shareholding) in the special-purpose company, incorporated for the specific project, that holds the assets, in the case of an incorporated joint venture (which is more usual than the upstream sector), a project participant may hold its individual interest through its own special purpose company. In this case, the parties may structure the transaction as a sale of the shares in the special purpose company, rather than that company's direct interest in the project assets.

The sale purpose

The process for the sale and purchase of oil and gas assets (whether by a share or asset purchase) does not differ materially from that followed in other sectors. The majority of share sales and purchases in the oil and gas sector relate to private, non-listed companies (typically special purpose companies established by oil and gas companies to hold interests in specific projects).

The process may be conducted by way of auction or bilateral negotiations. Depending on the commercial context, the parties may choose to enter into a preliminary agreement in relation to the proposed transaction, such as a confidentiality or exclusivity agreement, or even detailed heads of terms, which will give the parties a degree of certainty that a deal may be in prospect, in order to commit time and resources to the due diligence process and negotiation of the principal documentation.

Notably, upstream transactions usually involve obtaining host government consents, which will affect the process and will need to be considered at an early stage. Such approvals are required due to the state's sovereign ownership and the national importance of petroleum resources. The consent requirements will typically be contained in the 'petroleum contract' relating to the project rights (i.e., the production-sharing agreement, risk-service agreement, concession agreement or license under which the state granted the right to explore and exploit the relevant petroleum resource) or the applicable legislation. The consent requirements will generally be formulated as the right of the host government to approve any direct transfer of project rights and (relevant to share sales) any change of control in the project rights-holding entity. In some jurisdictions, however, the host government views a change of control in the holder of an interest in a petroleum contract as an assignment. Therefore government consent may be required even though the petroleum contract may be silent on the point. The parties should consider at any early stage, once a deal is in prospect, when first contact should be made with the relevant governmental authority in relation to the transaction, to ensure that there are no difficulties in obtaining the requisite consent which, in certain countries, may take a number of months to obtain. Official submission of any application is likely to take place after signing the SPA and will be a condition to completion.

Asset sale and purchase agreements

An asset sale and purchase takes place when a purchaser acquires assets directly from the seller who owns those assets. Here we will focus on the type of asset transactions that typically take place in the oil and gas industry, being the acquisition of participating interests in one or more host country upstream petroleum agreements (UPAs) such as licenses, concessions or production sharing contracts, together with associated contracts and as joint operating agreements (JOAs), and related assets such as geological and geophysical data, facilities and equipment.

Each asset transaction presents a unique set of facts and circumstances, including matters such as the allocation of risk between the parties and the economic terms of the transaction. As a result, there is no prescribed or standard form of an asset sale and purchase agreement (ASPA). Rather than discussing every provision that is common to most ASPA ,' here we will discuss about the parts of an ASPA that are unique to, or that frequently raise issues in, an upstream oil and gas asset sale and purchase.

Allocation of liabilities

In an asset transaction, as a general rule the seller will retain all pre-completion liabilities and the buyer will assume all post-completion liabilities with respect to the specific assets being transferred. Alternatively, the buyer and the seller could agree an economically effective date on which such liabilities would transfer. In either case, the result should be a clean break between the buyer and the seller, which is usually an attractive position for a buyer. However, it is also possible to structure an asset transaction and draft the relevant documents to provide that the buyer will assume some specific pre-completion liabilities, or that the seller will retain some post-completion liabilities.

It is common for a buyer to agree to assume known pre-completion liabilities that have been disclosed to the buyer. An example would be a contract, such as a drilling contract, entered into by the seller prior to the proposed sale to the buyer, where the buyer agrees to assume its proportionate share of the post-completion liabilities under the contract. In this case, the buyer would have had an opportunity to assess and quantify the relevant liabilities, and take them into account in the purchase price.

It is less common for a buyer in an oil and gas asset transaction to agree to assume unknown pre-completion liabilities. However, this can be the case even in an asset transaction. For example, in acquisitions from super-major international oil companies or in situations where the seller has disproportionate bargaining power, the seller may take the position that the buyer must assume all liabilities, past, present and future. Sometimes this assumption is limited to environmental and decommissioning liabilities, although these are often the most significant potential liabilities. Another example is where the acquisition is for the entirety of the seller's interests, as in a share purchase, but where the transaction has been structured as an asset sale for tax or other reasons. In these cases the ASPA will provide that the buyer assumes all such liabilities and obligations of the seller, whether known or unknown and whether contingent or absolute. The buyer is left to rely on its due diligence investigation of the relevant assets.

It is possible that certain types of liability may follow the assets as a matter of law. For example, under fraudulent conveyance laws, assets acquired by a buyer can be reached by the creditors of a seller if the purchase price was inadequate and if the seller is insolvent at the time of the transaction or is rendered insolvent as a result of the transaction. Also, under some environmental laws, a buyer may become liable for remediation with respect to pre-completion activities of a seller in cases where the seller can no longer be held liable (for example, where a seller has subsequently become insolvent).

It is also common for sellers to retain to retain certain known post-completion liabilities. For example, if a buyer has identified during its due diligence investigation that the seller is involved in litigation, then the buyer may require the seller to retain all liabilities with respect to such litigation and to indemnify the buyer against all such liabilities. In this case, the seller would want to retain control of the litigation post-completion, and may need ongoing access to records relating to the subject of the litigation.

CHAPTER 3

ENERGY SECURITY IN INDIA

"While the efforts of ONGC-Videsh and Indian Oil Corporation are laudable, there is still some distance our firms have to travel to catch up with global competition. I urge our oil and gas PSUs to think big, think creatively and think boldly in this context⋯They have to be more fleet-footed in making use of global opportunities, both on the supply and demand side. I find China ahead of us in planning for the future where energy security is concerned. We can no longer be complacent and must learn to think strategically in order to think ahead and to act swiftly and decisively."[21)]

It's not that the PM's speech galvanised the Indian oil companies into hunting for overseas energy assets. The policy for acquisition of overseas assets was launched in the 1990s, in a bid to minimize India's burgeoning oli imports even as domestic crude production continued to stagnate at around 32-33 million tonnes per annum, against a demand of 108 million tonnes, thereby meeting only 30 per cent of demand. The report of the ministerial group on India Hydrocarbon vision 2025,[22)] set up by the Prime Minister to focus on long-term energy security, had suggested, amongst others, that India's energy policy should have a focused approach to get equity oil and gas, besides building relationships with international oil companies. As per the Indian oil officials, India should produce at least 110 million tonnes per year

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21) "The Global Player", Frontline, 20, January 18-31, 2003

22) *Financial Express*, August 30, 2005

by 2025, with the demand for oil projected to touch 370 million tones. In order to maintain this level, we need to add 60 million tonnes of oil every year. We thought the only way to get this was to get it from outside India as equity oil. The mission, hence, is to get this 60 million tonnes every year by 2025[23] as per Atul Chandra, who was the managing director of ONGC Videsh Limited (OVL), facilitating in the overseas exploration of ONGC, in 2003.[24]

A significant plank of India;s energy security policy is to build up a portfolio of international oil and gas assets. Government understands that hydrocarbons are tradables and can be purchased in the open market. But keeping in mind the volatility of the global petroleum market, they do not wish to rely on arm ̓s-length transactions only. They consider that equity ownership offers higher level of security. Therefore they have encouraged public and private sector companies hitherto and they have achieved commendable results. But looking ahead, they are likely to face stronger competition. The Chinese, for one, are pulling out all the stops to secure their energy requirements. The government must therefore tweak its institutional structure and streamline the decision-making process to enable Indian companies to respond with greater agility. It should also consider putting its own weight behind their efforts.

ONGC Videsh (OVL), the 100 per cent subsidiary of ONGC, has significantly

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23) Petroleum Economist, March 2005

24) http://www.eia.doe.gov/emeu/cabs/MEC_Current/July.html, last visited on 10-01-2015

broadened its international footprint. In 2001, it had a stake in one producing asset in-Sudan and its equity share of oil production was 2,50,000 tonnes per annum. By 2012, it had extended its presence to 16 countries and had an interest in 32 assets.[25)] Its equity share had increased to 7.25 million tonnes.[26)] OVL has achieved these results despite three constraining factors.

One, as a public sector entity, it does not have financial and operational autonomy. Before submitting a bid, it has to obtain the approval of its shareholder i.e. ONGC, the ministry of petroleum and the committee of secretaries. At occasssions, it also has to pass muster with the empowered group of ministers. The ultimate result of this layered and time-consuming approval process is that bids are often leaked and OVL has difficulty meeting bid deadlines.

Two, the playing field has not always been level. The bidding process in many countries in Africa and Central Asia, where the resources are controlled by the government, is not transparent. The Chinese exploit this opacity in many ways, but often by simply sweetening their bid for an upstream asset with a "behind the scenes" commitment to invest in downstream infrastructure like refining, power generation, fertilizer units, roads and railways. These "two-for-one" offers have paid off

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25) Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security, visited on 23 Feburary, 2015

26) Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security, visited on 23 Feburary, 2015

handsomely in countries like Kazakhstan and Nigeria.

Three, CNOOC and SINOPEC –the two Chinese state-owned companies –have been aggressively backed by their government. They thus bid with the balance sheet of their petroleum industry and the weight of the sovereign behind them. A few weeks ago, for instance, Chinese President XI Jinping undertook a whirlwind tour of Central Asia. He signed a plethora of oil supply deals in Uzbekistan, Kyrgyzstan and Turkmenistan, and made a point of attending the ceremony to celebrate the start of oil production from the giant Kashagan field in Kazakhstan. While there, he announced financial support for the construction of fourth refinery of Kazakhstan’s. CNOOC had earlier been granted a stake in the Kashagan field.

OVL’s success has been reinforced by some dramatic portfolio wins by the downstream company Bharat Petroleum (BPCL). There was a time not long ago when every public sector entity had an aspiration to be an integrated company. ONGC wanted to build refineries and enter marketing, and IOC, BPCL and HPCL wanted to carry out exploration and production. They all set up subsidiaries for this purpose. None of the upstream subsidiary had any success except Bharat Resources (BRL), the upstream subsidiary of BPCL. BRL’s strategy was to acquire a small (10 to 20 per cent) non-operating stake in exploration assets around the world. Two of these acquisitions have struck dirt. A field in Mozambique in which BRL has a 10 per cent stake has confirmed gas reserves - at last count, over 60 trillion cubic feet (tcf) of gas reserves. I say last count because the number keeps going up with every well drilled. To put this discovery in perspective, the Reliance D6 find, which was billed as one of the large gas discoveries of the year, was listed at 15 tef and ONGC has just paid Videocon (which had invested on the back of BRL) nearly $3 billion for its stake of 10%. Second, is a discovery in the sub-salt basin of Brazil. It is too early on to put a reserve figure on the discovery, although it could well be the prelude to the unlocking of a super giant reservoir. Videocon and BRL have a 10 % stake each in this discovery.

These successes should not make us complacent. As noted, the Chinese have been aggressively expanding their portfolio. They have taken stakes in Iraq and Egypt. They have tied up gas supplies from Russia and are strong-arming the Africans. There are three things that the government should do to counter this competitive threat.

- ü Firstly, OVL should be unshackled from intrusive bureaucratic oversight and cumbersome approval procedures. As it is, this is an infractuous exercise. The bureaucrats and politicians do not have the technical knowledge to challenge OVL's bid proposal, for it is technical and stuffed with geological, reservoir and financial data. All that these committees can do is to ensure that the company is following the government's mandate on international acquisitions. However, that is a chack the OVL board could carry out effortlessly.

- Secondly, the balance sheet of ONHC Videsh Limited should be bolstered by putting the weight of "India Energy Inc "behind it. Perhaps, Coal India, Gail, ONGC/OVL NTPC, which are the biggest of energy companies in India should be brought together to devise an international energy acquisition strategy, wherein these companies would bid together as a consortium whenever any strategically significant asset that meets the criteria of profitability and return is put up for sale. If that is not feasible legally then they would support the bid by offering the strength of their balance sheet and, if required then consider going beyond an offer for just the upstream asset. Private sector could unite the consortia on a case by case basis, a la the BPCL/Videocon model.

- Thirdly, the government should also facilitate in an international bid by putting its sovereign power behind it. In the current times, the ministry of external affairs helps by providing advisory support to companies that seek international exposure. But that is not sufficient. The government should become a partner in the pursuit. The Chinese do it as well. Whereas other countries do it in a more subtle manner. That is the competitive reality. The government and its key agencies and officials should go out on a limb for all international initiatives by redesigning its institutional and decision-making structures and bat for all international initiatives, whether it is for the securing of an oil supply deal, the acquisition of an oil and gas asset, the, or an LNG contract, the negotiation of a construction contract, etc.

3.1. WHERE S THE COMPETITIVE EDGE?

Indian oil companies have experienced some successes over the past few years in buying equity stakes in foreign oil and gas blocks. The most notable are the Sakhalin-1 (offshore) project in Russia and the Greater Nile Project in Sudan and the Chinese where the Chinese also have major interest, it has failed in many more or manages to acquire marginal stakes in others.

For example, it lost a bid to acquire Royal Dutch/Shell s 50 % interest in Block 18 offshore Angola, that includes the Greater Plutonia development and has reserves of one billion barrels, after the Angolan government was offered a 17 yr, $2 billion loan at a low 1.5 % interest rate along with the offer to build electronic manufacturing factories, hospitals etc, by the Chinese Government..[27)]Indian government was also ready to support ONGC by offering $200 million to facilitate build a railway, however this was dwarfed by the Chinese package.[28)]

> *The overseas energy policy of India came into the light of late when it entered and lost to Chinese national oil companies in their bid to acquire a foreign oil company to China National*

[27)] http://www.eia.doe.gov/emeu/cabs/MEC_Current/July.html, visited on 12-03-2015

[28)] *Ibid*

Petroleum Company. Petro Kazakhstan is Canada-based $3.3 billion firm and has all its assets in Central Asia. After this occurred another acquisition by China National Petroleum Company (CNPC) for purchasing oil and pipeline interests in Ecuador from EnCana, a Canadian natural gas giant. The Chinese outbid ONGC, in the competition for overseas asset acquisitions, for the second time in a month pertaining to a $1.42 billion deal [29)]

The losses that have incurred off late would necessitate reconsidering India's overseas acquisition policies and the strategies that are pursued by its national oil companies. Despite the fact that procuring abroad resources helps loch the ceiling costs for future supplies, this relies on upon the long haul assumption of oil costs being incorporated with the cost of acquisition. Case in point, the Sakhalin rough would have a maximum price tag of about $25-30 a barrel for the following 10-years while on account of Sudan, it will be altogether lower.

Nonetheless, it is pertinent that the assumed oil price for acquisition should be reasonable and lower than the market price on the long-term basis. In the current environment, when the international price of oil is high, the risk exists that the

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[29)] *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security,* visited on 23-02-2015 countries that own the oil have no incentive to sell the asset unless a very high premium is paid. The risk is that the high premium would snatch away the whole value from the asset ultimately leaving almost nothing for the buyer except some risks.

In these instances a major role is played by geographical contiguity. Hence, in spite of the high price paid for the PetroKazakh deal ($4.18 billion), Chinese consider it a valuable asset.[30] Chinese have their own pipeline from Kazakhstan which would permit them to reduce the transportation cost by $2-3 per barrel, by sourcing Chinese goods and services to develop the field, their rate of return may exceed 12 %.[31] Additionally, supply security would be ensured even in case of a war. Such a high cost of acquisition may not make sense, for a company without any strategic advantage.

> *"The most pragmatic acquisition strategy in the oil industry would be to look for good exploration blocks. However this is dependent upon having a competent corporate tem that is has the ability of evaluating possible exploration acreages worldwide similar to those the big international oil companies. But, most of the Indian oil companies do not have a decent database or set-up to go ahead with this strategy, ultimately India ends up acquiring the "Very high risk" category of blocks. The exploration blocks are not even*

[30] *Supra* 41
[31] *Ibid*

acquired in the bidding round examined in depth because of shortage of time available resulting from lack of adequate research of the area. [32)]

3.2. CHINA LOOMS LARGE

Chinese and Indian energy companies appear to be in the race for the same assets. Ultimately, this competitiveness is pushing the prices of assets to a higher level. This scenario is expected to hurt Indians more than their Chinese counterparts. It has been observed that the aggressive bids by Indians and especially the Chinese companies in exploration auctions shows their willingness to accept a lower rate of return than western companies in order to secure a strategic asset. Resulting that, the Chinese seem to have procured some significant successes over a short period of time even though they entered the game of overseas acquisition in 1997, Chinese firms have been able to acquire numerous E&P assets worldwide.

"In countries like West Asia too, China is escalating its relationships with the regional producers. In 2001, Sinopec signed an exploration agreement for Iran's Zavareh-Kashan block. Furthermore, Saudi Arabia and China have an agreement on

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[32)] *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security,* visited on 23-02 - 2015 *petroleum cooperation since 1999 and CNPC's division of engineering facilitated in building several oil processing facilities in Kuwait. In January, the degree of Chinese involvement in the region grew sharply. An agreement for gas exploration and development was signed between Sinopec and Saudi Aramco in South Ghawar region, while Sinopec settled to a deal with Iran, in which it would buy 250 millions tonnes of LNG over a period of 30 yrs. Sinopec will also become the operator with a stake of 50 % in Yadavaran oil fields. The Yadavaran oil fields are expected to produce 300,000 barrels per day ."*[33)]

China is proving to be a major rival for other oil companies in Africa. In Sudan, CNPC was given a significant stake in the 320,000 barrels a day Greater Nile Oil Project (GNOP. In 2003 and 2004, CNPC signed exploration deals in a number of African countries including Chad, and during Premier Hu Jintao visit to Algeria, Egypt and Gabon in early 2004, a deal for exploration deal was signed between Gabon and Sinopec and alongside a cooperation agreement with Algeria was also entered into. Indonesia's Tangguh and Australia's North West Shelf projects are certain other projects where CNOOC has secured equity and is further negotiating for a 12.5 % stake in Gorgan (Australia). It is the biggest oil producer offshore Indonesia after it

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[33)] *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security*, visited on 23-02 -2015 bought oil and gas assets from Repsol YPF in 2002. Furthermore, both CNPC and Sinopec are driving significant investments in Canada's oil sands and number of Latin American and Chinese accords were signed in early 2005 including with Brazil, Argentina and Venezuela.[34)]

3.3. INDIA'S LIMITED SUCCESS

India's successes have been quite modest, in contrast. Selection of the target countries on the grounds of nine-block matrix with focus on the prospectivity of the region or the country and the capability of OVL to complete the projects that came under OVL's consideration there included those in Russia, Iraq, Iran, Vietnam, Russia, Libya, Sudan, Indonesia, and the US. In the order to have a strong hold, OVL has Joined hands with other domestic oil companies Such as GAIL, OIL and IOC similar to the multinational companies such as Exxon-Mobil, British Petroleum, British Gas, and Sodeco of Japan in the projects overseas. OVL, IOC and OIL formed a consortium and signed a contract in 2002 with Iran's National Petroleum Company for the purpose of exploration of Farsi block in the Persian Gulf and has entered into a partnership with GAIL for the Myanmar block.

"Among its projects, Sakhlin-1 (offshore) in Russia is one of the most

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34) *Ibid*

significant projects, where OVL has acquired the participating interest of 20 % in the project. It is engaged in the project via a consortium with Sodeco, Exxon-Mobil and the Russian companies RN Astra and SMNG. The operator is EXXON-Mobil. It stands to be the largest single investment ever made by an Indian Corporate i.e., $1.7 billion. Commencement of production is in the year 2005. The share of India in the first 6 or 7 years is around 5 million tonnes per year; this also includes the share of Russia as part of the repayment for a loan to the Russian government [35)]

After paying the loan, the share of India tapers off to 2.5 million tonnes per year.[36)] The production of gas is scheduled in the GNOP project in partnership with Malaysia ’ s Petronas and CNPC. In addition the company also has a stake in an offshore gas project in Vietnam along with petro Vietnam and British Petroleum and one more in the Myanmar offshore, wherein OVL is part in the process of exploration along with GAIL, Korea Gas Corporation (KOGAS) and Daewoo International Corporation.

OVL signed an agreement in Libya on August 22, 2002 with the Turkish Petroleum Overseas company for acquiring the stake of 49 % in two blocks for inland oil and gas exploration. In the United States, OVL has initiated exploration in the shallow waters

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35) *Ibid*
36) *Supra 42*

of the Gulf of Mexico. Sakhalin India Limited has entered into an agreement with a US company called McAlester Fuel to take a stake of 10 % in an offshore gas exploration block on the coast of Louisiana.[37)]

3.4. THE DOWNSIDES

The game of overseas acquisitions has its risks. Most of the countries know that they can gain advantage by forcing India and China to compete. One instance being that Russia is playing CNPC and ONGC off against each other for an interest of 15-20 % in the re-nationalized Yuganskneftegaz, which is a subsidiary of Yukos. The proposal of ONGC was a $2 billion investment and a $4 billion loan, whereas CNPS proposed a $6 billon advance payment on future oil sales.[38)]

Understanding the issues faced by Indian Oil Companies and in an attempt to put an end to the destructive competition, Mani Shankar Aiyar, Indian Petroleum Minister stated that India and China should adopt the collaborative approach while bidding whenever it is feasible and further stated that energy companies from China and India must cooperate well depending on the situation. The intention of Mr Aiyar is to visit China and there is good probability that the giants from the two countries will arrive at

37) *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India s'Energy Security*, visited on 23-02-2015

38) *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India s'Energy Security*, visited on 23-02-2015

an agreement for the purpose of fostering relations between the two.

For the time being the Indian companies are also attempting to gain composure in order to increase their leverage. For example, numerous Indian firms are joining their assets for increase their worth in the game of bidding. IOC and OIL have succeeded in joining forces exclusive of ONGC for winning an exploration block in Libya. The plan for the second round of bidding is to do the same. There was a proposal earlier to make a company with authentic overseas clout as part of a merger of the five NOCs and the proposal is still under consideration.

The strategy involving intensified acquisition of equity oil has faced serious skepticism the analysis by the international oil markets. The argument is that investments overseas are doubtful to protect the countries from the volatile nature of the oil market. The concern being that equity investment by India or China in far away producing fields of West Asia, Latin America or Africa is unlikely to procure energy security in their respective countries. This concern arises because they will have to ultimately pay the world market price, whether purchased on the open market, or produced by its national oil companies in foregone revenues if China were to ship every barrel of equity oil to its country. As a matter of fact, most of the oil that is currently produced by Chinese oil companies overseas is not shipped to China, but is sold on markets closer to production as per the industry press reports. By reason of the laws of demand and supply, any supply of oil in the world market will lead to an increase in global supply relative to its demand and will resultantly lead to a decline in prices. Similarly any increase in demand relative to supply will lead to an upward trend in oil prices. It is very doubtful that the NOCs will be able to meet the demand or insulate its economy though their acquisitions even if they go on with their acquisition strategy keeping in mind the impact of the global markets.

India and China are known to accept terms, that would mostly not be regarded commercially viable for the oil majors, in their hurry to stake claims around the world. Oil majors mostly base their investment criteria presuming a long-term average price of oil at between $20-30 per barrel.[39)] If oil continues selling for $50-60 per barrel the assets acquired may be beneficial, however if prices drop drastically, the result could be quite disastrous.

3.5. RENEWED THINKING

It is observed from the above discussion that doesn't have to play tug of war with China for acquisition of equity oil every time. The capability to forge long-term supply contracts is significantly important as much as is the capability to achieve energy security via discoveries within the country. Another truth is that the developing economy of India requires plenty of energy at the lowest price. But it is unreasonable

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39) *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's Energy Security*, visited on 23-02-2015

to state that pursuing alternative sources of energy is pointless based merely on the fact that oil is the most efficient and cheapest way to produce energy. Since worldwide oil production is reaching its peak, the production is only expected to fall from heron after. After all global oil production is reaching its peak; this is to say that production will only fall. Hence the only concern that remains is how to decrease the dependence on oil in circumstances where the oil prices are spiraling and the worldwide demand is projected to grow faster than the production capacity. The approach called 'power down' which is based on conservation, sharing and cooperation as well as aggressively developing alternative energy keeps tormenting us whenever any oil crisis erupts and it needs to be revived.

India-US agreement relating to civil nuclear cooperation, that also binds the Bush Administration to push its allies to allow India into the future-oriented nuclear ventures, it is fragment of a larger energy dialogue that offers oversight of not only oil & gas but also coal and renewable resources. Probably India is the only country which has a full-blown Ministry, i.e. Ministry of Non-conventional Energy Sources, which is dedicated to Renewable energy and this initiative need to be efficiently made stronger by way of commercialization driven by way of incentives. Shortly after Dr. Manmohan Singh's visit in July to Washington, India along with the United States, Australia, South Korea, and China agreed to the Asia-Pacific Partnership on Clean Development and Climate. The pact provides for using scientific innovation and technology transfers to decrease the carbon emissions, contrary to the mandatory targets of emissions of the Kyoto Protocol.[40] If complied with efficiently, this pact would act as a catalyst for converting the indigenous coal supplies into methanol, through proven clean development mechanism. Methanol is not only a high performance motor fuel but it can also be easily stored in tanks and transported by pipeline and tankers. Such initiatives will facilitate India, which is energy driven, to minimize the effect of fluctuations in global oil price and relatively free itself from being a captive to oil.

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[40] *Shebonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India s'Energy Security*, visited on 23-02-2015

CHAPTER 4

LEGAL DUE DILIGENCE

The New Exploration Licensing Policy (NELP) introduced by the Government of India (Government) in 1997-98 led to private sector participation in the exploration and production sector (E&P Sector). The succeeding NELP rounds (presently the Government is getting ready to roll out Round V) have worked towards establishing a more sophisticated fiscal and contractual regime. NELP has allowed private company participation in bid rounds independent of Oil and Natural Gas Corporation (ONGC, the Government's flagship upstream company) or Oil India Limited (OIL), as against the earlier regime, which required participation of ONGC/OIL. The NELP rounds have led to certain amounts of direct participation by foreign companies into the E&P Sector.

Under the NELP, the route to direct participation is: through engaging in the bid rounds, being awarded block(s) and entering into production sharing contracts with the Government. Our article focuses on one of the secondary entry strategies into the sector, i.e., investment through a Farm-in structure (we will use the term "Farm-in" as opposed to the term "sale-purchase" – which is also at times used to describe a farm-in/farm-out arrangement). The article reviews investment structuring and other major issues that may emerge in the exercise of a Farmin.

The chapter also analyses certain attendant matters, such as:

- issues to focus on in the legal due-diligence exercise;
- issues with regard to assignment of a production sharing contract (PSC); and
- issues regarding substitution into a joint operating agreement (JOA), which may ordinarily arise out of such an acquisition.
- Pursuant to a Farm-in, a company would acquire a participating interest in an existing PSC/block through a Farm-in agreement, which provides for such acquisition on flowing of the agreed upon consideration.

Ordinarily, the consideration would be structured in either of the following forms (or as a combination of these):

Cash consideration - Whereby the investing company agrees to pay, all or some of the following:

a) certain previous costs which have been incurred by the existing sellers or previous parties (carry payments);

b) agreeing to participate in on-going exploration, development and production activities;

c) pay a certain cash premium (or seek a discount) for participating in the transaction; or

Participation in the work programme – Whereby the investing company agrees to participate in fulfilling a particular work programme by offering to do certain of the activities required of the consortium members – such as conducting of the surveys, drilling of the appraisal wells etc.

Based on such consideration the investing company has right to participate in the underlying PSC/block. Once the investing company becomes a party to the PSC, then its obligations, depending on its participating percentage, are at par with the other participants of the PSC (subject to potential indemnities, exclusions or other limitations from the present participants/sellers).

The Farm-in process is of course led by the commercial agreement of the parties as to issues such as consideration (cash consideration and/or work programme participation), valuation and timing of making the agree payments (in case of the cash consideration route). These fundamentals when agreed upon can lead to the investing company deciding to participate in the underlying PSC/block. Often such commercial agreement is recorded in a term-sheet.

The steps which follow commercial agreement include:

a) agreement on the overall transaction structure;

b) due-diligence requirements; and negotiations in relation to the Farm-in agreement itself.

Often the transaction structuring and due-diligence exercises are undertaken in parallel.

As regards the transaction structuring following are considerations[41)] that may need to be addressed:

"agreement on the conditions precedent to the completion of the Farm-in (the most essential being the required Government approvals; "agreement on when the monies would flow from the investing company to the seller(s); "agreement on the timing of execution of documents i.e., the Farm-in agreement, the PSC and JOA addendums and any other deal specific documents such as off-take agreements; and "identification of

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[41)] John R. Baker, Richard M. Carson and Brandon M. Watson (2013), Top 10 Considerations for oil & Gas Asset Transfers, Gabel Gotwals Counsels termination events and remedies available to the investing company and other companies on such termination.

As regards the due-diligence exercise, as a first step, the investing company evaluates its due diligence requirements and then may conduct commercial, financial, environmental and legal-due diligence[42]. The legal due-diligence can be broadly classified into:

a) corporate due diligence: these are issues which the investing company may need comfort on as to its business counterpart(s) in the PSC (here due-diligence may be conducted on the seller of the participating interest, but more importantly on the other continuing partners in the PSC); and

b) specific PSC related issues which require review from a transaction specific perspective.

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[42] Joseph R. Dancy, John C. Harrison, *Environmental Issues Involved in Oil and Gas Acquisition and Divestitures* ,' Rocky Mountain Mineral Law Special Institute.

4.1 DUE DILIGENCE E&P SECTOR

- Ø Review the Production Sharing Contract (PSC) entered by the participants with the Government of India.

- Ø Check with the company/participant for compliance with the terms and conditions of the PSC including:

    - Operating Committee Resolutions
    - Management Committee Resolutions
    - Work Programme and Budgets

- Ø Ensure that the transaction (financing/farm in/farm out) does not trigger the "assignment provision" arising out of change in control provisions of the PSC.

- Ø Review the Joint Operating Agreement to determine: the rights and obligations of the participants determine the ROFO/ROFR provisions arising out of change of control/transfer of participating interest any other restrictive covenants.

- Ø Review the Petroleum Exploration License/Petroleum Mining Lease to determine any restrictive covenants.

- Ø Review the construction contracts for change in control provisions.

- Review the crude off take agreements/gas sale and purchase agreements for term and termination provision/quality/quantity/pricing and change in control provisions.

1.1.1 Due Diligence –Corporate

Standard corporate due diligence issues would include the following:

- Due incorporation/review of constitutional documents of the participating company(ies).
- Issues relating to any encumbrances, charges, liens or pledges created on the assets and shares of the company(ies).
- Control and participation issues arising from existing shareholder and share subscription/purchase agreements.
- Implications of restrictions (operational/corporate) specified in credit agreements, settlements or other agreements executed by the company(ies).
- Implications as regard labour and other human resource issues of the company(ies).
- Tax and PSC audit issues (which often involves using an accounting firm).

- Compliance issues in relation to applicable laws.
- Status check on licenses and permits required for the conduct of the business of the company(ies).

Detailed due-diligence questionnaires are often the norm, which are sent by the investing company to the company on which it wants to conduct due-diligence on (Target Company). Then, the Target Company may provide information and make available its personnel to answer queries. In larger more sophisticated transactions, the Target Company may establish a 'data-room' (containing information for the investing company to do due-diligence on) within the limitations of which the investing company will need to work. In the 'data-rooms', limitations as to time and number of personnel allowed, restrictions on photocopying and document removal are common. In either case, the investing company should always feel free to ask for any additional information, which it considers important for it to base its investment decision on.

1.1.2 Due Diligence – PSC Specific Issues

PSC related due diligence issues would, amongst others, include the following:

- Legal Status of PSC Parties – Details and status check (litigation matters, Government approvals) of all previous transfers or assignments of participating interests under the PSC.

- Work Programme Compliance – Compliance with the PSC provisions for the execution of the work programme and for the approval of the budget (including minimum work programme commitments).
- Financial Contributions – Compliance with funds contributions requirements.
- Taxes & Royalties – Whether all taxes, royalties, rentals, duties, etc. required to be paid under the PSC to the Government have been paid.
- Mining Lease – Status of the mining lease including details of exclusivity provisions.
- Relinquishments – Status and details of any areas relinquished under the PSC.
- Data Obligations – Check as to whether all information, data samples, etc which are required to be furnished under applicable laws have been duly furnished.
- Use of Equipment – Ownership/lease details of the equipment used by the present participants under the PSC. Also, details showing that all equipment is constructed, operated and maintained in accordance with internationally recognized standards.
- Petroleum Measurements – Whether standards for measurement of petroleum as laid down in the PSC are being followed.

- Environmental Matters – Whether the exploration, development and production activities are being carried out with due regard to environment protection and conservation of natural resources.[43)]

- Restoration & Abandonment Plans – Whether plans for the restoration, abandonment of the site have been prepared and submitted to the management committee under the PSC.

- Insurance Matters – Whether insurance coverage in relation to operations under the PSC for such amounts and against such risks as are customarily or prudently required in the international petroleum industry have been obtained and furnished to the Government. Further, whether such insurance policies include the Government as additional insured.

A detailed due-diligence on PSC matters often requires, technical teams, accountants and lawyers to work in close co-ordination to ensure that all relevant information has been gathered and analysed.[44)]

4.2 FARM-IN AGREEMENT

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43) Joseph R. Dancy, John C. Harrison, Environmental Issues Involved in Oil and Gas Acquisition and Divestitures ,' Rocky Mountain Mineral Law Special Institute.

44) Rising above the sub-optimal :Exploring ways to find energy solutions, by FICCI

Often in parallel with the due-diligence exercise the structure of the transaction is finalized. At this stage, one of the important issues is to identify the conditions precedent to consummation of the transaction (i.e., when monies flow, often called Closing or Completion).

Typically, these would include:

- government approval of the assignment;
- specific time periods for the Closing of the transaction (i.e., the drop-dead date when the parties need not wait anymore and have a right to walk away);
- undertakings in relation to representations/warranties made by the parties being true and correct as at the date of execution of the Farm-in agreement and at Closing; and
- receipt by parties of legal opinions certifying power and authority to execute and deliver the Farm-in agreement and associated assignment documents.

Another important issue faced at this juncture is what, if any, rights and obligations would be given to/undertaken by the investing company prior to transaction closing. For instance, does the investing company have the right to participate in the decision making process with regard to the exploration, development and production activities, and if so, will such right come with the obligation of advancing monies even before

Closing of the Farm-in transactions.

As regards the Farm-in agreement itself issues such:

a) the timing of payment of consideration;

b) the mechanism through which carry payments will be paid (escrow, currency, date of currency conversion etc.);

c) obligations of the parties during the interim period i.e. between signing and Closing (such as keeping the investing company informed);

d) liabilities of the parties under the Farm-in agreement and the limit of the indemnity to be provided by each party; and

e) representations/warranties to be obtained from the existing parties including in relation to the participating interest being free from any encumbrances, no material defaults existing, good and clear title to the contract area, subsistence of required permits and consents etc.

4.3 JOINT OPERATING AGREEMENTS ISSUES

The companies participating in the PSC ordinarily operate through an unincorporated joint venture structure. The parties to the PSC (except the Government) enter into a JOA. The objective of the JOA, is amongst other things, to appoint an operator

(Operator) for the block and determine the rights, obligations and immunities of such Operator in relation to the non-operators.

Additionally, the JOA provides for voting rights (suspension of voting rights), removal and reappointment of Operators, establishment and operation of the joint account etc. From a Farm-in perspective, once a Farm-in agreement is executed, the parties may want to execute the addendum to the JOA, or enter into a new JOA. Prior to the execution of the addendum to JOA, the investing company needs to review the provisions of the existing JOA to ensure that the JOA does not prove to be onerous on the investing company. Such review is particularly important when the counter-party to the Farm-in agreement is going to be the Operator of the block.

Such review can include the following issues:

- Conduct of Operator –The investing company needs o review the JOA so as to ensure that the Operator is required to conduct joint operations with due care especially in respect to the receipt, payment and accounting of funds. Actions of Operators should be in accordance with good and prudent practices as are generally followed by the international petroleum industry.

- Marketing Rights to Petroleum –in certain it is possible that the PSC does not specifically, or in reasonable detail, address issues as to the marketing rights to petroleum. In such cases the investing company should ensure that the JOA clearly addresses such issues.

- Indemnity Obligations and Liability of Operator – The investing company needs to carefully review the indemnity standard for the Operator, From the non-operators point such standard should provide for negligence (or gross negligence) and willful misconduct of personnel of the Operator (as opposed to negligence and misconduct only of Operator's 'senior management')

- Voting Rights &Thresholds under the JOA – The investing company needs to understand, and if required, amend the voting rights thresholds to provide itself effective rights (or be aware that it does not have such rights).

- Information Providing Obligation – Under the JOA, the Operator should be obliged to provide non-operators copies of data, reports, studies, contracts etc. (also a determination would be required it the flow of information needs to be on an on –going basis or on an 'on-request' basis of the non-operators).

- Suspension & Removal of Operator – The investing company needs to be comfortable with the Operator's suspension and removal related provisions including providing for suspension of financial rights, and interim operator continuation/appointment option.

- Default & Termination – The investing company needs to ensure that it is comfortable with the events of default under the JOA especially relating to cash calls, financial default etc. (which might lead to suspension of rights). Further the investing company needs to check that remedies are not Operator friendly, for instance rights to withdraw from the JOA on the occurrence and subsistence of a default should be equitable.

In addition to the certain other provisions of the JOA in relation to cash calls, manner of voting, withdrawal from the JOA, tax obligations and dispute resolution should be reviewed in detail[45)].

4.4. PROCEDURE FOR ASSIGNMENT OF A PSC

As the fundamental right which flows from the Farm-in arrangement is assignment into the PSC, in this section we briefly review the procedure for such an assignment. Into the PSC, in India typically provides for its assignment and each assignment is subject to the approval of the Government of India. The existing parties to the PSC and the investing company would be required to execute the following documents prior to submitting to the Government their application for approval of the assignment.

- Ø Farm-in/Farm-out agreement (which from the Government's perspective is the record of the commercial terms of the transaction).

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45) James R. Browne, Strasburger & Price, LLP & Dallas Texas, Tax Aspects of Acquisition and Disposition of Oil and Gas Properties

- Addendum to the PSC (which ordinarily is a sample document, which records the actual assignment of the PSC).
- Addendum to tht JOA (which might be a simple addendum in case of mere substitutuion, but depending on the parties may end-up being a new agreement).
- Deed of Assignment and Assumption (a deed to be executed by the existing parties and the investing party agreeing to the assignment).
- Deed of Indemnity (form the investing party to the Government, as this is an obligation of the contractor towards the Government, pursuant to the PSC).
- Deed of Undertaking (from the investing party to the Government, as this is an obligation of the contractor towards the Government, pursuant to the PSC).

Upon submission of the above document, the Government i.e., the Ministry of Petroleum and Natural Gas is expected to grant its approval to assignment. However, as a practical matter the Government, after being satisfied of the capability of the investing party may consider certain additional issues. Such issues can include detailed review of the plan for transportation/evacuation and monetization of the petroleum reserves. Affixing a time period for the actual Government approval process to be completed is difficult and is case specific, and there are cases where such process (including the back-and-forth on information requests/collection) has taken over a year.

4.5. CONCLUSION

In the context of the Indian E&P Sector different entry strategies for secondary investment exist. The Farm-in strategy is attractive for a couple of reason; firstly, it allows the investing company the opportunity to invest in the E&P Sector without going through the bid process. Secondly, it allows an investing company to participate in PSCs/blocks from which prospects of petroleum are potentially more promising (this is due to the fact that certain exploration, development activities may have already been undertaken, which essentially becomes the attraction for the investing company). However, such mitigation of risks comes at a monetary cost and the investing company may be paying a premium to Farm-in into such PSCs/block(s) (as opposed to participation pursuant to a bid round). An alternate to the Farm-in structure is equity investment in an exploration and production company itself (this is a corporate investment/acquisition). Through this alternate investment option the investing company acquires equity in an existing company holding participating interests in a particular PSC/block or a number of PSCs/blocks. This option would be more suitable from a pure investment point of view (or from a strategic point of view) for an investing company which does not intend to get involved in the actual operation of block(s). Overall, a Farm-in arrangement, being a common investment form in the liquid and dynamic world of the E&P Sector, is an investment option, which allows for easy entry (including not having to wait for a bid round) and relatively easier exit from a particular PSC/block.

CHAPTER 5

GOVERNMENT APPROVALS

The upstream Oil & Gas Sector in India is dominated by state-owned Public Sector Undertakings ("PSU"). Oil & Natural Gas Corporation (ONGC), is the lead player and accounts for almost 75% of the total national output. Oil & Natural Gas Corporation (ONGC) via its subsidiary ONGC Videsh Limited (OVL) makes acquisitions in upstream oil & gas assets overseas. In this sector, the inward investment has been mainly driven by the New Exploration Licensing Policy ("NELP") promulgated by Government of India that has facilitated the acquisition of oil and gas blocks and has alongside successfully attracted foreign investment [46)] and also facilitated entry of a significant number of private players in the Exploration & Production segment. PSU's have not been involved in any major overseas M&A activity, the behemoth state-run enterprises have been increasingly focusing on and in some cases intensively scouting for acquiring oil assets all around the World.[47)]

Total IX NELP rounds have been conducted till now, in order to attract further foreign investment in this sector. The Indian government is considering the Open Acreage Licensing Policy (OALP) under which year-round bidding would be achievable. But one of the hurdles is to agglomerate, prepare and manage a data depository for E&P

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46) http://petroleum.nic.in/nelp9.htm last visited 01-03-2015
47) H.Jayesh, M&A in Oil and Gas, last visited 10-03-2015

Companies to enable them to review the reliable data throughout the whole year. The Director General Hydrocarbons is in the course of developing the National Data Repository which will facilitate agglomeration of all of the appropriate data under one roof just like the data for minerals acreage for prospecting is accessible from the Geological Survey of India.

The ever increasing demand of the fossil fuel in the energy hungry world, primarily the developing nations like Korea, China and India has fueled the flow of private equity in this high risk sector. Indian O&G market has witnessed some major deals including the USD 8.6 billion acquisition of Cairn India by Vedanta group, the acquisition of the UK based BG Group owned Gujarat Gas Co. Ltd. by Gujarat State Petroleum Corporation for USD 442 million (approximately)[48)] and the USD 9 billion acquisition of Reliance Energy by British Petroleum.

5.1 FDI IN OIL AND GAS SECTOR

After the speech by Honorable finance minister Mr.Arun Jaitely which boosted the spirit of 100 percent allowance of FDI in Oil & Gas sector which includes several large funding projects such as oil and gas exploration, infrastructure development for marketing the oil and gas products i.e. downstream sector, building up the natural gas

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48) *Sherbonti Ray Dadwal and Uttam Kumar Sinha Equity Oil and India's'Energy Security*, last visited on 06-03-2015

pipelines, refineries construction , market study formulation , geographical survey etc. which forms the subject matter of sectorial policy in existence as well. The FDI capping in case of public sector undertaking have been kept at 49% for refining projects which needs to be approved by the FIPB and in case of private companies 100% FDI allowance subject to the sectoral policy.

5.2 MAJOR ISSUES & CHALLENGES

The political and regulatory system in India forms a major hurdle and raises major challenges for M&A activities in India and even after passing such challenge one major problem which still persists is the large capital requirement for such projects involving Oil & Gas related activities. Thus the M&A in oil and gas sector requires huge capital to be invested in order to acquire assets and thus it ultimately demarcates the need of private players to take resort to the foreign investment or foreign capital.

> *"The government of India through notification being issued by the ministry of finance has cleared its intent to have boost in the sector of oil and gas industry by allowing foreign direct investment up to 100%in the exploration activities excluding refining activities. The capping for foreign investment in the case of refining being*

undertaken by the Public sector undertaking it allowed up to 49% and that too without taking recourse to any dilution of domestic equity which is in existence under the FIPB route. [49)]

The major issue which ultimately craps the objectivity of company's aiming at higher returns for their investment in field of oil and gas industry is the requirement for government consent in case the company wants to enter into any arrangement of merger or acquisition as the Model Production Sharing contract itself contains a provision entailing the requirement of prior written consent of government in case the company wants to enter into any arrangement resulting in change in management and control of the company.

The Model PSC also provides for the factor to be taken into consideration while granting such consent. Some of those factors which clearly carve out the government intent of need of such prior consent are the technical and financial strength of the company, change in the Board of Directors, details pertaining to the shareholders agreement as a consequence of such transaction.

The Vedanta case clearly evidences that the M&A transactions are being delayed by the requirement of such consent by the government and forms a discouraging factor

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[49)49)] H.Jayesh, M&A in Oil and Gas, last visited 10-03-2015 for further investment in this field. Such delays even though not completely forms a discouraging factor but it ultimately adds up along with other factor to make it completely discouraging as even after getting such consent the exploration process still needs various clearances such as environmental, defense etc.

Also even though the bidding process have been completed under various NELP rounds but still the exploration activities will majorly be dependent on the efficiency of the administration which clearly depicts the need of early grant of approvals.

> *"Investment in oil and gas sectors involves both cases of finance the project finance as well as the corporate finance and these are huge funding s' and thus any arrangement in case of oil and gas be it merger or acquisition will ultimately require the permission of competition of India but the clearances relating to competition commission is obtained readily as in cases of Nelp acquisitions the company s' remain in their exploratory phase and thus their market share is undetermined and thus the impact which the arrangement is going to have on the market is considered as none."* [50)]

The reason for not being considered as a subject matter to the Competition Act is that the price caps of the product being made after exploration and other process is already

[50)] Report of the Working Group on Petroleum and Natural Gas for the 12th Five Year Plan fixed in the PSC which ultimately nulls the negotiating power between the companies to fix the prices.

As there has not been much instances of M&A activities in field of oil and gas sector therefore the government have not emphasized much on it but with the capping of FDI being moved upward to 100% it will increase the inward investment in this field and thus Indian Oil Companies need to have an open offer in order have investment being made by the foreign player. Further such transaction which will involve the fresh capital to be issued by the Indian Company will make it subject matter to the SAST regulation (Substantial Acquisition of Shares & Takeovers) Regulations governed by SEBI and also have to adhere to ICDR regulations (Issue of Capital & Disclosure Requirements).

M&A acts as an SPV (special purpose vehicle) in case of Oil And Gas industry as the Indian company needs investment capital to fulfill obligations under the contract thus requires funding which could be well done through foreign capital and thus such instances of M&A would ultimately become subject matter to provisions of FEMA Guidelines. But such transactions would be made subject to guidelines based on how the transaction is being crafted. As the transaction can be of either asset purchase directly, or can be of share purchase, or may involve cross border mergers in which a foreign company merges with Indian Company in that case section 394 of Companies Act will come into play. FEMA regulations have been enunciating various instances which have cleared its intent of boosting up outward investment in oil and gas industry in India and thus it further provide with supportive framework so as not to bring such actions within its purview.[51)]

Till now there have already been Nine Rounds of NELP in which oil and gas blocks have been allotted but the major proportion have been of the state owned companies and to a certain extent of private players but it had left a very little scope for foreign entity to invest in it. The mischief which raises concern to highlight this issue is that being a developing country and also not being rich in oil and gas production and exploration India in order to develop needs continuous flow of funds in order to ensure constant development of projects which are highly capital intensive specially the upstream projects which involves a lot of risk and also the offshore projects. Further the involvement of private players not only ensures funding in term s of money but it also ensures technology funding in the sense that if they work efficiently using latest technology then it will ultimately add up to their profit margin. Also the fiscal framework of our country is too complex and dynamic in nature which ultimately discourages foreign investment or eventually forces them to withdraw them from existing project.

Some of the major reasons which led to the drop off in production of crude oil are:

[51)] Report of the Working Group on Petroleum and Natural Gas for the 12th Five Year Plan

- Ø Problem of acquisition of land for building up infrastructure.
- Ø No single window clearance, each department have their own timeline for clearance which ultimately delays the process of approvals environmental clearance, pollution clearance etc.
- Ø Various socio cultural factors also come into play such as miscreant activities in the oil field.
- Ø Shutdown of refinery for prolonged period leading to huge loss in production due to upliftment problem.
- Ø Lack of labor with desired skills that have at least minimum level of expertise required for activities related to oil and gas industry.

a) Complex and dynamic nature of policies and regulations which govern the marketing and pricing of domestic gas acts a major barrier to the development of gas market in India. The dynamism involved in the process of amendments relating to policy can be very well highlighted by the Government of India stand on deregulation of petrol prices and then subsequently making it regulated after sometime.

This action made various private players suffering huge losses also they were not being made party to the subsidies which were being offered to the national oil companies. Thus the Government of India action is more towards fulfilling it obligations under social contract and not complying with the commitments under commercial contracts. Thus government should harmonize the interest of both the groups and underpin the lacunas involved in the process of policy making and make it at par with the global best practices.

b) The policies relating to marketing and pricing of gas sector in India have always been a subject matter of great criticism and have been a complex subject matter which has constrained the growth of gas sector. Constant dip in the supply of domestic gas has also gained attention towards ambiguity involved in the sector. Also slow developmental pace of infrastructure required keeping in pace the factors of demand and supply of gas has given a whole new face to the uncertainty involved in the gas sector in India. Also prioritization of allocation of focus to fertilizer and power sector has led LNG market not achieving its desired development pace.

c) Ministry of Coal, GoI (**"MoC"**) has awarded coal blocks to the operators, which have overlapping areas with CBM blocks. The overlapped area between coal and CBM operators is the cause of disputes since the oil & gas and CBM operations are under the administrative domain of MoPNG and MoC respectively and the grant of the licenses and activities of exploration, development and production of oil & gas and CBMs are governed by different set of regulations. While the oil & gas operations are under the domain of MoPNG and are governed by the relevant laws, namely, Oil Fields (Regulation

& Development) Act., 1948 and Petroleum & Natural Gas Rules, 1959 framed there under, which are also being administered by MoPNG, the coal operations are under the administrative control of the MoC and are governed by relevant laws like Mines Act 1952. Further, CBM and oil & gas operations are carried out under deferent contractual regimes within the existing CBM and NELP policies. CBM operations are carried out under the contractual regime, which envisages production linked payment to the GoI in addition to royalty and taxes. Whereas oil & gas operations are governed by production sharing contracts that provides for cost recovery, profit petroleum rshare to GoI in addition to royalty and taxes. At present it is therefore, not possible to conduct both the operations under a common contractual regime.

CHAPTER 6

CASE STUDY

6.1. CAIRN-VEDANTA DEAL

In August 2010 Vedanta Resources Plc ("Vedanta"), a company listed on the London Stock Exchange, announced it proposal to purchase 51% controlling stake in Cairn India ("Cairn India"), for a consideration of (reportedly) USD 9.6 billion. Cairn India is a subsidiary of Cairn Energy Plc, a listed entity in the United Kingdom, a leading player in the Indian oil and gas industry.[52)] The deal was structured to include a non-compete fee into the price of the shares of the promoters of Cairn India. One of the advantages on Cairn-Vedanta deal having been finalized prior to the Revised Takeover Regulations[53)] coming into force that the parties were able to retain the non-compete fee component incorporated into price of the promoter's shares, which is not permitted under the Revised Takeover Regulations. However, the conclusion of the deal was delayed, *inter alia, for the following reasons:*

a) Pursuant to, *inter alia*, the production sharing contracts between Cairn India and the Indian Government, which sets out the terms and conditions on which Cairn India would be permitted to conduct exploration of oil in the "Rajasthan Block", Cairn India was required to obtain consent of the Indian Government

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52) http://www.marketresearch.com/GlobalData-v3648/Cairn-Energy-PLC-Across-Oil-6490746/, last visited on 18-03-2015

53) Takeover Code, available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1316778211380.pdf, last visited on 12-02-2015

to effect a change in control of its ownership. The approvals from the Securities Exchange Board of India ("SEBI"), were also part of the government approvals required.[54)]

b) In terms of the *inter se* agreement between state-owned Oil and Natural Gas Corporation ("ONGC") and Cairn India ONGC had 30% participating interest under the "Rajasthan Block", while Cairn India had ownership of the remaining. Oil and Natural Gas Corporation had claimed that it had a pre-emptive right to purchase Cairn India's 70% interest, in the event of a change of control of Cairn India. Therefore, ONGC's waiver of this pre-emptive right was making royalty payments to the Indian Government not only in respect of its 30% rights in the Rajasthan Block but also in respect of Cairn India's 70% rights. After several months of deliberations, ONGC, in September 2011, finally agreed to waive its pre-emptive right, on the condition that Cairn India agrees to pay its share of the royalties and proportional taxes.

Since Vedanta announced its intention to acquire Cairn India in August 2010, it has taken the parties close to a year to obtain all requisite approval. Reportedly, on account of the delays and various approvals required in this acquisition, the deal value has now

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[54)] http://www.business-standard.com/content/researchpdf/cairn28071105.pdf, last visited on 07-01-2015 fallen by approximately USD 600 million. It is envisaged that the transaction will reach closure sometime this year. In rather striking contrast to the of the Cairn-Vedanta deal, the Competition Commission's maiden order under the new Combination Regulations was issued within 26 days of receiving the notification of transaction. Reliance Industrial Infrastructure Limited ("Reliance") acquired Bharti Group's (the "Bharti Group") 74% stake in each of two insurance companies, i.e., Bharti AXA Life Insurance Limited and Bharti AXA General Insurance Company Limited (the "Acquired Enterprises"). It was held by the Competition Commission that Reliance and the Bharti Group do not operate in interchangeable or substitutable products. Thus, there is no 'horizontal' overlap in the proposed combination. Competition Commission also did not find any important 'vertical' relationship in the proposed combination that could pose any competitive constraints in the business of general and life insurance. Taking into account the presence of numerous players in both the life and general insurance sectors and magnificent market share of each of the Acquired Enterprises, and having due regard to the factors to be taken into consideration in accordance with the Competition Act, 2002 (the "Competition Act"), the Competition Commission held that the proposed combination was not likely to have an 'appreciable adverse effect" on competition. The efficacy and promptness with which the Competition Commission has delivered its order has been well appreciated, and it is hoped that the Competition Commission will continue to deliver orders on the future transactions as promptly as it has in the Reliance- Bharti Group transactions.[55)]

M&A transactions involving acquisitions of private companies or public unlisted companies have had a relatively smoother ride. The issues in such transactions have typically hinged around:

a) Deferred Consideration and Valuation Issues: Indian law, i.e. the Foreign Exchange Management Act, 1999 (the "FEMA") does not permit the payment of 'deferred consideration' by foreign investors/ acquirers, i.i., the situations where the stake of Indian shareholders is sold to a foreign party, and the transaction consideration is staggered (structured usually as 'earn-outs') and payable subject to the achievement by the Indian shareholders of certain key milestonnes or merely a lapse of time.

Such deferred consideration is viewed by India's central bank, the Reserve Bank of India (the 'RBI'), as a 'credit facility', and is consequently not permitted under the existing law on the subject. Therefore, foreign acquirers are forced to stagger their acquisition over a period of few years. The price of each tranche of the acquisition cannot be determined upfront, but has to be determined in accordance with the existing pricing guidelines at the time of completion of the relevant tranche.

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55) http://articles.economictimes.indiatimes.com/keyword/cairn-energy/featured/4, last visited on 07-03-2015

In instances of a staggered acquisition by a foreign investor/acquirer, seller promoters have, typically, insisted on a floor prices or a base valuation for the next tranche of the acquisition to protect them from recessionary factors that could potentially affect the valuation of their shares, esspecially in the information technology and information technology-enabled services industries.

b) Operational Issues: The Operational flexibility in Mergers and Acquisition transactions where the promoters continue operating the company has given rise bit of concerns, especially on account of integration of past practices with new. Most often, these issues are resolved by having a detailed and flexible, operational matrix within which the promoters are required to operate.

c) Forum for Dispute Resolution: Foreign investors have been hesitant to submit to Indian laws on arbitration, particularly, since India is an unfamiliar turf, and the dispute resolution process is sluggish and not as effective as compared to the well-established processes in Singapore or London. However, with the London Court of International Arbitration establishing seat in New Delhi, India, this mindset of Foreign investors appears to be rapidly changing.[56)]

6.2. RELIANCE –BP DEAL

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56) http://www.scribd.com/firstpost/d/82949498-PDFOnline-1, last visited on 09-02-2015

Delivering one of the largest-ever foreign direct investments into India, Bharat Petroleum has completed its acquisition of a 30 per cent stake in 21 oil and gas production-sharing contracts[57)] operated by Reliance Industries Limited, the Mukesh Ambani- controlled private-sector conglomerate announced on Tuesday.

The London-headquartered gas and oil major will pay RIL an aggregate consideration of $ 7.2 billion subject to completion adjustments for the interests to be acquired in the 21 production-sharing contracts. Further performance payments of nearly $1.8 billion could be paid on the basis of exploration success that results in deelopment of commercial discoveries.

The deal shall help the companies begin the planned alliance, which will operate across the gas value chain in India - from E&P to distribution and marketing.

The two companies will also form a 50-50 joint venture for the sourcing and marketing of gas in India. This will speed up the creation of infrastructure for transporting, receiving and marketing natural gas.[58)]

Ambani stated that the alliance with BP would boost RIL's efforts to realize the

57) "BP and Reliance IndustiresAnnounce Transformational Partnership in India ", RIL, 21-02-2011

58) Report of the Working Group on Petroleum and Natural Gas for the 12th Five Year Plan

potential of hydrocarbon reserves of India. The worldwide renowned expertise of BP and the in-depth domestic experience of Reliance make for a formidable alliance which shall deliver unmatched value for the country in its efforts to attain energy security.

Chief executive of Bharat Petroleum group, Bob Dudley, stated that this major investment was directly aligned with the company's strategy of creating long-term value by forming alliances with strong national partners and to gain material positions in significant hydrocarbon basins and to increase the exposure to growing energy markets.

The twenty one oil and gas blocks cover 220,000 square kilometers approximately and lie in water depths that range from 400 to over 3,000m. They also include the KG D6 block that produces about 1.6 billion cubic feet of gas per day (bcf/d), over 40 per cent of India's total gas production.[59] Reliance India Ltd. will remain operator of the PSCs and Bharat Petroleum will utilize its global deepwater, sub-surface and gas expertise in order to enhance exploration and development of the blocks. At the time when the deal was originally announced, it covered 23 blocks as against the final deal of 21 blocks.

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59) "BP and Reliance Industires Announce Transformational Partnership in India," RIL, 21-02-2011

In February's announcement, there are ongoing discussions between RILd and the Indian Government with a decision expected at a later date pertaining to the remaining two blocks. Both companies at the time of the original announcement had labeled the deal as transformational partnership with worth of $20 billion in terms of the investments the deal will bring to the energy sector of India. The technology transfer into India's energy sector is one of the chief factors that Reliance hopes to achieve through this deal. The rationale of the deal from BP's perspective is the shift energy demand worldwide. It is expected that in the coming decades, two thirds of world energy consumption will be in emerging markets such as China and India. BP is a global energy company, and hence needs to take advantage of this growing opportunity.

Reliance Industries Limited and BP today announced a historic partnership between the two companies. Mr. Mukesh Ambani, Chairman and Managing Director of Reliance Industries Limited, and Mr. Robert Dudley, BP Group Chief Executive, signed the relationship framework and transactional agreements in London.

Across the full value chain, the partnership comprises BP taking a 30 per cent stake in 23 oil and gas production sharing contracts that Reliance operates in India, including the producing KG DG block, and the formation of a 50:50 JV between the two companies for the sourcing and marketing of gas in India. The JV between the two companies, for the sourcing and marketing of gas in India, shall also endeavor to speed up the creation of infrastructure for receiving, transporting and marketing of natural gas India.

Bharat Petroleum will pay Reliance Industries Limited a total consideration of US$7.2 billion, and completion adjustments, for the interests to be acquired in the 23 PSCs. Future performance payments of up to US$1.8 billion could be paid based on exploration success that ultimately results in development of commercial discoveries. These payments and combined investment could amount to US$20 billion.

Bharat petroleum's confidence in India is obvious from the fact that the transaction constitutes one of the largest FDIs into India. The concerned 23 oil and gas blocks together cover nearly 270,000 square kilometers,[60] making this partnership India's largest private sector holder of exploration acreage.

Hence, the joint venture can take advantage of Reliance's outstanding operations expertise and project management track record. Reliance will continue to be the operator under the PSCs, whose blocks lie in water depths varying from 400 to over 3,000 m. These currently produce nearly 1.8 billion cubic feet of gas per day (bcf/d),

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60) "BP and Reliance Industires Announce Transformational Partnership in India," RIL, 21-02-2011

over 30% of India's total consumption, and over 40% the total production of India.

RIL took only five months to secure an unconditional clearance for its $7.2-billiion deal with Bharat Petroleum, whereas the $9.6 billion Cairn-Vedanta deal is still hanging by a thread on a conditional clearance 10 months after the two companies had announced their tie-up.

Partly the reason lies in the very nature of the two deals. The chief difference between the RIL-BP and Cairn-Vedanta deals is that the former is a farm-out agreement and does not include transfer of control. On the other hand, the Cairn-Vedanta deal is a transaction between two London-listed companies and the money will not flow into India.

The Reliance-BP deal, on the contrary, will be the single-largest foreign direct investment (FDI) worth $7.2billiion in the petroleum sector.[61)] The $12billion FDI announcement made by Korean steel major POSCO in 2005 has failed to take off.[62)]

In the case of Cairn-Vedanta deal, Cairn Energy is transferring the control of its Indian Unit. The buyout will see the London-Listed mining group, which is led by NRI

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61) "BP and Reliance IndustiresAnnounce Transformational Partnership in India", RIL, 21-02-2011
62) "BP and Reliance IndustiresAnnounce Transformational Partnership in India", RIL, 21-02-2011

tycoon Anil Agarwal, take charge of operations with no any experience in the soil sector.

While in the RIL-BP deal, Reliance will continue to remain in charge of operations and retain majority stake. BP is also regarded as the work leader in the oil industry. Additional difference is that there is no third company to pre-empt the deal.

On the contrary, the Cairn-Vedanta deal saw a lot of opposition from government-owned ONGC that had a 30 per cent stake in Cairn India's mainstay Barmer block.

Avinash Chandra, the former director general of hydrocarbons, stated that the royalty issue has been the main reason for the delayed approval to the Cairn-Vedanta deal while there was no such complexity in the case of Reliance-BP deal.

At the beginning of this deal, ONGC and other companies under the administrative control of petroleum ministry also explored making a counter offer to the one made by Vedanta. However, it concluded that the deal would be extremely expensive.

As per the PSC signed by Cairn India and its partner ONGC for the Barmer field with the petroleum ministry, full royalty on production was to be paid by ONGC. Commercial production from the block commenced in August 2009 and ONGC started paying full royalty even though it had 30 per cent stake in the field and was entitled to

30 per cent share in output.

The view of ONGC was that royalty should be treated as 'cost-recoverable' and this was also endorsed by the government.

ONGC would have paid a royalty of Rs 18,000 crore for the complete life-cycle of the field. Whether Cairn and Vedanta will accept the condition or if the deal will reach its conclusion is something that their respective boards will have to divide.

Nevertheless, the approval given to RIL-BP will definitely brighten up prospects of more foreign investment in the energy space.

CONCLUSION

A significant increase in mergers and acquisitions in the oil and gas sector has been predicted for the year 2015, as a result of oil prices falling below $50 from Brent's $115 high late June. The enormous pressure on prices challenges cash flows so oil companies of all sizes need to have a clear and certain response to the situation - both short term and long term. Companies are expected to respond with mergers and acquisitions to reshape the competitive landscape to their benefit.

Mergers and acquisitions (M&A) in oil and gas (O&G) have shown a tough recovery in 2014 after a slow 2013 and keeping in mind the recent oil price decreases and the decision of OPEC's not to cut output, 2015 is expected to witness even more M&A activity across the value chain. These strategic deals will be vital to growing value, aiding and facilitating companies to navigate market turbulence.

Richard Forrest, global lead Partner for the Energy Practice and co-author of the Oil & Gas M&A study, A.T. Kearney stated that:

"Strategic approaches to M&A are crucial to address the extreme cost and cash-flow pressures that are experienced by Oil & Gas players. Our analysis and discussions with the industry executives revealed the likely onset of a new wave of mergers and acquisitions across the value chain in the next 6 to 12 months."

In his opinion the window of opportunity may be shorter than expected and will be driven by oil price expectations. The companies with strong cash flow and healthy balance sheets will be able to leverage opportunities, whereas others will need to define strategies in order to be able to survive.

Most players in the industry can receive benefit from a strategic approach to mergers and acquisitions, also including National Oil Companies (NOCs), International Oil Companies (IOCs), service sector businesses, financial investors and independent oil companies,.

The expectation is to see the largest M&A deal value as well as largest share of deals in the upstream segment, with noteworthy value increases in the midstream and among oil service providers. The companies across various sectors that best anticipate and prepare to take benefit of the volatile and fast moving market will be in a much stronger position than the others who are unable to do so.

In case of IOCs, optimizing portfolios will continue to be the focal point. Divestment of downstream and non-core assets could speed up to allow funding of targeted upstream activity and meeting cash flow needs throughout the year 2015. IOCs will favor selective acquisitions to build in their chosen areas. M&A activity for NOCs will be in line with the national agenda of the host government, which is often mostly influenced by near-term government agendas and domestic needs as much as by business and economic strategies.

The success of the independent oil companies in M&A will be determined by balance-sheet strength and varying levels of exposure to assets with elevated breakeven oil prices. The adventurous financial investors may take the opportunity to enter the market, although, the current margin squeeze sluggish demand and low oil prices, could suppress the appetite of some investors.

Oil service companies shall continue to be hit hard as operator margins are squeezed and alongside leaving an impact on service providers. There exists significant potential for consolidation and investors with capital to invest will continue to be active, also new entrants like large engineering companies may make strategic moves to enter the market.[63)]

The financial investors are expected to acquire in the oil-field services sector, downstream divestments by IOCs, and for those with confidence, some upstream assets beyond the traditional mature production.

The goal of this paper is to provide an understanding of the economic analysis of a transaction, in acquisition of oil and gas assets abroad, the risk elements involved, and an appropriate contract and due diligence process. It is our hope that this knowledge informs sellers, buyers and their counsel on methods to confirm their valuation assumptions and facilitates the efficient completion of transactions. Following this process does not mean that any transaction is without risk. The buyer necessarily assumes significant risks as we have described and in the current market, these risks are, if not always appropriate, at least voluntarily agreed to between buyers and sellers. Perhaps all parties to a transaction can accept a bad turn of events on risks they

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63) http://www.atkearney.com/news-media/news-releases/news-release/-/asset_publisher/00OIL7Jc67KL/content/id/5495555 visited on 07-03-2015

willingly and knowingly undertook.

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