OIL & GAS SECTOR – AN OVERVIEW

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INTRODUCTION

Oil and Gas sector in Pakistan has seen phenomenal growth since the independence in 1947 when oil quantities produced were scarce. At that time there was no gas production. Over the past half century the petroleum industry has played a significant role in national development by making large indigenous gas discoveries. With looming energy crises and the ongoing growing demand for oil and gas in Pakistan, the exploration and production of oil & gas, or upstream has garnered considerable interest from investors (both local and foreign).

This note attempts to encapsulate the evolution of the laws and regulatory framework governing the upstream sector and a high level summary of policy initiatives and regulatory and procedural measures taken by the Government from time to time. This note also briefly sets out the requirements for becoming a holder of a petroleum right in Pakistan either: (i) by making an application to the DGPC for grant of the right; or (ii) acquiring such right from an existing working interest owner / holder of petroleum right through an assignment.¹

We need not mention that the oil & gas industry is complex, extensively regulated and rapidly evolving to keep up with the global markets and initiatives. As such, the following is only intended to provide a high level summary and should not be construed as an exhaustive analysis of all regulatory/legal issues that will affect a potential investor. Accordingly, specific financial, legal and regulatory advice should be sought to ascertain and understand the applicable legal and fiscal regime before any investment decision is considered.

AN OVERVIEW OF LEGAL REGIME

The upstream activities in the oil and gas sector are administered and regulated through the Directorate General of Petroleum Concessions (DGPC) of the Policy Wing, Ministry of Petroleum and Natural Resources. Other regulatory bodies such as the Competition Commission of Pakistan and environmental agencies in specific set of circumstances can exercise jurisdiction in respect of transactions affecting the competition laws and environmental laws (as applicable). The Oil & Gas Regulatory Authority (OGRA) is a primary regulator for the midstream and downstream oil & gas industry and does not prima facie exercise regulatory control on the upstream sector. Be that as it may, in certain limited circumstances such as determination of wellhead prices, OGRA has exercised jurisdiction in the upstream sector. The potential regulatory overlap in such limited context is a complex area of law and subject to considerable legal debate.

The basic law that regulates the upstream sector is the Regulation of Mines and Oil Fields and Mineral Development (Government Control) Act, 1948 (the 1948 Act). The main purpose of the 1948 Act was to provide the basis for creating a legal framework for mineral development and production, and empower the Central and Provincial Governments to make rules in respect of various matters concerning mineral resources. The majority of the Rules governing the upstream petroleum sector have been made pursuant to section 2 of the 1948 Act. Though the 1948 Act provided that the power to make rules and regulations in respect of the petroleum sector would vest in the Central Government, it did not address the question of ownership of mineral resources including petroleum. This lacuna was filled by Presidential Order 1961 which provided that all minerals and rights...

¹ We have not considered the option of acquiring the shares of the E&P company for purposes of this note.
pertaining thereto shall stand acquired by and transferred to and shall vest in the Central Government, notwithstanding any law, custom, usage, agreement, decree or order to the contrary. It also provided that this acquisition of minerals by the Government shall be free from all encumbrances.

Prior to 1986, exploration for oil and gas and their production was governed by the Pakistan Petroleum (Production) Rules, 1949 (the 1949 Rules). These Rules were made pursuant to section 2 of the Regulation of Mines and Oilfields and Mineral Development (Federal Control) Act, 1948. Leases pursuant to these rules are known as “Oil Mining Leases”. The 1949 Rules continue to apply to the Oil Mining Leases that are still in subsistence.

Leases granted after 1986 are governed by the Pakistan Petroleum (Exploration and Production) Rules, 1986 (the 1986 Rules) also made pursuant to Section 2 of the Regulation of Mines and Oilfields and Mineral Development (Federal Control) Act, 1948. At times, leases formally executed after 1986 but relating to a pre-1986 discovery were executed as mining leases under the 1949 Rules. A lease granted under the 1986 Rules is known as “Development and Production Lease” 2. The 1986 Rules were replaced on 2001 by the Pakistan Petroleum (Exploration and Production) Rules, 2001 for onshore areas and in 2003 by the Pakistan Petroleum (Exploration and Production) Offshore Rules, 2003 for offshore areas. The 2001 Rules were replaced by the Pakistan Petroleum (Exploration and Production) Rules, 2009 and very recently the Pakistan Onshore Petroleum (Exploration and Production) Rules, 2013 3.

Pakistan’s oil & gas industry first captured interest of investors when the Exploration and Production Policy of 1991 was introduced. Through subsequent improvements in the policies of 1993, 1994, and 1997 Pakistan was generally regarded as an attractive location for upstream investment. Pakistan overhauled the policy in 2001 and accordingly introduced corresponding Rules in 2001 for onshore areas and in 2003 for offshore areas as discussed above. New policies revising the tax, fiscal and commercial regimes were issued from time to time. The last policy was revised in 2012 which has made several useful revisions to the tax and pricing regime from the position contemplated in the previous policy. A new Model PCA has also been issued incorporating changes in policy and reflecting changes in the Rules. It may be important to note that the regulatory regime provides option to the holder of the petroleum right to convert to a later policy and take advantage of the revised regime. Such conversion is subject to amendment of the underlying PCA (as approved by the Government) in order to make the same consistent with the new policy and the underlying Rules thereof. The requirements to exercise conversion option available under the policy framework are dealt with in the underlying policies and specific advice should be obtained prior to exercising the conversion option.

On account of a combination of factors such as improved returns on investment based on new fiscal incentives, transparent and open regulatory environments, induction of market reforms and technological advances, the Government expects a positive influence on the local upstream market and that forward momentum will be maintained. As per statistics published by the Ministry of Petroleum and Natural Resources, total 725 exploratory wells (since inception) have been drilled till December, 2008 (710 onshore and 15 offshore) in the sedimentary basins of Pakistan covering 827,268 sq. km. Upto December, 2008, 219 oil and gas fields (54 oil and 165 gas and gas/condensate) have been discovered in various basins of Pakistan. Despite vulnerable security conditions, Pakistan exploratory success compares favourably with other developing regions.

2 The 1986 Rules will continue to apply to licences or leases granted pursuant to their terms.
3 As published in the Ministry website. We have not presently verified this against official gazette notification.
It is generally understood that while a fiscal package with competitive incentives plays a vital role in also attracting fresh investment, an adequate protection of the companies’ investment is an essential prerequisite for promotion of petroleum exploration in the country. Foreign investors are generally permitted to acquire petroleum rights in Pakistan and undertake exploration activities. There are considerable protections available to foreign companies and foreign investments under the laws of Pakistan in particular, the Constitution of Pakistan, the Foreign Private Investment (Promotion and Protection) Act 1976 and the Protection of Economic Reforms Act 1992. These, to a large extent, address the investment protection concerns of the foreign investors in the upstream sector.

**ACQUISITION OF PETROLEUM RIGHT**

A foreign investor intending to acquire petroleum rights in Pakistan may either: (i) acquire same through issuance of a fresh license/permit or lease by the Government; or (ii) through assignment of working interest or petroleum right as approved by the Government (acting through the DGPC). The *modus operandi* relating to issuance of fresh license/permit or lease; or assignment of working interest is dealt with under the applicable Rules which may be applicable to a particular concession. In the context of onshore petroleum rights, although new Rules are promulgated from time to time, the legal regime has not been substantially amended from the position since 1986. Accordingly, for purposes of understanding the basic requirements governing the foregoing, we have considered the Pakistan Onshore Petroleum (Exploration and Production) Rules, 2013 which have been published in the Ministry of Petroleum and Natural Resources website.4

**APPLICATION FOR PETROLEUM RIGHT**

In terms of the 2013 Rules, any company may apply in accordance with these Rules for:

(a) a reconnaissance permit (the holder of a petroleum right shall have the non-exclusive right to undertake, within the designated areas, petroleum reconnaissance by such geophysical, geological, geo-chemical and geo-technical methods and such other related work including geological information bore-hole, as may be stipulated in the permit);

(b) an exploration licence (the licence gives a holder the exclusive right to undertake, within the licence area, all activities related to reconnaissance and exploration, including drilling for petroleum. The holder of the licence shall not be entitled to extract any petroleum from discoveries other than such test and early production as DGPC may allow provided that in no event, such test or early production shall cause loss of revenues to the Government or the Provincial Government);

(c) a development and production lease (upon commercial discovery and on the basis of development plan by the licensee);

Application for petroleum right may be submitted in accordance with the requirements stipulated along with specified fees either:

(a) at the initiative of the applicant, or
(b) on the basis of an invitation from DGPC to submit competitive bids which may be published in such national or foreign publications as DGPC may determine.

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4 We have not presently verified this against official gazette notification.
Generally DGPC will conclude and sign a Petroleum Concession Agreement (PCA) (in case onshore) or Production Sharing Agreement (PSA) (in case of offshore) on the model draft as issued with respect to a concession. Where the petroleum right is held by two or more companies, they shall be liable jointly and severally towards the Government for obligations and liabilities, resulting from their activities pursuant to the petroleum right. The companies shall, with the prior written approval of the DGPC, appoint an operator from amongst them, except that such special arrangements as to the operatorship shall be applicable as may be approved by the DGPC. No change in such appointment shall be made without DGPC’s prior approval.

**ASSIGNMENT OF A PETROLEUM RIGHT**

A petroleum right or any working interest therein is restricted to be assigned without the previous consent in writing of the Government. An application by a holder of a petroleum right for approval to the assignment of a petroleum right shall be made in writing addressed to DGPC, and shall be accompanied by the specified fee. With the application, the applicant shall furnish the like particulars in respect of the proposed assignee as are required to be furnished in the case of applicants for a petroleum right.

As a standard process, upon receipt of approval from the DGPC, the parties to the underlying concession (including the Government represented by DGPC) shall enter into a Deed of Assignment assigning the working interest to the assignee. The Deed of Assignment shall include provisions amending the joint operatorship agreement and relevant PCS/PSA as the case may be which shall only become effective upon execution by all the parties to the relevant concession.

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