

Would Lebanon be one of the richest producing countries in the Region?

By Lana Fayad¹

Mineral development is a high risk, long-term and large capital investment endeavor; as such it should form part of an overall legal and economic strategy. Regulation of the petroleum development in all its aspects and before starting exploration and exploitation activities is crucial for the protection of the national interests and natural resources in a country.

Experiences of oil producing countries show that there is always a challenge for the Host Government (HG) to strike a balance between attracting the International Oil Companies (IOCs) to their countries and efficiently regulating their activities.²

The Lebanese government as a HG worked thoroughly to build a strong legal regime to govern and regulate offshore hydrocarbon activities. With the Offshore Petroleum Resources Law (OPR), the Petroleum Activities Regulations (PAR) and the Lebanese Exploration and Production Agreement (EPA), Lebanon has taken major steps towards developing a reliable oil and gas sector in accordance with international standards. Whether Lebanon would be able to control its mineral resources and protect its national interests through these legal instruments, and how the Lebanese Government will maximize its revenues through the EPA are the real challenge.

The magnitude of the economic benefits for the Lebanese Government depends on the design of the best and proper profit sharing mechanism, especially that there is no universal or standard profit sharing formula; each country has to develop its own fiscal mechanism according to its specific geological, economic and political circumstances. Even in the same country, the HG may negotiate different fiscal terms for different geographical areas.

The cornerstone of the EPA's fiscal system is how it is structured to allow for **division of profits and recovery of costs**. As long as it is flexible, it should provide a more stable investment environment for both the IOC and the HG.³ In designing a petroleum fiscal mechanism, the main

¹ Partner with "Kouatly & Associates-Attorneys"; LLM with merit in Oil and Gas Law from Aberdeen-Scotland

² David Martyn, *Upstream oil and gas agreements with precedents* (Sweet and Maxwell 1996)

³ Daniel Johnston, *Petroleum Fiscal Systems and Production Sharing Contracts* (Penwell 1994)

objective of any HG should be to efficiently capture economic rent from their natural resources without undermining foreign investments⁴.

1-The Cost recovery parameter:

Usually, before sharing the profit oil between the Government and the IOCs, the Oil Company is entitled to a pre-specified share of production for recovering the exploration and production (EP) costs. Therefore, defining a limit for EP costs is a must, otherwise a HG cannot generate a high level of profits. In other words if cost recovery percentage is too high, a HG will end up with only a small share of the gross production. Moreover HGs shall be concerned that IOCs would waste the natural resources through EP costs and/or overbill such costs.⁵ The saving index is a measure that may be used by HGs to keep costs down. Regular approval and control of the budget through auditing is another way. Penalties for non-compliance with laws or for fraud may also be applied.⁶

Exploration and development costs in Lebanon are expected to be high as petroleum reserves in Lebanon are found in deep waters. Accordingly, IOCs will tend to offer a high level of cost recovery, arguing that high Exploration and development costs will increase their economic risks, but they are also willing to spend more as long as they expect to find huge fields.⁷ Areas previously regarded as too expensive or complex to explore or too politically unstable to justify operations, have become more economically viable given the expectations of high energy demand and advances in technologies.⁸ Even ultra-deep water drilling has become profitable; new innovative technologies, products and services have been developed and used to make substantial advancements in the most complex deep water fields.⁹

Consequently countries with huge reserves remain very attractive to the IOCs despite the high level of EP costs. Defining recoverable costs is also fundamental in the EPA. Environmental

⁴ Kirsten Bindemann, *Production-Sharing Agreements: An Economic Analysis* (Oxford Institute for Energy Studies, 1999)

⁵ Daniel Johnston, *International Exploration Economics, Risk and Contract Analysis* (Penwell 2003)

⁶ ibid

⁷ Mostafa Mabrouk,, "Oil exploration costs on the rise" 2013 Egypt oil and gas web portal

⁸ ibid

⁹ Halliburton, "Deepwater Exploration and Development" <http://www.halliburton.com/en-US/ps/solutions/deepwater/deepwater-exploration-development.page?node-id=h8cyv98m>

costs shall be properly addressed in the EPA and should not be considered recoverable costs as they may lead to major negative economic impacts on the Lebanese Government.

2-The Profit oil parameter:

This parameter plays the most important role in generating high or low level of revenues for HG. After recovering the EP costs, the remaining oil produced (called profit oil), is then shared between the Lebanese Government and the IOCs at a stipulated share. Production sliding scales are usually used for creating a flexible fiscal system; however they are unresponsive to fluctuation in oil prices. Therefore profit-sharing mechanism should be based on sliding scale tied to R-factor or ROR systems which usually increase the government's portion under higher oil prices as they contain a progressive profits-based fiscal element tied to profitability of the project, not only on production sliding scale.¹⁰ As for the portion of the HG's share of profit, it is mainly determined by the characteristics of the field and the size of the recoverable reserves. The investment decision by IOCs is influenced by the geological features of a field as water depth, proven or unproven reserves. Part of a well-balanced EPA involves matching the split of profits to the prospects of an area. Some of them are geologically rich to justify the high rate of government share.¹¹ This should be the case in Lebanon which has huge reserves of gas: preliminary surveys of the Lebanese offshore fields show that reserves in 45% of the Lebanese waters has reached 95.9 trillion cubic feet of natural gas.¹² Lebanon's oil reserves of its southern coast are of the richest and best in the region, as the British spectrum company has unveiled in 2012.¹³

Would Lebanon be one of the richest producing countries in the region? Many political, economic, legal and technical factors will determine the future of the sector.

¹⁰ Johnston (n 3)

¹¹ Johnston (n 5)

¹² Laila Bassam, "Gas, oil reserves may be higher than thought" (2013) The Daily Star
<http://www.dailystar.com.lb/Business/Lebanon/2013/Oct-28/235951-gas-oil-reserves-may-be-higher-than-thought.ashx#ixzz2wAnDfifX>

¹³ Caroline Anning, 'In Lebanon, officials talk of a bright future funded by offshore oil and gas reserves'

(2013) Washington Post