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Saurabh Chandra (http://www.infracircle.in/author/saurabhchandra/) | infra@vccircle.com (mailto:infra@vccircle.com)

Forthcoming auction of discovered small fields: sense of deja vu

OVL also plans to acquire another 11% stake in Russia's second-largest field by production. Photo by ONGC.

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Come 25 May 2016, the government will start the process of auctioning 67 discovered small fields organized into 46 clusters. Given on nomination basis to national oil companies (NOCs), Oil and Natural Gas Corp. Ltd (ONGC) and Oil India Ltd, these fields could not be monetized for years due to various reasons such as isolated locations, small size, prohibitive development costs, technological constraints, unfavourable fiscal regime, among others.

Flashback to 1991

Reforms were the flavor of the season. Liberalisation was in the air. Accordingly, petroleum sector reforms (PSRs) were also initiated. Exploration blocks put under the hammer during 1980s had not evinced any interest from private investors. The next port of call was small- and medium-sized discovered fields. Twenty-eight such fields were bid out to private investors, both domestic and foreign, between 1991 and 1993. The bid objectives have been more than achieved. 'State of the art' technology for exploration, development and production rode on foreign direct investment, which also catalysed domestic investment into this sector. Oil and gas produced is far in excess of prognosticated reserves. Investors have made handsome returns. For example, Panna-Mukta-Tapti has garnered in excess of $11 billion as profit for investors (share of ONGC, Reliance Industries Ltd and British Gas being 40%, 30% and 30%, respectively), with the government's share of profit being more than $1.3 billion. However, implementation of the contracts signed for these fields have not been without controversies, litigations and arbitrations. Their roots lay in the contract model itself which resulted in disputes pertaining to capping of cost recovery limit, calculation of post-tax investment multiple, scope of Controller and Auditor General of India audit, computation of the cost of unfinished work programme, procurement controversies and issues relating to royalty, cess and service tax.

Fast forward to 2016

Mark Twain is believed to have remarked that 'history does not repeat itself but it rhymes'. After a five-year period (2009-2014) during which oil prices reigned high, a combination of geopolitics and geoeconomics pulled the prices down to sub-$30 per barrel levels, before they started climbing again. Worldwide, exploration, development and production budgetary outlays have been chopped. The silver lining, however, is that costs have fallen in tandem.

Like 1991, attracting private investment is an imperative. Based on the earlier experience, inviting bids for monetisation of the languishing reserves of discovered small fields of NOCs could be a good starting point. Though discovered fields are relatively lower on the risk scale, the reward part of the risk-reward matrix had to be tweaked to enhance perceptions regarding their commercial viability.

Navigating through complex business procedures is a nightmare for investors. A revenue sharing model demystifies the complex procedures intrinsic to a profit sharing post-cost recovery model, that is the production sharing contract. Demystification lowers costs. A single licence to explore both conventional and unconventional hydrocarbons is an efficient way of going about this business. Availability of the entire lease period for exploration activities is necessary for improving the recovery ratio. The grant of freedom to price and market natural gas, besides crude oil, addresses a long-standing demand and fulfils a promise made in the New Exploration Licensing Policy resolution of 10 February 1999. No carried interest, no cess and custom duty on imported capital goods and provision for graded rates of royalty for production from onshore, offshore and deepwater fields, adds to the attractiveness of the fiscal package.

However, to attract enough competitive bids, significant challenges remain to be addressed. Not the least being the prevailing sectoral investment sentiment. In this context, advantage has to be taken of the peculiar mindset of oil entrepreneurs. A particularly intrepid lot, they are conditioned to working under conditions of uncertainty. A discerning observer will not fail to notice the historical fluctuations in crude oil prices. If 1973 and 1979-1980 saw highs, prices crashed in 1986 and 1998. In 2008, prices fluctuated between $3 per barrel and $145 per barrel. Most forecasters are of the view that prices for crude oil will stabilize at higher levels on account of supply-demand rebalancing. The bigger challenge is projecting prices of natural gas. There is no global price of natural gas. Hitherto, producers had the comfort of formula-based prices linked to prices of fuel oil, crude oil, etc. Price projections in imperfect market conditions, where gas-on-gas competition is still in the realms of discussion, will test the most complicated models of econometrics.

Simultaneously, a number of issues are required to be tackled administratively. Doubts about information asymmetry have to be assuaged. The possibility of NOCs bidding for some of the clusters offered under this policy cannot be ruled out. Hence, the perception that NOCs will be in an advantageous position, because they have better or more information, will have to be changed by putting all available information in the public domain. Stability of the fiscal regime has to be assured. The quantum of the signature bonus, which will influence bidding behaviour should not dampen investor sentiment.

People are willing to accept an unpleasant outcome, if they believe that the process to arrive at that outcome was fair and transparent. This has to be ensured while devising the criteria and procedures for bid evaluation, measurement and sale of petroleum, audit of production and revenue, etc.

The policy regime has progressed significantly, since discovered fields were first offered for private participation.

This needs to be supplemented by administrative measures to attract sufficient number of technology-endowed companies, essential for achieving the envisaged outcomes. Oil will be found as long as there is a belief that it would be found, and the right policies, technologies and markets are in place.