

# Clearing the waters: The Upstream Petroleum Resources Development Bill

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12 Jul 2021

Just over two years ago, Total made a major gas concentrate discovery in the Outeniqua Basin (Brulpadda prospect, Block 11B/12B) offshore South Africa - a deposit reportedly containing around one billion barrels of oil equivalent.



Source: Africa Energy Corp

Seemingly in response to the first discovery, on Christmas eve, 2019, the minister of mineral resources and energy published the Draft Upstream Petroleum Resources Development Bill seeking to ensure that the upstream petroleum sector is no longer regulated under the Mineral and Petroleum Resources Development Act, 2002 (MPRDA), but under discrete petroleum legislation.

The 2019 Bill has since been overhauled. On 1 July 2021, the revised Upstream Petroleum Resources Development Bill was introduced to Parliament.

This Bill is a significant improvement on its predecessor.

The regulatory framework created under the new Bill is promising and brings an additional degree of regulatory certainty – and, hopefully, investor confidence – to a sector which has been in a holding pattern for many years.

Despite these improvements, certain aspects of the 2021 Bill remain problematic. Fortunately, the Bill must still undergo an extensive Parliamentary process (including a national public participation process) which will afford the public (and the industry) an opportunity to voice their concerns and Parliament the opportunity to make further improvements.

## Key differences between the two Bills

### 1. Structure and administration

The structure of the 2021 Bill follows a more organised and systematic approach under which the application, grant and duration of reconnaissance permits, retention permits and petroleum rights, as well as the rights and obligations accruing to the holders of such rights, are set out in separate provisions. This is an improvement on the 2019 Bill which included such processes in a single provision, making it difficult to follow.

Moreover, all fiscal provisions have now been removed from the 2019 Bill. This is an important change since, constitutionally, fiscal matters fall under the responsibility and domain of South Africa's National Treasury and outside the jurisdiction of the Department of Mineral Resources and Energy.

## **2. Principal rights, permits and approvals**

The 2021 Bill provides that it will govern the following rights, permits and approvals:

- a reconnaissance permit (clauses 38 to 42);
- a petroleum right, comprising exploration and production phases (clauses 43 to 45 and clauses 49 and 50);
- approval to progress to the exploration phase (clauses 46 to 48);
- a drilling permit (clause 52);
- approval to progress to the production phase (clauses 58 to 60); and
- a retention permit (clauses 69 to 75).

## **3. State's carried interest**

The state's carried interest in a petroleum right, through the State Petroleum Company (SPC), remains at 20%, as provided for in the 2019 Bill. This will come as a disappointment to many in the industry who were expecting a reduced level of state participation, which is high by regional standards.

Different from the mechanism provided under the 2019 Bill, the new Bill confirms that the holder may recover the State's share of expenses from the State's proportionate share of production or revenue. These expenses include 50 per cent of the exploration costs and 100% of the production costs. More detailed cost recovery rules may be set out in subsequent regulations, as well as in the terms and conditions of the petroleum right itself.

Furthermore, the ambiguity surrounding the structure of the state's participation – resulting from the 2019 Bill interchangeably referring to PetroSA (the then state petroleum company) being a party to a shareholders agreement and to a joint operating agreement (JOA) – is now removed. The 2021 Bill provides that the SPC must conclude a JOA with the petroleum right holder, or become a party to an existing JOA, and appoint a minimum of two representatives to the joint operating committee to represent the state. The SPC's participation will therefore be held directly at the level of the petroleum right through a JOA.

## **4. Strategic stock obligations**

The 2021 Bill mandates petroleum right holders to sell a percentage of petroleum at the prevailing market price to the SPC to meet the State's strategic stock requirements. The percentage of petroleum to be sold will be determined by the SPC, and the terms and conditions, including the determination of the prevailing market price, must be agreed upon between the SPC and the right holder.

## **5. Exit and dilution of black persons' participation in petroleum rights**

As was the case with the 2019 Bill, the 2021 Bill provides that every petroleum right must have a minimum of 10% undivided participating interest by black persons.

The 2021 Bill provides that this participation by black persons may be diluted to no less than 5% for the purposes of raising capital. Such dilution will not trigger a requirement for the petroleum right holder to augment black persons' participation to 10%.

The 2021 Bill retains the minister's ability to reserve block(s) for black persons, but now allows such persons' participating interest in respect of such blocks to be diluted to no less than 3% in aid of capital raising. Under the old Bill, a dilution of black persons' participation below 51% triggered state-carried participation.

Black persons may exit from a petroleum right and the empowerment credentials of that specific petroleum right will be recognised for the duration of such right, provided that:

- (a) black persons have held an undivided participating interest for a minimum period equivalent to one third of the duration of the initial term of the production phase of that petroleum right;
- (b) at least 50% net value has vested in black persons;
- (c) an agreement detailing exit mechanisms and black persons' financial obligations is submitted to the Petroleum Agency; and
- (d) the recognition of empowerment credentials may not be claimed or recognised for other petroleum rights or future petroleum right applications.

## **6. Minimum work commitments and annual plans**

The 2021 Bill requires that petroleum rights must include a clause outlining a minimum work commitment, together with a corresponding minimum expenditure amount to be met by the petroleum right holder during the exploration phase or production phase. This must be accompanied by an annual work plan and corresponding budget.

Unusually, the notion of 'minimum work commitments' is extended beyond the exploration phase to the production phase as well. Ordinarily, such minimum work obligations are linked to the right to continue holding the exploration rights to the area, while oversight during production would normally be maintained through the submission of annual work programmes.

Failure to comply with minimum work commitments constitutes a breach of the terms and conditions of the petroleum right which may result in a fine or imprisonment. This is also unusual, as, ordinarily, a failure to comply with minimum work obligations would be sanctioned by payment of a penalty (for example, equivalent to the minimum expenditure obligation).

## **7. Transfer restrictions**

The 2021 Bill lightens the burden which the 2019 Bill placed on companies wishing to transfer and/or encumber a petroleum right. Listed companies are no longer subject to this provision, and the minister's written consent is only required for the transfer or encumbrance of a controlling interest in an unlisted company.

The reference to controlling interest has given rise to much controversy under section 11 of the MPRDA (the provision on which the wording of the clause under the 2021 Bill is largely based). Fortunately, the 2021 Bill includes a definition of controlling interest providing that it is "the majority of the voting rights attaching to all the classes of shares in a company or, where the holder is not a company, any interest that enables the holder to exercise directly or indirectly any control over the activities of the assets of the business or the petroleum right.

## 8. Postponement of the development of a petroleum field

The Petroleum Agency "may, having regard to national interests, after consultation with the minister and the holder, postpone the development of a petroleum field". The term of the production phase under the relevant petroleum right will be extended for the period of such postponement. The petroleum right holder is obliged to lodge an amendment to the petroleum right (relating to the extended term) with the Mineral and Petroleum Titles Registration Office.

Such a right to postpone development is somewhat unusual; it is not clear what factors or issues would be considered under "national interests". However, the impact of this provision is mitigated by the consultation obligation and the fact that the term of the petroleum right is extended for the period of such postponement.

## 9. Third party access to upstream petroleum infrastructure

A newly inserted clause 68 of the 2021 Bill governs third party access to upstream petroleum infrastructure. It provides that, if warranted by considerations of efficient operation and resource management, the Petroleum Agency may direct that a third party use upstream petroleum facilities which are owned by a petroleum right holder, provided that:

- (a) their use would not unreasonably interfere with the usage requirements of the holder; and
- (b) will not result in the reduction of production levels or disruption of the satisfactory progress of petroleum operations by the holder.

The Petroleum Agency is required to first consult with the affected petroleum right holder before making such a decision.

## 10. Exploration and production periods

Petroleum rights during the exploration phase are valid for nine years in shallow waters and 14 years in deep waters. Petroleum rights during the production phase, in turn, are valid for an initial period of 30 years and are subsequently extendable for further terms of 10 years each.

## 11. Transitional provisions

The 2021 Bill provides clear transitional provisions for existing right holders in comparison with the old Bill.

The grandfathering provisions allow for any reconnaissance permits, exploration rights (for the exploration and production phases), production rights, social and labour plans, permissions to remove and dispose, and technical co-operation permits in force immediately prior to the promulgation of the 2021 Bill to remain in force until their expiry.

Under the 2021 Bill, pending applications lodged in terms of the MPRDA, but not finalised before the 2021 Bill takes effect, must be finalised in accordance with the mechanism set out under the MPRDA. This clarifies the uncertainty ensuing from the 2019 Bill as to whether an applicant is required to supplement a previously lodged application in order to comply with obligations set out in the 2021 Bill that were otherwise inapplicable under the MPRDA.

## Moving forward

Once production commences, the Brulpadda and Luiperd deposits have the potential to generate substantial benefits for South Africa.

The Luiperd drilling campaign alone employed 195 South African professionals during its first four months from August 2020 to November 2020, and is expected to generate R1.5bn for the domestic economy through expenditure on training, housing, as well as logistics services to and from the oil rig.

The Brulpadda and Luiperd discoveries together would replenish gas supply at Mossel Bay's gas-to-liquid refinery, Moss gas – on the brink of running out of gas – which could supply 8% of the crude oil which South Africa currently imports; imports which cost the economy approximately R200bn per year.



## Second significant gas discovery in SA waters

29 Oct 2020



To accelerate Total's route to commercialisation, the natural gas infrastructure supplying Moss gas would be required to be converted into a large, natural gas-fired power station, rather than a peaking plant using diesel at four times the cost, which would result in R20bn worth of imports per year being substituted by domestic supply.

This increase in economic activity will, in turn, generate increased fiscal revenue for the country as a result of corporate tax and royalties imposed on profits from production.

From a socioeconomic perspective, the benefits include: a progressive development in South Africa's green energy transition as gas-to-power plants emit 60% less carbon dioxide than fossil fuels, as well as greater employment opportunities relating to oil refining, downstream activities and ancillary business.

The 2021 Bill clarifies a number of the unclear or ambiguous provisions from the 2019 Bill and sets a generally sound and bespoke legislative framework for the upstream oil and gas sector in South Africa. Industry participants can hope that regulation of the upstream petroleum sector will become a key regulatory focus, given the country's historical focus on mining in the extractives sector.

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