

Policy Issues for Streamlining the Working of Production Sharing Contracts

Background

Government has recently taken a number of major policy initiatives to boost the Petroleum and Hydrocarbon Sector, such as the Discovered Small Fields Policy 2015, Hydrocarbon Exploration Licensing Policy (HELP) and open acreage policy. These forward looking policies have addressed a number of issues which the sector faced in the earlier dispensations under Pre-NELP and NELP PSCs and have laid down a new, path breaking, progressive policy framework in line with the Government's Ease of Doing Business Initiative.

As regards the Production Sharing Contracts signed under the pre-NELP and NELP regimes which are currently active, Government has laid down a number of policy guidelines, from time to time, for grant of extension of exploration phases under Pre-NELP and NELP PSCs, policy guidelines for working out amount of unfinished minimum work programmes, etc. However, there are a few surviving issues relating to pre-NELP and NELP PSCs which require to be addressed by the adoption of appropriate policy guidelines in order to lay down a clear and transparent roadmap for handling issues arising under these PSCs and ensure the Government objective for expeditious development of the hydrocarbon resources of the country.

The following paragraphs of this paper seek to discuss some of the major issues afflicting progress of operations under the pre-NELP and NELP PSCs and propose policy prescriptions which may be considered for adoption by the Government.

Issue No. 1: Issue related to Cess and Royalty in the Pre-NELP blocks

There are seven Pre-NELP blocks, namely, CB-OS/2, CB-ON/2, CB-ON/3, CB-ON/7, CY-OS-90/1 (PY-3), RJ-ON/6 and RJ-ON-90/1 wherein ONGC has been designated as Licensee and the Licensee has been authorized to carry out E&P operations "in association with other companies". Under these PSCs, the companies are exempted from payment of royalty and / or cess and under PNG Rules, 1959 it is the Licensee who is liable for payment of the taxes on entire production of oil and gas from the Contract Area, including on the share of other JV partners. These payments made by the Licensee are not recovered as Contract Costs except in RJ-ON-90/1 wherein the constituents of Contractor agreed separately to share the Royalty and Cess and recover them as Contract Costs.

In most of these PSCs which are in production stage now, ONGC has found that the liability to pay cess and royalty by the Licensee of the block (ONGC) on the entire production makes the block economically unviable for the Licensee. As a result of this, it has been observed that the Licensee (ONGC) has no incentive for encouraging further E&P activities in such blocks. This results in a situation where E&P activities are not progressing further in those areas.

In the similar case of RJ-ON-90/1 block, during the transfer of ownership from M/s Cairn PLC to M/s Vedanta, an agreement was reached between ONGC and M/s Vedanta to share Royalty and other taxes between Licensee and Companies and the amount is recovered as part of Contract Cost.

In subsequent NELP PSCs all the constituents of Contractor are liable for statutory liabilities in proportion to their PI because they have themselves become Licensees.

Recommendation:

Under the above circumstances, the following dispensation is proposed to enable petroleum operations in these (PRE-NELP) contract areas.

Approval may be granted as under:

In pre-NELP blocks wherein ONGC is liable to pay Cess, Royalty and other charges to Government on the entire production irrespective of its Participating Interest and ONGC expresses economic unviability in respect of any development operation in the block, the Companies constituting the Contractor may agree to share the liability of Royalty, Cess and other charges in proportion to their respective Participating Interests in the block. In such event the Government will agree to allow the recovery of such payments as Contract Costs. ONGC will exit the Contract and all remaining constituents of Contractor will become licensee. The Contract shall be amended accordingly.

Issue No. 2: Exemption of LD if MC approved wells spud before expiry of Exploration Period / extended period and completed subsequently

Extant Extension Policy provides for extension of the exploration phases to accomplish exploration Work Programme committed in the PSC. There may be cases where drilling of well continues beyond the exploration period / extended exploration period though well spudded within the permitted period, in some of which discoveries may exist. In spite of this, such cases may get treated as non-completion of MWP leading to computation / demand for amount of unfinished work programme.

In the absence of clear PSC provision / guidelines, hydrocarbon discoveries may remain struck without monetization and the Contractor would also face hardship of the liability of unfinished work programme though work programme is completed albeit with some delay. In order to ensure that in genuine cases where the wells have been spud before the expiry of the exploration phase but the drilling continued beyond the date of expiry of phase, it is necessary to provide appropriate relief as the contractor has not given up the MWP mandated work even after expiry of the exploration period/ extensions.

Recommendation:

Accordingly, it is proposed to approve that:

- a) *Wells committed under MWP / additional wells approved by the Management Committee which have been spud on or before the date of expiry of the exploration or extended exploration period but the drilling of such wells is completed within 6 months after expiry of the said period will be accepted as completed within the specified time.*
- b) *This relaxation is applicable for all existing and past unsettled cases where Ministry has not determined / approved the cost and for any similar cases which may arise in future and will be applicable for all the exploration wells, whether dry or not.*
- c) *Already settled cases shall not be re-opened.*

Issue No. 3: Government Take as a basis of evaluation of development plan and annual work program & budget

C&AG, in Para 8.4.1 of its Report entitled “Performance Audit of Hydrocarbon Production Sharing Contract” (Report No. 19 of 2011-12), inter alia, recommended that the review and approval of Development Plans and of annual work programmes and budgets should also include an appraisal of the relevant plan / programme / budget from the point of view of Government’s Take, i.e., with reference to projected Royalties, Government Share of Profit Petroleum, etc.

Prior to any development operations, the Management Committee approves a long term Development Plan based on a detailed proposal from the Contractor for the construction, establishment and operation of all facilities and services for and incidental to the recovery, storage and transportation of the Petroleum from the proposed Development Area to the Delivery Point together with all data and supporting information (Article 10.7) with the objective of enhancing production. The provisions of Article 10.7 comprehensively cover all the obligations of the contractor as regards information to be included in the development plan.

As per PSC, the Contractor is required to submit to the Management Committee the Work Programmes and the budgets relating to petroleum operations to be carried out during the relevant year, within ninety (90) days before commencement of each following year (Article 5.9). Work Programmes and Budgets and, any modifications or revisions thereto relating to Exploration/ Development & Production Operations are to be submitted to the Management Committee for review /approval. The Contractor, as part of Work Programme and Budget does not give projection of Profit Petroleum and IM for future years.

There is no stipulation in the PSC that the Work Programme and Budget and FDP are to be approved with reference to Government Take. Hence, such condition cannot be enforced post award of contract.

FDPs are approved for a long time period that may extend beyond 10 years. Prices of Petroleum vary widely impacting profit petroleum and Investment Multiple (IM) in either direction. The Profit Petroleum and IM cannot be reliably predicted in view of changing economic conditions. The approvals granted by the Management Committee under PSC therefore cannot be based on Profit Petroleum. Royalty to Government always increases with more production.

Furtherance of E & P activity by undertaking additional exploration and associated work programme and budget may sometimes lead to a trade-off between the Profit Petroleum share of Government and increasing domestic production of oil and gas by undertaking more exploration and development. More production is in the interest of nation and energy security.

Recommendation:

The mechanism of determining Government take by way of profit petroleum has been fixed through bidding process, apart from the statutory Royalty. No fresh condition as to Govt take can therefore be stipulated on existing contracts. Therefore, the following approval is proposed:

The decisions on development plans and on WP&B shall continue to be on the basis of maximisation of production and proper addressing of Health, Safety & Environment (HSE) issues, without any new stipulation in respect of Government Take.

Issue No. 4: Allow entry to next phase pending resolution on amount payable for Unfinished MWP against furnishing Bank Guarantee for differential amount

Where contractors indent to move to the next phase without completing the committed Minimum Work Program (MWP) for the block, the policy guidelines of 10th November, 2014 allows the contractor to do so provided the contractor pays the amount in respect of the unfinished MWP. As per PSC, the contractor is liable to compute and pay the amount of unfinished MWP withing 60 days of expiry of the exploration phase. The amount so computed by the contractor, and in the absence of any such computation appropriate amount is validated / computed by DGH and approved by MOP&NG.

Cases arise wherein there is dispute between the Contractor and the Government on the amount payable by the contractor. In the event those contractors indent to enter into next phase of exploration, because of the dispute, the activities in the block may not progress. A policy in this regard needs to be adopted in the interest of continuation of E&P activities in the block seamlessly. In order to ensure seamless progress of E&P activities in the block notwithstanding any dispute on the quantification of the cost of unfinished work programme, it is proposed to approve the following.

Recommendation:

It is proposed to approve that -

- a) *the contractor is allowed to enter into the subsequent phase on submission of a Bank Guarantee for the differential amount of the amount of unfinished work as determined by Government, i.e., for the amount determined by Government minus the amount as calculated by the Contractor (for which it has already made payment to the Government);*
- b) *the Bank Guarantee should be initially valid for a period of one year;*
- c) *the Contractor is required to provide an undertaking that it will keep the aforesaid Bank Guarantee alive (by renewing it each year at least a month prior to the date of expiry of such guarantee) till such time as it makes final payments (with interest as may be applicable) to Government towards the differential amounts due on account of the amount of unfinished MWP as may be finally approved by the Government;*
- d) *the BG for the differential amount shall be in addition to the BG required to be submitted for the Minimum Work Programme of the exploration phase under the PSC; and*
- e) *in case the BG is not renewed in time, the Government / DGH will have the option to invoke the BG.*

Issue No. 5: Extended Exploration Period in North East and other Frontier Areas

Operators face several problems in the blocks of the North Eastern region. Key constraints in the region for exploration and production sector have been poor infrastructure and limited connectivity. Today, exploration activities in the northeast region are being carried out in hilly and mountainous areas, which pose logistical as well as environmental challenges. Moreover, the region, connected to rest of India by a narrow stretch of land called 'Chicken's Neck', needs infrastructure to support and ensure significant investments and developmental aid. The creation of connectivity infrastructure to support exploration and development activities will have a far-reaching impact on the overall development of the region as it will help unlock the larger economic potential by removing accessibility constraints that have held back the economic development of the region. However, development of any kind, particularly infrastructure, in this part of India will be challenging to say the least as infrastructure development encompasses socio-political issues such as land acquisition and displacement of people. Though a lot of improvement has taken place over the years, challenges still remain. Some of the challenges encountered while carrying out exploration activities, particularly in the 'New Exploration Licensing Policy' (NELP)

blocks, include law and order issues, infrastructure gaps, unavailability of service providers, unavailability of adequate evacuation infrastructure and lower local demand from industry¹.

The above hurdles make the exploration period of seven or eight years insufficient for completion of the committed Minimum Work Programme within the valid phase durations, as stipulated in the PSC. The present extension policy for grant of extensions under Pre-NELP and NELP contracts does not address these problems which are unique to the North Eastern region.

The North East Vision document 2030 registers that operating conditions in NER are tough and only a limited weather window is available for E&P operations due to rain / other weather conditions. Thus, the problems faced by the E&P industry in the North Eastern Region have been recognized as a Policy Level issue. Having regard to these factors, it is proposed that the North Eastern Region be given the following special dispensations:

Recommendation:

a) Additional Extension of Exploration/Appraisal Period

In all active Pre-NELP and NELP Blocks in the North Eastern Region, the Contractors may be allowed, upon their request, a maximum extension of two years in the exploration period (which can be availed either in whole during a single phase or in parts during different phases) and a maximum extension of one year in the appraisal period, respectively. This additional extension shall be over and above the extensions permissible under the extension policy related to Pre-NELP and NELP policy.

b) Freedom of Pricing of Natural Gas

(i) Contractor is provided marketing and pricing freedom if sale of the gas is at Arm's Length Price in the domestic market. While discovering the market price for Arm's Length Sales, the Contractor has to ensure a fully transparent and competitive process for sale of gas with the objective that the best possible price is realized, to the benefit of all parties to the Contract, without any restrictive commercial practices. An advertisement / Notice Inviting Tender (NIT) / e-Tender should be notified widely by the Contractor, in at least one local language daily newspaper and one English language national daily newspaper and other suitable electronic media, mentioning inter-alia the quality and quantity of gas available for sale. Detailed information on the evaluation criteria to be used along with broad salient features of sale agreement to be executed by the buyer shall also be made known and at least 15 days time is to be allowed to ensure maximum participation of all likely buyers in this process. The information regarding the final agreement reached

¹ Hydrocarbon Vision 2030 for North East India (Page 10)

with the buyer shall be hosted on the Contractor's / Operator's website and also communicated to DGH / Government.

(ii) In the event of market discovered price being less than the price notified by Petroleum Planning Analysis Cell (PPAC) under the New Domestic Natural Gas Pricing Guidelines, 2014, the Royalty and Profit Petroleum to the Government shall be paid on the basis of the latter.

(iii) On notification of these special incentives, the New Domestic Natural Gas Pricing Guidelines, 2014 and the Gas Utilization Policy announced earlier from time to time shall not be applicable to all Pre-NELP and NELP Blocks in the North Eastern Region, except to the extend of above.

(iv) The provisions of sub-paras (i) to (iii) above, regarding marketing and pricing freedom along with the minimum price for determining the 'Government Take' shall also be applicable to all Pre-NELP and NELP Blocks in the North Easter Region where pricing formula / basis has been approved earlier by the Government. Any order issued earlier not in consonance with this policy will be treated as withdrawn.

The above special dispensation will stand withdrawn when Government's gas trading mechanism is in place.

Issue No. 6: Force Majeure – Extension of Notice Period

Force Majeure has been defined as any cause or event other than unavailability of funds lying beyond the reasonable control of, and unanticipated or unforeseeable by, and not brought about at the instance of the party claiming to be affected by such event, or which, if anticipated or foreseeable, could not be avoided or provided for, and which has caused the non performance or delay in performance.

Article 31.3 of the PSC provides that where a party to the contract is claiming suspension of its obligation on account of Force Majeure, it shall promptly, but in no case later than 7 days after the occurrence of event of Force Majeure notify the MC in writing giving full particulars of Force Majeure, the estimated duration and the obligations affected and the reasons for its suspension. The time for the performance of the obligations affected thereby and for performance of any obligation or the exercise of any right dependent thereon, and the term of the exploration phase of the exploration period of the contract may be extended to the extent of Force Majeure. Pre-NELP PSCs also contain the same time limit of seven days for notifying the other Parties.

It has been observed that the time limit of 7 days for informing the Government / DGH / Parties about the occurrence of the event of Force Majeure is causing hardship in some cases. Having regard to the fact that a Force Majeure occurrence normally refers to natural calamities, earthquakes, typhoons, wars, fires, invasions, blockades and other unforceable events, the insistence on a narrow time limit of seven days to notify the other Parties / MC appears to be too harsh.

The focus of the dispensation should be the occurrence of the Force Majeure event and its severity rather than adherence to a time limit for notifying such event. Therefore, there appears to be ample justification for enhancing the time window of seven days as well as to condone delays in the notifications of such event when such delay is attributable to good reasons.

Recommendation:

The following guidelines may be approved:

The time limit of seven days available under PSC to operators for giving written notification to other Parties / MC about the occurrence of Force Majeure event is enhanced from the present limit of seven days to 15 days for both Pre-NELP and NELP contracts. The benefit of extension of Exploration Phase of Exploration Period or term of the contract to the extent of Force Majeure period or such period as may be agreed by the Management Committee shall be available to the Contractor. This dispensation shall be applicable prospectively.

Issue No. 7: Grant of area extending beyond Contract Area for appraisal prior to designation of Development Area

As per NELP PSC (Article 11.2), where a part of a reservoir in respect of which a commercial discovery has been declared extends beyond the Contract Area, such area may be included in the proposed Development Area, in relation to which application for a Lease is made, on terms and conditions as decided by the Government, provided such area is (a) not subject to a License/Lease granted to any other person (b) not the subject of any negotiations/bidding for license / lease (c) available for licensing (i.e. is not an area over which Petroleum Operations are excluded).

Further Article 10.15 states that in the event the area encompassing commercial discovery extends beyond the Development Area designated in the Development Plan, either within the original contract area but subsequently relinquished or, outside the original contract area, the Management Committee may make recommendations to the Government concerning enlargement of the Development Area, provided the same was not awarded to any other company by the Government or is not held by any other party or not on offer by the Government and no application for a License or Lease is pending with the Government. Government may consider such request for extension at its sole discretion and on terms and conditions, which it may consider fit.

Under both the above aforesaid provisions of the PSC, Government may make available to a Contractor an area which was not part of the original contract area (or which was originally part of the Contract Area but subsequently relinquished) by making such additional area as part of the Development Area designated in a Development Plan. In other words the PSC contemplates only a situation where a certain area requires to be included as part of a

development area (after appraisal). There may be situations where during the exploration phase a contractor makes a discovery within his contract area but the exploration data acquired by the contractor suggests that such a discovery may extend beyond his contract area and that a proper appraisal of the discovery can be undertaken only by undertaking further appraisal work in the adjoining area falling outside the contract area. The NELP PSC as it stands now does not contain any provisions to allow such appraisal activities outside the contract area during the appraisal phase. In the interest of better appraisal of such extended reservoirs and in the interest of avoiding future conflicts relating to migration of hydrocarbons from outside the contract area it may be desirable to provide for inclusion of any contiguous area which is in the opinion of the Contractor, on the basis of available data, to have contiguous reservoirs or prospects with an existing discovery within the contract area, as part of the appraisal area wherein the contractor can be permitted to carry out appraisal of the discovery. If on the basis of such appraisal connectivity/contiguity of the reservoir is established the contractor may be permitted to include the said additional area or part of it in the Development Area for development of the discovery (ies).

Recommendation:

The Management Committee may, either upon a request from the Contractor or on its own, recommend to the Government the inclusion of any additional area not part of the Contract Area, if the Management Committee, on the basis of available data, has reason to believe that the petroleum deposit in relation to any discovery made in the Contract Area may extend beyond the boundary of the Contract Area or that such area outside the Contract Area may have contiguous reservoirs with an existing discovery within the contract area, as part of the appraisal area of such discovery (prior to the declaration of commerciality of the discovery) and for the grant of a PEL in respect of such additional area, provided that such area has not been awarded to any other company by the Government or is not held by any other party or is not on offer by the Government and no application for a License or Lease is pending with the Government.

Issue No. 8. Demonstrable Delays on account of delays in grant of approvals from Central / State Governments during Development / Production Phases to be considered as Excusable Delays and power to approve excusable delays to be delegated to DGH.

The Production Sharing Contracts have stipulated timelines for carrying out various petroleum operations by the Contractor in order to expeditiously explore, develop and produce hydrocarbons from the contract areas.

The duration of the Pre-NELP contracts signed for exploration blocks as well as for blocks / fields for development and production provide for a period of 25 years from the Effective Date of the respective Contract, with the provision for further extensions of 5 years and 10 years, respectively, in case of commercial production of crude oil and NANG. The NELP contracts provides for 7/8 years of exploration period before seeking Mining Lease for Development and a period of 20

years is available for Development and Production Operations under the Mining Lease as per P&NG Rules, for development and production of hydrocarbons.

It has been observed that the approvals, permits, grant of PEL, PML, etc. required to be taken by the contractor from the Central Government and/or concerned State Governments get delayed, which adversely impacts the implementation of petroleum operations in a time bound manner as per PSC. In several cases, there have been delays in grant of PEL & ML and/or its extensions and other necessary statutory approvals and permits (forest, environmental, etc...) by the Government, which also leads to delay in execution of exploration and development operations by the Contractors.

In order to address the issue of extension proposals submitted by the Contractors, Government had issued Policy for extension in Exploration phases in NELP and Pre-NELP PSCs on 18 April, 2006. This policy, *inter alia*, states that demonstrable delays on account of getting the Government approvals/permits/clearances will be counted as excusable delay. The proposals of the contractors for such excusable delays are considered by the Government. However, the question of delays in undertaking Development and Production activities on account of delays in the grant of PML have not been addressed in the aforesaid policy guidelines dated 18.04.2006. There have been some cases where the delay in the grant of Petroleum Mining Lease by the State Government concerned, coupled with delays in securing environmental and other clearances, has resulted in substantial loss of time, extending up to months and in some cases even upto 2-3 years, in undertaking Development activities.

One such case is the PSC for Kharsang Field. The PSC for this field stated that the Government has granted a Mining Lease to OIL and the Companies to carry out Petroleum Operations. Presumably because of this, the PSC defined the Effective Date of the said Contract as the date on which the contract was executed, i.e. 16.06.1995. Subsequently, it was noticed that the said recitation in the PSC was erroneous and the Contractor was required to seek a fresh ML for carrying out operations under the PSC. The Contractor applied for grant of mining lease from the concerned State Government. Initially, the Contractor was given a working permission by the State Government for the purpose of production of crude oil and natural gas in the field, in the national interest, pending the formal sanction and issue of a Mining Lease, with a validity of one year, which was further extended till grant of formal ML. The Mining lease was granted eventually, after a delay of about 2 years and four months, i.e., on 21.10.1997, which was made effective from 16.06.1995. As the working permission was given only for the purpose of "not causing dislocation of operation relating to oil producing wells" of the said oilfield, the Contractor was not in a position to undertake Petroleum Operations as per the Work Programme commitments in the PSC, during the entire period of the 28 months delay in the grant of the Mining Lease.

Further, the Operator of the said field had also made application for forest land clearance /diversion for land required to drill the MWP development wells on 09.04.2001. The requisite clearance from the Ministry of Environment and Forest got delayed and was ultimately granted on 14.02.2005, after a delay of about 46 months. This had created cascading effect on the performance of the Contractor in terms of developmental activities in the fields in an expeditious manner and in meeting production targets as per the FDP.

As already mentioned above, in order to address the issue of extension proposals submitted by the Contractors in relation to Exploration Operations, Government had issued Policy for extension in exploration phases in NELP and Pre-NELP PSCs on 18 April, 2006. This policy *inter-alia* states that demonstrable delays on account of getting the Government approvals/permits/clearances will be counted as excusable delays. In order to provide similar relief to Contractors whose Operations have been delayed due to such delays in securing government approvals, it has become necessary to provide for a policy dispensation allowing excusable delays and contract extension in cases where Development/Production gets delayed for want of government approvals/clearances. It may not be out of place to mention in this context that recently, Government has, in its Policy Framework for Early Monetisation of Coal Bed Methane (CBM) dated 11th April, 2017, made a provision for grant of excusable delay in development phase due to land acquisition/ force majeure issues or any other such matters beyond the control of Operator. Para 2.4 of the said Policy provides that “DGH is empowered to approve the excusable delays, without set off from subsequent Phases, in development phase due to Land Acquisition / Force Majeure condition or any other such matter beyond the control of Operator after confirming demonstrable delays”. A similar dispensation in respect of PSCs for blocks / fields for Development and Production (Pre-NELP) would go a long way in addressing this issue.

Further, it has been observed that inordinate delays in granting approvals for excusable delays (on account of delays in getting the Government approvals/permits/clearances) after such proposals are considered and examined by the Core Group of DGH on Excusable Delays and after consideration and approval by the Ministry, have caused petroleum operations in the block to suffer in the mean time, leading to further loss of precious time. Many a time, approval of the Ministry is effective from a back date which does not help the contractor as, during the interregnum, the Contractor has already lost considerable time without any work and in some cases even the Exploration Phase has expired. In such cases, the grant of excusable delay would serve no purpose unless it is conveyed in time and takes effect prospectively, so that the timelines in the PSC can be adhered to. Having regard to this, it is proposed that the power to approve excusable delays in individual cases may be delegated to DGH.

Recommendation:

The demonstrable delays in carrying out Development/Production Operations according to the Development Plan/Work Programme due to reasons beyond the control of the Contractor such as Land Acquisition / Force Majeure conditions or any other reasons [such as delay in grant of mining leases, permits, clearances, etc. by the Government, including the State Government concerned], may be considered as excusable delays and the contractors may be suitably compensated by extending the contract duration by a period equal to the period of such excusable delay on the same terms and conditions of the PSC in respect of Pre-NELP PSCs for Development and Production. Any further extension beyond this period may be governed under the policy dated 28.03.2016 for Grant of Extension to the PSC signed by Government awarding Small, Medium Sized and Discovered Fields to private joint venture. DGH may be delegated the power to approve the demonstrable delays as excusable delays in all such cases after confirming Demonstrable delays.

Issue No. 09: Recovery of cost petroleum over material differences from the Bench Mark

The PSC signed under NELP-VI onwards provides for an itemized break-up of cost estimates given by the Contractor in the bid documents which is annexed as Appendix-H to the PSC and the contract stipulates that any material increase over such Bench Mark estimates shall not be allowed for cost recovery unless approved by the Government. The relevant provisions of the PSC read as under:

(1) Article - 15.13 (CB-ONN-2003/1 PSC)

“The Contractor acknowledges that the cost estimates for Minimum Work Programme are the realistic estimate of expenditure. For the purposes of allowing cost recovery under Article 15 herein read with Section 3 of the Accounting Procedure, the cost estimates given by the Contractor in the bid documents towards the Minimum Work Programme in all three Exploration Phases shall be taken as Bench Mark notwithstanding any claims for higher actual cost. Any material increase over the Bench Mark shall not be allowed for cost recovery unless the Government on the recommendation of the Management Committee agrees that the cost increase is due to change in circumstances after the Contract comes into effect.

For the above purpose, an itemized break-up of cost estimates given by the Contractor in the bid documents is placed at Appendix-H to this Contract.”

(2) Section-3 Clause 3.1 of the Accounting Procedure:

Costs Recoverable and Allowable Without Further Approval of the Government

Costs incurred by the Contractor on Petroleum Operations as per reviewed or approved Work Programme and Budget by the Management Committee as the case may be, pursuant to the Contract as classified under the headings referred to in Section 2 shall be allowable for the purposes of the Contract except to the extent provided in Section 3.2 or elsewhere in this Accounting Procedure, and subject to audit, as referred to in Articles 25.4.1 to 25.4.4 and Article 25.5, as provided for herein. Further in case of variation in costs over the reviewed / approved Work Programme and Budget, as the case may be, or re-appropriation of costs, shall be submitted to the Management Committee for review / approval, as the case may be, within thirty (30) day from end of the relevant Financial Year and subject to the audit and other provisions of the Contract, such costs shall be allowable for the purposes of the Contract.”.

Management Committee has been recommending to Government for approval all such cases without exception thus making the entire process a routine exercise, without any tangible benefit to Government. Costs are incurred as per the procedure stipulated in

PSC for the work program approved by the Management Committee. The actual expenditure incurred by the contractor over and above Appendix-H, due to change in circumstances is required to be allowed for cost recovery. Having regard to this, the procedure of seeking Government approval (under Article 15.13) through the recommendation of Management Committee may be dispensed with for ease of doing business. This will bring uniformity between PSCs signed before NELP-VI and those signed under and after NELP-VI.

However, in case of 'S' blocks, the PSC does not allow cost recovery in excess of Appendix-H. In such blocks, Article 15.13 states as under:

“The Contractor acknowledges that the cost estimates for Minimum Work Programme are the realistic estimate of expenditure. Under Article 15 herein read with Section 3 of the Accounting Procedure, the Contractor shall be allowed such recovery of the Exploration Costs on the basis of the cost estimates given by the Contractor in the bid documents towards the Minimum Work Programme in the Initial Exploration Period or the actual cost incurred in the contract Area, whichever is lower. For the above purposes, an itemized break up of the cost estimates given by the Contractor in the bid documents is placed at Appendix-H to this Contract.”

It is therefore not proposed to include 'S' blocks in the present proposal for special dispensation.

Recommendation:

The procedure stipulated in Article 15.13 of the PSCs signed under NELP-VI to NELP-IX for obtaining Government approval for cost recovery in excess of Appendix H estimates, is waived (except in case of S-type exploration blocks where such procedure has not been prescribed).

Issue No. 10: Allowance of tax benefits under section 42 of Income Tax Act, 1961 during PSC extension period under the policy for extension dated 28.03.2016.

Background

Government of India had signed 28 Production Sharing Contracts (PSCs) for small and medium size discovered fields and 28 PSCs for Exploration Blocks, respectively, under pre-NELP regime. Out of the 28 Small and medium size discovered fields, 24 are Small size fields and 4 are medium discovered fields.

Out of 24 Small size discovered fields, PSCs for 13 Fields were signed in 1994-95 with the Government of India. These PSCs, unlike other PSCs did not include a provision for applicability of section 42 of the Income Tax Act, 1961. Section 42 allows the companies to

claim 100% of cost incurred under a PSC as expenditure allowance for the purpose of computing taxable income, in the year of incurring such expenditure instead of depreciating the capital expenditure over a period of years. The provision has been kept considering the unique high risk nature of the E&P industry, where sub-surface uncertainty is a huge risk.

The list of these 13 signed PSCs is given in **Annexure-I**. The list of remaining 11 PSCs for small fields and the four PSCs for medium fields is given in **Annexure-II, wherein PSC provided for application of Section 42 of Income Tax Act**. The production sharing contracts for the 28 Exploration Blocks which were signed by the Government during the Pre-NELP regime, also contain the provision for availing the tax benefits under section 42 of the Income Tax Act, 1961. The list of these 28 Exploration Blocks is given in **Annexure-III**.

Section 42 of the Income-tax Act, 1961 allows deductions in the case of business for prospecting, etc. for mineral oil, i.e. for the purpose of computing the profits and gains of the business of prospecting for or extracting or production of mineral oil, in relation to which, the Central Government has entered into an agreement with any person. As per the conditions prescribed in section 42, only those allowances / deductions are allowable which are specifically provided in the agreement entered into between the tax payer (contractor) and the Central Government and such agreement has been laid on tables of both Houses of Parliament.

Some of the contractors (out of the 13 PSCs) while filing returns of income in India, claiming deductions under Section 42 of the Income Tax Act, the Income Tax Department has disallowed the said deductions on the ground that the relevant PSCs do not contain provisions regarding allowability of deductions under section 42. Since the issue related to tax benefit of section 42, the said issue was agitated in legal proceedings by one of the affected Contractors, namely the Contractor of the Dholka and Wavel field (Joshi Technologies Inc., USA). The matter was agitated by the contractor up to the Supreme Court of India but the Hon'ble Supreme Court dismissed the petition of the contractor, holding, inter alia, as under:

“Though it may be somewhat harsh on the appellant when it availed the benefit of Section 42 for few years and acted on the understanding that such a benefit would be given to it, but we have no option but to hold that PSCs did not provide for this benefit to be given to the appellant and the contract can be amended only if both the parties agree to do so, and not otherwise.”

This has resulted in a situation where the Contractors of these 13 PSCs (who signed contracts during 1994-95) have not been provided tax benefits under section 42 while the Contractors who signed contracts at a later date, i.e., during 2001-2004, out of the same bidding round have been able to avail tax benefits under the said section.

This benefit is uniformly extended to contractors in all NELP Contracts, other Pre-NELP Contracts and also to the National Oil Companies in respect of nomination blocks. The tax provision was introduced keeping in view of the special nature of E&P business and also to attract investment in this high-risk operation. Having regard to this, there is no justification for continuing the discriminatory provision in respect of the blocks whose PSCs do not contain provisions regarding tax benefits under section 42 of the Income-tax Act, 1961.

Recently, Government notified the Policy dated 28.03.2016 for grant of extension to the Production Sharing Contracts signed by Government awarding small, medium sized and discovered fields to private Joint Ventures. This policy has, inter alia, laid down that during the extended period of Contract, the Royalty rate and Cess for these blocks shall be payable at prevailing rates applicable to nomination blocks and not at the concessional rates as stipulated in the PSC for both small and medium sized fields. Thus, the new dispensation proposes a significant deviation from the provisions of these PSCs.

In order to provide for a level playing field amongst all Contractors in the pre-NELP regime, in the matter of extension of tax benefits under section 42 of the Income-tax Act, 1961, it is proposed that Government may consider the incorporation of suitable provisions in the said Policy dated 28.03.2016 for grant of extension to the Production Sharing Contracts, to the effect that in those PSCs which do not contain provisions for availing of benefits under section 42 of the Income-tax Act, 1961, appropriate provisions for application of tax benefits under the said section during the extended PSC period shall be incorporated in the relevant PSCs. It is accordingly proposed that the Policy notification dated 28th March, 2016 may be amended by insertion of the following as sub-para 2.3 in para 2 (Fiscal Parameters for Extension), namely:-

“2.3. Tax benefits under section 42 of the Income-tax Act, 1961, shall be made available to all Contractors of the small and medium sized discovered fields during the extended period of Contract. The Production Sharing Contracts, which do not, at present, contain any provisions on section 42 of the Income-tax Act, 1961 shall be permitted to be amended so as to incorporate applicability of the tax provisions during the extended period of the Contract.”.

Issue No. 11: Permitting exploration in Petroleum Mining Lease (PML) area.

Background

In order to discourage holding of areages without serious petroleum operations or production, all the PSCs provide for a limited initial period of 'Exploration Phases' when the Contractor is allowed to retain in full or part of the Contract Area under a Petroleum Exploration License (PEL) and no petroleum is produced. At the end of the limited period of Exploration Phases, the Contractor is mandated to relinquish the entire Contract Area except the 'Discovery Area' and 'Development Area'. The Discovery Area is allowed to be retained for a short period for further appraisal of discoveries already made by the

Contractor and thereafter only Development Area approved by the Management Committee is retained for production in respect of which Petroleum Mining Lease (PML) is granted. PML allows the Contractor to do all Petroleum Operations including production and is granted for a longer period of 20 years.

The Contractors and other stake holders have raised an issue time and again that exploration operations may be permitted seamlessly in Development Area where a PML has been granted, after the Exploration Phases are over. Globally exploration operations are allowed through out the field life.

In pre-NELP PSCs awarded to Contractors for discovered fields such as Panna Mukta, Mid and South Tapti and Ravva the Contractors continued exploration operations in PML area. These pre-NELP discovered field PSCs though awarded in respect of discovered fields, provided for recovery of Exploration Cost at par with NELP PSCs awarded for exploration blocks. Neither PSCs nor the PML explicitly prohibit exploration operations in PML area after expiry of Exploration Phases.

However, a view was taken in the past that Exploration Operations after Exploration Phases would adversely affect Government share of Profit unless such operations are successful and hence such exploration operations were not approved by the Management Committee. In cases like RJ-ON-90/1 where Contractor did exploration activities after Exploration Phases, recovery of Exploration Cost was not considered. This practice has been in line with the view of CAG that Management Committee should agree for petroleum operations only if the Government Take is increased.

MOP&NG brought a policy dated 01.02.2013 wherein MOP&NG allowed exploration in PML area prospectively subject to the condition that the exploration operations are ring fenced and cost recovery is taken only when the Contractor proves the economic viability of successful exploration not reducing the Government Take. However, subsequently there have been views that the terms and conditions are regressive, not in the interest of promoting petroleum operations in the country. The terms are also found to be difficult to administer particularly the 'ring fencing' concept.

The practice is at variance with corporate taxation policies where the Finance Ministry promotes investments without consideration of loss of income tax (Government Take) resulting from higher depreciation and investment allowance.

In PSC, the Contractors' interest is aligned with Government interest. Contractor is mandated to share any profit earned by him with the Government as per the agreed ratios when profit arises in the petroleum operation. Government does not commit its own funds and Government's share of profit increases when the Contractor's profitability increases. Generally, every prudent Contractor is expected to be motivated to increase his

profitability irrespective of the fact that such increase in profitability would lead to increase in Government's share also.

Permitting exploration throughout field life will promote investment and chances of increasing new discoveries and more production. A higher Royalty is invariably paid to Government when production increases consequent to further exploration.

Exploration Operations are already allowed during the entire contract period under DSF and HELP contractual frame work.

Facilitating ease of doing business is need of the hour to reach the target set by Hon'ble Prime Minister to reduce import of petroleum by 10% before 2022. It is therefore proposed that petroleum operations may be allowed seamlessly to all Contractors in PML area also without any additional restrictions, in line with the current policy of Government under DSF and HELP. Such decision would replace the existing MOP&NG Policy dated 01.02.2013 prospectively.

Recommendation:

Exploration Operations are allowed under all the PSCs after the Exploration Phases throughout the license/lease period. This clarification will be applicable prospectively and old cases will not be reopened.

List of the Pre-NELP discovered fields with no provision of availing benefits under section 42 of Income Tax, Act

Sl. No.	Name of PSC	Consortium Partners	PSC Signing date	PSC Expiry date	Duration of PSC
1.	Asjol	HOEC	03.02.1995	02.02.2020	25
2.	Boala	Sun Petrochem	05.04.1995	04.04.2020	25
3.	PY-1	HOEC	06.10.1995	05.10.2020	25
4.	Hazira	GSPCL and NIKO	23.09.1994	22.09.2019	25
5.	Bhandut	GSPCL and OILEX	23.09.1994	22.09.2019	25
6.	Cambay	GSPCL and OILEX	23.09.1994	22.09.2019	25
7.	Indrora	Selan Exploration	13.03.1995	12.03.2020	25
8.	Bakrol	Selan Exploration	13.03.1995	12.03.2020	25
9.	Lohar	Selan Exploration	13.03.1995	12.03.2020	25
10.	Dholka	JTI	20.02.1995	19.02.2018	23
11.	Wavel	JTI	20.02.1995	19.02.2018	23
12.	Matar*	GSPCL and NIKO	23.09.1994	22.09.2019	25
13.	Sabarmati*	GSPCL and OILEX	23.09.1994	22.09.2019	25

***Relinquished**

Annexure-II**List of Pre-NELP discovered fields with the provision of availing benefits under section 42 of income Tax, Act**

Sl. No.	Name of PSC	Consortium Partners	PSC Signing date	PSC Expiry date	Duration of PSC
1.	Allora	GSPC and GNRL	23.02.2001	22.02.2026	25
2.	Amguri	ONGC and ACIL	23.02.2001	22.02.2026	25
3.	Dholasan	GSPC and GNRL	23.02.2001	22.02.2026	25
4.	Kanwara	GSPC and GNRL	23.02.2001	22.02.2026	25
5.	N.Balol	GNRL, GSPC and HOEC	23.02.2001	22.02.2026	25
6.	N. Kathana	GSPC and GNRL	23.02.2001	22.02.2026	25
7.	Sanganpur	PPCL and HDCPL	23.02.2001	22.02.2026	25
8.	Unawa	GSPC and GNRL	23.02.2001	22.02.2026	25
9.	Karjisan	SELAN	16.02.2004	15.02.2029	25
10.	Ognaj	SELAN	16.02.2004	15.02.2029	25
11.	Modhera	Sun Petrochem	23.02.2001	22.02.2026	25

List of Pre-NELP Medium size discovered fields

Sl. No.	Name of PSC	Consortium Partners	PSC Signing date	PSC Expiry date	Duration of PSC
1.	Kharsang	Geo-ENPRO, OIL, JEPL and GPI	16.06.1995	15.06.2018	25
2.	Ravva	CEIL,ONGC,RAVVA,VIDEOCON	28.10.1994	27.10.2019	25
3.	Tapti	ONGC	22.12.1994	21.12.2019	25
4.	Panna-Mukta	BGEPL,RIL and ONGC	22.12.1994	21.12.2019	25

Pre-NELP Exploration Blocks

Sl. No	Block Name	Consortium Partner	Date of Signing Contract
1	RJ-ON-90/1	CIL, CEHL & ONGC	15-05-1995
2	RJ-ON/6	FEL, ISIL & NOCL	30-06-1998
3	CB-ON/7	HOEC & GSPCL	12.04.2000
4	CB-ON/2	GSPC, GGR	12-04-2000
5	CB-ON/3	ESSAR OIL LTD	16-07-1998
6	GK-ON/4	FEL	30-06-1998
7	AAP-ON-94/1	HOEC, OIL & IOC	30-06-1998
8	AA-ON-07	CRL, ACL	19-02-1999
9	AA-ONJ/2	ONGC	07-11-2003
10	CY-OS-90/1PY3	HARDY, ONGC, TPL & HOE	30.12.1994
11	CB-OS/1	ONGC, HOEC & TPL	19-11-1996
12	CB-OS/2	CIL, ONGC & TPL	-
13	AA-ON/3	OKLAND	-
14	CR-ON-90/1	PONEI, EOL, IOC & OIL	30.06.1998
15	RJ-ON-90/5	EOL & POGC	-
16	RJ-ON-90/4	EOL, POGC	-
17	GK-ON-90/2	OKLAND	-
18	GK-OS/5	RIL, TIOL & OKLAND	16.07.1998
19	GK-OSJ/1	RIL, TIOL & ONGC	-
20	KG-ON/1	RIL & TOIL	-
21	KG-OS/6	CAIRN & VPL	30.06.1998
22	KG-OS-90/1	HARDY, HOEC, NIKO, NAGA FERTI	-
23	BB-OS/5	ESSAR & PETROM SA	-
24	CY-OS/2	HEPI & GAIL	19-11-1996
25	SR-OS-94/1	RIL	12-04-2000
26	GN-ON-90/3	HOEC & MIL	29-09-1993
27	CB-ON/1	RIL, TOIL & OOHL	16-07-1998
28	GK-OSJ/3	RIL, ONGC & OIL	06-09-2001