THE DAILY STAR
LEBANON

March 04, 2013

Keep Lebanon oil and gas bids transparent

By Carole Nakhle

On Feb. 15, the Lebanese government initiated the country's first ever offshore licensing round. Companies interested in bidding for oil and gas exploration and production licenses off the Lebanese coast have until the end of March to submit their prequalification package. Short-listed companies will be notified by mid-April; bidding will start in May and is expected to continue for six months. Various bid evaluations will take place between November 2013 and January 2014, and the first exploration and production agreement is scheduled to be signed in February 2014. Lebanon has opted for what amounts a relatively transparent process for allocating its offshore blocks, in contrast to many developing countries, which often use less transparent methods, such as direct negotiations or awarding contracts on a "first-come, first-served" basis. These latter approaches encourage rent-seeking behavior and corruption as the criteria for award of contracts are not predefined and known to potential investors beforehand. Licenses therefore become vulnerable to favoritism and corruption.

Competitive bidding, if well designed and applied, in principle encourages financially strong, technically competent companies to offer the best terms (highest state take) to the host government to obtain exploration and production rights. In that sense, the approach adopted by Lebanon can be described as "so far, so good."

Four typical criteria were listed for prequalification – specifically legal, financial, technical and environmental. Some countries also add local content. By setting such specific criteria, the Lebanese authorities improve the odds of attracting serious players who are able to carry out capital intensive and risky exploration programs. Such a strategy is becoming common in many developing countries who have in the past suffered from investors acquiring large blocks, sitting on them for a while, with only limited exploration carried out (if any at all), waiting for the right moment to sell for financial gain.

The application of competitive bidding, the choice of the biddable parameters, and therefore the degree of success of this strategy, nonetheless, vary across countries. License allocation by competitive bidding has long been a preferred policy in the United States, where the cash bonus payment – the only biddable item – accounts for nearly 46 percent of the Federal government's Outer Continental Shelf revenues. In Norway and the United Kingdom, licenses are normally awarded on the basis of a proposed work program. In developing countries, biddable factors can also include state participation, local content, production targets, cost recovery ceiling, and royalty and tax rates. In Lebanon, the biddable items are likely to be the work program and profit sharing.

Experience shows that there are risks involved in allowing fiscal terms to be biddable. On the one hand, this may create differentiated fiscal structures that apply on different investors, creating an additional administrative burden. However, some companies offer onerous terms just to win the bid, then renegotiate the terms if oil and gas prices fall or if subsequent discoveries prove uneconomic.

A combination of factors affects the success of a licensing round, in particular the prospectivity, economic conditions, political risk, legal and regulatory framework, and fiscal terms. This is not an "a la carte menu" from which investors choose. On the contrary, investors weigh various factors together before making a bid. In principle, the size of the bid corresponds to the project's anticipated profitability and underlying economics, including the impact of the fiscal regime.

It is often argued that competitive bidding tends to be the most successful approach once a proven commercial resource has been established; before such a find the geological uncertainty is likely to act against large bids being offered. While geological endowment is certainly an important factor, it is not the only determinant of investment decisions. Despite its huge proven oil and gas potential, Algeria's licensing round in 2011 resulted in only two licenses out of 10 being awarded. The reason is that the country's tough fiscal terms and political risks dampened investors' enthusiasm.

In Lebanon, more than 40 international oil and gas companies – private and state-owned alike – have purchased the seismic data from the Energy and Water Ministry. This is positive development, creating a competitive framework for the licensing round, adequately reflecting wide interest. The key point is to bring to fruition that interest.

A difference exists between the number of companies that purchase the data, those that prequalify, those that actually bid and the number of contracts awarded – the numbers shrink as we move toward the latter category. Iraq best illustrates this case. The country holds more than 127 trillion cubic feet of proven gas reserves, or the equivalent of 1.7 percent of world total. Its fourth licensing round took place in 2012 and focused mainly on onshore gas exploration. Around 47 companies prequalified, including oil majors such as BP, Shell and Total. Twelve blocks were offered. When the terms were revealed, only 11 companies actually bid on four blocks. Only three blocks were awarded.

Many eyes are on Lebanon as it tries to navigate a new and long path ahead. So far, the prequalification process seems to be in line with international good practice. It looks reasonable and does not create unnecessary constraints that limit potential competition – the latter being an important ingredient for the success of any licensing round. One area of concern is the short time between the announcement of the prequalification process and the beginning of the bidding procedure.

A careful design of the bidding process is essential to achieving the country's desirable objectives. Weak administrative capacity and unfamiliarity with the bidding process among domestic stakeholders need to be addressed. Strong governance, an anti-corruption framework, non-discriminatory treatment of bidders (especially during the solicitation and evaluation process) are the most important ingredients.

In the end, transparency will benefit both the bidders and the country.

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A version of this article appeared in the print edition of The Daily Star on March 04, 2013, on page 7.