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OIL & GAS ALERT



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PART 5

Draft Upstream Petroleum Resources Development Bill, 2019: Participation by black-owned oil and gas companies and the State in exploration and production rights

In this instalment of our analysis on the draft Upstream Petroleum Resources Development Bill, 2019 (the Petroleum Bill) we delve into chapter 4 of the Petroleum Bill and focus on the participation by black-owned oil and gas companies and the State in exploration and production rights, as provided for in section 38 and section 39 of the Petroleum Bill.

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Section 2(d) states that one of the objects of the Petroleum Bill is to substantially and meaningfully expand opportunities for black persons, to enter into and actively participate in the upstream petroleum sector and to benefit from the exploration of the nation's petroleum resources.

In this instalment of our analysis on the draft Upstream Petroleum Resources Development Bill, 2019 (the Petroleum Bill) we delve into chapter 4 of the Petroleum Bill and focus on the participation by black-owned oil and gas companies and the State in exploration and production rights, as provided for in section 38 and section 39 of the Petroleum Bill.

Black-owned oil and gas company participation

Section 2(d) states that one of the objects of the Petroleum Bill is to substantially and meaningfully expand opportunities for black persons, to enter into and actively participate in the upstream petroleum sector and to benefit from the exploration of the nation's petroleum resources. This object is given effect to through the inclusion of section 38 which requires mandatory participation by 'black persons' in every exploration and production right and the reservation of blocks in an open area for oil and gas companies. The transformation principles as proposed in the Petroleum Bill by the Department of Mineral Resources and Energy (DMRE) are welcomed, however, the devil is in the detail and as such some of the proposed provisions may have unintended consequences for black owned oil and gas companies. A discussion of these unintended consequences is detailed below.

Section 1 of the Petroleum Bill defines a 'black person' as:

"a generic term which means Africans, Coloureds and Indians—

- (a) *who are citizens of the Republic of South Africa by birth or descent; or*
- (b) *who became citizens of the Republic of South Africa by naturalisation—*
 - (i) *before 27 April 1994; or*
 - (ii) *on or after 27 April 1994 and who would have been entitled to acquire citizenship by naturalisation prior to that date; or*
- (d) *a juristic person which is managed and controlled by persons contemplated in paragraph (a) or (b) and the persons collectively or as a group own and control all issued share capital or members' interest, and are able to control the majority of the members' vote." (our emphasis)*

Section 38(1) of the Petroleum Bill introduces the first form of participation by oil and gas companies. This section states that *"[e]very exploration or production right must have a minimum of 10 percent participating interest by black persons which must include economic interest*

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The definition of black person read with section 38(1) ultimately means that black-owned oil and gas companies will be unable to share risk and raise funding by diluting their shareholding or their 10% participating interest (Dilution Restrictions).

plus corresponding percentage of voting rights, per exploration right or production right". The section effectively requires active participation by black persons in every exploration and production right, to the extent of a 10% participating interest. The term 'economic interest' is not defined in the Petroleum Bill and it therefore is unclear what was envisaged by this term, this would benefit from clarification by the drafters.

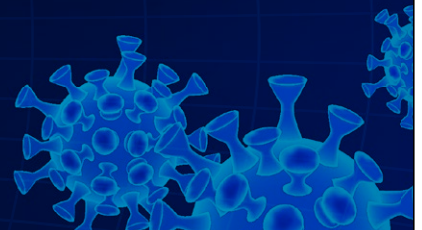
Importantly, the definition of black person and the requirement to own and control all issued share capital, as opposed to a majority of the issued share capital, read with section 38(1) which requires that the participating interest be held at 10% appears to impose a restriction on oil and gas companies. This restriction arises because the primary funding methods for exploration activities arises through dilution of participating interest and/or

dilution of shares. The definition of black person read with section 38(1) ultimately means that black-owned oil and gas companies will be unable to share risk and raise funding by diluting their shareholding or their 10% participating interest (Dilution Restrictions).

These Dilution Restrictions are particularly crippling because black-owned oil and gas companies are meant to be participating under section 38(1) on commercial terms. The ability to share risk and raise funding for exploration and production costs is as critical for international oil companies as it is for black-owned oil and gas companies, so the exclusion of conventional funding options is a significant restriction on black-owned oil and gas companies because this will impede the ability of black-owned oil and gas companies to participate on a commercial basis with international oil companies.

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Requiring that black-owned oil and gas companies obtain ministerial consent in order to encumber its interest or shares is another significant and impractical funding restriction and is not contained in section 11 of the MPRDA.

In addition to the above, section 36 of the Petroleum Bill, which will replace section 11 of the Mineral and Petroleum Resources Development Act, 28 of 2002 (the MPRDA), expressly provides inter alia that:

"[a]n exploration or production right or an interest in any such right in an unlisted company or a controlling interest in a listed company may not be ceded, transferred, encumbered, assigned or alienated without the prior written consent of the Minister". (our emphasis)

Requiring that black-owned oil and gas companies obtain ministerial consent in order to encumber its interest or shares is another significant and impractical funding restriction and is not contained in section 11 of the MPRDA. It should be noted that section 36(3) does contain an exception in respect of the encumbrance by mortgage or interest as security, but these are limited to banks / financial institutions. These are, however, not the primary funders of exploration risk capital and black-owned oil and gas companies may benefit from additional exemptions in respect of encumbrances.

Section 38(2) introduces the second form of participation by oil and gas companies. This section provides that the Minister of the DMRE may, by notice

in the gazette, reserve a block or blocks in an open area for 100% black persons owned companies. These reserved blocks require that black persons participation in such a company not be diluted to less than 51% for purposes of raising capital, however there is a proviso to this in that any dilution to below 51% triggers a State carried participation of up to a minimum of 10%. Section 38(2) participation does not suffer the same fate as section 38(1) participation, because it allows and in fact contemplates dilution as a means of funding exploration activities, albeit through dilution of participating interest and/or dilution of shares. It is unclear as to whether section 38(1) participation still needs to be complied for purposes of section 38(2) participation and this would benefit from clarification by the drafters.

In summary, the Petroleum Bill facilitates two forms of participation by black-owned oil and gas companies, participation in terms of section 38(1) and participation in terms of section 38(2). We anticipate that section 38(1) participation will entail the acquisition of a 10% participating interest by way of a farm-in to existing exploration or production rights alongside international oil companies. This form of participation requires that the black-owned oil and gas company remain 100% black-owned under the

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Section 39 of the Petroleum Bill provides that the State has, through PetroSA, a right to a 20 percent carried interest in exploration and production rights.

current drafting of the Petroleum Bill. Contrast to this, section 38(2) participation envisages the award of a reserved and open block to a black-owned oil and gas company and unlike section 38(1) participation, section 38(2) permits dilution for purposes of funding exploration and production activities.

State Participation

Section 39 of the Petroleum Bill provides that the State has, through PetroSA, a right to a 20 percent carried interest in exploration and production rights (the State Option). The section goes on to provide that exploration and appraisal costs associated with the State Option are not recoverable, but that development and production costs shall be recovered from the proceeds generated from production operations. There are three key points for discussion arising from section 39 of the Petroleum Bill.

Firstly, section 1 of the Petroleum Bill defines the term “*carried interest*” as the interest allocated to the State in an exploration or production right, which interest vests exclusively for the benefit of the State and the costs of which are borne by the carrying holder as contemplated in section 39. This definition currently only

contemplates the State being a carried party. Furthermore, the term ‘carrying holder’ is undefined in the Petroleum Bill. If the interpretative position is taken that the term ‘carrying holder’ refers to all participants in an exploration and production right, except the State, then this may result in black-owned oil and gas companies also being required to contribute to a proportionate share of the costs associated with the State’s 20% carried interest, relative to the 10% participating interest which it holds under section 38(1).

Given that the Dilution Restrictions imposed on black-owned oil and gas companies participating in terms of section 38(1) impedes such companies’ ability to seek funding for its own 10% participating interest, it could not have been the intent of the drafter to also place the burden of the State’s carry on such black-owned oil and gas companies, however, this does require clarification in the next iteration of the Petroleum Bill.

Secondly, as stated in section 38(2)(b) of the Petroleum Bill any dilution to below 51% will trigger the State carried participation of up to a minimum of 10%. From the current drafting, it is unclear whether (i) the State carried participation of up to a

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The Petroleum Bill currently requires existing exploration or production right holders to comply with section 38 and section 39 when the holder applies for renewal of such right.

minimum of 10% is in addition to the 20% participating interest acquired under the State Option; or (ii) whether section 38(2) participation is exempt from the State Option and is therefore only triggered by a dilution of black ownership in the company to below 51%.

Finally, comparatively speaking, a 20% State carry, in a non-producing jurisdiction, is high when compared to competing jurisdiction and this, combined with the Dilution Restrictions on section 38(1) participation, is perhaps not an ideal combination.

In conclusion, it is important to note that section 24(9) of the Petroleum Bill provides that any exploration or production right

granted before the date on which the Petroleum Bill is enacted will continue in force, subject to the terms and conditions on which such right was granted, until such time as it is due for renewal. As such, the Petroleum Bill currently requires existing exploration or production right holders to comply with section 38 and section 39 when the holder applies for renewal of such right.

In our next article in this series, we will be unpacking retention permits and the introduction of care and maintenance permits under the Petroleum Bill.

Megan Rodgers, Shameegh Allen and Kirsten Felix

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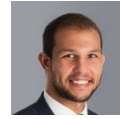
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