OIL & GAS

ANNUAL REVIEW **2015**

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Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in the oil & gas sector.

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INTRODUCTION

As has been well documented, the oil & gas market has experienced a tumultuous 12 months. The recent and rapid decline in oil & gas prices has had a significant impact on the sector globally. Indeed, the economic turmoil caused by the tumbling price of oil has created a great degree of volatility in the sector as a whole.

Since the price drop began in mid-2014, there has been a substantial shift in the oil & gas space; from insolvencies to big ticket M&A transactions, the shape of the sector has been changed irrevocably. In the US a number of major segments within the oil & gas space have been heavily impacted. The drilling and services segment, for example, has seen numerous firms go to the wall, resulting in substantial job losses. The exploration and production segments have also been hit hard by the sector's precarious state. In the UK, too, exploration has been curtailed by recent travails; with the prospect of further drilling in the remainder of the year unlikely, firms must respond to this new pricing benchmark.

Domestic production has become a watchword in many jurisdictions, with legislative developments in Italy, Ukraine and others aimed at increasing production at home becoming a priority for governments. In Ukraine in particular, efforts are being made to improve and increase foreign investment into the country's oil & gas network. Henceforth, Ukraine will allow US and EU companies to become operators of the Ukrainian gas transportation system, a positive move which could make a significant impact.

As 2015 progresses, it is probable that the oil & gas space will play host to a number of substantial M&A transactions. Industry consolidation looks increasingly likely, so expect non-traditional investors to play a key role going forward.

UNITED STATES

ROBERT A. JAMES
PILLSBURY WINTHROP SHAW PITTMAN LLP

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN THE US OVER THE LAST 12-18 MONTHS?

JAMES: Hydrocarbon prices have fallen before, but notable from the US standpoint are the diverse sources of the current economics. On the supply side, US production has grown so large and efficient that reductions in rig counts to a five-year low have not resulted in production declines until quite recently. On the demand side, the US and other Western economies have shifted toward more efficient uses of cleaner sources, and even Chinese growth is now focused more on consumer spending than on energy-intensive projects. The OPEC members that previously functioned as swing producers have lost some of their clout or have elected not to intervene. The takeaway is that there is no single factor – such as recovery of demand after 2008 – that could be expected to arrest or reverse the impact of the others.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN THE US?

JAMES: As is the case worldwide, the dramatic price declines have had disparate impacts in different segments of the American energy sector. The first and heaviest blow is being absorbed by the drilling and services segment, which has suffered financial reverses and layoffs. The next impact is on the exploration and production segment, where the oil and gas that is most expensive to produce will sit in the ground, and where capital budgets are being slashed. In contrast, the refining and petrochemical segments, the integrated majors, and utilities have reaped the benefit, or at least the offset, of cheaper inputs. Across all these segments, companies with flexible hedging strategies have advantages over others. A rapid change in fundamentals has thus burdened most but benefitted some.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN THE US OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

JAMES: The projected expansion of shale development has been tempered by moratoria, regulations and statutes in New York and various localities, as well as on federal land subject to regulation by the Bureau of Land Management (BLM). Additional regulations for offshore development were promulgated by the reorganised agencies within the Department of the Interior in the aftermath of the Deepwater Horizon spill. Another product of the public debates is the plodding approval process for the Keystone XL pipeline. Hydrocarbon companies manage relations with the federal and state legislatures and agencies but generally do not anticipate positive support from them.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

JAMES: Executives must make decisions on development at a time when the US government is deciding whether and to what extent exports of oil and gas will be allowed. A full-scale advocacy effort is being made to authorise crude oil exports on a broad scale. Numerous liquefied natural gas (LNG) export projects are lining a queue awaiting federal approvals and final investment decisions. The effects of these potential exports on the national balance of trade, and on the domestic downstream economy that has enjoyed the rise in US production, are being hotly debated. Cyber security has also emerged as a significant field to be managed by energy enterprises of all sizes and regions. The industry has become strongly dependent on electronic information, and executives need to defend against attacks on that asset. And the industry is still coping with the need to replace a large cohort of 'baby boomers' now entering retirement.

"The industry incurred large amounts of debt in a low-interest rate environment, and some companies are managing that load better than others."

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

JAMES: It is remarkable that renewable sources of energy have held their own in the US despite the reductions in hydrocarbon prices. Mandates and policy benefits on the West Coast and in the Northeast, and increasing renewable efficiencies throughout the country, have provided wind, solar and similar sources with ongoing opportunities for development. The hydraulic fracturing segment is entering a new era of maturity, in which companies and regulators alike are addressing water quality, water supply and related concerns with greater effectiveness. The ratios of oil, gas and coal prices suggest that there is still room to shift industrial and transportation fossil fuel usage toward cleaner-burning natural gas.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

JAMES: The most promising targets are upstream companies blessed with attractive resources in the ground, but saddled with debt burdens that cannot be serviced at reduced production levels. The industry incurred large amounts of debt in a low-interest rate environment, and some companies are managing that load better than others. Upstream M&A activity has been low in the early stage of the oil price decline, as the expectations of buyers and sellers diverged widely, but may now be now gathering momentum. Service companies are motivated to combine, but mergers in this field will require considerable creativity; in the meantime, large layoffs and insolvencies are taking their toll. Integrated companies and large downstream players are weathering the storm better, though with reduced budgets. Depending on the circumstances, they may either divest assets or be opportunistic buyers.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

JAMES: From the US standpoint, we expect both greater exports and sustained leadership in shale development. The US is emerging as the world's swing producer, but it is significant that the control of that role is more in private company hands than in those of the government. Shale development must accommodate regulation to address water quality, water supply and land use concerns, and must cope with rapid declines in production from a given well. But the prize is great, because the US enjoys great untapped resources close to potential markets, and because there is the prospect of great environmental and technical advances in what is, in historical terms, a relatively recent technology.

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MEXICO

EDMOND FREDERIC GRIEGER
VON WOBESER & SIERRA

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN MEXICO OVER THE LAST 12-18 MONTHS?

GRIEGER: In December 2013, Mexican Congress approved an historic energy bill ending a 75 year state monopoly in the energy sector. The main objective of this bill was to open the doors for the private sector to participate in the oil & gas sector under a freer and transparent legal framework. The reform also sought to regulate the hydrocarbon and electricity industry, providing a new legal regime for Petroleos Mexicanos (PEMEX) and the Federal Electricity Commission (CFE), and give rise to a new chapter in the country's energy sector. In this respect, the sector would transition from a system of nationalism with fierce governmental control over energy resources to a scheme being very close to a free market. In August 2014, Congress reached the approval of the reform minutes to the secondary legislation derived from the constitutional energy bill. Since then, the country has been undergoing a transitional phase related to the implementation of the new legal framework in the sector.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN MEXICO?

GRIEGER: As a consequence of Mexico's recent oil & gas reform, which is creating important new investments and opportunities in the up, mid and downstream sectors, we have not been able to detect a significant pause or regression of investments that could be attributable to current oil & gas prices. Quite the opposite, in fact, has been true. The National Hydrocarbons Commission has been calling for several tenders, known as 'Round One bids', comprising exploration and extraction activities in shallow waters, and will continue to tender for important projects related to deep water and unconventional projects of interest to both national and foreign investors. While the tenders for shale gas projects have been pushed back slightly in the bidding schedule in order for oil & gas prices to stabilise, we expect these tenders to materialise in due course.

Q HAVE THERE BEEN

GRIEGER: One of the most interesting new policies and regulations in the sector relates to the Round One bidding process, through which the

ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN MEXICO OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

National Hydrocarbons Commission is offering the private sector 169 areas for engaging in oil & gas exploration and extraction projects in deep water, shallow water and for unconventional resources such as shale gas, of which 109 correspond to exploration projects and 60 to extraction projects. Also included within this Round One bidding process are the so-called farm-outs, which will be the conversions that PEMEX can make of the assignments granted to it, to contracts with the private sector by a bidding process and with prior approval of the Ministry of Energy (SENER). SENER will also determine and design the type of contract that will apply to each contractual area, i.e., production sharing, profit sharing, licence agreement, etc.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

GRIEGER: In connection with the current production sharing contract (PSCs) draft that has been approved by the National Hydrocarbons Commission for the Round One bidding process, the 50 or so companies that have expressed interest in Mexico's Round One have expected Mexico to soften the fiscal terms in light of lower oil prices and due to the restricted investment budgets and are seeking to soften the national content restrictions included in the PSCs draft. Acknowledging this new reality, recent clarifications and amendments to the PSCs draft are being negotiated and intend to accommodate the industry concerns. Notwithstanding the above, investors still believe there are some risks included in the Hydrocarbons Law and PSCs drafts, particularly related to administrative rescission causes and international arbitration restrictions.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL

GRIEGER: It is important to mention that with the Mexican energy reform also came the creation of a new governmental agency, the National Agency for Industrial Security and Environmental Protection in the Hydrocarbons Sector (ASEA). It was imperative to create a new agency focused exclusively on the hydrocarbons space, particularly

CHALLENGES AND SUSTAINABILITY ISSUES?

since we will see a substantial increase in activities in the sector moving forward. These activities also come with higher risks which will need to be evaluated, controlled and strictly verified by a specialised state body. The ASEA will regulate and supervise, among others, environmental protection arising from activities in the hydrocarbons sector in general terms, and specifically the dismantling and abandonment of onshore and offshore facilities, as well as the integrated control of waste, water and pollutant emissions from the hydrocarbon sector. These developments are all of paramount importance, primarily because these activities are comprised of higher risks in both Mexican territory and in areas in which the country exercises sovereignty or jurisdiction – areas such as deep and ultra-deep water exploration and extraction projects, as well as hydraulic fracking.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

GRIEGER: Firstly, we have to identify the most important business alternatives that we will be dealing with in Mexico in the years to come, such as the possibility of engaging directly in Round One and subsequent public bidding tenders being called by the National Hydrocarbons Commission for shallow, deep, ultra-deep and unconventional projects in the sector, and other business alternatives such as entering directly into alliances and contracts with PEMEX. For both of these commercial alternatives, and most notably the second one, we are seeing intensive M&A transactions allowing foreign investors to enter into the national market by partnering with national companies that have vast experience in the Mexican oil & gas sector and are familiar with the operations of PEMEX, as well as with the Mexican administrative process, land acquisition process, and other administrative and environmental compliance matters.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL

GRIEGER: With the Mexican structural energy bill that is currently in its implementation phase, Mexico has opened its doors to private national and foreign investment which will certainly boost its oil, conventional and non-conventional gas resources. The reforms are giving rise to significant commercial opportunities to invest in infrastructure projects in the country. However, due to increasing activity in the sector, we

"Mexico has opened its doors to private national and foreign investment which will certainly boost its oil, conventional and non-conventional gas resources."

SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

are also expecting to see a surge in disputes, mainly due to the ample degree of discretion that was given to the new regulatory agents of the state with regard to the implementation of economic, tax, national content and specific contractual aspects, in addition to the potential occupation of lands of vulnerable social sectors for the execution of new energy projects. Ultimately, the structural energy reform will bring substantial economic benefits, jobs and business opportunities to the country. However, it will also demand a great responsibility of the state to live up to the expectations and challenges of the reform. A rock-solid legal framework needs to be further developed to secure a clear and transparent outline for activities in the sector, and to benefit and protect communities, to safeguard the country's natural resources, as well as to secure sustainable development for Mexico.

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Edmond Frederic Grieger is a partner at Von Wobeser & Sierra, S.C. and has been with the firm since 1998. He is head of the Environment, Energy & Natural Resources practice areas of the firm, and provides legal counsel to some of the most important transnational, Fortune 500 enterprises and local companies as well as the Mexican government. Furthermore, he has broad experience related to disputes in these areas and substantial know-how and expertise in the practice areas of Constitutional & Administrative Proceedings, Government Procurement and Real Estate.

UNITED KINGDOM

CLARE MUNRO
BRODIES LLP

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN THE UK OVER THE LAST 12-18 MONTHS?

MUNRO: A lot has happened in the past 18 months. At the end of 2013, the oil price was still at $120 and had been steady for a considerable period of time. The UK Continental Shelf (UKCS) had been 'booming' for a number of years, resulting in a lack of resource – particularly personnel – and severe cost escalation. 2014 was a tumultuous year, seeing the publication of the Wood Review into Maximising Economic Recovery on the UKCS, the Scottish independence referendum, a significant and sustained drop in oil price towards the end of the year and a fiscal review into oil & gas taxation. 2015 has seen further fiscal changes introduced in the recent pre-election budget, oil prices remaining at $50-$60 per barrel, and the establishment of a new regulator – the Oil and Gas Authority – which was officially launched on 1 April. This year has also seen a wave of redundancies affecting both operators and the service sector as they struggle to control costs.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN THE UK?

MUNRO: The drop in oil price after such a relatively long period of oil price stability has, through necessity, accelerated the drive to get costs under control. It has also forced further fiscal review, with the recent pre-election budget announcing a reduction in the supplementary charge, and various beneficial tax changes. These include a 15 percent reduction of the Petroleum Revenue Tax (PRT) rate and the introduction of the Investment Allowance. Unfortunately, exploration has been particularly adversely affected, with a drop in drilling activity. The Oil & Gas UK 2015 Activity Survey noted that exploration had been worse than anticipated in 2014, with only 14 wells drilled out of the expected 25. This downward trend is expected to continue into 2015 with between 8 and 13 exploration wells forecast. There is less transparency in relation to wholesale UK gas prices. Although there is a 'spot' market for trading – where trades can be made on a day, week or month ahead basis – most gas is sold on longer term contracts, which

are private commercial arrangements and for which prices are therefore not published. Longer term contracts give more certainty to buyers and sellers, creating less volatility. However, some of the indexation factors will be linked to oil price, which will depress the price received under these contracts. The 'spot' market for gas tends to have seasonal fluctuations – such as higher prices in winter. As of 30 April, gas was trading at around 42p per therm, around the same price as the same time last year.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN THE UK OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

MUNRO: There has been significant regulatory change in the oil & gas sector in the UKCS, with the establishment of the Oil & Gas Authority. This Authority will act as an executive agency of the Department of Energy & Climate Change (DECC), and will become an independent government company in the summer of 2016. In addition to DECC activities related to licensing, exploration and development work, it will be responsible for implementing actions arising out of the 'Maximising Economic Recovery from the UK' review published in 2014. A further regulatory change is the introduction of the Offshore Safety Directive Regulator (OSDR) – the regulator responsible for implementing the requirements of the EU Directive on the safety of offshore oil and gas operations. The UK needs to implement the requirements of the Directive by 19 July 2015. Currently DECC and the Health and Safety Executive (HSE) are working together to establish the OSDR.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE

MUNRO: The main challenges are uncertainty and volatility, together with increased scrutiny by regulators. The UK oil & gas sector faces difficulty on a number of fronts, chief among which is political uncertainty caused by the Scottish independence referendum and the recent general election. There is fiscal uncertainty, following the

THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

complete fiscal review that was undertaken recently. Oil prices have been volatile, with the price per barrel dropping from $110 to below $50 in less than six months. Equally, the sector is operating against an uncertain European backdrop, with banking and financial issues affecting various countries. Increased regulation has also posed problems with the establishment of the Oil & Gas Authority and transfer of responsibilities from the DECC. We have seen the impact of these challenges of late with a short-term decline in M&A activity, and a real focus on costs for operational activities. UKCS exploration activity is expected to be at its lowest level ever this year.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

MUNRO: The sector generally gets a 'bad rap' from the media and general public in relation to environmental and sustainability issues – certain criticisms will always be aimed at the sector simply because of what we do. However, environmental and sustainability issues are always at the top of the agenda, and in many areas the sector is at the cutting edge of progress and development. That doesn't mean that anyone is taking these issues for granted – they are not; the important thing is that the industry is always striving to do better.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

MUNRO: Oil & gas M&A in the UKCS – both offshore assets and corporate deals and the service sector – slowed during the tail end of last year and has yet to pick up. This is largely due to the drop in oil price and the inevitable delay that then occurs while buyers and sellers adjust expectations around valuation going forward. Given that there is evidence of a drop off in shale production from the US, we are hopeful that the supply-demand situation is balancing out, and that the oil price will stabilise or rise. Of course, the other effect of the lower oil price is to make certain companies more vulnerable – whether this is related to contracts being cancelled or price hedging coming to an end – so taking all of that together we expect M&A activity to pick up significantly in the second half of this year.

"We expect to see significant M&A activity in the latter part of this year."

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

MUNRO: We expect to see significant M&A activity in the latter part of this year. We will also likely see a rise in new entrants to the market and certain assets being acquired by 'non-traditional' investors in the UKCS – such as infrastructure funds. In the medium to longer term the decommissioning market will develop and we will understand decommissioning risks and costs better as more decommissioning is carried out. We also expect further fiscal restructuring to ensure that recovery of hydrocarbons from the basin is maximised and regulatory and policy change to facilitate the development of 'unconventional' onshore oil and gas.

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Clare Munro is the head of the oil & gas team. She has over 15 years' experience in the sector and has worked extensively in-house as well as in private practice. As well as her wealth of experience of the UKCS sector, Ms Munro spent time abroad working on projects in Indonesia and China, and also has experience in Norway and the Netherlands. She has particular expertise in project development and transportation, and processing agreements, as well as broad experience in corporate/asset acquisitions and disposals and related diligence exercises, joint venture issues, licensing, farm-ins and production sharing contracts.

ITALY

ROSELLA ANTONUCCI
LEGANCE – AVVOCATI ASSOCIATI

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN ITALY OVER THE LAST 12-18 MONTHS?

ANTONUCCI: Despite the strong growth in renewable energy generation, Italian primary energy consumption is still highly dependent on fossil fuels. Oil products still represent the largest share of energy consumption supplying most of the domestic transport sector's demand. Natural gas provides about 32 percent, supplying industry, power and residential/tertiary sectors' energy demand. The share of coal and solid fuels represents less than 10 percent of domestic consumption. Consumption of oil products continued its long-term declining trend, dropping by about 5 percent, although the first signs of recovery can be detected from increased consumption of diesel, jet fuel and asphalts.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN ITALY?

ANTONUCCI: Italy is still strongly dependent on imports in order to meet domestic demand – in 2014 about 90 percent of oil and natural gas was imported from abroad. Italy imports crude oil mainly from Saudi Arabia, Libya and Russia and natural gas from Algeria and Russia. Considering such import dependency, the slump in oil prices in 2014 is expected to positively affect the Italian economy given the substantial nature of the price reduction for gasoline and automotive diesel over the last 12 months. On the industry side, eroded margins and decreasing cash flows led financial stress in E&P companies, even in cases where hedging strategies were put in place, causing a temporary stop in investments. Downstream activities' impact on margins has been limited, because of the weak link between revenues and oil prices. Natural gas prices in Italy showed a trend similar to other major EU markets in 2014 and in some way opposite to the oil global price trend – renegotiation of long-term oil-linked contracts and increased liquidity in spot markets led to a partial decoupling of EU gas prices from oil prices. On an annual basis, the natural gas price in Italy decreased in 2014 by 17 percent. The decrease has had a positive impact on industrial and residential sectors and led to a strong decrease in electricity prices.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN ITALY OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

ANTONUCCI: Domestic production of hydrocarbons is a priority for the Italian government. In 2014 the government defined a new policy for the E&P sector, aimed at doubling domestic production by 2020. The conversion law of the so-called 'Sblocca Italia' decree introduced simplified permitting procedures for exploration and production in domestic onshore and offshore reservoirs. In particular, Art. 38 of the law introduced a new one-stop licensing regime for E&P activities, based on a single title directly issued by the national government upon completion of a maximum 180-day long proceeding. In addition, the competence for carrying out Environmental Impact Assessment (EIA) processes has been shifted from regions onto the national government and simplified procedures for land-planning variations have been introduced. In February 2015 the Italian Constitutional Court declared 2008's so-called 'Robin Hood Tax' unconstitutional; accordingly, the tax will no longer apply from 2015 onwards. New regulation incentivising generation flexibility in the Italian power market, which will come into effect in 2017, might have an indirect positive impact on the oil & gas sector through the long term stabilisation of natural gas demand from power generation.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

ANTONUCCI: Drops in oil and natural gas prices have resulted in significantly reduced cash flows and financial stress for upstream companies. Executives are being required to assess the most suitable means for raising new capital to cover cash shortfalls and avoid default risk. Under such financial constraints, affecting more 'pure' E&P companies than integrated groups, executives are required to keep production costs as low as possible, temporarily cutting production in high price reservoir and new site explorations, and concentrating operations in a few strategic sites. Accordingly, it is reasonable to expect a significant decrease in development investments in 2015. Companies operating in the downstream sector are also facing challenges to remain competitive in a largely oversupplied market.

"New upstream investment opportunities might arise thanks to the new regulation on Italian E&P."

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

ANTONUCCI: Italy's 2020 target for renewable energy in transportation is set to 10 percent of domestic gross consumption. As of 2013, renewable quotas in transportation were less than 5 percent, covered by domestic and imported biofuels meaning that a lot still needs to be done in order to meet national targets. Specific support schemes have been established to drive renewable energy consumption growth in the transport sector – the 'Certificati di Immissione in Consumo' is a quota obligation system based on an incremental share of renewables in domestic final energy consumption. Retail downstream distributors are obliged to meet annual mandatory quotas of biofuel injection to consumption, either by means of their own production or by the purchase of certificates by other players. Italian investments in biofuel production facilities are still limited. Recent research describes the Italian petroleum industry as energy-efficient, thanks primarily to the quality of machinery and technology adopted by the E&P sector. In addition, thermal energy reuse for self-consumption purposes contributes to boost process energy efficiency, and decrease emissions.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

ANTONUCCI: Some M&A opportunities may arise for financially stable integrated groups that could benefit from the low price acquisition of distressed E&P upstream assets. Yet M&A deals might be constrained by complex price agreements – unless they are under severe distress conditions, sellers would hardly accept strong asset depreciation as potential buyers would expect. Such a mismatch in buy-side and sell-side expectations might slow down potential deal flows. Downstream companies suffering from refining overcapacity and low utilisation rates might also be targeted for acquisition by upstream players interested in the integration of their activity with lower but more stable downstream margins, thus hedging the intrinsic price risk of E&P business.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING

ANTONUCCI: New upstream investment opportunities might arise thanks to the new regulation on Italian E&P. Production of proven oil & gas reserves and the exploration of new sites will mostly be concentrated in southern regions, both onshore and offshore. The natural gas downstream sector might

FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

also benefit from the completion of the new regulatory framework which applies to gas distribution concessions. This could unleash investments in strategic infrastructures, such as LNG terminals and international natural gas pipelines. New investment actual realisation might be slowed down by NIMBYism at local levels, causing unexpected cost increases and eventually risking temporary or even permanent stops in investment pipelines. On the consumption side, domestic oil & gas demands are not expected to reverse in the short term – oil consumption is in a seemingly inescapable decline, even if cheap oil might raise gasoline and diesel consumption. The Italian oil & gas sector might offer interesting opportunities for financially stable majors going forward, both in terms of upstream deployment and of downstream integration, considering that Italy's hydrocarbon reserves are widely regarded as the most important in Europe, after the North Sea. The increase in production of hydrocarbons is a priority from the Italian government in order to make the country as autonomous as possible.

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Rosella Antonucci specialises in project financing, infrastructures and energy, usually assisting Italian and foreign lenders and corporate entities in financing and acquisition matters in the conventional and renewable energy sector, in the financing of construction and operation of infrastructures and in PPP transactions. Mentioned in major individual league tables and legal directories, Ms Antonucci also has considerable experience in the relevant regulatory issues of both the energy and infrastructures/PPP sectors. Ms Antonucci would like to thank, Barbara Paulangelo, a partner at Reliable Energy Advisors, for her assistance and cooperation with these responses.

UKRAINE

OLEKSIY FELIV
GIDE LOYRETTE NOUEL

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN UKRAINE OVER THE LAST 12-18 MONTHS?

FELIV: The oil & gas sector was heavily affected by the annexation of Crimea, the conflict in the Donbass and as a result, disputes with Russian Gazprom over the gas supply to Ukraine. This pushed the government, for the first time in modern Ukrainian history, to diversify the country's gas supply through reverse flow from the EU countries. The government has also moved to reform not only Naftogaz, but also the country's coal industry. Moves have also been made to significantly increase consumer prices and reshape the entire energy sector.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN UKRAINE?

FELIV: The sharp fall in oil prices on key international oil exchanges has enabled Ukraine to purchase reverse flow gas in the range of $270 per 1 q.m. It has also afforded the country a good argument in talks with Russian Gazprom over the gas price for so-called 'summer package' supply. At the same time low gas prices, high royalty rates and restatement of the product sharing agreement were used as official justification, and apparently pushed Chevron to step back from its shale gas project in Western Ukraine. Despite fallen prices, Shell will maintain its shale gas project in Eastern Ukraine.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN UKRAINE OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

FELIV: The government is still looking into increasing local production of natural gas and oil, and recently cancelled the requirement for hydrocarbons producers to provide monitoring and scientific support of subsoil use, which should simplify development of oil and gas fields. The Ukrainian parliament has cancelled the licensing of the supply of natural gas and coal gas methane at non-regulated tariffs. Moreover, Ukraine has allowed US and EU companies, as well as companies owned and controlled by the Energy Community member states, to become operators of the Ukrainian gas transportation system which may trigger foreign investment activity in the gas sector and stimulate gas pipeline upgrades. Finally, the Ukrainian parliament has recently adopted a new gas market law which provides free access to the Ukrainian gas transportation system to any eligible party, secures free choice of a gas supplier and separates activities of vertically integrated gas companies, known as unbundling. Such changes should reshape the gas market and attract significant investments into the oil and gas sector.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

FELIV: High royalty rates for producers of hydrocarbons are the main concern. In particular, royalty rates for oil production have been fixed at the rate of 45 percent if oil is produced from fields less than 5km deep and 21 percent if oil fields are more than 5km deep. Meanwhile, royalty rates for natural gas production have been increased from 20 percent to 70 percent if gas fields lie less than 5km deep, provided that gas is produced for consumption by individuals. At the same time, the rates for gas production for consumption by industrial consumers have been almost doubled to 55 percent from 28 percent for gas fields that lie less than 5km deep and to 28 percent from 15 percent for gas fields which lie more than 5km deep. Moreover, new royalty rates of 70 percent have been introduced for the extraction of shale gas.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

FELIV: Environmental challenges and sustainability issues have not been a top priority for Ukrainian legislators for many years. Nor have these issues been a matter of concern for the majority of industry players. Therefore, oil and gas market players are only expecting legislative changes which should affect the oil and gas sector. In line with the provisions of the Association Agreement, Ukraine will have to develop environmental legislation in order to improve the quality of petrol, reduce greenhouse gas emissions, improve air quality and mitigate climate change risks. In order to comply with the requirements of the EU Directives, Ukrainian oil and gas companies will have to significantly upgrade their worn-out equipment.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

FELIV: Ukraine has a wealth of opportunities in the energy sector, many of which may be very attractive for foreign investors. Reform of the entire energy sector offers opportunities for every market player starting from big projects such as the joint operation of gas transportation systems, down to upstream projects and distribution. Ukraine still has significant reserves of natural gas, oil and shale gas. New opportunities might come for LNG terminals in southern Ukraine, where an LNG terminal may be constructed on the Black Sea coast. Here the Ukrainian government expects positive talks with Turkey on the use of the Bosporus for passing gas tankers. Increased gas prices for private consumers, which should reach the market price by 2017, are considered to be the greatest trigger for the development of the gas market.

"In order to comply with the requirements of the EU Directives, Ukrainian oil and gas companies will have to significantly upgrade their worn-out equipment."

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

FELIV: Unpredictable relationships between Naftogaz and Gazprom and ongoing disputes between the two companies will lead to an increase in the volume of reverse-flow gas supplies from the EU countries in late autumn and winter. This will likely stimulate local gas production and accelerate the substitution of natural gas with alternative fuels and renewable energy sources. Legislative developments will concentrate on the adoption of legislation to implement the new gas market law, the Third Energy Package Directive, within the Ukrainian legal framework.

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CHINA & HONG KONG

VIVIEN YANG
SIMMONS & SIMMONS

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN CHINA & HONG KONG OVER THE LAST 12-18 MONTHS?

YANG: With the dramatic fall in oil prices since June 2014, we have seen an overall slowdown in exploration and production activities with an increase in M&A activities. The increased M&A appetite seems to have come mostly from smaller players, such as Chinese private or provincially-owned oil and gas companies. Indian state-owned companies are also playing an important role in maintaining the level of global oil & gas M&A activity, while Chinese national oil companies (NOCs) significantly reduced their investment in new, large-scale oil and gas projects both at home and abroad, mostly due to their desire to reposition themselves to focus on returns on investment. Indian NOCs are actively seeking upstream investment opportunities worldwide, and many believe that they may replace Chinese NOCs as the new powerhouses for M&A activity in the oil & gas industry. In China, notable trends include the presence of non-NOC players in the LNG market.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN CHINA & HONG KONG?

YANG: Theoretically, low oil & gas prices benefit oil importing countries and hurt exporting countries. Many Asian countries, such as China, India, Korea and Japan, as importers of crude oil, have much to gain from falling prices. However, the low oil & gas price environment has a negative impact in many respects. Firstly, it does not benefit many of the oil & gas companies from the region. Most Asian NOCs and Japanese trading houses have significant upstream investments. The return on such investments is significantly reduced in the current low-price environment. This has a negative impact on the ability of these companies to make further investments in upstream E&P assets, leading to reduced drilling activities and a drop in acquisition appetite. While interests in acquisitions seem high due to potentially low valuations and the likelihood of picking up distressed assets, we have not seen a large volume of transactions. This is due to reasons including lack of ammunition as a result of players' reduced income, increased uncertainty over future return on investment, and tightening of bank finance.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN CHINA & HONG KONG OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

YANG: Domestically, the Chinese government announced a reformation plan in November 2013, calling for a break-up of monopolies in certain sectors and diversified ownership of SOEs. The oil & gas sector and Chinese NOCs are targets of this reformation. By way of a response, PetroChina has partnered with asset managers for the western section of its first and second west-to-east gas pipelines and will open up the eastern section for investment. The LNG import market in China, which used to be the exclusive business of Chinese NOCs, is also being reformed. The PRC NDRC issued guidelines in early 2014 to encourage private companies to invest in LNG and natural gas infrastructure. It also opened access to existing LNG regasification terminals controlled by the Chinese NOCs. From 2014 onwards we have seen small amounts of LNG being imported by private companies from the LNG spot market. In the context of foreign policy and outbound investment, the 'one belt one road' initiative announced in late 2013 is expected to promote Chinese investment into infrastructure and energy sectors in the regions involved. The initiative envisages a Silk Road economic belt that links China with Central Asia, Russia and the Baltic States over land, and with nations in Southeast Asia and around the Indian Ocean by water.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

YANG: In the oil & gas industry, there seems to be a sentiment that there are abundant oil and gas resources; the only question is the cost of extracting them. Low oil & gas prices do not justify high extraction costs, and currently much E&P investment is stalled. This is further exacerbated by the fact that the low price of oil & gas has had a significant impact on the financial performance and profitability of oil and gas companies from the region. Companies may need to scale back new E&P expenditure and cut investment in unconventional oil & gas resources exploration and other costs to minimise loss of profit. Additionally, executives may need to deal with other financial and employment issues arising from poor performance

in their global business. Apart from the risks and challenges derived from low oil & gas prices, anticorruption compliance in the oil & gas sector has been an increasing concern for this sector.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

YANG: The revised and more stringent Environmental Protection Law (EPL) took effect on 1 January 2015. It introduced new measures including increased accountability of polluters, heavier disclosure obligations, more severe punishment for violations and the possibility of public interest lawsuits. These new measures will have a strong impact on the oil and gas business in China. Pollution or environmental liability issues arising from oil companies' activities have not been properly addressed or managed in China to date. After two oil spills in 2011 at the Peng Lai 19-3 oilfield, CNOOC and ConocoPhillips were sued by a group of 21 Chinese firms for damages stemming from the spills. The case was not heard by the court until December 2014 but has raised public awareness of pollution and environmental issues in the oil & gas sector. With the implementation of the newly revised EPL, we believe that there is likely to be heightened scrutiny and more actions from the government and the public against the oil and gas players in China.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

YANG: Sliding oil & gas prices may offer more opportunities to acquire distressed assets and also lower transaction prices in general, which makes investment in the sector more appealing. But buyers are cautious about these distressed assets as it is not always clear whether distress is caused by the low oil price environment or inadequate management. Companies may also consider oil & gas M&A with a view to diversifying risk, reducing costs or organically growing their business. Chinese NOCs used to be the oil & gas M&A powerhouse of the world but we have seen an obvious decline of late. Chinese NOCs are considering a shift to their overseas business operational and investment strategies – the focus has switched from simple growth to profitable growth. Other Chinese companies, however, are emerging in the oil space.

"Chinese NOCs used to be the oil & gas M&A powerhouse of the world but we have seen an obvious decline of late."

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

YANG: We would expect to see more Chinese private firms and foreign companies investing in oil & gas projects in China, despite the temporary setback caused by the current low oil price environment. We believe there will be more opportunities for non-Chinese NOCs in China as access gradually opens to upstream oil & gas investments and LNG import projects. We would also expect a growing diversity of Chinese oil & gas players actively investing in upstream and midstream oil & gas assets worldwide, including provincial state-owned companies, power companies and private oil companies.

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SINGAPORE

JUSTIN TAN
CLYDE & CO CLASIS SINGAPORE PTE LTD

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN SINGAPORE OVER THE LAST 12-18 MONTHS?

TAN: Many countries in Southeast Asia produce significant amounts of crude oil and natural gas, with Singapore a major player in the downstream energy sector and a regional LNG centre of growing importance. The key distinguishing factor of the Southeast Asian region is the fact that most of these countries are relatively stable politically and have fast-growing economies that have continuous year-on-year growing energy needs. With fast-growing energy demand coupled with heavy government direct and indirect involvement in securing energy supplies, oil and gas exploration, production and distribution as well as downstream energy markets, the story has been that of continued investment and growth, particularly by state-owned or state-linked oil and gas production and distribution players that are in the region for the long haul. Some players in oil exploration and production who had invested on the basis of higher energy price levels may have had to relook at their numbers or even liquidate assets, but the overall outlook remains positive. There has also been a trend of some global state-owned oil and gas players, particularly from China and India, acquiring assets in the region, in line with their respective government's energy security policies.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN SINGAPORE?

TAN: There has perhaps been a slight roll back in new investments by Western oil companies whose long term investment plans are vulnerable to the volatility of oil prices, but the slack has been more than picked up by other market players who are more insulated from market volatility. On the downstream and fiscal side, the biggest impact has been the opportunity for previously cash-strapped governments to remove crippling fuel subsidies – fuel subsidies in ASEAN totalled US$51bn in 2012, allowing them more room for restructuring their fiscal policies that encourage more balanced economic growth and that ultimately increases energy demand and continues the ASEAN growth story.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN SINGAPORE OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

TAN: At present, there is much uncertainty surrounding the future trend of oil prices. As such, it may be premature to implement any new policies or regulations, which may be quickly rendered obsolete should prices re-stabilise at a higher level. In the short term, there seems to be a consensus that oil prices will remain low for the rest of 2015. However, the outlook for 2016 remains uncertain, with very few agencies and companies attempting to provide such forecasts. Against this backdrop of uncertainty, polices and regulations that have a longer term impact on oil and gas exploration and production may not be prudent at this stage. However, that is not to say that there have been no changes. To date, a few countries in the region have taken advantage of the lower oil prices to reduce fuel subsidies. Malaysia and Indonesia have removed or reduced most subsidies for gasoline and diesel. Brunei and Vietnam are also considering reducing fuel subsidies. Myanmar is one market that is slowly coming into the mainstream with gradually increasing certainty on its foreign investment climate, and looks very promising in the medium to long term.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

TAN: Until recently, oil and gas companies did not innovate beyond what was required to pull resources out of the ground with a reasonable amount of success. However, there has been a noticeable shift as companies begin to view technology as a new frontier for competitive advantage. Oil and gas companies are using the latest ideas, such as mobility, cloud computing and knowledge management, and wrapping them around their current processes to make everything work better. However, as innovation takes off, companies must turn their attention to protecting the R&D that went into creating this intellectual property, which creates another layer of security that must then be implemented. Oil and gas companies are facing an explosion in the amount and types of data that their assets generate, yet they risk being less competitive if they do not make this data work for them. Organisations must also understand that while their

"The declining oil prices undoubtedly present a significant window of opportunity to reform energy taxes and fuel subsidies."

data presents business opportunities, it also raises certain challenges. For example, industry leaders must determine how to analyse and present their data in a way that allows the firm to create action, both in terms of driving business strategies and in understanding anomalies associated with their critical assets.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

TAN: Some trends are promising. The share of official development assistance committed to green objectives is larger on average in Southeast Asia than the global average, though the share varies widely amongst individual countries. Unfortunately, Southeast Asian countries are not yet systematically implementing the policies that will support green investment. For example, current policies provide insufficient and unsteady support for renewable energy, and subsidies unduly favour fossil fuels. Coal, being cheap and abundant, remains the fuel of choice for power generation, with three-quarters of new power generation capacity coming online in the region over the next few years being coal-fired, despite its adverse environmental impact.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

TAN: The energy-related M&A in Southeast Asia, particularly in the upstream sector, is driven primarily by the need of most of these developing countries to fuel their fast-growing economies and populations. The focus remains very much on fossil fuels rather than renewables. In the near term, most of Southeast Asia will benefit from the downward pressure of low oil and natural gas prices on transportation, consumer goods and other commodities. But protracted low energy prices could deter foreign investment into offshore oil and natural gas developments. However, we expect intra-ASEAN investment to remain consistently strong given the region's energy demand growth. Southeast Asia is a diverse, fast-growing and dynamic region, so there are always a varied range of opportunities across the region, whichever part of the market you operate in.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

TAN: The declining oil prices undoubtedly present a significant window of opportunity to reform energy taxes and fuel subsidies, which are substantial in several developing countries, and reinvigorate reforms to diversify oil-reliant economies. If sustained over the medium-term, low oil prices may encourage a move towards production, which is generally more intensive in fossil fuels or energy. This runs counter to broader environmental goals in many countries. To offset the medium-term incentives for increased oil consumption, while at the same time building fiscal spaces, policymakers could modify tax policies on the use of energy, especially in countries where fuel taxes are low. For oil exporting countries, the sharp decline in oil prices is also a reminder of the vulnerabilities inherent in a highly concentrated reliance on oil exports and an opportunity to reinvigorate their efforts to diversify. These efforts should focus on proactive measures to move incentives away from activities in the non-tradable sector and employment in the public sector, including encouraging high-value added activities, exports in non-resources intensive sectors, and development of skills that are important for private sector employment.

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UZBEKISTAN

UMID ARIPDJANOV
COLIBRI LAW FIRM

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN UZBEKISTAN OVER THE LAST 12-18 MONTHS?

ARIPDJANOV: The government of Uzbekistan has promoted the construction and financing of petrochemical facilities in an effort to diversify the economy and shift the focus of exports from exporting raw materials. In order to address growing oil consumption, Uzbekistan plans to gradually reduce its oil imports by converting natural gas into other hydrocarbon products such as diesel, kerosene and LPG. Furthermore, the withdrawal of Malaysian Petronas Carigali from all existing petroleum upstream projects in Uzbekistan, including its withdrawal from the Baisun Production Sharing Agreement, Surkhanski Production Sharing Agreement and Urga Production Sharing Agreement, has had a major impact. The company also opted out of the investors' consortium operating under the Aral Sea Production Sharing Agreement.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN UZBEKISTAN?

ARIPDJANOV: The Uzbek economy is somewhat isolated from global trends in the oil and gas industry, as it is one of only two double-landlocked countries in the world, accordingly there are not many choices to market hydrocarbons. Due to declining production of oil, Uzbekistan has only benefitted from importing crude oil by refining it in its numerous but underutilised refineries and marketing the refined products through local monopolistic chains. As to gas, Uzbekistan was able to balance export channels and, equally, invested significantly in the downstream industry. The industry has seen only major 'strategic' investments on a large scale and has never permitted small or medium size investors to engage. This approach enabled Uzbekistan to attract massive investments estimated at around $8bn in field developments and construction of gas treatment facilities under production sharing agreements.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN UZBEKISTAN OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

ARIPDJANOV: There have been many public discussions and sessions of the government that have identified a number of policies in the energy sector. With the completion of the 100 MW Samarkand Solar Power Project by 2019 and the introduction of other renewable energy initiatives, the government is aiming to generate about 21 percent of all its energy from renewable sources by 2031. The government is also contemplating developing a strategy for the use of alternative sources of energy, along with the very intensive construction of small HPPs in the near future. There have been a number of developments in energy efficiency – campaigns are being carried out to install modern meters for consumers of natural gas, hot water and electrical power for households. With the implementation of electronic electricity meters, the government plans to introduce an automated system to the commercial recordkeeping of electric power. The government intends to diversify the economy by building and operating petrochemical facilities that use natural gas as a raw material to produce petroleum products, instead of exporting natural gas. The Uzbekistan GTL facility is expected to convert gas into liquid hydrocarbons and decrease the import of crude oil. Consumer vehicles are also expected to convert from use of gasoline to use of gas-powered engines. In terms of utilisation Uzbekistan is one the world's top 20 gas-flaring countries with 1.8 bcm flared annually. This is being addressed through a program on the utilisation of associated gas which was developed by Uzbekneftegaz for its subsidiaries, and is followed by foreign investors operating under Production Sharing Agreements. In terms of gas exports, to increase and diversify exports, the government plans to increase gas production by attracting foreign investors for the exploration and development of hard-to-recover fields and committing additional volumes for the Central Asia-China Gas Pipeline. The government also plans to significantly increase production of oil and gas condensate to keep the country's economy independent of oil imports that normally comes from Kazakhstan. As Kazakhstan becomes a member of the Russia-led Customs Union with its specific charges on oil for non-members, Uzbekistan is seeking alternative ways to import oil.

"In the long run, conventional petroleum corporations are likely to experience further pressure from shale gas players once the prices for oil & gas go up."

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

ARIPDJANOV: A rather rapid change in pricing for oil and gas caught many executives off-guard. This is particularly true for those corporations and their management that were heavily reliant on unconventional or offshore projects that require sizable and risky investments at the first stage and costly capex injections at later stages. Now with the declining cash flow, executives need to optimise their books, revise and reduce opex, review development and exploration work programs, find a long-term debt financier or reach those willing to farm-in. Selling a minority share or forming a portfolio offer is an option, but many cash-cows may not be really willing to put cash at risk. The role of multilaterals, exims and sovereign funds will only increase going forward, as they would be the best possible last resort for many executives to keep their upstream companies floating. This will have a chilling effect on costly oil & gas projects, but that is not everything. This would also affect the market for refined petroleum or gas products. Infrastructural downstream projects that the government and foreign investors were eyeing to develop on the basis of vast oil and gas reserves pale in terms of economic feasibility. Likewise, unfortunately, alternative energy projects are likely to be promoted exclusively with the support of the government.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

ARIPDJANOV: The failure of governments to reap the benefits from taxation or production sharing in upstream projects has made them move to collect fines for non-compliance or emission fees. Many producers were not prepared for environmental challenges, but the situation is different in Uzbekistan. Environmental control or ecological monitoring have always been in place for upstream operations – an investor needs to procure 'favourable' opinions from the State Committee for Environmental Protection before commencement of operations. Similarly, any blow-out is viewed as an extraordinary circumstance that requires proactive intrusion of the specialised unit.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A

ARIPDJANOV: Oil & gas M&A in today's market is in keeping with the 'shared economy', and basically offers parties the chance to share risks at this stage to share production or profit later. We have seen many pull outs,

IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

farm-ins and joint ventures used to save a particular upstream project from collapsing. Also we are seeing more Asian and governmental entities coming in to replace Western and private players. Gulf region investors are also more active; increasingly Western investors are scaling down to sharing contracts instead of M&A deals. Early exploration projects are unfortunately first to suffer, and, are normally abandoned first.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

ARIPDJANOV: In the long run, conventional petroleum corporations are likely to experience further pressure from shale gas players once the prices for oil & gas go up. This trend will cause the government to restructure the industry to minimise exports of crude hydrocarbons and to build more downstream facilities to add more value and diversify the economy. The government will also put serious efforts toward the efficient use of energy, strengthening environmental regulations and the utilisation of associated gas. Energy companies will also be required to sponsor or co-invest into green energy or alternative energy projects.

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SOUTH AFRICA

ROY WALIGORA
KPMG

Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN SOUTH AFRICA OVER THE LAST 12-18 MONTHS?

WALIGORA: In South Africa, developments in the oil & gas sector are presenting local industry with certain challenges. First and foremost is the energy crisis – public interest in energy is at unprecedented levels given the power crisis in South Africa. Eskom, the national power and utility company, and the South African government have acknowledged that due to various factors, the electricity network will be under severe capacity constraints for the foreseeable future. To manage the grid, Eskom has implemented structured power outages or 'loadshedding' that is negatively impacting daily life and crimping the country's economic growth. Loadshedding has shined a spotlight on diesel supply required to run power stations and the price being paid for diesel by Eskom. There has also been a lot of excitement about the potential for shale gas for South Africa with much public debate between the exploration companies and environmental groups over the impact this may have in the environmentally sensitive area of the Karoo. However, notwithstanding this debate there has been a lengthy delay with the regulations over the development of shale gas. Equally, there is an uncertain regulatory regime covering the level of government's participation in new oil ventures as set out in the Mineral and Petroleum Resources Development Act (MPRDA) and various proposed amendments. The timing of clean fuels regulations that clarify the recovery mechanism for significant capital spend on required upgrades to aging refineries in South Africa have also been the subject of considerable regulatory uncertainty. Regulatory concerns have also extended to South Africa's focus on core businesses, there is a continued drive by the multinationals (MNCs) to simplify or even exit the traditional downstream operations and concentrate on supply and refining.

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN SOUTH AFRICA?

WALIGORA: The sharp fall in the oil price has affected the view on long term capital investment decisions, particularly in upstream projects. We've seen a decline of requests for feasibility studies and postponements to committing capital in the region. The low oil price and the existing uncertain regulatory environment are not positive factors for new investment in South Africa. In neighbouring countries such as Mozambique and Namibia, investment in gas continues to grow. In South Africa, the oil & gas industry is mainly a downstream market – refining, supply and retail – and the petrol price is strictly regulated so the decline in the oil price has not necessarily led to any significant decline in profitability in the downstream environment.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN SOUTH AFRICA OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

WALIGORA: In South Africa there are two main regulatory issues. The first is employment equity via the Broad-Based Black Economic Empowerment Amendment Act 2013 (BBBEE). The industry, represented by the South African Petroleum Industry Association (SAPIA), is seeking to transform itself in line with new regulations and ownership requirements. This is particularly relevant with the introduction of new operators in the retail and wholesale sector. The proposed amendments to the MPRDA are controversial and unclear. In a widely welcomed move, the amendments have been put back to parliament for consideration, though this has not clarified the position. Prior to the amendments there was an independent oil & gas regulator, the Petroleum Agency SA (Pasa) which has effectively been cancelled and the Department of Energy (DoE) has authority over oil ventures. The issues included giving the State a free 20 percent stake in all new energy projects, as well as a seemingly unlimited additional share at an undefined 'agreed price'. There has been much public discussion that the legislation should separate oil & gas from mining in the MPRDA, which has also not been clarified.

"Expenditure will be focused on maintenance of existing infrastructure rather than expansion in South Africa."

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

WALIGORA: In the face of regulatory uncertainty, there will be a delay to capital projects, such as shale gas and the upgrades to the refineries. The uncertainty over the lengthy delay is a concern as corporates may choose to focus on different markets in the interim. In terms of consumption patterns, there has been a steady increase in demand for diesel, which has outstripped petrol for the first time in 2013. In the short-term, industry leaders are worried about the power situation and will seek to avoid unannounced power interruptions as much as possible with the use of private generators. With loadshedding and power supply issues unlikely to change soon, industry needs to manage supply of diesel, adequate storage facilities and stock on hand.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

WALIGORA: The nature of the industry seems to polarise views on environmental challenges and safety. For example, the proposed shale gas development in the Karoo by means of hydraulic fracking is hotly opposed by environmental groups over concerns ranging from traffic, excessive water use and ground water contamination. In our experience, the industry is very sensitive about compliance with Health, Security, Safety and Environmental (HSSE) obligations and standards and invests substantially in training and monitoring these risks. All industry players, it would appear, are acutely aware of the reputational damage that a major incident could have. However, it is hard to say whether public opinion is convinced. The move to clean fuels must also be considered an environmental issue.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

WALIGORA: The major transaction was the proposed $1.5bn acquisition of Engen by the national oil company PetroSA. This did not go ahead and we are seeing a number of smaller M&A activity, including the acquisition of storage facilities, the continued expansion of trading and supply companies with a focus on BBBEE partners, new entrants of non-producing wholesalers, and an active market in the sale and purchase of forecourt operations. In the medium to long term, clean fuels may also present deal opportunities. In 2013, the government gazetted legislation requiring all South African refiners to comply with EuroV fuel specifications by 2017. The estimated cost of the refinery upgrades is estimated at approximately $3.4bn. The lack of infrastructure makes it difficult for gas to play a significant role in South Africa's energy mix, more specific the lack of investment in pipelines, shipping and storage facilities. This is an area that may also drive investment.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

WALIGORA: The downstream industry will continue to transition in the near term with traditional MNCs focusing on supply and refining and the distribution and retail segment being taken over by a number of new entrants – with less emphasis on branded retail sites. Expenditure will be focused on maintenance of existing infrastructure rather than expansion in South Africa. In a sense, these assets will remain the same but the ownership will change and become more widespread over time. The role PetroSA plays cannot be ignored and it can change the oil & gas landscape. In terms of upstream investment, this is correlated to underlying commodity prices and stability of regulation. Unless there is some regulatory certainty, South Africa is unlikely to see any significant new investment.

KPMG

cutting through complexity

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Roy Waligora is a chartered accountant and partner at KPMG, specialising in servicing the oil & gas and mining sector in a number of Southern Africa countries. He conducts a variety of projects on behalf of many well-known oil and gas multinationals. Mr Waligora's service line is the provision of forensic services and he is an experienced project manager of complex fraud and financial investigations and disputes. He has also advised local and global clients to manage and improve compliance and governance, and has helped coordinate KPMG's responses to issues in the oil & gas and mining sectors.

GHANA

ATSU AGBEMABIASE
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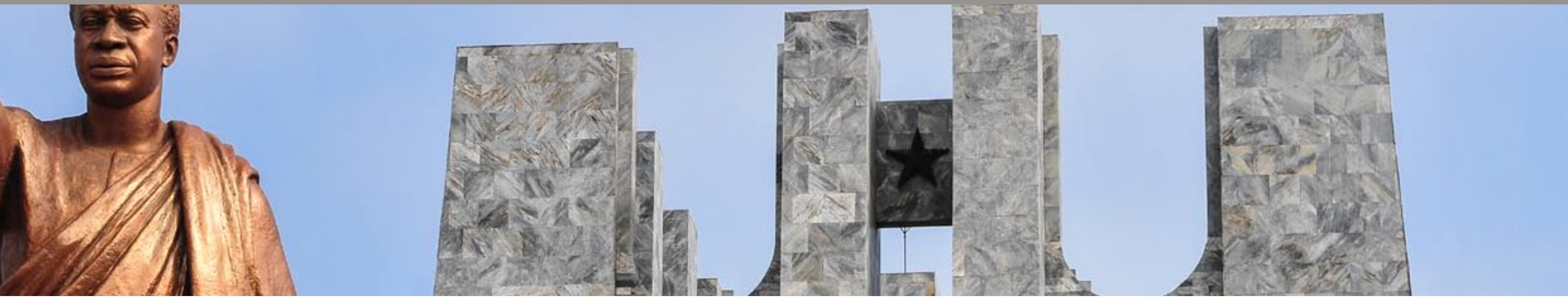
Q COULD YOU OUTLINE SOME OF THE MAJOR TRENDS IN THE OIL & GAS SECTOR IN GHANA OVER THE LAST 12-18 MONTHS?

AGBEMABIASE: The oil & gas sector over the past 12-18 months has seen the beginning of the production of gas locally by the Ghana Gas Company at Atuabo. The production of gas at Atuabo is meant to be used to feed Ghana's thermal plants for electricity or power production. Some of the gas is also meant to be used locally for domestic purposes. There has also been ongoing exploration works by Tullow and its partners on the newly discovered TEN fields. The TEN fields have been and continue to be the subject of an ongoing boundary dispute between Ghana and the Ivory Coast. The case is currently before the International Tribunal of the Law of the Sea (ITLOS).

Q HOW HAVE RECENT OIL & GAS PRICES IMPACTED THE SECTOR IN GHANA?

AGBEMABIASE: The recent fall in oil & gas prices has affected the revenues and budgets of oil producing countries such as Ghana and Nigeria. Nigeria is reported to have recently borrowed money to pay public sector workers and Ghana has also sought loans for budgetary support. In terms of oil & gas firms, the fall in oil prices has meant that some, like Tullow, have had to downsize and lay off workers. Others are also reviewing and further streamlining their operations in response to the falling prices.



Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN GHANA OVER THE LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

AGBEMABIASE: There has been the introduction of the local content law. The effect of that law is that, as much as possible, all goods and services for the oil & gas industry must first be sought locally. Also, as part of the law, there must be Ghanaian equity participation and ownership in all oil & gas firms operating in Ghana. As a result, all companies are expected to restructure their undertakings where necessary to take into account this new local content law.

Q WHAT PARTICULAR RISKS AND CHALLENGES ARE EXECUTIVES FACING IN TODAY'S MARKET? HOW ARE THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

AGBEMABIASE: The major challenges being faced by executives in the oil & gas industry relate to how to smoothly incorporate or rework the new local content requirements into their already established operations. Executives are also facing the challenge of how to effectively restructure during this downsizing, which has been necessitated by the recent slump in oil prices.

Q IN YOUR OPINION, HOW WELL IS THE SECTOR RESPONDING TO ENVIRONMENTAL CHALLENGES AND SUSTAINABILITY ISSUES?

AGBEMABIASE: The sector is trying its best to take the best care possible of the environment. A lot of civil society groups are also in the picture, putting a lot of pressure on the industry for environmental and sustainability concerns to be addressed. All stakeholders are doing their best, albeit with limited resources.

Q WHAT FACTORS ARE DRIVING OIL & GAS M&A IN TODAY'S MARKET? ARE THERE ANY SEGMENTS OR REGIONS THAT SEEM TO BE OFFERING A WEALTH OF DEAL OPPORTUNITIES?

AGBEMABIASE: The need for local equity participation and ownership of Ghanaians in the oil & gas industry as promulgated by the local content law drives a lot of joint venture partnerships in Ghana's oil and gas industry. Both local and foreign firms in the industry are coming together to form joint ventures for operations in order to fulfil local content requirements.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING FORWARD? WHAT ISSUES DO YOU BELIEVE WILL SHAPE REGULATIONS AND BUSINESS STRATEGIES IN THE MONTHS AND YEARS AHEAD?

AGBEMABIASE: The price of oil will affect the growth or otherwise of the industry in Ghana. If the price rises, more players are likely to come on board. Also, the ruling in the maritime boundary dispute between Ghana and Ivory Coast would also have a telling impact on production of oil in the country.

"Both local and foreign firms in the industry are coming together to form joint ventures for operations in order to fulfil local content requirements."

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Atsu Agbemabiase is a researcher, business consultant and adviser with a finance background. He is currently one of the International Bar Association's contacts on money laundering in Ghana. He also acts as a consultant on AML/CFT issues. He is the co-partner and manager in charge of content for all of A & A Consulting Limited's advisory services. Mr Agbemabiase is also currently a Research Fellow at a top corporate law firm in Ghana, and as a consultant has co-authored several publications on topics such as mergers & acquisitions, oil regulation, arbitration and anti-money laundering with respect to the Ghanaian jurisdiction.

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