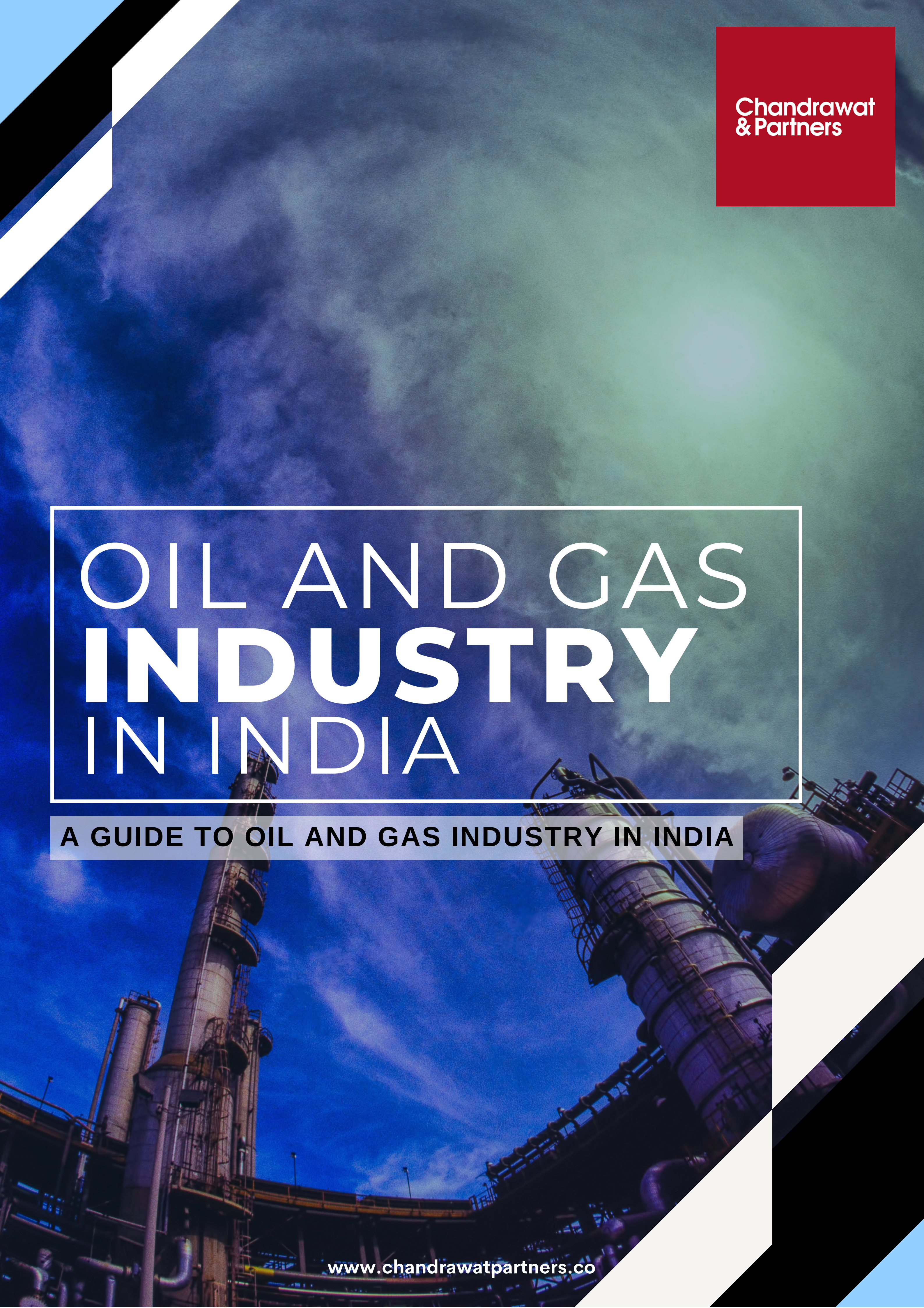

Chandrawat & Partners

OIL AND GAS INDUSTRY IN INDIA

A GUIDE TO OIL AND GAS INDUSTRY IN INDIA

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INTRODUCTION

India is the third-largest energy consumer in the world. The oil and gas industry has been playing a vital role in the development of the Indian economy as well as being a crucial sector among the eight core industries in India.

Apart from the other major industry sectors, the oil and gas industry has been lobbying for an impact on the Indian economy since its inception. India's need for oil and gas is projected to increase, thereby making the sector quite conducive to investment.

As of August 1, 2022, India had 10,420 km of crude pipeline network, with a capacity of 147.9 Million metric tonnes per annum ("MMTPA"). India's crude oil production in April–July 2022 stood at 9.91 Million metric tonne ("MMT"). As of June 30, 2022, Gas Authority of India Ltd. ("GAIL") had the largest share (57.74% or 19,524 km) of the country's natural gas pipeline network (33,815 km).

India's refining capacity stands at about 248.9 MMTPA as of April 2022, comprising 23 refineries—18 in the public sector, 3 in the private sector, and 2 in a joint venture. Indian Oil Corporation ("IOC") is the largest domestic refiner with a capacity of 80.55 MMTPA.

India plans to almost double its oil refining capacity to 450 mega tonne ("MT") in the next 10 years to meet rising domestic fuel demand as well as cater to export markets. Natural gas production for Financial Year 2020-2021 was 28.67 billion cubic meters ("BCM") and Natural gas production for Financial Year 2021 was 28.67 billion cubic meters.

The government has adopted several policies to fulfil the increasing demand. It has allowed 100% foreign direct investment ("FDI") in many segments of the sector, including natural gas, petroleum products, and refineries, among others.

India is expected to be one of the largest contributors to non-organization for economic co-operation and development ("OECD") petroleum consumption growth globally. India's consumption of petroleum products stood at 72.74 MMT in April–July 2022. High-speed diesel was the most consumed oil product in India. and accounted for 38.84% of petroleum product consumption in Financial Year 2022.

LEGAL AND REGULATORY FRAMEWORKS

ROLE OF THE UNION AND STATES

As per the Constitution, the union has exclusive powers to make laws regarding the regulation and development of oil fields, mineral oil resources, petroleum, and petroleum products.

In terms of the states, licences and leases for land vested in a state are granted by the respective state governments, with prior approval from the union government. The Union Ministry of Environment, forests, and climate change, environmental clearances in cases of oil and gas exploration must be obtained from the state government concerned.

OWNERSHIP

As far as the ownership of oil and gas rights is concerned, Article 297 of the Constitution declares that petroleum in its natural state in the territorial waters and the continental shelf of India is vested in the union.

According to the Model Production Sharing Contract ("Model PSC") and the Model Revenue Sharing Contract ("Model RSC"), which serve as templates for agreements with exploration and production contractors, the union government is the sole and exclusive owner of the petroleum underlying the area.

Domestic oil and gas legislation

The following are the key pieces of legislation pertaining to upstream oil and gas sector:

1) **The Oilfields (Regulation and Development) Act, 1948 ("the Oilfields Act"):** The Act regulates and develops oilfields and mineral resources, respectively, in the public's interest. The Oilfields Act also regulates the licensing and leasing of oil and gas blocks. In this regard, the Oilfields Act provides rule-making power to the Indian government with respect to mining leases and mineral oil development, etc.

2) **The Petroleum and Natural Gas Rules, 1959 ("the PNG Rules"):** The rules regulate exploration licences and mining leases with respect to petroleum and natural gas belonging to the Government of India and the conservation and development thereof.

3) **The Mines Act, 1952 ("the Mines Act") and Oil Mines Regulations, 2017:** The Act establishes the provisions relating to the health, safety, and welfare of workers in oil mines. The Mines Act also highlights the duties of owners, agents, and managers and the penalties in cases of contravention of the provisions.

4) **The Petroleum and Natural Gas ("Safety in Offshore Operations") Rules, 2008 ("the PNG Safety Rules")**: The PNG Safety Rules prescribe safety standards and measures to be taken for the safety of offshore oil and gas operations. The PNG Safety Rules provide for the manner of preparation of information and records; various consents and intimations in relation to the offshore installations; safety, health, and environment measures, etc.; and prescribe the penalties for contravention of the PNG Safety Rules.

Apart from the above legislation, the Indian government from time to time promulgates policies, standards, directives, and guidelines for governing various aspects of the upstream oil and gas sector.

GOVERNMENT REGULATIONS

The following are the key regulatory and administrative agencies concerned with the upstream oil and sector in India:

1) **The Ministry of Petroleum and Natural Gas ("MoPNG"):** This is the nodal ministry at the federal government level that supervises the exploration and production activities of petroleum and natural gas and administers various pieces of legislation, including the Oilfields Act.

2) **The Directorate General of Hydrocarbons ("DGH"):** The objective of DGH is to regulate and oversee the upstream activities in the petroleum and natural gas sectors and to advise the MoPNG in these areas. The major responsibilities of the DGH include providing technical advisory services to the MoPNG with respect to exploration and optimal exploitation of hydrocarbons.

3) **The Petroleum and Natural Gas Regulatory Board ("PNGRB"):** It is the regulator for the midstream and downstream sector and has been empowered to regulate the refining, storage, transportation, distribution, marketing, and sale of petroleum, petroleum products and natural gas. Therefore, transportation and evacuation of petroleum by pipelines outside the delivery point is subject to the PNGRB's oversight and regulations.

In addition to the above, there are other general regulatory and administrative bodies looking into matters such as the environment, labour and tax that may be relevant for a company operating in the oil and gas sector in India.

EXPLORATION AND PRODUCTION

Both onshore and offshore oil exploration activities are undertaken in India. Some areas may be off-limits due to defence requirements or other reasons, like the existence of national parks, and will not come under bid for exploration. Furthermore, drilling is prohibited (except with special permission from the central government) within specified distances of pipelines, railways, dwellings, industrial plants, aircraft runways, buildings used for military or public purposes, or within 3 kilometres of any mine.

Exploration and Production – Rights

The rights to explore and produce are granted by the MoPNG through international competitive bidding and pursuant to the policies of the government. The government executes a revenue-sharing contract ("RSC") with the successful bidder. RSC's are not open for any significant negotiations.

The successful bidder is required to apply for a license or a mining lease to the relevant government in accordance with the Petroleum and Natural Gas Rules of 1959. A fee of 100,000 Indian rupees for a license and 200,000 Indian rupees for a lease is to be paid to the relevant government along with the application.

There are no prescribed timelines for the grant of a licence or lease. The fees specified here are subject to change.

Every licence or lease shall contain terms and conditions prescribed by applicable rules and such additional conditions as may be provided in the agreement between the government and the licensee or lessee.

Government Participation

A state oil company has a right to participate for a license. There is no mandatory participation through state oil companies or any interest on the part of the government. The statutory mandate is with respect to participating interests.

The model RSC also provides for the determination of the government's share of revenue. Under this model of operation, the government receives a share of the gross revenue from the sale of oil, gas, etc., from the first day of production. Bidders are required to quote revenue sharing in their bids. They are required to quote a different share at two levels of revenue called "lower revenue point" and "higher revenue point."

LICENSING

Lease/license/concession terms

Under the model revenue sharing contract issued according to the Hydrocarbon Exploration and Licensing Policy, an exploration period of eight years is provided for onshore (including coal bed methane) and shallow water blocks, and a period of ten years is provided for forward area, deep water area, and ultra-deep water blocks. In certain circumstances, the period can be extended by six months. Requests for extensions beyond six months will be decided by the Directorate General of Hydrocarbons based on the policy for extension of exploration phases set out by the government.

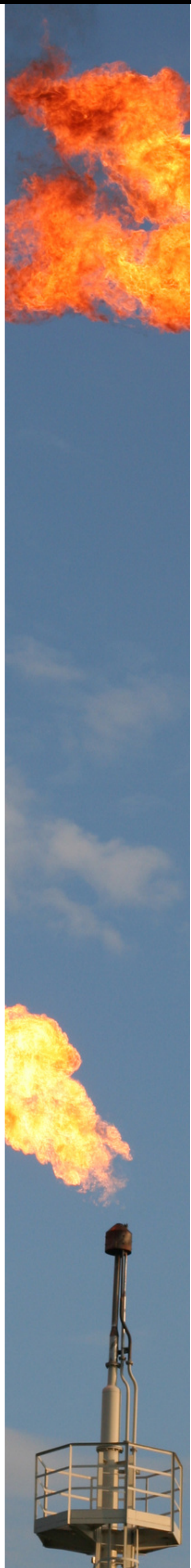
Statutory conditions of licence/lease

One of the main conditions of a petroleum mining licence is that the contractor be appointed and constituted as the exclusive entity to conduct petroleum operations in the oil and gas block. The contractor is solely responsible to the government for executing and managing the petroleum operations in accordance with the production and/or revenue sharing contract.

The contractor can lay pipelines, build roads, construct bridges, ferries, aerodromes, landing fields, radio telephones, and related communication and infrastructure facilities as necessary for carrying out the petroleum operations, subject to approval from relevant authorities.

Where the contractor comprises two or more members, a joint operating agreement must be entered into, providing details on contribution to costs, default, sole risk, and responsibilities relating to the preparation and implementation of the work programme.

During the exploration phase, the contractor must complete the minimum work programme laid out, failing which it will be liable to pay liquidated damages to the government. The contractor is also required to submit a bank guarantee and a guarantee from its parent company for the due completion of the minimum work programme under the production/revenue sharing contract.



Exploration and production rights- procedure

The application process to obtain a contract or license for exploration and production rights involves the following procedure:

- **Bidding:** A technically and financially qualified company or consortium submits an expression of interest along with the notified application fee and a participation bond of a specified value, depending on whether the expression of interest is for a petroleum operations contract or a reconnaissance contract.

- **Acceptance window:** Suo-moto expressions of interest are accepted throughout the year in three windows. Applications for expressions of interest are evaluated on a first-come, first-served basis. The DGH endeavors to finalize the expressions of interest received within 30 days of the closure of each window, subject to internal/government approvals.

- **Carving of blocks:** Upon conclusion of the evaluation period, the DGH carves out blocks based on the suo-moto expression of interest.

- **Notice inviting offer:** The DGH then offers the blocks by way of competitive bidding through a "notice inviting offer." The DGH endeavors to complete the evaluation within 45 days of the bid closing date, which is generally 60 days from the date on which the notice is published.

- **Evaluation:** The evaluation criteria are specific to the category of sedimentary basins, depending on whether these belong to Category I, II, or III as formulated by the central government.

- **Execution of revenue sharing contract ("RSC"):** In the case of competitive bidding, blocks are awarded to the successful bidder, which is then given 45 days to sign the contract.

TAXATION AND TAX INCENTIVES

Corporate tax is levied at the rate determined by the Income Tax Act of 1961. Domestic companies with a turnover of up to INR 250 billion pay a standard corporate tax of 25%; those with a turnover of more than INR 250 billion pay corporate tax at a rate of 30%. A 4% health and educational tax is also levied on domestic companies.

Similarly, foreign corporations (or their branches) pay a standard corporate tax rate of 40% on income earned in India. In addition, a surcharge of 2% on tax for a foreign company must be paid if income is more than 10 million INR. Both domestic and foreign companies are also subject to a surcharge.

A minimum alternate tax (MAT) is applied to a company if its tax liability is less than 15% of its book profits. If MAT is applicable, the tax will be calculated at 15% of the business's book profits.

Crude oil, high-speed diesel, petrol, natural gas, and aviation turbine fuel are exempt from the ambit of goods and services tax, but continue to be subject to central excise duty, state value-added tax, and electricity duty.

Tax incentives

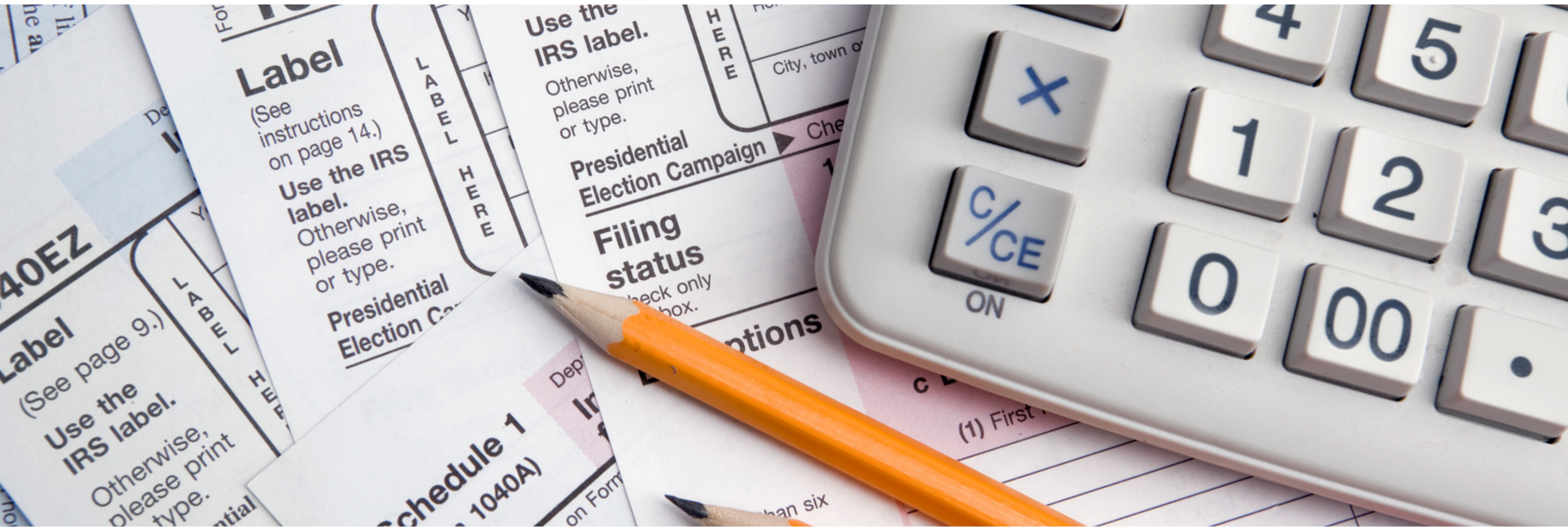
The Income Tax Act provides for a tax holiday for an assessee whose profits and gains are derived from the commercial production and refining of mineral oil in India. Such assessments must have commenced:

- mineral oil production after 31 March 1997, but before 1 April 2017.
- mineral oil refining between October 1, 1998, and March 31, 2012; or
- natural gas production (in certain blocks) on or after April 1, 2009, but before April 1, 2017.

1) Capital and revenue expenditures on exploration and drilling are 100% tax deductible. These costs are aggregated until the year of the commencement of commercial manufacturing.

2) Provisions for site restoration expenses are eligible for a special deduction, provided that the funds are placed in a designated bank account. The deduction is limited to the lesser of either the sum deposited in a separate bank account (the site restoration account) or 20% of the business's income for the preceding fiscal year.

3) Additionally, the Income Tax Act provides for accelerated depreciation, which supplements deductions from taxable income. For mineral oil companies' field activities, the depreciation rate for designated assets is 40%, as opposed to the generic rate of depreciation on a written-down basis at only 15%.



DISPUTE RESOLUTION

Forums for oil and gas disputes

Petroleum and Natural Gas Regulatory Board (PNGRB): The PNGRB Act empowers the PNGRB to exercise such jurisdiction, powers, and authority as are exercisable by a civil court on matters relating to:

- The refining, processing, storage, transportation, and distribution of petroleum.
- The marketing and sale of petroleum, the quality of service, and the security of supply to consumers.
- Registration or authorization issued by the PNGRB under Section 15 or Section 19 of the act.

The Appellate Tribunal for Electricity, established under the Electricity Act, 2003, has been designated as the appellate authority to hear appeals against the PNGRB's orders. The second appeal lies before the Supreme Court of India.

Arbitration

Arbitration is an exception to the jurisdiction of the PNGRB. Accordingly, if the agreement between the parties provides for the settlement of disputes by arbitration, as is typically the case with revenue sharing contracts (RSCs), then a party will be required to initiate arbitration proceedings.

Conciliation and mediation by expert committee

The Ministry of Petroleum and Natural Gas issued a notification appointing an Expert Committee for Dispute Resolution to undertake conciliation and mediation for the resolution of disputes concerning exploration and licensing between the parties, as per the Arbitration and Conciliation Act, 1996.

SALE AND TRADE

The Hydrocarbons Exploration and Licensing Policy grants freedom to exploration and production companies to market and price natural gas and crude oil. Companies have the freedom to market natural gas and sell its entitlement under the policy for gas utilisation among different sectors for domestic sale.

The contractor must sell 100% of its entitlement to petroleum from the contract area into the domestic market until India becomes self-reliant.

Oil pricing

A contractor has the freedom to price and market the oil produced from blocks under a revenue-sharing contract. The price of petroleum must be determined on an arm's-length basis by the contractor.

Gas pricing

Under the revenue sharing contract's domestic sale obligation, the contractor is free to market natural gas and sell its entitlement in accordance with government policy for gas utilisation among various sectors.

HOW WE CAN HELP?

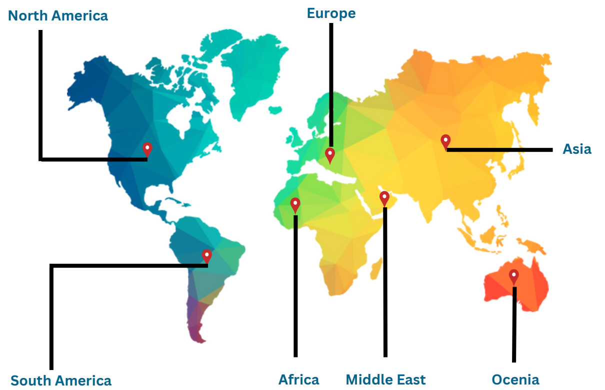
We guide and advise our clients through the process of developing, financing, and operating a wide range of onshore energy projects, from licencing through decommissioning. Our team provides continuous support and guidance on various facets of oil and gas law throughout the business lifecycle.

We are well placed to assist our clients in capitalising on opportunities in emerging markets, such as the development of flexible gas peaking projects, the decommissioning of offshore oil and gas installations, and carbon capture and storage.

Our team helps clients in:

- Production sharing agreements, licensing (royalty and taxation regimes) and risk-sharing agreements.
- Risk advisory, including sanctions and export controls, and human rights.
- Shale and hydraulic fracking
- Structuring of oil and gas operations, including joint ventures and other commercial arrangements.
- Taxation and compliances.

SERVING CLIENTS WORLDWIDE



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