OIL & GAS

ANNUAL REVIEW **2016**

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

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INTRODUCTION

Oil & gas is an industry that has seen its fair share of ups and downs over recent years – a commodity business seemingly embroiled in a constant cycle of adversarial challenge underpinned by a 'boom to bust and back again' mentality.

Certainly, volatility and dramatic change have done much to shape the industry landscape over the past 12 months or so, with plummeting oil prices doing much to plunge a substantial number of operators into distress.

Moreover, across the globe the consequences of the downturn are stark. An estimated 350,000 jobs have been lost. Graduate programmes are being cut, meaning a sizeable gap in talent further down the line. Many oil & gas companies are filing for bankruptcy protection, although many that have done so are still operating. And companies are frantically redesigning their operating models to accommodate a world where oil trades at $45 to $65 per barrel.

Compounding the gloomy scenario is a recent report by Bloomberg which asserted that the oil & gas industry is set to cut $1 trillion from its planned spending on exploration and development due to the slump in oil prices – a move that will make it even more difficult for the industry to maintain high safety and delivery standards at a reduced cost.

In the past, the oil & gas industry was undoubtedly profligate in its expenditure; however, with market conditions currently difficult and the impact of extraordinarily volatile oil prices continuing to bite, those day are over, leaving a landscape that is unknown territory for many of those operating in the oil & gas sector today.

UNITED STATES

JENNIFER A. MORRISSEY
DENTONS US LLP

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN THE US OVER THE PAST YEAR?

MORRISSEY: Volatility and dramatic change have shaped the US energy landscape. Plummeting oil prices have sent a substantial portion of the industry into distress, requiring many oil & gas companies to file for bankruptcy protection. Nevertheless, the majority of companies that have filed for bankruptcy are still operating, and the US remains the world's top producer of petroleum and natural gas. Rig counts are down, but careful selection of profitable locations, such as the Permian Basin, has allowed operators to continue producing even at today's low prices. Technological advances have kept natural gas abundant and cheap. Low gas prices and the ability of gas-fired power plants to cycle to support renewables have given gas an advantage over coal. Energy-intensive industries continue to exploit price differentials between natural gas and other fuel sources, and federal climate policy initiatives, although not driving the switch to natural gas, will certainly continue to boost it.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

MORRISSEY: Natural gas production is at a record high, and low prices spur higher consumption. Petroleum continues to fuel the US economy, but oil production growth from shale oil is dropping, with declines from existing wells exceeding output from new wells in recent months. The industry has taken a blow from low prices, which were at an 11 year low last December. Industry bankruptcies are up, although the trend is toward restructuring rather than liquidations, with divestment of non-core assets and businesses and massive lay-offs. Companies are operating on reduced capital budgets, which has prompted an increased drive toward efficiency in order to bring production costs down. Although many companies are highly leveraged or capital-constrained and risk becoming distressed, current market conditions may present buying opportunities for those with adequate capital. Low prices have also taken a toll on the development of LNG export projects, as falling oil prices have made US LNG less competitive.

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?

MORRISSEY: The US government unexpectedly reversed its decades-long ban on oil exports last December. The result of effective industry lobbying efforts, the move reflected a compromise that also included an extension of certain renewable energy tax benefits and addressed congressional concerns about instability in the Middle East. The impact of other federal policies and regulations, such as the Obama administration's Clean Power Plan and rules addressing methane emissions and hydraulic fracturing, are less certain. All are being aggressively litigated, and, with the passage of time, are also susceptible to economic and political change. Companies are more directly affected by state-level developments. Local and municipal fracking bans were overturned in several states recently. The future of Pennsylvania's severance tax on drilling operations is being debated. Oklahoma is examining the connection between earthquakes and drilling and has halted activity in some locations. New York's opposition to pipeline construction is posing challenges for some operators.

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

MORRISSEY: Price is the primary risk that oil & gas executives face. Low prices are impacting access to capital, especially debt, and are driving consolidation. The past year has witnessed numerous lay-offs in both the oil and natural gas sectors. While necessary to the survival of many companies, there is a significant risk that when the market turns, there will be a labour shortage, which will complicate recovery. This is further exacerbated by the US energy industry's current shortage of sufficiently skilled workers to replace retiring baby boomers. Another relatively recent concern is the vulnerability of the federal permitting process to politics. Denial of the Keystone XL pipeline presidential permit and the recent halt of the permitting process for the Dakota Access project are leading companies and lenders to re-evaluate project risk, as the costs of shutting down and demobilising are significant when the government intervenes to halt a project during construction.

"The US oil and gas industry has undergone significant consolidation at all levels over the past year."

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

MORRISSEY: The sector is responding quite well to environmental challenges, media portrayals to the contrary notwithstanding. The EPA has again found that hydraulic fracturing causes no "systemic" or "widespread" risk to water supplies. Earthquakes in Oklahoma, Ohio and elsewhere appear tied to deep disposal wells, as opposed to production wells, and the industry is working to mitigate this risk. The California Aliso Canyon storage leak was a serious problem that caught many off guard, but prompted quick industry response. That event will likely result in some degree of federal safety regulation of underground natural gas storage. Companies have sought authorisation to construct additional pipeline capacity to move crude, as rail transport is riskier and more costly. Likewise, some companies are seeking to capture rather than flare natural gas produced in oil drilling operations. However, in some regions these efforts have met with strong opposition from the 'keep-it-in-the-ground' movement.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

MORRISSEY: The US oil and gas industry has undergone significant consolidation at all levels over the past year. Companies are restructuring to focus on core businesses, selling off non-essential assets to raise cash to pay creditors. Access to capital has been challenging, traditional commercial banks have tightened lending criteria, prompting a movement toward equity rather than debt. Two major midstream pipeline merger proposals are under consideration –Transcanada/Columbia and Enbridge/Spectra. The ETP/Williams deal recently fell through and a few service companies have also sought bankruptcy protection. Low prices, reduced cash flow and tight capital markets have made some companies attractive targets for acquisition, including investment by foreign companies – for example, Total's acquisition of Chesapeake's Barnett Shale assets.

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?

MORRISSEY: Supply and demand economics will continue to drive the sector. Agency review of LNG export applications will proceed. However, low oil and LNG prices overseas have slowed the development of US export terminals. Only one of more than 30 planned LNG export projects has come on line, and only four others are under construction. The immediate impact of lifting the oil export ban has been modest. Exports are uneconomic unless West Texas Intermediate crude is cheaper than Brent, and logistical bottlenecks prevent rapid development of large-scale exports because US infrastructure is geared to receive, not export, crude. The presidential election brings policy uncertainty. A Trump administration would seek to 'undo' Obama's climate policies, support a renewed Keystone XL pipeline, and lift moratoria on energy production on federal lands. A Clinton administration, instead, would likely continue current climate policies, end oil & gas tax subsidies, and increase regulatory oversight of hydraulic fracturing.

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Jennifer Morrissey is a member of Dentons' Global Energy practice, dividing her practice between traditional regulatory and transactional matters relating to energy and infrastructure, and federal litigation and appellate work related to energy and natural resources. She regularly advises clients operating in the oil and gas and electricity sectors before the Federal Energy Regulatory Commission (FERC) on matters related to operations, rates, project development, enforcement and compliance, and agency rulemaking. On the transactional side, her work ranges from negotiating simple agreements to advising clients regarding substantial investments in utility assets, including assisting with M&A due diligence and obtaining regulatory approvals.

MEXICO

ROGELIO LOPEZ-VELARDE
DENTONS LOPEZ VELARDE

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN MEXICO OVER THE PAST YEAR?

LOPEZ-VELARDE: Despite the low prices of oil worldwide, and what that has represented in terms of a slowdown of the sector on a global basis, Mexico has continued its pace in opening up the energy sector following the 2014 reform and overhaul of the industry. The National Hydrocarbons Commission (CNH) has continued the launch of bids to award blocks for exploration and production, both onshore and offshore, and including shallow and deep water, conventional and unconventional resources. So far the efforts have been successful, with a number of companies participating. Round one will soon be completed, and round two is already actively underway. On the midstream side, the accelerated opening of the market for importation of diesel, gasoline and other products is creating pressures for the development of additional transportation and storage infrastructure and the arrival of new players into the market. At the same time, a whole new electricity market, with considerable participation of new entrants, is shaping up.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

LOPEZ-VELARDE: Companies have obviously more restrictions from cash flow and investment budget perspectives, so this has limited the scope and breadth of parties that can get into the new market opportunities opening up in Mexico. However, given the relevant opportunities that the reshaping of the market presents in Mexico, where specific market demands are waiting to be met, we have seen companies focusing on Mexico as a good alternative for positioning their investments in a difficult global scenario. On the other hand, crude oil price cuts have created stringent conditions for Pemex, the national oil company, which has impacted those oilfield service companies contracted for a number of activities.

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

LOPEZ-VELARDE: The legal framework that implemented the constitutional energy reform in 2014 required myriad implementing regulations and other regulatory instruments to be issued by different regulators, including the CNH and the midstream authority, the Energy Regulatory Commission. There have been numerous instruments detailing how companies have to shape their business in Mexico's opened market, including principles and rules for international sale and purchase of products, how capacity in the existing infrastructure – mostly owned by Pemex – will be utilised, quality specifications and requirements that need to be satisfied from technical and environmental standpoints for products to be sold in Mexico, and rules on importing and exporting products, among others. The CNH and its environmental counterpart, the so-called ASEA, are also continuing to develop principles and norms to operate on the E&P side.

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

LOPEZ-VELARDE: Executives and managers in the oil and gas sector are working in an increasingly challenging business environment in many of the world's active oil and gas areas, including Mexico. Companies and their management are no longer able to focus their efforts only on maximising rates of return while maintaining a safe operation; nowadays, management need to be involved in matters such as environmental sustainability, social responsibility and social commitment, measures to prevent and limit money laundering, and implementing effective anticorruption measures, among others. This is certainly positive for the sector, but also for companies, which will be able to work on a long-term basis in an industry that was in the past seen as a threat to sustainability, and which in many cases is now leading the way toward effective measures in these different fields.

"The energy industry is clearly one of the most sensitive sectors when dealing with environmental and sustainability issues."

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

LOPEZ-VELARDE: The energy industry is clearly one of the most sensitive sectors when dealing with environmental and sustainability issues. However, my view is that there have been quite remarkable examples of energy companies leading the way internationally when it comes to programmes to deal with climate change, orderly use of natural resources and the reduction of environmental footprint. These efforts have been significant not only in the shift to using more renewable energy resources, but also, for example, in better and cleaner fossil fuel products. In both of these issues, Mexico is making headway: firstly, by ensuring the development of renewables by anchoring renewable generation sources through securing long-term purchase of energy, and secondly, by regulating the specifications of fuels to better international industry standards, and migrating the use of fuels such as fuel oil to cleaner alternatives, such as natural gas.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

LOPEZ-VELARDE: Reduced cash flow has impacted the number of transactions seen in the market in terms of M&A activity over the past year. However, the opening of the sector in Mexico is allowing opportunities for those companies that are well established in the industry, or have done good positioning work, to become targets of potential acquisitions. Moreover, some companies that have been struggling with reduced amounts of work and with considerable backlogs pending collection, may increasingly become targets for restructuring and acquisition in the months to come.

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?

LOPEZ-VELARDE: On the E&P side, the CNH will continue to award blocks on a number of areas in Mexico, which will entail, in the short to mid-term, the commencement of business for several new operators in Mexico. We may expect to see growing needs in the services industry to address the needs of these operators. On the midstream side, the need for infrastructure and the multiple options for acquiring products from different marketers will create more sophisticated buyers and a more developed market. Whether private marketers are able to gain a significant share in the market vis-à-vis Pemex with shippers and end users will be key in the development of the market, and we may foresee regulators continuing to play an important role in ensuring market opening and options for consumers. The electricity market is a huge challenge, but the ability of the wholesale electricity market to operate under rules that effectively give and incentivise access to a number of marketers and suppliers, as well as of qualified users, will be key to its success.

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Rogelio López-Velarde's practice focuses on the energy and infrastructure industries. With respect to energy, he covers the full spectrum of the industry with the highest level of expertise, from oil and gas upstream, midstream and downstream to the power industry, and is considered the top energy lawyer in the Mexican market. As to the energy and infrastructure industries, his practice includes regulatory matters, corporate, mergers and acquisitions, project finance, antitrust, anti-bribery and real estate. Mr López-Velarde held various positions at Pemex from 1988 to 1993, including acting as in-house counsel in Houston and New York, as well as heading Pemex's international legal department.

BRAZIL

ANDERSON DUTRA
KPMG

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN BRAZIL OVER THE PAST YEAR?

DUTRA: Optimisation, cost reduction, M&A and restructuring, in order to improve operational synergy, have been key trends. After going through the anticipation of 'the golden age' around the pre-salt reservoirs, the Brazilian oil & gas industry is restructuring, particularly now that we have had a significant change in the country's government – former president Dilma Rousseff has been impeached and the new president Michel Temer has taken office. Right now there are a series of steps being undertaken to try to hasten investment in the sector – which was one of the most promising sectors in the country, representing almost 13 percent of GDP – and to recover an area that has also been affected by the political and financial crisis in the country. The *Lava Jato* or 'Carwash' Operation, whereby many politicians and executives were investigated, arrested and charged on corruption allegations involving companies in the sector, also impacted the space. In addition, the sector has suffered from other external factors, such as the fall of oil prices, the shale gas effect in the US, the deceleration of the Chinese economy and new entrants in the international market.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

DUTRA: In reality, cost steers the price. In other words – the more competition there is, the lower the cost and the price. These are the new dynamics of the market and it is a consequence, mainly, of the shale effect in the US and the maintenance of production in the Middle East. It is worth highlighting that when the price falls, the whole supply chain feels the effects within a certain period of time. This creates a damaging effect and an even longer recovery period.

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

DUTRA: There is the matter of the single operator of the pre-salt, the creation of production sharing agreements (PSA) and the local content rule. The most relevant matter is the fact that Petrobras will no longer be the single operator and take ownership of 30 percent of all consortiums. This might give the state company some financial breath, with a qualitative direction toward strategic projects, besides boosting the market with new members. The Brazilian government is in a hurry to approve in parliament a project that will end the single operator condition. The proposal says that the company needs to reveal its operation preferences among the fields to be bid on, which will be evaluated by the National Energy Policy Board (CNPE). On the other hand, some specialists believe that this might reduce the competitive advantage of the state company by handing over the pre-salt resources to companies that have never invested in the prospection business in Brazil, diminishing the strategic control of the reservoirs and of local production. Another important matter in the regulatory field: in March 2016 the government published a resolution from the CNPE, which gave a 12 month deadline to the paralysed oil fields in Brazil ordering them to return to operations. Otherwise, the concessions will be taken back by the National Oil, Natural Gas and Biofuel Agency (ANP). This resolution is also part of the measures package developed to unlock investments in the oil sector and guarantee an incentive to generate royalties and local jobs. According to the text, the holders of inactive areas will have to restart operations or sell off the concession to another company within a year from the ANP's notification.

"Today, there is an effort from suppliers to downsize frameworks and reduce costs to optimise competitiveness."

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

DUTRA: The two main challenges are pressure from cash flow and a low level of investments.

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

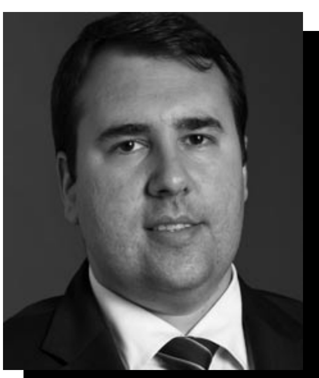
DUTRA: In Brazil, the regulatory landscape is well defined; that is, we have comprehensive policies and procedures. However, it is still an expensive and bureaucratic process, which needs to become faster and less constrained.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

DUTRA: The M&A market is very active. The important factors driving deals are cost reduction and synergy of technological capabilities.

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?

DUTRA: The fall of the single pre-salt operator, the flexibility of local content rules, reservoir unitisation policy and foreseeable auctions are major developments for the future. We know that the main determining factor to invest in Brazil is the potential for reservoirs to be exploited, including the pre-salt, and the oil & gas sector, which has great bearing on the national supply chain, impacting heavily on the country's growing capability. The sector's showiness has ended and the price dynamics impact on cost has forced the sector to change. Today, there is an effort from suppliers to downsize frameworks and reduce costs to optimise competitiveness. In this very competitive market, winners will be the ones who apply this formula correctly. It is a redesigning moment in which the whole of the industry will have to remodel to be able to stay in the market and generate financial returns for the investors.



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Anderson Dutra is an audit partner at KPMG in Rio de Janeiro, Brazil. He has more than 15 years' professional experience in auditing and advising many national and multinational clients. Mr Dutra joined KPMG in Brazil in 2000 and has since been acting in the industrial market, basically energy and natural resources, and specially the oil and gas industry. He has experience working on accounting practices adopted in Brazil (BR GAAP) and rules of the Brazilian Securities Commission (CVM), accounting principles generally accepted in the United States (US GAAP), including SEC registrants (PCAOB rules; SOX environment) and International Financial Reporting Standards (IFRS).

SPAIN

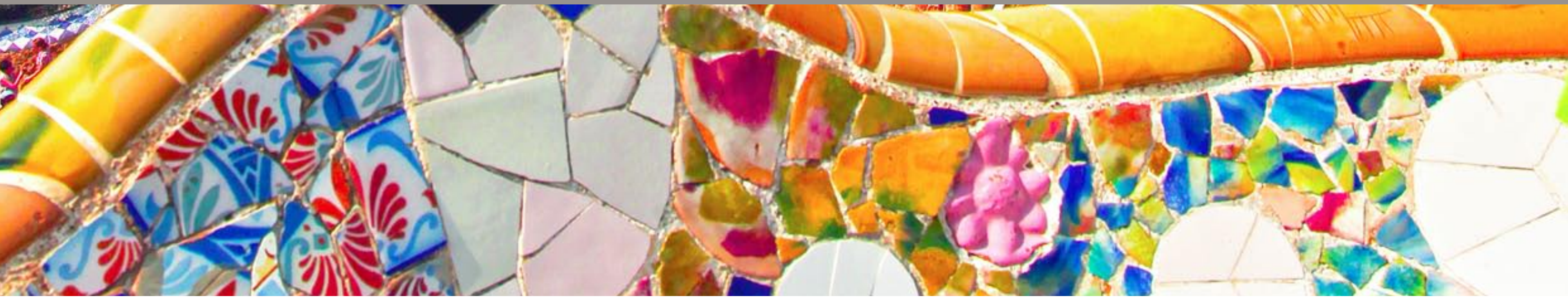
JUAN I. GONZÁLEZ RUIZ
URÍA MENÉNDEZ SLP

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN SPAIN OVER THE PAST YEAR?

GONZÁLEZ RUIZ: Spain has been affected by the political impasse originating in the general elections held in December 2015. Ten months later, and after new elections were held in June 2016, we continue without a government and the threat of new elections looms on the horizon. In a highly regulated legal environment as that of oil & gas in Spain, a lack of government means that new projects and politically sensitive transactions are suspended. Nevertheless, low oil prices have put a great deal of pressure on Repsol, and to a lesser degree Cepsa. Repsol has divested and disposed of certain businesses – such as Spanish LPG, and oil refining and LPG in Peru and Ecuador – and has been forced to dispose of its stake in CLH and reduce its stake in Gas Natural. Cepsa is reported to be interested in selling its stake in Medgaz.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

GONZÁLEZ RUIZ: Clearly, oil & gas prices force companies to dispose of non-core businesses and passive stakes in other companies, as well as to re-evaluate their total financial indebtedness to prevent damaging their credit rating.



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

GONZÁLEZ RUIZ: Precisely as a result of the political impasse, there have been no notable policies and regulations introduced in Spain since October 2015.

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

GONZÁLEZ RUIZ: Executives are facing a number of challenges. First, dealing with low oil prices and its effects. Disposals of non-core businesses and assets are being accompanied by cost-cutting policies. Re-evaluating projects and longer lead-times are having an impact on how executives are facing any business planning. Second, the political uncertainty created by the lack of government puts senior management at a loss when evaluating sensitive issues. The lack of political guidance holds back investments and strategic decisions.

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

GONZÁLEZ RUIZ: The sector is responding rather well. Spanish oil and gas companies have a good track record in Spain when it comes to responding to environmental challenges. Public opinion is very strong when it comes to environmental issues. Greenfield projects face enormous opposition which is extremely difficult to overcome. Shale gas and offshore exploration is severely hampered as a result of a heightened environmental preoccupation among the public. The seismic events that paralysed the offshore underground gas storage project 'Castor' have had severe implications for new exploration permits.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

GONZÁLEZ RUIZ: Low oil prices seem to be the major driver. Disposals of non-core businesses, assets and stakes in other companies have been triggered by the need of oil & gas companies to generate more income and reduce their overall financial indebtedness.

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?

GONZÁLEZ RUIZ: One probable development is a de-coupling of gas prices from oil prices driven by all the new LNG projects coming to the market and lower power prices. A thorough overhaul of the electricity industry and regulations is needed to deal with capacity mechanisms to provide much needed back up to the growing capacity of renewable energy projects. This should provide some comfort to gas-fired power plants, which are currently suffering the impact of low electricity prices. But it seems hard to foresee the need for more electricity generation capacity to be installed. We will see oil prices picking up in the medium term and we will face yet another cycle of investments in, and acquisitions of, new oil & gas projects.

"We will see oil prices picking up in the medium term and we will face yet another cycle of investments in, and acquisitions of, new oil & gas projects."

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Juan I. González Ruiz joined Uría Menéndez in 1988 and became a partner in 1998. His practice is focused on banking and finance, energy law and project finance. Mr González Ruiz has over 25 years of experience. He has advised leading international investment banks on setting up products for, and deals in, the Spanish market, while retaining direct involvement in all areas of energy law. In the wake of the liberalisation of Spanish energy markets, Mr González Ruiz advised on many legal 'firsts' in such markets, as well as in numerous renewable energy projects.

PORTUGAL

RUI PENA
CMS RUI PENA & ARNAUT

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN PORTUGAL OVER THE PAST YEAR?

PENA: Portuguese imports of crude oil and natural gas increased in 2015 compared to the previous year, thus increasing Portugal's energy dependency from 22.4 percent in 2014 to 78.3 percent in 2015 and putting an end to a trend of reduction of foreign oil dependency that had begun in 2005. This was mostly due to a decrease of the weight of renewables in the electricity generation mix, especially hydroelectric generation, which saw a year-on-year decrease of almost 22 percent. Portugal also experienced a re-launch of onshore and offshore oil & gas prospecting in the Lusitânica basin, as well as in the deep offshore just off the west coast of Algarve.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

PENA: The fast and sudden collapse in oil prices that began in June 2014, paired with the high levels of volatility that the market is experiencing, have all been contributing factors in shaping an environment of distrust and uncertainty among the integrated majors. In the case of publicly listed companies, their shares float in line with the oscillations in oil prices, experiencing significant swings without there being any major change in their operating margins. Investments in the upstream sector have decreased both in Portugal and elsewhere, with operators seeking to strategically lengthen their engineering studies to push back decisions regarding new drilling sites. Some producers with active drilling sites have the need to ramp up production in order to compensate for falling revenue, thus worsening the current surplus of oil and gas stocks and contributing to the deterioration of the market.

Q HAVE THERE BEEN ANY NOTABLE POLICIES AND REGULATIONS INTRODUCED IN PORTUGAL OVER THE

PENA: The government has brought forward a set of new policies for the sector, based upon a model of sustainability that seeks to reduce our energy dependency and to re-establish, on one hand, the primacy of renewable energies and the effort to drive their installation costs down, and to promote, on the other hand, the efficient use of resources, with

LAST YEAR OR SO, WHICH WILL AFFECT OIL & GAS COMPANIES GOING FORWARD?

a special emphasis on transport and mobility in general. Furthermore, the government is also seeking to leverage the geo-strategic position of the Iberian Peninsula, in order for it to become one of Europe's energy suppliers and serve as an alternate gateway for oil & gas into the union, thus reducing the old continent's energy dependency on the East and promoting alternate sources of oil & gas originating in the African and American continents. For this purpose, in addition to enhancing existing port and storage capacity, Portugal also plans to promote the construction of new connecting pipelines, thus linking every port that supports the offloading of LNG to main pipelines that run all the way to central Europe, through a set of projects included in the Connecting European Facility. In the field of R&D, the government has set forth its intention to promote the creation of technology and applied research in the areas of oilfields and marine engineering for deep offshore interventions, taking advantage of the know-how of operators and of the emergence of start-ups in these sectors.

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

PENA: In terms of exploration and production (E&P), there is the need to balance costs with the current price downturn. This need is tempered, however, by trying to compensate the price decrease with an increase in production, with a view to softening the effects on company P&L statements, ensuring the resiliency of corporate profits. In refining, distribution and retail, taking into consideration that there is excess installed capacity in most operations worldwide, there is a fundamental need to ensure high efficiency levels and to promote new types of products and services that target niche markets. Of course, none of these activities are immune from structural and conjunctural risks, such as the high volume of stocks in the global oil & gas market, excess installed capacity in the European refining sector and rising public concern in favour of active de-carbonation policies.

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

PENA: It seems that oil & gas operators are burying their heads in the sand and are not investing enough into innovative technologies that would allow for the de-carbonation of their products and bring about a sharp decrease in the amount of greenhouse emissions produced each year. The integrated majors are dragging their feet and not tackling a problem that must be solved urgently. They rely on the purported lack of alternative solutions to oil products, particularly electricity generation, focusing on natural gas as the main source of primary energy in this phase of transition into a lower CO2 intensity economy. However, natural gas is not a green energy and is still relatively expensive.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

PENA: We have had a relatively lacklustre past 12 months in terms of M&A activity in the upstream sector mostly due to the fall in crude oil prices. Most transactions that occurred were linked to the capital needs of some operators to meet liquidity events, and have revolved around the sale of non-core assets. During this time, the big players have been taking advantage of their favourable cash positions and picking up assets on sale, as seemed to be the case with the multinational BG Group by Shell, one of the most noteworthy operations of the past few years.

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?

PENA: This is a capital intensive industry that has immense capex requirements and is subject to a plethora of threats including geopolitical risks, unforeseen changes in the fiscal and regulatory background and environmental risks, to name just a few. The former can compromise the security of investments and normal market functioning, especially if we consider that the political systems of some oil producing countries still rely on force, rather than on the law. This often results in violent disruptions to the public order, but also in the expropriation and sometimes even nationalisation of private assets. Changes in the fiscal and regulatory environment, which unfortunately these days are not exclusive to emerging countries, negatively affect the expected rate of return of international operations and adversely impact the financial

"Most transactions that occurred were linked to the capital needs of some operators to meet liquidity events, and have revolved around the sale of non-core assets."

situation of the operators. Finally, we must not disregard the pressure that environmental NGOs are putting on governments, forcing the creation of new sanction instruments like those recently announced by the European Environment Agency which force operators to make new high value investments to meet targets set by Brussels. In this context, I am not optimistic about the future, but I feel that this regulatory pressure can be offset by the will, determination and resolve of the people working in R&D in the most diverse geographies, toward a new energy paradigm shift. Unfortunately, however, until that new era comes, we will sit and watch the slow decay of the oil & gas business.

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NETHERLANDS

ERIC WESSELMAN
KPMG ADVISORY NV

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN NETHERLANDS OVER THE PAST YEAR?

WESSELMAN: The key trend seems to be innovation and collaboration to outsmart the globalising industry. Historically, Dutch companies have proven to be quite successful in innovating their products and production techniques, putting our Dutch offshore industry in a world league leading position. The Dutch offshore industry does not compete on price, but on quality and the capability to create solutions that can operate in very complex and harsh environments. Now that investments in large capital projects are declining, we see that our industry is reinventing itself and finding new ways to new markets to sustain its success. Other trends are the business focus on growth in new markets – specifically in Asia – combined with fierce internal cost reduction and cost optimisation programmes. It seems cash is king in the industry at the moment.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

WESSELMAN: Low oil & gas prices have a major impact – not just on the oil & gas majors, but also on their whole ecosystem of suppliers. In the Netherlands, we see that traditionally highly successful suppliers have already shed their flexible workforce and are now also significantly reducing their own workforce as a result of order books running empty. Some of these companies are seeking to quickly diversify their portfolios to build in some defence against the low oil price impact. Offshore wind seems to be a promising new field of play for the Dutch offshore oil & gas industry. We notice that companies like Shell, Van Oord and Fugro are bidding for tenders in this space. Meanwhile, banks have become risk aware and are seeking ways to stabilise the risk of their investments. In some cases, this results in divestments and sale of parts of companies in the Dutch offshore industry.

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

WESSELMAN: The buzzword covering the most notable recent policies and regulations affecting oil & gas companies in Europe and the Netherlands going forward is 'transparency'. This has resulted in the implementation of various country-by-country (CbC) reporting initiatives to increase transparency of cross-border financial flows in different jurisdiction. Most recently, the OECD introduced model legislation on non-public CbC reporting aimed at tax transparency, requiring large multinational enterprises to report revenue, taxation, capital, assets, employment and activities to taxing authorities across the globe. These CbC initiatives lead to an increasing demand from oil & gas companies for data gathering solutions and assurance.

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

WESSELMAN: Oil and gas fields are facing the end of field earlier than expected due to low oil prices, which brings into question whether they have to decommission these oil production platforms. When you consider that there is pressure on current funding of investments needed for this, you can imagine the business dilemma. Meanwhile, for the ecosystem supply industry, only a few new projects are available in the market, resulting in strong competition on price, especially in new markets like Iran. The low availability of new projects results in low utilisation of assets and staffing, resulting in impairments of assets and reorganisation of staff. Both are having a large impact on the results of the company and several ratios. A big question for the industry is how to reorganise without losing technical knowledge. History has demonstrated that large reorganisations do result in a large talent gap in the industry, due to a leak of knowledge toward the internet industry and other high tech industries.

"New ways of thinking, collaboration and a high degree of standardisation in the current supply chain will free up the necessary cash to finance the innovations of the future."

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

WESSELMAN: In terms of operational performance, the Dutch oil & gas industry is continuously working on addressing the environmental impact of its operations, considering topics such as greenhouse gas emissions and oil spills, next to addressing challenges in occupational and process safety. On a strategic level, the industry is being challenged for the risk of stranded assets. Climate change, related emerging regulation, and the transition to lower carbon economies lead the sector to stress test its business strategies and develop future business scenarios. Long-term investment horizons make the sector vulnerable to a quicker-than-expected energy transition, which raises the question of whether the sector would be able to adapt its business model to this new reality. Investors, lenders, insurers and other stakeholders increasingly expect the sector to provide reliable financial information on the potential impact of climate change, as is illustrated by developments in the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), which is in the process of developing voluntary, consistent climate-related financial risk disclosures for use by companies in oil and gas and other sectors in providing information.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

WESSELMAN: Low oil & gas prices continue for a third year and the M&A market for all oil & gas sub-sectors has remained consistent, with a low number of deals in 2015. The first half of 2016 even had the lowest number of deals and deal value for five years. Continued price volatility is creating significant uncertainty for the whole sector. Continued low and volatile oil prices force companies to structurally reduce costs, which will impact the whole oil value chain and especially the service companies. Weak operators with high debt are facing cash constraints and will be forced to sell assets, and companies with a strong balance sheet will continue to streamline their portfolios and continue to sell non-core assets. A pick up in M&A will depend on the pace of resolution of these challenges that the sector faces and the return of confidence. Currently, there are limited buyers in the market, however, when there is more consensus on the long-term oil price, the oil & gas companies that have successfully managed through the cycle will look to make strategic

and accretive acquisitions. For these companies, M&A will be taking centre stage in their transformation strategies and quality opportunities occur among others triggered by weaker companies running short on options to fund large debt repayments. Also, an increasing amount of private capital, often in combination with an industry buyer, will start capturing M&A opportunities.

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?

WESSELMAN: I believe that the current energy transition will have a major impact on the oil & gas industry. It will drive a transformation of the whole oil & gas ecosystem. Those in the ecosystem that collaborate and create new business models on top of the existing will be able to navigate a highly volatile market and remain relevant for years to come. New ways of thinking, collaboration and a high degree of standardisation in the current supply chain will free up the necessary cash to finance the innovations of the future. The time to go it alone is gone.

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Eric Wesselman is a partner at KPMG Advisory NV and has a background in electrical engineering. In his consulting career, Mr Wesselman has focused on IT strategy, outsourcing, performance improvement, innovation and robotics. His current role with KPMG is as sector leader of energy & natural resources and sector leader of oil & gas. In 2014 and 2015, Mr Wesselman and his team conducted two studies on the Dutch oil & gas sector, focusing on the industry relevance of supply ecosystems.

ITALY

CRISTINA MARTORANA
ORRICK

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN ITALY OVER THE PAST YEAR?

MARTORANA: In the context of the liberalisation of the gas market inside the EU through Directive 2009/73 CE, among others, Italy only began implementing a policy in this respect in 2000, pursuant to Legislative Decree 164/2000. Since then, no significant changes in gas market regulation have been carried out, but there is a positive commitment from the Italian government and regulatory authority AEEGSI to promote a competitive system based on a call for tenders for gas distribution concessions, one of the final segments of the gas industry chain. In fact, local districts, called ATEM, are starting to call for tenders in this respect. Another promising sector is the transportation of gas. In particular, thanks to LNG technology and gas compression, it is possible to transport gas through other ways, such as camion, train and ship, instead of pipelines. Italy's exploration has benefited from an accelerated licensing and drilling approval process on licences, which now forms part of the government's energy plan. Thus, the National Energy Strategy is starting to bear fruit, with several exploration and production permits approved since its implementation. Drilling activity has accelerated as a result.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

MARTORANA: Current uncertainty and price volatility have affected many companies' business plans and investments. More precisely, as expected profits have declined, market operators have had to reconsider their portfolio agendas and limit or reduce planned investments development in the sector, vis-à-vis increased costs. In other words, low prices have had an impact on sector growth, which has slowed down in the last year or so.

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?

MARTORANA: Gas distribution and transportation, which is a regulated activity performed under concession granted by the relevant local authority, have been particularly interested in light of significant developments, mainly linked to the completion of the reform process of these sub-sectors, with a particular focus on distribution, which started in 2000. The 'Letta Decree' was aimed at dismantling the previous monopoly, or oligopoly, regime and creating an open market, multiple players, and a transparent and competitive environment. This resulted in a deep reorganisation of the concession regime, aligning it with European principles such as the Third Energy Package, currently based on public tenders managed by 177 local units, the so-called ATEM. After a transitional period that lasted for more than 10 years, the envisaged regime for distribution services concession is currently being implemented; ATEMs have recently published several calls for tenders in relation to various distribution service awards, finally allowing new incumbents to enter the distribution market. With reference to oil & gas drilling, the reintroduction of the ban on exploration and production activity within 12 nautical miles of the Italian coast will stem some of the interest for offshore exploration. Nevertheless, the April 2016 referendum on banning renewals of offshore licences failed to reach the necessary turnout, meaning existing production sites offshore within 12 miles of the coast will continue to produce until they reach depletion. However, new drilling concessions are no longer being handed out.

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

MARTORANA: Considering the price volatile environment and the present framework, some of the main challenges executives are facing are capex expenditures, budget and cost allocations, keeping pace with a quickly changing scenario, and health, safety, security and environmental compliance. These issues directly affect companies' investment plans and development policies.

"Acquisitions are the easiest way to enter an undeveloped field and quickly monetise an otherwise unproductive asset."

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

MARTORANA: Provided that oil & gas related activities have a different impact and effect on the environment, we know that the main common issues are landscape and ground stability, potential contamination and the greenhouse effect. Therefore, there are several provisions on health & safety environmental standards which companies have to comply with in respect to project, designing, implementation and management. Recent trends show that most companies meet such standard and have also adopted bespoke internal risk management policies. However, the gas sector, compared to other fossil fuels, is better at complying with environmental and sustainability needs.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

MARTORANA: The dramatic drop in crude oil & natural gas prices over the year, combined with a high level of uncertainty about their future trajectory, challenged oil & gas merger M&A activity in 2015. Total global reported deal value declined in 2015 to just under US$380bn, a reduction of 17 percent compared with 2014, while the total number of oil & gas transactions declined by almost 33 percent. There is, however, a significant pool of industry and financial investor capital targeting the sector, which could be very busy in 2016. Hotspots for M&A activity include the UK, Ireland, Germany and Spain. Designer brands, knowhow and patents attracted interest from the US and China. Lower prices and tighter liquidity conditions in the Russian market have given rise to opportunistic M&A from Asia, particularly in the energy and infrastructure sectors. The main key drivers for M&A are, firstly, the need for resources, as the oil & gas industry is dependent on finite natural resources. To remain successful, an oil & gas company must replenish its reserves of oil by using profits from selling its products. Acquisitions are a way to secure access to proven reserves in other markets. Secondly, diversification is also helping to drive dealmaking. A diversified portfolio can minimise risk by spreading it across multiple unrelated revenue streams. The larger the company, the more important geographic diversification becomes. The need to develop fields is a further deal driver. Acquisitions are the easiest way to enter an undeveloped field and quickly monetise an otherwise unproductive asset. Further, know-how and technology will also help to push through deals. Compared to in-house research and development, acquiring a company that possesses the desired know-how and technology is much quicker and less risky and brings

positive benefits in terms of economies of scale and production. Finally, perceptions about future tax and regulatory policy can also help.

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?

MARTORANA: Italy's oil & gas sector will continue to suffer from a gradual depletion of its hydrocarbon reserves and the rapid downsizing of the country's ailing refining sector. While an active exploration scene and a gradually improving regulatory environment are positive signs, these improvements will take some years to garner more substantial industry changes. This is particularly the case in the context of low oil & gas prices expected over the coming years. Italy's oil production is expected to receive a significant boost from the Tempa Rossa field, which is set to come on line in late 2018. Additionally, distribution and transportation could be considered as interesting investment opportunities. The implementation of a more market friendly regime, the new tender procedures and LNG technology would probably favour a higher degree of competition with positive effects on quality of service for end-users and new business opportunities.

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JAPAN

MINA SEKIGUCHI
KPMG

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN JAPAN OVER THE PAST YEAR?

SEKIGUCHI: Low oil prices have triggered majors and regional NOCs to reconsider their asset portfolio in the Asia Pacific region. Not only are some selling down their equity stakes, some development projects are being postponed, some abandoned. Those that could possibly be abandoned are the ones with more technical difficulties and will likely by the most time and cost consuming before completion. Some majors have their global business service centres in Asia. In pursuit of further cost reduction under the current oil prices, some major players are considering taking advantage of robotics or digital labour in their back office operations. At the time, when the industry is facing the new paradigm of 'the lower, the longer' scenario, oil & gas companies, which have been relatively profitable in the past, may drastically change their way of doing businesses very quickly. And this will be made possible by emerging disruptive technology. While lower oil prices for the longer period may attract the world's attention, there is another emerging trend which could largely affect the global energy industry in the mid to long term: liquid natural gas (LNG).

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

SEKIGUCHI: The common effects shared by all the sector players in the region, and globally, is that the lower oil & gas price is accelerating their cost consciousness, and has made them much more aware of taking advantage of emerging disruptive technology. However, if you look closely into each region, the impact of, and the issues resulting from lower oil & gas prices in the Asia Pacific region vary due to the fact that countries in the region have largely different positions in terms of fuels. Australia is becoming a large LNG producing and shipping country. China needs cleaner and reasonably priced fuel with higher energy security and stability, but will have more choice in procurement with pipeline connection in the continent. Japan's demand for LNG is said to be higher, assuming the restart of nuclear plants will not happen soon, due to its geography as being detached from the continent.

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

SEKIGUCHI: The recent regulatory change which has had the biggest impact in the sector is Japanese power liberalisation. On 1 April 2016, power retail market liberalisation came into effect and for the first time in 60 years of oligopoly by nine regional power companies, the Japanese power retail market became competitive. As of April 2016, the Ministry of Economy, Trade and Industries (METI) reported 331 new entrants into the space. Since most of the new entrants do not have generating capacity, they may not have much of advantage in pricing, however, obviously power providers should become more customer centric in creating and delivering various new values. This deregulation in the power sector affects fuel procurement by power companies indirectly. In order to secure profitability in a competitive market, incumbent utilities are required to control fuel cost more than ever.

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

SEKIGUCHI: Broadly, the world is becoming increasingly multi-polarised. Some may call this emerging world order as 'G zero', where global stability is becoming harder than ever to attain. Given that the oil & gas industry and businesses are closely linked within the geopolitical landscape, this emerging world order poses fundamental risks to this sector. Those players that accept this risk, adapt to the required dynamism and transform for the future, may be the winners in the coming decade. The fundamental changes we are seeing today in the oil & gas sector, such as lower prices for a longer period, provide good reasons to change the industry, which historically prefers greater stability.

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

SEKIGUCHI: Sectoral responses to environmental challenges and sustainability issues vary depending upon countries in the region. Especially in the Asia Pacific region, Australia may be the most advanced, while China faces serious environmental issues from its coal-fired thermal generation. ASEAN countries, bar Singapore, are still in need of power generation capacity with more affordable prices. In that sense, coal is the preferred option. In emerging economies, governments are suffering from the dilemma of balancing environmental issues and their country's economic growth with a cheaper and stable supply of power. As for Japan, the feed-in tariff scheme for renewables, introduced in 2012, contributed to some extent, but mainly in the area of smaller scale photovoltaic plants.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

SEKIGUCHI: Major M&A trends in oil & gas include majors divesting or at least considering some of their assets in the Asia Pacific region, either in upstream or in generation. Some are operator positions while others are non-operator positions. Obviously this is to reconstruct their asset portfolio and balance sheet in response to the lower oil price. Some oil service companies are experiencing financial difficulties partly because of the higher construction costs they incurred in projects over the last five years, which operators are not willing to pay in full due to the current market price level, and because fewer greenfield projects are expected in the near future. The M&A derived from this take the shape of distressed assets sales.

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?

SEKIGUCHI: From a Japanese viewpoint, the highest interest we have is the development of the LNG commodity market in Asia. This would be an essential part of a major LNG player globally, either from the seller side, such as Shell, BP and Chevron, or from the buyer side, such as JERA, in order to pursue a more flexible and agile operating model in the fuel market landscape, which is and will be constantly changing with uncertainties. Historically, Japan has purchased LNG mainly from the Middle East on a long-term purchase contract. Under the current situation, the spot price of LNG is lower than the long-term contract price. Considering this, it

"From a Japanese viewpoint, the highest interest we have is the development of the LNG commodity market in Asia."

is reasonable to assume that Japanese buyers have started to consider portfolio optimisation through more flexible contracts, in light of the recent deregulation of the electricity and gas market in that country. The need for more flexible LNG contracts is also set to increase, as more countries, especially emerging economies, start to import fuel. Backed by its stronger bargaining power, Japan may become an intermediary to those new buyers. In terms of renewables and the development of distributed networks, the US and Australia are advanced in utilising renewables as a base to develop distributed power networks. Germany, as we see in the radical strategy change in E.On and RWE, is also following. The UK is also trying to accelerate the shift into more agile distributed power network as a way to relax its energy trilemma – to balance affordability, security and the environment. The basis of this new trend is residential rooftop solar, and what this envisions is that consumers will also become producers of energy, or 'prosumers'.

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SINGAPORE

DARREN MURPHY
JONES DAY

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN YOUR REGION OVER THE PAST YEAR?

MURPHY: The oil & gas sector in Southeast Asia has been impacted not only by regional developments but also by global trends. Large parts of the sector operate in a truly global market, with issues such as excess supply, faltering world demand, increasing environmental regulation and developments in renewables being of primary importance. At the regional level, Southeast Asia is facing challenges from falling production, turning once significant energy exporters into net importers, and having to deal with many maturing fields. At a business level, a feature of the region is the continued rise of the national oil companies, which now have decades of experience and are expanding their influence in their domestic markets as well as internationally. In terms of energy markets, a developing trend is a shift toward natural gas, in particular the small to mid scale LNG opportunities for power and transportation fuels.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

MURPHY: Oil & gas is a cyclical business, and oil & gas companies are equipped to a degree to respond to pricing events. In a lower price environment, attention quickly turns to lowering production costs. The first task is to reconsider those projects which are higher up the cost curve – a report this year shows approximately $380bn in global project deferrals – and to shut in projects with high marginal costs. The second is to actually lower the unit cost of production for projects that are continuing. A low price environment also stimulates innovation, as can be seen by continued success in parts of the US shale industry. This includes technical innovation, but also commercial innovation such as collaborations between upstream and midstream players. Already, $50 is considered by some as a sustainable price, whereas just two years ago it would have been considered below marginal cost for most opportunities.

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

MURPHY: Energy security is a chief driver of policy in Southeast Asia, with access to reliable energy being central to the economic wellbeing of the growing populations. In Singapore, for example, the government has provided the regulatory space for LNG imports to become a reality, unshackling Singapore from reliance on its immediate neighbours for hydrocarbon supply. In Indonesia, the state-owned power company, PLN, has launched a small-scale LNG policy to promote gas as the fuel of choice for the archipelagic nation, and this is attracting much interest from European, Japanese and other investors. Other policy areas seeing changes include the electrification targets adopted in many Asian countries, the removal of some fuel and power subsidies, policies around the expiry of long-term oil & gas concessions and the domestic implementation of climate-related commitments under the Paris Agreement. Something to watch over the medium term will be the impact of new international treaties on domestic regulations.

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

MURPHY: Among the significant challenges facing decision-makers, a key issue remains the ongoing uncertainty around pricing across all time horizons. One industry executive recently described volatility as now being structural. Price uncertainty, coupled with questions over the future make-up of the world's energy supply, makes long-term decisions increasingly difficult. This uncertainty directly impacts the level of activity both in transactions, due to lack of consensus, and in project development, due lack of confidence. It is important to appreciate that cuts in activity now do not just impact current production, but also production into the future. Oil & gas projects have extremely long lead times, requiring exploration, complex commercial arrangements, government and other stakeholder alignment, as well as physical development and construction, so the switch cannot be immediately turned back on.

"Governments will need to balance maximising their share of individual projects against the need to attract new and ongoing investment."

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

MURPHY: Environmental and sustainability issues are obviously extremely important for the oil & gas industry. This extends from operational issues, such as minimising and responding to spills, leaks and other incidents, to strategic matters including understanding the role of oil & gas in the world's energy mix going forward. The sector is a major contributor to global carbon emissions, yet natural gas can be a better option than coal and can therefore assist in the transition to alternative energy sources. This can manifest in decisions to use gas for major base-load power, but also in areas such as the growth of LNG for road transport and bunkering. An acute issue in Southeast Asia impacting the environment is ongoing fuel subsidies which distort demand. While there have been subsidy reforms in Indonesia, Thailand, Malaysia and Myanmar, the current low oil price had provided an opportunity for more to be achieved on this front.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

MURPHY: Expectations for 2015/2016 were that, if prices remained low, deal flow would rebound as buyers and sellers came to alignment on asset values and more and more owners suffered financial distress forcing sales. However, while prices did remain low, increased deal activity did not eventuate. Sellers have shown resilience, in some cases aided by hedging positions, but more generally through cost containment. Going forward, deals will be driven on the sell side due to financial pressure, as well as changes in strategic direction. On the buy side, there will be opportunities for those with access to capital, in particular government-backed investors, but also financial investors, utilities and industrials. Much as was the case 12 months ago, the market will also be looking for a return of traditional investors who sense the bottom of the market and who make the necessary adjustments to profit in a low price environment.

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?

MURPHY: From a regulatory perspective, fiscal terms for oil & gas developments will be a continued focus in the Southeast Asia region. Governments will need to balance maximising their share of individual projects against the need to attract new and ongoing investment. In terms of business strategies, each company will need to identify its strengths and how to leverage them in a period with ongoing price concerns and regulatory challenges. Innovation and flexibility will be paramount. The recent announcement by Singapore's Pavilion Energy and Indonesia's Pertamina of a MOU to collaborate on energy projects is an interesting case study in this regard, with the companies agreeing to jointly explore opportunities in small-scale LNG among other things. Also, while managing costs will remain paramount, companies will need to maintain investment in key areas such as technology to remain competitive and capitalise on future rebounds in the market.

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AUSTRALIA

JONATHAN SMITH
KPMG

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN AUSTRALIA OVER THE PAST YEAR?

SMITH: Clearly, the defining trend has been the decline in oil prices. Remember that it was only in June 2014 that oil was trading at around US$107 per barrel, which is not that long ago. Since that time, it plummeted to around $26 per barrel, before bumping back to around $45. That is a huge drop in prices in a relatively short space of time. The last time the industry went through a serious down-cycle like this was way back in 1986, so it is unknown territory for many of those operating in the oil & gas sector today. The industry is now wondering: "What does the new normal look like?"

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

SMITH: The impact of volatile oil prices has been extraordinary. Bloomberg recently reported that the oil and gas industry would cut $1 trillion from planned spending on exploration and development due to the price slump. Graves & Co calculated that more than 350,000 jobs have been axed. Companies are redesigning and reinvigorating their operating model to fit a world where oil trades at $45 to $65 per barrel. They are assessing their risk profile and their practices to determine how they can maintain high standards of safety and delivery at less cost. They are also cutting their graduate programmes, which will have an impact down the line. As older engineers retire, there may be a sizeable gap in young talent coming through to replace them. The industry is aware of this potential consequence, but market conditions make it very difficult for them to maintain such expenditure. In the past, the oil & gas industry used to 'gold-plate' everything, but there is an acceptance that those days are well and truly over.

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

SMITH: Governments around the world have been forecasting increased tax revenues from the large oil & gas projects but this is not transpiring due to the low oil price and the high capital costs. You can only tax profits and many of these projects have not started earning. It will be some time before they are cash flow positive. Indeed, the Australian government put in place a super profits tax called the Petroleum Resource Rent Tax, which had previously been in place for onshore projects and was extended to offshore projects. The low oil price makes it a considerable challenge for governments around the world – whether it be Australia, Nigeria, Angola, Venezuela or elsewhere, to raise significant tax revenues from the oil business.

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

SMITH: Oil & gas executives operate in an industry where, if projects fail, they make the front page of the news. That public profile is always on their mind. They are very sensitive to going into new countries and new areas of exploration, and they want to understand the related risks they will face. In some of the most difficult places, the legislation, regulations and tax rules are being written right now. Executives take their 'licence to operate' very seriously.

"There tends to be a flight-to-quality in tough times, whether asset or project and that is what we are seeing."

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

SMITH: In Australia, oil & gas companies are particularly sensitive to environmental issues. They still have a responsibility to shareholders and of course will seek to maximise energy opportunities, but they will also consider the environmental factors. Australia has rigorous environmental legislation in place, but even so, oil & gas executives do not want to harm the environment. Executives operating in the liquefied natural gas (LNG) field point out that LNG is 50 percent cleaner as a base fuel compared with any other hydrocarbon. In this sense, it is a great interim fuel. As we transition into renewables, which still need a base-load of energy, LNG is one of the best sources of that base-load.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

SMITH: Private equity firms, perhaps for the first time ever, are interested in entering the oil & gas exploration and production (E&P) space. Anecdotally, those players say that, firstly, they think we are at the bottom or near the bottom of the market. Secondly, they feel that there are real opportunities in oil & gas to warrant bringing the discipline they impose on other industries to the sector to turn them around and make them leaner. Thirdly, they recognise that oil & gas companies are trying to service debt; capital outlay has to be funded in some way, and most of it is funded by debt. In turn, that debt has to serviced, whether through cash flow or by selling assets, and we are at a point where high or even reasonable quality assets may have to be sold to service debt – which is exactly what PE firms are looking for. Overall, there tends to be a flight-to-quality in tough times, whether asset or project and that is what we are seeing.

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?

SMITH: Innovation and technology will have a massive impact as levers of change for the oil & gas industry. The industry is awash with data, and being able to compile and convert that data into information, leading to better and quicker decision-making, is a very positive prospect. That is one of the most exciting developments for the industry at this time. There is a reduced outlook for large scale projects in the near term, but there are opportunities for small scale energy projects in the region. This would include projects such as LNG as an integrated energy solution. As far as the price of oil is concerned, there is a little more stability and the right sentiment is coming from OPEC and others. That means energy companies have a better outlook on which to plan projects and assess whether the economics work – all of which is crucial to bring about the next wave of activity.

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NIGERIA

OLUFEMI ABEGUNDE
DELOITTE

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN NIGERIA OVER THE PAST YEAR?

ABEGUNDE: The oil & gas sector serves as the Nigerian economy's main external source of funds, upon which a significant share of government budgets and expenditures are hinged in its annual appropriations, and no doubt it is facing very challenging times. The key underlying challenges of the sector were even more precipitated by the over two-thirds decline in price from the high of over $100 per barrel in 2014 to current levels of about $40 per barrel. The industry's challenges can be segmented into externally driven factors and country specific issues. The global decline in price has been caused by a combination of global politics; Iran's entry into the supply system and the pre-existing supply gluts, as well as the continued supply from key OPEC members and non OPEC members and the lifting of export restrictions by the US, have resulted in the price decline. With regard to internal factors, issues such as security challenges in core areas of operations, opaque policy trust on licensing rounds and development, a constrained ability to meet JV counterpart funding, near non-existent enthusiasm around the enactment of the Petroleum Industry Bill (PIB) over the last few years, perennial subsidy claims issues, market regulation around the premium motor spirit (PMS) market and refining capacity challenges, among various other issues, have collectively put significant pressure on the industry.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

ABEGUNDE: The price effect on Nigerian entities is pretty much the same as on other entities in the world's major oil and gas hubs. Firstly, we have seen strategic shifts from exploration and development to production on existing fields, aimed at optimising production and minimising exposures to capital project costs. Some entities have also ramped up production profiles within regulatory limits to mitigate against reduced incomes and cash flow constraints. Secondly, due to declining cash flows, highly geared and leveraged operators are calling for extensive restructuring of their loan portfolios with financial institutions, with more stringent covenants being instituted and at a high premium to the facility lenders. The raising of additional equity capital through the dilution of existing shareholders from diverse sources is also becoming common. Furthermore, from

the operational side, increases in costs verification and restructuring programmes aimed at optimising value are being witnessed among partners. Also, business process restructuring, including retrenchments, redundancies and pay offs, reorganisations, cancellation or deferment of work programmes and FDI, among others, are common.

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

ABEGUNDE: The PIB, the production sharing contract terms for gas, clear policy statement on the deregulation of downstream markets, refineries and oil fields licensing rounds and policies on the continuation of the OPA scheme and incorporated joint venture (IJVs) structure are critical regulations and policy thrusts that investors desire in assessing their medium to long term corporate and operational strategies. However, at this point no clear policy decisions have been made as most initiatives are either in the planning phase or not receiving the desired attention as would have been expected. In recent times, due to constraints in supporting huge subsidy claims from product marketing companies and the impact of continued devaluation of the national currency, the Naira, the Petroleum Products Pricing Regulation Agency announced a price ceiling of US$0.50 per litre, an increase of about 66 percent. Although, this appears to have had a cushioning effect on both the demand and supply sides of the PMS market, this effect is gradually fading off due to continued pressure on the Naira in the foreign exchange market. Other industry operators keenly await the government's policy framework, especially in respect of the PIB, which is anticipated to redefine the Nigerian oil and gas landscape.

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

ABEGUNDE: There are a number of risks, namely funding existing loan facilities and meeting related covenants to keep investment and operating plans afloat. Other risks include the optimisation of production and further development plans, especially on assets acquired at high valuations during price highs. Strategic and business risk management in the face of unclear policy and regulatory guidelines

THESE FACTORS IMPACTING OIL & GAS ACTIVITIES?

is a notable challenge, as it impedes decisions around E&P activities for reserves replacement and production development. Security risk management in core production areas and community relations is a further challenge as companies look to safeguard investments in both facilities and human capital.

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

ABEGUNDE: The most significant environmental challenges concern oil well spills and pipeline incidents, including those caused by the sabotage of facilities. Gas flare issues also continue to be a major challenge which remain unresolved. The recent upsurge in sabotage by resource agitators lends credence to the negative impact that their activities have on environmental pollution seen in the region. There are however, some positive steps from both the previous and current administrations regarding the initiation of clean-up exercises of the extensive oil spillage in Ogoni land in Rivers State and the increased response rate by the National Oil Spill Detection and Response Agency (NOSDRA). The Nigerian gas master plan, which includes the gas to power initiatives, is a critical step toward converting associated gas currently being flared to industrial use, through gas gathering projects. Similarly, the increasing collaborative arrangements between operating communities and oil & gas companies through MOUs and CSR arrangements also seeks to safeguard operations and forestall environmental degradation. There is also a significant awareness among communities and environmentalists on policy frameworks and legal redress that can be instituted against environmental pollution to protect and sustain the environment, especially in oil and gas producing regions.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

ABEGUNDE: Current challenges have provided incentives for M&A activities in the local space and divestment or acquisition of field interests. However, the decline in the oil price and exposures to banking obligations appear to be constraining the execution of such opportunities, as witnessed around three to five years ago.

"Security risk management in core production areas and community relations is a further challenge as companies look to safeguard investments in both facilities and human capital."

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?

ABEGUNDE: With the recent NNPC-China Investors' Roadshow, we would expect to see more Chinese private firms and foreign companies investing in oil & gas projects in Nigeria, despite the temporary setback caused by the current low oil price environment. We anticipate investment activities in the midstream sector as Nigeria tries to encourage investments in refineries and the gas sector as the country makes efforts to implement the gas master plan to cut gas flaring and harness it for increased power generation. We also anticipate the restructuring of the Nigerian state oil company and the current joint venture arrangements to IJVs, aimed at ensuring joint ventures are self-financing and operating without, or with limited, cash call obligations from the NNPC. The legislative process for passage of the PIB may also feature prominently in the near future, due to its key strategic importance to the Nigerian oil and gas industry.

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GHANA

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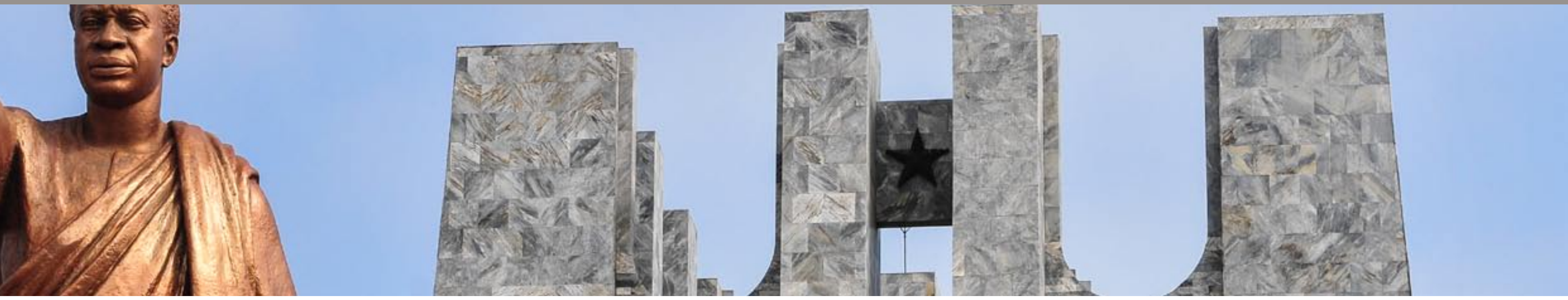
Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN GHANA OVER THE PAST YEAR?

AGBEMABIASE: The newly discovered Tweneboa, Enyera and Ntomme (TEN) oil fields, which were being explored by Tullow Oil and its partners, successfully started commercial production of oil on 18 August 2016. The new TEN fields are expected to produce up to 76,000 barrels of oil per day and approximately 15 million standard cubic feet of gas when fully operational. This development has breathed new life and impetus into Ghana's relatively new oil industry, which was going through some challenges, especially on the back of falling global oil prices. Oil production from the TEN fields is expected to not only boost oil revenue, but also produce a substantial amount of the oil & gas required for power generation in Ghana. It must also be noted that the TEN fields, which are subject to an ongoing boundary dispute between Ghana and its neighbour Ivory Coast, are still being adjudicated before the International Tribunal of the Law of the Sea. It is expected that a definite ruling within the next year will finally settle this dispute.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

AGBEMABIASE: Oil & gas companies have had to streamline their operations to make sure they do not fold up operations. Many of them have had to cut staff and reorganise their operations to avoid bankruptcy. This is simply because the sharp and somewhat unexpected drop in global oil prices threw revenue projections and spending plans out of the window. Cutting to the chase, we have seen austerity and belt-tightening for oil firms.



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: Notable policies and regulations have been introduced in Ghana's oil industry over the past year. Firstly, a new oil exploration and production law was recently passed by Ghana's parliament and approved by the president. This is the main oil law in Ghana. The new exploration and production law was necessitated by the simple fact that the previous law was promulgated at a time when major activity in the oil sector was mainly exploration. Consequently, the old law was inadequate to address issues that had to do with commercial production of oil and its attendant matters. The new law, which has been on the drawing board for about five years, appears to have finally addressed a lot of the loopholes in the old law. Hopefully its operation will help entrench Ghana's relatively new oil industry. There has also been new local content and local participation guidelines for the formation of joint ventures for oil activities, which has been promulgated by the country's upstream oil regulator, the Petroleum Commission. The new guidelines are meant to ensure that indigenous Ghanaian oil companies and Ghanaians in general obtain appropriate benefits from Ghana's oil industry. The guidelines cover areas such as local equity ownership in such joint ventures, employment of Ghanaians and the prohibition of fronting by Ghanaians on behalf of oil companies.

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

AGBEMABIASE: Executives, especially of multinational oil companies, are facing the major challenge of how best to comply with Ghana's petroleum laws and regulations, especially with respect to local content and participation in Ghana's oil industry. It is self-evident that many of them would have loved to operate in Ghana as wholly owned subsidiaries of their parent companies. However, due to local content requirements, they have had to find local partners with which to incorporate joint ventures in order to undertake petroleum activities, as required by the laws of Ghana. Sometimes finding

local partners has been a challenge to say the least because of the relatively new nature of the industry in Ghana. Also, oil executives have had to strategise to maintain operations in the face of falling global oil prices. Many have had to revise their revenue forecasts and projections, cut budgets and even lay off staff in order to stay afloat.

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

AGBEMABIASE: The new and recently passed oil exploration and production law has very strong provisions with respect to environmental and sustainability issues. It is fair to say that in terms of law and regulation, the regime for sustainability and addressing of environmental challenges is quite strong. These issues are being rolled out and administered by the country's authorities and hopefully with the keen eye of civil society groups, Ghana's oil industry will not harm the environment and should proceed in a sustainable manner.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

AGBEMABIASE: In Ghana, and Africa too, M&A activities in the oil & gas industry generally involve the formation of joint ventures for the purposes of exploration and production. These joint ventures between foreign multinational oil companies and their local partners are meant to ensure that local oil companies develop capacity to take active part in the oil industry and also benefit their societies. The major factor driving such joint ventures is simply the desire or requirement to comply with the oil laws of the jurisdictions concerned. In Ghana, it is absolutely required by law to enter into such a joint venture before one can function in the oil industry.

"In Ghana, it is absolutely required by law to enter into such a joint venture before one can function in the oil industry."

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 implementation of the new and recently passed oil exploration and production law, and also the new local content law, will shape regulations and business strategies in the months and years ahead. If these laws prove effective and beneficial to the industry, they will be entrenched. However, if they appear cumbersome and do not work too well, they may be reviewed or amended. Also, Ghana will soon be producing an average of about 300 million standard cubic feet of gas on a daily basis when the $7bn ENI Sankofa project also comes on stream. This should also positively impact the industry and the country.

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SOUTH AFRICA

ROY WALIGORA
KPMG

Q IN YOUR OPINION, WHAT HAVE BEEN THE KEY TRENDS SHAPING THE OIL & GAS SECTOR IN SOUTH AFRICA OVER THE PAST YEAR?

WALIGORA: South Africa still faces an ongoing energy crisis balancing supply and demand. To address this, the last 12 to 18 months have seen the country obtain 6377 MW of renewable energy and connected 44 projects with 2021 MW capacity to the national grid, with private investment in the initiative exceeding R194 billion through the successful Independent Power Producer Procurement Programme. However, the Department of Energy (DoE) has recognised the need to support the base-load energy mix with gas and cogeneration. In the absence of significant proven gas reserves, importing liquefied natural gas (LNG) has become a trend to support the development of power generation capacity. The DoE recently issued a Request for Information regarding development of a 3126 MW Gas to Power Programme, consisting of 3000 MW imported gas and 126 MW domestic gas. Other developments in the gas to power sector have seen the Dedisa Peaking Power Open Cycle Gas Turbine (OCGT) Plant, located in the Eastern Cape with 335 MW capacity, commence operations in September 2015, with another OCGT plant, Avon Peaking Power, located in KwaZulu Natal with 670 MW capacity, expected to reach commercial operations by October 2016. LNG is a key component of South Africa's energy supply mix and a strategic focus area.

Q WHAT FUNDAMENTAL EFFECTS ARE OIL & GAS PRICES HAVING ON COMPANIES OPERATING IN THIS SECTOR?

WALIGORA: The petrol price in South Africa is regulated, so in that way the impact of low oil prices has been muted, although the significant fall in the oil price has not flowed all the way to the petrol pump. However, as a mainly downstream market in a low oil price environment, the oil majors have been under pressure to run lean operations with a focus on producing healthy cash flows, so investment has been to maintain existing infrastructure.

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: The proposed amendments to the Mineral and Petroleum Resources Development Act (MPRDA) are still with Parliament, after having been sent back by the president on the basis that the changes violate the Constitution. These included a 20 percent share to government in all new upstream oil and gas ventures as well as an unlimited additional share at an undefined 'agreed' price and participation by historically disadvantaged South Africans. These changes were strongly opposed by the upstream oil and gas industry. More recent indications from the DoE is that new legislation is being planned to separate the oil and gas rules from legislation governing the mining industry. It is expected that exploration and gas concessions will fall under the Upstream Gas Bill and a separate Gas Amendment Bill will encompass the midstream elements of the gas value chain. If these regulatory changes go ahead, regulation of upstream oil and gas will move from the Department of Mineral Resources to the DoE, which currently regulates the downstream industry.

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

WALIGORA: The top challenge facing oil and gas executives in South Africa is regulatory uncertainty. The industry will need to lobby and consult extensively with the government in order to finalise the changes to the MPRDA as soon as possible. Oil and gas companies have also found the signing of fiscal stability agreements with the Department of Finance to be challenging. South Africa had a change in the Minister of Finance portfolio in December 2015 which has had the effect of significant delays in receiving approvals for fiscal stability agreements.

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

WALIGORA: It is common knowledge that South Africa has potentially large shale gas resources, most of which are located in the Karoo Basin. Although several international companies obtained permits to explore the region, environmental concerns had led to a moratorium on further permitting and existing licences being reviewed. However, regulations were recently published and a comprehensive strategic environmental assessment of the area has been initiated amid protest from anti-fracking groups. Stalled applications recommenced last year with companies like Falcon and Bundu proceeding with the processing of applications following consultation with affected communities. The sector appears aware of the environmental sensitivities, having looked to government to establish clear guidelines through the regulations intended to address the concerns of environmental protestors and ensure that fracking is carried out responsibly and in line with international best practice.

Q HOW WOULD YOU CHARACTERISE GLOBAL MERGERS AND ACQUISITIONS (M&A) ACTIVITY IN THE OIL & GAS INDUSTRY OVER THE PAST 12 MONTHS? WHAT FACTORS ARE DRIVING DEALS?

WALIGORA: It is possible that the lower oil price environment and regulatory uncertainty over refinery upgrades has created some opportunities in the market. For example, Chevron announced its intention to sell its South African business which has generated considerable interest in the market. The deal includes Chevron's attractive retail network but also its old Cape Town based refinery which will require significant investment in terms of the proposed Clean Fuels II upgrades. This attracted media attention when the South African government through the Strategic Fuel Fund proposed to acquire Chevron SA's assets, although this was later revoked by the Central Energy Fund on the grounds of it being unauthorised. The lower oil price is not driving significant investment and deal flow in South Africa and the region, although there is interest in trying to find good retail assets.

Q WHAT MAJOR DEVELOPMENTS DO YOU EXPECT TO SEE GOING

WALIGORA: The Gas to Power Programme is expected to stimulate the gas industry and gas infrastructure development within South Africa, requiring new policy frameworks and legal and regulatory amendments. Linked to this programme is the Gas Strategic Partner Programme for the development and

"South Africa seems determined to explore nuclear energy as a long term energy solution."

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

implementation of a 600MW gas fired power generation project. Operation Phakisa is a programme initiated by the South African government aimed at growing the ocean economy and other sectors. There is a focus on creating an enabling environment for the oil and gas industry. Some of the initial targets include building a 'one-stop' shop to streamline and regulate the licensing process for offshore oil and gas exploration and production. As part of Operation Phakisa, Saldanha Bay in the Western Cape is being established as an oil and gas hub through public-private partnership. Work on the offshore supply base has already commenced, which will see Saldanha Bay attracting oil rigs for repair and maintenance. Saldanha Bay is also undergoing a feasibility study by PetroSA for import of LNG to support its gas-to-liquids facility at Mossel Bay. Shale gas exploration, following appropriate approvals from stakeholders, is expected to commence in the next few years. In addition, South Africa seems determined to explore nuclear energy as a long term energy solution. The costs and viability of nuclear energy are contested and the programme was put on hold following a Court decision in March 2016. However, despite the public disagreement over nuclear, the procurement programme seems likely to proceed in the next few months and will be a significant area of spending.

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