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Introduction

The South African energy sector is reasonably diverse, with coal being the protagonist and significantly smaller roles being played by an aging nuclear power plant and a nascent renewable energy sector. Although the State has made no secret of its fluctuating ambition to invest more than it can afford into new nuclear projects, it has, for more than a century, maintained a consistent interest in pursuing the possibility of commercially viable domestic oil and gas resources. Despite such interest, which was heightened by the two world wars, the oil crises of the 1970s, Apartheid-related sanctions and, more recently, by the possibility of South Africa being home to some of the largest reserves of conventional and unconventional resources in Africa, a potentially vibrant South African oil and gas industry has yet to flourish. It is against this backdrop that the upstream oil and gas endeavours are currently the most intriguing aspect of the South African energy sector, hence they form the focus of this chapter. What follows is an overview of South Africa's upstream oil and gas industry, a synopsis of the primary statute governing its activities, an analysis of the uniquely South African issue of black economic empowerment and its interaction (or lack thereof) with the upstream oil and gas industry, as well as a discussion of the manner in which development of the industry has been curtailed by ongoing legislative and regulatory uncertainty. In conclusion, it is suggested that sober steps will need to be taken by the State to steer the oil and gas industry away from the uncertainty that has come to define the legislative and regulatory frameworks that govern the country's upstream oil and gas sector.

Overview of the South African oil and gas industry

After many years of spasmodic and fairly basic terrestrial oil exploration, the South African government resolved in 1913 to hire the best available overseas expert to conduct exploration efforts aimed at proving or disproving theories of commercial oil reserves. The person that they turned to was Edward Hubert Cunningham Craig, a Scottish geologist, who, although he failed to uncover any noteworthy hydrocarbon accumulations, did state as follows:

> "[W]hile I regret that it has been necessary to give a gloomy view of many propositions, where hard and careful prospecting work has been performed, I am hopeful that my tour may not be without some results in turning the attention of prospectors and capitalists to areas more worthy of exploration."[1]

As hindsight has revealed, the primary area worthy of further exploration was not onshore but offshore. It was not until professors Simpson, Hales and Brock of the University of Cape Town drew attention in 1964 to the petroleum potential of South Africa's continental shelf that the government reconsidered the possibility of significant accumulations occurring

within its jurisdiction. The possibility of domestic offshore reserves was particularly exciting, not simply due to the oil-related sanctions that were being imposed upon the Apartheid regime, but also because of South Africa's substantial oceanographic territory. The South African coastline is roughly 2,900 kilometres in length and it stretches from South Africa's north-western border with Namibia on the Atlantic coast, southwards around the tip of the continent, then north along the Indian Ocean to the country's north-eastern border with Mozambique.

The genesis of the South African oil and gas industry occurred in January 1965 when the State-owned parastatal, the Southern Oil Exploration Company ("Soekor"), was established to manage oil and gas exploration in South Africa. In 1967 Soekor was granted a prospecting lease under the now repealed Mining Rights Act 20 of 1967, to prospect throughout the territorial waters and continental shelf of South Africa. Shortly afterwards, Soekor subleased prospecting rights to certain local and foreign companies and, in 1969, the Superior Group drilled the first offshore well, Ga-A1, in the Pletmos Basin, where gas and condensate were discovered. It was, however, the Bredasdrop Basin which, like the Pletmos Basin, is located off South Africa's South Coast, that became the focus of the most seismic and drilling activity and led, in 1987, to the establishment of Mossgas (Pty) Ltd ("Mossgas") to own and operate South Africa's lone offshore platform, which is located 85 kilometres southwest of Mossel Bay. In 1992 Mossgas produced South Africa's first natural gas as feedstock for its gas-to-liquids ("GTL") plant at Mossel Bay. The next significant event affecting the South African oil and gas industry took place in 2002 when Soekor and Mossgas merged to form the Petroleum Oil and Gas Corporation of South Africa (Pty) Ltd ("PetroSA"), which is the national oil company of South Africa.

South Africa's oil and gas industry is relatively minute by global standards and, currently, exploration activities are predominantly offshore, although a number of companies have applied for onshore exploration rights so as to pursue the potentially huge shale gas reserves of the Karoo Basin. While South Africa possesses an estimated 1.5 trillion cubic feet ("tcf") of technically recoverable coalbed methane, estimates for technically recoverable shale gas resources vary between 390 tcf and 40 tcf. Consequently, the government has repeatedly acknowledged that domestic resources of that sort could be an economic game changer for the country; even President Jacob Zuma has used the words "game changer" when talking about South Africa's potential shale gas reserves. However, due to significant resistance from various environmental organisations, combined with problematic legislative and regulatory regimes that are in an extended state of flux and which, until recently, did not cater for hydraulic fracturing, exploration rights for shale gas have yet to be awarded. As far as the awarding of such rights is concerned, it should be noted that the State, as custodian, acting through the Minister of Mineral Resources ("the Minister") holds all title to oil and gas resources within South Africa. The Minister is empowered to authorise companies to explore for and produce oil and gas where they have, amongst other things, suitable financial and technical capabilities.

While the Minister is empowered to authorise the activities of international oil companies ("IOCs"), the promotion and regulation of their upstream operations falls to the South African Agency for the Promotion of Petroleum Exploration and Exploitation (Pty) Ltd ("the Petroleum Agency" or "PASA"). In general, the Petroleum Agency performs an advisory and administrative role that includes receiving, evaluating and making recommendations to the Minister on applications for petroleum rights and permits, and monitoring compliance with such permits and rights. It also acts as the custodian of the national petroleum exploration and production database. In practice, IOCs generally respect the ability of the Petroleum

Agency to accommodate and assess applications for rights and permits. The ability of the Department of Mineral Resources ("DMR") to fulfil its statutory duties has occasioned significant frustration among IOCs and indeed mining houses, particularly in relation to the amount of time it takes to grant or refuse applications. Interestingly, the current Minister of Energy, Tina Joematt-Petterssen, has stated that ministerial oversight of the oil and gas industry may well be moved out from under the DMR and over to the Department of Energy ("DoE"). Whether such a move will in fact materialise and, more importantly, whether it will be beneficial *vis-à-vis* the needs of the oil and gas industry, remains to be seen. It is, however, generally accepted that, in view of the successful manner in which the DoE ran the country's relatively recent Renewable Energy Independent Power Producer Procurement Program ("REIPPPP"), it may well take a different approach than that of the DMR.

Red tape-related frustration aside, another issue that has played a role in stifling foreign investment in South Africa's upstream sector is a lack of legislative and regulatory certainty, which is an issue that is discussed in more detail below.

The Mineral and Petroleum Resources Development Act

The primary legislation governing the South African upstream sector is the Mineral and Petroleum Resources Development Act, 28 of 2002 ("the MPRDA"). Significantly, the MPRDA, which took effect in 2004, replaced what was a system of private ownership with a system of State ownership that allows for the granting of permits and rights by the Minister on behalf of the State. Although the MPRDA governs South Africa's oil and gas industry as well as its mining industry, a situation that has occasioned a fair degree of jurisprudential criticism, oil and gas activities are primarily accommodated within a separate chapter of the statute, namely, Chapter 6. Chapter 6 makes provision for two permits (reconnaissance permits and technical co-operation permits) and two rights (exploration rights and production rights).

Reconnaissance permits are required for the carrying out of reconnaissance operations which are defined as "any operation carried out for or in connection with the search for a mineral or petroleum by geological, geophysical and photogeological surveys and includes any remote sensing techniques, but does not include any prospecting or exploration operation". To qualify for a reconnaissance permit, an applicant must demonstrate that, amongst other things, it has the financial resources and technical ability to conduct the proposed survey. Reconnaissance permits are valid for a period not exceeding one year and are not renewable or transferable.

If issued, technical co-operation permits, which are not defined under the MPRDA, allow IOCs to conduct what are essentially desktop studies into the hydrocarbon prospectivity of South African acreage by, for example, undertaking exercises in basin modeling and seismic interpretation. Technical co-operation permits are valid for a period not exceeding one year and are not renewable or transferable. The holder of a technical co-operation permit has the exclusive right to apply for and be granted an exploration right in respect of the area to which the permit relates. If the holder of a technical co-operation permit has lodged an application for an exploration right, the technical co-operation permit remains in force notwithstanding its expiry date, until such time as the exploration right application is either granted or refused.

If granted, exploration rights allow the holders to conduct exploration operations which are defined under the MPRDA as "the re-processing of seismic data, acquisition and processing of new seismic data or any other related activity to define a trap to be tested by drilling,

logging and testing, including extended well testing, of a well with the intention of locating a discovery". In order to be granted an exploration right, an IOC must demonstrate that, amongst other things, it has the financial resources and technical ability to conduct the proposed exploration operation. A further, and uniquely South African, requirement that will be discussed in more detail below, is the fact that applicants for exploration rights are bound to demonstrate that the granting of such right will further particular objects of the MPRDA, including the need to expand opportunities for historically disadvantaged persons to enter the petroleum industry. A historically disadvantaged person is defined as:

(a) any person, category of persons or community, disadvantaged by unfair discrimination before the Constitution took effect;

(b) any association, a majority of whose members are persons contemplated in paragraph (a); or

(c) any juristic person other [than] an association, in which persons contemplated in paragraph (a) own and control a majority of the issued capital or members' interest and are able to control a majority of the members' votes.

Exploration rights are split into successive terms, the initial term not exceeding three years and three further renewal terms, each not exceeding two years. Upon each renewal, relinquishment of a percentage of the exploration area is usually required. Although the relinquishment percentage is not prescribed by legislation, it is common practice for the relinquishment requirement to take the following proportions: 20% relinquishment of the exploration area on completion of the initial exploration period; thereafter, not less than a 15% relinquishment of the exploration area on completion of each of the first and second renewal period. Where the holder of an exploration right has lodged an application for renewal, the exploration right remains in force until such time as the renewal application has been granted or refused. The participating interests in exploration rights are transferable subject to ministerial consent. Upon discovery of oil or gas, the holder of an exploration right has the exclusive right to apply for a production right.

Production rights, if granted, allow the holders thereof to conduct production operations, which are defined as "any operation, activity or matter that relates to the exploration, appraisal, development and production of petroleum". A successful application for a production right will be contingent upon an IOC being able to demonstrate that, amongst other things, it has the financial resources and technical ability to conduct the proposed operation and, as with applications for exploration rights, the granting of a production right will expand opportunities for historically disadvantaged South Africans to enter South Africa's oil and gas industry. Production rights are split into successive terms, each term not exceeding 30 years. There are no prescribed limits in the MPRDA in respect of the number of renewals. Such rights of renewal are exclusive to the holder of the production right. The participating interests in production rights are transferable subject to ministerial consent.

State participation, local content and economic transformation

Albeit that IOCs operating in African jurisdictions are undoubtedly *au fait* with variations in State participation, local content requirements and, concomitantly, the deference that must be paid thereto, they would do well to note that the South African government has developed a *sui generis* strategy towards commercial involvement of specific South Africans in the oil and gas sector. Although state participation and local content requirements are commonplace in the oil and gas sectors of resource-rich developing countries, and E&P

companies that possess noteworthy pedigrees for breaking ground in such jurisdictions may view the potential acquisition of South African acreage with well-earned self-confidence, it must be understood that the South African situation is particularly unusual. Access to the South African upstream cannot be achieved without a strong understanding of the rules governing the country's singular state participation and local content strategies, together with a demonstrable readiness to play by those rules. Failing to gain a strong understanding of these issues and to approach them with the requisite reverence may turn well-earned self-confidence into misplaced hubris.

As a starting point, gaining an understanding of how the rules in question apply to upstream endeavours must be based upon a general understanding of South Africa's economic transformation policies, which policies have been developed in an attempt to rectify the race-based economic inequalities that remain a burning socio-political issue in post-Apartheid South Africa.

The touchstone statute for South Africa's economic transformation policies is the Broad-Based Black Economic Empowerment Act 53 of 2003 (the B-BBEE Act), which applies to all companies operating in South Africa. By means of the B-BBEE Act, the government aims to increase the number of black people that manage, own and control the country's economy, thereby rectifying the race-based inequalities that took root prior to the advent of democracy in 1994. In order to achieve the requisite transformation of the South African economy, the B-BBEE Act provides for a rating system in terms of which companies are awarded points for meeting particular targets, including, for example, percentage-based ownership by black South Africans. Although the targets are not prescriptive, IOCs that are eyeing South African acreage must be alive to the fact that it will be to their detriment not to establish and maintain significant B-BBEE ratings. The reasons for this are, in essence, twofold. Firstly, under the B-BBEE Act, organs of state are bound to take B-BBEE ratings into account when issuing licences and State-owned enterprises such as PetroSA, the national oil company of South Africa, are bound to take B-BBEE ratings into account when they enter into partnerships with the private sector or when they procure goods or services. Secondly, a poor B-BBEE rating will hinder the day-to-day running of a company's business as most private sector businesses, including those operating in the oilfield services space, are actively pursuing their own B-BBEE targets. In the circumstances, it would be imprudent to pursue the acquisition of South African assets without a B-BBEE strategy that has been developed to manage economic transformation pressures from government and from the private sector.

Although the purport of the B-BBEE Act will undoubtedly have an unavoidable impact upon the activities of IOCs operating in the South African upstream sector, the provisions of the B-BBEE Act are not specific to the industry or the sector. In that regard, cognisance must be taken of certain sections of the MPRDA, as well as particular aspects of the Mineral and Petroleum Resources Amendment Bill 15B of 2013 ("the Bill").

Under the MPRDA, South Africa's economic transformation agenda is evident from the outset in that the preamble specifically states that the MPRDA was enacted in consideration of "the State's obligation under the Constitution to take legislative and other measures to redress the results of past racial discrimination". Additionally, section 2 provides that the objects of the MPRDA are, amongst other things, to "substantially and meaningfully expand opportunities for historically disadvantaged persons, including women, to enter the mineral and petroleum industries and to benefit from the exploitation of the nation's mineral and petroleum resources", and to "promote employment and advance the social and

economic welfare of all South Africans". Importantly, the ability of an oil and gas company to obtain exploration and production rights is inextricably linked to these particular objects of the MPRDA. In that regard, sections 80 and 84 of the MPRDA, which, respectively, set out criteria for the granting of exploration and production rights, dictate that the Minister must grant the relevant right if, amongst other things, the granting thereof will further the specific objects in question. Consequently, it is unsurprising to note that the language of the relevant aspects of exploration and production rights is reflective of the economic transformation-related objects of the MPRDA. To that end, local content requirements that are usually incorporated as licensing conditions include undertakings by the holders of the relevant rights to, amongst other things, implement programmes for the training and skills development of historically disadvantaged South Africans, and to give preferential treatment in the procurement of goods and services from such persons.

The granting of upstream authorisations is not only subject to the specifically pro-transformation objects of the MPRDA but also the empowerment-related provisions of s100 of the MPRDA. At the heart of s100 is an obligation that has been placed on the Minister to "develop a broad-based socio-economic empowerment Charter that will set the framework, targets and time-table for effecting the entry of historically disadvantaged South Africans into the mining industry, and allow such South Africans to benefit from the exploitation of mining and mineral resources." Although the language of s100 does not refer directly to the oil and gas industry, s69 of the MPRDA allows for terms such as "minerals" and "mining" to be construed as references to "petroleum" and "production". As far as the "Charter" that is mentioned in s100 is concerned, debate exists regarding the relevance and legal weight, if any, that can be attached to the so-called Liquid Fuels Charter. That said, amendments to the MPRDA are afoot that, in all likelihood, will render the debate moot. The specific amendment in question proposes to make the Mining Charter the applicable charter for the purposes of s100 of the MPRDA. Notwithstanding the fact that the Liquid Fuels Charter may soon be of no relevance *vis-à-vis* the operations of upstream E&P companies, for the sake of good order, it is perhaps worth touching on certain aspects thereof.

The Liquid Fuels Charter, which was a product of negotiations that took place in 2000 between the South African government and various industry stakeholders, came into force on 26th April 2004 as a schedule to the downstream-focused Petroleum Products Amendment Act 58 of 2003. As set out in its preamble, the Liquid Fuels Charter was developed "to provide a framework for progressing the empowerment of historically disadvantaged South Africans in the liquid fuels industry". Although the term "liquid fuels industry" is not defined and, as mentioned above, the legal standing of the Liquid Fuels Charter is a debatable issue, it specifically states that it "applies to the privately owned parts of the industry and to all parts of the value chain, [including,] *inter alia*: [e]xploration and production of oil…." Consequently, bearing the scope of the Liquid Fuels Charter in mind, the crux thereof for companies wishing to access the upstream sector is twofold: firstly, in relation to every exploration and production right, the South African government is entitled to reserve not less than 9% for buy-in by historically disadvantaged South Africans; and, secondly, it requires companies to make financial contributions to the Upstream Training Trust to fund skills development at various levels.

As far as buy-in from historically disadvantaged South Africans is concerned, it is clear that, in line with the government's economic transformation policies, the government wants to see heightened investment by such persons into the upstream oil and gas sector. The Liquid Fuels Charter, however, contains an acknowledgment that "[t]he activity of oil and gas exploration and production is ... a high-risk activity that provides limited opportunities

for new entrants" and, with that in mind, it should perhaps be unsurprising that there is a problematically low number of historically disadvantaged South Africans who have the financial resources, technical abilities and, simply put, the appetite for upstream ventures. The dearth of historically disadvantaged partners is problematic because, not only is there competition for the handful of desirable entities, it may well be the case that a suitable partner cannot be identified.

Another point to note regarding buy-in from historically disadvantaged South Africans is that, in practice, a 10% participating interest is usually reserved for such persons. A further important point to bear in mind regarding the allocation of participating interests is that it is standard practice for exploration and production rights to contain clauses that reserve an additional 10% participating interest in favour of the State, which option is to be exercised at production. In such instances, the State will not be liable for any costs arising from exploration operations, but it will be bound to pay its share of production costs incurred subsequent to its acquisition of the relevant 10% participating interest. It has happened in the past that PetroSA has fulfilled the role of the State in that regard, however, in view of the troubled nature of its financial standing (it posted a R14.6bn loss for the 2015 financial year), questions are being asked regarding whether or not PetroSA will be able to pay its share of such costs. Nevertheless, the most important questions that are being asked by the South African upstream industry do not pertain to the financial standing of the national oil company but to certain proposed amendments to the MPRDA, which amendments are briefly discussed below.

The MPRDA Amendment Bill

The Bill is set to introduce a number of wide-ranging changes to the laws governing South Africa's upstream oil and gas sector, and it has been staunchly opposed by the industry. In addition to the actual provisions of the Bill, drawn-out consultative processes involving repeated consideration of the Bill by Parliament's Portfolio Committee on Mineral Resources, as well as time spent by the office of the President in assessing the constitutionality of the Bill, have proven to be a triumph of techniques for torturing foreign investment. In hindsight, it appears that the legislative treatment that the Bill has endured was perhaps not aimed at revealing the facts about its purport but rather about forcing the industry to collude with the fiction that, simply put, the Bill is not that bad.

Of the upstream industry's various concerns, the most significant relate to changes to State participation, the amendment of s100 of the MPRDA to refer to the Mining Charter, and the proposed scrapping of the Petroleum Agency. As mentioned above, players in the South African upstream view the expertise of the Petroleum Agency in a favourable light and, consequently, its potential undoing was an unpleasant surprise. Apparently, upon publication of the Bill in the Government Gazette, multiple members of the Petroleum Agency's senior management were equally surprised to read about that which was to be tabled in Parliament.

On the issue of State participation, the Bill proposes the introduction of s86A which will not only grant the State an automatic 20% free carried interest in all new exploration and production rights, it will also entitle the State "to a further participation interest in the form of … acquisition at an agreed price; or production sharing agreements". In addition to the fact that members of the oil and gas industry have stated that the introduction of a 20% fee carry may sound the death knell for their upstream endeavours, it is not clear what is meant by "at an agreed price" or what will transpire when agreement cannot be reached in that regard.

As regards the Mining Charter, the Bill aims to subject the upstream oil and gas sector to the empowerment provisions of the Mining Charter which, amongst other things, requires companies to be 26% black-owned. While the industry understands the current position to be a not more than 10% divestment of a participating interest in a particular right, the potential arises upon implementation of the Mining Charter that the participating interest of historical disadvantaged South Africans might move from not more than 10% to 26%. This potential 16% jump in participation is a troubling development for IOCs, particularly in view of the manner in which it will impact upon their financial planning and the various empowerment-related issues discussed above.

In spite of multiple submissions to the relevant authorities, industry lobbying seems not to have been persuasive as the Bill is on course for entry into law before the end of 2016.

Quo vadis?

"As one envisages South Africa's possible upstream future, the pictures are exciting: an 'Aberdeen-like' regional cluster of global companies situated here, a marine repair and services sector of five to ten times its current size, a training hub rivalling the major global industry centres, and even a thriving domestic production region off the northwest coast."

The above statement was made in February 2010 by Warwick Blyth, the then-CEO of the South African Oil and Gas Alliance ("SAOGA"). Six years later, in the light of the various issues discussed above, it seems that the particularly bright future envisaged by Mr Blyth may well be placed on hold until the relevant issues have been comprehensively addressed. In that regard, it is hoped that the challenges that have been triggered by South Africa's economic transformation policies will be overcome and that the Bill will not become a barrier to entry into the upstream sector, or a reason to leave it. Without a doubt, an enduring theme among members of the South African oil and gas industry is that providing regulatory certainty is an impending obligation that cannot and must not be shirked by the State. Their views do not amount to mere talk around the proverbial watercooler as an increasing number of IOCs with 'skin in the game', so to speak, have opted to provide the government with accounts of the frustrations that they have been enduring. It remains to be seen whether or not their efforts will yield the desired results.

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Endnote

1. E Rosenthal, *South Africa's Oil Search Down the Years* (Citadel Press Lansdowne 1970) 136.

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