

Expert Guide

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M&A in the Indian Energy Sector: Recent Trends & Challenges

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The upstream segment of the Oil & Gas Sector in India is dominated by the state-owned Public Sector Undertakings (“PSU”). The Oil & Natural Gas Corporation (ONGC), a PSU, is the lead player and accounts for nearly 75% of the total national output. ONGC through its subsidiary ONGC Videsh Limited (OVL) makes acquisitions in upstream oil & gas assets overseas. The inward investment in this sector has been primarily driven by The New Exploration Licensing Policy (“NELP”) promulgated by the Government of India which has facilitated the acquisition of oil and gas blocks and successfully attracted foreign investment¹ and facilitated entry of large number of private players in the E&P segment. PSUs have not been engaged in any major M&A activity overseas, the behemoth state-run enterprises have been increasingly focusing on and in some cases aggressively scouting for acquiring oil assets around the World.

IX NELP rounds have been conducted so far, in order to attract further foreign investment in this sector. Government is considering the Open Acreage Licensing Policy (OALP) under which year-round bidding would be possible. However one of the hurdles is to agglomerate and prepare a data depository for E&P Companies in order for them to review the reliable data throughout the year. Director General Hydrocarbons is in the process of developing the National Data Repository which shall facilitate agglomeration of all of the relevant data under one roof just like the data for minerals acreage for prospecting is available from the Geological Survey of India.

The increasing demand of the fossil fuel in the energy hungry world, especially the developing nations like China, India, and Korea has fueled the flow of private equity in this high risk sector. The Indian O&G market has witnessed some prominent deals including the USD 8.6 billion acquisition of Cairn India by the Vedanta group, the USD 9 billion acquisition of Reliance Energy by British Petroleum and the acquisition of the UK based BG Group owned Gujarat Gas Co. Ltd. by Gujarat State Petroleum Corporation for USD 442 million (approximately).

Major Issues & Challenges

The major challenges faced by the M&A activities in the energy sector arises from the restrictive nature of political and regulatory system in India, and the lack of large capital required to invest in this capital intensive sector. Since M&A activity in this sector entails extensive capital investment it results in limited private players to take benefit of Government policy and therefore the requirement of foreign capital becomes imperative. The Government of India in order give fillip to this sector has eased the norms for foreign investment under the automatic route for 100% investment in the exploration activities in the Oil & gas fields, Petroleum product marketing, Petroleum product pipelines, natural gas pipelines, LNG regasification infrastructure, and such other activities other than refining but including market study and formulation. However, foreign investment is permissible up to 49% in the petroleum refining by the Public Sector Undertakings without any divestment or dilution of domestic equity in the existing PSU under the non-automatic/FIPB route.



The requirement of government consent for any change in the status of the company to which the oil or gas blocks have been allotted has proven to be a major issue in this field. The Production Sharing Contract (“PSC”) which is entered into by the Government and the acquirer of the oil or gas blocks provides that a company which has been allotted the oil blocks may enter into a transaction which may result in a change in the management or control of the company only with the prior written consent of the Government.² It further

provides that the government consent should factor various considerations such as the technical and financial strength of the new company, details of the shareholders agreement and the composition of Board of Directors consequent upon such transaction.³ The Vedanta-Cairn India deal which sought government approval in August, 2010 got clearance only in July, 2011. Moreover, being a government order it was challenged in the courts and got the Supreme Court’s approval only recently in May, 2013. The Vedanta case evidences that these requirements tend to delay the M&A transactions and have the potential to discourage new investment in this area. The requirement of government approvals permeates even beyond the acquisition process and very often the exploration slackens for want of environmental, defense and other clearances. The majority of the exploration process being carried under the previous NELP rounds will be dependent on the efficiency of the administration and the timely grant of government approvals.

Most acquisitions in this sector are large transactions and shall require the approval of the Competition Commission of India. However, the general trend suggests that clearances from the Competition Commission are readily obtained. This may be due to a number of factors. The competitive impact of combinations is often measured on the basis of the market shares of the companies. However, in a number of NELP acquisitions, the ventures are still in their exploratory phases and the actual market share is therefore undetermined. Moreover, since the price caps for the output is already fixed in the PSC, there is little fear of adversely affecting the consumers. In January 2013, the Competition Commission, after assessing the natural gas sector, the market share of the parties, and the impact of the combination, granted its approval to the GSPC-GGCL deal.

Since the M&A activity in this sector has been rather subdued so far, once the M&A activities in the Oil and Gas sector intensifies with inward investment into India, from an acquirers perspective, upon a substantial acquisition amounting to

change of control of an Indian Oil Company shall trigger an open offer requirement. If such transactions entail combination of both the acquisition and the issuance of fresh capital by the Indian Company it shall require besides the SAST Regulations further compliances and adherence to the ICDR regulations.

As is expected that since much of the M&A activity shall be dependent on infusion of foreign capital, the investors and company resident in India shall have to adhere to the extant FEMA Guidelines.

Much will depend on the structure of the transaction being crafted i.e. asset purchase, share purchase, mergers within India or cross border mergers wherein a foreign oil & gas entity merges with an entity incorporated in India under Section 394 of the Indian Companies Act and the tax planning under each of these structures. It is pertinent to mention that the Indian Companies Act precludes the merger of an Indian Company with an entity overseas. In order to boost the outward investment, the FEMA Regulations facilitates investments in Oil & Gas entities overseas.

Conclusion

It is exciting times in the Oil and Gas sector in India and 68 blocks are expected to be offered in the NELP X round with prior approvals on each of the blocks from the Ministry of Environment, Ministry of Defense, and other relevant departments of the Government.

If this is accomplished, a major hurdle in speedy development which has plagued this sector would have been addressed. Since Government is keen to engage with the market players from overseas such a move shall boost investor confidence. Consolidation of geo-scientific information at one nodal National Data Repository will further ease and facilitate the investment climate within India.

The implementation of C.Rangarajan Committee's report and reviewing the system of production sharing should be the top priority. However, a focused due diligence, intensive geo-scientific research and a well deliberated PSC would be significant step to bolster investment and M&A activity in this sector.

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- 1 - <http://petroleum.nic.in/nelp9.htm>
- 2 - Article 34, <http://petroleum.nic.in/nelp93.pdf>
- 3 - Article 34, <http://petroleum.nic.in/nelp93.pdf>

