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MOOT PROBLEM

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1. Gerardia is one of the fastest developing countries of the world, blessed with ancient cultural heritage and a mineral rich diverse topography. Its governance structure, laws and constitutional principles are in complete consonance with that of the Republic of India. The country possesses scanty hydrocarbon reserves and lacks the economic potential and technological prowess required, to explore them; hence, Gerardia imports most of its crude oil and natural gas from a range of other oil rich countries.

2. Around the end of the twentieth century, observing the incessant rise in prices of oil and natural gas in the international market, the Government of Gerardia resolved to reduce its dependency over imported petroleum and natural gas by focusing on exploration and development of its own hydrocarbon reserves.

3. For rational exploitation of these reserves, the Government of Gerardia came up with the *New Exploration Licensing Policy, 1997* (“NELP”) based on the Production Sharing Model, wherein the entire capital for such projects was to be derived from the investments made by the contractor, who were to get a share in the production from such reserves along with possible recovery of the entire costs incurred in the performance of such exploration and production, if successful. Under the model, the Ministry of Petroleum and Natural Gas (“MoPNG”) was to invite bids for auctioning its hydrocarbon reserves through a process of international competitive bidding, to enter into Production Sharing Contracts (“PSC”) with the contractor for exploration and development of the oil and gas blocks so awarded.

4. Making no delays, in the year 1999, the Government conducted the first round of bidding under NELP with its launch as NELP-I, through which the MoPNG advertised twenty blocks from across the country including five deep-water blocks for bidding. The bidding round witnessed overwhelming participation of various prominent oil companies from around the world, which successfully concluded by awarding ten blocks *in toto*, including five deep-water blocks.

5. *Santoras Petroleum Corporation Limited* (SPCL), a company incorporated in Gerardia, is a Fortune 500 upstream multinational of Gerardia, performing exploration and development activities in five continents around the world. Enthused by the local advantage and attracted by the investment possibilities in Gerardia, SPCL participated in the bidding round as a part of a consortium with another major player of the domain – *Delaware Resources Limited* (DRL), a

company incorporated in Canada, and successfully secured one of the deep-water blocks *Ni-2* located in the basin of *Lisa* river.

6. Having secured the *Ni-2* block, the consortium led by SPCL entered into a PSC with the MoPNG (on behalf of the President of Gerardia) and also signed a Joint Operating Agreement with DRL setting the terms for their collaboration. Under the PSC, SPCL was appointed operator of the block, holding a participating interest of 80% while DRL held the rest 20% (“Contractor” – SPCL & DRL together). After obtaining the Petroleum Exploration License from the Government of Gerardia, the Contractor commenced its petroleum operations in the block in the later months of 1999, and successfully announced a major commercial discovery of natural gas within four years of its commencement, for which it also made a public announcement. The Chief Marketing Officer of SPCL made a public appearance with the following statement:

I am elated to share with you that our consorted efforts have reaped promisingly. Within this short span of four years we've made a commercial discovery for natural gas in Ni-2 block located in the Lisa river basin, which I am confident is the biggest natural gas discovery ever made across the country. Also, as per the statistical projections recorded by us, it surely has the potential to bridge the gap between the domestic requirement and the current domestic production significantly in a matter of another few years.

7. The Contractor notified the Managing Committee constituted under the PSC and the Government about its discovery, and also submitted the Initial Development Plan (IDP) in accordance with the provisions laid down under the PSC. In the following few years, production from the block remained exemplary, which even exceeded the expectations of the Contractor themselves. With production taking a significant leap, the Contractor submitted a revised IDP to the Management Committee, doubling its approved production from the block to 80 mmscmd from its earlier limit of 40 mmscmd. Courtesy to *Ni-2* block, the huge rise in domestic production of natural gas cut down its import for Gerardia by 60% and Gerardia's vision of self-sufficiency in natural gas started appearing to be in sight.

8. Four years later, in 2008, the production of natural gas from *Ni-2* block started plummeting astonishingly from its approved production of 80 mmscmd to as low as 42 mmscmd (about 50%

of the approved). Given the immense importance of this block for the whole country, this fall in production was widely covered by the media, which continued consistently for the next two years. In the following years, this fall deepened drastically to as low as 25 mmscmd (nearly 30% of approved) and 15 mmscmd (not even 20% of approved) for the approved production of 80 mmscmd for both the years. Concerned by the continued fall in production from the block, the Government notified the Contractor for its non-compliance of the IDP; warning to revise its stipulated cost-recovery and impose appropriate penalties under the PSC lest it further failed to increase its production output. Also, the Government alleging breach of the PSC, called upon the Contractor asking as to why the PSC in respect of the contract area should not be terminated as per Art. 30 of the PSC.

9. In its reply, the Contractor stated that the fall in production of natural gas was inevitable in light of the unforeseeable circumstances that had arisen due to geological complexities, which could not be anticipated. Also, it requested the Government to increase the well head price determined under the PSC for its production from the block since the newly discovered conditions had significantly inflated production costs, which unless balanced proportionately by revising the well head price, would cause significant losses to the Contractor. The Government expressing its dissatisfaction with the problems highlighted by the Contractor denied request for revision of the well head price.

10. The falling output from *Ni-2* block had raised concerns all over the country as it continued to push the country back to the old days of energy dependence and escalate the petroleum prices again, adversely affecting a wide spectrum of industries and economy as a whole. Prompted by the surprising fall in production from *Ni-2* block and its direct nexus with the deepening economic inflation, the Comptroller and Auditor General of Gerardia (CAG) sought the approval of the MoPNG, to initiate a financial and performance audit for the Contractor in *Ni-2* block, which was approved by the Ministry. However, both SPCL and DRL took exception to this audit, citing that no audit of the block could be performed by the CAG under the PSC regime, seeking the Ministry to revoke its approval. The Ministry, in its reply, not only declined to accept this argument of the Contractor, but also reaffirmed its intention of reducing the cost recovery amount and imposing appropriate penalty upon the Contractor unless they managed to increase their output. Enough time having passed with no response from the Contractor, the Government

notified the Contractor of slashing of cost recovery amount by 25% and imposition of a \$10 million penalty on the Contractor. Aggrieved by the Government's approval to the CAG for conducting financial and performance audit and alleging illegality of the reduction in the cost recovery amount as well as the imposition of penalty, the Contractor initiated arbitration proceedings against the Government under the PSC, claiming grave infraction of the PSC by the Government. An arbitral panel was setup in accordance with the provisions of the PSC, which passed an award in favour of the Government. It not only upheld the conduct of the Government in approving financial and performance audit by the CAG, but also the validity of the action of the Government in reducing cost recovery and imposing penalty on the Contractor, and held the action of the Government as *intra vires* the PSC. The Contractor took the matter in first appeal before the High Court, where the arbitral award was upheld. Aggrieved by this decision, the Contractor appealed to the Apex Court of the Country – the Supreme Court of Gerardia.

11. While the arbitral proceedings were pending before the panel, the energy crisis deepened and the Government mulled enhancing its imports so as to compensate for the deficit created due to fall in production from *Ni-2* block. With the unanimous approval of the Council of Ministers, the Government approved the import of natural gas from certain countries in Latin America and the Middle East. At that time, the petroleum prices in the international market were going amok, as a result of which, the imports proved disastrous for the economy, which was already crisis ridden, causing surplus burden on the exchequer. As a direct implication of these imports, high prices in the international market caused the foreign exchange reserves of Gerardia to dry out and its trade deficit to grow exorbitantly, compounding the already severe inflation. A wide spectrum of industries including steel, power, fertilizers, pesticides etc. was affected, which also took a toll on the domestic consumers. Prices of almost all commodities in the common market saw an unprecedented hike, the stock market crumbled and the transportation costs sprung with massive increase in domestic fuel prices.

12. With no relief from the imports and the biggest domestic producer at loggerheads with the Government, the people of Gerardia were faced with a perilous challenge. The only possible rescue they had in sight was a perceptive judgment from the Apex Court, which could remove the impasse and bring breath back to the economy.

13. The Supreme Court of Gerardia, concerned with the threatened energy security of the country and the evident adverse effects of importation on the national economy, called for an expedient hearing of the matter, wherein the Government of Gerardia submitted that the limited scope of appeal within the scheme of the Arbitration and Conciliation Act, 1996 could not be overridden by seeking the Court to act as the Court of Original Jurisdiction, and that the parties may address the Court only within the scope of the issues and the scope of intervention by the Court. Outlining the primary points of dispute between the parties and considering the distressful condition persisting in the country, the Court formulated the following issues –

- Whether the approval granted by the Government to the CAG for conducting financial and performance audit violates the PSC.
- Whether the Government can revise the cost recovery amount under the PSC regime.
- Whether the Government can impose penalty on the Contractor for non-compliance with the Initial Development Plan.

Both the parties have to make their representations before the Court to argue the matter.

NOTE:

1. NELP-I shall be assumed to be NELP-IX for the purpose of the problem.

2. The Model Production Sharing Contract published under NELP-IX shall be applicable to the problem.

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