



**Performance Audit Report**  
**on**  
**Management of Leases and Licenses**  
**By Director General, Petroleum Concessions**  
**Ministry of Energy - Petroleum Division**

**For the Period 2010-20**

**Audit Year 2020-21**

**AUDITOR-GENERAL OF PAKISTAN**



## **PREFACE**

The Auditor-General of Pakistan conducts audits under Articles 169 and 170 of the Constitution of Islamic Republic of Pakistan, 1973 read with Sections 8 and 12 of the Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001. The Performance Audit of "Management of Leases and Licenses" was carried out accordingly.

The Directorate General Audit, Petroleum and Natural Resources, Lahore conducted Performance Audit of "Management of Leases and Licenses" for the period from 2010-11 to 2019-20, during September 08 to October 16, 2020 with a view to report significant findings to relevant stakeholders. The Audit further evaluated whether the Directorate General of Petroleum Concessions had been able to manage leases and licenses effectively and efficiently for promoting exploration and production of indigenous resources. The Audit examined on test check basis the entire process of awarding exploration rights and subsequent process under different exploration and production policies and rules and thereon reported deviations from legal framework and industrial norms. The Audit Report indicates specific actions that, if taken, will help the management realize the objectives and ends of Petroleum Exploration & Production Policies as well as boost exploration and production activities. The report has been finalized in light of discussion in the DAC meeting held on December 30, 2021.

The Performance Audit Report is submitted to the President of Pakistan in pursuance of the Article 171 of the Constitution of the Islamic Republic of Pakistan, 1973 for causing it to be laid before both houses of Parliament (Majlis-e-Shoora).

Islamabad  
Dated:

**(Muhammad Ajmal Gondal)**  
Auditor-General of Pakistan



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## Abbreviations and Acronyms

BOPD	Barrel oil per Day
BTU	British Thermal Unit
C&F	Cost and Freight
CCI	Council of Common Interests
DAC	Departmental Accounts Committee
DG (PC)	Director General Petroleum Concessions
ECC	Economic Coordination Committee
E&P	Exploration & Production
EWT	Extended Well Testing
FDP	Field Development Plan
GOP	Government of Pakistan
GHPL	Government Holding Private Limited
GPA	Gas Purchase Agreement
INTOSAI	International Organization of Supreme Audit Institutions
KPOGCL	Khyber Pakhtunkhawa Oil & Gas Company Limited
LDs	Liquidated Damages
LMKR	Land Mark Resource
LPG	Liquefied Petroleum Gas
MoE (PD)	Ministry of Energy (Petroleum Division)
MPCL	Mari Petroleum Company Limited
MMBTU	Million Metric British Thermal Unit
MMCFD	Million Metric Cubic Feet per Day
NPV	Net Present Value
OGDCL	Oil & Gas Development Company Limited
OGRA	Oil and Gas Regulatory Authority
PAC	Public Accounts Committee
PCA	Petroleum Concession Agreement
PEL	Petroleum Exploration (Pvt.) Ltd.
PSA	Petroleum Sharing Agreement
PPL	Pakistan Petroleum Limited
SNGPL	Sui Northern Gas Company Limited
SSGCL	Sui Southern Gas Company Limited
SAPM	Special Assistant to Prime Minister

UEPL  
WLO

United Energy Pakistan Limited  
Windfall Levy on Crude Oil



## Glossary

BOPD	BOPD is a measure of oil out put
BTU	BTU is a unit of heat
EWT	EWT is test production allowed for estimation of reservoir volume and confirm reserves for field development
FDP	FDP is a plan showing the optimum production of hydrocarbon reservoirs by considering technical, economics, health, safety and environmental aspects
Hydrocarbons	Hydrocarbons are compounds comprised exclusively of carbon and hydrogen and they are by far the dominant components of crude oil, processed petroleum hydrocarbons namely; natural gas, gasoline, diesel, kerosene, fuel oil, and lubricating oil etc.
LMKR	LMKR is a private limited company that provides different technological services
Upstream	Upstream activities include exploration, drilling, and extraction of Petroleum Products
Midstream	Midstream activities include the storage, processing, and transportation of petroleum products
Downstream	Downstream activities are oil and gas processes that occur after the production / processing phase to the point of sale
WLO	WLO is a levy imposed on the E & P companies, if price of crude exceeds from base price



## **EXECUTIVE SUMMARY**

### **Management of Leases and Licenses**

The Director General Audit, Petroleum and Natural Resources, Lahore conducted Performance Audit of Management of Leases and Licenses for the period from 2010-11 to 2019-20, during September 08, 2020 to October 16, 2020. The main objective of the audit was to evaluate the extent to which the Directorate General (PC) had been able to manage leases and licenses effectively and efficiently for promoting exploration and production of indigenous hydrocarbons related resources within the country. The audit was conducted in accordance with the INTOSAI Auditing Standards.

The Article 154 of the Constitution of Islamic Republic of Pakistan empowers the Council of Common Interests (CCI) for formulation and regulation of policies in the field of exploration and production of hydrocarbons with relation to matters in Serial No. 2 of Part II of the Federal Legislative List. It exercises supervision and control over institutions related to the subject of mineral oil and natural gas; liquids and substances dangerously inflammable as declared by federal law. Ministry of Energy (Petroleum Division) is vested with the powers of administration and other allied matters on the subject under Rules of Business, 1973 framed by the Federal Government. Besides these, the Economic Coordination Committee (ECC) constituted by the Cabinet Division under Rule 17(2) of Rules of Business, 1973 has also the mandate to consider the cases of agreements and licensing for oil prospecting and exploration.

The study of annual data of oil and gas production for the last 5 years reveals that the production of gas and crude oil has decreased approximately 11%; from 4,047.95 MMCFD to 3,597.36 MMCFD and from 86,481.375 BOPD to 76,739.479 BOPD respectively during 2015-16 to 2019-20. The production profile showed the downward trend of production of hydrocarbons as well.

During the Performance Audit, number of deviations from relevant polices, laws, rules and regulations by DG (PC) have been observed.

**Key Audit Findings:**

- i. Sub-optimal performance of DG (PC) led to non-achievement of formulated objectives of Petroleum Exploration and Production Policy 2012;<sup>1</sup>
- ii. Non-monitoring of terms of licenses followed by litigation resulted into non-recovery of liquidated damages and other financial obligations;<sup>2</sup>
- iii. Loss to government due to accepting un-realizable guarantee from the operator;<sup>3</sup>
- iv. Huge loss due to un-authorized grant of price incentives to E&P companies;<sup>4</sup>
- v. Non/delayed approval of applications for renewal of leases by the Regulator resulting into irregular production, non-deposit of Social Welfare Obligations by E&P companies, discouraging investment (local/foreign) and inviting potential litigation;<sup>5</sup>and
- vi. Absence of integration among various E&P policies and poor liaison among directorates of Petroleum Division.<sup>6</sup>

**Recommendations:**

- i. Streamline the mechanism of awarding concession rights;
- ii. Effective monitoring and implementation mechanism of terms of licenses be ensured;
- iii. Contract management may be done in a professional, transparent and competitive manner;
- iv. Marginal/Standard-Gas Pricing Criteria and Guidelines may be approved from the competent forum i.e. CCI;
- v. SOPs with respect to time frame for disposal of renewal of leases and licenses may be devised; and
- vi. Effective liaison between the directorates of Petroleum Division may be ensured.

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<sup>1</sup> Para Nos. 4.1.1

<sup>2</sup> Para No. 4.1.3

<sup>3</sup> Para No. 4.1.5

<sup>4</sup> Para No. 4.2.1

<sup>5</sup> Paras No. 4.2.11

<sup>6</sup> Paras No. 4.3.3 & 4.3.4

## 1. INTRODUCTION

The Government of Pakistan promulgated “The Regulation of Mines and Oilfields and Mineral Development (Government Control) Act, 1948” for the administration of matters connected with the regulations of mines, oil fields and minerals. The Pakistan Petroleum (Production) Rules, 1949 were framed by the Federal Government under this Act. According to these rules, any person or company desirous of undertaking exploration activities within the specified areas could apply for the license if it fulfills the prescribed conditions. Prospecting license was granted to a party on fulfillment of all codal formalities. On discovery of hydrocarbons, mining lease was granted for production purpose. At the time of audit, 32 mining leases were producing hydrocarbons. The initial term of mining lease was 30 years which was renewable for another period extending upto 30 years.

In 1986, the Government framed the Pakistan Petroleum (Exploration and Production) Rules, 1986 wherein only company(ies) were entitled for seeking permit, license or Development and Production lease through competitive bidding process on the basis of invitation of Expression of Interest (EOI) from the Government.

In order to boost the exploration and production of hydrocarbons in the country, the government introduced Petroleum Policy in 1991. Subsequently, 09 policies have been issued till finalization of this Report.

Before the promulgation of Petroleum Policies, licenses were granted generally on the basis of negotiations. The terms of negotiation were reflected in the exploration licenses, and companies performed E&P activities in accordance with the terms of licenses. However, in order to bring uniformity in the terms and conditions of licences, the MoE (PD) drafted the Model Petroleum Concession Agreement after introduction of Petroleum and Exploration Policy of 1994. Currently, Production and Exploration Policy, 2012 is applicable and under the policy Onshore and Offshore E&P rights are awarded through three distinct procedures:

- i. Grant of Petroleum Exploration Licenses for entering into PCA or PSA in relation to onshore and offshore blocks offered through competitive bidding;

- ii. Grant of Petroleum Exploration Licenses for entering into PCA or PSA in relation to onshore and offshore blocks offered without competitive bidding to Strategic Partner Companies on Government to Government basis; and
- iii. Grant of non-exclusive Reconnaissance Permits for undertaking studies and multi-client surveys after direct negotiation.

Ministry of Energy (Petroleum Division) deals with all the matters that inter-alia include permits, licenses and leases relating to oil, gas and mineral at the national and international level. As per Serial No. 29 of Schedule II (Distribution of Business among the Divisions) of Rule of Business, 1973, Policy Wing of the Petroleum Division is responsible for developing policies for oil and gas sector, forecasting future requirement and assessing the impact of existing policies, rules and regulations. DG (PC), being part of the Policy Wing, is the sole regulator of all upstream petroleum exploration and production activities in Pakistan.

The study of production profile of the hydrocarbons revealed that production is continuously declining and there is an urgent need to overcome the factors responsible for this decline. During 2019-20, 19 exploratory and 28 development wells were drilled against target of 52 and 40 respectively.

By considering the fact that production of hydrocarbons is declining and MoE (PD) has not been able to achieve drilling target, the Director General Audit, Petroleum and Natural Resources, Lahore planned Performance Audit of DG (PC) to the extent of management of leases and licenses to evaluate operational inefficiencies and identify causes for non-achievement of targets. The Preliminary Survey Report (PSR) was prepared and got approved from Performance Audit Wing.

## **2. AUDIT OBJECTIVES**

In the instant assignment, Audit endeavors to evaluate the effectiveness in management of leases and licenses. Objectives of this Report are as under:

- i. To obtain level of assurance whether blocks were awarded through open, transparent and competitive process;
- ii. To evaluate efficiency and effectiveness in extension and renewal of leases and licenses against required benchmark;

- iii. To review if measures taken by the DG (PC) against slow/non-exploration in blocks are adequate;
- iv. To what extent DG (PC) was effective in removing hurdles in exploration activities;
  - v. To examine and determine compliance with relevant policies, rules etc.;
  - vi. To evaluate that price advice is prudently portrayed by the DG (PC) to DG (Oil), DG (Gas) and OGRA according to applicable policies and rules; and
- vii. To examine whether DG (PC) is performing its functions independently and effectively as per law.

### **3. AUDIT SCOPE AND METHODOLOGY**

The office of Director General Petroleum Concessions is responsible for entering into agreements on behalf of Federation with companies desirous to seek licenses for explorations or leases for production of hydrocarbons in Pakistan. Leases and licenses were issued under the policies of 1994, 1997, 2001, 2009 and 2012. There are 123 licenses (37 located in Balochistan, 42 located in Sindh, 20 located in Punjab, 20 located in KP and 4 offshore) and 197 leases (07 located in Balochistan, 150 located in Sindh, 29 located in Punjab and 11 located in Khyber Pakhtunkhwa) as on June 30, 2020. Some licenses were also granted during the period when no policy was in place. Both quantitative and qualitative data have been taken into account for analysis. Nature and attributes of leases and licenses were kept in view while sampling to reach objective and representative audit results. Following features were kept in view for drawing the samples from the population for detailed review of record;

- i. Blocks where price incentives were granted under Marginal Pricing Guidelines;
- ii. Blocks where price incentives were extended on incremental basis;
- iii. Files of blocks granted by making amendments in Policy in vogue;
- iv. Blocks where Gas Price Agreements were made either on provisional basis or not signed;
- v. Blocks granted under Petroleum Policy, 2012; and
- vi. Cases where leases have expired and action is initiated by the DG (PC);

## **4. AUDIT FINDINGS AND RECOMMENDATIONS**

### **4.1 Award of Exploration Rights and License Management**

The process of grant of E&P licenses underwent a series of successive reforms: under 1949 Rules the license grant was on the basis of negotiations; in 1986, concept of competitive bidding was introduced and in 1988 blocks were offered to international companies. Currently, Petroleum Exploration and Production Policy, 2012 is in vogue.

The DG (PC), being the regulator for grant of E&P rights, is required to ensure compliance to the provisions of respective rules/policies while awarding/monitoring E&P rights. However, audit found multiple instances of weak regulatory oversight.

#### **4.1.1 Sub-optimal performance of DG (PC) led to non-achievement of formulated objectives of Petroleum E&P Policy 2012**

According to Clause 1.3 of Petroleum Exploration and Production Policy, 2012, read with functions of Directorate General of Petroleum Concessions, DG (PC) is required to achieve maximum self-sufficiency by enhancing local oil and gas productions.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that only two bidding rounds were held in 2012-13 and 2018-19 with a gap of 5 years. Self-sufficiency for enhancing local oil and gas production was possible only by invitation for bidding of blocks. Infrequent holding of bidding process not only led to non-exploration in new areas but also resulted in non-achievement of formulated policy objectives.

Audit is of the view that sub-optimal performance by DG (PC) resulted in non-achievement of objectives of Petroleum Policy.

DG (PC) on 30.08.2021 replied that clearance of every block from Ministry of Defence is mandatory before the award. The delay in frequent holding of bidding rounds is attributable to non-receipt of requisite clearance from Ministry of Defence.

Audit holds that reply is not tenable due to the fact that Policy in vogue clearly provides that no area clearance would be required for concession blocks



falling inside white/green areas as the same are marked after the clearance by provincial governments and security agencies.

The DAC in its meeting held on 30.12.2021 directed the management to share the details of efforts made for clearance of blocks for verification of audit besides expediting the process of clearance for blocks.

Audit recommends to seek plausible justification for delay in holding of bidding processes and initiate steps for streamlining the mechanism for awarding of concession rights.

#### **4.1.2 Execution of PCA in violation of policy and short recovery of royalty - Rs 50.91 million**

According to Rule 38 of the E&P Rules, 2009, the lease holder shall pay the royalty at the rate of twelve and a half percent of the value of petroleum produced and saved to Federal Government and in the Rule 39 value is defined as the actual selling price which means the price determined in accordance with the relevant sales and purchase agreement. According to Articles 5.1 (2) of Petroleum Exploration and Production Policy, 2009, the Royalty will be paid in cash or kind at the option of GOP on liquid and gaseous hydrocarbons (such as LPG, NGL, solvent oil, gasoline and others) as well as on all substances, produced in association with such hydrocarbon.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that production of LPG commenced from Gambat South Block (located at Nawabshah, Matiari & Sanghar districts) from July, 2017. As per Policy, royalty was to be paid on LPG at actual sales price while royalty was paid on LPG at the shrinkage value of gas used in extraction of LPG. This resulted in short payment of royalty (for the period from July 2017 to June 2020) to the extent of Rs 50,909,551.

Audit is of the view that weak regulatory oversight by DG (PC) resulted in short recovery of Royalty amounting to Rs 50.91 million.

DG (PC) on 30.08.2021 replied that issue of royalty on LPG at its realized market value was referred to CCI on the direction of PAC. It was decided by the CCI that the provision of royalty on LPG at its realized market value may be made for all future concession agreements. Accordingly, model PCA's has been amended and a clause has been inserted. However, no such provision is available in the old PCAs and therefore recovery of royalty on LPG at market value cannot

be made. In a similar para (DP 1075), the DAC in its meeting held on 17.12.2020 directed the DG (PC) to seek opinion from Law and Justice Division in the light of audit observation.

Audit holds that PCA should be executed according to the prevailing policy and there is no ambiguity in Petroleum Policy, 2009 regarding payment of royalty on LPG at selling price. Execution of PCA in contradiction to the applicable policy is not justified.

The DAC in its meeting held on 30.12.2021 directed the management to share the reference submitted to Law Division for verification of Audit.

Audit recommends to ensure incorporation of explicit clause for collection of royalty on LPG on market value besides seeking opinion from Law and Justice Division for instant case.

#### **4.1.3 Non-monitoring of terms of license followed by litigation resulted in non-recovery of LDs and other financial obligations – Rs 528.336 million**

According to Rule 21(2) of Pakistan Onshore Petroleum Exploration and Production Rules, 2013, a holder of a license shall perform the work programme stipulated in the license as per schedule contained therein, along with other obligations as referred to in these Rules. Further, Rule 28 of the said Rules provides that where upon the surrender or the expiry of a license, the obligations pursuant to Rules have not been fulfilled, holder of a license shall pay to the Federal Government such sum by way of liquidated damages corresponding to the minimum expenditure of un-discharged work obligations as set forth in the license within a period of thirty days from the surrender or expiry of the license.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that Karak North Block (3370-1 located at Karak District) was awarded to M/s Tallahassee Resources Inc. (TRI) for a period of 3 years on 25.08.2014 with minimum work commitments of 307 Work Units. M/s TRI applied for extension of two years on 18.08.2017 w.e.f. 25.08.2017. DG (PC) granted extension for two years despite the fact that the operator did not complete even a single Work Unit during 3 years agreement period nor paid other obligations like Social Welfare, Training Fund, Rental etc. Moreover, M/s KPOGCL, a Working Interest Owner, also requested DG (PC) to direct M/s TRI to expedite exploration activities vide letter dated 17.09.2019. M/s

TRI again applied for extension in license period for one year on 10.07.2019, which was rejected by DG (PC) on 06.02.2020 on the ground of non-fulfillment of agreed work commitment; a reason that already existed at the time of first renewal. The DG (PC) directed to pay US \$ 3,180,393 (LDs US \$ 3,070,000, Social Welfare US \$ 80,940 & US \$ 29,453 Training Fund calculated at exchange rate of Rs 165.84 / US\$ I) and an amount PK Rs 900,000 on account of rent. M/s TRI approached the court of law against this decision. Issue was sub-judice till the finalization of this report.

Audit is of the view that weak regulatory oversight and non-monitoring of terms of license by DG (PC) resulted in non-fulfillment of work commitments, litigation and non-payment of LDs and other financial obligations.

DG (PC) on 30.08.2021 replied that according to Rule 22(6) of Rules 2013 extension in the license can be granted if seismic and drilling service are not readily available in the country or if a holder of an exploration license commits to undertake additional work which is equivalent to at least 10% more or if a holder of an exploration license makes additional accelerated area relinquishment equivalent to 10% of the original license area; or if a holder of a license was unable to perform work because of circumstances beyond its control such as law and order situation, or for any unforeseeable reason including but not limited to a flood or earthquake. The extension was granted under Rule 22 (6) (c) of the Rules 2013 and company was asked to relinquish 10% of the original license area. The bank was asked for the encashment of bank guarantee. However, M/s TRI challenged the same in the Islamabad High Court. The IHC directed the Company to submit the extended bank guarantee up to 23<sup>rd</sup> November, 2021 to the Court, which has been submitted in the Court.

Audit holds that DG (PC) as sole regulator was required to ensure discharge of work committed by the company during license period according to the terms of license. Granting extension merely on the basis of area relinquishment is unjustified.

The DAC in its meeting held on 30.12.2021 directed the management to share the bank guarantee with audit for verification besides strengthening the internal controls and monitoring mechanism.

Audit recommends to strengthen monitoring and implementation mechanism. Further, to pursue the case in court of law vigorously for recovery of government revenue and fix responsibility on persons at fault.

#### **4.1.4 Weak implementation of White and Green Areas Map Policy**

According to Clause 3.2 of Petroleum Exploration and Production Policy, 2012, no area clearance would be required for concession blocks in updated and predefined areas falling under "White and Green Areas Map".

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) awarded two blocks (Peshawar East located at Swabi, Mardan, Kohat, Nowshera and Attock districts and Gawadar located at Gawadar, Pasni and Kech districts) to M/s MPCL and M/s OGDCL under the Petroleum Exploration and Production Policy, 2012. As both blocks were in the White and Green areas, no NOC was required from the security agencies. However, M/s MPCL and M/s OGDCL requested for NOC from security agencies which was rejected by DG (PC). Similarly, the Government of Baluchistan rejected the request of M/s OGDCL for working in blocks covered in white and green areas due to law and order situation. This resulted in non-fulfillment of work commitment despite the lapse of considerable time.

Audit is of the view that poor coordination with security agencies led to weak implementation of white and green areas maps of Petroleum Policy 2012. Such instances led to non-performance of E&P activities.

DG (PC) replied dated 30.08.2021 that Policy clearly mentions white and green areas. Accordingly, these blocks were granted as they were located in the green area. However, Ministry of Defence did not give clearance due to reasons best known to them.

Audit holds that, in 2010, M/o Defense directed the M/o Energy (Petroleum Division) to award block after clearance from M/o Defence. DG (PC) may have finalized Petroleum Production and Exploration Policy 2012 accordingly.

The DAC in its meeting held on 30.12.2021 directed the management to share the complete correspondence made on the issue with Audit for verification.

Audit recommends implementing the policy in vogue effectively to avoid hurdles in expanding the exploration activities.

#### **4.1.5 Loss to government due to accepting un-realizable guarantee from the operator - US \$ 20.1 million**

According to Article 3.7 (a) and (b) of Model PCA, the company shall provide a bank guarantee or a parent company guarantee as required and notified by the Government or such other security package as may be prescribed by the Government for local Working Interest Owners as per applicable policy.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) awarded three blocks through competitive biddings to M/s PEL under the Petroleum Exploration and Production Policy, 2001 with the minimum Work Commitment of US\$ 20.71 million to be performed by the operator during the initial term of license. M/s PEL entered into Hypothecation Agreement with DG (PC) by rendering Kandra Gas Field, as security, against unfulfilled minimum work obligations. However, Kandra Gas Field was undeveloped and all rights of oil and gas reservoirs were still vested with the Government of Pakistan. DG (PC) could not accept anything as security which did not belong to the licensee. This type of security (undeveloped reservoir) could not be realized by DG(PC) on revocation of licenses due to failure of the M/s PEL to execute minimum work commitments.

Audit is of the view that accepting unrealizable guarantee and weak monitoring resulted in non-realization of liquidated damages.

DG (PC) on 30.08.2021 replied that enforcement of the Hypothecation Agreement for the recovery of LDs could not be materialized as the revocation was challenged by the company in the Islamabad High Court and status quo was granted.

Audit holds that department accepted unrealizable guarantee that needs justification.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the court case vigorously.

Audit recommends fixing responsibility for accepting unrealizable security and pursue the court case vigorously.

#### **4.1.6 Non-enforcement of Hypothecation Agreement**

According to Article 3.7 (a) and (b) of Model PCA, the company shall provide a bank guarantee or a parent company guarantee as required and notified by the Government or such other security package as may be prescribed by the Government for local Working Interest Owners as per applicable policy.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) awarded New Larkana block (located at Larakana, Shikarpur, Jacobabad, Kamber and Jafarabad districts) to M/s PEL under the Petroleum Exploration and Production Policy, 2001 with the minimum work commitment of US\$ 4.7 million. M/s PEL executed Hypothecation Agreement with DG (PC) by way of hypothecation of sale proceeds of natural gas of Block 22. M/s PEL failed to perform work commitment during the first three years as set forth in the license. License period was renewed twice but still operator did not start the work. DG (PC) revoked the license and demanded liquidated damages along with other obligations but the operator did not pay the same and approached court of law against the orders of DG (PC).

Audit is of the view that there was inherent flaw in the Hypothecation Agreement as it did not entail any mechanism to realize security. Operator kept on receiving sale proceeds during the currency of the agreement without performing work.

DG (PC) replied dated 30.08.2021 that enforcement of the hypothecation agreement for the recovery of LDs could not be materialized as the revocation was challenged by the company in the Islamabad High Court and status quo was granted.

Audit is of the view that in the similar case, management stated that the reserves were intact whereas, in the instant case the reserves held as guarantee were being depleted. Further, DG (PC) took 03 years from the date of show cause i.e. 2016-2019 to decide the matter of revocation.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the court case vigorously besides conducting internal fact finding inquiry.

Audit recommends that responsibility be fixed for negligence and recovery be effected.

#### **4.1.7 Potential Loss on account of faulty Petroleum Concession Agreement – Rs 11,917 million**

Article 2.2.2 (iii) of the Petroleum Exploration and Production Policy, 2001 sets parameters for determination of price for associated and non-associated gas, wherein zonal discount was applied before application of sliding discount. However, DG (PC) is of the view that zonal discount was applicable after application of sliding scale.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that the Block No. 3070-10 (SafedKoh located at Dera Ghazi Khan District) was acquired by M/s Dewan Petroleum (Pvt.) Ltd. in the year 2005. In 2006, M/s Dewan Petroleum (Pvt.) Ltd. applied for price advice and applied zonal discount prior to application of sliding discount. The application of zone wise marker price prior to application of sliding discounts resulted in excess price demand by the company. This price was contested by the Ministry of Petroleum & Natural Resources, on the different interpretation, wherein sliding discount was applied first and then zonal discount was applied. The company opted arbitration where Arbitrator decided the matter in the favour of the company.

For an assumed weighted average C & F price of US\$ 100, and appropriate factor of conversion MMBTU /BBL 5.7, Audit calculated impact of above two interpretation as:

Price as per DG (PC)	US \$ 2.6053 per MMBTU
Price claimed by M/s Dewan Petroleum (Pvt.) Ltd.	US \$ 3.8596 per MMBTU
Difference	US \$ 1.2543 per MMBTU

On the basis of aforementioned calculation, M/S Dewan claimed a cumulative excess price of US \$ 73,110,540 (decided by arbitrator in decision dated 08.10.2018) equivalent to Rs 11,917,018,020 at the exchange rate of Rs 163/USD1.

Audit is of the view that ambiguity in prescribing the pricing parameters in Petroleum Policy resulted in arbitrary price interpretation and a law-suit by M/s Dewan. If the outcome of this litigation goes in the favour of the operator, the public exchequer will have to bear a burden of approximately Rs 12 billion.

The DG (PC) replied dated 30.08.2021 that all rules and agreements are manmade and nothing can be termed as perfect. However, after the lesson learnt from dispute raised by M/s Dewan, an illustration was included in the Model PCA 2001 in year 2007 as well as in subsequent model PCAs of 2009 and 2012.

Audit holds that “manmade error” cost Rs 12 billion approximately to exchequer.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the matter of arbitration vigorously.

Audit recommends fixing responsibility for flawed formulation of Petroleum Policy 2001.

#### **4.1.8 Loss on account of non-withdrawal of exemption of Production Bonus – Rs 60.613 million**

According to Clause 4.1.2 of Petroleum Exploration and Production Policy, 2012, “Production Bonuses will be payable on a contract area basis”. Further, Section VI of the policy provides the option for conversion from previous exploration licenses and Development & Production leases to new one with the condition of accepting as a package which will include financial obligations relating to Production Bonus, Social Welfare and Training.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) executed Supplemental Agreement with M/s OGDCL in Sinjhoru PCA (located at Sanghar, Khairpur districts). However, while executing the Supplemental Agreement, DG (PC) did not withdraw the exemption of Production Bonus as required under Petroleum Policy, 2012. Resultantly, an amount of US\$ 360,000 equivalent to Rs 60.613 million at the exchange rate of Rs 168.37 / US\$ 1 has not been deposited by M/s OGDCL at the start of commercial production.

Audit is of the view that poor contract management by DG (PC) resulted in non-imposition of Production Bonus amounting to Rs 60,613,200.

DG (PC) on 30.08.2021 replied that in the PCAs where OGDCL/GHPL are exempted, their share of Production Bonus has to be paid by other partners. Therefore, no change in Production Bonus related clause(s) was made through Supplemental Agreement. There were certain blocks where OGDCL and/or GHPL owns 100% working interest and shifting of OGDCL’s obligation to any other



company was not a question. Further, Model Supplemental Agreement was developed in consultation with all stakeholders including Finance Division as well as vetting of Law Division and the Supplemental Agreement were signed exactly in accordance with approved Model SA, therefore the question of fixation of responsibility does not arise.

Audit holds that whether or not the relevant stakeholders were informed about non-incorporation of production clause in finalization of MPCA.

The DAC in its meeting held on 30.12.2021 directed the management to get the stated stance verified from Audit.

Audit recommends fixing responsibility on persons at fault for loss of Rs 60.613 million besides improving contract management.

## **4.2 Granting Leases and their Management**

The upstream industry carries out a range of activities that include geological surveys, geological maps/ models, seismic surveys, processing of seismic data, drilling activities etc. Once the drill bit reaches the reservoir, either wells are developed or plugging and abandoning of dry hole is carried out. If the company is of opinion that it is economical to produce hydrocarbons, the company intimates the fact to DG (PC). DG (PC) issues the notice of Declaration of Commerciality and on the request of licensee grants conditional lease over that area. Thereafter, terms of PCA(s) such as pricing of natural gas, allocation of hydrocarbons, delivery points etc. are decided.

DG (PC), being the regulator for the grant of leases, was required to ensure compliance to provisions of relevant Policies while awarding / monitoring of lease rights.

### **4.2.1 Un-authorized grant of price incentives to E&P companies - Rs 1,926.746 million**

According to Article 154 of the Constitution of Islamic Republic of Pakistan, the Council of Common Interests shall formulate and regulate policies in relation to matters in Part II of the Federal Legislative List and shall exercise supervision and control over related institutions. According to Clause 10.2 of Petroleum Exploration and Production Policy, 2012, “the price for Associated or Non-Associated Gas will be indexed to the C&F price of crude oil import in Pakistan as illustrated at annexure”. According to Clause 4.1.2 of the policy,

“Production Bonus of USD 600,000 will be payable at start of commercial production by the operator on contract area basis”.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC), through Ministry of Energy (Petroleum Division), issued the Marginal/Standard- Gas Pricing Criteria and Guidelines, 2013 without approval from CCI. As a result an unauthorized incentive of US \$ 0.25 per MMBTU was granted to fields qualifying the criteria of Marginal fields (M/s MPCL in case of Konj field located at Sukkur district and to M/s PEL in cases of Ayesha-1, Ayesha North located at Badin district and Aminah located at Sujawal district gas fields) in violation of Clause 10.2 of Petroleum Exploration and Production Policy, 2012. Besides, undue favour related to exemption of first Production Bonus through drafted/ un-approved guidelines was also given in violation of Clause 4.1.2 of the policy.

Audit is of the view that DG (PC) granted Price incentives and waiver of Production Bonus without seeking the approval from CCI. This resulted in loss to public exchequer and in undue favour of Rs 1,926.746 million (US\$ 7,647,154 in case of Ayesha-I, Ayesha North & Aminah and US\$ 3,938,810 in case of Konjat the exchange rate of Rs 166.3 / US\$ 1, according to Economics of FDP submitted by E&P companies) to E&P companies.

DG (PC) in its reply dated 30.08.2021 stated that Section 2(1)(xxvi) of OGRA Ordinance 2002, provides that: “policy guidelines” means policies of the Federal Government covering or related to any or all of the regulated activities which are issued in writing pursuant to a decision of the Cabinet of the Federal Government or any committee thereof; Keeping in view these provisions of law, Marginal/Standard- Gas Pricing Criteria and Guidelines, 2013 were approved by ECC of the Cabinet.

The DAC in its meeting held on 30.12.2021 directed the management to refer the matter to CCI.

Audit recommends to: (a) fix responsibility on persons at fault for loss to government revenue; (b) recover loss and (c) get approval of guidelines from CCI.

#### **4.2.2 Non-revocation of leases on material breach of terms and condition of the contract**

According to Rule 39 (e) and 68 (a) of Pakistan Petroleum (Production) Rules, 1949 and Pakistan Petroleum (E&P) Rules, 1986 respectively, the

Government shall have the right to cancel/ revoke the license or lease if the holder thereof is in a material breach of the terms and conditions of the contract. Further, according to the Rule 37 (2) and 36 of Pakistan Petroleum Production Rules, 1949 and E&P Rules, 1986 respectively, the lessee shall pay the royalty @ 12.5% on the well-head value.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that M/s PEL defaulted with regard to payment of royalty for its Badar Mining lease (located at Ghotki, Sukkur and Kashmore districts) and Block 22 (located at Shikarpur and Sukkur) since August 2015 but DG (PC) did not revoke the leases. The show-cause notice related to non-payment of royalty with respect to Badar Mining lease was served on 14.02.2020 to M/s PEL with the gap of 5 years while in case of Block 22 the notice was never served at all.

Audit is of the view that negligence of DG (PC) resulted in non-revocation of leases after the lapse of more than 5 years.

DG (PC) in its reply dated 30.08.2021 stated that other Joint Venture Partners (OGDCL, PPL, GHPL etc.) are already paying the Royalty therefore, revocation at this point of time would be difficult and may not be in the national interest keeping in view the demand supply gap in the country. The Company has assured that the payment of pending obligations will be made shortly. Management further explained that the matter is sub-judice in the Islamabad High Court.

Audit holds that failure of DG (PC) to recover the due amount of royalty from the E&P company on the plea that any action against the company would be against the national interest is not justified. DG (PC) is required to follow rules in letter and spirit.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the court case vigorously.

Audit recommends to fix responsibility on persons at fault for not initiating timely action as required under rules, besides pursuing the court cases vigorously.

#### **4.2.3 Illegal sale of hydro-carbons from expired leases - Rs 3,131.398 million**

According to Rule 34 of Pakistan Petroleum (Production) Rules, 1949, the initial term of lease was 30 years which could be renewed for another period upto

30 years. Later, as per Rule 32 of Pakistan Petroleum Production Rules 1986, the initial term of lease was reduced to 25 years with a possible renewal of 5 years.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that application for the extension of lease for Badar Mining lease (granted on 13.03.2002 to 12.03.2019) and Block 22 (granted on 03.04.2003 to 02.04.2013 (Sadiq), 02.04.2017 (Hasan), 02.04.2020 (Khanpur)) was pending for decision with DG (PC), till date of audit. This resulted in an un-authorized production and sales of hydrocarbons besides depletion of the reservoir and blockage of government dues. This resulted in illegal sale of hydro-carbons of Rs. 3,131.398 million.

Audit is of the view that failure to discharge of the duties by DG (PC) resulted in non-revocation of leases and financial implications to the tune of Rs 3131.398 million (sales proceed from the date of expiry of lease).

DG (PC) replied dated 30.08.2021 that other Joint Venture Partners (OGDCL, PPL, GHPL etc) are already paying the royalty, therefore, revocation at this point of time would be difficult and may not be in the national interest keeping in view the demand supply gap in the country. The request for extension has been received but was not processed due to non-payment of obligations. The Company has assured that the payment of pending obligations will be made shortly.

Audit holds that failure of DG (PC) to revoke lease on the plea that any action against the company would be against the national interest is not justified. DG (PC) is required to follow rules in letter and spirit.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the recovery vigorously.

Audit recommends fixing responsibility on persons at fault besides recovery of sale proceeds of defaulted company and depositing in govt. treasury.

#### **4.2.4 Grant of irregular price incentives under Marginal Pricing Guidelines**

According to Clause “C” of Marginal Field Guidelines, 2013, the incentives of this guidelines shall apply to discoveries that qualify and are accepted as Marginal Fields under the existing and future exploration licenses, PCAs, Development and Production leases and Mining leases but are not in production prior to the notification of these guidelines. Further, the Clause “B” of guidelines aims at fast track development and production of hydrocarbons from

existing dormant Marginal reservoirs and encourages field re-development/infield drilling to expand production from producing fields that are uneconomic at their valid contract prices.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) granted price incentives to MPCL in violation of the parameters laid down in Marginal Pricing Guidelines 2013, in the case of Koonj field. The field was producing hydrocarbons under Extended Well Testing arrangements since 2010. The company desired to deplete the field under EWT arrangement through sale of gas to SSGCL vide its letter number MGCL/BD-Expl/ SKr/147 dated 05.10.2012. Moreover, the recoverable reservoir size was nominal, therefore, the question of expanding production by re-development/infield drilling did not arise which were both prerequisite conditions for awarding price incentive.

Audit is of the view that poor internal controls and weak regularity oversight by DG (PC) resulted in grant of irregular price incentives under Marginal Pricing Guidelines.

DG (PC) replied dated 30.08.2021 that Company initially produced gas under EWT arrangement till 25<sup>th</sup> December, 2014 and on 26<sup>th</sup> December, 2014 submitted Declaration of Commerciality, Field Development Plan and application for grant of Development and Production lease under the Marginal Guidelines. Therefore, the gas production before Declaration of Commerciality could not be termed as commercial production, hence, Audit's contention is misplaced.

Audit holds that by granting price incentives of Marginal Field, the burden of risk undertaken by the operator was shifted to the gas consumers.

The DAC in its meeting held on 30.12.2021 directed the management to share the opinion of Law Division with the Audit for verification. No further progress was reported till the finalization of the Report.

Audit recommends implementing the decision of the DAC besides justifying the reasons for deviation from approved pricing criteria and initiating remedial action for granting inadmissible price incentives.

#### **4.2.5 Endorsing assignment of Working Interests without ensuring financial qualification resulting into non-realization of government dues**

According to Rule 8 of Pakistan Petroleum (Production) Rules, 1949, the applicant shall furnish the like particulars in respect of the proposed assignee as are required to be furnished in the case of applicants for leases and licenses under Rule 4. The Rule 4 of *ibid* requires furnishing evidence of financial and technical qualifications and as to his ability to comply with any term and conditions contained in the model clauses.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) received an application from M/s Sherritt (one of the Working Interest Owners of Badar Mining Lease) in October, 2015, wherein the applicant requested for assignment of its entire Working Interest (15.79%) to the operator of Badar Mining lease namely M/s PEL. The DG (PC), being the regulator, was required to ensure that the proposed assignee, M/s PEL had no pending liabilities on account of royalty, Social Welfare Obligations and Training Fund etc. before approving the assignment. However, it allowed the assignment of 15.79% share to defaulted company without ensuring the financial qualifications of PEL.

Audit is of the view that poor internal controls and weak regularity oversight by DG (PC) resulted in assignment of 15.79% shares to a defaulted company causing non-realization of government dues.

DG (PC) in its reply dated 30.08.2021 stated that assignment of Working Interest in exploration licenses/leases is a routine business activity in petroleum sector. If we create hurdles in someone exiting the business who has no outstanding liability, that will be termed as discouraging the investment which is contrary to the government's drive of creating 'Ease of Doing Business'. Further, the responsibility of payment of obligations relating to Social Welfare, Training Fund etc. rests with operator which are recovered from other non-operating partners. Therefore, even if the Sherrits assignment was not approved, the issue of collection of such obligations from operator would have remained as such. The matter of recovery of outstanding amounts from PEL is being pursued.

Audit holds that M/s PEL, being the operator is not paying financial obligation and endorsing the assignment of share of M/s Sherrits to M/s PEL

which resulted in further non-payment of royalty equivalent to share of M/s Sherrits.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the recovery vigorously.

Audit recommends to fix responsibility for non-complying with the rules at the time of assignment of field to PEL besides pursuing the recovery vigorously.

#### **4.2.6 In-effective handling of expired Sui mining lease resulting in blockage of obligations - Rs 24,262.39 million**

According to Articles 153 and 154 of the Constitution of Islamic Republic of Pakistan, the legislative and executive authority in respect of matters dealing with mineral and natural gas (as well as liquids and substances declared by the Federal law to be dangerously inflammable) vests exclusively in the Majlis-e-Shoora (Parliament) and the Federal Government respectively, subject to power of the Council of Common Interests to formulate and regulate policies in relation to these matters.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that Sui Mining Lease (located at Dera Bugti district) of M/s PPL expired on May 31, 2015. As a stop gap arrangement, regulator relaxed the rule of maximum period of lease as envisaged under the Rules of 1949. Meanwhile, the Ministry signed a Memorandum of Understanding (MOU) with the Government of Baluchistan on May, 2016. The MoU provided the terms and conditions for re-granting of Sui Lease. Further, progress related to the implementation of the signed MoU could not be achieved. Resultantly, Government of Baluchistan is deprived of following funds (figures adopted from FDP of Sui):

(Amount in million US\$)

S. #	Year	Production Bonus	Lease Extension Bonus	Training obligations	Social Welfare obligations	Total
1	2015-16	0.6	30.8	0.05	0.53	31.98
2	2016-17	1.2	28.8	0.05	0.53	30.58
3	2017-18	2	27	0.05	0.53	29.58
4	2018-19	5	25.1	0.05	0.53	30.68
5	2019-20	0	22.9	0.05	0.53	23.48
<b>Total in US \$</b>						<b>146.3</b>
<b>Exchange Rate *</b>						<b>165.84</b>
<b>Total in Pak Rs.</b>						<b>24,262,392,000</b>

\*Note:- Exchange rate prevalent on 09.10.2020

Audit is of the view that weak regulatory oversight by DG (PC) resulted in in-effective dealing of expired Sui mining lease and blockage of obligations amounting to Rs 24,262.39 million.

The DG (PC) replied dated 30.08.2021 that Petroleum Division did its best to settle the matter which is pending with Baluchistan Government.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the case with Government of Baluchistan for early settlement.

Audit recommends to justify the position besides making efforts for resolution of the outstanding issue.

#### **4.2.7 Loss of Windfall Levy – Rs 9,151.635 million**

According to Section 31 of Specific Relief Act, 1877, when through fraud or a mutual mistake of the parties, a contract or other instrument in writing does not truly express their intention, either party, or his representative in interest, may institute a suit to have the instrument rectified; and if the Court find it clearly proved that there has been fraud or mistake in framing the instrument, and ascertain the real intention of the parties in executing the same, the Court may in its discretion rectify the instrument so as to express that intention, so far as this can be done without prejudice to rights acquired by third persons in good faith and for value. Moreover, according to the Section 4.3 of Supplemental Agreements to Petroleum Concessions Agreements of Mirpur Khas and Khipro, Windfall Levy on crude oil and condensate is applicable using the prescribed formula on production from discovery arising out of new exploration efforts commenced or after 30<sup>th</sup> August 2012.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) did not incorporate the clause of Windfall Levy in execution of Supplemental Agreement to Petroleum Concession Agreements in Tal Block (operated by M/s MOL located at Kohat, Karak, F.R. Bannu, Hangu, Kurram, Attock, F.R. Peshawar & North Waziristan) and Mubarik Block (operated by M/s OMV located at Ghotki & Sukkur districts). However, the said clause was incorporated in execution of Supplemental Agreement in Mirpur Khas Block (operated by M/s UEPL located at Tando Allah Yar, Matiari, Sanghar, Umar Kot, Jamshoro and Mirpur Khas districts) and Khipro blocks (operated by M/s UEPL located at Sanghar district). Instead of approaching the relevant forum i.e. court of law for amending the



Supplemental Agreement, the Division moved a summary to CCI for imposition of Windfall Levy. The approval, granted vide case No. CCI.8/4/2017, dated 24<sup>th</sup> November, 2017, was challenged by the concerned E & P companies in the court of law. Audit holds that referring the case to CCI for already signed agreements with and without Windfall Levy clause resulted in undue litigation.

Audit is of the view that weak management controls resulted in inordinate expenses on litigation. The financial impact of litigation in blocks alone comes to Rs 9,151.635 million for three years i.e. from 2017-18 to 2019-20.

The DG (PC) replied dated 30.08.2021 that initially the conversion of regime as elaborated in E&P Policy 2012 did not include Windfall Levy on new exploratory efforts. Later on, the Ministry of Energy (Petroleum Division) moved a summary to CCI for inclusion of Windfall Levy on the PCAs where previously no Windfall Levy is applicable besides adding a clarification in the policy to make the WLO applicable on the new expletory efforts as part of conversion package. On the approval of summary, the E&P companies were advised to submit supplemental agreements to incorporate the aforesaid amendments in PCAs, failing which the working interest owners will not remain eligible for gas price incentives. However, the companies opted to challenge the matter in court of law. The matter is being actively pursued in the court of law.

Audit holds that once the DG (PC) entered into agreements with the concerned E&P companies for price incentives without incorporating the WLO, then forcing them to make amendments in supplemental agreement on the ground that otherwise they will not be entitled for price incentives is unjustified and leads to litigation.

The DAC in its meeting held on 30.12.2021 directed the management to pursue the court case vigorously.

Audit recommends to fix responsibility for not taking the legal course of action in time instead of approaching CCI.

#### **4.2.8 Non-revocation of leases due to non-commencement of commercial production**

According to Rule 43 of Pakistan Petroleum (Exploration and Production) Rules, 1986, the lease may be revoked if regular commercial production has not commenced within five years from the grant of the lease.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) granted two Development and Production leases, NIM West and Chakk-66 in Nim Block and Sinjhoru Block, to M/s OGDCL on 21.05.2012 and 16.09.2013 respectively. Operator failed to produce oil and gas from the said leases within five years.

Audit is of the view that weak regularity oversight by DG (PC) resulted in non-revocation of leases within the stipulated period.

The DG (PC) replied dated 30.08.2021 that considerable reserves are in-place, OGDCL has made multiple efforts to revive the production and has planned future activities for production revival and revocation of aforementioned leases is not a suitable option.

Audit holds that reply of DG (PC) is not tenable as it is clear violation of rules.

The DAC in its meeting held on 30.12.2021 directed the management to get stated stance verified from Audit.

Audit recommends to make efforts for bringing the leases into production or initiate action as per prevailing rules.

#### **4.2.9 Non-renewal of leases resulting in un-authorized production of hydrocarbons**

According to Rule 32 of Pakistan Petroleum (Exploration and Production) Rules, 1986, the period of lease shall be for the period for which application has been made but not exceeding twenty-five years in respect of the on-shore areas of Pakistan and up to thirty years in respect of the offshore areas. Upon application from the holder, the Government may renew the lease for a period, not exceeding five years, if commercial production is continuing at the time of the application.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that in following seven cases the concerned E&P companies submitted applications for renewal of leases after the expiry of initial terms but DG (PC) did not process the same after a lapse of considerable time.

<b>Sr. No.</b>	<b>Name of Field</b>	<b>Date of Renewal Application</b>	<b>Status</b>	<b>Remarks</b>
1	Lashari South	21.02.2019	Not granted	2 reminders sent by M/s OGDCL. On 08.09.20 DG (PC) directed to provide current status of wells.
2	Meyun Ismail Deep	09.03.2016	Not granted	M/s UEPL again sent reminder for extension on 17.12.2018.
3	Naimat Basal	12.06.2018	Not granted	M/s UEPL again sent reminder for extension on 17.12.2018.
4	Thebo	22.07.2019	Not granted	
5	Salamat	17.07.2018	Not granted	M/s UEPL again sent reminder for extension on 17.12.2018.
6	Chak Dim 5 South	04.12.2004	Not granted	M/s OGDCL sent 21 reminders for extension. Last reminder sent on 21.12.2020.
7	Zaur	19.11.2014	Not granted	DG (PC) directed M/s UEPL to finalize Supplemental agreement on 08.03.2017

Moreover, in three cases it was observed that the leases were renewed after lapse of 2 to 10 years. It was also observed that companies did not comply with the rules while submitting application.

Audit is of the view that weak internal controls in DG (PC) resulted in inordinate delays in renewal of leases.

During DAC dated 30.12.2021, management explained that extension/renewal has been granted to Lashari South, Naimat Basal, Thebo, Salamat and Zaur Lease. Copies of letters will be provided to Audit whereas renewal cases of Meyun Ismail deep and Chak Dim 5 is under consideration/review of this Division. The DAC directed the management to get the stated stance verified from Audit.

Audit recommends to fix responsibility on persons at fault besides devising SOPs with respect to time span for renewal.

#### **4.2.10 Non-revocation of expired lease and un-authorized production of hydrocarbons – Rs 7.513 million**

According to Rule 43 of Pakistan Petroleum (Exploration and Production) Rules, 1986, the lease may be revoked if regular, commercial production has not commenced within five years from the grant of the lease, or within seven years in the case of an offshore field. The lease may also be revoked if production has terminated for more than 90 days, unless this is due to force majeure. Further the Rule 20 (1) of said Rules provides that the license gives the holder the exclusive right to undertake, within the license area, all activities related to reconnaissance and exploration, including drilling.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) granted Development & Production lease (Bilal located at Sanghar district) to M/s OPI in Khipro Block vide its letter dated 13.08.2007 for a period of 3 years thereafter M/s UEPL acquired the rights of Khipro Block. In January, 2010 production from the field was terminated. The E&P company vide letter dated 22.07.2010 requested for extension up-till 31.05.2013. The request for extension was followed by reminders dated 27.01.2015 and 03.02.2015. DG (PC) vide its letter dated 18.02.2016 directed M/s UEPL to clarify position regarding production from the field ceased since February, 2010. Moreover, US Aid consultant pointed out that the E&P company penetrated in lower formations not covered in the lease, without any approval from regulator.

Audit is of the view that weak regulatory oversight by DG (PC) resulted in non-revocation of lease and un-authorized production by M/s OPI. An amount of 17,662 MMBTU gas having the value of US\$ 45,552 equivalent to Rs 7,512,902 at the exchange rate of Rs 164.930/ US\$ 1 was sold by the operator.

During DAC dated 30.12.2021 management explained that matter will be re-examined and decided in the light of applicable rules and audit will be intimate accordingly.

The DAC in its meeting held on 30.12.2021 directed the management to expedite the matter accordingly and share the outcomes with audit.

Audit recommends to fix responsibility on persons at fault.

#### 4.2.11 Non-revocation of expired lease

According to Rule 43 of Pakistan Petroleum (Exploration and Production) Rules, 1986, the lease may be revoked if regular, commercial production has not commenced within five years from the grant of the lease, or within seven years in the case of an offshore field. The lease may also be revoked if production has been terminated for more than 90 days, unless this is due to force majeure. Further, Rule 69(2) authorize the Government to take over the permanent installations including related equipment in the lease area after expiry or surrender of lease.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that in four cases the leases ceased to produce (as detailed in table below) but DG (PC) did not revoke leases and failed to take over the installation of the field. Further, it was also revealed that companies were in correspondence with the DG (PC) with regard to extension of expired leases as detailed below;

Sr. No.	Name of field	Last month of Production	Status
1	Nur	October, 2015	OGDCL applied for extension for seismic evaluation on 19.02.2020
2	Baloch	April, 2017	On 04.10.2019 DG (PC) granted extension till March, 2020. OGDCL again requested for extension on 17.02.2020 and requested again vide reminder dated 23.09.2020.
3	Buzdar	November, 2012	OGDCL requested for extension on 15.11.2019 and requested again vide reminder dated 18.08.2020.
4	Suri	2010-11	M/s Spud Energy requested for extension on 21.03.2019 and again requested vide reminder dated 28.02.2020

Audit is of the view that weak regulatory oversight by DG (PC) resulted in non-revocation of expired leases.

During DAC dated 30.12.2021 management explained that extension/renewal has been granted to Baloch and Buzdar leases. Copies of letters have been provided to Audit whereas renewal/extension cases of Nur and Suri leases are under consideration/review of this Division.

The DAC directed the management to get the relevant record verified from Audit.

Audit recommends to fix responsibility on persons at fault besides devising SOPs with respect to time span for renewal.

#### **4.3 Other factors having impact on the management of leases and licenses**

Organizational success is ensured through synergy of a clear-cut strategy and an effective HR management. DG (PC) being a part of the Policy Wing of MoE (PD) and a regulator of all E&P activities is required to set standards of excellent HR management. Audit, however, observed the inability of DG (PC) to meet its objectives in an efficient and effective manner. Instances of departure from the standard procedure were observed due to inefficiency of legal team, lack of understanding of its own guidelines and existence of non-integrated policies etc. During the execution phase, following issues were observed by the Audit.

##### **4.3.1 Potential loss of Rs 13,989.397 million due to in-efficient management**

According to Section 31 of Specific Relief Act, 1877, when through fraud or a mutual mistake of the parties, a contract or other instrument in writing does not truly express their intention, either party, or his representative in interest, may institute a suit to have the instrument rectified; and if the Court find it clearly proved that there was fraud or mistake in framing the instrument, and ascertain the real intention of the parties in executing the same, the Court may in its discretion rectify the instrument so as to express that intention, so far as this can be done without prejudice to rights acquired by third persons in good faith and for value.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that dispute on the fixation of pricing arose between M/s Dewan Petroleum (Pvt.) Ltd. and DG (PC) for gas discovery at the Salsibil Well in the Safed-Koh Block in the year 2007. The dispute arose due to ambiguity in the pricing parameters. According to the operator, it was entitled for price of US\$ 3.8596 per MMBTU, while according to DG (PC) applicable price was US\$ 2.6053 per MMBTU as per policy and norms of industry

(the prices are calculated by assuming reference crude oil price of US\$ 100 per barrel). The dispute with the M/s Dewan Petroleum (Pvt.) Ltd. is sub-judice with regard to pricing. Audit observed that despite the fact that M/s OMV, the operator of Latif Block, also expressed his intent that it will be entitled for the price of 2001 (PCA) subject to the decision of court in the favour of Salsibil gas price. DG (PC) did not make any tangible effort for incorporating its interpretation in Petroleum Concession Agreement.

Audit is of the view that in-efficiency of DG (PC) may cause loss amounting to Rs 13,989.397 million to general consumers.

No reply was received from the department.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends rectification of errors/mistakes in contract management in general and in this subject in particular.

#### **4.3.2 Granting in-admissible price incentives to M/s PEL under Marginal Fields Guidelines**

The Ministry of Energy (Petroleum Division) issued the Marginal/Standard-Gas Pricing Criteria and Guidelines, 2013, after seeking approval from ECC, whereby incentive of US\$ 0.25 per MMBTU is granted on the price set in accordance with the Petroleum Exploration and Production Policy, 2012 to fields qualifying the criteria of Marginal fields, besides the waiving of the first Production Bonus, which is to be paid on the start of commercial production. The Clause D of the Guidelines defines and provides the parameters for the field to be a Marginal Field or Marginal discovery which means a field which is un-economic for development and production using current technologies based on the terms of current PCA applied to the size of reserves. However, the Clause E of the Guidelines provides that in order to become eligible to claim incentives given in these Guidelines, the producers of Marginal Fields shall be required to obtain a certificate from an independent consultant for (i) confirmation that such gas qualifies as Marginal Gas as defined in this policy, (ii) assessment of Marginal Gas Reservoir to be done in accordance with best international petroleum industry methods and (iii) certification that such gas cannot be produced naturally through conventional methods at commercial rates.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that M/s PEL submitted Field Development Plan for Ayesha-I, Ayesha North and Amina of Badin-IV South Block. The third party consultant, IPR, certified the NPV of the project with combined field analysis under conventional price using discount rate of 10% i.e US\$ 24.129 million and marginal price of US\$ 28.134 million. DG (PC), due to fact that concerned fields did not fulfill criteria, refused to grant incentive. But later on, in June, 2020, the meeting was held under the Chairmanship of Special Assistant to Prime Minister (SAPM) to seek advice over Third Party Consultant Studies pending for approval in DG (PC) and ways to improve and expedite the assessment process. The SAPM in the said meeting directed that “Findings/recommendations/certification by independent third party consultant would be final and binding in full conformity on the E&P Company and DG (PC)”. DG (PC) accepted the claim of M/s PEL and granted price incentives.

Audit is of view that directing DG (PC) for accepting the Third Party Certification marred the independence of regulator. Further, question regarding SAPM chairing the meetings of public sector business and influencing regulator to accept the Third Party Certification is sheer violation of the ruling given in judgment of Writ Petition No. 2304 of 2020 wherein Hon’ble Islamabad High Court ruled that “an Adviser has no role either in policy matters of a Division or Ministry nor its execution and running the business of the Federal Government in terms of the Rules of Business 1973 (Part-D of the Rules of 1973, read with Articles 90 (2) and 91)”. Due to the interference of the SAPM without having any legal authority, DG (PC) had to take decision which was not in conformity with the policies but also resulted in excess burden of Rs 1,271.722 million (calculated on the basis of economics provided by the company) on the exchequer. Audit holds that besides the case illustrated above, impact of other cases where the DG (PC) had accepted Third Party Certification without any provision in the policy in vogue may be calculated and rectified by the management.

The DG (PC) replied dated 30.08.2021 that guidelines clearly provide to deal each discovery or field separately and the assertion made by Audit regarding joint economics of all the three fields is not in accordance with Policy provisions. Hence, all the fields were considered separately and decisions were made accordingly. The reply of the department is not tenable on the ground of stand-alone basis that the fields under question yield negative NPV at discount rate of



10% even if price incentive of Marginal gas field was granted which makes the field un-economical.

The DAC in its meeting held on 30.12.2021 directed the management to take up the matter before PAC.

Audit recommends to implement recommendations of the DAC.

#### **4.3.3 Absence of integration among various E&P policies**

According to Article 154 of the Constitution of Islamic Republic of Pakistan, the Council of Common Interests shall formulate and regulate policies in relation to matters in Part II of the Federal Legislative List and shall exercise supervision and control over related institutions. Further, the Policy Wing of Petroleum Division is responsible for developing policies for oil and gas sector, forecasting future requirement and assessing the impact of existing policies, rules and regulations.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that Policy Wing of Petroleum Division framed multiple policies like Tight Gas Petroleum Exploration and Production Policy 2001, Petroleum Exploration and Production Policy 2012 and Low BTU Gas Pricing Policy, 2012 etc. in the last one decade. Instead of a comprehensive policy, the issues were dealt in piecemeal manner resulting in execution of Supplemental Agreement.

Audit is of the view that a comprehensive policy may ward off the need of supplemental agreements.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to formulate an integrated comprehensive policy for upstream sector.

#### **4.3.4 Improper utilization of petroleum rights after expiry due to lack of liaison among the Directorates of Petroleum Division**

According to Clause 16 of the Gas Pricing Agreement for Badar Gas Field executed among the Government of Pakistan, operator & Working Interest Owners and M/s SNGPL on August, 2004, the agreement shall be effected unless otherwise agreed by the parties in writing and continue for the duration of Gas Sales Agreement or until the expiration of initial term and renewals of the Petroleum Development and Production Leases, whichever is earlier.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that Badar Mining Lease expired on 12.03.2018 and application for its extension was pending with Directorate General of Petroleum Concessions, Islamabad. On the expiry of lease term, Gas Pricing Agreement also became ineffective in terms of Clause 16 of the agreement. However, DG (PC) did not communicate this fact to DG (Gas) and OGRA for de-notification of gas price of Badar Gas field.

Audit is of the view that weak internal controls resulted in improper utilization of petroleum rights even after expiry of lease.

DG (Gas) in its reply dated 01.03.2021 stated that matter is sub-judice in Islamabad High Court for incentive of incremental price to M/s PEL. DG (Gas) is of the view that both buyer and supplier continued supplying gas in the system in the larger national interest.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to develop better coordination within Directorates of Petroleum Division.

#### **4.3.5 Outsourcing of highly confidential data to a private party**

According to Clause 6.4 of the Pakistan Petroleum Exploration and Production Policy 2012, all data and records concerning operations within the permit area, license area or lease area are required to be submitted to DG (PC). All data is to be treated as confidential and may not be disclosed by the parties except as provided for in the agreement or where the data is in the public domain.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) not only

outsourced data collection to a private party but also allowed sale of data by the private party. For data management pertaining to Pakistan's petroleum exploration and production, a contract was awarded to M/s LMK Resources Pakistan (Pvt.) Ltd. on September, 2016. To cover the cost of handling and management of data, M/s LMKR was allowed to retain and share revenue.

Audit is of the view that inefficiency of management resulted in outsourcing of highly confidential data.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to strengthen the data management system of DG (PC).

#### **4.3.6 Non-signing of GSA and delay in notification of well-head gas price**

According to Section 3 of Natural Gas (Well-head Price) Regulations, 2009, the Authority on its motion or upon application made to it by a producer or any interested person shall determine the well-head price in accordance with the terms and conditions of the relevant agreement and the well-head price so determined shall be notified in the official Gazette.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that M/s POL acquired the petroleum exploration license for Block 3372-18 in 2003. After the inauguration of Petroleum Exploration and Production Policy, 2012, the operator opted for conversion in terms of Para 13.7 of the said policy. M/s POL spud Jhandial-1 well on 22.08.2016 and commenced production under EWT arrangement. Production was started in 2017-18 but OGRA and DG (PC) could not execute agreement for the wellhead gas price.

Audit is of the view that weak liaison by DG (PC) with OGRA resulted in delayed notification of price.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to notify wellhead gas price at the earliest to avoid probable conflict and litigation.

#### **4.3.7 Non-allocation of gas to province resulting in delayed production and realization of royalty - Rs 1,704.203 million**

According to Article 158 of the Constitution of Islamic Republic of Pakistan, the Province in which a well-head of natural gas is situated shall have precedence over other parts of Pakistan in meeting the requirements from that well-head, subject to the commitments and obligations as on the commencing day. Further Rule 43 of Pakistan Petroleum (Exploration and Production) Rule, 1986, provides that the lease may be revoked if regular commercial production has not commenced within five years from the grant of the lease.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) granted Development and Production lease on July 25, 2009 to M/s OGDCL over the Jhal Magsi South area. For the utilization of gas from the field M/s Pakistan Electric Power Company (M/s PEPCO) recommended installation of power plants at Zarghon Town which was subsequently endorsed by the Governor of Baluchistan, vide his DO No. 0021/PSG/2012/386 dated 24.01.2012. However, DG (PC) rejected the request on the ground that M/s OGDCL was going to supply the gas to M/s SSGCL. Thereafter, the DG (Gas) allocated 15 MMCFD gas from the field to SNGPL and SSGCL on equal sharing basis on March 05, 2013. As per plan SSGCL was required to lay 85 kilometers pipeline of 8” dia from Jhal Magsi South field to Quetta. The pipeline was not laid due to law and order situation till 2016. Audit observed that while allocating the gas, the constitutional right of province was not catered for and despite failure of the operator to produce gas from the filed the lease was not revoked.

Audit is of the view that weak management control resulted in non-allocation of gas to province as required under the constitution. It also resulted in potential loss of royalty amounting to Rs 1,704.203 million.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to fix responsibility besides taking remedial action.

#### **4.3.8 Non-determination of final wellhead gas prices by the OGRA**

According to Section 3 of Natural Gas (Well-head Price) Regulations, 2009, the Authority (OGRA) on its motion or upon application made to it by a producer or any interested person shall determine the well-head price in accordance with the terms and conditions of the relevant agreement and the well-head price so determined shall be notified in the official Gazette.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that OGRA failed to determine the final wellhead gas prices in 55 cases, despite passage of considerable time period and submission of gas advice by the DG (Gas). In 21 cases, Working Interest Owners opted for new policies through execution of Supplemental Agreement.

Audit is of the view that weak liaison by DG (PC) with OGRA resulted in non-finalization of wellhead prices which may lead to litigation in future.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to ensure determination of final wellhead gas price at the earliest.

#### **4.3.9 Non-finalization of Gas Pricing Agreements**

According to Rule 12 of Rules of Business, 1973, no Division shall, without previous consultation with the Finance Division, authorize the issue of any orders, other than orders in pursuance of any general or special delegation made by the Finance Division, which will affect directly or indirectly the finances of the Federation.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (Gas) failed to execute the Gas Pricing Agreements in three cases with E & P companies because of the fact that these draft GPAs remained pending with Finance Division despite lapse of 7 years.

Gombat south	Pending with Finance Division, send vide O.M No DGO(AC)5(228)14 dated 24.02.2015
Saqib (Mubarak Block)	Pending with Finance Division, send O.M No DGO(AC)5(203)09 dated 16.01.2016
Rehman	Pending with Finance Division, send vide O.M No DGO(AC)5(206)09 dated 23.06.2015

Audit holds that Gas Pricing Agreement is essential to determine rights and responsibilities of the parties. It also provides way forward in case of dispute arisen between the parties.

Audit is of the view that lack of coordination with Finance Division resulted in a delayed/or non-finalization of Gas Pricing Agreements.

The DG (Gas) replied dated 01.03.2021 that in order to avoid delays a model GPA has been developed which is being finalized and necessary approvals will be obtained.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to justify the position besides initiating steps for finalization of GPAs.

#### **4.3.10 Lack of coordination in determination of wellhead price**

According to Section 3 of Natural Gas (Well-head Price) Regulations, 2009, the Oil and Gas Regulatory Authority on its motion or upon application made to it by a producer or any interested person shall determine the well-head price in accordance with the terms and conditions of the relevant agreement and the well-head price so determined shall be notified in the official Gazette.

During the Performance Audit of Management of Leases and Licenses for the years from 2010-11 to 2019-20, it was observed that DG (PC) / DG (Gas) and Working Interest Owners are responsible for PCA/GPA but the power for determination of gas prices is vested with OGRA. The terms and conditions of pricing are elaborated in accordance with the terms spelled out in the relevant policies. Such duality of regulators causes delays. Audit observed that in Latif gas

field the discovery was made in 2009 but final wellhead notification is still pending.

Audit is of the view that division of responsibility between OGRA and DG (PC) / DG (Gas) is delaying determination of well-head prices.

No reply has been received from the management.

The DAC in its meeting held on 30.12.2021 directed the management to submit a detailed reply and get the relevant record verified from Audit.

Audit recommends to take necessary steps to develop an effective mechanism for finalization of wellhead price.

## **5 CONCLUSION**

Government framed Petroleum Policies, rules and guidelines in order to boost exploration activities and attract foreign and local investment. However, DG (PC) remained unable to achieve the major objectives of increasing exploration activities through investment. Operational inefficiencies in the management of leases and licenses is the major factor in non-achievement of drilling targets, decline in production, delayed revenue collection and resultant loss to public exchequer. The poor liaison/lack of coordination among the Constitutional bodies, Federal Government, Provincial Governments, Local Governments and other stakeholders i.e. Law Enforcement Agencies and E&P companies has also hampered the performance of E&P sector. Effective management of leases and licenses both at the policy and the execution levels will be helpful in attracting investment and boosting exploration and production of hydrocarbons. Prudent and timely decision making by the appropriate competent forum i.e. CCI, ECC, PAO and DG (PC) will enhance economy, efficiency and effectiveness of the E&P sector. The performance of DG (PC) will significantly improve through integration among various policies and liaison among the directorates of Petroleum Division.



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