

Energy & Natural Resources - Israel

Regulatory regime for acquiring petroleum rights in Israel

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[Introduction](#)

[New legislation on petroleum rights](#)

[Applying for petroleum rights](#)

[Financial capability requirements](#)

[Operational capability requirements](#)

[Transfer of petroleum rights](#)

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Introduction

Since the discovery of the Tamar natural gas field offshore Israel in 2009, there has been a significant increase in the number of transactions connected to the acquisition of interests in petroleum rights in Israel. The bulk of these acquisitions have been carried out not by acquiring new licences, but instead by farming into existing ones - whether directly by acquiring working interests in existing licences or indirectly by acquiring equity or other interests in the licence holders. Israel is a small country and therefore most of the relevant areas, especially offshore, have already been licensed out.

The Petroleum Law 1952 regulates the acquisition and transfer of interests in petroleum rights, as detailed below. In view of the flurry of transactions in petroleum rights in the past two years, the relevant authorities have been taking steps aimed at tightening the degree of control that they have over such transactions and at imposing new and stricter requirements for acquiring petroleum rights. This update sets out these steps and describes the requirements in place for acquisitions of petroleum rights in Israel.

New legislation on petroleum rights

The law sets out the rules and procedures for granting preliminary permits, licences and leases (collectively, petroleum rights). A preliminary permit grants the right to conduct preliminary tests (eg, seismic exploration) in the permit area, but does not grant the right to drill. The recipient of a permit is entitled to request a priority right to obtain a licence in the permit area. A petroleum licence confers on its holder the exclusive right to explore for petroleum (both oil and natural gas) in the licensed area, including the right to conduct drilling in the licensed area. A licence is granted for an initial term of up to three years and may be extended for a total term of seven years. A lease confers on its holder the exclusive right to produce petroleum in the area covered by the petroleum lease and is granted to a holder of a petroleum licence that made a discovery of petroleum in commercial quantities during the term of a licence.

Applying for petroleum rights

Petroleum rights are granted by the petroleum commissioner and, with respect to licences and leases, further to consultation with the petroleum council, in response to applications submitted by applicants.⁽¹⁾ Similarly, the transfer of petroleum rights is subject to the commissioner's consent, and with respect to licences and leases, further to consultation with the council. The council typically convenes around once a quarter.

Regulations published further to the Petroleum Law⁽²⁾ set out the formal requirements for applications for petroleum rights, as well as the corporate, technical and financial requirements that must be fulfilled. In addition, prior to council meetings, the commissioner customarily publishes guidelines with respect to applications to be submitted to the upcoming council meeting. Although applicants usually make all efforts to comply with such guidelines, the guidelines' legal status is unclear for several reasons, especially in cases where the guidelines stipulate different requirements from those set out in the law and its regulations. Furthermore, since the guidelines change from one council meeting to another, it is not possible to give a definitive answer on the applicable requirements for the acquisition and transfer of licences at any given time.

Financial capability requirements

For offshore petroleum rights, according to the Marine Regulations, the applicant must prove to the commissioner's satisfaction that it has the financial capability sufficient to finance half of the estimated cost of the licence's approved work programme. However, guidelines published by the commissioner in March 2010 set the average cost of a single deep water drilling at \$100 million, so that in fact applicants must prove a financial capability of at least \$50 million.

For onshore rights, the 2010 guidelines provide that applicants must have the financial capability sufficient to finance the estimated cost of the licence's approved work programme plus 50% of the cost of one drilling. The estimated average cost is set at \$10 million.

The 2010 guidelines state that the applicant company or group will be considered as having the requisite financial capability if it has at its disposal liquid assets (cash, deposits and securities) and shareholders' equity in the amounts set out above, to be proven by its most recent audited financial statements.

Operational capability requirements

For offshore licences, according to the Marine Regulations, the applicant must prove to the commissioner's satisfaction that it (or its proposed contractor) has experience in performing at least one drill in a water depth of at least 100 metres.

In January 2011 guidelines were published by the commissioner revising the 2010 guidelines with respect to operational requirements. The 2011 guidelines determine that the group that owns the petroleum right must include an operator, as defined therein, and that such operator must be a partner in the requested petroleum right with at least a 5% share. An 'operator' is defined as a corporation with experience in the management, supervision and performance of petroleum exploration and will be responsible for carrying out all of the professional activities related to petroleum explorations and the petroleum right for which it is a partner.

The 2011 guidelines further determine that the operator of an offshore right must have experience in conducting petroleum explorations at an overall cost of at least \$100 million in a single offshore petroleum field in the preceding five years. Most importantly, these guidelines determine that such an operator must prove its experience in managing and supervising drills at a water depth which matches that of the petroleum right in which it is to be an operator, determined as the deepest point in the area of the requested right.

Transfer of petroleum rights

It has become apparent in the past two years that the petroleum commissioner and the Ministry of National Infrastructures are determined to retain control of transactions in petroleum interests.

The 2010 guidelines introduced significant new requirements for the transfer of rights. One of the new rules is that in reviewing an application for the transfer of any part of a petroleum right, the professional and financial capabilities of the new group of licence holders, following the transfer of rights, will be reviewed for fulfilment of the requirements. The requirements for new petroleum rights, as set out above, are therefore applicable to the transfer of rights. As a result, every transfer of rights in a licence will subject the whole group of licence holders to re-examination.

In October 2010 the ministry released another announcement detailing its proposed policy on the issuance of approvals for the transfer of petroleum rights under the Petroleum Law. According to this document, which was published for public hearing, as a rule a transfer of rights arising from rights conferred by the state for no consideration would not be approved, other than in special circumstances. Under the current legal regime, petroleum rights are granted for no real consideration;⁽³⁾ therefore, this announcement seems to reiterate the policy already announced in September 2010 of not approving transfers of petroleum rights other than in extraordinary cases.

The October notice adds further details and specifies a long list of considerations that must be taken into account when reviewing requests in such special circumstances. In addition, this notice stated that a change in control, whether direct or indirect, in a company that holds a petroleum right requires approval by the petroleum commissioner.

In late May 2011 a proposal for new regulations with respect to the transfer of petroleum rights was published for public hearing. This draft amended the October notice and was again published for public hearing. According to these proposed regulations, direct and indirect transfers - including changes of control - petroleum rights and interests in petroleum rights would be subject to the petroleum commissioner's approval. These regulations apply not only to each individual petroleum rights holder, but also to the

group holding the petroleum right as a whole.

If the regulations are enacted, the transfer of control in the joint operating committee will also be subject to approval by the petroleum commissioner. In addition, the proposed regulations condition the commissioner's approval on a number of terms and conditions that limit the commissioner's discretion - for example, the licence must have been in force for at least a year and the transferor must have held the licence for at least a year prior to the transfer. Discussion of the draft regulations was on the agenda of the Petroleum Council's most recent meeting; therefore, further developments are expected in this area in the near future.

It is fair to assume that the current lack of certainty in the regulatory framework for acquiring and transferring petroleum rights is detrimental to investment in this sector. It follows therefore that the importance of the gas and oil industry to the Israeli economy will expedite the finalisation of upstream regulation in a manner that is conducive to the development of the market.

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Endnotes

(1) The Petroleum Law allows for the granting of licences and leases by way of competitive bidding; however, these procedures have not been used in recent years and nor has the petroleum commissioner initiated any licensing rounds.

(2) The Petroleum Regulations 1953 and the Petroleum Regulations (Principles for Offshore Petroleum Exploration and Production) 2006.

(3) A modest annual fee, calculated per square kilometre, is imposed on petroleum rights.

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