

## Oil and Gas Concessions in Hungary

### 2013 Bid Round

In this article we provide a brief overview of the issue of an invitation for tender by the Ministry of National Development (**2013 Bid Round**) currently under way in Hungary and to provide a brief comparison with the system it replaces along with some commentary.

Hydrocarbons exploration in Hungary has come into focus again with the long awaited issue of the 2013 Bid Round which closes in November 2013. The 2013 Bid Round has been long awaited by the industry, as there have been no new concessions since 1998 and no new exploration licenses issued since 2010, when the majority of the country's available territory was declared a "closed area" for exploration. Thus for the past 3 years only existing exploration licences and mining plot/production licenses were available to participants.

The 2013 Bid Round has made available 4 exploration areas or blocks and it would appear that these have been selected as a test of the new system and the appetite of participants. We will soon know the outcome as the closing date is 15 November 2013 and within 90 days a winning bid should be announced.

### **Legislative Background**

In Hungary, Act XLVIII of 1993 on Mining (**Mining Act**) regulates exploration for and production of hydrocarbons. There have been 2 available options, namely (i) concession agreements and (ii) exploration licences, followed by a mining plot/production license to exploit a commercial discovery.

The legal difference between them is that a concession agreement is a civil law contract concluded between the government (represented by the competent ministry) and a privately owned entity, whereas an exploration license is an administrative permit granted by the competent authority within the framework of applicable regulations. No concession agreements have been issued since 1998. Exploration licenses were available for award until 2010, but since then there have been no new licenses awarded.

Under the Mining Act, previous exploration licenses were awarded primarily on a first-come first-served basis, and so long as the proposed work program was satisfactory, the earliest applicant was awarded the exploration license. The applicant then submitted a technical operating plan, the approval of which started the 4 year exploration period (extendable by 2 consecutive periods of 2 years each). This system was generally seen as not fulfilling the objectives of the relevant EU Hydrocarbons Directive aimed at ensuring a fair and level playing field for participants and is partly why no new exploration licenses have been awarded since 2010.

The 2013 Bid Round provides a new system for awarding concession agreements and, importantly, provides a new framework for evaluating applicants and their bids. Exploration licenses are not being made available. The aim is to provide a fair and equal system whereby the technical and financial capabilities of the proposed work programs are compared contemporaneously and the bidder with the most appropriate capabilities is chosen. The bid round documentation provides more details of the bidding requirements and the basis of evaluation.

### **Key Aspects of the Concession Agreement**

As expected, there are fees to be paid to participate in the tender, but from a fiscal perspective the most important point to note is the requirement to pay a self-determined concession fee (over and above the regulated minimum fee) on the successful award of a concession agreement. This differs from the previous system where no such fee was payable, and moreover it is normal for the fiscal regime and rates to be maintained throughout the term of the concession agreement.

Anecdotal evidence suggests that the combination of the proposed level of concession fees, the applicable royalty rates and the current fiscal regime, is proving unattractive for new entrants as well as some of those already in the market. And this is before considering any possible changes to the fiscal regime generally.

The winning bidder, which has to be an oil and gas company with established technical and financial capability to carry out the proposed exploration operations, must then sign the concession agreement with the government within 60 days of its winning bid.

Unfortunately, a draft form of concession agreement was not included as part of the tender documents, with only a description of its key terms and conditions included. This will no doubt give cause for some concern as a draft agreement will need to be made available at the earliest opportunity to enable the parties to negotiate and conclude it within the specified timeframe.

However, according to the regulations, the winning bidder must itself establish a concession company within 90 days from the signing of the concession agreement, which company will enjoy the right and bear the burden of the obligations under the concession agreement. It is not clear why it has been designed in this way as it would facilitate matters if it would be the concession company itself which would sign the concession agreement in the first place.

As the concession company itself will not be signatory to the concession agreement, it is likely that the concession agreement will have to be assigned by the winning bidder to the concession company as such company will hold the exploration and production rights, have all obligations, and most importantly, will acquire the eventual production. As a consequence, the winning bidder will have to provide appropriate guarantees as well as the necessary technical services for the operations as the concession company itself is likely to lack them.

In other words, there are likely to be structuring issues to be considered from both a legal and fiscal perspective, as well as taking into account deployment of technical expertise, not only at the outset when contemplating submitting a bid either alone or jointly with another, but also in the event of winning the bid.

Moreover, as the winning bidder must establish and maintain majority control in the concession company (by way of a majority of its shares, business interests and voting rights), there is clearly going to be an adverse effect on the "marketability" of the concession, limiting farm-outs to minority interests only and seemingly precluding any sale of the concession company whereby a purchaser would have to acquire the winning bidder itself.

As a result, it will be interesting to see how any potential farm-out transactions will be structured regarding the use of either a joint operating agreement (JOA) and/or shareholders agreement applying to the concession company as a joint operating company (JOC). Particularly given the elements of control which are usually provided to holders of a minority participating interest or shareholding in industry standard JOAs in specific circumstances, such as due to the payment default by the concession holder. This may arise in relation to voting matters on specific operations (operating committee decisions), but also in relation to an un-remedied default where the defaulting party is required to exit from the JOA or to transfer its shares to the non-defaulting shareholder.

### ***The Future***

It may be too soon to talk about the future whilst the 2013 Bid Round still remains open, but with it closing on 15 November and the results expected to be published in February 2014, the time will soon be here when the success of the 2013 Bid Round will be reviewed and analysed by both industry and government.

We should know not only the winning bidder, but also if there were new entrants who were sufficiently attracted to come to Hungary to participate and perhaps more importantly if the new system works and if it is regarded as a success.

The final terms of the concession agreement signed with the winning bidder will also be scrutinised and its terms will allow industry to consider how such terms will affect their fiscal analysis for participating in future bid rounds.

Whilst the majority of the country remains a "closed area", it would be fair to assume that with the expiry of current exploration licenses coming in over the next 18 months or so, the next bid round in Hungary may be under way before too long, when hopefully the bidding process will cover larger and more attractive exploration areas and take into consideration feedback provided from both industry and stakeholders to try to bring more success to Hungary.

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