Lessons Learnt for Model PSC Contract and Terms

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Agenda:

- Myanmar Model PSC – Overview and Comments
- What to consider on the PSC's commercial terms - Foreign investors' concerns
- Comparison of Myanmar Model PSC with other countries
- Vietnam's experience in the PSC negotiation process

Myanmar’s types of Model PSCs

- PSC for Onshore Blocks
- PSC for Offshore Blocks
  - Shallow Water Offshore Blocks
  - Deep Water Offshore Blocks.

Myanmar Model PSC for Offshore Blocks – Overview and Comments

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- Myanmar's outcome of the last bidding (2013) – one of the most eagerly awaited events in the industry
  - 10 shallow water blocks
  - 10 deep water blocks

  Recent update:
  - Myanmar's state-owned Myanma Oil and Gas Enterprise (M.O.G.E.) has signed a production sharing contract (PSC) with Gulf Petroleum Myanmar, a Thai-owned company based in Myanmar, for an offshore oil and gas block (M-10) in the country's Gulf of Mottama.
  - As for the remaining six, the Ministry disclosed that oil and natural gas exploration, drilling, and production activities are underway in Yadana, Yetagun, Zawtika, and Shwe.

- Role of recent development in oil and gas regulatory framework:
  - Petroleum and Petroleum Products Law, 2017
  - Petroleum Well Law, 2017
  - Myanmar Companies Law, 2017 (MCL)
  - Myanmar Investment Law, 2016 (MIL)
  - Environment Conservation Law, 2012 (ECL)
  - State Owned Economic Enterprises Law,1989 (SOEEL)
  - Other rules regarding transparency and governance.

Foreign investment in Oil and Gas sector

Locally incorporated company

Bidding process

PSC contract

Joint Operating Agreement

- Incorporation as expressly regulated under MCL.
- ❿Foreign company: Foreign stake of more than 35% in company considered as foreign company.
- ❿Branch Office /Overseas Corporation.
- Signed between the Myanmar Oil and gas Enterprise ("MOGE") – a SOE in oil and gas industry and branch or company of relevant foreign investor

- Signed between the foreign investor (Holding Myanmar Investment Commission - MIC Permit) and a local company approved by MOGE

Model PSC for Offshore Blocks

- Management: MOGE
- Production period: 20 years from completion of development or depending on contract terms, the longer applies.
- Signature bonus: payment within 30 days of signing PSC.
- Relinquishment (requiring the Contractor to surrender certain parts of the contract area to the State after a given period of time; these are typically areas that have not been exploited (and are not expected to be exploited): 25% at end of initial term; 25% at end of first extension
- Royalty: 12.5% of available petroleum
- Domestic requirements: 20% of crude oil and 25% of natural gas of Contractor's share of profit petroleum to be sold to the domestic market, at 90% of fair market prices
- Arbitration: In line with the New York Convention and UNCITRAL Arbitration Rules

Model PSC for Offshore Blocks

- Training funds (for local workers): USD 25,000/year during exploration; USD 50,000/year during production
- R&D fund (established by Contractor for developing R&D capabilities during Project Operation, expenditure to be consulted with MOGE): 0.5% of contractors' share of profit petroleum
- Governing law: laws of the Union of Myanmar
- Exploration period: **5 years** - 3 years (Initial exploration period, including seismic and drilling programs) + 2 one-year extensions
- Production split: 60%-90% depending on the rate of production and the depth of the well
- Production bonus:
  - Shallow water offshore block features: USD 1.0 million– USD 10.0 million
  - Deep water offshore block features: USD 10 million – USD 100 million
- Cost recovery limit:
  - Shallow water offshore block features: 50% in water depths of 600 feet or less; 60% for water depths more than 600 feet
  - Deep water offshore block features: 50% in water depths of 600 feet or less; 60% for water depths between 600 feet and 2,000 feet 70% in water depths more than 2,000 feet

PSC's commercial terms – Foreign investors' concerns

- Governing law: laws of the Union of Myanmar – state of Flux

  Other laws? Not possible
- Dispute resolution: UNCITRAL Rules / Myanmar Arbitration Law
  - Myanmar acceded without reservations to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards effective 15 July 2013 and further passed Myanmar Arbitration Law 2016.
  - Foreign investors may seek protection under the MIL or bilateral investment treaty.

- Work obligations, bonuses, production splits, etc.: negotiable terms? Unknown, depending on decision of the Ministry of Energy
  - For offshore blocks: non-negotiable
- Limit on foreign ownership:
  - FIL 2016 & Myanmar Investment Commission Notification 15/2017: no restriction for oil and gas exploration, but approval of Ministry of Energy is required.

- "Inalienable rights"- undefined concepts

"No term or provisions of this Contract, including the agreement of the Parties to submit to Arbitration herein, shall prevent or limit the Government of the Republic of the Union of Myanmar from exercising its ***inalienable rights****".*

→ PSC terms are set aside in case any PSC obligation is not in consistency with Myanmar's inalienable rights.

What about "profit allocation", "cost recovery", "arbitration"?

→ Seek legal opinion from MOGE before concluding PSC

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- Parent company guarantee

We hereby absolutely and unconditionally guarantee to the Myanmar Oil and Gas Enterprise, Ministry of Energy, the Government of the Republic of the Union of Myanmar that the CONTRACTOR is financially sound and technically competent and shall perform the tasks such as funding necessary capital, assets and supplying machinery, equipment, tools, technicians, specialists and discharge of expenditure obligations undertaken by it through the ……….... Offshore Block ……… Production Sharing Contract, for the exploration, extraction and development work of the …………….. Offshore Block ……… and ***we hereby undertake to discharge all its obligation under the Contract on its failure to perform****"*

- Liabilities including environmental and social issues are unforeseeable → risks foreign investors cannot control
- Does not reflect the principle of risk allocation → risk of project not being bankable

- The rate of return on the transportation of gas

“For the payment of transportation tariffs by the users of the facilities which are based upon the costs of financing, constructing, operating and maintaining the pipeline and/or other transportation facilities, including depreciation thereof, any applicable taxes, ***and a reasonable return on investment.”***

Comparison with other countries

	Myanmar	Kurdistan	India	Vietnam	Bangladesh
Preparation/ Exploration/ production period	Exploration period: up to 5 years Production: 20 years	Exploration period: Up to 7 years Development Period: 20 years from declaration of commercial discovery, automatic rights to a 5-year extension	Exploration: max 4 years (first period) + max 3 years (second period) Petroleum Mining: lease for an initial period of 20 years with extension by mutual agreement	Max 25 years for petroleum contract, exploration period max 5 years (30 and 7 years respectively for gas)	Initial production period: 4-5 years Production: 20 and 25 years from the date of approval of development for an oil and gas field respectively – 5 year extension possible
Royalty	12.5% of available petroleum	10% on all petroleum produced and saved	12.5% of the well-head value of crude oil 10% of the well-head value of natural gas	Depending on petroleum agreements	Depending on mutual agreements

	Myanmar	Kurdistan	India	Vietnam	Banglades h
Bonuses	Signature bonus: payment within 30 days of signing PSC. Production bonus: Shallow water offshore block features: USD 1.0 million– USD 10.0 million Deep water offshore block features: USD 10 million – USD 100 million	Signature bonus: payable within 30 days of ratification of PSC Production Bonus: payable on first production and when production reaches certain amount	No bonus payment due	Signature bonus: payable within 30 days of ratification of PSC Sliding scale Production Bonus: payable on first production Bonus: 30 days from declaration of first commercial discovery	Sliding scale

	Myanmar	Kurdistan	India	Vietnam	Bangladesh
Domestic market obligation	20% of crude oil and 25% of natural gas of Contractor’s share of profit petroleum to be sold to the domestic market, at 90% of fair market prices	Sale of crude oil depending on mutual agreements	100%	Priority of domestic sale of crude oil Sale of natural gas depending on mutual agreements	Varying across agreements
R&D fund	0.5% of contractors’ share of profit petroleum	No such obligation	No such obligation	No such obligation	US$0.03 per barrel of Contractor's profit oil and profit condensate and/or NGL and US$0.40 per MCF of Contractor’s profit natural gas

	Myanmar	Kurdistan	India	Vietnam	Bangladesh
Income tax	25% on Contractor's net profit	15% on Contractor's net profit	30% for domestic companies and 40% for foreign companies Surcharge: 5% on tax for domestic companies and 2% on tax for foreign companies (for income >INR 10 million) 100% tax deductible for all exploration and drilling costs	Enterprise Income Tax: 32% (exempt for first 2 years and 50% reduction for 2 subsequent years possible) VAT: 0-10% Export tax: 4% for Oil, 0% for Gas (deductible)	

Source: http://www.charltonsmyanmar.com/natural-resources/myanmar-oil-and-gas/pscs-in-myanmar/

Myanmar's Model PSc vs. Other countries' Model PSCs

- ✓ No extension of production period possible
- ✓ No provision specifically dealing with appraisal and commercialisation of natural gas discoveries
- ✓ Many expenses (R&D fund, royalty, etc.) are not recoverable from Cost Petroleum (*i.e.*, Petroleum out of which Contractor may recover the costs and expenses of the Petroleum Operations)

Experience in negotiating PSC

Vietnam's legal framework

- **MONOPOLY POSITION OF PETROVIETNAM**
- **PRODUCT SHARING CONTRACT (PSC):** All PSCs must comply with the model form of contract issued by the Vietnamese Government. Decree No .33/2013/ND-CP about standard PSC issued on 22 April 2013
- **Major issues of PSC are:**
  - ***PVN's participation and pre-emptive right:***
    - Required to sign a standard PSC with PVN. The petroleum producer and contractor cannot sell to any party other than PVN
    - If a contractor proposes to assign a participating interest to a third party, PVN must exercise its statutory pre-emptive rights in accordance with a prescribed process
  - ***Non market based Pricing Mechanism:***
    - Pricing based on negotiations with PVN
    - Not reflective of the actual production and distribution costs with reasonable returns on investment for investors
    - ***Failure example of an US Oil&Gas Firm:*** We hope PVN will learn this lesson

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- **DISPUTE RESOLUTION:** **How to choose the governing law and the method of dispute resolution?**
  - ***Article 20 in Product Sharing Contract:***

"The laws and regulations of the Socialist Republic of Vietnam shall apply to this Contract. However, in the absence of a specific Vietnamese law or regulation governing any matter that may be raised, the relevant provisions of international law or Generally Accepted International Petroleum Industry Practices shall apply, provided that such international law and Generally Accepted International Petroleum Industry Practices are not contrary to fundamental principles of Vietnamese law"

  - *Arbitration or local court?* The Vietnamese courts and judges have the broad interpretation of legal instruments
  - *International arbitration agreement?* Recognition and enforcement of foreign judgments and arbitration in Vietnam are very arduous

WHY CANNOT NEGOTIATE EFFICIENTLY WITH THE STATE OWNED ENTERPRISES?

- **INCOMPETENCE: Lack of knowledge on international business practice, language barriers, skilled lawyers, etc.**

- **Complex Approval Procedure under the State-Owned Enterprise regulations: TOO many parties involved**

- **IMPACTS OF INEFFICIENT NEGOTIATIONS :**
  - ✓ **Negotiation process is SLOW and INEFFICIENT**
  - ✓ **Mistrust and reluctance from foreign investors**

Risk Management Strategies - Recommendation

- Risk management by the contractual assurances of negotiated terms to protect the interests against the unilateral actions of the State
- Risk management by the insurance strategies on legal and contractual liabilities and indemnities
- Exemption of state sovereignty by an expressly contractual waiver
- Limitation by recognition of international law and investment treaties

Risk Management Strategies - Recommendation

- In-depth understanding of local law and extensive local expertise!
- Maintaining a close relationship with the licensing authorities and building the mutual interests with the key local partners!
- Careful and thorough plan of project risk management, especially with risk evaluation corporate expectations and timelines will lead to great success!

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Thank you very much!

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