Production Sharing Contract

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Production Sharing Contract (PSC) a special agreement between the government of Bangladesh and foreign contractors signed mainly for petroleum exploration and development in the country. Under the Bangladesh Petroleum Act 1974, the government owns all mineral resources including petroleum within the territory, continental shelf and economic zone of the country and has the exclusive right and authority to explore, develop, exploit, process, refine and market petroleum resources. The government has also the exclusive right under the act to enter into petroleum agreements with any person for the purpose of any petroleum operations. On behalf of the government, the petrobangla exercises the rights and powers to explore, develop, process and market petroleum and also to enter into petroleum agreements with any person/company for these purposes.

In 1973, following a comprehensive policy review, the government started setting up a new legal framework to encourage rapid exploration and development of natural gas and oil and to safeguard the national interest. The government also took initiative for development of national capacity in the oil and gas sector with assistance by international companies. The idea came from the experience of significant success achieved under production sharing contracts (PSC) of Indonesia, Malaysia, Egypt, China, India and some other countries with international oil companies.

In 1974, the government of Bangladesh invited bids from international oil companies for exploration and development of petroleum in the territory of the country under established criteria and ground rules. The bids submitted were evaluated on a 40-points grading, ten points for each of the four criteria including financial capability, technical capacity, experience, and work programme. A selected number of qualified companies were invited to negotiate on the basis of the model PSC and finally, seven contracts were concluded for offshore exploration and development. The companies with which the PSC was signed were Atlantic Richfield, Union Oil of California (later renamed as UNOCAL) and Ashland of the USA, Superior Oil Company of Canada, Deminex and Ina-Napthaline of Europe, and a Japanese company. UNOCAL discovered an offshore gas reservoir at Kutubdia but under some economic considerations, the company did not start its exploitation.

The foreign companies soon started loosing interest in PSC since they found Bangladesh to have large reserve of gas and not of petroleum. In 1981, Shell Oil signed a PSC for onshore areas. In the mean time Petrobangla developed significant capability for exploration and development of oil and gas resources and in 1989, established the Bangladesh Petroleum Exploration Company (BAPEX) for exploration of petroleum in the country. Petrobangla made the first discovery of oil in the Bangladesh territory in 1986 at Haripur, Sylhet. There were different offers from reputed international oil companies for development of the oil field and one of them was Scimitar, a company incorporated in British Virgin Islands in June 1987 with an authorised capital of only $50,000. The technical experts of Petrobangla suggested not to award the contract to Scimitar but the suggestion was ignored and in December 1987, the government signed a PSC with the company. Scimitar was not able to start work by the stipulated dates. It repeatedly sought extensions, which were granted and meanwhile, it explored the whole world to raise necessary funds.

The international scenario for gas development underwent major changes since the end of the nineteen eighties. A review of the policy and legal framework carried out under the World Bank's Petroleum Exploration Promotion Programme in 1987 pointed out that there were bright prospects for gas exploration. A new model PSC was formulated in 1988 to encourage exploration for gas and to ensure that the price for gas would have parity with the market price for fuel oil. It was further revised in 1993 commensurate with government policy changes and new incentives to the investors for petroleum exploration. Some more changes in the model PSC were made in 1997.

Bangladesh signed a PSC in May 1994 with Cairn Energy and Holland Sea Search, a British-Dutch joint venture for exploration of oil and gas in block 16. The joint venture signed another PSC for block 15 in June next year. These two blocks cover partly Chittagong onshore and adjacent offshore areas. In January 1997, Hallibarton Energy of United States joined the Cairn-Holland Sea Search in the Sangu gas field portion of Block 16. Shell Oil purchased Cairn's PSC rights in these two blocks in mid-1999. In 1995, Occidental signed PSCs for blocks 12, 13 and 14 in the Sylhet area (Surma basin) but transferred its PSC rights to UNOCAL in 1999. A low profile US joint venture Rexwood-Oakland signed PSC in January 1997 with Petrobangla for blocks 17 and 18 located in Cox's Bazar-Teknaf region with 80% offshore exploration areas. Rexwood later merged with Oakland. The United Meridian Corporation (UMC) was another small US oil company that signed PSC in late 1996 for oil and gas exploration and development in block 22 in the Chittagong Hill Tracts area. Later, the UMC transferred its rights to a US company Ocean Energy. Subsequently the block 17 and 18 were relinquished as no commercial prospects were identified.

The PSCs resulted in new discoveries of gas fields in the Surma basin by Occidental-Unocal (Bibiana and Maulavibazaar) and at Sangu (offshore). They also generated new gas production and supply of over 200 million cubic feet of gas per day to national gas grid. The additions accounted for one fifth of the country's daily consumption. By 1997, both Cairn and Occidental signed gas purchase and sales agreement with Petrobangla for the sale and delivery of the gas into the national gas distribution systems operated by Petrobangla. Enthusiasm of both government and private investors in the gas sector was so great between 1996 and 1997 that during the period, Bangladesh attracted attention of top international investors in petroleum sector. In this backdrop the government following exploration promotion meetings in London and Huston in February-March 1997, issued a worldwide invitation to bidders in April 1997 (Second round gas bidding). International oil companies were invited to submit bids by

15 July 1997 on the basis of the model PSC updated in 1997 for remaining 15 blocks.

The number of companies showing interest in response to the invitation for bids was 23, some of which were less known and perhaps appeared in the exploration scene for the first time. Companies like Tallow Oil Plc, Hondo Oil and Gas, South Asia Oil and Gas, Nico Resources, Triton and Pangea, Maersk Oil were the new entries. Texaco, Shell, Mobil, Chevron, Unocal and Enron are known names in the international petroleum exploration business. Available information indicates that there was no bid for blocks 1, 2 and 23. Of the remaining 12 blocks, number 9 attracted the largest number of bidders, followed by block 10, 11, 6, 5 and 7 (onshore) and there were more than two bids for each of the offshore blocks 19, 20 and 21. No block was kept reserved for the national company bapex. Negotiations were in process in 2001 for blocks 5 and 10 (with Shell Oil and Cairn), block 8 (with Pangea) and for blocks 19, 20 (with Maersk Oil) and two PSC were concluded, one with Unocal for block 7 and the other with Chevron-Texaco-Tullow for block 9. In this second round bidding, however, 10% percent of shares by the name of carried over interests for BAPEX were considered. Second round block bidding resulted the signing of PSC for block 9 with Tallow Bangladesh Ltd as its operator. For this PSC Tallow has 30% share, 60% share belongs to Nico Resources and 10% carried interest enjoyed by BAPEX. Bhangura gas field discovered within this block which currently produces 100 million cubic feet of gas daily.

PSC signed with Occidental in the first round of block bidding for blocks 12, 13 and 14 were transferred to Unocal and subsequently to the International Oil and Gas Company Chevron. Important gas fields like Jalalabad, Maulavibazar and Bibiana are discovered within these blocks. Only the Bibiana Gas Field now produces approximately 500 million cubic feet gas daily. In addition Jalalabad and Maulavibazar Gas Fields are producing daily 230 and 75 million cubic feet of gas respectively.

Sangu Gas Field discovered earlier in the block 16 currently produces 35 million cubic feet of gas. The International Oil Companies working in Bangladesh (Chevron, Cairn Energy, Tallow and Nico Resources) produce approximately 943 million cubic feet of gas daily which is more than the half of the total produced gas in the country.

In their proposals the companies were to indicate their competitive bids in respect of six items: (a) cost recovery ratio, (b) profit of oil/gas sharing ratio, (c) work programme, (d) performance guarantee in support of work programme, (e) discovery bonus, and (f) production bonus. Arthur Andersen, an international firm of chartered accountants was appointed as consultant to assist the government in evaluation of the bids. A large number of international oil companies came up with proposals for petroleum exploration in Bangladesh during that period. However, subsequent global oil crunch and uncertainty in government decisions caused a decline in the enthusiasm of the private investors. The whole process was further complicated by the issue of gas export to India through pipelines raised by the World Bank in 1995 on the ground that when PSC operators would start selling gas to Bangladesh in large quantity, the country would face a balance of payments crisis. Almost simultaneously, the international oil companies initially having no agenda to export gas also started arguing that there was no ready gas market in the country and therefore investment would no longer be attractive. The idea created a controversy as to whether the gas reserves in Bangladesh are sufficient enough to justify pipeline export or, the country itself has a market potential to use its reserves for domestic consumption and industrial purposes. At present the production of gas has significantly been increased but the expanded market and enhanced demand could not be fulfilled with the produced volume of gas.

Key provisions of the present model PSC includes following:

Contact area 'Block size ranges from 1,650 to 13,500 sq km. Two blocks can be in one contract if geologically justified and in offshore, more than two blocks are allowed to include in one PSC. Separate work programme is necessary for each block.

Term of exploration' seven years (basic period of three years plus two extensions of two years each).

Production 'For each area 25 years from the contract effective date for an oil field and 30 years for a gas field, subject to an extension of five years on mutually agreed terms.

Relinquishments' 25% of contract area at the end of the third year and an additional 25% at the end of the fifth contract year are to be relinquished. All areas which are not declared production areas are to be relinquished at the end of the seventh contract year. First relinquishment will be waived if the contractor has completed an exploratory well within three years of the initial exploration period.

Repatriation of profit' Repatriation of all the profit as per PSC provision will be allowed.

Production sharing' Petrobangla and the contractor shall allocate any petroleum from the contract area between themselves in tranches according to total average daily production over the contract period in a mutually agreeable terms separately before and after the cost recovery period.

Cost recovery' Biddable up to 40% for oil and 50% for gas.

Valuation of gas' The pricing for associated gas would be on a cost plus basis, while for non associated gas it will be 75% of the international price of high sulfur fuel oil with negotiated discounts. To encourage exploration in offshore areas associated or non- associated gas from such fields will be priced at 25% higher than the gas from onshore areas.

Tax and duty' No duty will be levied on machinery, equipment and consumables imported for petroleum operations during the exploration, development and production stage. Companies will be free of all corporate tax and such other taxes as are determined under the terms of PSC.

Deductible costs' Operating costs, exploration costs and other capital costs.

Other payments to government: Discovery and production bonuses biddable and applicable as specified in the agreement not cost recoverable.

Annual contract service fee' Negotiable, but not less than US$ 50,000 per block. This cost is recoverable.

Annual training fee' US$100,000, not recoverable.

Export of gas' Contractor may export natural gas (contractor - cost recovery and profit gas; Petrobangla - profit gas) in the form of liquefied natural gas subject to negotiation with government. Petrobangla will compensate contractor for relinquishment of rights for required volume of discovered and apprised natural gas located west of Padma-Jamuna rivers up to a maximum 1 TCF. The required volume represents the minimum volume estimated to be economically recoverable for domestic use.

Domestic consumption: Contractor shall provide pro rata up to 25% of his profit oil at 15% discount and remaining, if required at full fair market price in convertible currency.

The commercial energy sector and the economy as a whole remain excessively dependent on natural gas. On the other hand insignificant investment was made for the exploration and production of natural gas for long period of time. As a result shortfall of gas supply has become a regular phenomenon in the country. It will be impossible to meet the demand of natural gas from the proven and recoverable reserves after 2011 if we continue to produce gas at the present rate. If the probable gas reserves can be recovered the discovered gas may meet the demand until 2015. And gas supply demand may be met until 2019 if the possible gas resources are recovered. At the same time exploration activities for oil and gas needs to be enhanced for meeting the growing demands.

Earlier in 1989 Bangladesh was divided into 23 blocks for the purposes of exploration of oil and gas out of which 5 blocks were in the offshore territory and 17 were onshore blocks. Onshore areas of the country ware comparatively better explored and considerable gas reserve has been discovered here. Success in securing gas resource discovery from the offshore areas was so far limited.

Under these circumstances new initiative for oil and gas exploration in the offshore areas of the country was undertaken in 2006. A new draft Model Production Sharing Contract was prepared. This draft Model PSC includes the following significant features: i) The territorial offshore area of the country was divided into 28 blocks which are limited within 2,611 ' 7,400 squire kilometre areas; ii) The new PSC has included the Mandatory Work Program which was absent in the older version of PSC; iii) The old PSC did not have clear policies on Insurance and Bank Guarantee commensurate to the market cost and the new PSC included them; iv) The cost recovery limit in the new PSC is fixed at 55% maximum. This provision was biddable and negotiable in the older version of the PSC; v) Similarly in the profit sharing section the minimum rate of profit sharing rate has been fixed in the new PSC depending on the gas production rate changing the old PSC provision for determining the rate of profit sharing through negotiation and bidding; The profit sharing allocation has been defined for shallow offshore blocks at a rate of 55% and for the deep offshore blocks at a rate of 50%. v) Among the other significant amendments the new PSC imposed the liability of payment of Corporate Income Tax to the Contractor. Also the dispute resolution section refers to the Bangladesh Arbitration Act, 2001 and the arbitration to take place in Dhaka. In case of transfer of more than 50% shares of the company mandatory requirement for prior approval from Petrobangla is needed.

Petrobangla invited international tenders for bidding in the 28 offshore blocks of Bangladesh within the scope of the new model PSC 2008 in February 2008. Seven international companies (CNOOC China, Longwoods Ltd., Tallow Bangladesh, Comtrac Services, Korea National Oil Company, Cnoco Philips and Santosh International) participated in the bidding process. Out of 28 offshore blocks no bidder was attracted for 12 (block nos. 4, 6, 7, 8, 19, 22-28) blocks. Petrobangla has scrutinised the proposals submitted by interested oil and gas exploration companies for offshore blocks in 2008 and placed its recommendations to the government for decision. If approved new initiatives will be taken for oil and gas exploration activities in the offshore blocks. [Mushfiqur Rahman]
