Production Sharing Contracts

Production Sharing Contracts (PSCs) are one of the most common forms of granting instrument between the host government and the investor for exploration, development and production of oil and gas reserves and resources. First used in Indonesia in the 1960s, these contracts were a mechanism which, in contrast to the more traditional concession systems, allowed the State to retain ownership of its oil and gas resources.

1 Key Concepts:

- **Cost Oil**: A share of production through which contractor may recover costs.
- **Profit Oil**: The profit element of PSC production, split between host nation and contractor on a tiered or sliding scale basis.
- **Tax and Royalty**: due to the Government and charged to profit and revenue respectively
- **Control**: the Government retains management control of operations

2 Contractor Considerations

- The Contractor holds the full burden of exploration risk
- The Government retains ownership of the resources and facilities
- Caps may be in place restricting cost recovery
- Government is (theoretically) responsible for decommissioning, but Contractor revenue is at risk if it is not handled appropriately
- Conflicting roles of the Government and National Oil Company

3 Government Considerations

- Hard to balance the desire to maximise profits with optimal exploration program
- National Oil Company can often be at odds with the National Tax Authority
- Government is (theoretically) liable for decommissioning
- Opportunity to target economic rent very efficiently

4 PSC Components

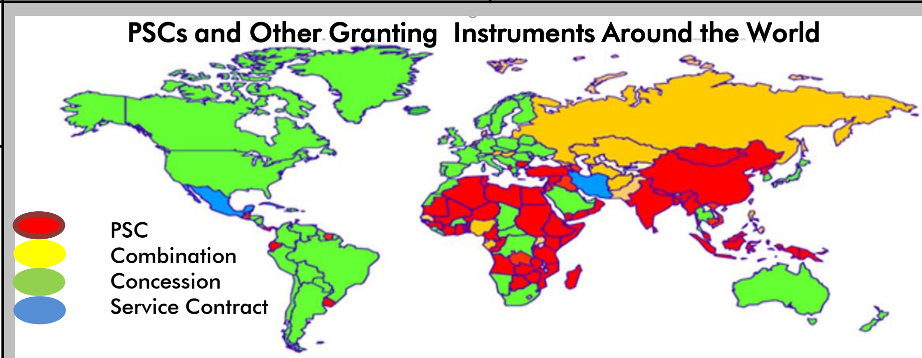
- Contract terms can vary over time, be re-negotiated and are not consistent even within a single country
- PSCs can result in higher "reported reserves" by Contractor when oil price is low, due to a greater share being allocated as "cost oil" to Contractor
- "Cost oil" calculation allows Contractor to receive an increased share of oil in order to recoup investment
- "Cost oil" in any one year can be capped to protect Government revenues
- "Profit oil", tax and royalty calculations can be fixed or can vary

5 Potential Participants:

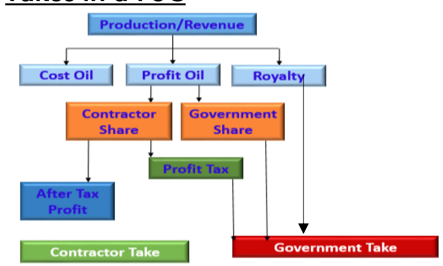
- National Oil Company
- International Oil Company
- Local partners

6 PSC "Phases"

- Fixed Term Exploration Phase with well commitment
- Fixed Term Development Phase post exploration phase
- Relinquishment of acreage



7 Government and Contractor Takes in a PSC



8 Profit Oil Calculation:

- Fixed
- Relative to production or cumulative production
- Relative to Return on Investment or R-Factor

R-Factor = (contractor total revenues from project)/(contractor total costs)

9 PSC Main Clauses

- Management and Control
- Minimum Work Obligation
- Relinquishment
- Commercial Discovery
- Cost Recovery
- Bonus and Taxes
- Local Content
- Stabilisation
- Decommissioning
- Term

Courses

- 3 Day MBA in Oil & Gas
- Contracts & Negotiations
- Risk Management in Oil & Gas
- Project Governance
- Leadership

…..and others

Other WBC Guides:

- Risk and Uncertainty
- Petroleum Economics
- Decision Analysis
- Portfolio Management
- Performance Metrics

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