Memorandum regarding model production sharing contract for the exploration and production of petroleum for onshore blocks issued by the Government of the Union of Myanmar (May 2013)

We set out below a general analysis of the main terms of the draft model production sharing contract for the exploration and production of petroleum for onshore blocks issued by the Government of the Union of Myanmar in May 2013 (the “**Myanmar PSC**”). In particular, we suggest certain amendments that could be made to the Myanmar PSC in order to improve the position of the “Contractor” thereunder and raise other issues for consideration. In conjunction with this Memorandum, we have also prepared a table comparing certain key terms of the Myanmar PSC against production sharing contracts (“**PSCs**”) in other jurisdictions (the “**PSC Comparison Table**”).

Unless otherwise defined, capitalised terms used in this Memorandum shall have the same meanings as set in the Myanmar PSC.

1. **Term (section 3)**
   1. Section 3 (which covers the term of – and potential extensions to – the exploration and development / production periods) is broadly acceptable and gives the Contractor a fairly broad discretion to extend exploration periods. It also allows for automatic extension of the exploration period to allow for completion of seismic or drilling operations or to appraise a discovery.
   2. There are some possible amendments / improvements Contractor may consider, as set out below.

*Extension of Exploration Period during consideration of Development Plan*

* 1. Contractor may consider amending section 3 to provide for automatic extension of the Exploration Period if a development plan for development of a Commercial Discovery is under consideration (at least in respect of that part of the Contract Area to which the development plan relates) (a similar provision is contained in the India PSC).

*Commencement of Development and Production Period*

* 1. In section 3, the Development and Production Period runs from the time of declaring a Commercial Discovery in the Contract Area (section 3.5). However, after declaring a Commercial Discovery, the Contractor is still required to submit and finalise a “Development Plan” under section 8, and this process could take over a year (from preparation of the plan to government approval and finalisation).
  2. Contractor may want to amend this section so that the Development and Production Period only runs from the date of finalisation of the Development Plan. This would be similar to the Mauritania PSC, where granting of the exclusive exploitation authorization occurs within a certain number of days following approval of the development and production programme (and the development / production period runs from the date of authorisation grant).
  3. Alternatively, as per the Indian PSC or the Madagascar PSC, Contractor could amend so that the Development and Production Period only runs from the time of grant of the corresponding development / production lease / mining title.

*Production run-off following expiry of Development and Production Period*

* 1. Contractor may wish to add a provision regarding expiry of the Development and Production Period so that if commercial production from a particular production area is still possible, the Contractor can request an extension of the applicable Development and Production Period, for example, by five years (as is the case in the Kurdistan PSC), or possibly longer in the event of a commercial production of non-associated natural gas (see, for example, the India PSC, 11.5(b)).

1. **Relinquishments (section 4)**
   1. Section 4.1 provides for automatic relinquishment of areas within the Contract Area on expiry of the Exploration Period. Section 4.2 allows for voluntary relinquishment by the Contractor.

*Phased relinquishment*

* 1. Contractor should note that there is no phased relinquishment under the PSC, so that the entire Contract area other than all Discovery Areas and Development and Production Areas are automatically relinquished at the end of the Exploration Period. Under other PSC regimes, certain percentages of the contract area are relinquished on fixed dates during or at the end of the exploration period (see for example the Madagascar, Kurdistan and Bangladesh PSCs)

1. **Minimum expenditure commitment (section 5)**
   1. Section 5 (which provides the framework for minimum expenditure during the Exploration Period) is broadly acceptable, although the minimum amounts are not yet specified. Please refer to the PSC Comparison Table for some examples of minimum expenditures in third country PSCs.

*Form of guarantee*

* 1. Under section 5, the Contractor is required to provide a “Bank Guarantee or a Parent Company Guarantee” in the form set out in Annexure D in respect of the minimum expenditure commitment. This provision seems to give the Contractor the option of providing either a bank or a parent guarantee, which compares favourably to several other PSCs where a bank guarantee is required.
  2. In any event, the form of guarantee in Annexure D is really only suitable as a parent guarantee, as a bank is unlikely to agree, for example to confirm that the Contractor is “financially sound and technically competent” and shall perform all of its obligations under the Myanmar PSC.
  3. To the extent that a bank guarantee is required under the Myanmar PSC, there are certain safeguards that could be included in section 5, as detailed below.

*Work units / reduction of guaranteed amounts*

* 1. The work programme for the Exploration Period (and any extensions thereof) could be broken down into a number of “work units” (for example, 3D seismic, other geophysical, geological studies, drilling). When particular work units are completed, the bank guarantee(s) can be reduced by the value of such work units (please refer to the Trinidad & Tobago PSC for an example of such an approach)

*Release of bank guarantees*

* 1. We could also stipulate in the Myanmar PSC that the amount of the bank guarantee shall be released at the end of each exploration phase (provided the minimum exploration work obligation stipulated in the Myanmar PSC for the relevant phase has been completed), regardless of the cost incurred by the Contractor to complete the obligatory work commitment (see the Madagascar PSC for an example of such an approach).

*Cost recovery*

* 1. We should clarify whether the costs of any bank guarantee required under the PSC is recoverable (it is not specifically listed in Annexure C, although it could be covered by “Charges and Fees” in paragraph 2.9 of Annexure C).

*EIA, SIA and EMP expenditure*

* 1. Finally, Contractor may want to clarify whether the costs of preparing the Environmental Impact Assessment (“**EIA**”), Social Impact Assessment (“**SIA**”) and Environmental Management Plan (“**EMP**”) – all of which are prepared during the “Preparation Period” – will count towards the exploration minimum expenditure requirement.

1. **Work programmes and expenditures (section 6)**

*Carrying forward of work programmes/expenditure*

* 1. The Myanmar PSC is silent as to whether expenditure or other works performed in excess of that proposed for any particular Contract Year can be carried forward or credited to the next Contract Year. Under the Tanzania PSC, for example, if in any exploration period the contractor has carried out more than the minimum technical work obligations specified under the PSC for that period, it is permitted to credit such excess work obligation as satisfying work obligations for the next exploration period. A similar provision relating to minimum expenditure only exists in the Myanmar PSC (section 5.9). Contractor may therefore wish to amend the Myanmar PSC to expressly provide that excess works can be carried forward

*Mandatory expenditure / expenditure estimates*

* 1. Tentative work programmes and / budgets required to be submitted under section 6.7 of the Myanmar PSC must include expenditure estimates for the “First Extension Period” and “Second Extension Period”. For the avoidance of doubt, wording could be added to clarify that the work programme and expenditure estimates in respect of any extension periods will only apply if the Contractor elects to extend the Exploration Period.

1. **Discovery and appraisal (section 7)**
   1. Section 7 deals with the procedure for the appraisal of a discovery by the Contractor (including submission of Appraisal Work Programme and Budget to MOGE), and is broadly acceptable. However Contractor may certain amendments as set out below:

*Submission of Appraisal Work Programme and Budget to Management Committee*

* 1. The proposed Appraisal Work Programme and Budget could be submitted for review / approval to the Management Committee established under section 18 (and to which MOGE appoints the majority of members[[1]](#footnote-1)) rather than MOGE, as this may result in a more expedited approval process.

*Permission to drill additional exploration wells / appraisal wells*

* 1. Contractor may wish to add an express permission for the Contractor following a Discovery to drill any additional exploration well or appraisal well deemed necessary by the Contractor, both before or during MOGE’s (or the Management Committee’s) review of the Appraisal Work Programme. A similar right is contained in the Kurdistan PSC.

1. **Development and production (section 8)**
   1. Section 8 – which deals with the preparation and review of the Development Plan following Commercial Discovery – is broadly acceptable and not overly onerous for the Contractor. However, some points for consideration are raised below.

*Development plan deemed to be accepted after 90 days*

* 1. Under section 8.5, if MOGE does not request in writing that changes be made to the Development Plan with 90 days of submission, the Development Plan shall be deemed approved and adopted. The 90-day period is lengthy in comparison to certain other PSCs. For example, the equivalent period under the Trinidad & Tobago and Kurdistan PSCs is 60 days. On the other hand, the Madagascar PSC also provides for a 90-day approval period.

*Delivery facilities to include cable and pipelines*

* 1. For the avoidance of doubt Contractor might want to consider the addition of the wording “cable and pipelines” in relation to “delivery facilities” in section 8.3(b).

1. **Cost recovery (section 9)**
   1. Cost recovery under section 9 of the Myanmar PSC is limited to “Cost Petroleum”, which is a maximum of 50% of “Available Petroleum” (i.e. petroleum produced and saved and not used in Petroleum Operations) (section 9.4). Costs are generally recoverable when incurred or in the financial year in which commercial production occurs, whichever is later. Costs are ring-fenced (section 9.4). If costs exceed the value of Cost Petroleum they can be carried forward to the next accounting period, as so on (section 9.5). Signature and Production Bonuses are not cost recoverable (sections 2.7 and 11.3)[[2]](#footnote-2).
   2. Recoverable costs include:

* exploration and appraisal costs
* intangible drilling costs
* capital expenditures (recoverable at a rate of 25% per year based on amortization)
* labour and related costs (in respect of local employees and assigned personnel resident in Myanmar, and overseas personnel working on time sheet basis)
* employee training expenses (and training spend under section 15 of the PSC)
* costs of materials (which sliding scale discounts to market price for new materials in the case of used materials)
* material transportation costs
* employee transportation and relocation costs
* costs of contract services, professional consultants
* costs of use of facilities and equipment for direct benefit of the Petroleum Operations
* repair and replacement costs
* insurance premiums
* expenditure incurred in settlement of claims etc. for the benefit of the Petroleum Operations
* all “charges and fees” paid by the Contractor “with respect to the [PSC]”
* costs of offices, camps, warehouses and other employee facilities (allocated on an equitable basis if such facilities serve more than one Contract Area)
* general and administrative expenses
* other reasonable expenditure pre-approved by MOGE

*Decommissioning costs*

* 1. Decommissioning / site rehabilitation costs are not expressly stated to be recoverable costs under the Myanmar PSC. Arguably, such costs are covered by the definition of “Petroleum Costs”, which means “all of the costs and expenditure borne and incurred by Contractor in or in connection with Petroleum Operations”[[3]](#footnote-3). However, it is advisable to clarify that decommissioning costs are covered and are recoverable.
  2. In addition, Contractor may consider providing for a right to establish a reserve fund for future decommissioning and site restoration towards the end of the term of production operations. Any contributions to the Decommissioning Reserve Fund would be deemed recoverable petroleum costs.

*Expenditure on EIA, SIA and EMP*

* 1. It is not clear whether expenditure on preparation of the EIA, SIA and EMP during the “Preparation Period” (before the Exploration Period) is recoverable as “Petroleum Costs”. For the avoidance of doubt, Contractor may consider to include such expenditure expressly as recoverable. For example, in the Kurdistan PSC, costs incurred in environmental or ecological surveys required by regulatory authorities, including an environmental impact assessment commissioned under the Kurdistan PSC are expressly recoverable.

*Pollution, clean up costs*

* 1. Contractor may consider to expressly include as recoverable costs, costs to provide or have available pollution containment and removal equipment, as well as the costs of actual control and cleanup of oil spills, and of such further responsibilities resulting therefrom as may be required by applicable laws and regulations.

*Financing costs, bank guarantees*

* 1. Generally, very few PSCs will allow for the recovery of financing costs or interest expense. However, financing costs are not expressly excluded from the list of recoverable costs under the Myanmar PSC and Contractor may wish to go further to clarify that such costs are recoverable. As an example, under the Bangladesh PSC, interest payable for any loan taken out by Contractor to finance any development is recoverable, subject to such development loan being approved by the national company (Petrobangla), and provided the interest rate is competitive with rates for loans for comparable projects.
  2. Under the Bangladesh PSC, interest is not recoverable to the extent that it is payable on any loan, or part thereof, which relates to exploration or appraisal operations. In addition, where a development loan exceeds 50% of the overall costs of the development, interest thereon is only recoverable only insofar as it relates to 50% of the costs.
  3. In addition, as mentioned above in relation to the minimum expenditure commitment under section 5 of the Myanmar PSC, Contractor may wish to clarify whether the costs of any bank guarantee required under the Myanmar PSC is recoverable (it is not specifically listed in Annex C, although it could be covered by “Charges and Fees” in paragraph 2.9 of Annex C).

1. **Profit allocation (section 9)**
   1. Contractor will note that the split of “Profit Petroleum” (i.e. after deduction of royalty and costs) is done using a sliding scale to increase the Government’s share of profit oil as the project attains different production criteria, as follows:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Crude Oil   |  |  |  |  |  | | --- | --- | --- | --- | --- | | BOPD |  | MOGE (%) | Contractor (%) |  | |  |  |  |  |  | | 0 – 10,000 |  | 60 | 40 |  | | 10,001 – 20,000 |  | 65 | 35 |  | | 20,001 – 50,000 |  | 70 | 30 |  | | 50,001 – 100,000 |  | 80 | 20 |  | | 100,001 – 150,000 |  | 85 | 15 |  | | >150,000 |  | 90 | 10 |  | | Natural Gas   |  |  |  | | --- | --- | --- | | MMCFD | MOGE  (%) | Contractor (%) | |  |  |  | | Up to 60 | 60 | 40 | | 61 – 120 | 65 | 35 | | 121 – 300 | 70 | 30 | | 301 – 600 | 80 | 20 | | 601 – 900 | 85 | 15 | | >900 | 90 | 10 | |  |  |  | |

*Entitlement in cash or kind*

* 1. There is no provision giving the Government the option to take its entitlement to Profit Petroleum in cash or in kind (in contrast to royalty payments under section 10 of the Myanmar PSC).

*Accounting period*

* 1. Note that the “accounting period” for profit allocation under section 9, both for measuring and splitting Profit Petroleum and for calculating average daily is quarterly (see section 2.3 of the Myanmar PSC).

*Export and sale of petroleum*

* 1. Although section 9.8(a) of the Myanmar PSC provides that Contractor can “separately dispose” of its Cost Petroleum and its share of Profit Petroleum, Contractor may wish to clarify here that Contractor may freely export its petroleum and retain abroad any proceeds from sale of all such petroleum (similar express rights are contained in the Kurdistan and Tanzania PSCs).

*Lifting costs*

* 1. Contractor may wish to clarify whether the costs or expenditure incurred relating to the lifting of the Government’s share of petroleum by the Contractor are recoverable by the Contractor under the PSC cost recovery mechanism, or whether such costs and expenses will be charged to the Government on agreed terms (see the Kurdistan PSC for an example of the latter approach).

1. **Royalty (section 10)**
   1. Royalty is payable at the rate of 12.5% of “Available Petroleum” (i.e. petroleum produced and saved and not used in Petroleum Operations). Please refer to the PSC Comparison Table for some examples of royalty payments in third country PSCs. Although the royalty provision is broadly acceptable, we suggest below certain amendments and improvements to the royalty provision that Contractor may wish to consider.

*Royalty not recoverable*

* 1. The Myanmar PSC states that the royalty is not recoverable from Cost Petroleum. The India PSC provides an example of the alternative approach, stating that the contractor is entitled to recover in full any royalty payments out of cost petroleum.

*Accounting period*

* 1. Contractor may wish to clarify the meaning of “accounting period” as used in section 10.2 (which provides that the royalty accruing during an accounting period must be paid within 30 days after the end of that accounting period). We assume such period is also each quarter (as is the case for profit allocation under sections 2.3 and 9 of the Myanmar PSC).

1. **Bonuses (section 11)**

*Signature bonus*

* 1. Section 11.1 provides for a signature bonus, which is not credited to minimum expenditure (under section 5) and not recoverable from Cost Petroleum. The amount of the signature bonus is not specified. Section 11.1 appears to be fairly standard compared to other PSCs where a signature bonus is also applied (please refer to the PSC Comparison Table for further details).

*Whether signature bonus is tax deductible*

* 1. Unlike the production bonus, the signature bonus is not expressly allowed as a tax deductible expenses. Contractor may wish to clarify this point.

*Production bonuses*

* 1. Section 11.2 provides for production bonuses payable following Commercial Discovery (once the development plan is approved) and thereafter at defined production rates (total average production over consecutive 90-day periods), as follows:

|  |  |
| --- | --- |
| Crude Oil  Upon approval of Development Plan = US$500,000  10,000 BOPD = US$1,500,000  20,000 BOPD = US$2,000,000  50,000 BOPD = US$3,000,000  100,000 BOPD = US$4,000,000  150,000 BOPD = US$6,000,000 | Natural Gas  Upon approval of Development Plan = US$500,000  60 MMCFD = US$1,500,000  120 MMCFD = US$2,000,000  300 MMCFD = US$3,000,000  600 MMCFD = US$4,000,000  900 MMCFD = US$6,000,000 |

* 1. As mentioned above, production bonuses are not recoverable from Cost Petroleum, but are tax deductible.

1. **Valuation of petroleum (section 12)**
   1. Section 12 of the Myanmar PSC sets out the procedure for valuing Crude Oil and Natural Gas, with different mechanisms depending on whether a certain percentage of sales are Arms Length Sales. The provisions are broadly acceptable, but we set out below some possible amendments and improvements that Contractor may want to consider.

*Accounting period*

* 1. As mentioned above in relation to royalty payments, Contractor may wish to clarify the meaning of “accounting period” as used in section 12 of the Myanmar PSC, and whether this is also each quarter as per the provisions on profit allocation.

*Disagreement in relation to determination of Crude Oil value*

* 1. Under section 12.6 of the Myanmar PSC, disagreements in relation to the determination of Crude Oil value (including the selection of the Crude Oil to comprise Reference Crude if not previously agreed) may be submitted by either party to an expert in accordance with the provisions of section 22 of the Myanmar PSC (Consultation and Arbitration).
  2. Contractor might consider whether technical disputes as to Crude Oil valuation could be resolved without recourse to formal arbitration, for example by requiring for such disputes to be resolved by a pre-appointed expert (or alternatively by an expert to be selected by an independent third party such as an internationally recognised petroleum valuation). For example, in the Tanzania PSC, the parties can apply to The British Energy Institute (formerly British Institute of Petroleum) to have an expert appointed in relation to disputes in relation to commerciality of discoveries.

*Metering clauses*

* 1. Under section 9.2 of the Myanmar PSC, Available Petroleum, Available Crude Oil and Available Natural Gas is to be measured at the Delivery Point. Contractor might consider whether metering clauses (or other provisions relating to the measuring and or recording of measurements) are appropriate.

1. **Natural gas (section 13)**
   1. Section 13 contains provisions allowing for flaring of natural gas (with less restrictions than contained in other PSCs reviewed by us) and briefly dealing with assessment of Natural Gas discoveries. Unlike other PSCs reviewed by us, there are no provisions specifically dealing with appraisal and commercialisation of natural gas discoveries (both associated and non-associated). Contractor may consider detailing the procedure for appraisal, particularly where the general provisions relating to discovery and appraisal under section 7 are not appropriate.

*Pre-emption rights*

* 1. Going one step further, Contractor may consider adopting the approach taken in the Kurdistan PSC, whereby the contractor can request amendments to the PSC if considered necessary to commercialise a discovery of non-associated natural gas. If the Government rejects the request, and subsequently agrees to develop such discovery with a third party within eight years, the original contractor will have certain pre-emption rights to develop the relevant discovery.

*Rights with respect to natural gas*

* 1. Contractor may wish to expressly provide for the Contractor’s rights to dispose of its share of natural gas production (subject to any domestic market obligations), including to sell for export. A similar provision is already included in respect of Crude Oil under section 9.8(a) of the Myanmar PSC[[4]](#footnote-4).

1. **Domestic crude oil and natural gas requirement (section 14)**
   1. Under section 14 of the Myanmar PSC, 20% of the Crude Oil and 25% of the Natural Gas allocated to the Contractor is to be used to supply the domestic market, at 90% of the value of such Petroleum. Please refer to the PSC Comparison Table for examples of domestic supply obligations in third country PSCs.

*Title in production*

* 1. It is not stated in section 14 of the Myanmar PSC when title in production will pass to MOGE or its nominee. Under section 9.8(a), title and risk of loss pass to the buyer / receiver of Crude Oil at the Delivery Point. For the avoidance of doubt, this wording can be restated in section 14 in relation to the supply of Domestic Crude Oil.

*Suspension of domestic supply obligation*

* 1. Contractor may consider to include a provision that any domestic supply obligations can be suspended when Myanmar attains self-sufficiency (or pre-determined levels of self-sufficiency) and / or creates a domestic reserve of crude oil. Please see the India PSC for an example of this approach.

*Priority to supply domestic downstream industries established in Myanmar*

* 1. Section 14 sets out a general obligation on the Contractor to prioritize the supply of oil / gas to domestic downstream industries established in Myanmar. This is in addition to the domestic supply obligations discussed above. Contractor may consider whether such obligation to prioritize will restrict Contractor’s ability to enter into off-take / purchase agreements with third parties. If this is the case, Contractor may wish to amend this section so that it applies only to the Contractor’s share of Petroleum as remains after supplying third parties pursuant to ongoing off-take / purchase agreements.

1. **Employment and training (section 15)**
   1. Section 15 of the Myanmar PSC contains provisions similar to other PSCs regarding the employment of local personnel. There is also a requirement to spend at least US$25,000 per year during the Exploration Period and US$50,000 during the Development and Production Period on training funds. All such funds are recoverable from Cost Petroleum. In addition, the Contractor must spend 0.5% of its share of Profit Petroleum on an R&D fund. However, these R&D expense is not recoverable from Cost Petroleum. Please refer to the PSC Comparison Table for some examples of employment training and R&D funding requirements in third country PSCs.
2. **Title of assets (section 16)**
   1. Section 16 of the Myanmar PSC provides that the Contractor’s physical assets will become the property of MOGE upon importation into Myanmar and shall be cost recoverable. This transfer of title provision does not apply to assets that are leased or rented by the Contractor or its Affiliates. Therefore, it may be possible to circumvent this clause by registering title in the relevant assets in the name of a special purpose vehicle, which would then lease such assets to the Contractor.

*Option to acquire physical assets*

* 1. An alternative approach would be for MOGE to be given the option to require vesting of title to physical assets, exercisable on expiry or termination of the PSC or at the time the portion of the full costs of the acquisition of the asset in question have been recovered by the contractor out of cost petroleum, rather than automatic vesting on importation. This approach to physical assets is used in the India and Tanzania PSCs.

1. **Rights and obligations of MOGE and Contractor (section 17)**

*Environment-related obligations and site restoration of brownfield sites*

* 1. Section 17 of the Myanmar PSC contains a number of references to environmental protection and clean up and the end of operations. If parts of the Contract Area are brownfield sites, Contractor may wish to clarify that the Contractor is only responsible for site restoration or environmental damage to the extent the same pertains solely and directly to petroleum operations under the PSC. For examples of this approach, please refer to the Kurdistan and India PSCs.

*Reporting obligations*

* 1. Under the Myanmar PSC, the Contractor must submit weekly staff returns and progress reports. To ease the administrative burden on the Contractor, Contractor may consider amending to require monthly reporting on these issues only (see for example the Bangladesh PSC).

*Locally sourced goods and services*

* 1. Section 17.2(p) of the Myanmar PSC requires the Contractor to utilise 25% of the annual budget on local goods and services. This is an absolute requirement and not subject to such goods and services being comparable in terms of price, quality and time of delivery to internationally sourced goods and services.

*Additional / ancillary rights for Contractor*

* 1. Contractor may consider expressly providing for certain ancillary rights for Contractor, such as the following:

(from the Bangladesh PSC)

* to right to use Petroleum from the producing field within the Contract Area in Petroleum Operations for the particular producing field free of charge (s
* to right to free access to all geological and geophysical information and data available to the Government pertaining to the Contract Area
* to right to use entitlement to Contractor's share of production as security for loans or other financing arranged for development

(from the India PSC)

* the right to lay pipelines, build roads, construct bridges, ferries, aerodromes, landing fields, radio telephones and related communication and infrastructure facilities necessary for the conduct of Petroleum Operations

(from the Mauritania PSC)

* the exclusive right to perform the Petroleum Operations inside the Contract Area

(from the Trinidad & Tobago PSC)

* to right to use in Petroleum Operations sand, gravel and water belonging to the public domain in accordance with the relevant laws (and on payment of the generally prevailing charge for such resources in the locality of use)

1. **Management Committee (section 18 and Annexure E)**

*Number of members*

* 1. Under paragraph 1 of Annexure E of the Myanmar PSC, the majority of the members of the Management Committee (four out of seven) are to nominated by MOGE. Typically under PSCs, management committees are constituted with an equal number of members appointed by the government partner (or its nominee) and the contractor, with the Chairman being a government nominee (see, for example, the PSCs for Trinidad & Tobago, Kurdistan, Timor-Leste and Tanzania). Under the Indian PSC, each company constituting the Contractor has one nomination each whereas the Government has two.

*Quorum*

* 1. The number of members necessary to establish a quorum is not stated. However, decisions taken by the Management Committee shall not be valid unless at least one representative of MOGE and one representative of the Contractor are present at the meeting. For the avoidance of doubt, the quorum provision could be amended to require attendance by at least one representative of MOGE and one representative of the Contractor (although, the practical effect of requiring the consent of representatives of both parties for any decision will be that the Management Committee cannot operate without the cooperation of both parties).

*Place and procedure for meetings of the Management Committee*

* 1. The location at which Management Committee meetings are to take place is not specified. Nor is it specified whether or not members can attend by video or telephone or by any other means of online communication.

1. **State participation (section 19)**
   1. Section 19 of the Myanmar PSC provides that MOGE will have the option to take between 15 to 25% interest, exercisable within three months after Contractor’s notification of its first Discovery within the Contract Area. Some potential amendments and points to clarify in relation to the state participation provisions are discussed below.

*Assignment*

* 1. To the extent that, following exercise of the participation option, MOGE’s participating interest is assignable, Contractor may consider to stipulate in the Myanmar PSC that the Contractor will be entitled to require any proposed third party assignee to demonstrate that it has the financial capability to perform its payment obligations under the PSC (and any joint operating agreement) (an example of a similar requirement is contained in the Kurdistan PSC).
  2. Contractor may also want to clarify that MOGE’s option to participate is not itself assignable (see, for example, the Kurdistan PSC).

*Reimbursement of expenses*

* 1. Under section 19.6 of the Myanmar PSC, if MOGE elects to exercise its participation option, it must reimburse the Contractor for its portion of previously incurred and ongoing Petroleum Costs and the Signature Bonus. However, there is no specific time limit on reimbursement of Petroleum Costs and Signature Bonus under section 19.6. Contractor may wish to stipulate the time limit for such reimbursements.
  2. For example, the Mauritania PSC requires such reimbursements to be made by the Government within 18 months from the effective date of the corresponding option (without bearing interest), stipulates the currency for such reimbursements (US Dollars), and allows the Government to reimburse in cash or in kind. The Mauritania PSC also clarifies that the contractor will not be subject to any tax in respect of such reimbursements.
  3. The Tanzania PSC provides that if the national company defaults of payment of contract expenses, the contractor must loan the unpaid amount, which shall bear interest at LIBOR plus 2%, to be recovered on a preferential basis from the national company’s share of profit oil / gas.

*Default by national company*

* 1. Certain PSCs clarify that any default of the national company will not be considered as a default by the contractor that would allow the Government to terminate the PSC (see, for example, the Mauritania and Kurdistan PSCs).

*Relationship with arbitration provisions*

* 1. It is also typical in PSCs to include an express provision to the effect that the capacity of the national company as a contractor entity does not affect the rights of other contractor entities to refer any dispute to arbitration in accordance with the applicable arbitration clause (see, for example, the Mauritania and Kurdistan PSCs).

1. ***Force majeure* (section 20)**
   1. Although the *force majeure* provisions as set out in section 20 of the Myanmar PSC are broadly acceptable, some possible amendments and improvements Contractor may consider are discussed below.

*Extension of time*

* 1. Contractor may consider an “extension of time” provision to the effect that the Myanmar PSC (and any applicable exploration or development and production period) shall be extended by a period corresponding to the duration of the *force majeure* event (see, for example, the Kurdistan PSC).

*Expanding the list of force majeure events*

* 1. The list of *force majeure* events in section 20.1 could be extended to include “civil unrest” and “re-imposition of economic sanctions” (although the latter is arguably already caught by the “restraint of a government” *force majeure*). In addition, the list set out in section 20.1 could be stated to be non exhaustive so that any disruptive event outside the control of the parties and which prevents a party from performing its obligations under the Myanmar PSC could potentially be a *force majeure* event. Finally, the definition of a *force majeure* event could be expanded to include a “combination of events” (to provide protection where a combination of events triggers a breach of duties or obligations).

*Force majeure event affecting Affiliate*

* 1. A provision could be added to section 20 so that a *force majeure* event that affects an Affiliate of party could be deemed to affect the relevant party (to the extent it indirectly prevented the party from performing its obligations under the contract) (see, for example, the Kurdistan PSC).

1. **Governing law, jurisdiction and inalienable rights (section 21)**
   1. Section 21 provides that the governing law of the Myanmar PSC shall be the laws of Myanmar, with the parties agreeing to submit to the jurisdiction of the courts in Myanmar.

*Waiver of sovereign immunity*

* 1. We would recommend to include an express waiver of sovereign immunity by MOGE in the Myanmar PSC (see, for example, the Kurdistan PSC).

*Deletion of courts submission clause*

* 1. As section 22 of the PSC provides for dispute resolution through arbitration, it may not be appropriate to include a contradictory provision for submission to the courts of Myanmar (to the extent this may cast doubt on the agreement to arbitrate)[[5]](#footnote-5). Instead, we can include a provision allowing for enforcement of any arbitration award in any court having competent jurisdiction.

1. **Consultation and arbitration (section 22)**
   1. Section 21 provides for resolution of disputes through arbitration conducted under the Myanmar Arbitration Act, 1944 (Myanmar Act IV, 1944), which is generally considered to be a very outdated piece of legislation.

*Alternative mechanisms for disputes of a technical nature*

* 1. As discussed in paragraph 11 above in relation to disagreements on valuation of Crude Oil, Contractor might establishing an alternative mechanism to address certain specified disputes of a technical nature which could be referred to a pre-appointed expert (or to an expert appointed through a pre-agreed process). As a dispute resolution method, expert determination can be less formal than arbitration, and it allows for the appointment of an expert who is familiar with the relevant technical issues.

*International arbitration procedures / forum*

* 1. We understand that in contracts for its state entities, the Government of Myanmar typically insists on Myanmar substantive law and arbitration. However, certain investors in a strong bargaining position have been able to insist on foreign governing law and international arbitration outside Myanmar (under, for example, International Chamber of Commerce (“**ICC**”) or the Arbitration Rules of the United Nations Commission on International Trade Law (“**UNCITRAL**”)). Contractor may consider whether to pursue such an option. Please note that that although Myanmar has acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the “**New York Convention**”), it is still necessary to amend Myanmar’s domestic arbitration laws and regulations to ensure the judicial enforcement of foreign arbitral awards issued in New York Convention states.

*Appointment and independence of third arbitrator*

* 1. Section 22.2 of the Myanmar PSC provides for the appointment of two arbitrators, one by each party. If the arbitrators cannot reach agreement, the matter is referred to an “umpire” nominated by those arbitrators. A more efficient mechanism would be simply to provide for appointment of three arbitrators at the outset (so that there is no risk of deadlock). The third arbitrator could be appointed through a pre-agreed procedure to ensure its independence from the parties.

*Arbitration costs*

* 1. Contractor may consider to push for the costs and expenses of arbitration and any expert determination be recoverable (currently they are not recoverable).

1. **Insurance (section 24)**
   1. While the core insurance provisions in section 24 of the Myanmar PSC are generally acceptable, some provisions are unique to the Myanmar PSC, as discussed below.

*Insurance in accordance with Foreign Investment Law*

* 1. Section 24.1 of the Myanmar PSC requires that the Contractor shall secure and maintain insurance in accordance with Foreign Investment Law of Myanmar (“**FIL**”). Under the FIL, registered companies must procure fire, marine, injury, natural disaster and life insurance from locally-registered companies (Rule 77 of the FIL). Therefore, Contractor may not be able to utilize its normal worldwide insurance programmes and coverage to satisfy the Myanmar PSC’s insurance requirements.

*Waiver of recovery*

* 1. Section 24.3 of the Myanmar requires both parties to procure that insurance policies are endorsed so that insurers etc. will “not have any right of recovery against either of the parties … in any form whatsoever; and the rights of recovery with respect to this operation are mutually waived”. It is not entirely clear what the “right of recovery” means in this context. Assuming that it refers to an insurer’s general subrogation rights, then the provision is not unusual. For example, requirements for subrogation rights to be waived are also included in the Madagascar and Timor-Leste PSCs. However, this point should be clarified.

1. **Termination (section 25)**

*Termination for detrimental “political activities”*

* 1. Section 25.2 of the Myanmar PSC allows MOGE to terminate the PSC if Contractor is involved in political activities detrimental to the Government of Myanmar. Clearly there is a risk that this clause could be used arbitrarily to terminate the PSC. This is not a typical termination provision in PSCs.

*Title to physical assets on termination*

* 1. Section 25.2 and 25.3 provides that any unexpended minimum expenditures and any imported equipment. The costs of physical assets are recoverable under the Myanmar PSC (see section 16 of the Myanmar PSC, as discussed in paragraph 15 above). Pursuant to paragraph 2.1 of Annexure C of the Myanmar PSC, capital expenditures incurred in respect of Petroleum Operations are recoverable at a rate of 25% per annum based on amortization at that rate. However, the situation regarding cost recovery of physical assets on termination is not clear.

1. **Secrecy (section 27.5)**
   1. Section 27.5 requires the Contractor to maintain in secrecy and confidence all data and information purchased or acquired from MOGE as well as during the course of operations in Myanmar. We would recommend to push for a carve out to allow for disclosure if and to the extent required by law, any securities exchange on which the Contractor’s (or its Affiliate’s) securities are listed, or any regulatory or governmental authority to which the Contractor submits.
   2. **Stabilization (section 27.7)**
   3. Section 27.7 of the Myanmar PSC contains a mutual “economic equilibrium” type stabilization clause providing for adjustments to the contract in order to maintain each party’s normal economic benefit thereunder. This is in contrast to the “freezing” type stabilization clause (used in, for example, the Kurdistan PSC) whereby the Government guarantees for the duration of the PSC that it will maintain the stability of the fiscal and economic conditions of the contract. We understand that investors’ preference has shifted from “freezing” type stabilization provisions towards “economic equilibrium” clauses, in particular as economic equilibrium clauses are considered to be more likely to be enforceable because they are less of a fetter on a state’s legislative power.
   4. Contractor may consider to include a clear mechanism to deal with situations where the Contractor believes that its economic position has been detrimentally affected, and in particular to provide for arbitration of the matter if the parties are unable to agree on amending the contract. Contractor may also wish to push for a provision to the effect that the Contractor shall be entitled to request the benefit of any future changes to the petroleum legislation or any other legislation complementing, amending or replacing it.

Please note that information regarding third country PSCs as referred to in this Memorandum is for illustrative purposes only and is compiled by reference to publically available model production sharing contracts / agreements and other third party sources. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this Memorandum relating to such third country PSCs or other third party sources. Charltons does not advise on the law of any of the jurisdictions referred to herein.

# CHARLTONS

3 June 2013

1. Although see our comments on composition of the Management Committee in paragraph 17 below. [↑](#footnote-ref-1)
2. For further details on bonuses payable under the Myanmar PSC, please see paragraph 10 below. [↑](#footnote-ref-2)
3. “Petroleum Operations” means “all operations under [the PSC], including without limitation, Exploration Operations, Development Operations, all associated planning, design, administrative, engineering, construction and maintenance operations, and any other operations and activities, otherwise contemplated under the provisions of [the PSC]”. [↑](#footnote-ref-3)
4. We also suggest including an express right to export and sell Crude Oil (and retain the proceeds abroad) in section 9.8(a) of the Myanmar PSC (see our comments in paragraph 8.4 above). [↑](#footnote-ref-4)
5. However, we understand that under Myanmar law, it is not possible for parties to oust the jurisdiction of the Myanmar courts entirely and agree to arbitration as an exclusive remedy. The Myanmar courts have the discretionary power to stay legal proceedings where the dispute is covered by an arbitration agreement, but they retain a supervisory role over the conduct of the arbitration and enforcement of the award. [↑](#footnote-ref-5)