Gross Split Production Sharing Contracts

On January 16, 2017, the Minister of Energy and Mineral Resources issued Regulation No. 8 of 2017 dated regarding Gross Split Production Sharing Contracts ("MEMR Reg. 8"). MEMR Reg. 8 partially revokes MEMR Regulation No. 38 of 2015 regarding Acceleration of Non-Conventional Oil & Gas Business, which remains in force, except for provisions related to Production Sharing Contracts ("PSCs") using a Gross Split sliding scale.

As opposed to the long-existing cost-recovery model for PSCs, under which oil and gas contractors are entitled to recover certain production expenses before sharing the revenues with the Government, the Gross Split approach determines the allocation of production sharing between the Government and a contractor from the beginning (base split).

Minimum Requirements and Provisions for Gross Split PSCs

Gross Split PSCs must adhere to the following principles:

- Ownership of oil and gas resources must be retained by the Indonesian Government up to the delivery point;
- Operational management shall be controlled by the Special Task Force for Upstream Oil and Gas Business Activities ("SKK Migas"); and
- The contractor must bear the entire capital investment and risk of the project.

There are 17 basic provisions that must be stipulated in a Gross Split PSC, including the following:

- Government’s take;
- Work Area and relinquishment;
- Expenditure obligations;
- Transfer of ownership of produced oil and gas;
- Environmental protection;
- Workplace health and safety;
- Prioritization of Indonesian manpower and domestic goods and services;
- Community development; and
- Domestic market obligation.
Production Sharing Allocation

In an oil Gross Split PSC, the Government share is 57%, while 43% belongs to the contractor. In a gas Gross Split PSC, the Government share is 52%, while the contractor receives 48%.

The production sharing allocation may be adjusted depending on “variable” and “progressive” components that may impact business prospects. The variable components consist of, among others, the status of the Working Area, the site location, availability of supporting infrastructure, and the physical content/quality of the oil or gas reserves; while the progressive component consists of oil price and cumulative oil and gas production.

In order to incentivize production when investment returns might be low, the government can award the contractor an additional 5% allocation. On the other hand, if returns exceed certain economic criteria, the Government will be entitled to an additional 5%.

Revenue Calculation

The Government’s take under the contract shall be calculated with respect to the Government’s share of the oil and gas proceeds, bonuses, and direct and indirect taxes paid by the contractor.

The contractor’s take includes the contractor’s proportion based on the gross production percentage, after being deducted by income tax. Whereas operational costs are deducted off the top in a cost recovery method PSC, under the Gross Split system, operational costs may only be used to reduce the contractor’s taxable income.

Domestic Market Obligation

PSC contractors must hand over 25% of their oil/gas production to the Government for domestic use, which will be repaid by the Government based on the recent Indonesian crude oil price as the benchmark.

Transfer of Ownership

After a Gross Split PSC ends, all of the assets held by the contractor that had been used to carry out its activities under the contract must be transferred to, and will be managed by, SKK Migas. Those assets will then be state-owned assets. This includes all lands that had been acquired by the contractor, except for lands under a land lease arrangement.

Obligation to Use Gross Split Method

Using the Gross Split method in a PSC is not mandatory for existing PSCs; rather it becomes mandatory for new PSCs and expiring PSCs that are not being extended by the parties. The obligation to enter into a Gross Split PSC applies to future contractors that will operate the same Work Area. For expiring PSCs that want to be extended, the Government will determine whether to use cost-recovery or to convert to the Gross Split method.
Expired PSCs that were extended before the issuance of this regulation may continue using an existing cost recovery method. The decision to use the Gross Split method will be up to the contractor. The same applies to new PSCs that had been executed before the issuance of MEMR Reg. 8.

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