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Petroleum Act amendments: more choices for producers

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The petroleum industry has seen a lot of turbulence over the past two to three years, with the prices of Brent and West Texas Intermediate, the global oil benchmarks, falling from over $100 per barrel to less than $30, before recovering to around $45 in recent weeks. In Thailand, a new round of bidding for petroleum concessions was announced in 2014, only to be cancelled shortly afterward in anticipation of amendments to be made to the Petroleum Act and Petroleum Income Tax Act.

In June of this year, the cabinet and the National Legislative Assembly considered an amendment to the Petroleum Act which would introduce two new structures for oil and gas development in Thailand. The amendment has not yet been enacted.

Until now, the only way for international oil companies to engage in exploration and production (E&P) activities in Thailand has been by way of a concession. While the proposed amendment would retain the concession option, it would also allow for E&P activities to be carried out through a production sharing agreement (PSA), or through a services contract.

These types of agreements are commonly employed in resource development in the Middle East and other oil and gas producing regions. In Indonesia, one of the most oil-rich countries in the region, PSAs have been used in practice for several decades.

A concession to conduct E&P activities essentially operates as a licence for the international oil company. While the company is required to pay its taxes and comply with the concession agreement, as well as all relevant laws and rules that regulate its activities, the state takes a more "hands-off" approach to E&P activities under the concession regime.

Although petroleum is owned by the state when it is in the ground, under the concession regime, ownership transfers to the company at the wellhead. From the company's perspective, this generally increases the appeal of concessions greatly. Even though it will shoulder a large amount of risk, the upside is that it obtains ownership of the petroleum products it produces, although it generally is required to sell produced natural gas to PTT, the state majority-owned oil and gas company.

By contrast, a PSA allows the state to take a more active role in E&P activities. Under the PSA model, the company essentially acts as a contractor with the state, and is paid for its services by way of ownership interest in a percentage of the oil and gas produced. While the company continues to assume a large portion of the risks in carrying out E&P work, it usually is entitled to receive a percentage of the produced petroleum to compensate for the costs it has incurred.

In order for the company to claim all of its "cost oil" (the petroleum allocated to cover its costs under the PSA), it is required to comply with a work programme and other terms outlined under the agreement. In the end, the PSA model generally allows the state and the company to share the rewards from E&P activities, while also spreading the risk of undertaking such operations.

Under the proposed Thai model, the cap on cost oil would be the amount stipulated in the approved budget, which must not exceed 50% of total oil produced. If actual costs exceed this amount, then the rules would permit the company to carry some of these costs forward to subsequent years.

In addition to the PSA, the amended Petroleum Act would introduce a third structure, the services contract, which would permit oil companies to enter into agreements with the state to perform E&P services in exchange for monetary compensation. This type of arrangement is similar to a "hire of work" agreement, whereby the state acts as the employer or principal, while the company acts as the service provider.

Under this arrangement, the state would retain full ownership in the petroleum products and would pay the company fees based on the success of its E&P work. The proposed amendment would include a term limit of 30 years for any services agreement.

The potential introduction of two alternative structures to how international oil companies can operate in Thailand would provide the state with additional tools for promoting and expanding E&P operations. A number of existing concessions have already been extended and are scheduled to expire within the next decade. Moreover, given the prevailing market volatility in the global price of oil, many investors will be looking for lower-risk alternatives in order to diversify their asset portfolios.

Both the PSA and services contract models shift some of the risk of low oil prices to the state, since both contain mechanisms to recover investment costs. Creating more varied structures to promote investment in petroleum exploration and production may allow for greater flexibility in achieving public policy objectives during a period of market volatility.

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