A Practical and Innovative Application of OPEX Allocation Relating to Joint and Exclusive Operations in Indonesia Offshore PSC Block

Seungkyun Huh,1 Junghyun Yoo,2 Kwangseok Jeong,3 Mark Schneider4

1,2,3KODECO Energy Co., Ltd., 4rose & Associates
Jakarta, Indonesia

ABSTRACT

One section of the Model Joint Operating Agreement (JOA) endorsed by Association of International Petroleum Negotiators (AIPN) seriously deals with “Operations by Less Than All Parties”. Once a Party who elects not to participate in an operation (Non-consenting Party), Non-consenting Party shall focus to be indemnified from “any and all” costs and liabilities arising from such exclusive operation. This paper presents a practical mechanism and innovative application of operating expenses (OPEX) allocation for an Indonesian offshore Production Sharing Contact (PSC) block in the year of 2012, having Non-consenting Party, 20% Participating interest (PI) holder in this block save 29% of OPEX, amounting to several millions of US Dollars.

KEY WORDS: OPEX allocation; exclusive operation; sole risk; operating expenses; non-consenting Party; joint operating agreement.

INTRODUCTION

The Operator in a PSC block has an obligation to propose an annual work program and budget (WP&B) for approval by Non-operating Parties to make sure that all Parties reach mutual consent for proposed WP&B to be economically feasible. Should non-operating Parties just consent and follow to work programs proposed by the Operator? The answer is definitely “NO”, because each Party may have a quite different view on project economics for even same work programs due to different financial capabilities, different corporate strategy for risk management, or even different contract terms stated in PSC for each Party. That is why one section of the standard model of JOA endorsed by AIPN seriously deals with “Operations by Less Than All Parties (exclusive operation or sole risk operation)”. Exclusive operations may normally be proposed and conducted based on the level of well activities as followings.

(1) Drilling and/or test of exploration and appraisal wells;
(2) Completion of exploration and appraisal wells;
(3) Deepening, sidetracking, plugging back, reworking, and/or recompletion of exploration and appraisal wells;
(4) Declaration and/or development of a commercial discovery;
(5) Acquisition of geological and geophysical (G&G) data
(6) Well re-activation and remediation; enhanced oil recovery; major facility upgrade; and
(7) Abandonment and restoration of wells.

Once a well activity is elected as an exclusive operation through Operating Committee Meeting (OCM), only consenting Parties have the right for any entitlement of hydrocarbons from such exclusive operation. Therefore, it is not really a matter for Non-consenting Parties whether such exclusive operation is proven to be commercially success or not. Meanwhile, Non-consenting Parties shall focus on indemnification from “any and all” costs and liabilities arising from such exclusive operation. However, in most worldwide cases, Non-consenting Parties might be indemnified only from direct expenses of exclusive operations, such as drilling cost, and capital project cost for platform and pipeline installation for instance, which expenditures are easily monitored and included in an Authorization for Expenditure (AFE). It is worth noting that surface facilities, human manpower, and other sharable resources shall be utilized to operate such exclusive operations, which increase OPEX of the entire block. In a word, some portion of OPEX from the entire block shall also be indemnified to Non-consenting Parties by a reasonable OPEX allocation mechanism, even though it may not be covered by JOA. The most important thing is how to make the mechanism simple and practical but not conflicting with the terms of JOA, so as to be acceptable to all Parties. The following presentation provides the practical mechanism for addressing how to apply OPEX allocation. There are not any other example cases of OPEX allocation we have seen before.

OPEX CLASSIFICATION

OPEX can be classified into two major categories as followings;

(1) Special OPEX: operating expenses to be monitored and allocated through Special Cost Center by the Operator, which expenses can usually be captured in its individual AFE or can be clearly allocated to specific well level, such as work-overs, work services, and Abandonment and Site Restoration (ASR) fund.
(2) Other Direct and Indirect OPEX: other operating expenses which – because of their nature – cannot be allocated to a specific well.

For the purpose of OPEX classification, it basically refers to the Operator’s monthly Actual Expenditure (AE) report as shown in Table 1, so that all Parties can easily monitor the movement of operating expenses without prejudice.