

<b>CLIPPER BOOK MIRANDA</b>				 Miranda & Associados Sociedade de Advogados RL
<b>MEDIA</b>	<b>PETROLEUM AFRICA</b>			
<b>Nº PAG.</b>	14 - 16	<b>DATA</b>	março 2016	

## Local Impact

By Diogo Xavier da Cunha  
 Managing Partner  
 Miranda & Associados

# MOZAMBIQUE

## GETTING READY TO NEGOTIATE NEW UPSTREAM CONCESSIONS

The last couple of years brought significant changes to Mozambique's legislation governing petroleum upstream and midstream operations. These changes were principally prompted by the country's new industry reality following the large natural gas discoveries in the Rovuma Basin, Province of Cabo Delgado, in the Northeast of Mozambique. The general belief that Mozambique had become resource-rich and that the terms for future exploitation of resources should be more aligned with the national interests constituted a specific motivation for the changes that were introduced. The award of new upstream concessions was simultaneously seen as an opportunity for the country to attract more international oil companies, affirm its status of new industry player and obtain some immediate return, but at the same time there were calls for greater Mozambican participation and domestic use of the resources.

This article seeks to provide an overview of the recent legal and regulatory developments in Mozambique and to identify some of the issues which are perceived to be of greater concern in terms of future petroleum exploration and production concession contracts (EPCCs). This is particularly relevant following the award, in October 2015, of six new offshore and onshore concessions within the scope of the 5<sup>th</sup> Licensing Round for exploration and production acreage which had been launched a year earlier. It is therefore with great interest and expectation that one is waiting for the new model EPCC that will be used by the government as the basis for the negotiation of the terms of those concessions. It is known that the National Petroleum Institute (INP) has been working on the new model EPCC for quite a while, but a new model has not been disclosed yet. The expectation around

the new model EPCC is even greater with regard to certain matters that we discuss below, which arise both under the new petroleum legal and regulatory framework and other non-industry specific legislation.

### Legal Developments

#### *The 2014 Petroleum Law*

After a considerable long period of institutional and public debate, a new Petroleum Law was eventually enacted by the Parliament in August 2014 – Law No. 21/2014, of August 18, 2014. The new Petroleum Law replaced the one which had been in force since 2001<sup>1</sup> and which served as the legal basis for most of the existing petroleum contracts. It is fair to say that the new Petroleum Law did not substantiate a material reform of the legal framework applicable to petroleum exploration and production operations in that the direct concession system in place since 2001 remained unchanged and rights acquired under pre-existing contracts were safeguarded.

Notwithstanding, some of the new measures introduced have the potential of somewhat changing the industry landscape. This is mainly the case of the enhanced role entrusted to the national oil company *Empresa Nacional de Hidrocarbonetos, EP* (ENH), in particular in terms of marketing, the requirement for oil and gas companies to register with Mozambique's Stock Exchange, the requirement for the government to ensure that a quota of at least 25% of the oil and gas produced in the country be allocated to the domestic market, and, on the side of procurement of goods and services, the requirement for foreign oilfield service providers to associate with Mozambican companies or individuals. Natural gas liquefaction was also expressly included in the scope of application of the 2014 Petroleum Law

and a new type of concession contract was created for the construction and operation of facilities used for petroleum operations. Some of the foregoing key matters were however addressed in a high-level manner and it was expected that subsequent regulations would resolve some of the doubts that initially arose as to how the government would or should approach the new requirements.

#### *The Decree-Law for the Rovuma Basin Project*

Notwithstanding the enactment of a new Petroleum Law, the Mozambican authorities also recognized the need for certain specific legislative measures to support the natural gas liquefaction developments then being contemplated. Consequently, upon authorization from the Parliament<sup>2</sup> the government approved the special legal and contractual regime applicable to the liquefied natural gas project in Areas 1 and 4 of the Rovuma Basin by means of Decree-Law No. 2/2014, of December 2, 2014. To some extent, this statute seeks to resolve some of the issues which petroleum legislation and the relevant contracts did not address or did not address in a way that could satisfy the requirements of the LNG projects. Matters such as procurement of goods and services, land rights, specific port facilities, third party access to project facilities, foreign exchange, financing, labor rules and employment and training of Mozambicans and expatriates, insurance and reinsurance, anti-trust, dispute resolution and legal and fiscal stability were thus thoroughly and specifically addressed in respect of the LNG developments to be undertaken as part of the overall Rovuma Basin Project.

#### *The Petroleum Operations Tax Law*

The subject of taxation of petroleum operations was not dealt with in the 2014 Petroleum Law,

<sup>1</sup>Law No. 3/2001, of 21 February 2001.

<sup>2</sup>The legislative authorization was granted by way of Law No. 25/2014, of 23 September 2014.

<b>CLIPPER BOOK MIRANDA</b>				 Miranda & Associados Sociedade de Advogados RL
<b>MEDIA</b>	<b>PETROLEUM AFRICA</b>			
<b>Nº PAG.</b>	<b>14 - 16</b>	<b>DATA</b>	<b>março 2016</b>	

which merely contains the principle that the specific taxation regime for petroleum operations is set forth by law. Despite this, simultaneously with the debate on the new Petroleum Law, the government and the Parliament were also working on a separate tax law applicable to petroleum operations. A new Petroleum Operations Tax Law (POTL) was thus passed by the Assembly of the Republic as Law No. 27/2014, of September 23, 2014. This new statute replaced the previous relevant legislation which was in force since 2007<sup>3</sup>. However, it did go a lot beyond that. In fact, the 2007 statutes essentially provided for the Petroleum Production Tax / Royalty (PPT) payable by exploration and production concessionaires to the government and the fiscal benefits available to those concessionaires. The scope of application of the POTL comprises not only the PPT rules and the fiscal benefits – with no material differences from the 2007 legislation – but also specific rules on Corporate Income Tax (CIT) and, for the first time, the mechanism for production sharing between the government and the concessionaires and related cost recovery rules. Indeed, the POTL sets a 60% cap for cost petroleum and a mandatory formula – the R-factor – on the basis of which profit petroleum is to be split between the State and the concessionaire. The practical consequence of the inclusion of these cost recovery and production sharing elements in the POTL and of dealing with them on a strict basis is that these are no longer negotiable items when the government awards new concessions.

#### *The Recent Regulations*

Both the new Petroleum Law and the POTL were to be regulated by the government, respectively within 60 and 90 days of their date of publication. The government actually took longer to do so and only approved the new Petroleum Operations Regulations (POR) and the POTL Regulations by the end of December 2015. The new POR – which replaced those in force since 2004<sup>4</sup> – were approved by way of Decree No. 34/2015, of December 31, 2015, and the POTL Regulations were passed by means of Decree No. 32/2015, also of December 31, 2015.

Insofar as the POTL Regulations are concerned, the more salient aspects pertain to a stringent regime of joint and several liability for the concessionaires in the case of capital gains obtained by their non-resident shareholders or

parent companies in indirect transfers of participating interests and the clear set aside of any ring fencing among development and production areas within the same concession for purposes of calculation of the government and the concessionaires' production entitlements. But the more emblematic measure is no doubt a 50% reduction in the applicable PPT rate whenever the production is used for the development of local industry. In these cases, the PPT rate will thus be of 5% for crude oil and condensate and 3% for natural gas and LNG. The reduction will however only apply when the sale is made to ENH for ongoing supply to the relevant industrial project. This measure is in fact consistent with two of the goals laid down in the 2014 Petroleum Law: on the one hand, to stimulate the domestic use of petroleum produced in the country; and on the other, to have ENH effectively performing the role of manager of the petroleum production quota for use in the development of the domestic market and the country's industrialization efforts.

“ *But the more emblematic measure is no doubt a 50% reduction in the applicable PPT rate whenever the production is used for the development of local industry. In these cases, the PPT rate will thus be of 5% for crude oil and condensate and 3% for natural gas and LNG.* ”

On the side of the POR, to a considerable extent they do not materially deviate from the 2004 POR that have now been replaced. One aspect of particular interest is that some of the new provisions reflect clauses that hitherto were only included in EPCCs. This seems to indicate that a stronger regulatory approach has been taken by the government, in that it is expectable that matters that are now addressed in these statutes will not be included in the EPCCs.

It was hoped that the new POR would address in more detail certain matters introduced by the 2014 Petroleum Law on a high-level basis. While in some instances this was indeed the case, it is also a fair critique that in other cases nothing of relevance has been added. With regard to the Stock Exchange registration requirement, for example, the POR simply add that it shall only apply after the approval of a development plan. However, the doubts on

whether this entails mere registration or an actual listing and a public offering of petroleum concessionaires' stock to Mozambican nationals remains unanswered. And if the requirement is indeed for a listing and public offering there is no guidance on how this should be achieved in a way that does not unduly interfere with the proper conduct and management of petroleum operations. On the side of procurement, the association requirement for foreign oilfield service providers to be able to provide goods and services to the concessionaires has not been significantly expanded, notably as to the eligible forms of association and the level of participation of the foreign company and the local partner. Despite this, a general duty is placed on concessionaires to ensure that such an association results in a substantial contribution for the production or creation of value in terms of goods and services originating in Mozambique or generated by Mozambicans. The formula is clearly vague and will surely lead to interpretation problems. Another area where the POR failed to bring more clarity was the role of ENH as the entity that shall lead the marketing and commercialization of oil and gas, in particular in view of the ownership and disposal rights that the 2014 Petroleum Law and the POR also afford to the concessionaires. It seems critical to understand whether ENH's role is limited to the State's and/or its own entitlement under each EPCC and/or the domestic marketing and commercialization, or is intended to cover all oil and gas produced in Mozambique regardless of its owner or the market being supplied. Conversely, the POR have further elaborated on the domestic market supply obligations. On the one hand, all development plans to be approved by the government will have to provide for a domestic market delivery point, as well as the volumes of petroleum to be made available at such delivery point by the relevant concessionaire. In turn, the principles of efficient management of resources and open market prices as laid down in the Gas Master Plan and subsequent documents are to be adopted in the natural gas purchases, through ENH, by domestic off-takers. The regulatory language used in respect of the terms and conditions of natural gas to the domestic market, including on indicative volumes and pricing, is however erratic. On the one hand, it is said that such terms and conditions are set by the Ministry of Mineral Resources and Energy (MIREME). On the other hand, though,

<sup>3</sup>Specifically, Laws Nos. 12/2007 and 13/2007, both of June 27, 2007.

<sup>4</sup>The former Petroleum Operations Regulations were set forth in Decree No. 24/2004, of August 20, 2004.

<b>CLIPPER BOOK MIRANDA</b>				 Miranda & Associados Sociedade de Advogados RL
<b>MEDIA</b>	<b>PETROLEUM AFRICA</b>			
<b>Nº PAG.</b>	14 - 16	<b>DATA</b>	março 2016	

## Local Impact

reference is made to contracts between ENH and the concessionaires having regard to commercial market conditions. It will likely be necessary to wait for MIREME to use its regulatory powers in this regard so as to have a better view on the actual intention of the government on this commercially sensitive subject.

### *ENH's New By-Laws*

Another development of interest was the approval of the new By-Laws of ENH, on December 28, 2015 and by means of Decree No. 29/2015. The previous By-Laws of ENH – approved in 1997<sup>5</sup> – were somewhat outdated and had to be adapted to the Framework Law of state-owned companies enacted by the Parliament in 2012<sup>6</sup>. More significantly, though, the new ENH By-Laws seek to provide greater support to what ENH has been doing in recent years and the role it is expected to perform pursuant to the Petroleum Law. The incorporation of special purpose subsidiaries to carry on certain ancillary activities, such as those relating to logistics, and the participation in joint ventures with other foreign and national companies are expressly permitted. This indicates, for instance, that it is likely that ENH will carry on with its strategy of being an active player in the provision of goods and services to the petroleum industry. The new By-Laws of ENH also expressly provide for ENH's specific duties in terms of participation in upstream activities, in the development of facilities for production of LNG and synthetic fuels (Gas-to-Liquids or GTL projects), in the development of gas processing and transportation facilities, and in leading the marketing and commercialization of natural gas and crude oil.

### The Challenges Ahead for New Concessions

As initially noted, the new model EPCC to be used in the negotiations for the new concessions

awarded within the 5<sup>th</sup> Licensing Round is eagerly awaited. It is a given that certain matters previously subject to negotiation are now addressed in the law and therefore no longer open for negotiation. Notwithstanding, it remains important to inasmuch as possible use the EPCC to clarify certain of the issues in the industry new legislation that we have previously identified and that remain open-ended. Some other older industry specific statutes also require thought on how to address their requirements in the EPCC, most importantly in connection with the hiring of expatriates for petroleum operations.

But perhaps even more important will be to resolve challenges presented by other legislation of general application that has been enacted in the last five or six years. This is notably the case of the legislation governing the so-called Public Private Partnerships, Business Concessions and Large Scale Projects – also known as the Mega-Projects legislation. The 2011 Mega-Projects Law<sup>7</sup> and its 2012 Regulations<sup>8</sup> apply to all eligible projects in the country, including petroleum concessions.

However, those statutes very much failed to take into account the specificities of the petroleum industry and, more importantly, the specific legal regime and contracts that govern petroleum operations, which to a considerable extent already addressed the lawmaker underlying concerns in passing the Mega-Projects legislation. The mandatory public offering of 5% to 20% of project companies' share capital to Mozambican individuals via the Stock Exchange on terms that are not at all clear is one of the key areas of concern. The interaction between EPCC terms and specific petroleum legislation, on the one hand, and the requirements of the Mega-Projects legislation, on the other, was dealt with in the 2014 Decree-Law applicable to the Rovuma

Basin Project. But will a similar solution be incorporated in the new model EPCC to resolve the challenges presented by the Mega-Projects legislation?

Lastly, but by no means less important, new concessions will have to face the difficulties associated with the legislation on foreign exchange. As there is no specific foreign exchange legislation applicable to petroleum concessions – other than the one set forth in the Decree-Law governing the Rovuma Basin Project – the new EPCCs will be subject to the Foreign Exchange Law<sup>9</sup> and the Foreign Exchange Regulations<sup>10</sup> generally applicable in Mozambique. Historically, EPCCs contained a specific foreign exchange regime, but the inclusion of such a regime in the model EPCC will have to observe the limits imposed by law. Several rather relevant issues will no doubt arise, but the more obvious one is how the requirements for all export proceeds to be repatriated to Mozambique and for the conversion into local currency of 50% of such repatriated proceeds will be catered for.

By way of conclusion, it is fair to say that Mozambique has put in hand a tremendous effort to improve its legal and regulatory framework applicable to petroleum operations. However, it is also patent that the industry is now a focal point of different stakeholders, including within the state organization. Recent legislative developments have thus been influenced by industry "outsiders" and this has brought an additional layer of concerns and challenges that new concessions will have to tackle. To some extent, the new model EPCC and the ensuing negotiation of its terms for new concessions is an excellent opportunity to resolve a number of uncertainties and loose ends. Hopefully for the future of the country's rising industry this opportunity will not be missed. 

<sup>5</sup>By Decree No. 39/97, of November 12, 1997. <sup>8</sup>Decree No.16/2012, of July 4, 2012.

<sup>6</sup>Law No. 6/2012, of February 8, 2012.

<sup>9</sup>Law No. 11/2009, of March 11, 2009.

<sup>7</sup>Law No. 15/2011, of August 10, 2011.

<sup>10</sup>Decree No. 83/2010, of December 31, 2010.