

<b>CLIPPER BOOK MIRANDA</b>				 Miranda & Associados Sociedade de Advogados RL
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## Monthly Focus

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# Winds of Change in the Angolan Upstream Regulatory Model

**A**lthough the Angolan oil sector and its regulatory model has been stable for the last two decades, attracting quality international investment, over the last couple of years the Angolan Executive has not been shy of making public its intention to rethink and restructure the current regulatory model. The most recent indication that a deep change in the existing framework was indeed in the works was given last October with the creation of a commission responsible for the reorganization of the petroleum sector. In the current economic environment, and with all the negative forecasts and uncertainty in the sector, it is still not clear what direction the Angolan Executive will follow. One thing is certain – a new chapter in the Angolan petroleum sector is expected to arrive shortly.

**First signs of change and the “new oil paradigm”**  
The first clear signs of a potential change in Angola’s upstream regulatory system arose with the enactment of Presidential Decree No. 256/11, of September 29, 2011 which approved the National Energy Security Policy and Strategy (NESPS). Despite having a mere programmatic nature, the NESPS clarified the government’s concerns in respect of the energy sector, and also indicated the path the Angolan Executive intended to follow regarding the same. In the NESPS, the Angolan Executive set forth 14 priority initiatives for the crude oil and natural gas subsector to be implemented between September 2011 and January 2013. However, no significant amendments came to light within this timeframe, as the country continued to ride the wave of high oil prices and successful licensing rounds (notably the Pre-Salt licensing round that saw international big names once again invest heavily in the Angolan oil sector).

However, the sharp drop in oil prices since mid-2014 was seen by many in the industry as a wake-up call and contributed to a significant reduction of oil-income, which is the main source of government revenue in the country. To make things worse, the initial forecasts of the Ministry of Petroleum for 2015 indicating production of 1.835 million bpd were later adjusted downwards to 1.802 million bpd, while the effective daily production ended up dropping to 1.776 million barrels. This, along with other endogenous factors, led the Angolan Executive to postpone its initial strategy for the oil and gas sector as set forth in the NESPS, while it scrambled to define the most adequate policies to deal with the budgetary shortfall arising out of the low oil price environment.

With the house now in order in terms of the State budget for 2016, and the implementation of a fiscally conservative approach aimed at reducing state spending during the downturn, the Executive can finally turn its attention to restructuring the oil sector to make it more competitive and streamlined.

Although currently there is no official public document setting forth the areas which will be subject to reform, it is anticipated that the petroleum reform will likely cover the following areas: (i) a new regulatory regime for upstream concessions, (ii) the restructuring of Sonangol, (iii) the development of natural gas deposits, and (iv) management of petroleum revenue.



One of the priorities of the Angolan Executive back in 2011 was to assess the possibility of establishing a transition period for the development of a new regulatory regime for upstream concessions. The NESPS determined that operations in the upstream sector would remain open to IOCs, and Sonangol would continue to be the entity responsible for the management of these concessions. Additionally, Presidential Decree No. 243/11, of September 7, 2011 (which approved the General Strategic Framework for Exploration of Angola’s Pre-salt Play) already envisioned the creation of an independent regulatory entity for the subsector.

With the latest news suggesting that a new agency may take over Sonangol’s powers as National Concessionaire, the exact powers and scope of activity of the new entity, as well as the powers that will remain with Sonangol are still unknown.

Currently Angola’s petroleum sector has three main players: Sonangol, the President of the Republic, and the Ministry of Petroleum.

### Sonangol

Sonangol is, since 1978, the National Oil Company and the National Concessionaire for the petroleum sector, with supervisory, commercial and “governmental” powers. Sonangol’s corporate object is the prospecting, exploration, production, transportation, marketing, refining and processing of liquid and gaseous hydrocarbons and related products, including petrochemical activities.



Being the sole concessionaire, Sonangol may enter into agreements with foreign companies to carry out petroleum operations, and foreign companies are only allowed to carry out petroleum operations provided

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they associate with Sonangol under one of the forms foreseen in the Petroleum Activities Law. Under petroleum contracts, Sonangol is given wide supervisory powers and responsibilities, covering all aspects of operations, including in respect of the approval of recoverable costs. Sonangol also plays an active role in the hiring of oilfield goods and services providers, which powers range from the approval of the list of prequalified bidders to, in certain cases, the final contract.

From a purely commercial standpoint, Sonangol also holds a stake in Angolan blocks (typically 20%, although it has sometimes been higher for various reasons) through its subsidiary and upstream arm Sonangol P&P. Part of Sonangol P&P's costs are carried by IOCs, through the exploration and sometimes development phases, and may typically be recovered from Sonangol's share of cost oil (Angolan petroleum companies are exempt from carrying Sonangol P&P).

Also, in the majority of the petroleum contracts, Sonangol is responsible for collecting the National Concessionaire's share of profit oil, which means that a substantial part of the government's oil revenues is channeled through Sonangol. Moreover, Sonangol is also responsible for receiving all bonuses paid by its associates under petroleum contracts (e.g. signature bonuses, social contributions, production bonuses, etc.). This means that the Ministry of Finance takes "backseat" in terms of management of an important part of State petroleum revenues, although it is responsible for the overall management of State revenue and expenditures.

Additionally, and for historical reasons, in addition to its E&P business, Sonangol's business involves other areas such as corporate and finance, distribution and non-core businesses (e.g. MSTelcom for telecommunications services, SonAir for air transportation services, Sonip for real estate, various oilfield goods and services JVs, and participating interests in companies operating in Angola and abroad).

#### *The President of the Republic*

Since the enactment of the new Constitution of the Angolan Republic back in 2010, the President of the Angolan Republic – as the Head of the Executive Power – is responsible for enacting concession decrees, which grant the concession rights to Sonangol, define the concession area and respective duration, authorize Sonangol to enter into a petroleum contract and appoint the operator. Prior to 2010, these powers belonged to the Council of Ministers.

#### *The Ministry of Petroleum*

The Ministry of Petroleum is the supervising ministry, which oversees the activities of Sonangol, oil operators and oilfield service providers. Among other things, the Ministry of Petroleum is responsible for defining the areas/blocks in which petroleum operations can be carried out, granting extensions to the relevant phases of the operations, approving assignments between non-affiliates, approving the work programs and budgets and amendments thereto, approving the change of operator, approving the flaring of petroleum, etc.

#### What's to come?

The industry in Luanda is aware that a thorough due diligence on Sonangol assets and a review of its operating model are currently underway, and that new statutes will be prepared when the time comes, although there is still little guidance on the major changes that the new legislation may bring. In order to assess the industry's own view of the Angolan oil sector (which has been highly regarded by the Angolan authorities over time), the oil companies present in the country were invited to provide comments on the impact of existing statutes in the petroleum sector, namely in respect of the Petroleum Activities Law, the Petroleum Customs Law, the Petroleum Tax Law and the Petroleum Operations Regulations. All oil companies had the opportunity to be heard in a process that ended in 2015.

Irrespective of the feedback received from companies, there is at least one area where changes are expected: natural gas monetization. In this

respect, it is worth noting that Angola does not currently have specific legislation applicable to upstream gas projects, with the main statute on this matter being the Petroleum Activities Law, which only sets forth basic rules in this respect. The current petroleum contracts are also mostly silent on gas monetization, containing only one very high level article on the subject.

The fact that the government sees natural gas development as a possible driver for the national economy is obvious, with Sonangol being recently awarded direct concessions (some exclusively for gas) to carry out prospecting,

exploration, development and production works in gas fields on its own (i.e., without entering into associations with IOCs). In some cases, these awards have affected the legitimate expectations of IOCs, which are watching closely to see how things develop. It is still not clear whether Sonangol will later on partner with other companies to conduct the operations, or if it will put these blocks out for tender if they are proved to hold commercial reserves. One thing appears certain: that gas-to-power and petrochemical projects (some of which were already contemplated as offshoots of the Angola LNG Project) may be in the pipeline. It is thus no surprise that one of the matters allegedly on the table of the reform commission is the drafting of a natural gas plan.

This appears to be confirmed by Presidential Decree No. 40/16, of February 24, 2016 which approved the guidelines for the strategy to overcome the existing crisis resulting from the oil price drop in the international market, according to which the President of the Republic intends to promote the implementation of renewable power and gas-to-power projects.

Other areas that are also apparently under discussion include spinning off Sonangol's non-core business (i.e., everything that is not upstream-related), the clear separation of the Concessionaire/regulatory role from the commercial (E&P) role, a new model for the financial management of oil revenues, and possibly a change to procurement procedures to turn the country's oil sector more competitive. One thing is certain, IOCs big and small have not shied away from mentioning in public and behind closed doors that Angola has to do something urgently to

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make the country's oil sector attractive to international investment in the "new normal" environment.

### Learn from your peers

The oil industry is full of examples of how regulatory changes and "unbundling" can make oil & gas provinces more attractive to investors. For instance, Norway is a great example of co-existence of checks-and-balances, with the participation of the Ministry of Petroleum and Energy (including the Norwegian Petroleum Directorate), the Petroleum Safety Authority, Petoro AS, Gassco AS, and of course Statoil. This regulatory line up has been acknowledged throughout the years as transparent and attractive, and has been exported (to a greater or lesser extent) to other countries.

On the other side of the Atlantic (and a good example for Angola in terms of "unbundling" and scaling down the influence of a powerful NOC) Mexico recently successfully overhauled its regulatory model through the "Peña Nieto reforms", which resulted in PEMEX having to share the stage with the Ministry of Energy (SENER), the Ministry of Finance (SHCP), the National Hydrocarbons Commission (CNH), the Energy Regulatory Commission (CRE), the National Agency for Industrial Safety and Environmental Protection, and the National Natural Gas Control Center (CENAGAS). Although things are still in the early stages, the truth is that this major reform was a breath of fresh air that has attracted a significant amount of interest in the Mexican oil sector that many had left for dead.

### Conclusion

Although the Angolan petroleum legal and regulatory framework has remained stable over the years, there are recent signs that the industry is looking for change. The onshore licensing round (although aimed

mostly at domestic players) which didn't attract the types of players that traditionally showed up in Luanda in previous bid rounds, and the complaints from the IOCs are an indication that things have to change. Extreme situations call for extreme measures, and low oil prices have had a cascade effect throughout the oil & gas value chain, and the country's economy in general.

Although the recent gas discoveries in some of the country's pre-salt blocks are positive signs that the Angolan upstream sector remains active, players are eagerly looking for signs that the country is looking to be more investor friendly and flexible. The winds of change make this the perfect time for drawing up an integrated organization model that mitigates the impact of oil prices on the economy. Reviewing Angola's priorities, policies and rules, as well as amending existing outdated statutes in order to increase the efficiency and rate of return of the sector, while at the same time improving management of the State's oil revenues should be the main goals of the commission which is chaired by the President of the Republic, and also comprises the Minister of Petroleum, the Minister of Finance, the Minister of the Economy, and the Governor of the National Bank of Angola. Angola now stands at the cross-roads of time; let us hope that it chooses the right path to prosperity. 

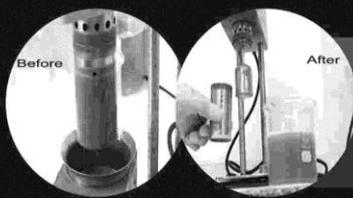
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