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Sustainable Investment in Angola and Mozambique
Forecasting Value Creation for the Petroleum Industry

In this day and age, it is no longer feasible to consider a business sustainable without the creation of shared value. What started years ago with the idea that consumers could potentially influence capital markets with their "wallet vote" on a daily basis has now become a reality. And proof that this is real is that the majority of companies are now aware of the importance of implementing sustainability as a strategy and that, in the long run, there will most likely be no market-share for organizations which aren't purpose driven.

Just how quickly this idea has spread can be confirmed by reading Blackrock CEO Larry Fink's 2019 letter to CEOs, in which he clearly states that "society is increasingly looking to companies, both public and private, to address pressing social and economic issues" as a result of the lack of capacity of governments to provide lasting solutions.

This change in how society as a whole, and more importantly how institutional and individual investors see the role of companies in addressing the challenges of the future has also impacted on oil and gas and other energy industry companies.

The year is 2020, the criteria for sustainable investment is fastidious, and if you are an oil company, you must obtain and maintain a "social license to operate." It is an up or out license, as it requires a constant and ongoing alignment of the company's actions with the expectations of its stakeholders and surrounding community.

Winds of Change in Southern Africa

For a long time, the oil and gas industry was often accused of not giving enough backing to communities in Africa. For years, the world heard of problems in Nigeria, where local communities, especially in the Niger Delta, protested against the activities of international oil companies, and the fact that in their view the region had not adequately benefited from oil and gas production. Oil companies, to a certain extent fairly, replied that they paid a significant amount of the revenue generated by their operations to the government, and that it was the latter that was responsible for not enough being done for the host communities. However, in 2020, this is no longer an adequate response, and company executives are well aware of this.

When we look today at the practice of companies active in Southern Africa's oil and gas industry, the outcome is quite positive. For instance, in its development of the Greater Plutonio project, BP has factored in solutions that are contributing to Angola's energy transition, notably by reducing GHG emissions including from operational flaring. On the social front, BP has also committed to funding the *Halo Trust* charity project, which aims to train local women as deminers to help

Source: Halo Trust

BP supports the Halo Trust demining operation in Angola

find and clear land mines that have been a major hindrance to rural development since the end of the country's civil war. Besides assisting the Angolan government in trying to reach its target of making Angola landmine-free by 2025, *Halo Trust* has employed 31 new staff, contributing both to employment and gender equality.

In turn, Equinor, which has also made strong commitments to sustainability over time, has opted to increase the capacity and expertise of its Angolan petroleum engineering staff through the establishment of MSc and PhD programs in Angola. Similar to BP, it has also done notable work in the clearing of landmines across the country and is openly committed to reducing its carbon footprint.

On the East coast of Africa, in Mozambique, Italian major Eni has implemented the *Promoting Energy Efficiency and Clean Cooking* project in the city of Pemba, where it aims to replace 10,000 traditional stoves. This initiative would have a direct impact on deforestation, insofar as it will reduce the felling of trees for coal for domestic use, while improving the health and safety of the community and reducing emissions. Concurrently, the company has also been responsible for implementing a package of health-related measures, which include the supply of radiology, ultrasound and laboratory equipment to the health unit in the Palma district, together with the setting up of a home-birthing unit and an off-road vehicle to provide clinical services to remote areas of the province.

Source: Eni

Eni implements the Promoting Energy Efficiency and Clean Cooking project in Mozambique

These measures, together with many others by different companies in southern Africa are a clear indication of the industry's increased commitment towards the creation of shared value. Notwithstanding, it is legitimate to ask whether there is a formal social license to operate within the oil and gas industry that companies have to comply with?

"Contractual" Social License to Operate?

In order to better assess this question, it is necessary to look at the clauses agreed in the contracts established between the governments and the international oil companies. Thus, two model contracts in use in Angola and Mozambique were analyzed to assess the standards imposed by both Governments.

In Angola, and although other options have also been used over time, most oil and gas exploration and production rights in the country have been contractually enshrined in Production Sharing Agreements (PSA). It is common for Angolan PSAs to include an obligation by the contractor group to pay certain bonuses and contributions, including a contribution to social projects.

In Mozambique, the contractual relation between the contractors and the government is established through an Exploration and Production Concession Contract (EPCC). In this respect, some contracts include an obligation of the concessionaire to support projects for communities in the areas where petroleum operations take place. These programs are to be agreed with the Government and can be recommended by the concessionaires. Although different contracts are negotiated and designed for each concession area, it is not uncommon for companies to be bound to these types of obligations.

Notwithstanding the foregoing, and as the Nigerian example shows, the contribution by companies to social projects, or the agreement of such projects with the government, does not, *per se*, incorporate the "social license to operate." Instead, in order to ensure that they maintain this fluid and ever-changing license, companies should keep an open dialogue with the communities where they operate and try, to the best of their capacity, to ensure that the programs they develop meet specific needs of such communities.

Tax Treatment of Costs

Since it is beyond doubt that, either as a result of ethical considerations, stakeholder pressure, or due to compliance reasons, oil companies will increasingly allocate an important amount of their budget to social projects, the question to be asked is – are these costs deductible for tax purposes?

In general, in order for a cost to be deductible, it must be either (i) admissible under applicable law or (ii) essential to the conduct of petroleum operations.

To determine how Petroleum Operations in Angola have been taxed since the 2004 reform, the first statute we must consider is the Petroleum Activities Law (Law no. 10/04, of 12 November 2004), which sets forth the specific catalogue of rights and obligations to be complied with by operators and other members of the contractor group. The second relevant statute is the Petroleum Activities Tax Law (PATL – Law no. 13/04, of 24 December 2004), which foresees the general framework for taxing income derived from operations under PSAs and, more specifically, the rules on deductible costs for Petroleum Income Tax (PIT) purposes. Under the PATL rules, donations for social, educational, cultural and scientific purposes are currently deemed deductible.

Turning now to Mozambique, in addition to a Petroleum Law (Law No. 21/2014, of 18 August 2014) which solely sets out that the specific taxation regime for petroleum operations is set forth by law, Mozambique's Petroleum Taxation framework is governed by the Petroleum Operations Tax Law (POTL), approved by means of Law No. 27/2014, of 23 September 2014. Unlike the Angolan PATL, this statute does not categorically establish cost deductibility, and refers such deductibility to the Corporate Income Tax Code (CITC) rules. However, the CITC also does not include specific rules on cost deductibility, which leads us back to the discussion of whether or not a given cost is essential to the conduct of the company's operations.

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Regardless of being legally explicit, it is always arguable – even though subject to approval – that the costs that companies incur with social projects are fundamental to the company's operations, and should thus be deemed deductible to the extent that the relevant statute does not provide for their non-deductibility. This, however, needs to be subject to careful planning and assessment.

Another different topic that also needs to be carefully considered in each specific jurisdiction and contract is whether or not these types of costs are cost recoverable.

What Does the Future Hold?

If 2020 is a year full of uncertainty, the one thing we can be certain of is that the discussion around energy transition and sustainability is here to stay. We know liquefied natural gas will definitely be part of the transition, and we also know that the largest private investment project in Africa to date is the Mozambique LNG project. Yet, there are still a lot of opportunities when it comes to value creation and sustainability in Southern Africa, especially in terms of energy efficiency and sustainable power generation. Diesel power plants are still a major energy source, despite the availability of natural gas in the region. Additionally, both Angola and Mozambique still lack a strong national backbone infrastructure for energy supply, which creates opportunity for micro-grids to be set-up locally using renewables. Many traditional IOCs are looking to reinvent themselves as full scale energy companies, and Africa can be a good testing ground for their renewable ventures.

This being said, it seems safe to conclude that energy companies are increasingly committed to impact management and value creation. This effort must be steady and consistent, as stakeholders expect companies in today's world to be able to demonstrate their purpose through a strategy and culture that fosters sustainable financial performance.

At a local level, this can be achieved by linking their contractual social obligations to their non-contractual social license to operate. By seeking to ensure that their social contributions and other similar contractual duties are adequately channeled to meeting the needs of the local communities where they operate, oil companies can show they are committed to socially conscious investment. If they manage to do that and contribute to a greener and more sustainable energy generation and distribution infrastructure, then they will have gone full circle, creating a socially conscious and environmentally sustainable business model for the African countries where they operate.

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