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Local Impact

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ANGOLA'S PETROLEUM REFORM

Difficult Times Call for Wise Measures

In recent years, the Angolan government has been striving to diversify the country's economy, in an attempt to reduce its dependency on oil. This caused the Executive to promote a series of reforms to be implemented throughout various sectors and areas of the economy (such as tax, private investment, foreign exchange, corporate law, etc.). One such reform which has been envisioned by the Executive for some time now is the restructuring of the country's petroleum sector and respective framework, which has remained fairly stable over the years.

Marked by the sharp drop in oil prices, which deeply affected the country's foreign exchange reserves and urged the Executive to expedite the reform, the biggest challenge is to conciliate the attractiveness of the sector for investors in the current oil price environment, with an increase in the State revenue deriving from petroleum operations, while bearing in mind the possible impact of the petroleum reform on other economic sectors.

The creation of a commission responsible for the reorganization of the petroleum sector last October, whose goal was to draw up an integrated strategy and organizational model capable of fostering efficiency in the petroleum sector in order to mitigate the impact of oil prices on the economy, was seen as the first step of Angola's petroleum reform.

Since then, statutes directly or indirectly related to the petroleum reform have been enacted, which are mainly aimed at achieving two essential but different, goals: on the one hand addressing petroleum sector organizational issues; while on the other improving exploration and production terms and conditions to make Angola a more attractive oil province in these difficult times.

Petroleum Sector Organization

Restructuring of the petroleum sector

The Angolan petroleum sector has been faced with organizational issues for some time now. Although the Ministry of Petroleum has, at least on paper, always been the body of the Government responsible for coordinating and supervising petroleum matters, Sonangol E.P., as the National Oil Company, has to-date had a major regulatory role. Over time, Sonangol within its wide powers developed a series of parallel activities (from provision of oilfield goods and services to aviation, insurance, telecoms and banking investments, just to name a few) which were seen by some industry players as capable of giving rise to conflict of interest situations.

In order to deal with this matter, the Angolan Executive enacted Presidential Decree 109/16, of May 26, 2016, which approved the Model for Readjustment of the Petroleum Sector's Organization (Reorganization Model).

In line with what are deemed the best international practices by the local authorities, the new Reorganization Model aims to increase efficiency and promote the sustainable management of hydrocarbon resources and transparency in the sector, with a view to developing and diversifying the Angolan economy. Based on the principles of stability, minimum intervention, transparency and careful management of public resources, the ongoing reform will not affect contracts and other commitments previously undertaken by the Angolan State and Sonangol towards investors, and which are expected to be grand-fathered.

According to the information available, the new organizational framework basically entails:

- (i) Maintaining Sonangol's role as the national concessionaire. By remaining the exclusive concessionaire for the sector and, as such, responsible for managing and monitoring petroleum contracts, Sonangol is expected to refrain from engaging in other activities, whether in exploration, production or operation of oil blocks, and in the oilfield goods and services sector. This will, in principle, add credibility and transparency to the sector, including to the tendering for goods and services.
- (ii) The creation of an Agency for the Petroleum Sector (Agency). The Agency shall be responsible for *inter alia* coordinating, regulating and evaluating the performance of the sector, preparing and negotiating the granting of oil blocks, and resolving, by administrative means, conflicts arising between the supervising Ministries and the various industry stakeholders.
- (iii) The creation of the High Council for Monitoring the Petroleum Sector (High Council). The High Council will be responsible for issuing opinions on multiannual plans for the oil sector, approving investments with a high value and strategic importance, and monitoring the execution of investment plans. The High Council will also be responsible for assisting the Angolan State in the exercise of its shareholder rights in different companies. It is not clear, however, whether the High Council will directly manage the equity interests of the State, or whether a different company will be entrusted with this task, in which case the High Council would occupy solely a monitoring and advisory role.
- (iv) Maintaining the Ministry of Petroleum's regulatory powers and authority, and the Ministry of Finance, the Ministry of the Environment and the Ministry of Public Administration, Labor and Social Security as supervising Ministries for sectorial matters.

The Ministerial functions and duties will probably be adjusted to ensure the required cooperation and coordination with the Agency's functions.

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However, there is still no guidance whatsoever on the exact adjustments to be made.

At the top of the chain, the President of the Angolan Republic, as the Head of the Executive Power, is expected to remain the highest supervising body of the sector, monitoring the activity of the Agency, the Ministry of Petroleum, the High Council and other public entities with authority over petroleum matters.

Amendment of Sonangol's by-laws

Since 1978, Sonangol has been the National Oil Company and the national concessionaire for the petroleum sector, with supervisory, commercial and *ius imperii* powers.

In its capacity as sole concessionaire, over the years Sonangol entered into agreements with E&P companies to carry out petroleum operations, and E&P companies were only allowed to undertake petroleum operations provided they associated with Sonangol under one of the forms foreseen in the law. Under the existing petroleum contracts and legal framework, Sonangol was given wide supervisory powers and responsibilities, covering all aspects of operations, including the approval of recoverable costs. Sonangol also plays an active role in the procurement of oilfield goods and services by IOCs.

Sonangol holds a stake in Angolan blocks (typically 20%, although more in certain blocks) through its subsidiary and upstream arm Sonangol P&P. Part of Sonangol P&P's costs are normally carried by the IOCs through the exploration and sometimes development phases, and are typically recovered from Sonangol's share of cost oil.

Also, in the majority of the petroleum contracts, Sonangol has been responsible for collecting the concessionaire's share of profit oil, being also responsible for receiving all bonuses paid under petroleum contracts (e.g. signature bonuses, social contributions, production bonuses, etc.). One of the most important aspects to be determined in the ongoing reform is exactly whether this will remain the practice, or if there will be any changes in respect of collection of State petroleum revenue.

The refocusing of Sonangol on its role as the concessionaire, and the new Agency taking over part of the former's "traditional powers" has entailed the amendment to Sonangol's by-laws. This amendment reflects a change in the company's governance structure, which now includes an Executive Committee made up of members of the company's Board of Directors (BOD). Hereafter, Sonangol's BOD will comprise up to 11 members, seven being executive members (one of them the CEO). Accordingly, the new BOD was recently appointed in early June including executive and non-executive directors, and having been entrusted with bringing added efficiency and transparency to the sector.

It is still not clear whether Sonangol's by-laws will have to be further amended to reflect other changes in the sector's organizational structure (for instance, in respect of its corporate purpose, which currently covers prospecting, exploration, production, transportation, marketing, refining and processing of liquid and gaseous hydrocarbons and related products, including petrochemical activities).

Since the appointment of the new BOD, three situations apparently confirm that Sonangol is attempting to put its house in order (or at least shake up the "establishment"): (1) Sonangol suspended, with immediate effects, all plans for assessment, negotiation and disposal of assets of both Sonangol and its subsidiaries, (2) Sonangol cancelled all powers of attorney issued, including those for legal proceedings, except for those granted for disciplinary procedures of employees of both Sonangol and its subsidiaries, and (3) Sonangol suspended the construction of the Lobito Refinery and the Ocean Terminal of Barra do Dande.

Insurance

The petroleum reform also touched the insurance sector, which is another area where Sonangol has played a traditional role.

Recently, the President of the Republic appointed the State-owned insurance company ENSA Seguros de Angola, S.A. (ENSA), on a provisional basis, as leader of the special co-insurance regime for petroleum activities, in replacement of another participating State company that previously held that role, and that is apparently being wound up, AAA Seguros. This transfer of leadership to ENSA entails the transfer of all assets held as collateral for the performance of the obligations now assigned.

The new rules exclude non-petroleum related insurance taken out by petroleum sector companies from their scope of application, and set forth that all insurance policies as well as re-insurance agreements in force on the date of publication of this statute remain in place.

Moreover, within six months, the Angolan Regulatory and Supervising Agency for the Insurance Sector (*Agência Angolana de Regulação e Supervisão de Seguros*) is to prepare an in-depth review of the new co-insurance and reinsurance model for petroleum activities conducted in Angola, which means that additional news is expected on this front in the coming months. This is also an important issue for the IOCs, who had not been overly happy with the previous state of things.

Over time, Sonangol within its wide powers developed a series of parallel activities (from provision of oilfield goods and services to aviation, insurance, telecoms and banking investments, just to name a few) which were seen by some industry players as capable of giving rise to conflict of interest situations.

Upstream New Terms and Conditions

Development areas

Special rules applicable to oil and gas exploration activities carried out inside existing development areas, so as to allow for the discovery of additional resources within an existing concession were also recently enacted. Aimed at maximizing production levels in existing development areas, the new rules include specific percentages and special time-frames for cost recovery of exploration expenses incurred prior to a commercial discovery, among other incentives.

Under the new rules, in case of a commercial discovery, 50% of the exploration costs shall be recovered within six years as from the year following the submission of the General Development Plan, being the remaining 50% of such costs recovered within six years as from the year following the commencement of production.

Although these rules only currently apply to the development areas in Blocks 14 and 17 expressly identified therein, the statute also foresees

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the possibility of other development areas (including from other blocks) being subject to these rules, following Ministry of Petroleum approval.

Marginal fields

Another area of concern for quite some time has been the approval of incentives for the development of marginal fields to motivate E&P companies to develop such discoveries. This matter has finally been addressed in the recent Presidential Legislative Decree 2/16, of June 13, 2016, which covers the procedures and incentives for the adjustment of contractual and fiscal terms applicable to concessions including marginal discoveries.

Over the years, many petroleum companies have made marginal discoveries in Angola, whose development with the existing contractual and fiscal terms has proven to not be economically efficient or viable. Prior to the enactment of the new rules, the existing legal framework, together with the use of the most recent technology was not sufficient to make these discoveries attractive to investors. In view of the foregoing, the incentives for the development of marginal discoveries will aim to ensure adjustment of each relevant concession's contractual and fiscal terms, and promote investment by E&P companies in marginal fields. The Angolan State expects that these changes will lead to the tapping of significant resources that have traditionally been left in the ground due to the lack of flexibility of the legal and contractual model for upstream activities.

The new statute sets forth the following indicators based on which a discovery could be deemed marginal: (i) reserves under 300 million barrels, (ii) water depth in excess of 800 meters, (iii) revenues for the State of less than \$10.5/barrel, (iv) revenues for the IOCs of less than \$21/barrel, and (v) an Internal Rate of Return substantially lower than 10%. This gives the contractor groups in Angolan oil blocks certainty as to when they could declare a marginal discovery and, as a result, benefit from the special economic incentives.

In terms of procedure, the Ministry of Petroleum is responsible for deciding whether a discovery should be considered marginal, as well as on the exact incentives to be granted, subject to a proposal from Sonangol.

Fiscal incentives applicable to marginal discoveries apply to marginal discoveries in petroleum contracts in force, as from the financial year commencing after publication of the statute, and include: (i) the rates for Petroleum Production Tax and Petroleum Income Tax (PIT), and the percentage of Investment Allowance for PIT purposes and of Production Bonus, are to be determined by reference to the volume of recoverable resources, (ii) the amortization period for capital expenditures varies between 2 and 4 years, depending on the volume of recoverable resources, (iii) the assessment of PIT only becomes required as of the 3rd, 4th or 5th year of amortization of capital expenditures, at percentages depending on the volume of recoverable resources, (iv) the period for recovery of development expenses to be set between 2 and 4 years, based on the volume of recoverable resources, and (v) a full exemption of customs charges and duties on petroleum exports to be granted for a five-year period from commencement of commercial production.

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Conclusions

Investors, especially IOCs, are keen to see to what extent the new changes will affect their activities, and the interaction between the different decision-makers that will henceforth be involved in managing the oil sector.

Investors are also concerned about a possible amendment of the existing statutes governing the sector (such as the Petroleum Activities Law, the Petroleum Customs Law, the Petroleum Tax Law, the Petroleum Operations Regulations and the Regulations on Environmental Protection for the Petroleum Industry), as no clear indication has been given as to when these amendments might be expected, as well as the consequences of such amendments.

Finally, another area of crucial importance for investors is the definition of clear rules for the development of gas reserves, as various IOCs that have recently made gas discoveries are anxiously waiting for developments on this matter. 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). This appears to be confirmed by the strategic guidelines 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.

Angola's petroleum reform is well under way and indicates a major overhaul in the not-so-distant future. The changes approved so far and the ones yet to come will have a direct impact on several areas of the country's economy and business sectors, ranging from the oil industry to the insurance sector and possibly industry and electrical power.

These changes also present an opportunity for the Executive to diversify the Angolan economy, making it less dependent on the oil sector by spreading the benefits of Angola's prolific oil and gas industry to other sectors. The industry will continue collaborating with the authorities in order to make this reform as smooth as possible and beneficial for all stakeholders involved. However, the ability of the petroleum sector reform to increase the attractiveness of the sector, particularly in the current economic environment, heavily depends on the exact measures that the reform will bring, and the benefits (notably contractual and economic) that are made available to investors. 

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