Cristal Advocates

# Investment protection for energy and infrastructure projects

## The case of Uganda

Compared to other sectors, investment in the energy and infrastructure space attracts far greater scrutiny because of the heightened sovereign risk that is exacerbated by its long term profile. Project sponsors and lenders consider from the very outset ways of managing the exercise of government legislative prerogative that may erode the commercial viability of the venture in question. Private investment in Uganda's power sector opened up in 1999 has trodden this intricate path and the financial closure of the country's crude oil development will no doubt have carefully deliberated means of buttressing the associated investments. Public infrastructure projects between government and the private sector under the Public Private Partnership Act of 2014 too will attach utmost importance to investment protection.

This publication provides an overview of the risk mitigation measures that investors in Uganda's energy and infrastructure domain have pursued to protect their investments. These include but are not limited to legislative, treaty and contractual based protection via stabilisation clauses.

### 1. The risks

Prior to project sanction, the sponsors and their lenders carry out a comprehensive due diligence of the country's socio-economic, political, legal and fiscal environment the findings of which inform the strategy of managing the risks identified.

Energy and infrastructure projects are not only capital intensive but also have a long term profile from development to commissioning and recoupment of spend. Capital outflow is frontloaded and incurred prior to production and investors need time to recover their capital as well as earn a return on the investment. Project sponsors are vulnerable once the investment is committed because they may not easily exit without financial loss. Governments can equally in the future expropriate such investments or at the least engage in manoeuvres that interfere with the investors' right of enterprise. Legislation too may be amended imposing additional taxes or increasing operational costs adversely affecting project viability as previously evaluated.

International bankers and financiers are also keen on investment protection and may not provide financing unless satisfied that there are sufficient safeguards in place against potential legislative or administrative actions that may eat away project returns affecting its ability to meet debt repayment obligations.

### 2. Legislative based tools

Legislative based tools involve inclusion in the law provisions setting out general or specific guarantees for the protection of investments. The effectiveness of legislative based tools is sometimes questioned on the basis that whatever Parliament enacts, it can undo.

Uganda's constitution enshrines the right to private property by stating that no property may be compulsorily taken by the government unless it is necessary in public interest and subject to the prompt payment of adequate compensation. This position is reaffirmed by Uganda's investment Code Act which provides that any property or undertaking forming part of any enterprise, may not be compulsorily taken possession of or acquired except in accordance with the Constitution of Uganda subject to national interest considerations and compensation.

Another example of legislative based investment protection is the Nigeria LNG Act of 1990 that prohibited unilateral change and froze the fiscal regime for the Liquefied Natural Gas (LNG) project which international lending institutions required prior to providing project finance.

Uganda recently elevated the provisions of the Intergovernmental Agreement on the East African Crude Oil Pipeline between the Governments of Uganda and Tanzania to International Agreement status under the provisions of the Income Tax Agreement. International Agreements generally override the provisions of the Income Tax Act and the fiscal terms therein take precedence over the Income Tax Act in case of any conflict. We also anticipate that other agreements relating to Uganda's crude oil commercialisation will be given the overriding force of law.

### 3. Treaty based investment protection tools

Bilateral Investment Treaties (BITs) and Multilateral Investment Treaties (MITs) such as the North American Free Trade Agreement (NAFTA) accord protection to foreign investments and investors in the energy and infrastructure space are cognisant of their effectiveness. A BIT represents an international agreement concluded between two states, typically a developed and developing country with the contracting states offering substantive and procedural protection to investors and investments which originate in either state. Under the terms of BITs, investors are able to initiate arbitration claims against host states, without the intervention of their home countries.

BITs can offer investors deterrent protection against potential actions of host countries. A host state pursuing policy reforms with adverse impact to investments may be reminded by investors of its BIT obligations and the risk of arbitral proceedings if the reforms proceed as conceived. The threat of arbitral proceedings under a

BIT can lead to consultations and potentially a change in the policy mooted by the host state.

Upon expropriation of its investment in Venezuela in 2007 by the Government of late President Hugo Chavez, ExxonMobil commenced arbitral proceedings under the terms of the Netherlands-Venezuela BIT. ExxonMobil had incorporated the holding entity for its Venezuelan investment in the Netherlands. The Government of Uganda has in the recent past faced or been threatened with international arbitration proceedings under the provisions of the relevant BITs.

Uganda has BITs with Denmark, France, German, Italy, Netherlands, Switzerland and the United Kingdom. The ones with Belgium, Luxembourg, China, Cuba, Egypt, Eritrea, Nigeria, South Africa and Zimbabwe are not yet to come in force.

## 4. Contractual based stabilisation clauses

Stabilisation clauses represent commitments by countries not to revise the terms of the relevant project agreements without the consent the other party. Project sponsors and lenders desire to anchor the terms of their project agreements based on the legal regime in effect at the time of the investment to ensure predictability enabling investment recovery and return at the soonest.

Stabilisation clauses have been in existence for a long time but also evolved over time. Stabilisation clauses would preclude host countries form amending legislation that would impact the investments in question in their original form but this was protested against as a restraint on the sovereignty of countries. Modern stabilisation clauses today outline the need for reinstatement of prior fiscal balance in the event of change in the law rather than restraining the revision of legislation.

Stabilisation clauses reiterate countries' belief in the sanctity of project agreements and the assurance that fiscal and legal commitments under investment agreements will outlive the government that signed on the venture and endure for the duration of the project. The commonest forms of stabilisation clauses are;

- **Balancing clauses:** These are also known as economic stabilisation clauses and provide for automatic adjustments or negotiations to restate the initial economic balance of the project agreement following legislative changes.

- **Allocation of burden:** These clauses seek to allocate the fiscal and related burdens created by a unilateral change in the law. In oil and gas agreements, it is common for the resultant burden to be borne by the National Oil Company.

- **Freezing Clauses:** These ordinarily preclude the host state from changing its legislation and are criticised as a restraint on countries sovereign legislative prerogative.
  In the alternative, any changes in country's legislation subsequent to the project agreements do not apply to the specific project. Project agreement terms take precedence in the event of a conflict with new legislation

Many of the Production Sharing Agreements for oil and gas exploration, development and production in Uganda contain stabilisation clauses. The Intergovernmental Agreement for the East African Crude Oil Pipeline too holds one and it is expected that the same will be replicated in the underlying Host Government Agreements currently being negotiated.

## 5. Conclusion

It is worth noting that many of the investment protection demands sought from developing countries by foreign investors may not be granted by their countries in the developed world. Governments in developed countries are reluctant to provide some investment protection assurances notably the stabilisation clauses on the premise they cannot bind future governments to the policies of the current administration. On the other hand, the foreign investors demand for these in developing countries on suggestions that rule of law is either not firmly entrenched or simply does not operate in the way expected.

The above notwithstanding the significance of investment protection in promoting inward investment to the energy and infrastructure projects in the developing world cannot be understated. The competition for foreign direct investment has seen developing countries heed to demands for investment protection as a means of outbidding each other for the highly mobile capital. While the investors' pursuit for stability in these capital intensive and long term investments is understandable, the assurances they seek ought to be reasonable to the developing countries. An excessively favourable deal for the investor may indeed be too good to be true and can be the reason for instability in the host state that may completely erode project returns that the private investors sought to insulate against in the first place.

## Contacts for this Publication

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Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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Denis leads the energy and tax practice at Cristal Advocates. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates. He had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

He holds a Bachelor's degree in Law, the Post Graduate Diploma in Legal Practise from the Law Development Centre and various other qualifications. ■

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holdings Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOCs formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enactment of the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He holds a Bachelor's Degree Law from Makerere University, a Post Graduate Diploma in Legal Practice and Masters of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom. ■

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He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

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