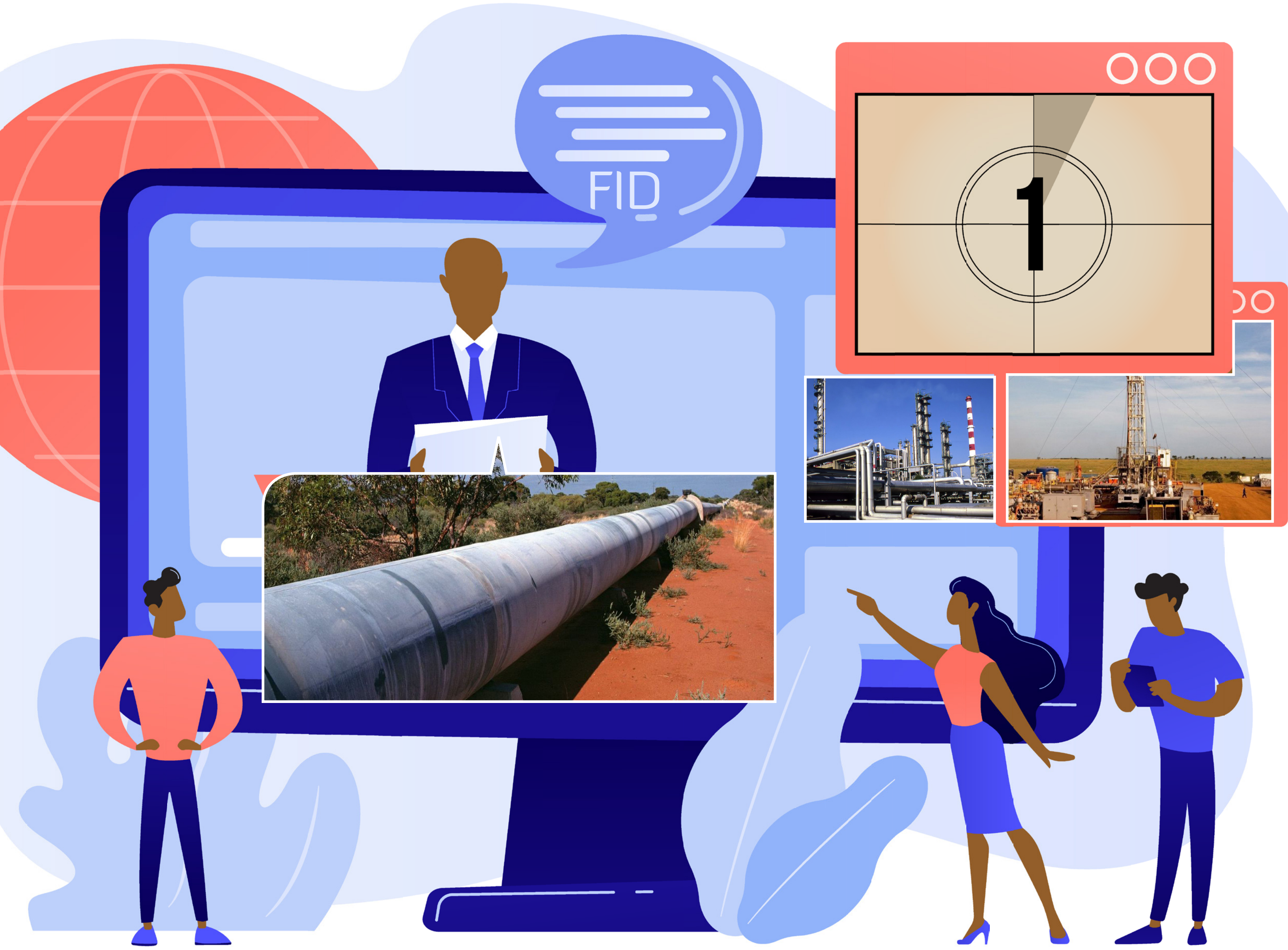
Cristal Advocates

Countdown to the Final Investment Decision

Tracking Uganda's oil and gas journey



Cristal Knowledge Series

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1. Introduction

Uganda's long awaited oil and gas final investment decision ("FID") is expected shortly during this month. The Government of Uganda acting through the National Oil Company ("UNOC") together with French oil major Total E&P ("Total") and the China National Offshore Oil Corporation ("CNOOC") will commit to move ahead with investment in the requisite infrastructure for crude oil production.

FID signifies that the investors have determined that it is commercially viable to move ahead the intended project and that they also have sufficient financial resources for investment. There will be two simultaneous decisions launching both the oil production fields and East African Crude Oil Pipeline ("EACOP") projects. Building the enabling project infrastructure is expected to take up to 3 years costing more than $ 10 billion which will be transformative investment capital.

This publication tracks a highlight of Uganda's long journey to FID.

2. Crude oil discoveries in 2006

There was palpable excitement in 2006 when Uganda found oil that the government organised national thanksgiving prayers on 8th October 2006 to celebrate this feat. To the ordinary folk, an immediate economic bonanza that is yet to materialise was imminent! As a nascent country finding oil for the first time, it is not surprising that it has been a long journey to the FID. There was lot of work to be embarked upon putting in place the necessary legislative framework and enabling infrastructure.

Uganda's petroleum discoveries were made at a time of rising oil prices and raging resource nationalism. Governments were tightening further their grip on the sector to extract as much economic rent and major disagreements between the International Oil Companies ("IOCs") and host governments were common at the time.

Uganda too adopted a hardline stance. It was government's irreducible demand for all the crude oil to be refined locally a position that was contested by the IOCs. Generating consensus on the matter was long and protracted. It took more than 10 negotiation meetings chaired by the President of Uganda to find compromise recorded in the memorandum of understanding ("MOU") signed on 5th February 2014 between the government and the IOCs. This MOU provided for the building of both an inland refinery and export pipeline to monetise the country's hydrocarbon discoveries.

3. Production Sharing Agreements (PSA) transfers and tax disputes

Major IOCs rushed to acquire a stake in Uganda's oil and gas sector following the 2006 discoveries. Unfortunately, the government misunderstood this interest leading to amendments in the law to tax the windfall profits that were "apparently" being made by the IOCs on the oil license transfers. As such, transactions for the transfer of PSA interests that followed were marred with major disputes over tax issues between the government and IOCs. This partly contributed to the delay in commercialising Uganda's oil discoveries.

Countries customarily achieve growth in their oil and gas sector through the transfer of interests in oil licenses. Smaller players have more risk appetite to explore countries that are yet to make any discoveries. Once oil finds are made, the interest of the bigger players with the financial and technical ability to propel further the industry is awakened. Countries that place onerous requirements on such transfers are inadvertently obstructing the growth of the sector. Oil rights not relinquished back to government are transferred to other interested parties keen to participate in the country's oil and gas industry. This has in fact been the trend in Uganda's oil and gas industry.

Petrofina SA, a Belgian petroleum conglomerate acquired by Total S.A in 1999, had signed a PSA with the government in 1991 to carry out exploration activities in the Albertine Graben but withdrew 2 years later without any tangible works. The oil rights reverted back to the government. In 1997, the government entered into two PSAs with Jersey domiciled Heritage Oil ("Heritage") and Australian incorporated Hardman Resources. Heritage carried out the first seismic survey in Uganda in 1998.Hardman Resources did not start exploration operations until 2001 with its new partner Energy Africa. Heritage continued with its exploration activities in concert with its new partner Energy Africa.

The promising prospects and the rising crude oil prices enticed Irish founded Tullow Oil ("Tullow") to purchase the entire shareholding in Energy Africa giving it a 50% stake in the blocks that Energy Africa co-held with Heritage. Hardman Resources found Uganda's first crude oil in June 2006 at the Mputa well. Other finds by Tullow and Heritage at the Kingfisher well followed and by 2009, Uganda had passed the threshold for commercial crude oil discoveries. In 2007, Tullow acquired Hardman Resources.

In 2009, Heritage announced the proposed sale of its 50% stake in the blocks it held to Italian oil major ENI but Tullow exercised its pre-emptive rights acquiring full ownership of the rights in these blocks. This transaction triggered off a long standing dispute for capital gains tax ("CGT") which Heritage contested but was won by the government. Tullow remained holding 33.334% when it divested two thirds of its interest in blocks 1, 2 and 3A to Total and CNOOC in 2012 with each party holding 33.333%. Either party became an operator of one of the three blocks. This transaction too triggered off a tax dispute that Tullow eventually settled with the government.

On 23rd April 2020, Total agreed to acquire the entire Tullow oil interests in Uganda. It is understood that a payment of $ 500 million was paid to Tullow on the completion date. A further $ 75 million will be paid to Tullow upon achieving FID for the Tilenga and the export pipeline projects. When oil production commences, Total would further pay Tullow up to 2.5% of its annual profit oil, from the Interests acquired therefrom, when the oil price is above $ 62.

The 2020 sale differed from the aborted 2017 deal where Tullow was to remain in Uganda but with significantly reduced footprint. It is understood that the CGT that was payable by Tullow to the government on this transaction was about $ 14.5 million compared to the $ 167 million which would have been payable under the 2017 Sale and Purchase Agreement. The Government also earned about $ 9 m as stamp duty from the sale.

4. Breakthrough with negotiations

Enduring disagreements between the government and IOCs in 2019 prompted Tullow Oil to call off its intended sale of stake to Total and CNOOC. Total followed suit by suspending procurement activities for the EACOP project. Both Tullow and Total attributed their decisions to the unresolved tax disagreements with the government. This impasse cast doubt on the future of Uganda's oil and gas industry.

Both the IOCs and government were however cognizant that a lasting standstill would benefit none and re-engaged behind the scenes to search for a win-win resolution of the outstanding contentious matters. In November 2019, Total's President and Chief Executive Officer made his 3rd visit to Uganda in the year to meet President Yoweri Museveni. Total highlighted that there were legitimate fiscal issues that had to be dealt with if Uganda's oil project was to move to FID stage especially around how the fiscal regime affected the project return on investment. This fiscal regime concern is understood to have been an issue with the IOC's from as back as 2010 but had never been formally raised with Government!

This meeting renewed intense behind the scene negotiations between Total representing the other IOCs and the government to narrow down further their positions of disagreements. These deliberations moved on to 2020 and by the time the coronavirus pandemic disrupted global travel and business in March 2020, a framework agreement on major issues had been reached between Total and the government. While details of the agreed positions are not in the public domain, it is speculated that the government conceded on a majority of fiscal issues that had led to a breakdown of relations with the IOCs in August 2019 with agreements reached to amend the subsisting PSAs and the Income Tax Act. In September 2020, Total and Uganda initialled the Host Government Agreement (HGA) a key agreement for the progress of the EACOP project.

It is now anticipated that all agreements for the project to move to FID have been substantially finalised or close to finalisation. A key meeting between the oil companies and the Presidents of Uganda and Tanzania is expected shortly to sign off all these agreements and announce the final investment decision to launch Uganda's oil project.

5. Status of upstream projects

As earlier noted, monetising Uganda's crude oil discoveries would involve a simultaneous FID for both the oil field production facilities and the EACOP. The absence of a pipeline would mean that there is no evacuation route for crude oil to the export markets. While efforts are underway to ensure that the construction of a crude oil refinery also goes ahead, there are strong headwinds in the way of unlocking financing for the project.

It is understood that all the requisite upstream commercial agreements have been substantially finalised. These include a new Joint Operating Agreement between CNOOC, Total and UNOC, the Power Purchase Agreements for excess electricity produced by the production facilities, the Common Development, Production and Cost Allocation Agreement. The evaluation of major upstream procurements has also been completed with announcement imminent of the successful Engineering, Procurement and Engineering (EPC) contractors amongst other vendors.

6. Status of the EACOP

The late President of Tanzania John Pombe Magufuli pulled off a major coup when he convinced Uganda and Total at the East African Community bloc in March 2016 to route the crude oil pipeline through Tanzania. The pipeline had originally been intended to go through Kenya and this seemed like a foregone conclusion at the time.

Uganda and Tanzania signed the Intergovernmental Agreement ("IGA") for the EACOP in 2017. The IGA is the agreement between the states through whose territories a pipeline is constructed and operated. Some of the issues dealt with by the IGA include co-operation, the provision of land rights, and harmonization of tax structures applicable to the project and other issues relevant to the implementation of the project. Both Uganda and Tanzania have ratified the IGA and in the processing of pushing through their legislature the requisite EACOP enabling laws that will include an EACOP Act

Total also completed negotiating HGAs separately with the governments of Uganda and Tanzania. The HGA is an agreement between the IOCs or project investors and the government within whose territory the pipeline traverses. The HGA expands on some of the issues identified in the IGA including the various governmental obligations, investor duties, environmental and other relevant standards, liability, termination and issues relevant to the implementation of the project in each specific territory.

The other commercial agreements required to move forward with the EACOP project have also been substantially finalised. These include the shareholders agreement between the shareholders to the EACOP Company, the tariff and transportation agreement and the primary capacity rights agreement. The marine services agreement for using Tanga port in Tanzania has also been finalised. The evaluation of major pipeline procurements has also been completed with announcement imminent of the successful EPC contractors amongst other vendors.

7. The refinery

The timelines envisaged in the previously signed project framework agreement between the government and the Albertine Graben Refinery Consortium comprising Yaatra Africa LLC, Lion works Group Ltd, Nuovo Pignone International SRL and Saipem SPA for completing key project development activities, including conceptual engineering studies, front end engineering design ("FEED") and the environmental social impact assessment ("ESIA") has since expired. An addendum was signed in August 2020 giving the consortium an extra 18 months to complete the project ESIA and FEED. Until these works are completed and the financing structured, timelines for the construction of Uganda's refinery cannot be determined. At the completion of the preparation studies and designs, the consortium is expected to announce a final investment decision for the 60,000 barrels per day refinery worth about $ 3-4 billion.

8. Conclusion

16 years later after making its crude oil discoveries, Uganda is on the cusp of the final investment decision for developing the necessary infrastructure for crude oil production. This FID is coming at a time of completely different market fundamentals compared to when oil was first discovered. In 2006, it was a bullish market with rapidly rising oil prices while today the market is bearish with depressed oil prices. Countries are also rethinking their energy strategies focussing more on cleaner renewable energy and reducing their dependence on fossil oil. Uganda could not afford any longer to delay the development of its oil project even if it meant ceding ground to some of the IOC demands.

For support with structuring commercially focused local content compliant investment structures for Uganda's oil and gas business opportunities, please contact your usual Cristal adviser for further information.

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. 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.

He holds a Master of Laws degree in Petroleum Taxation and Finance from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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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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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 of Laws degree from Makerere University and a Post Graduate Diploma in Legal Practice 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 Holding 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 UNOC's 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 enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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Francis leads the litigation and dispute resolution practice at the firm. He is an Advocate of the High Court of Uganda with expertise in oil and gas, infrastructure and dispute resolution. He has been part of teams advising on projects in Uganda, Tanzania, Mozambique and South Africa. He specializes in regulatory compliance, national content, health and safety and dispute resolution.

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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