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Planning a joint venture to serve Uganda's oil and gas industry

Some considerations

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Cristal Knowledge Series

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1. Introduction

As Uganda's upstream oil project passes critical milestones on the road to commercial production, it is important for Ugandans to grasp the opportunities presented. Since 2006 it has been a key objective of the government to encourage participation by local businesses in order to maximise the economic benefits of oil development for the people of Uganda. This lies behind the creation of UNOC and its key role in oil development. It is also the reason for legislation and regulations promoting Ugandan participation in the project through direct employment and the provision of goods and services by Ugandan businesses to the international oil companies operating the project.

The complexity of the Ugandan oil project means that specialist expertise and technology is required which is not currently available in the country. Whilst it is accepted that this must be provided by established international engineering, construction and oil field service companies, such companies are encouraged to establish joint ventures with Ugandan businesses to stimulate the creation of a local specialist business sector. This approach has been used successfully in other oil producing countries such as Kazakhstan and Nigeria.

The purpose of this article is to highlight some key issues that need to be considered in setting up such a joint venture. It has been prepared on the basis that a joint venture ('JV') is established by a Ugandan business and a single foreign partner. JVs with more than two parties are possible, but less common.

2. Choosing a JV partner

Whether the prospective JV partner is able provide the required goods and/or services is likely to be uppermost in choosing a partner. However, before establishing a JV, the parties should also consider more subjective areas such as:

- Has an effective working relationship been established between the key decision makers on both sides?
- If the prospective JV parties use different languages in day-to-day business communication, how is translation to be managed to ensure that there is complete clarity in communication between them?
- There may also be differences in business culture: how are these to be managed to avoid misunderstandings and friction between the parties?

For a Ugandan business, the first indication of some of these issues may arise in the 'due diligence' phase, when the prospective JV partner requires to see detailed financial and legal information about the business. For a family-owned business the request to disclose private information about sensitive matters such as tax and finances may present a challenge. There are also likely to be questions about relationships with government and business ethics which may seem impertinent to the uninitiated. These issues should be taken seriously as they are usually driven by the need to comply with anti-corruption legislation in the prospective JV partner's home jurisdiction. Such issues will also affect the day-to-day running of the JV if it goes ahead. Careful preparation for due diligence is essential and it is very important to consult with experienced advisers prior to starting the process of establishing a JV. And of course the Ugandan party should also consider what due diligence it needs to perform on its prospective partner: this should not be a one way street.

3. What kind of joint venture?

Once the prospective JV partners have taken the decision to proceed to the next step, a decision needs to be made about the type of JV to be used. This will be influenced by many factors including the requirements of local content regulations issued by the Ugandan government and the nature of the joint business. The most commonly used structures are the following:

- <u>A JV company</u>: this is a common approach and requires the parties to set up a company to carry on the JV activity. This will be a new legal entity separate from either of the JV partners. It will generate its own revenues and costs, requiring its own board of directors, management, assets, financing, financial statements and tax returns. This is most suitable where the JV is expected to engage in multiple projects over a long period and is the form aligned with the requirements of Uganda's local content rules.
- <u>An unincorporated JV</u>: this tends to be used for a single project and is usually based on a contract between the

parties defining a specific set of activities associated with that. No separate legal entity is created and there is no need for a separate management structure to be established. Costs and revenues will be shared between the JV parties in accordance with the contract and reflected in their individual financial statements and tax returns. Though this may assist towards meeting some local content requirements it will not constitute a *Ugandan company* for the purposes of the local content regulations.

Legally constituted partnerships between legal entities are also sometimes encountered but are not commonly used in Uganda so have not been addressed further in this article. More complex JV structures with multiple entities are also found, but to highlight the key issues this article will focus on the two models described above.

4. Establishing and operating the joint venture

Whatever JV structure is selected, a great deal of careful planning is required to ensure smooth operation. Critical issues to be considered include:

- The respective ownership interests of the JV parties. This will usually dictate how much share capital each party is required to invest and the proportion of profit distribution available to each. Where shares are not equal, care will need to be taken to ensure that the interests of the minority party are adequately protected. In the case of a 50/50 JV it will also be necessary to consider how to resolve a deadlock when the parties disagree on a course of action and in all cases a clear dispute resolution mechanism will be required.

- Agreeing the scope of the JV's activities. Both parties will have a clear idea of this at the outset but circumstances will change over time and it will be important to ensure that everyone is clear what the JV is (and is not) to do, particularly if there is a risk of competing for similar new business with one or both of the JV partners.

- Appointment of key management. This will include directors in the case of an incorporated JV. Executive directors and other personnel of the JV will need to be seen as acting in the interests of the JV itself rather than one or other of the JV partners. Each party to the JV will normally appoint non-executive directors to the board to represent it. It may be desirable to have an independent non-executive chairperson to assist in resolving any disagreements.

- Ensuring the JV has the resources it needs to conduct business. This may include providing assets, transferring employees and providing finance. In the case of an unincorporated JV this is likely to be simply a case of designating resources to be used for the joint activity. In the case of a JV company, it will be necessary to identify the legal nature of each provision of resources. For example, assets may be sold to the JV company, leased to it or contributed as consideration for the issuing of shares. Where assets are transferred, the value will need to be agreed between the parties which could be tricky in the case of specialised assets such as intellectual property. Where partners provide goods, services or finance to the JV, both parties will need to be satisfied that an arm's length consideration is being provided by the JV in return so as to ensure that one JV partner is not profiting at the expense of the other. Such transfers will also give rise to direct and indirect tax issues.

- JV partners will require means to monitor performance of the JV. Preparation and audit of annual financial statements (legally required only in the case of an incorporated JV) will not provide sufficiently timely information to monitor the performance of a JV. Financial reports are likely to be required quarterly or even monthly with timely access to JV management to monitor performance against budget. The partners should also be involved in budgeting processes itself.

In the case of an incorporated JV, a shareholder agreement should be prepared to address all relevant issues. In the case of a contractual JV, the JV agreement should fulfil the same function.

5. Dissolving a JV

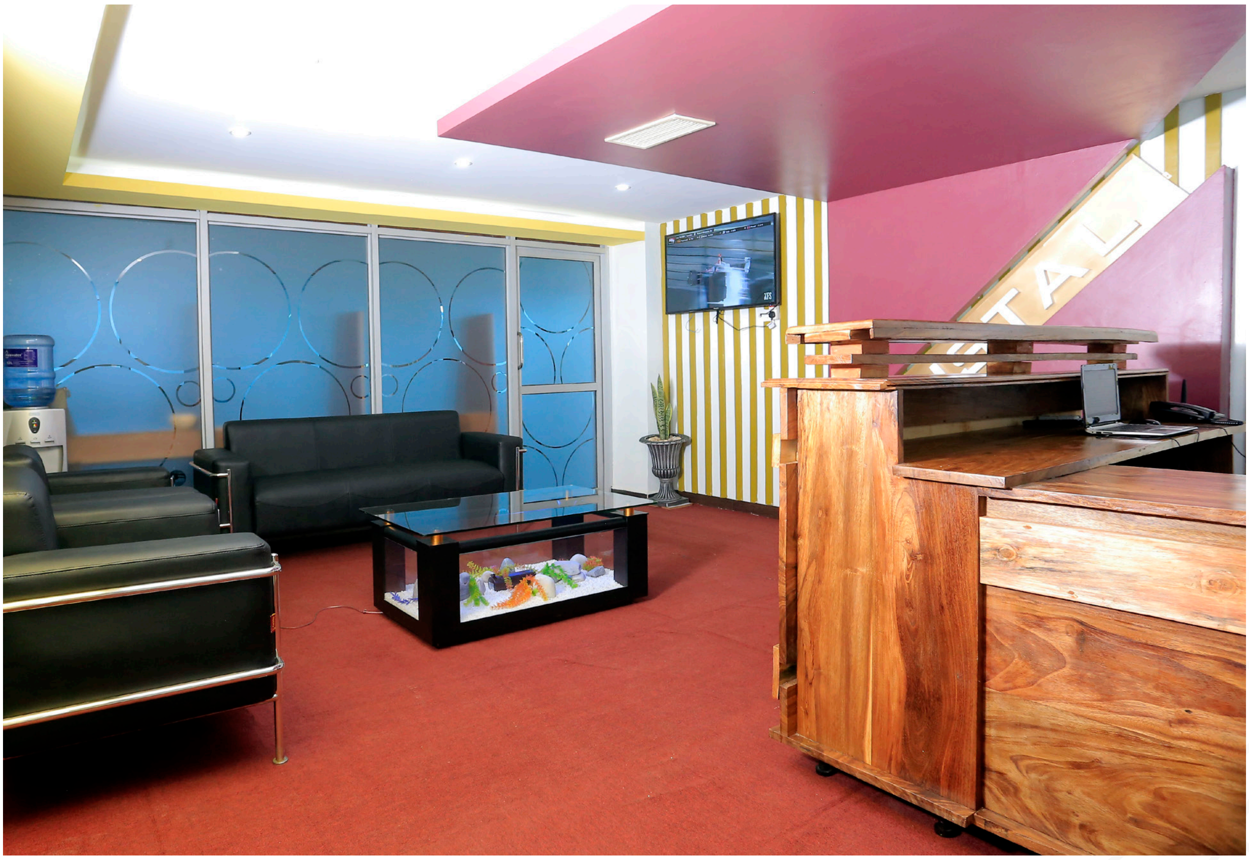
Both parties should appreciate that the JV will have a finite life even if it is very successful. A key part of JV planning, often neglected, is ensuring that the parties have a clear exit strategy when the time comes to wrap up the JV. This is likely to be straightforward in the case of an unincorporated JV as the parties will simply terminate the agreement between them and continue with their respective businesses. An incorporated JV will be a different story however as any remaining assets will need to be disposed of and any remaining liabilities (including tax) settled. In particular, the parties will need to ensure that there is an agreed plan to address any contingent liabilities.

6. Other approaches

Given the complexity of establishing a JV, some businesses may prefer a less elaborate form of cooperation, particularly at the start of a business relationship. One option might be for a Ugandan business to contract with the prospective partner to purchase goods and/or services and in turn provide these to the ultimate customer. The transfer of expertise and relationship-building can also be enhanced by seconding staff from the Ugandan entity to the international business and vice versa. There may be other options, depending on the specifics of the respective businesses.

7. Concluding remarks

Establishing a JV is one of the most complex areas of business and involves the consideration of a wide range of commercial issues. Tax, financial, legal and human resource aspects are also critical in ensuring success. For Ugandan businesses considering this strategy for the first time, it is important to get the best advice before embarking on the establishment of a JV. We at Cristal Advocates have extensive experience in the area and would be happy to assist, of course.



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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.

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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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