Conducting oil and gas activities in Uganda

CMS Cameron McKenna

Laws and regulations

List the main legislation governing petroleum exploration and production activity in your country.

The relevant legislation governing oil and gas activities in Uganda is as follows:

1. The Petroleum (Exploration and Production) Act, (Cap 150) (the 'PEPA').
2. The Petroleum (Exploration and Production)(Conduct of Exploration Operations) Regulations, S.I 150-1 (the 'Petroleum Regulations').
3. The Petroleum (Exploration, Development and Production) Bill, 2012 (the 'Upstream Bill') seeks, inter alia, to amend the existing laws and to put in place institutions to regulate the licensing and participation of commercial entities in petroleum activities. The Bill was passed by Parliament in December 2012 and assented to by the President, but has not yet been gazetted.

Identify the Government, regulatory and/or oversight bodies principally responsible for regulating oil and gas activities.

The Ministry of Energy and Mineral Development (the 'MEMD') is responsible for regulating oil and gas activities in Uganda. The petroleum sector policy objectives of the MEMD are carried out by the Petroleum Production and Exploration Department. The Parliament of Uganda exercises an oversight function over the oil and gas sector.

The Upstream Bill provides for the establishment of the Petroleum Authority to monitor and regulate the exploration, development and production of petroleum in Uganda. Although the Upstream Bill guarantees the independence of the Authority, it empowers the MEMD to give directions to the Authority with respect to policy to be observed and implemented by the Authority.

Entry requirements

What are the registration requirements for becoming a licensee of an oil and gas production sharing contract/ licence/concession (Licence) in your country? For instance, is it necessary to incorporate a subsidiary, or register a branch?

In order to be eligible for a Licence under the PEPA:

(a) a natural person must be a citizen of Uganda;

(b) a body corporate must:

- (i) be incorporated in Uganda; or
- (ii) if incorporated outside Uganda, establish a place of business in Uganda and be registered as a foreign company in accordance with the Companies Act.

Under the Upstream Bill, the licensee will be required to maintain a company registered in Uganda which is authorised and capable of independently managing petroleum activities subject to Ugandan jurisdiction.

Are there any foreign investment approval requirements or restrictions when commencing business in your country (e.g. a minimum local shareholding in the entity undertaking the activity)?

A company must have a place of business in Uganda and also be registered as a foreign company in Uganda in order to qualify for a Licence under the PEPA. There are no other foreign investment approval requirements or restrictions when commencing business in the oil and gas sector.

Licensing

Identify the main fiscal/legal model granting rights to explore and produce oil and gas.

Legal

Under the PEPA, the property in and the control of petroleum in its natural condition in or upon any land in Uganda is vested in the Government on behalf of the Republic of Uganda. Rights to explore and produce oil are granted through a production sharing agreement (PSA). A Licence may be granted in addition to the PSA.

Further information, including a list of our offices, can be found at
www.cms-cmck.com

Fiscal

(a) Income Tax

A contractor is subject to tax in accordance with the Income Tax Act, (Cap 340) (the 'ITA') and the PSA. Uganda has special provisions for taxation of petroleum operations. These are incorporated in Part IXA of the ITA. In summary the tax rules as per Part IXA state that:

(i) The gains taxable on petroleum companies are those derived after taking account of petroleum sales (which should be determined at arm's length) and claiming certain eligible expenses such as: a) cost of an asset or other exploration expenditure incurred in undertaking petroleum operations; b) development and production expenditure; c) any expenditure incurred in transportation facilities; d) operating expenses; e) service costs; and f) general and administrative expenses (as defined in the schedule to the ITA). Contractors are taxed on their share of the profit oil only.

(ii) For the purpose of determining contractor's gross income derived from petroleum operations from a contract area, petroleum is valued and measured in accordance with the provisions of the petroleum agreement, subject to any further procedures that may be agreed in writing between the Government and the contractor.

(iii) Repatriation of profits by contractors: a participation dividend paid by a resident contractor to a non-resident company is liable to a withholding tax at a rate of 15%. A lower rate of withholding tax may apply if the dividend is paid to a resident of a country with whom Uganda has a favourable Double Taxation Agreement.

(iv) Contract areas are ring fenced for tax purposes. Each contract area of a contractor is taxed as if it is a separate tax payer. Therefore this puts a limitation on consolidation of income and deductions for tax purposes across different activities or different projects undertaken by the same taxpayer. Tax deductible costs or expenditure incurred in respect of a contractors petroleum exploration and development expenditure in one contract area or block or oil field will only be deducted from income derived from that contract area only. Losses arising from activities in one contract area will only be carried forward and offset against future income derived from petroleum operations of that contract area.

(v) The rate of tax applicable to contractor's share of the profit oil is the standard corporation rate tax of 30%.

(b) Other forms of revenue under the PEPA and the PSAs include:

(i) Royalty;

(ii) Signature bonus;

(iii) Discovery bonus; and

(iv) Charge payable on the grant of a Licence and thereafter annually on the anniversary of the grant until the termination of the Licence.

Please outline the procedure to apply to the Government for an interest in a Licence in your country. Please include details of cost and timing for obtaining such interest.

An application for a petroleum exploration licence must be made to the MEMD and satisfy a number of conditions:

(a) in respect of the person making the application, in the case of an individual, provide his or her full name and nationality and in the case of a body corporate, provide its name and place of incorporation, the names and nationality of the directors or equivalent officers and, if the body corporate has share capital, the name of any person who is the beneficial owner of more than 5% of the issued share capital;

(b) identify the block or blocks in respect of which it is made;

(c) be in respect of not more than sixty blocks (except that the Minister may consider an application in respect of more than sixty but not more than two hundred blocks where she is satisfied that special circumstances exist for doing so);

(d) give or be accompanied by a statement giving particulars of work and the minimum expenditure proposed for the block or blocks over which the Licence is sought;

(e) give information on the financial status and the technical and industrial competence and experience of the applicant; and

(f) give or be accompanied by a statement giving particulars of the applicant's proposals with respect to the employment and training of citizens of Uganda, and may set out any other matter which the applicant wishes the Minister to consider.

The PEPA does not provide for cost and timing for obtaining a petroleum exploration licence.

The Upstream Bill introduces the changes below with regard to the procedure of applying for an exploration licence:

(i) The Minister is required first to call for bids for a petroleum exploration licence by notice published in the Gazette and a newspaper of national and international circulation. The bidding process must be carried out in a fair, open and competitive manner in accordance with the Public Procurement and Disposal of Public Assets Act, 2003. In exceptional circumstances, the Minister is permitted to receive direct application for an exploration licence. The exceptional circumstances include where there are no applications received in response to the invitation for bids, application in respect of areas that are adjacent to an existing licensed reservoir and promotion of national interest.

(ii) Any party affected by the proposed exploration activity is given an opportunity to lodge, with the Minister, an objection to the grant of the exploration licence, setting out the grounds of the objection.

(iii) The form and requirements for the application for an exploration licence under the Bill have not changed save that the application shall only be in respect of not more than 10 blocks (as opposed to the 60 blocks that are permitted under the PEPA). The Minister is permitted to consider an application in respect of more than 10 blocks but not more than 20 blocks where the Minister is satisfied that special circumstances exist for doing so.

(iv) The Minister may grant the exploration licence after consultation with the Authority and with the approval of the Cabinet.

(v) The application must be accompanied by a prescribed fee. The fees are to be prescribed in the Regulations made under the Upstream Bill.

(vi) In terms of timing, the Minister must, within 60 days after receipt of an application for an exploration licence, confirm in writing to the applicant that the application is complete in all respects. The Minister must process all applications expeditiously and in any case not later than 180 days after receipt of the application.

Upon discovery of petroleum in an exploration area, the licensee is required to immediately inform and furnish to the Commissioner for Petroleum Exploration and Production (the 'Commissioner') particulars of the discovery, run tests in respect of the discovery, undertake a technical evaluation of the discovery and submit the technical evaluation to the Commissioner as soon as it is complete.

The holder of the petroleum exploration license may then apply for a grant of a petroleum production licence over any blocks in that area which, following appraisal, can be shown to contain a petroleum reservoir or part of a petroleum reservoir.

The application for a petroleum production licence must be made within two years from the date on which the technical evaluation of test results was submitted to the Commissioner or as may be stipulated in the PSA.

The application for grant of a petroleum production licence must be accompanied by:

(a) a report on the petroleum reservoir (as defined under the PEPA)
(b) a development plan (as defined under the PEPA)
(c) any relevant information that the Minister may reasonably require, including information relating to alternative proposals for development and production not included in the development plan and
(d) any other information that the applicant may deem necessary.

The Upstream Bill introduces the following changes with regard to the application process for a petroleum production licence:

(i) The holder of a petroleum exploration licence who has made a discovery of petroleum in his exploration area shall have an exclusive right to apply for the grant of a petroleum production licence over any block or blocks in that area which, following appraisal, have shown to contain a petroleum reservoir or part of a petroleum reservoir.
(ii) Where the holder of an exploration license does not apply for a production licence, the Minister may, by publication in the Gazette and in newspapers of national and international circulation, announce that the areas are open for bidding for a petroleum production licence.
(iii) The Minister may in consultation with the Authority and upon the approval of the Cabinet grant to the applicant a petroleum production licence, on such conditions as the Minister may determine.
(iv) A petroleum production licence may be granted jointly to the applicant and the national oil company.
(v) The application must be made in a manner prescribed by regulation and must be accompanied by the prescribed fee.
(vi) In terms of timing, the Minister must process all applications or bids for a production licence expeditiously and in any case no later than 180 days after receipt of the application.

What is the customary duration of the relevant Licence?

An exploration licence is valid for the period stated in the Licence but for not more than four years. The Licence may be renewed for a term of no more than two years, except that the Licence shall not be renewed more than twice.

Under the Upstream Bill, a petroleum exploration licence unless otherwise determined by surrender or cancellation shall remain in force for the period stipulated in the Licence but not exceeding two years after the date of the grant and it may be renewed for a further period of two years, except that the Licence shall not be renewed more than twice.

A production licence is valid for a period not exceeding 25 years. It may be renewed for a period prescribed by the Minister. The PEPA does not state the term of renewal. A production licence may be renewed only once.

Under the Upstream Bill, a petroleum production licence shall remain in force for the period for which the application has been made but not exceeding 20 years from the date of the grant and for any period for which the Licence is renewed under the Act.

Does the Government have any right to participate and be carried in the Licence? If so, please describe the extent of this entitlement.

Is there any mechanism for recovery of carry costs?

Unless otherwise stated in the PSA, the Government does not have a right to participate and be carried in the Licence.

The Upstream Bill contains provision on the right of Government to participate in petroleum operations. It provides that the Government may participate in petroleum activities through a specified participating interest of a Licence or contract granted under the Act and in the joint venture established by a joint operating agreement in accordance with the Licence and the Act. The Minister shall, with the approval of the Cabinet, specify the Government share under this section.

Does the Government have any right to participate in the operatorship of the Licence?

Unless otherwise stated in the PSA, the Government does not have a right to participate in the operatorship of the Licence.

Assignment

What Government and/or regulatory approvals are required for the acquisition of oil and gas interests held under a Licence (whether by asset or corporate sale/change of control)?

If any, what are the timing requirements and costs of obtaining such Government and/or regulatory approvals?

A Licence may not be transferred or assigned, whether directly or indirectly, without the Minister's approval. The transfer or assignment can only be effected by an instrument in writing.

The Minister is mandated to approve a transfer if the transfer is to a person controlling, controlled by or under common control with the transferor provided that that person is not disqualified under any provision of the PEPA from holding a Licence.

The PEPA does not prescribe timelines.

The Upstream Bill contains similar provisions on transfer or assignment. The requirement to obtain the Minister's consent also applies to any direct or indirect transfer of interest or participation in the Licence, including the assignment of shareholdings and other ownership shares which may provide decisive control of a licensee possessing a participating interest in a Licence. Control in relation to any person is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management by that person, whether through the ownership of shares, voting, securities, partnership or other ownership or participation interests, agreements or otherwise.

Are there any pre-emptive rights reserved to any Government entities in the event of a proposed assignment of an interest held under a Licence? If so, what are the terms upon which such entities are allowed to acquire the interest?

There are no pre-emptive rights reserved to the Government in the event of a proposed assignment of an interest held under a Licence.

Economic support

Are parental guarantees or other economic supports commonly required to be provided by oil and gas companies?

Under the PEPA, the Minister may require an applicant to make arrangements as may be satisfactory to the Minister for the execution of a bond or some other form of security for the performance and observance of the conditions to which the Licence when granted may be subject.

The Commissioner is also empowered to make such arrangements as appear appropriate to secure that a licensee complies with the PEPA and Licence, and the Commissioner may, in particular, accept guarantees, whether from shareholders or otherwise, in respect of that compliance.

We are unable to ascertain whether such guarantees are commonly requested in practice since the PSAs that have been signed by the Government are not available to the public.

Are security deposits required in respect of work commitments or otherwise?

The PEPA does not state a requirement for security deposits.

Abandonment and Decommissioning

What abandonment regime is in place?

Are security deposits required in respect of future decommissioning liabilities?

The PEPA does not contain detailed procedures on abandonment and decommissioning. It only provides that the closure or plugging of any well must only be carried out with the prior consent, in writing, of the Commissioner and in the manner approved by the Commissioner.

The Petroleum Regulations provide that every exploratory well, whether a dry hole or a discovery, shall be abandoned in a safe condition. The wells must be plugged with appropriate cement plugs, the wellhead removed and a steel plate welded on the top of the casing. The location of the abandoned well must be restored to the original site condition to the extent possible and must be marked with the well name and number in a manner approved by the Commissioner

The PEPA does not state a requirement for security deposits in respect of future decommissioning liabilities.

The Upstream Bill contains elaborate provisions on decommissioning and abandonment process. A licensee is required to submit a decommissioning plan to the Petroleum Authority before a Licence to install and operate facilities expires or is surrendered; or at the earliest four years but at the latest two years before the use of a facility is expected to be terminated permanently. A licensee is required to establish a decommissioning fund for each development area which must be applied to the implementation of activities approved in the decommissioning plan.

Payments into the decommissioning fund must commence from the calendar quarter in which any of the following situations occur:
(a) the petroleum production has reached 50% of the aggregate recoverable reserves as determined in an approved development plan and any successive reappraisal of such initial recoverable reserves;
(b) five years before expiration of the Licence; or
(c) on notice of surrender.

For every subsequent calendar quarter in which petroleum is produced or a facility operated, the Petroleum Authority is required to charge the licensee a proportion of the estimated future cost for decommissioning of facilities to be deposited in the fund.

The amount deposited in the decommissioning fund is charged as operating costs subject to the cost recovery limitations stipulated in the PSA and/or the Regulations.

Information provided by:
Mr. Phillip Karugaba
Masembe, Makubuya, Adriko, Karugaba and Ssekatawa Advocates (MMAKS Advocates)
3rd Floor, DTB Centre, Plot 17/19 Kampala Road
P.O. Box 7166, Kampala, Uganda

T: +256 414 251388
www.mmaks.co.ug

Contacts

Bob Palmer
Partner, Energy
M +44 (0) 7831 248814
T +44 (0)20 7367 3656
E bob.palmer@cms-cmck.com

CMS Cameron McKenna LLP
Mitre House
160 Aldersgate Street
London EC1A 4DD
T +44 (0)20 7367 3000
F +44 (0)20 7367 2000
www.law-now.com