

Energy briefing

# Petroleum Law in Uganda: Will a new regime and lower taxes lead to a successful licensing round?

Following a seven-year moratorium on petroleum activities in the Republic of Uganda (**Uganda**), the Ugandan Government announced its first ever licensing round for petroleum exploration on 26 February 2015. On offer are six blocks in the Albertine Graben, which Uganda has estimated could hold as much as 6.5 billion barrels of oil. Most of the other four sedimentary basins remain unlicensed and unexplored at this stage. The closing date for receipt of qualification documents for Uganda's first licensing round is 29 May 2015. The licensing round will be based on the current petroleum regime, which was revised in 2013.

In addition, the Government recently announced that it is taking action to reduce the tax burden on oil and gas companies in order to attract investment. Specifically, companies will be exempted from value-added and withholding taxes during the investment phase of projects. This is a clear change from the general trend towards increased taxes and royalties in many African jurisdictions over the last few years and demonstrates that Uganda is anxious to develop the potential offered by its oil and gas resources.

In this briefing, we consider the key features of the Ugandan petroleum regime.

## Legal framework

On 5 April 2013, Uganda's Petroleum (Exploration, Development and Production) Act 2013 (the **Act**) came into force. This repealed the earlier 1985 petroleum law.

## A new institutional regime

Under the Act, the upstream oil and gas sector in Uganda is managed by three main entities:

- The Minister for Energy and Mineral Development (the **Minister**) is responsible for granting and revoking licences, developing and implementing Uganda's oil and gas policy, issuing regulations,

approving field development plans and negotiating petroleum agreements.

- A newly established Petroleum Authority of Uganda (the **Authority**) is tasked with monitoring, approving and regulating exploration, development and production of petroleum in Uganda. The Authority is stated to be independent. However, the Minister may give written directions to the Authority with respect to the policy to be implemented. Funding for the Authority is provided by Parliament and Authority profits. The Authority has been given certain enforcement powers where a licensee fails to comply with written directions.
- A newly established State-owned National Oil Company (the **NOC**) is to manage the commercial aspects of Uganda's petroleum activities and the participating interests of the State under petroleum agreements. As with the Authority, the Minister may issue instructions in respect of the NOC's execution of its functions under the Act.

In addition, the National Environment Management Authority and the Uganda Revenue Authority are also responsible respectively for environment and fiscal matters.

## Petroleum rights

The Act confirms that all petroleum rights are vested in the Government of Uganda. Companies are allowed to carry out petroleum exploration, development and production activities only if they hold certain consents and permits. The Act sets out six petroleum rights:

- (1) reconnaissance permits providing a non-exclusive right to carry out certain surveys and potentially shallow drilling for data calibration purposes;
- (2) petroleum exploration licences;
- (3) petroleum production licences;
- (4) licences for the placement and operation of a facility;

- (5) permits to operate drilling rigs; and
- (6) production permits.

Items (2), (3) and (6) are the most relevant in the context of the current licensing round so are explored in more detail below.

#### **Petroleum exploration licences**

The Minister may, in consultation with the Authority and with the approval of the Cabinet, grant petroleum exploration licences. Typically this will be done by a bidding process. However, in exceptional circumstances, the Minister may receive direct applications.

The Act sets out the following steps in the bidding process for petroleum exploration licences:

- A public announcement in the Gazette and national and international newspapers kick-starts the process. In this instance, an announcement was published on 26 February 2015. Applications must be in writing and accompanied by the prescribed fee (here, US\$20,000). The application must identify the name and place of the applicant's incorporation, the applicant's directors, any beneficial owners and the blocks in respect of which the application is made. It must also be accompanied by a statement of work and minimum expenditure commitment, information on the financial status and technical competence of the applicant as well as information on its proposals with respect to the training and employment of citizens of Uganda. Applications relating to more than one block must relate to blocks situated so as to form one single area or be such that each block in the area has a side in common with at least another block in the area.
- The Minister shall, within 60 days of receipt of an application for a petroleum exploration licence, provide confirmation in writing to the applicant that the application is complete. Where the Minister receives an incomplete application, he shall, in the case of a bidding round, reject that application.
- Successful applicants will receive a licence, which grants an exclusive right to explore for petroleum in specified blocks and binds licensees to:
  - a) carry out a minimum work programme;
  - b) explore the licensed area;
  - c) commence seismic surveying; and
  - d) drill a minimum number of wells.

There may be included in the licence a term that the Government, or any person identified in the licence, may hold an option to acquire an interest in any

venture for the production of petroleum which may be carried on in any of the blocks covered by the licence.

- The initial term of an exploration licence will be two years, with the possibility to extend twice for two years at a time. For this licensing round, however, the Ugandan government has stated that exploration licences will be issued for these blocks for an initial six-year term, split into three two-year periods, each carrying minimum work, expenditure and relinquishment obligations. If a commercial discovery is made, the Ugandan government has stated that it will "back-in" for a minimum interest of 15 per cent.
- If petroleum is discovered, the licensee must immediately inform the Authority and, within 30 days, submit particulars of the discovery in writing, followed by a technical evaluation report in due course.

#### **Petroleum production licences**

The Act sets out the following steps in the bidding process for petroleum production licences:

- A petroleum exploration licensee, who has made a discovery of petroleum, shall for two years after the submission of the technical evaluation report have the exclusive right to apply for a petroleum production licence over the blocks shown to contain a petroleum reservoir.
- If the licensee fails to make an application within this two-year period, the Minister may by notice in writing to the licensee direct that the discovery area shall cease to form part of the petroleum exploration area. The area may then be re-opened to bidding.
- An application for a petroleum production licence must include (1) a report on the petroleum reservoir (including the chemical composition and properties of the reservoir); (2) a field development plan (including the method for development, financing and drilling) and (3) anything else that the Minister may require or the applicant thinks is relevant.
- The Minister shall process all applications not later than 180 days after receipt.
- The granting of a petroleum production licence grants exclusive rights to the licensee to carry on petroleum activities in the licence area. It may be granted jointly to the applicant and NOC or two or more applicants.
- A petroleum production licence shall continue in force for the period stated in the application, but not exceeding 20 years and may be renewed for a further 5-year period(s).

### Production permits

The Act states that the Minister shall in consultation with the Authority before or concurrently with a petroleum production licence approve the production schedule in a licensee's field development plan and issue an annual production permit to the licensee. This will approve, for a fixed period of time, the quantity of petroleum which may be produced. The Minister may order production to be increased or decreased in relation to an approved production plan and shall apportion such increase or decrease proportionately between relevant reservoirs.

Where a licensee is not recovering petroleum in an area in which the Authority believes there is recoverable petroleum, the Authority may direct the licensee to recover that petroleum. The Minister may also, in consultation with the Authority, postpone petroleum production.

### Petroleum agreements

The regime also gives the Minister the power to enter into an agreement relating to petroleum activities to be performed in connection with a licence, including the granting and renewal of the licence, and the performance of petroleum activities on behalf of the licensee.

The Act requires the Minister to procure a model production sharing agreement (or any other model petroleum agreement consistent with the Act). The new model petroleum agreement shall be submitted to the Cabinet and the Parliament for approval. A new model petroleum agreement has not yet been published at this stage.

Under the Act, the model petroleum agreement is intended to "guide negotiations of any future agreements". However, it is not very clear how licences and petroleum agreements interact. The regulatory process for the award of hydrocarbons exploration and exploitation rights in Uganda remains based on licences and does not specifically include the entry into a petroleum agreement. Certain legal and tax terms and conditions pertaining to a licence shall, however, be provided for in a related petroleum agreement, which therefore seems necessary under the Act.

### Transfers

Direct and indirect transfers and changes of control are permitted provided the Minister provides his written consent in consultation with the Authority. The Minister may not unreasonably withhold this consent unless he believes that public interest or safety is at stake.

Capital gains generated in connection with assets disposals in Uganda trigger capital gains tax at the current rate of 30 per cent.

### Local content

Under the Act, any application for an exploration or a production licence must include a local content plan for the involvement of local employees and the use of local goods and services. The licensee shall also submit recruitment and training plans to the Authority ever year.

The licensee is required to give preference to goods which are produced or are available in Uganda and services rendered by Ugandan citizens and companies. Where such goods or services are not available, the licensee is obliged to enter into a joint venture with a Ugandan company under which the Ugandan company holds at least a 48 per cent stake.

The Act does not, however, define when goods or services can be deemed "not available" in Uganda, what qualifies as a "Ugandan company" and what involvement this Ugandan company must have in the joint venture.

### State participation

The State may participate in petroleum activities through a specified participating interest in a licence or contract granted under the Act and in a joint venture established by a joint operating agreement in accordance with the licence and the Act.

### Fiscal framework

The Act also sets out the fiscal framework applicable to licensees, namely mainly:

- **Royalty** in cash or kind is due at the delivery point as stipulated in the petroleum agreement. In previous production sharing agreements, royalty is based on gross production with a 5-12.5 per cent range.
- The Act does not specifically provide for **cost recovery** and **production sharing**. In previous production sharing agreements, however, the production remaining after payment of the royalty is allocated to the licensee (cost recovery) with a 60 per cent ceiling and then shared between the licensee and the State (production sharing) with a 46-67 per cent range for the State on a sliding scale basis.
- An **annual charge** is payable on the grant of a licence and thereafter annually until termination.
- A single, non-recoverable lump sum bonus is due on award of petroleum exploration or production licences.
- **Corporation tax** at the current rate of 30 per cent is due on the profits of sale of the licensee's share of production in accordance with the Income Tax Act.

## Main key issues at this stage

The following are some issues that potential bidders should note:

- The new petroleum regime applicable to hydrocarbons exploration and exploitation activities in Uganda is not yet comprehensive. Unless and until implementation regulations and a model contract are issued, it will be challenging for bidders to assess the attractiveness of the new regime and therefore to submit an application.
- Some of the key commercial terms will be set out in the petroleum agreements, and will be subject to negotiation between the Government and international oil and gas companies.
- The Act does not contain any provisions mandating stabilisation or equilibrium provisions. However, the parties may agree these.
- Similarly, the Act does not contain any provisions governing potential dispute resolution.
- The NOC has not yet been fully established. Companies should therefore expect delays as the setting-up of this entity is being finalised and the three institutions tasked with managing Uganda's upstream oil and gas sector delineate roles amongst each other.

## Licensing round timetable

Date	Activity
26 February 2015	Publication of notice of request for qualification documents
29 May 2015	Closing date for receipt of qualification documents
1-30 June 2015	Evaluation of applications
10 July 2015	Display of qualified applicants
20 July 2015	Issue of request for proposal/ bidding document to qualified applications
Q4 2015	Petroleum agreement to be signed and exploration, development and production licences to be issued

If you have any questions on the content of this briefing, please speak to your usual Ashurst contact, or one of the contacts below.

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