



global witness

A GOOD DEAL BETTER?

UGANDA'S SECRET
OIL CONTRACTS
EXPLAINED



SEPTEMBER 2014

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UGANDA'S SECRET OIL

CONTRACTS EXPLAINED

ACRONYMS

ADF	Allied Democratic Forces	IRR	Internal Rate of Return
AFIEGO	Africa Institute for Energy Governance	JOA	Joint Operating Agreement
AGM	Annual General Meeting	MMDA	Model Mining Development Agreement
AIM	Alternative Investment Market	MOU	Memorandum of Understanding
AIPN	Association of International Petroleum Negotiators	NEMA	National Environmental Management Authority
BOPD	Barrels of Oil Per Day	NGO	Non-Governmental Organization
BVI	British Virgin Islands	NOC	National Oil Company
CNOOC	Chinese National Offshore Oil Corporation	NPV	Net Present Value
CSOs	Civil Society Organisations	NRC	Natural Resource Charter
DfID	(UK) Department for International Development	Oxcarre	Oxford Centre for the Analysis of Resource Rich Economies
DRC	Democratic Republic of the Congo	PEPD	Petroleum Exploration Production Department
EA	Exploration Area	PSA	Production Sharing Agreement
EIA	Environmental Impact Assessment	PSC	Production Sharing Contract
EITI	Extractive Industry Transparency Initiative	SEA	Strategic Environmental Assessment
FCO	(UK) Foreign and Commonwealth Office	SIA	Social Impact Assessment
GEI	Green Environment Initiative	SIAP	Social Impact Assessment Plan
GIDS	Green Impact and Development Services	TAT	Tax Appeals Tribunal
IFC	International Finance Corporation	UNCITRAL	United Nations Commission on International Trade Law
IMF	International Monetary Fund	UNGPs	United Nations Guiding Principles on Business and Human Rights
IOC	International Oil Company	UPDF	Uganda People's Defence Force
IPIECA	International Petroleum Industry Environmental Conservation Association	URA	Uganda Revenue Authority
IPIS	International Peace Information Service	US EIA	United States Energy Information Administration
		UWA	Ugandan Wildlife Authority

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1 / EXECUTIVE SUMMARY

This report analyses and makes public two Production Sharing Agreements agreed by the Ugandan Government and international oil companies in February 2012. They determine what share of oil revenues the government of Uganda will get and almost every aspect of its relationship with the oil companies. Despite general contract terms being widely available within the industry, these contracts have not been public until now.



EXECUTIVE SUMMARY

As Uganda moves closer to oil production, and the Government prepares to announce another allocation round of oil licences in areas of great social and environmental sensitivity, the need to understand and address any gaps in the country's regulatory framework has never been more urgent.

Global Witness has taken the decision to publish two oil contracts that we have seen due to the overwhelming public interest inherent in contract transparency (more information on this topic can be found in both our [contract transparency briefing](#) available on our website, and in Box 3 on [page 17](#)). The publication of contracts allows Ugandan citizens to monitor companies' activities on the ground and their compliance with their contractual obligations, including environmental and social protection. This is a crucial part of corporate accountability. Publication empowers citizens to demand more from companies as well as assist their government to negotiate more favourable terms in future. It also enables citizens to evaluate and monitor the financial benefits that will accrue from their countries natural resources.

If Ugandan citizens are to understand whether their government is getting a good financial deal on their behalf as well as safeguarding their rights, then they need to be able to examine these documents. These PSAs are fundamental to any meaningful understanding of the sector and the deal that has been done on their behalf. All three companies currently operating in Uganda have told Global Witness that they are willing for the contracts to be published if the other companies and the Government also agree. Both Total and Tullow have publicly stated this position. Tullow voluntarily discloses disaggregated payments it makes to the Ugandan government already.

Our analysis actually shows some good news for the country that the Government should want to share with its citizens. To its credit, the Government of Uganda has achieved a better financial deal for its oil in these contracts than under similar agreements made before 2008. Our analysis also seems to indicate significant weaknesses that still need to be addressed. The contracts appear to lack some important human rights and environmental safeguards. This is of particular

concern given the unique habitats of the oil region in Uganda which sits on the DRC border and the Nile river.

The improved financial terms in the contracts could earn the state hundreds of millions of dollars in additional revenue and secure the Government a very high percentage of the oil profits. This is positive, but there is a danger that any economic benefit will be undermined by detrimental social and environmental impacts unless better protections are put in place. Issues identified in this report include:

- There is no legal obligation on ministers to publish impact assessments, mitigation plans and other key information, resulting in Ugandans being kept in the dark about what has been agreed or how much money is being put aside for their protection. The confidentiality clauses in these contracts may even prevent the Government from publishing this information.
- Gaps in the laws and in the contracts risk leaving communities affected by oil drilling or pollution without the compensation that they may need to rebuild their lives.
- The contracts make no provision for a conflict resolution mechanism to resolve disputes between communities, government and companies.
- There is no requirement in the PSAs or Ugandan law for companies to set aside funds for decommissioning at an early stage. This creates the risk that companies could 'cut and run' leaving the Government to foot the bill for rehabilitating extraction sites.
- Unsatisfactory "cost recovery" provisions could leave the Ugandan Government paying some of the bills for company lawsuits, even if the dispute was with Ugandan communities affected by pollution.

This report also contains the results of a financial modelling exercise to build a picture of how much money the Government might receive for its oil. This



The Albertine Rift is home to half of all species of African birds. © Rolling Earth

shows that Uganda is likely to receive between 80% and well over 90% of revenues, after costs have been recovered, depending on the amount of oil which is discovered and its price.

However, obscurity surrounds payments made by oil companies into the national budget. Currently Tullow Oil is the only company that is voluntarily disclosing disaggregated payments to the Ugandan Government. Soon EU and US legislation will oblige the three

companies operating in Uganda to publish the payments that they make to the Government. However, the current standard of government reporting makes it impossible for citizens to track these revenue payments accurately into the national budget. It also remains unclear how the national oil company will operate and how transparent it will be.

Much of the extraction of oil discovered to date will continue to be governed by pre-2008 PSAs. These



Contract transparency helps citizens hold companies and government to their contractual obligations. © istockphoto/mtcurado

contracts share many weaknesses with the 2012 PSAs as they are based on the same model. A particular concern is that, unlike the 2012 contracts, the pre-2008 contracts allow companies to seek compensation from the Government for any additional costs resulting from more robust environmental and social protection measures.

Global Witness calls on the three companies operating in Uganda to agree to change the stabilisation clauses in these older contracts to bring them into line with those in the 2012 contracts which are limited only to tax. This would give the Government a free-hand to safeguard its people and environment.

We hope that this report will provide useful guidance as the Government of Uganda develops a new “model contract” for future deals and further regulations for the sector, as prescribed by its new petroleum laws. This analysis, [the contracts themselves](#) and [the economic modelling tool](#) used to create the results will also help civil society, journalists and policymakers to make more informed assessments about how to manage Uganda’s oil and the money that comes from it in future.

2 / INTRODUCTION

This report was produced with the help of three teams of legal experts and contract specialists as well as in-house lawyers and Global Witness staff, each with a particular area of specialisation including environment, human rights and financial terms. This report also uses a financial modelling tool created in order to assess the terms of the contract under different scenarios. This tool is available to download on our website as are all the supporting documents, including the contracts themselves.

INTRODUCTION

This report provides a detailed analysis of the two contracts including the financial terms, environmental protection requirements, and social and human rights provisions. It also compares these terms with those in the two new petroleum laws. The intention is to help policy makers and civil society identify strengths and weakness in the legislative and contractual framework as well as potential risks. The report contains detailed recommendations and best practice examples.

2.1 Aims, contracts and methodology

Aims of this report

This report scrutinises the two Ugandan Production Sharing Agreements (PSAs) dated February 2012 and puts them in the public domain for the first time, giving citizens access to vital information about their oil sector. It provides a detailed analysis of the two contracts including the financial terms, environmental protection requirements, and social and human rights provisions. It also compares these terms with those in the two new petroleum laws– the Petroleum (Exploration, Development and Production) Act (known as the Upstream law) and the Petroleum (Refining, Conversion, Transmission and Midstream Storage) Act (Midstream law) – in order to evaluate the overall regulatory environment and how it will affect companies, the Government, people and the environment.

This report will help policy makers and civil society identify strengths and weakness in the legislative and contractual framework as well as potential risks. It contains detailed recommendations and examples of best practice. Annex 2 provides examples of alternative model PSA terms and specific guidelines.

What is a Production Sharing Agreement?

With commercial quantities of oil only recently having been discovered, Uganda does not have a domestic oil and gas industry with the expertise and financing to fully exploit its natural resources. For this reason the Government partners with International Oil Companies (IOCs) that provide the know-how and capital to exploit the resources.

Production Sharing Agreements (“PSAs”) are the primary contracts, alongside exploration and production licences, which govern this relationship, setting out the terms on which the IOCs will explore for and extract oil. They do so for the life of operations in the particular area, from exploration, through to appraisal and development, in to the production phase and right through to decommissioning. Typically, therefore, PSAs cover a timeframe of 25-30 years.¹³ Most fundamentally, PSAs dictate what share of oil production, and revenue generated, belongs to the government and the nation, and what percentage can be retained by the company. They also dictate key environmental and social protection measures.

While PSAs and laws provide the overarching framework for the relationship between the government and companies, companies will also need licences to operate. Exploration licences, which are usually granted alongside or after PSAs, give exclusive permission to companies to explore for oil within a given timeframe and specific area. Production licences, which are granted after companies have successfully appraised oil discoveries and submitted development plans, give companies the exclusive right to extract the oil in a specific area. They may also set certain terms and conditions on the operation of the companies. They are both governed by the PSAs.

Methodology

This report was produced with the help of three teams of legal experts, and contract specialists as well as in-house lawyers and Global Witness staff, human rights and financial terms as well as in-house lawyers and Global Witness’ staff. The report also uses a [financial modelling](#)

BOX 1: WHICH CONTRACTS DOES THIS REPORT ANALYSE?

In 2010 Platform, a London-based NGO, along with a number of Uganda NGOs, produced an analysis of several Ugandan Production Sharing Agreements (PSAs) which were signed before February 2008 (henceforth the pre-2008 contracts).¹ The analysis was heavily critical of the contracts and the deal the Government of Uganda had agreed, stating that the contracts represented a bad deal for Uganda and a significant risk for people and environment.²

Global Witness has seen two further oil contracts dated February 2012 between the UK-listed international oil company Tullow Oil and the Government of Uganda for Exploration Area (EA) 1 and the 'Kanywataba Prospect Area' located in EA 3A (henceforth the 2012 contracts). These contract areas are jointly owned by Tullow, giant state owned China National Offshore Oil Company (CNOOC) and French Oil Major Total which have gone into partnership in Uganda. The EA1 area is operated by Total³ while the Kanywataba area was operated by CNOOC until it was relinquished back to the Government in August 2012 after the company failed to discover oil in the area before its exploration licence expired.⁴

EA1 and EA1A

There are two PSAs for EA1 to reflect the fact that the area has effectively been split into two areas (EA1 and EA1A). EA1 covers the area where discoveries were made prior to the signing of the new PSA in February 2012. This area is still governed by a pre-2008 contract (2004).

No discoveries had been made in the EA1A area prior to February 2012, when the new PSA was signed and a new exploration licence was issued for this area.⁵ This is the PSA analysed here.

The Lyec field

Total oil drilled 5 wells in EA1A during 2012/2013 and made one discovery - the Lyec field.⁶ While the exploration licence for EA1A expired in February 2013, it is anticipated that Total will submit an application for a production licence for the Lyec field during 2014.⁷ As such, this area will continue to be governed by the 2012 PSA.⁸ It is not yet clear how much oil is contained in the Lyec field.



Map of Oil Exploration Areas 2014. © Tullow Oil plc

EA2 and the Kingfisher field

EA 2 and the Kingfisher field, which contain the remaining discovered oil, are still governed by the terms of the pre-2008 contracts.⁹

The 2012 contracts are similar to the pre-2008 contracts and are based on the same model PSA.¹⁰ However, they do differ in a few crucial areas as outlined in this report. According to the Ugandan Government, only 40% of the Albertine Graben region in north-western Uganda has been explored for oil.¹¹ The Government is also investigating additional areas including Karamoja.¹²

While the Government may find it difficult to amend its current PSAs, it does have the opportunity to improve future contracts and additional regulations for the sector. There is now a narrow window of opportunity for the Government to sure up future contract terms and laws before it allocates new areas and ramps up exploration and production.

As part of this project, Global Witness has produced an oil contract **financial modelling tool** which is available on our website. The model is open source which means that anyone can download and use it to predict the amount of revenue the Government of Uganda will receive depending on different variables. We have also produced a **simplified version** which is also available on our website. This will help citizens to understand oil contracts and revenue data and make informed decisions about how Uganda's oil

The World Bank Institute is developing an 'Open Contracting Partnership' and the Columbia Center on Sustainable Investment, UN Programme's Green Environment Initiative (GEI) programme and Revenue Watch are developing a contracts database to facilitate greater access to publicly available information,¹⁴ intended to allow governments around the world to negotiate more favourable contract terms and citizens to hold companies and governments to account.

As part of our research, we wrote to the China National Offshore Oil Company, Tullow Oil, Total, the Ugandan Petroleum Exploration Production Department at the Ministry of Energy and Mineral Development and the Ugandan National Environmental Management Authority and made several follow up enquiries. Tullow Oil and Total provided detailed responses to our questions, unfortunately none of the other organisations provided responses to our questions.

2.2 Background to the signing of the 2012 contracts

In July 2010, Tullow bought Heritage Oil out, acquiring the remaining 50% shares in EA 1 and EA 3A





Parliament passed a 10 point resolution calling for greater transparency in the management of the sector and a moratorium on any further deals until a satisfactory legal framework was in place. © istockphoto/mtcurado

of Uganda to resolve the capital gains tax dispute stemming from Heritage's sale, Tullow signed sale and purchase agreements with CNOOC and Total, setting the scene for the US\$2.9 billion¹⁸ sale of one third interest in each of the five licence areas (EA 1, EA1A, EA2 and, Kingfisher and Kanywataba – formally EA3A) to each of the companies.¹⁹

Parliament blocks the deal

In October 2011, following significant criticism of the Government's handling of the oil sector, 166 Members of the Ugandan Parliament (MPs) successfully petitioned the Speaker for the recall of Parliament to discuss the events of the past few years. They raised a number of concerns including secrecy, lack of adequate legislation and (unproven) bribery allegations. After several days of often stormy debate,²⁰ the newly elected parliament passed a 10 point resolution calling for greater transparency in the management of the sector, investigations into (unproven) corruption allegations, and a moratorium on any further deals until a

satisfactory legal framework was in place. The resolution also explicitly called for the Government to withhold its 'consent to the transaction between Tullow Oil (U) Limited and Total and CNOOC, until the necessary laws are put in place.'²¹

New deals signed despite parliamentary concerns

However, on 3 February 2012, despite the parliamentary resolution and days before new draft petroleum laws were tabled in Parliament, the Government pushed ahead and signed two new PSAs with Tullow Oil.²² Although general contract terms are often widely available to the industry, these contracts have not been published or analysed by industry experts until now. This is despite repeated attempts by civil society organisations (CSOs), journalists and MPs to make them public.²³ These are the PSAs analysed here.

New Oil Laws

On 8 February and 14 February 2012²⁴ respectively, the Government of Uganda tabled the long awaited

Petroleum, Exploration, Development and Production Bill (henceforth the Upstream law) and the Petroleum, Refining, Conversion, Transmission and Midstream Bill (henceforth the Mid-stream law) to regulate the sector. In late February 2012, Global Witness published an analysis of the draft laws highlighting significant concerns including:

- excessive ministerial powers especially in the allocation process and in deciding the terms of contracts;
- a failure to guarantee transparency of key documents and information;
- a limited role for parliament and public consultation;
- weak environmental and social protection measures.²⁵

These concerns were shared by many commentators, including Columbia University, the World Bank and local NGOs.²⁶

While MPs succeeded in moving some amendments to improve the legislation, the laws, which are considered here alongside the PSAs, still contain a number of weaknesses. The Upstream law was passed on 7 December 2012 while the Mid-stream law was passed on 22 February 2013.²⁷ Both laws have been ratified by the President of Uganda and are now operational.²⁸

Discoveries to date

By August 2013, 104 wells had been drilled. The Petroleum Exploration and Production Department (PEPD) at the Ugandan Ministry of Energy and Mineral Development reported oil and/or gas in 92 of them.²⁹ All the commercially viable finds have so far been made in EAs 1, 1A, 2 and 3A, the areas now owned and operated by Tullow, Total and CNOOC. Only 40% of the oil areas have been explored to date and the Government is conducting reconnaissance elsewhere.³⁰

Next steps

The Government is now in the process of producing new regulations and a new model PSA to accompany the two new petroleum laws which will be used as the basis for future contracts.³¹ The Government is expected to allocate new rights to companies to explore additional areas in a process known as an allocation round, in late 2014 or early 2015. This allocation is likely to focus on areas which were previously licenced to companies which failed to discover oil within the given time under the terms of the exploration licence (referred to as relinquished areas). Companies which are selected will sign an exploration licence and a production sharing agreement.³² This will provide an opportunity for the Government to negotiate more favourable terms and carefully select companies (for further information please see [Global Witness briefing](#) on best practice for allocation in Uganda available on our website) Preparations for mid-stream infrastructure, such as transportation and refining facilities, are under way³³ and oil production is currently scheduled for 2017/2018.³⁴ The Public Finance Bill, which

contains the petroleum revenue management regulation, was expected to be passed imminently by the Ugandan Parliament at the time that this report went to print.³⁵ This law will decide how Uganda's oil money is managed and how transparently.

3 / **GENERAL TERMS IN THE CONTRACTS**

The following section, 'general terms', analyses some of the key areas in these Production Sharing Agreements before the report goes on to analyse the financial terms and, environmental and social protection provisions in more detail.



GENERAL TERMS IN THE CONTRACTS

Publication of contracts creates a strong incentive for governments and companies to ensure that they include the best possible terms. It also helps protect against corruption.

3.1 Who do these contracts apply to?

THE ISSUE: It is important that joint venture partners and sub-contractors are also bound by the terms of a PSA so that all companies adhere to the same standards set out in the contract.

THE CONTRACTS: The 2012 contracts (Clause 3.6) allow for 'joint and several liability' meaning that each of the companies party to the contract are subject to its terms and share responsibility for contractual breaches. CNOOC and Total bought into these agreements when they purchased the 33.3% interest in each area from Tullow,³⁶ and the Government can pursue any of the three partners for the full amount of any debts or compensation claims related to the contracts. The three companies are also required to ensure that sub-contractors abide by the same terms (Clause 25.13 (c)). These are normal and useful provisions which will make it easier for the Government to hold the companies to account and recover money owed to it should any problems arise.

3.2 How transparent are these contracts?

THE ISSUE: Oil contracts often contain confidentiality clauses relating both to the contracts themselves and information which a company is required to provide to governments as part of its contractual obligations. This is a problem because both the contracts and the documents presented to governments contain vital information about the oil sector which can help enable citizens to hold companies and their governments to account. While companies will argue that some information which they present to governments is genuinely commercially sensitive, the majority is not and documents like Environmental Impact Assessments



Contract transparency helps citizens hold companies and government to their contractual obligations. © istockphoto/mtcurado

and safety inspections should be made public as standard. Contracts themselves do not usually contain any information which is genuinely commercially sensitive. For more information see [Global Witness' briefing](#) on contract transparency in Uganda available on our website.

THE CONTRACTS: In the case of the 2012 contracts (Clause 8.6), all data submitted to the Government by the companies must be kept confidential except where companies provide prior written consent – and such consent should not be unreasonably withheld. Confidentiality is defined by the disclosing party.³⁷ This means that if the company gives its permission to disclose information it would be at the discretion of the Government as to whether this information is disclosed to the public. The Government also needs to grant permission to the companies for them to make their own disclosures.

Clause 36.1 in these contracts requires that the contract itself is kept confidential. This means that

the terms of the agreement are to be kept secret by the parties unless they all consent. Global Witness has been told by representatives of all three companies covered by these contracts that they would be willing for the contracts to be disclosed if the other companies and the Government agreed. At least two of the companies have publicly stated this position.³⁸ This in practice releases the Government from the confidentiality clauses which restrict it from making the contracts public.

Global Witness believes that the secrecy afforded by these contracts deprives citizens of access to crucial information. Contracts should be published in full. Data and development plans should also be published with only limited and tightly defined exemptions. After all, oil belongs to all Ugandans.

THE LAWS: The Upstream Law also requires that information submitted by the companies to the Government is kept confidential unless the parties agree (Section 152 and 153), however, consent should not be ‘unreasonably’ withheld or delayed. It also imposes strict

penalties for government employees who breach these rules. The law provides some scope for the Government to publish information, which is positive, but it also acts as a significant disincentive for government employees to release information which they believe to be in the public interest.

Recommendations

1. The Government should request permission from the companies to publish key information, such as safety inspections and EIAs, which they have provided. The Government should then publish this information.
2. The companies should publicly state their willingness to disclose such information.
3. The Government should make it a legal requirement that all contracts are published online.

BOX 3: WHY IS CONTRACT TRANSPARENCY IMPORTANT?

Contracts are a crucial element of the regulatory framework which governs the oil industry and making them publicly available is key to good governance. Contract transparency allows citizens to ascertain what kind of deal the Government has negotiated on their behalf. It helps citizens understand the obligations and liabilities of companies when it comes to social and environmental protection allowing them to hold companies to their contractual obligations.

Publication of contracts creates a strong incentive for governments and companies to ensure that they include the best possible terms. It also helps protect against corruption by ensuring that PSAs are open to public scrutiny. This scrutiny will also help identify any weaknesses enabling governments to negotiate stronger more favourable terms in future and build greater trust between governments and citizens. International contract transparency will also allow governments to compare terms and ‘borrow’ strong terms from other contracts. Above all contract transparency allows citizens to better understand their oil sector. There is therefore an overwhelming public interest in publishing these contracts.

Companies and governments will often cite confidentiality clauses in contracts or ‘commercial sensitivity’ as a reason not to release contracts and other information. The reality is that these arguments do not stand up to scrutiny. Companies often already

have access to one another’s contract terms via informal channels. Coupled with the vast resources and extensive expertise commanded by international oil companies this leaves governments at a significant disadvantage in contract negotiations.

PSAs are unlikely to contain genuinely commercially sensitive information and companies are sometimes required to produce some of the information contained in contracts to regulators as part of their stock market listing requirements. All three upstream companies currently active in Uganda (Tullow, Total and CNOOC) have told Global Witness that they would be willing in principle to publish their Uganda PSAs but they cite the confidentiality clauses and the Government position as a barrier.

Many countries around the world, including; Afghanistan, Australia, Azerbaijan, Bolivia, Burkina Faso, Democratic Republic of Congo (DRC), Republic of Congo, Ghana, Guinea, Kurdistan, Liberia, Mauritania, Mexico, Niger, Peru, Sierra Leone and Timor-Leste, do now publish primary extractive industry contracts.³⁹ It is worth noting that Tullow Oil has disclosed its contracts in Ghana where it is legally mandated to do so.⁴⁰

For a further discussion of the benefits of contract transparency for Uganda see our [briefing](#) available on our website.



Global Witness believes that as much information as possible from these documents should be made available to the public.

© Greenshoots Communications/Alamy

3.3 Do the contracts allow for changes in the law?

The Stabilisation clauses 33.2 – 33.5

THE ISSUE: Stabilisation clauses are designed to insulate companies against regulatory changes which are likely to impact on the profitability of a project, particularly in countries which they consider higher risk. They are common in PSAs because companies bear the upfront costs and therefore risk and so seek to secure their investment return. The problem with some types of stabilisation clause is that they can prohibit a government from demanding fair returns on their natural resources as companies seek to minimise their liabilities (chiefly taxes), and restrict a government's ability to apply more robust environmental and social protection measures.

THE CONTRACTS: The stabilisation clauses contained in the pre-2008 PSAs were heavily criticised in Platform's analysis.⁴¹ Not only do they require that the Government compensate any companies for applying new financial terms, the clauses are potentially wide enough to apply to new social or environmental protections which result in additional compliance costs for the company. Even if the company was highly polluting or disproportionately

benefitting from unpredicted financial conditions, such as higher oil prices, the Government could still be required to compensate. This potentially pits the Government's financial interests against its prerogative to improve environmental and social protection. These contracts are still active in EA1, EA2 and the Kingfisher area as such the companies could still demand compensation for losses resulting from changes in the law.

In the 2012 contracts the Government succeeded in negotiating more favourable stabilisation clauses for which it should be congratulated. This is one of the most substantive changes.

Firstly, the 2012 stabilisation clauses do not require the Government to compensate companies for costs accrued from applying new laws and regulations (with the limited exception of tax laws). This is extremely important as it allows Ugandan policy makers to identify weaknesses in these contracts and plug them with future laws and regulations without risk of compensation claims from companies.

Secondly, they specifically allow the Government to introduce new "windfall taxes" on additional profits, that is higher than expected profits resulting from higher oil prices, higher than expected production or lower than expected costs.^A

Recommendations

This is a successful re-negotiation of the stabilisation clauses. Given that companies very often insist on stabilisation clauses in PSAs the Government should seek to include similar clauses, limited to changes in taxation law only, in future contracts. The Government should also use the opportunity provided by the stabilisation clause to introduce tighter environmental and social protection measures and ‘windfall profit’ taxes.

Given that they have agreed to the revised stabilisation clauses in the 2012 contracts the companies should also agree to amend the pre-2008 contract stabilisation clauses to limit them to changes in tax law in the same way. This is an important clarification of the contracts which would allow the Government to address the weaknesses identified in this report and introduce more robust environmental and social protection measures without fear of compensation claims from the companies governed by the pre-2008 contracts.

3.4 Development Plans

THE ISSUE: The Development Plan, which is produced by the company and approved by the Government prior to the granting of a production licence, is one of the most important documents in any petroleum project, however, they are often not made public. Critical decisions are made in the plans, including technical drilling specifications, the number and location of wells, production rates and, environmental and social protection measures. There is also the opportunity to create ‘shared value’ through infrastructure programmes which benefit communities as well as oil companies. These decisions will have an impact on the revenue received by the Government, the environment and the people that live near these operations. Global Witness believes that as much information as possible from these documents should be made available to the public.

THE CONTRACTS: Under the 2012 contracts the development plans are submitted to the Government and subsequently agreed by the ‘Advisory committee’ before they are submitted to the Minister for approval (Article 5 and Clause 7.5). If the company and the Government fail to agree either can choose to take the matter to the sole expert pursuant^B or an arbitration tribunal (Clause 7.6 and Article 26). Global Witness has been informed that the Ugandan Government has received a number

of development plans, is insisting on quality and has requested numerous changes – which is positive.

THE LAWS: The Upstream law also says that development plans should be submitted to the Petroleum Authority before being approved by the Authority and ultimately the Minister^C (Sections 8, 10, 71, 73, 74, 78, 85, 96, 113 and 151). Section 151 gives the Minister the authority to make approved development plans, alongside other key documents, available to the public.

Recommendations

The Government of Uganda should make approved development plans available to the public with tightly defined exemptions for genuinely commercially sensitive information such as proprietary technology. This will help people understand the plans for the oil sector and how it will affect them.

3.5 Arbitration

THE ISSUE: Arbitration is a private system of adjudication where parties resolve their disputes outside of any state judicial system. Parties jointly select a sole arbitrator or a panel of arbitrators. Parties can choose the venue of the proceedings as well as the procedural rules that would guide them – details which are often stated in the PSA. The arbitrators review the facts, and make a final and binding award that may be contested only in a narrow set of circumstances.

Arbitration hearings and outcomes are typically confidential. Companies tend to strongly favour arbitration as it allows them to deal with potentially damaging disputes behind closed doors. Global Witness’ concern is that this undermines citizens’ rights to information about how their resources are being managed.⁴² This is particularly true in countries where contracts are also not made public.

THE CONTRACTS: The Government of Uganda has learned from its experience in recent tax disputes and stipulated in its 2012 PSAs that companies will pay capital gains tax (Clause 24.7) and that companies will not be able to settle tax disputes (stemming from the terms of these contracts) in international arbitration (Clauses 14.2 and 26.1).^D However, companies will be able to resolve other kinds of disputes such as those relating to compensation

A The clauses stipulates that in the event of any change in any law “dealing with income tax” in Uganda which “substantially and adversely” alters the economic benefits to the Licensee, the parties shall negotiate “in good faith” with a view to modifying the agreement so as to restore/maintain the economic benefits of the Licensee (failing which, either party may refer the issue to expert determination and ultimately arbitration). This is known as an ‘economic equilibrium’ clause. Clause 33.4 specifically carves out additional profit taxes from the stabilisation clauses. In practice this will come down to the assessment of value of the project which should be agreed by the Government in advance. More details on windfall profits can be found in the financial analysis.

B This is alternative dispute resolution process, where the parties agree to have a specific technical or financial dispute resolved by an agreed expert, rather than going to the time and expense of court proceedings.

C Where the laws refer to ‘the Minister’ they are referring to the Minister with responsibility for petroleum activities.

for pollution damage in international arbitration. Any dispute relating to “windfall taxes” (see stabilization clauses section) is likely to be treated as a tax dispute and therefore not subject to arbitration, however, a company could argue that the dispute is contractual (e.g. related to an interpretation of the PSA terms) and therefore subject to arbitration.

In these cases, a fairly standard three member arbitral panel is used (Clause 26.1), similar to that provided for in the pre-2008 contracts. The proceedings would take place under international UNCITRAL⁴³ arbitration rules in London in private, with confidential proceedings and judgments, depriving Ugandans of information about the handling of their natural resources.^E The fact that the contracts are silent on who shall bear the cost of arbitration tribunals leaves the losing party potentially paying all costs.^F The tribunal will decide on how the court costs are divided and how much each party will pay, this could leave the Government paying most, or even all, of the costs of the tribunal.

Recommendation

It is unlikely that companies would be willing to sign contracts without arbitration clauses, as the tendency of internationally operating companies is to prefer international arbitration to local African courts. However, the government and companies should commit in future contracts to holding arbitration tribunals in public and waive the confidentiality which deprives citizens of the right to information.

3.6 Gas

To date there have been only limited discoveries of gas in Uganda and as such it does not feature highly in the contracts or laws. There is a different and higher cost recovery rate in the PSAs for gas at 70% (as opposed to 60% for oil). According to the contracts the royalty rate – the percentage of the revenue generated from the sale of oil or gas paid to the government before cost recovery – for gas will be negotiated upon discovery of gas (Clause 10.1.5). Natural gas could also be processed at the refinery, or re-injected into the reservoirs in order to boost field recovery rates. We have not modelled the presence of gas in our financial analysis.

Recommendation

If commercially viable deposits are discovered in Uganda the government will need to revise the treatment of gas in future contracts.

D The Government of Uganda is involved in two tax disputes with Tullow Oil, one over VAT and another over the capital gains tax assessment for the sale to Total and CNOOC. Tullow maintains that their PSA for EA 2 exempts them from capital gains tax, a point which the Government disputes. The Government of Uganda – Heritage Oil arbitration in London over the capital gains tax assessment relating to the 2010 farm down to Tullow oil is still ongoing as far as Global Witness is aware.

E In July 2013, the United Nations Commission on International Trade Law (UNCITRAL) adopted a set of arbitration rules (The UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration) that will help open some investor-state arbitrations to public view in future.

F It should be noted that companies may be able to rely on other treaties in order to take international arbitration or legal proceedings to resolve disputes. For example companies have the option to submit disputes arising out of Uganda’s violation of obligations under Bilateral Investment Treaties between their host states (e.g. the UK and Uganda) to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “ICSID Convention”).

4 / THE FINANCIAL TERMS – A GOOD DEAL FOR UGANDA?

The 2012 contracts differ in only a few key areas to the contracts signed before 2008. However, they offer a better financial deal for Uganda as the government has negotiated a higher share of oil revenues.

THE FINANCIAL TERMS – A GOOD DEAL FOR UGANDA?

The improved 2012 contract terms will likely increase government take by around 1-2% when compared to the pre-2008 contracts potentially generating hundreds of millions of dollars in additional revenue.

Global Witness' analysis shows that 'government take', which is the percentage of incoming revenues that the government will collect, appears to be high by global standards in both the pre-2008 and 2012 contracts, ranging from 80% to well over 90% depending on circumstances.⁴⁴

The improved 2012 contract terms will likely increase government take by around 1-2% when compared to the pre-2008 contracts potentially generating hundreds of millions of dollars in additional revenue in one contract area alone. Under the 2012 contracts Uganda will begin to collect this revenue soon after production begins. However, the 2012 contracts, like the pre-2008 contracts, fail to capture an increased share of higher profits meaning that Uganda will receive a lower percentage share of revenues if long term oil prices rise while company profits will rise as a percentage. The Government will have to take advantage of the revised stabilisation clause ([see page 18](#)) and introduce new taxes on higher than expected profits to ensure they maintain the same percentage of larger profits.

The 2012 contract modelled here only governs discoveries made after February 2012 in the EA1A area (older discoveries in EA1 and the Kingfisher and EA 2 areas are still governed by the pre-2008 PSA terms).⁴⁵ It is not yet clear how much oil is in this area. As such, we have modelled three different field sizes to illustrate the difference between the pre-2008 and the 2012 contracts.

The financial analysis is split into two main sections. The first (Section 4) explains the key financial changes in the 2012 contracts, compared with the pre-2008 contracts, and the impact that they are likely to have on the amount of revenue the Government of Uganda will collect. The second section (Section 5) looks at the impact that some of the other terms may have on the revenues ultimately collected by the government. This is followed by a conclusion for both sections.

The figures given here are based on Global Witness modelling which was itself based on the best information



Oil money will be a substantial boost to Uganda's economy. © Laura Darby

available to us. Many key pieces of information are as yet unknown or not in the public domain. Global Witness used the best information and assumptions available to us to create these figures which represent our best estimates and are indicative rather than absolutely accurate. (For further information on our assumptions see Annex 1).

HOW OIL REVENUES ARE SHARED BETWEEN COMPANIES AND THE GOVERNMENT

PRE-PRODUCTION PHASE



COMPANIES PAY **SIGNATURE BONUSES** WHEN THEY SIGN THE CONTRACT



COMPANIES **INVEST MONEY** INTO TESTING, DRILLING WELLS & INFRASTRUCTURE



COMPANIES PAY **DISCOVERY BONUSES** WHEN OIL IS FOUND

OIL COMPANY

GOVERNMENT

PRODUCTION PHASE

OIL BEGINS TO FLOW AND REVENUES COME IN FROM SALES

COMPANIES RECOVER THEIR **COSTS** (UP TO 60%) FROM THE OIL REVENUES REMAINING AFTER ROYALTIES HAVE BEEN PAID

REMAINING REVENUES (PROFITS) ARE SHARED BETWEEN THE GOVERNMENT AND THE COMPANIES

A SLIDING % OF OVERALL REVENUES GOES TO THE GOVERNMENT AS **ROYALTIES**

REMAINING REVENUES (PROFITS) ARE SHARED BETWEEN THE GOVERNMENT AND THE COMPANIES

COMPANIES PAY **TAX** TO THE GOVERNMENT ON THE REVENUE THEY RECEIVE

1

2

3

4

4.1 The key changes in the 2012 contracts

The 2012 PSAs have secured significant additional financial benefits for Uganda. Three key changes will have a significant impact on the amount of money the Government is likely to collect:

1. A new royalty based on cumulative production has been introduced which is in addition to the existing royalty based on daily production;
2. The 'stabilisation clause'^G has been renegotiated to allow the Government to potentially introduce a new tax which would capture a greater sum of any 'windfall profits'.
3. Unlike the pre-2008 contracts these PSAs stipulate that companies shall pay capital gains tax on profits made from the sale of rights to another company (and Ugandan tax law is to be used for the resolution of tax disputes) (Clause 24.7 and 14.2).^H

Before considering these 3 points in more detail, section 4.2 briefly considers the pre-2008 contracts as a basis for comparison.

4.2 The pre-2008 PSA terms

This section looks at the revenues generated under the pre-2008 contract terms as a means for comparison with the 2012 contracts.^I

Under the pre-2008 contracts the Government will receive revenues through a share of oil production plus a daily production royalty (a tax collected on daily production) and other taxes. In combination these revenue streams generate the 'government take' – the percentage of revenues, after costs have been deducted, which the Government will receive. The Government is also entitled to take up a 15% stake in the contract, in the same way that a company would, in a process known as 'state participation.' This is likely to be done through the national oil company (NOC) which will be 100% state owned – NOC take. See Annex 1 for further details.

Ultimately Global Witness does not believe that the pre-2008 contracts represent a particularly poor financial deal for Uganda. The problem with the financial

terms in these contracts, as raised in Platform's analysis, is that the Government fails to capitalise if oil prices rise while company profits increase incrementally.

According to Global Witness modelling, if the long term oil price rises by US\$20 per barrel,^J with 200 million barrels being recovered, the percentage of revenue the Government would collect might fall from 87% to 84%^K (including NOC take). Company Internal Rate of Return (IRR), a measure commonly relied on by companies to make investment decisions, would rise to 30%. Generally speaking, companies will look for a minimum of 12% IRR to justify investment depending on risk and other factors. If long term oil prices rise by US\$50 then government take would fall to 82% (including an NOC take of 3%) company IRR would rise to 37%. Of course the actual sum of money the Government received would be greater, but the percentage would be less. As such, the Government has not included a mechanism in these contracts which will enable them to capture a larger share of higher profits.

However, if long term oil prices fall, while the sum of money the Government would receive would also go down, the Government take would actually go up. For example if oil prices fell by US\$10 per barrel then government take would rise to 91%. As such, the Government has succeeded in insulating itself against a fall in international oil prices by ensuring it receives a higher share of post cost revenues.

The other impact of these contract terms is that a significant fall in oil prices would shrink company IRR to a level which might risk making the project uneconomical for the companies. While this does create some risk to investors in reality companies are likely to slow production rates until oil prices rise, reduce their production costs or re-negotiate with the Government.⁴⁶ Companies will have already covered the majority of their costs, including wages, transport, expenses, office costs and so on, through the cost recovery process.

G 'Stabilisation clauses' can insulate companies from changes in law which post-date the signing of a PSA by restricting the ability of the Government to apply new laws to companies operating under the contract or make the Government liable for any reduction in profits which result from those laws.

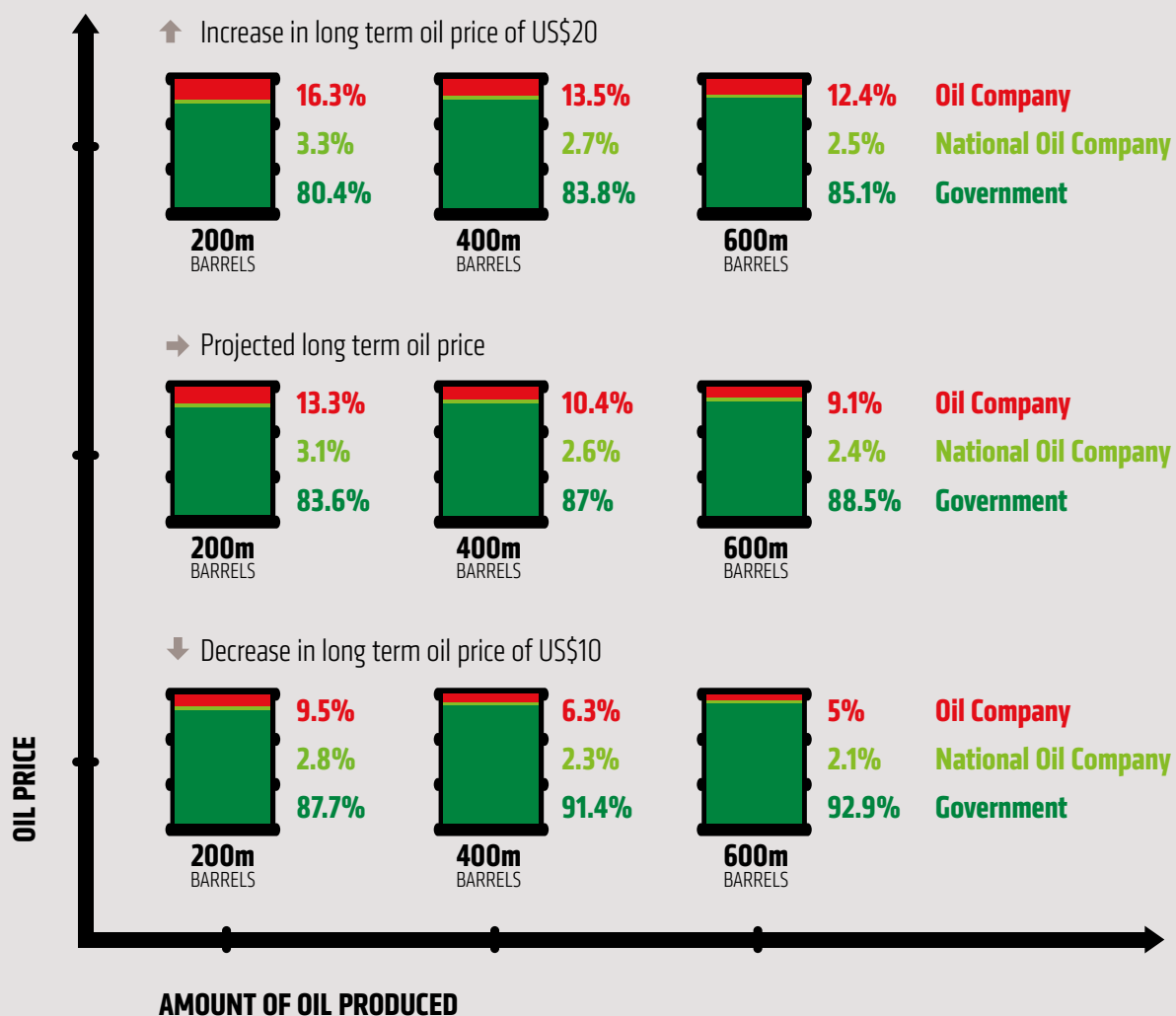
H However, the percentage of oil production allotted to the Government under the 2012 EA-1 contract is 1% lower at every threshold of production than the 2004 contract and the 2012 Kanywataba contract. It remains unclear why this is, but when considered in conjunction with the new cumulative royalty the contract still yields a higher government take than the older Heritage contract. For further information on production sharing see Annex 1.

I It should be noted that the figures here differ from the Platform analysis which is based on the draft contract for EA2 and is based on different assumptions, in particular the 'company take' in the Platform figures includes the repayment for costs incurred by the company. Global Witness figures are based on the split between company and government after costs have been deducted.

J The Model assumes an US\$80 per barrel price rising annually which is in line with current predictions – for further information see Annex 1.

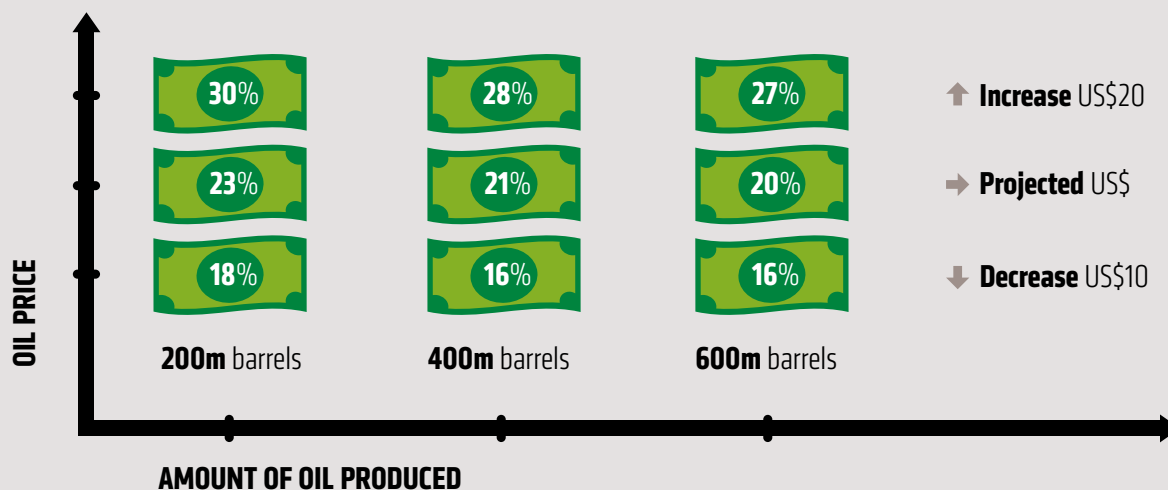
K The figures in this report are rounded to the nearest round number.

HOW OIL REVENUES ARE SPLIT UNDER THE PRE-2008 CONTRACTS



All figures in this infographic were generated using our online model and have a 10% discount rate applied. For further information see Annex 1.

COMPANY INTERNAL RATE OF RETURN (IRR*) FOR THE PRE-2008 CONTRACT



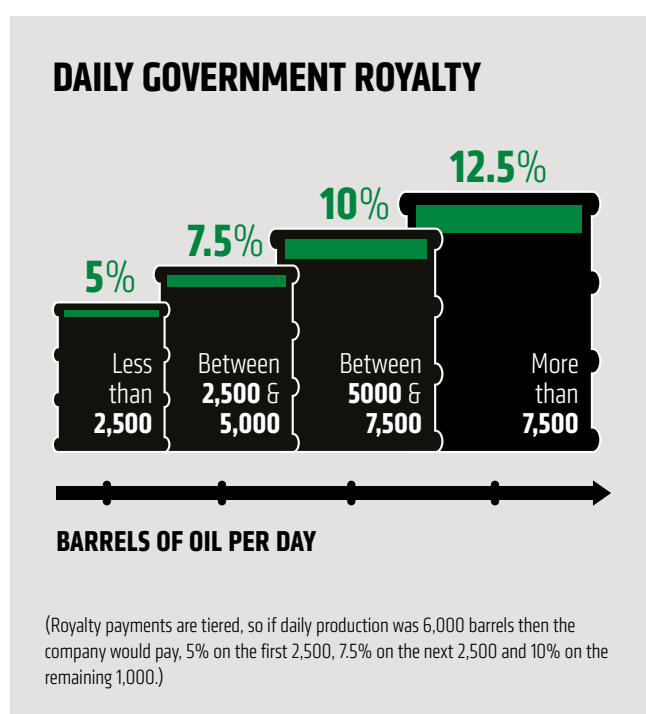
* Internal Rate of Return – a figure which describes the rate of return for the investor in a project. For further information see Annex 1.

4.3 New Cumulative Production Royalty

The pre-2008 contracts contained only a single royalty based on daily production. Essentially the higher the daily production the higher the royalty rate the Government would collect.

The daily production royalty, illustrated below, is included in both the pre-2008 contracts and the 2012 contracts (Article 10).

The two 2012 contracts also contain a second royalty based on 'cumulative production. In other words the



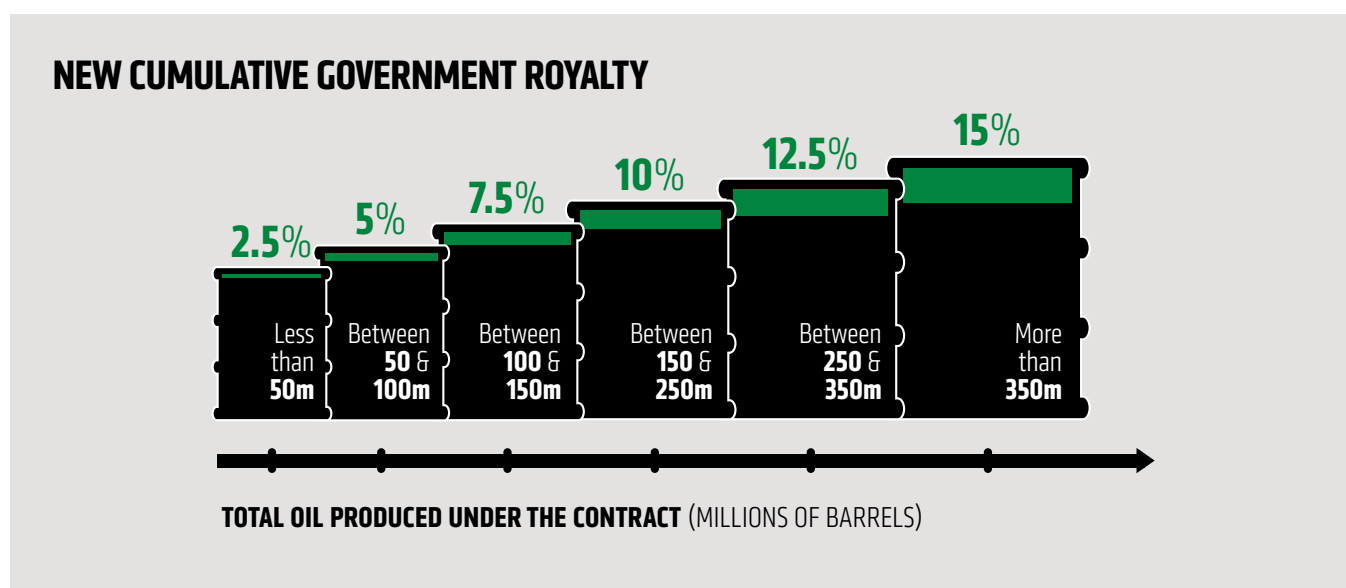
higher the overall cumulative production from the project rises, the higher the rate that the Government can collect under this royalty. The Government will therefore collect two royalties under the 2012 contract. The first based on the amount of oil pumped each day, the second based on how much has been pumped since production began. This is a fairly unusual revenue provision in an oil contract which has broadly positive benefits for Uganda. The cumulative royalty, as explained below, is only included in the 2012 contracts (Clause 10.2.1)

The success of this cumulative royalty in bringing in significant revenue is heavily dependent on the size of the discoveries made in the contract area. The more oil there is in a contract area the more the Government will benefit from this royalty as more tax will be collected at the highest tier.

In this regard it appears that the Government may have been unlucky as CNOOC failed to make discoveries in the Kanywataba area, and Total only made one discovery under its exploration licence for EA1A. That said it is too early to know how much oil is in this area. The modelling provides an illustration of the impact of the new terms in different scenarios and a guide for future contract terms.

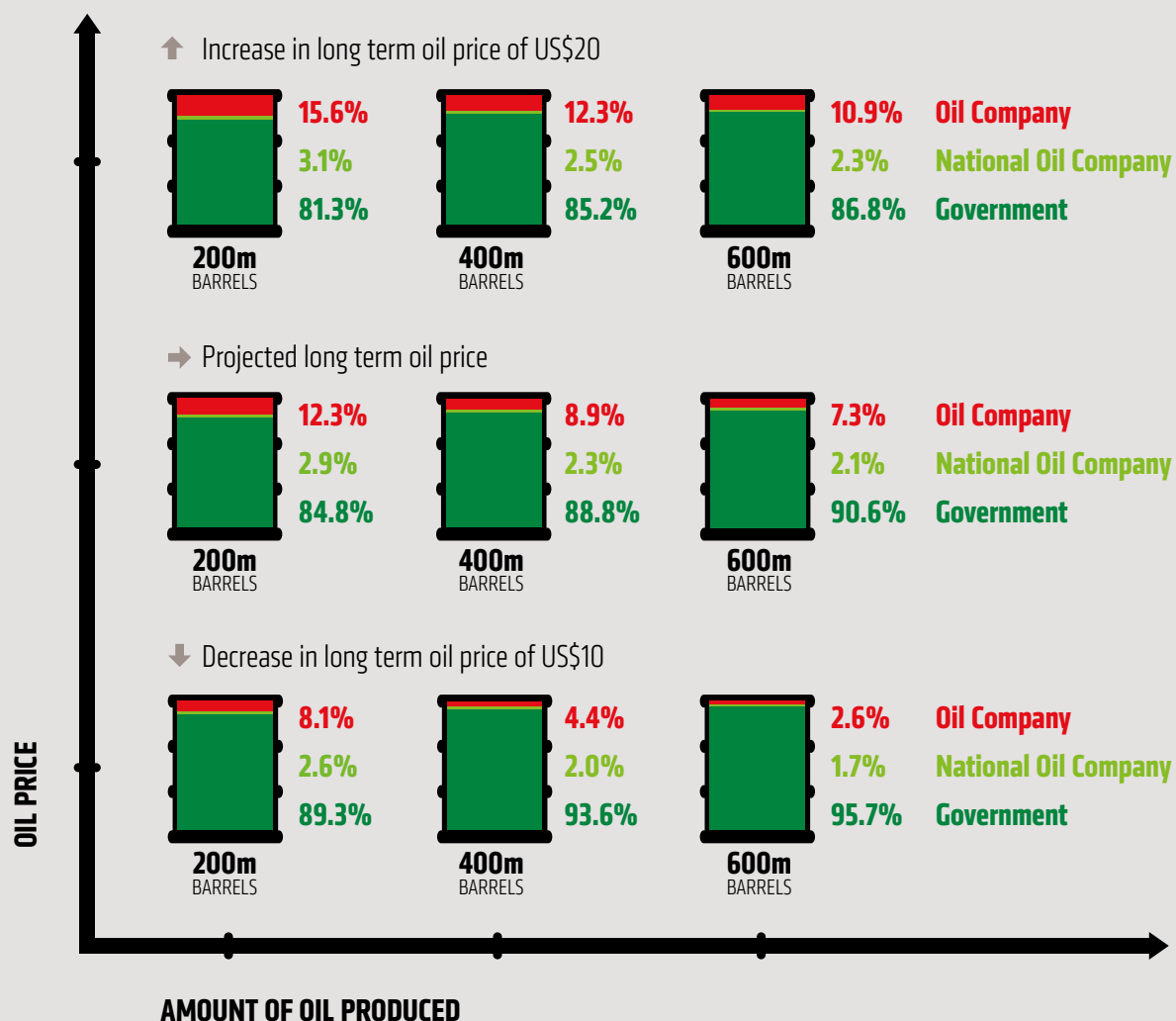
According to Global Witness' modelling, the additional royalty alone could result in roughly an additional 1-2% government take. This could translate to between an additional US\$94 million and US\$780 (or US\$27 million and US\$190 million with a 10% 'discount rate')^L for one contract area alone (depending on oil prices and field size) and potentially far more if larger oil fields are discovered or long term oil prices rise. US\$780 million is more than the entire education budget for 2013.⁴⁷

This new cumulative royalty also means that not only will Uganda receive more money in total over the life of



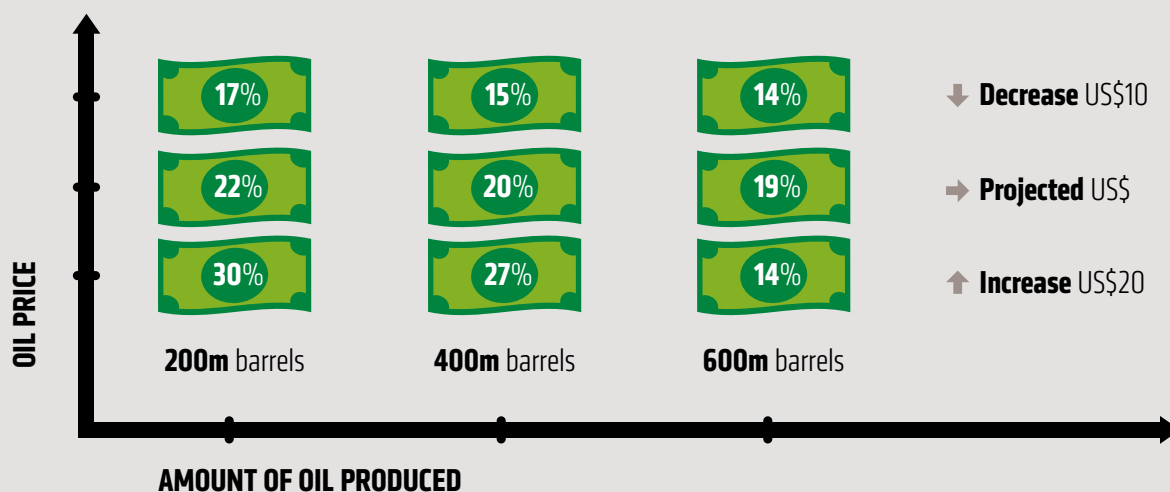
^L Investors and governments value money now more than money in the future. They therefore apply a 'discount rate' to projected future revenues in order to calculate the value of those returns to them at the present time. This does not affect the actual revenues received. A 10% discount rate is fairly standard for the industry. See Annex 1 for further information.

HOW OIL REVENUES ARE SPLIT UNDER THE 2012 CONTRACTS



All figures in this infographic were generated using our online model and have a 10% discount rate applied. For further information see Annex 1.

COMPANY INTERNAL RATE OF RETURN (IRR) FOR THE 2012 CONTRACT



* Internal Rate of Return – a figure which describes the rate of return for the investor in a project. For further information see Annex 1.

the project, but it will begin to receive this additional revenue early on in the project.

The 2012 contracts, as with the pre-2008 contracts, fail to capture a higher share of higher profits for the Government. However the contracts also enable windfall taxes to be applied to counter this (see section 4.4) making them extremely beneficial in Uganda. Government take is projected to fall if oil prices rise above what is currently anticipated while company IRR will rise dramatically as per the info-graphic on page 26. This means that the companies will receive a greater share of additional profits from higher oil prices. According to Global Witness modelling, if long term oil prices rise by US\$50 per barrel and 200 million barrels are discovered, government take will fall to 83% (including NOC take) while the company IRR would hit 36%.

One potential challenge for the Government of this additional cumulative royalty is that companies might choose to leave the project early, leaving oil in the ground because there is little profit to be made. The reason for this is that unlike the royalty rate based on daily production which will decrease at the end of the life of the field, under the new cumulative royalty rate the companies will continue to pay the highest royalty rate even as production falls. As such, companies will find themselves paying an overall higher royalty rate on increasingly smaller amounts of oil, making the project less profitable sooner. Companies may therefore leave early, leaving oil in the ground which could have generated further income.

There is a risk that companies may take decisions about how to extract which ultimately reduces the amount of oil that can be recovered based on their financial assessment of profitability in the later stages of production. The Government can take further steps

to ensure that the maximum amount of oil is extracted by dictating production methods in the development plans as part of the licensing process. A diagram of a typical oil production curve to illustrate this process can be found below.

As with the pre-2008 contracts the Government has succeeded in insulating itself against falls in oil price under the 2012 PSA terms while the companies stand to gain less if oil prices fall. The companies will always cover their costs, including wages and expenses, through the cost recovery process before profit is divided between the companies and the Government.

Recommendations

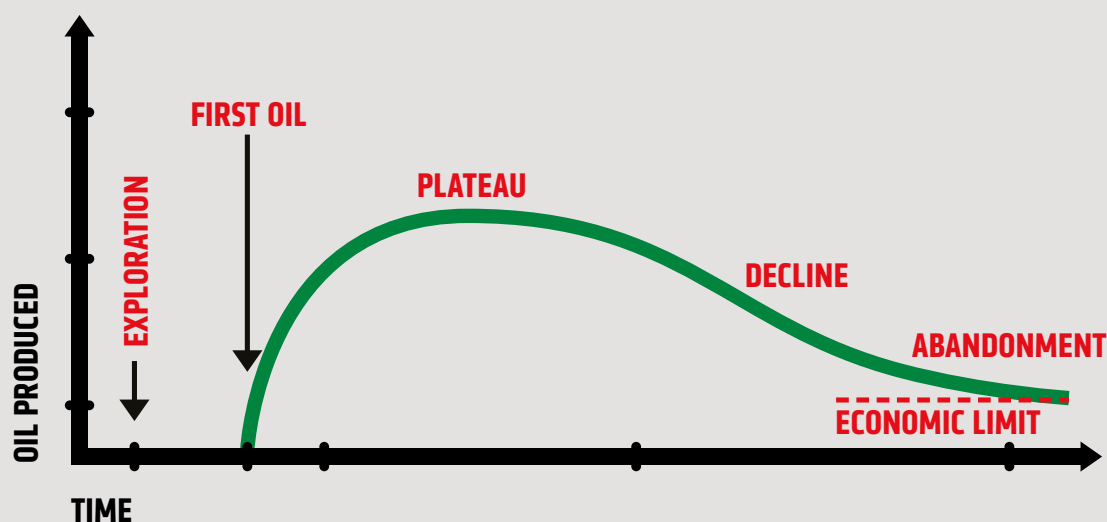
In order to benefit from the additional royalty, the Government will need to carefully and accurately track and record production and the value of its petroleum as well as maintaining robust tax collection systems. The Government and its development partners should make resources available to strengthen capacity in order to achieve this.

The Government should maximise recovery rates through its licensing regime by dictating production rates and technology/ techniques used when approving production licences and consider the impact of future tax policies on field abandonment.

4.4 Additional profits or 'windfall' tax

The 2012 contracts, unlike the pre-2008 contracts, allow the Government to introduce additional taxes on higher than expected profits, for example, if international oil prices are high. This is unusual because 'stabilisation

OIL PRODUCTION CURVE





Overall, the 2012 contracts, particularly when a new windfall tax is introduced, offer a very high government take. © FrankvandenBergh

clauses' often prohibit governments from applying new taxes to the licensee, as is the case with the pre-2008 contracts, preventing them from fully benefitting from higher than expected revenues while company profits increase. The two 2012 PSAs specifically exempt a 'windfall tax'^M from the stabilisation clause and only provide the companies with the assurance that changes in law will not 'substantially and adversely' affect the value of the project (Clauses 33.2 – 33.5)^N

The Government is therefore able to collect a greater share of higher than expected revenues, most likely due

to high international oil prices, by introducing additional taxes on the additional profits generated. This is extremely positive for Uganda. To consider the potential impact of the new stabilisation clause, Global Witness has modeled the impact of a hypothetical new 50% tax rate on additional profits. To be clear, the Government has not yet introduced a windfall tax, but it could in theory introduce any tax rate it chooses.^O The 50% figure is only illustrative and was chosen because company and government share equally from unexpected profits. The percentage can be amended in the online model.^P

M A tax levied by governments against certain industries when economic conditions allow those industries to experience above-average profits.

N For further information on the stabilisation clauses please see [page 18](#).

O An agreement on a realistic Net Present Value (NPV) is key to the Government's ability to benefit from such a tax. In essence, the higher the starting value the Government and the companies have agreed upon, the less likely there is to be 'additional profits' which can be taxed. If the company is allowed to overvalue its predicted profits at the outset, the Government may not benefit as much as it should from a higher than expected revenues. For the purpose of our modelling, we have assumed that the Government and companies will have agreed on a realistic net present value for the project (i.e. one which assumes a similar oil price prediction to the one used in the model – for further info see Annex 1).

P Global Witness has modelled a 22% IRR threshold for the windfall profit tax.



Oil money will be a substantial boost to Uganda's economy. © Crispin Hughes/Panos Pictures

If oil prices and project costs stayed in line with those predicted then the Government would not benefit from a 'windfall tax'. However, if long term oil prices were to rise by US\$20 per barrel higher than expected then Government take would be much higher with the windfall tax than without. Under the 200 million barrel scenario government take, including the NOC money, would increase to 91% (compared with 84% without the windfall tax). This would be worth roughly US\$1.2bn (or US\$260 million with a 10% discount rate) in additional revenues for the Government over the lifespan of the field for one contract area alone or US\$1.34bn (or US\$300 million with a 10% discount rate)^Q compared with the pre-2008 contracts. In a 600 million barrel production scenario the difference between the pre-2008 contracts and the 2012 contracts, with the addition of a new 50% tax, could be more than US\$3bn or US\$628 million with a 10% discount rate.

Even if long term oil prices were to rise by US\$50 per barrel (with 200 million barrels) government take would rise to 91% with NOC take and company IRR at 31% meaning the Government would capture a larger share of rising profits. There is of course the option for

the Government to levy even higher taxes to gain an even greater share of windfall profits.

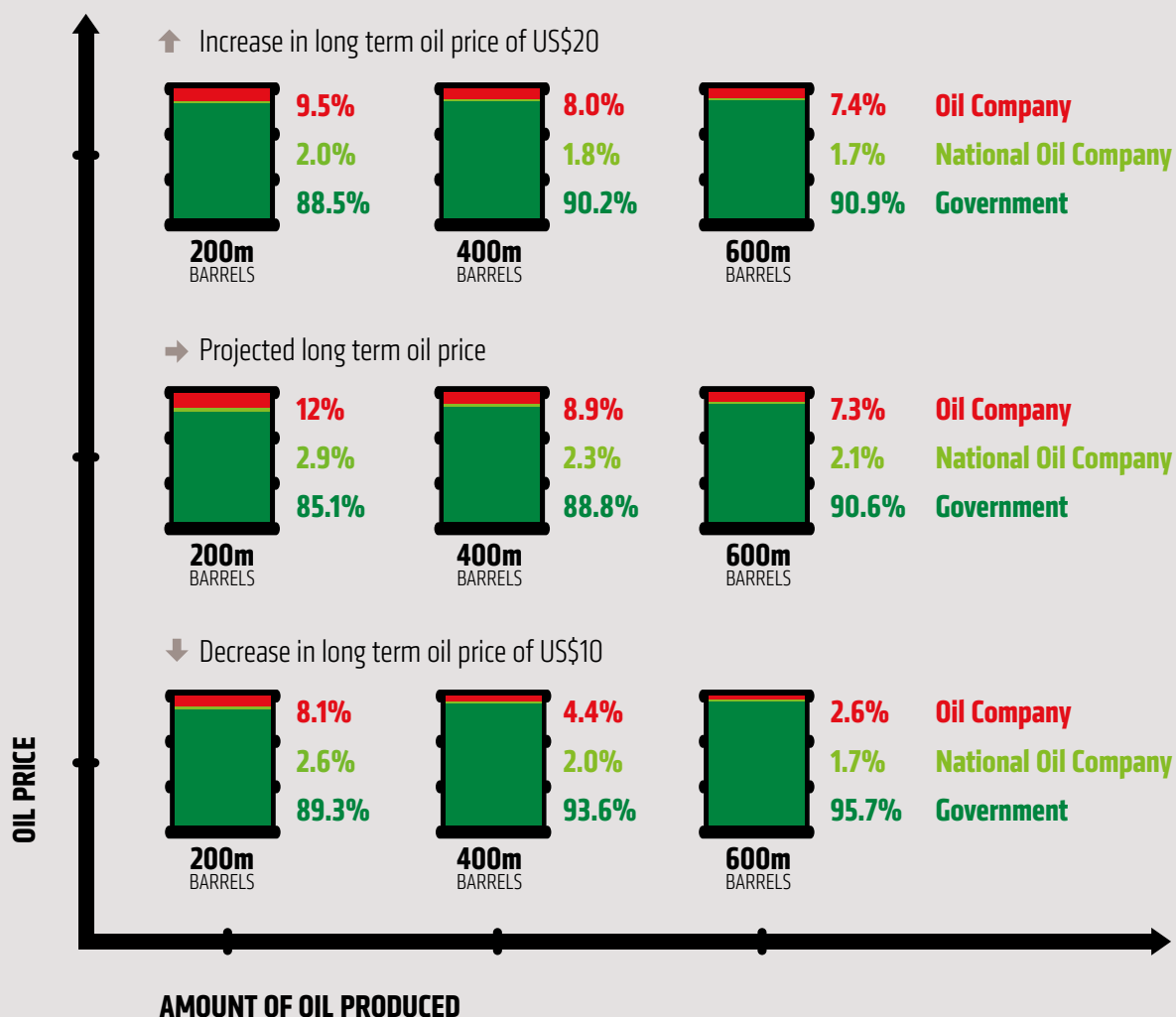
Overall, the 2012 contracts, particularly when a new windfall tax is introduced, offer a very high government take. The introduction of a windfall tax, as allowed under the 2012 contracts, would ensure that the government take would increase as oil prices rise.

4.5 Capital gains tax

The capital gains tax provision in these contracts will help Uganda avoid the kinds of costs and difficulties associated with previous tax disputes⁴⁸ and potentially collect significant revenue from any lucrative sales which could take place in future. However, capital gains taxes are only payable when a company sells a part, or all, of its interests in an oil exploration area to another company. It is impossible to predict if and when this might happen. As such, capital gains tax cannot be relied upon as a source of revenue. For that reason we have excluded it from our modeling (Clause 24.7).

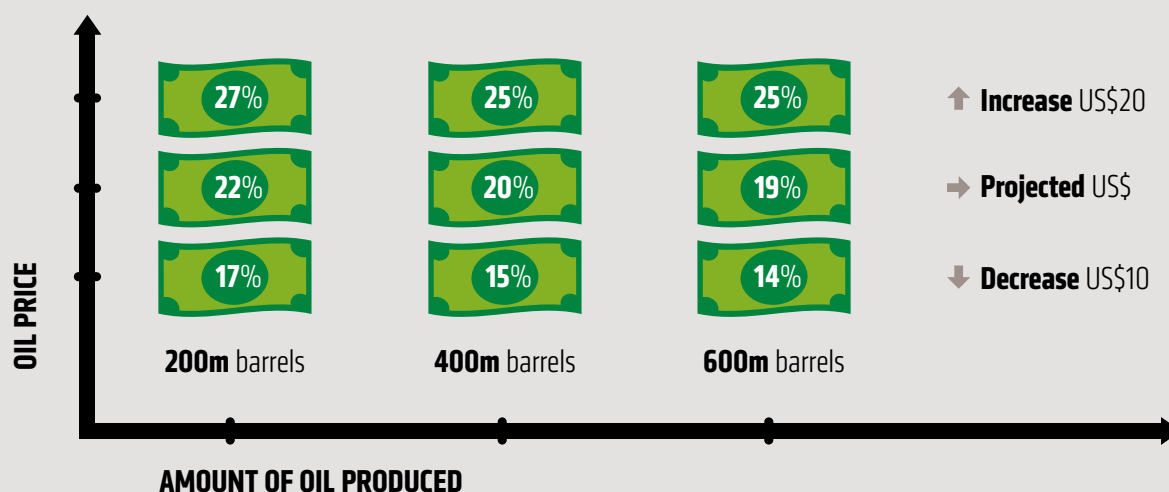
^Q Investors and governments value money now more than money in the future. They therefore apply a 'discount rate' to projected future revenues in order to calculate the value of those returns to them at the present time. This does not affect the actual revenues received. A 10% discount rate is fairly standard for the industry. See Annex 1 for further information.

HOW OIL REVENUES ARE SPLIT UNDER THE 2012 CONTRACTS WITH ADDITIONAL HYPOTHETICAL 50% TAX RATE ON 'WINDFALL PROFITS'



All figures in this infographic were generated using our online model and have a 10% discount rate applied. For further information see Annex 1.

COMPANY INTERNAL RATE OF RETURN (IRR*) FOR THE 2012 CONTRACT (EA1)



* Internal Rate of Return – a figure which describes the rate of return for the investor in a project. For further information see Annex 1.

4.6 How much money will Uganda get for its oil?

This is an obvious but extremely difficult question to answer. So much is still unknown about the sector such as how much oil will ultimately be recoverable, how much development and transportation will cost, and how much oil will be worth in future. A very rough estimate based on the best information available to us for EA1, 2 and 3A might assume that if oil prices rise as expected and the number of recoverable barrels remains at 1.2bn – 1.7bn barrels Uganda will receive roughly between US\$54bn and US\$77bn (or US\$15bn and US\$21bn with a 10% discount rate) over the lifetime of the project. This equates to roughly US\$3.3bn a year over a 20 year period although in actuality the revenues received will be higher in some years than others, peaking in the mid to late 2020s at between US\$3.8 and US\$5.6bn depending on the volumes of oil. Changes in oil price have a huge impact on the revenue the Government will receive.^R

The World Bank had previously predicted that Uganda would receive US\$3bn per year from oil near peak production, while the Oxford Centre for the Analysis of Resource Rich Economies (Oxcarre) predicted that the Government would receive US\$20bn for its oil over the life of the project with a 7% discount rate.⁴⁹ It is likely that these estimates were based on lower rates of production volumes reflecting the smaller finds at the time. To put this in perspective, the GDP for 2013 was around US\$21bn, while the government budget for 2013 was around US\$4.4bn.⁵⁰ Some additional value could be generated from the sector through service industries, refining and petroleum bi-products. These figures are set to rise as the economy grows.⁵¹

Global Witness hopes that the publication of this analysis, the contracts themselves and the economic modelling tool used to create the results will help others to make more informed assessments about the macro-economic impact of oil in Uganda. Particularly whether the benefits of further exploration outweigh the potential costs.

4.7 How much money will be available for revenue sharing between different areas across Uganda?

The draft Public Finance Bill, which was expected to be passed imminently by the Ugandan Parliament at the time this report went to print, contains provisions for the sharing of government oil revenues between central government and the oil producing districts in Uganda. At the time of this report going to print the draft law dictates that 7% of 'royalties' shall be shared out amongst the districts located within the petroleum exploration and production areas in Uganda. It is likely to be an area of intense debate and negotiation between national and local officials. Currently local officials and civil society are at a disadvantage in their negotiations due to their having little information about how much money they are likely to receive in practice (Section 71).⁵² According to Global Witness' modelling of the contract terms, 'royalties' are likely to make up around 20% of the overall government revenue received under the pre-2008 contracts and around 30.5% under the 2012 contracts (due to the new cumulative royalty in these contracts). This means that a 7% share of royalties equates to around 2.1% of total government oil revenue under the 2012 contract and 1.4% of pre-2008 contract revenues. For further information see our simplified [online modelling tool](#) available on the website.

Greater transparency on the part of the Government and the companies is needed if citizens are to be able to track government oil revenues once oil begins to flow to make sure they receive their fair share. [See Box 4 on page 35](#) for further details on Revenue Transparency.

^R Global Witness has modelled a standard production curve and it may be that the infrastructure will cap production leading to a plateau of production at a lower rate leading to a longer project life for oil in Uganda. This would mean that oil production and therefore the receipt of revenue will be spread out over a longer time period.

5 / **ADDITIONAL TERMS THAT WILL AFFECT GOVERNMENT REVENUE**

Uganda's oil sector is likely to provide a significant boost to the country's economy during the 2020s and after. This incoming revenue could help lift millions of people out of poverty and push Uganda towards middle income status.



ADDITIONAL TERMS THAT WILL AFFECT GOVERNMENT REVENUE

Publication of contracts and other key information such as production volumes and sales data would allow citizens to monitor payments more effectively by understanding how much money the Government should be receiving.

5.1 Signature and Discovery Bonuses – following the money

A signature bonus is a one off payment paid by a company to the Government on signing a new contract. This is standard in the industry. While a very high signature bonus may incentivize government officials to sign unfavourable contract terms in order to secure ‘up front’ payments this does not appear to be the case in Uganda.

Signature bonuses can run as high as the hundreds of millions of dollars in more established markets. The signature bonus in the Kanywataba contract is US\$300,000 while the 2012 EA1 contract has a signature bonus of US\$200,000 (Clause 9.1). This is similar to the pre-2008 contracts.⁵ These figures are tiny when compared with the other revenue streams for the sector. But, while the Government may have been able to negotiate higher signature bonuses this should not be seen as a failure given the overall terms.

The contracts also require the company to pay a US\$2m discovery bonus to the Government upon disclosure of an oil discovery (Clause 9.2). This is also fairly standard practice for the industry.

The more important question outside the scope of the contracts themselves is; where have these bonuses been paid to and can they be accounted for in the government accounts? We can assume that US\$500,000 was paid in February 2012 when the two contracts were signed and that US\$2 million was paid as a discovery bonus in February 2013,⁵³ however, Global Witness has looked at the budget and it is not clear where these payments are as the Government does not publish disaggregated data



It is not currently possible to track payments by international oil companies into government accounts. © Aidan O'Donnell

for this sector.⁵⁴ This matters because Ugandan's cannot see for sure where the money has gone.

⁵ EA 3A had a US\$300,000 signature bonus, while the EA 4 contract figure was US\$200,000.

BOX 4: THE NEED FOR REVENUE TRANSPARENCY IN UGANDA

The lack of information about the fate of signature bonuses highlights a significant problem in the way that payments and receipts in the Ugandan oil sector are currently disclosed and accounted for. On the company side, to Global Witness' knowledge only Tullow has published disaggregated payments to the Government of Uganda.⁵⁵ The Government only publishes large aggregated annual figures. This means that the public cannot tell what money is being paid by each company and where it is going.

Consequently it is not currently possible to track payments by international oil companies into government accounts with Tullow Oil being the only company voluntarily publishing disaggregated payments to the Ugandan Government. This creates the risk that any theoretical tax avoidance by companies or embezzlement by government officials may go unnoticed (Global Witness makes no claim of any such wrongdoing in relation to the contracts we have examined in this report). This will be increasingly important as oil production begins and more and bigger payments begin to flow into government accounts.

Under new laws in the US, EU and Norway, companies which are registered or listed in these jurisdictions, which includes Tullow, CNOOC and Total, will soon be required to publish a detailed breakdown of the payments they make to governments making them easier to trace into government accounts. This information will be broken down by project area (licence area) and type of payment (signature bonus, royalties etc). However, in order for MPs, journalists and NGOs to follow the money, the Government of Uganda will also need to publish the payments that it receives according to the same reporting standards so that the two can be compared against one another.^T

Uganda's Oil and Gas policy commits Uganda to "participate in the processes of the Extractive Industries and Transparency Initiative (EITI)"^U and to ensure the "development and harmonisation of accounting standards in oil and gas activities including implementing principles of the Extractive

Industry Transparency Initiative (EITI)."⁵⁶ Despite repeated public commitments by government officials,⁵⁷ the Government of Uganda has so far failed to take concrete steps to join the initiative. Privately other government officials have told Global Witness staff that they do not wish to join citing sovereignty and bureaucracy reasons.⁵⁸

The Public Finance Bill, currently before the finance committee in the Ugandan Parliament, and its subsidiary regulations, offer an opportunity to ensure all future revenues are disclosed by both the company and the Government according to the same reporting standards as those required by the EU, Norwegian and US legislation, and the EITI.

Publication of contracts and other key information such as production volumes and sales data would allow citizens to monitor payments more effectively by understanding how much money the Government should be receiving. The open model which Global Witness has produced along with this report will allow citizens to use contracts to see approximately what payments should be made, now or in future, depending on different variables.

Uganda is in the process of establishing a National Oil Company (NOC) which will be 100% state owned according to the law.⁵⁹ Transparency in its accounts and dealings will be equally as important as revenue transparency. This is not guaranteed by current legislation (See Upstream Law, Sections 42 – 46) The NOC is likely to hold a participating interest in some or all of the oil blocks. Yet there is no detail on where its funds and profits will be held, what payments it is likely to receive, and whether it will publicly disclose the receipt of payments or details of its financial management.^V NOCs in other countries, such as Angola, have raised concerns due to their opacity and close links to the ruling elite. Despite Angola being one of the poorest and most corrupt countries in the world, the Angolan state oil company has long been used by the Government to borrow huge sums in a highly opaque manner and with little public accountability for the use of the money.⁶⁰

^T The disclosures will also need to be broken down by month at the most so that they are comparable with the reporting years of the companies.

^U The EITI is a voluntary multi-stakeholder initiative designed to marry payments by oil companies and receipts by government. For more information on this see our briefing on mandatory reporting, EITI and reporting requirements here: <http://www.globalwitness.org/library/briefing-benefits-uganda-joining-emerging-global-transparency-standard-extractive-industry>

^V It is unclear whether information submitted to the AGM by the Board of Directors, including account details, will be shared with Parliament or other oversight bodies including the Auditor General. It is also unclear how the NOC will be funded and whether it will be allowed to borrow on international markets against its interests in the sector.

5.2 Cost recovery

THE ISSUE: A key principle in production sharing agreements is that the oil company pays the upfront costs of exploring and developing the oil field, which usually runs into the hundreds of millions, if not billions, of US dollars. It is only when the oil starts to flow that the companies will begin to recoup the money that they have invested from the revenues generated from the sale of the first oil.

How this money is recovered, referred to as 'cost recovery,' is set out in detail in PSAs. The **cost oil** clauses determine what percentage of revenue can go towards cost recovery in any given year while the **cost recovery** clauses specify which costs are recoverable and which are not. These terms can have a significant impact on the amount of money the Government eventually receives for its oil.

5.2 i) Cost oil clauses (Article 12)

THE CONTRACTS: Although the cost oil allowances in the contracts (at 60%) are at the high end of the international spectrum, this is not in itself a problem: while the companies will recoup their costs more quickly, the Government has guaranteed an early revenue stream through the two royalties outlined previously, which are paid on 100% of production even before the company has recovered its costs.

5.2 ii) Cost recovery clauses (Annex C)

THE ISSUE: The "cost recovery" clauses, usually an annex to the PSA, specify which costs are recoverable and which are not. In other words which of the upfront costs incurred by the company will be paid for from the sale of oil before it is split between the company and the Government, and which costs the company will have to pay for from its own share of profits generated from the sale of oil. Every barrel which goes towards cost recovery, is a barrel lost to the Government who would have otherwise split its value with the company, with the Government taking between 45% and 67.5% through the production sharing mechanism plus additional taxes on company profits (Clause 13.1). This is therefore a crucial clause for the Government.

THE CONTRACTS: The key provisions in these contracts are the lists of costs which can be recovered in Annex C of the 2012 contracts. The provisions are not as detailed as they might be in countries with a longer history of oil production and more experience of the cost recovery process. Future contracts should be much more specific.

There are some specific weaknesses in these PSAs. There are also some more general concerns about cost recovery that are international in nature and which are difficult to mitigate through contracts alone. Both are covered below.



The Government should exclude litigation expenses from the list of recoverable costs in future contracts. © Shutterstock/Pichugin Dmitry

A. Litigation costs

THE CONTRACTS: Under Annex C of the 2012 contracts all costs and expenses of “defending or prosecuting lawsuits involving the contract area or any third party claim arising out of activities under the Agreement” are recoverable (Annex C, 4.1 i); only costs of arbitration or expert determination under the PSA itself are excluded (which of itself is welcome) (Annex C 4.2 d).

This means that the company has less incentive to operate at high standards in order to avoid costly litigation. This is because it will be paid for out of the oil revenues before they are divided between government and company. They will both share the costs. The Government is less likely to raise concerns as a result. Litigation could happen in many scenarios for example;

- Where a local community seeks compensation for the impact of operations on their livelihoods or;
- Where the company takes legal action against local activists protesting against its activities.

Recommendation

The Government should exclude litigation expenses from the list of recoverable costs in future contracts.

B. Interest on loans

THE ISSUE: Most exploration companies rely on loans for some of their upfront costs (which is reflected in our modelling). Interest rates will vary according to the type of company, its financial standing and the inherent risk in the project. The interest costs are sometimes cost recoverable. While a government can include clauses in a PSA to try and ensure that companies borrow at reasonable rates, in practice once a company has been selected these terms are unlikely to act as an effective limit on recoverable financing costs.

THE CONTRACTS: Under Annex C, the companies can recover the interest on up to 50% of total financing for development operations (that is cost of extracting and transporting the oil once it has been discovered) through the cost recovery process (Annex C, 4.1 l).

The cost of financing exploration activities (which is not cost recoverable under the contracts) before commercially viable oil is discovered are borne by the company (Annex C, 4.2 j).

THE PROBLEM: Although Global Witness has no evidence to suggest that the existing companies involved do this, the risk is that companies, in theory, could borrow at high or inflated rates, potentially from affiliated companies, and reduce the revenue that will be split with the Government. The requirement in the contracts that interest and financial charges “do not exceed prevailing commercial rates” is likely to be of limited protection (Annex C, 4.1 l). Under the PSAs the Government can examine loans

from affiliates and check them against ‘commercial rates’ (Annex C, 4.1 l) as well as use its audit and inspection rights to check other borrowing arrangements (Annex C, 1.5). In practice however the situation is not this simple. Global Witness has been told by Ministry of Finance officials that they have had difficulty assessing the company lending arrangements and costs and, are concerned that they may be losing out as a result.

Recommendations

It is difficult to provide tighter contractual controls on company lending rates. The financial standing and creditworthiness of a company should be considered as part of the selection process during allocation rounds.^W The Government should also be diligent in considering loans from companies’ affiliates and using their audit and inspection rights (Annex C, 1.5), in order to fully protect its revenue. Development partners should also consider providing additional support to help the Government accurately assess cost recovery liabilities and avoid losses.

C. Transactions with affiliated companies

THE ISSUE: One problem associated with cost recovery is that unscrupulous companies can and do seek to boost their earnings by reclaiming inflated costs or by claiming costs that should have been the companies’ responsibility to pay. For example a company could pay inflated fees to affiliated companies, or disguise one outsourced service as another listed under ‘recoverable costs’, and recoup those payments through the cost recovery process. While contracts can offer some limited protection against these abuses there are also some general areas of concern where they cannot.

THE CONTRACTS: Annex C in these contracts contains a requirement that such affiliate contract fees must be comparable with market rates. However, in practice it may be challenging to make this assessment. In East Africa, there may be relatively few logistically comparable providers of certain services, and many of these will be affiliates of other companies who are themselves operating under similar cost recovery terms. It can also be hard to ascertain what services have been provided.

Recommendations

There is little the Government can do to improve contract terms in this area so it will need to focus on enforcing existing terms which will require substantial resources and rigorous monitoring, particularly using audit rights. Uganda’s development partners could assist the Government by providing additional technical assistance for cost recovery and access to information from their home countries.

^W For further information see [Global Witness’ briefing](#) on allocation on the Global Witness website.

5.3 Pipeline cost recovery

One positive aspect of the cost recovery requirements is that the costs of building the export pipeline to the coast through Kenya,⁶¹ in order to sell the oil onto international markets, are not cost recoverable under this contract. The upstream profits are therefore “ring-fenced” or protected by this language, which is generally considered by experts to be to the benefit of Uganda.

5.4 Gross negligence or wilful misconduct

The contracts specify that costs not covered by insurance can be recovered from the Government unless they have resulted solely from an act of ‘gross negligence’ or ‘wilful misconduct’ on the part of the licensee (Annex C, Clause 4.1 (h)). In practice it may be difficult to demonstrate that costs are ‘solely’ the result of ‘wilful misconduct’ or ‘gross negligence’, which could leave the Government paying costs even where such actions have played a part.

Ultimately, contract terms can only provide limited protection to government in the area of cost recovery. Although the PSAs stipulate that recoverable costs must be “necessary, appropriate and economical expenditures incurred in the Petroleum Operations,” (Annex C, 2.2 and 2.3) the Government must actively protect itself by verifying that all costs claimed are honest, permitted under the contract and represent commercially realistic sums. In particular, the Government should make use of its audit rights.

5.5 Conclusion for financial terms section 4 and 5

In summary, the 2012 contracts represent a better financial deal for Uganda than the pre-2008 contracts potentially generating hundreds of millions of dollars in additional revenue (and even billions of dollars if more oil was discovered). If the Government chooses to introduce a new windfall tax it could benefit significantly under these contract terms.^x If long term oil prices rise above what is expected, or project costs are significantly less than predicted, then Uganda would receive significant additional royalties through this tax when compared with the pre-2008 contracts.

However, there are still some areas of concern. It is currently not possible to trace revenues from the oil sector into the budget, leaving the risk of mismanagement and corruption. The Public Finance Bill, and associated regulations, provide an opportunity to publish

information which would change this situation. Joining the EITI would have an even stronger impact.

There is also a risk that the cost recovery clauses in the contract and the processes in place to enforce them are insufficiently robust to stop companies which may seek to take advantage. The Government and development partners should work closely together to avoid this.

Uganda’s oil sector is likely to provide a significant boost to the country’s economy during the 2020s and after. This incoming revenue could help lift millions of people out of poverty and push Uganda towards middle income status. However, if managed badly oil revenue could lead to corruption, economic stagnation, poor governance and even conflict.

Recommendations

It is therefore vital that the Government puts in place robust and transparent procedures to govern the sector.

This should include:

1. Amend the Public Finance Bill (or associated regulations) to ensure that all future payments made to the Government, are disclosed on a project by project basis, and disaggregated by payment type in line with EITI and EU/US reporting standards. The reporting timelines of company and government data should align.
2. Publish all other key information such as contracts and sales data so that citizens can make sense of their oil sector and track incoming revenues effectively.
3. Provide Parliament with an enhanced oversight role.
4. Set up a multi-stakeholder committee to oversee revenues from the sector similar to the Public Interest and Accountability Committee in Ghana.⁶²
5. Join the EITI.
6. Put in place regulations to ensure that the national oil company is managed with the utmost transparency and independent oversight.
7. Given the value of revenues which are expected from the sector, and the fact that there will be far more revenue in some years than others, it would be wise to lock in saving and spending rules (fiscal rule) in the Public Finance Bill. This will help the Government manage incoming revenue prudently, avoid the politicisation of revenue management, and ‘Dutch disease’ – the process of currency inflation and economic stagnation associated with an over dependence on oil revenue at the expense of other areas of the economy.

^x Assuming it has also successfully agreed on a fair valuation of the projects with the companies.

6 / **PROTECTING UGANDA'S PEOPLE AND ENVIRONMENT**

Global Witness is deeply concerned about the failure of these Production Sharing Agreements to give adequate protection to the Ugandan people, and the environment in Uganda and neighbouring countries.



PROTECTING UGANDA'S PEOPLE AND ENVIRONMENT

The Albertine Graben, situated in the Northern part of the Western arm of the East African Rift valley, is one of the most biodiverse environments on the planet. The Graben contains 52% of all species of African birds and 39% of the continent's mammal species.



Lake Albert, where the oil has been discovered also spans the border between Uganda and the Democratic Republic of Congo, and the lake also feeds the River Nile which flows onto South Sudan, Sudan, Egypt and the Mediterranean. © National Geographic

6.1 Summary

Global Witness is deeply concerned about an apparent failure of these Production Sharing Agreements (PSAs) to give protection to the Ugandan people, and the environment in Uganda and neighbouring countries. This is of particular concern because of the global environmental significance of the contract areas and the prospect of further exploration in new areas through upcoming allocation rounds. While the Government has succeeded in securing more favourable financial terms in the 2012 contracts the environmental and social provisions have not improved on the heavily criticised pre-2008 contracts.⁶³

A failure to provide adequate environmental protections could be truly catastrophic. Although the stabilisation clauses in the 2012 PSAs leave the door open for the Government to apply legislation and regulations with stronger environmental and social protection measures without fear of compensation claims from companies, the current contracts and laws leave people and environment at risk.

An additional problem beyond the weaknesses in the contracts and the laws is the Government's ability to implement and enforce them. Urgent concerns have been repeatedly raised, by government officials, civil society organisations and foreign donors,⁶⁴ about the capacity of the National Environmental Management Authority (NEMA) and other environmental agencies^Y to execute their responsibilities. An independent capacity assessment funded by the Norwegian Government provides a devastating analysis of government capacity in this area.⁶⁵ The report highlights a litany of problems^Z concluding that these have "rendered most of the institutions incompetent to implement their mandates leading to inability to regulate oil and gas sector environment impacts."⁶⁶ If this situation remains unaddressed this presents a potential disaster for Uganda. Even with strong contracts and laws without the capacity to implement them Uganda will be at the whim of the oil companies when it comes to protecting people and the environment. This situation should be urgently addressed.

In March 2013, NEMA, with the help of the Norwegian Oil for Development Programme and the Netherlands Commission for Environmental Assessment, produced a Strategic Environmental Assessment (SEA) for the Albertine Graben, the area where oil has been discovered in Uganda, with 14 key recommendations.⁶⁷ The Government is due to develop an implementation plan for the SEA with the intention of developing a framework for the sustainable use of the Albertine Graben's oil and gas

reserves, balancing their exploitation with other users and the local environment.⁶⁸ This provides an opportunity to tighten the regulatory environment. In Global Witness' view petroleum activities should be prohibited in protected areas in future.

Section 6.4 of this report considers the environmental and social provisions in the contracts alongside the petroleum laws to identify legislative gaps. Policymakers should strengthen future laws, regulations and the model PSA to fill these gaps.^{AA}

6.2 What's at stake?

The Albertine Graben, situated in the Northern part of the Western arm of the East African Rift valley, is one of the most biodiverse environments on the planet. For example, the Graben contains 52% of all species of African birds and 39% of the continent's mammal species.⁶⁹ The region has the largest number of protected areas in Uganda, including game reserves and wetlands of international importance designated under the Ramsar Convention, and a large number of endemic species including the mountain gorilla, Rwenzori red duiker and the golden monkey.⁷⁰

The region is inhabited by pastoral, fishing and agricultural communities who depend on the natural habitat for their livelihood.⁷¹ The national parks and wildlife reserves are one of the most important tourist attractions in Uganda. Although oil has the potential to stimulate socio-economic growth, both in Uganda as a whole and in the Albertine Graben, it could also cause serious damage to the environment and social wellbeing of the local communities as acknowledged by the Ugandan Government's own sensitivity study.⁷²

Lake Albert where the oil has been discovered also spans the border between Uganda and the Democratic Republic of Congo (DRC), and the lake also feeds the River Nile which flows on to South Sudan, Sudan, Egypt and the Mediterranean. As such, it is not only the people of Uganda who have a vested interest in ensuring the protection of the environment and the careful management of the oil and gas sector.

6.3 Decision to extract

There is a global debate emerging about whether countries with oil should exploit those resources at all given the significant environmental and social problems that exploitation may cause. While oil could be extremely valuable to the Government of Uganda over the next

^Y The National Forestry Authority, the Uganda Wildlife Authority, the Department of Fisheries, the Directorate of Environment Affairs, the Ministry of Lands, Housing and Urban Development and Directorate of Water Resources Management.

^Z Including inadequate staffing levels, lack of knowledge and skills amongst staff, absence of appropriate training institutions, and chronic shortages of equipment and funds.

^{AA} It is crucial to remember that parts of EA1 as well as EA 2 and the Kingfisher field are still governed by the pre-2008 PSA terms and as such, should the Government apply stronger environmental and social protection measures, it may have to compensate the companies for reduced profits.

30 or so years, it is a finite resource and the negative impacts of oil production could be felt for many more years. Given the environmental significance of the Albertine Graben, the current weakness of government environmental institutions, the other economic activities in the area, and the risk of conflict, Global Witness believes that policy makers should carefully consider whether extraction is ultimately in the best interests of the country before new areas are opened up for exploration. Furthermore, local communities should be consulted and where possible give consent before activities commence. Consultation processes should take care to ensure that the most vulnerable are considered.

Uganda's tourism industry is worth over US\$1.7 billion per year, or 9% of GDP, at present with the number of tourists increasing by 34% between 2010 and 2011.⁷³ While this figure may not be as large as the revenues from oil, the tourism industry is still in its infancy and it is likely to far outlive Uganda's oil sector. Further significant increases in tourism could make Uganda's tourism industry an extremely important source of external revenue for the country. Much of the tourism appeal is based on the area's natural beauty and wildlife. Juggling the needs of the oil sector with those of the tourism industry could prove difficult, and careful consideration should be given to the decision to extract and how to manage competing priorities. Sadly, demand from more developed countries for oil and other raw materials is likely to increase the pressure to extract in sensitive areas regardless of local impacts.

6.4 Environmental and social provisions

This section highlights some of the key areas of environmental and social risk in Uganda's oil sector, explains and compares the provisions in the contracts and petroleum laws^{BB} which deal with them, and makes recommendations for improving the regulatory framework. Although this section refers to other applicable laws and regulations, it is not an exhaustive analysis of all relevant legislation. Annex 2 contains examples of clauses from other countries' contracts that deal with the same risks to highlight best international practice in relation to each area.

6.4 a) General terms

The PSAs tend to use vague language when it comes to the applicable legal standards. For example 'good oilfield practice' is poorly defined and 'international standards applicable' is also vague. The contracts and

the laws leave a lot to the discretion of the Government. While this may allow the Government to issue a strict interpretation it does leave it finding its own way and the contracts could benefit from more specific references to international standards such as The International Finance Corporation Performance Standards, The IMF's Guide on Resource Revenue Transparency and The Natural Resource Charter.

6.4 b) Protected areas

Significant areas designated by the Government for exploration contain, or are adjacent to, protected areas including National Parks and wildlife reserves.⁷⁴ This is a concern as these areas have been specifically designated for greater protection by the state due to their environmental importance or sensitivity. Oil extraction is also likely to have a significant impact on other economic activities such as fishing and tourism. The implications for job creation and the local economy should be carefully considered.^{CC}

Concerns have already been raised about the impact of oil activities in the Murchison Falls National Park where numerous wells have been sunk.⁷⁵ Local people have been reported as saying that animals have been leaving the park and causing destruction to crops and homesteads.⁷⁶ They have also reportedly raised concerns about the impact of oil related activities on tourism in the park and a suspected increase in poaching.⁷⁷ Total Exploration and Production Uganda, the operator of EA1 and EA1A which covers part of Murchison Falls National Park, is the only company in the Total Group operating in a National Park despite the fact that the group have operations in over 130 countries.⁷⁸ This illustrates how unusual this situation is. Total has committed itself to meeting the International Finance Institution standards on Environmental and Social Sustainability.

THE CONTRACTS: The PSAs make it clear that a national park and game reserve can be licenced to companies for oil and gas activities, subject to consultation between the company and the Government over the nature and extent of those activities and taking into consideration 'good oilfield practices' (Clause 25.2).

THE LAWS: The Upstream law 2013 (Section 135) states that a licensee shall not exercise any right under a licence without permission from the relevant authority including; 'in a national park or wildlife reserve without the written authority of the Uganda Wildlife Authority'; 'in a forest reserve without the written consent of the National Forestry Authority' or 'in a fish breeding area without the written consent of the department

BB The Petroleum Exploration, Development Production Act and the Petroleum Refining, Transmission and Midstream Storage Act 2013.

CC The Government's own Strategic Environmental Assessment [available here: <http://www.petroleum.go.ug/documents.php?id=27>] notes that associated infrastructure and secondary activity such as in-migration are also likely to have an impact on flora, fauna and tourism in the surrounding area. These concerns are only likely to be exacerbated as the sector moves into production phase when additional infrastructure, activity and staff will be required. Opening up national parks for oil operations also potentially sets a dangerous precedent for further activity.



There is an obvious contradiction in allowing oil companies to explore on one side of the border in Uganda while campaigners fight to save the precious natural habitat on the other in DRC. © shutterstock.com/Sergey Uryadnikov

BOX 5: VIRUNGA NATIONAL PARK, DRC

In DRC where oil companies have been granted permission to undertake initial exploration in Virunga National Park, on the border with Uganda, there has been a campaign to stop the exploration and save the park.⁷⁹ Opponents of oil exploration have argued that it is incompatible with Virunga's status as a UNESCO World Heritage site. SOCO International, a UK company, holds 85% rights to the DRCs Block V which covers part of Virunga National Park and part of Lake Edward in the DRC.⁸⁰ In a deal with WWF in June 2014, SOCO agreed that after having completed its seismic tests it would not explore for oil in Virunga unless UNESCO

and the Congolese Government, "agree that such activities are not incompatible with World Heritage status." Although this appeared to be a victory for opponents of oil exploration, the area could still be drilled if the park's boundaries or classification are changed.

There is an obvious contradiction in allowing oil companies to explore on one side of the border in Uganda while campaigners fight to save the precious natural habitat on the other in DRC. Uganda and the DRC signed the Arusha pact on security and oil in 2007 but further careful consultation between the two sides will be necessary to avoid future problems.

responsible for fisheries.’ While this does offer a degree of oversight and protection in theory, in practice these institutions may not always be consulted or have the capacity to engage and it is difficult to envisage a situation where they are likely to overrule the Minister let alone State House (the Office of the President).

The contracts, laws and agencies currently in place to safeguard protected areas in Uganda offer limited protection. Petroleum operations in EA 1 are already having an impact on wildlife in protected areas. These impacts are likely to increase as the sector moves into production.⁸¹ The Government could prohibit activities in protected areas and require companies to use techniques like *deviation/directional drilling*^{DD} and *closed loop drilling*^{EE} to minimise harm. This may increase costs, and therefore lower the profitability of the oil sector for both companies and the Government, but it may help safeguard wildlife and the tourism industry bringing lasting benefits to Uganda.

Recommendations

National Parks and Nature Reserves should be classified as prohibited areas for economic activities and excluded from contract areas in future. In addition, it is recommended that Government and companies leave a belt of land between the National Parks or Nature Reserves and the contract area to ensure there is no disturbance to the flora and fauna from petroleum operations. Given that petroleum operations are underway already the Government should carefully review its policies for protecting the environment and tourism industry, bringing environmental agencies closer to the decision making and providing them with additional capacity to oversee the sector. Donors should play a role through capacity building programmes.

6.4 c) Environmental Impact Assessments (EIAs)

The production of environmental impact assessments by companies operating in the oil and gas sector is an international norm. The quality of these reports, subsequent mitigation measures adopted, and the monitoring and enforcement of these safeguards is crucial to protecting people and the environment. This section of the report assesses the quality of the provisions on the production of EIAs in the contracts.

The 2012 Uganda contracts require companies to produce environmental impact assessments with broad enough terms to encapsulate social issues. This

is positive (such studies are sometimes referred to as Environmental and Social Impact Assessments – ESIAs). However, they are not tied to international standards^{FF} which they should be to ensure companies uphold the highest possible standards. (Clause 25.8)

Ugandan EIAs are not widely publicly available. Additionally the quality of EIAs has been publicly criticised by government employees and CSOs. NEMA has experienced significant capacity issues in dealing with EIAs in a timely manner.⁸²

6.4 c) i. Confidentiality of EIAs

THE ISSUE: EIAs contain key information about the potential risks of oil related projects to people and the environment, and the mitigation strategies companies intend to take to avoid them. It is crucial that the Ugandan public has access to EIAs so that they can hold companies and the Government to account. While some Uganda oil sector EIAs have been shared they are not widely available or published on any government websites.

THE CONTRACTS: The confidentiality clauses in these contracts may restrict the ability of the Government to release environmental data it receives from the companies including EIAs without their permission (Article 36).

THE LAWS: The Upstream law does not require the minister to make company EIAs public, and to date, they are not widely available. It is not therefore possible for citizens to review the risks that companies and the Government have identified for a specific project or to evaluate the effectiveness of the mitigation measures they have put in place.^{GG}

Recommendations

- Companies should declare their willingness for EIAs to be made publicly available in line with international best practice.
- The Government of Uganda should commit to publishing all EIAs and mitigation strategy information so that citizens can be assured that their concerns have been both considered and addressed as part of the process.
- Future contracts should explicitly carve EIAs and other key information out from confidentiality requirements.

DD Drilling at an angle or angles which allows the platform to be located outside the specified area

EE A closed circulating system which keeps discharge of drilling fluid and well cutting to a minimum.

FF These include the International Finance Corporation's (IFC) Sustainability Framework, the 2002 Association of International Petroleum Negotiators (AIPN) Joint Operating Agreement (JOA), the Model Mining Development Agreement (2011) (MMDA) drafted by the International Bar Association, the International Council on Mining and Metal's Sustainable Development Framework, Natural Resource Charter (NRC), the United Nations Guiding Principles on Business and Human Rights (UNGPs) and the Voluntary Principles on Security and Human Right

GG The Upstream Law does mandate the Minister to make public an assessment of the impact of the petroleum activities on trade, industry and the environment, and of possible risks of pollution, as well as the economic and social effects that may result from the petroleum activities conducted by the Government ahead of the decision to open up new areas, but not at other stages of development such as new infrastructure or production licences, and allows interested parties the opportunity to comment (Clause 47.4). This is unlikely to be as detailed as individual EIAs for specific projects.

6.4 c) ii. **Timing and ministerial discretion**

THE ISSUE: EIAs should be completed prior to the commencement of any activity which is likely to negatively impact on the environment including drilling of wells or construction of oil-related infrastructure. They should also be completed as part of applications and renewals for reconnaissance, exploration or production licences.

THE CONTRACTS: The Ugandan PSAs do not meet any of these standards. They leave the timing of the EIAs to the discretion of the minister and do not mandate that such studies must be carried out prior to exploration activities (Clause 25.9 and 25.10).

THE LAWS: The Upstream Law only requires that companies produce an EIA after they have received a production licence (Section 76(f)). The law only entitles, but does not oblige, the Minister to produce further guidelines on the production of EIAs (Section 183(f)). As such, it seems that neither the contracts, nor the oil laws, require companies to produce EIAs as standard ahead of the granting of licences or ahead of new infrastructure projects. However, companies are required to produce EIAs where a government agency identifies a risk under separate environmental legislation.⁸³ Global Witness was told by NEMA that they have been receiving EIAs and that they are happy with their general standard.⁸⁴ Tullow has also told us that they have produced EIAs before sinking wells and it has been reported that companies have submitted EIAs prior to seismic testing.⁸⁵ Given that they have not been published, it is difficult to assess their number or quality.

Recommendations

The Government of Uganda should make it a legal requirement that companies produce EIAs before receiving both exploration and production licences and ahead of any related infrastructure projects. NEMA should use its existing powers to request them. They should be publicly disclosed at the time of submission to government.

6.4 c) iii. **Consultation with relevant stakeholders and affected communities**

THE ISSUE: A formal and transparent process for stakeholder engagement is crucial to ensuring that risks are correctly identified and the views of affected communities are taken into consideration with mitigation measures tailored to the needs of the local people and environment.⁸⁶ Access to certain information, i.e. about potential social and environmental impacts of the project and the proposed mitigation measures, is a pre-condition for effective community engagement. Compensation should also be considered.

THE CONTRACTS: In Global Witness' view, Uganda's contracts lack a clear obligation to adequately consult relevant



The views of affected communities should be carefully considered at all stages. © Greenshoots Communications/Alamy

stakeholders such as local communities, NGOs and local authorities as part of the development process; nor is there a requirement to make the reports from EIAs readily accessible to citizens.

THE LAWS: Under Ugandan environmental legislation the lead agency is required to hold a public hearing to inform local residents – however, this does not qualify as an adequate consultation process.⁸⁷

Recommendations

Companies or the Government should carry out thorough consultations with local communities as part of every EIA process. The agency or company carrying out the consultations should ensure that special attention is paid to collecting the views of men and women equally, and ensuring that the most vulnerable are included.

1. The EIA process must include the option for communities to refuse a project if the impact is deemed to be too great.
2. The EIA process must be conducted transparently with results available to those affected by the project. It must also be conducted independently, free from interference from the company and/or authorities.
3. See Annex 2 for further detail on specific standards.

6.4 d) **Grievance mechanism for affected communities**

THE ISSUE: A reliable and independently run grievance mechanism is essential to ensuring that local communities' concerns are taken seriously and conflicts are avoided. Companies also benefit by avoiding conflict which can translate into significant costs.⁸⁸

THE CONTRACTS: The PSAs deviate from best practice as they lack an easily accessible and affordable environmental and social grievance or dispute resolution mechanism that addresses the needs of the community, and gives an effective voice to those likely to be affected by the projects. The closest the contracts come is Clause 25.3^{HH} which only requires the Government to consider the *protests* (rather than complaints) of those it considers to be responsible third parties (which is not defined and left to the discretion of the Government), and only when they relate to petroleum operations in a National Park or Game reserve. Even then neither the Government nor the company are under any obligation to engage with the protestors or take their views into account.

THE LAWS: The new Upstream Law does allow interested parties to submit their views regarding the decision to open up new areas for exploration in writing to the minister (Clause 47.6). Again however, the final decision still lies with the Minister. It also allows people affected by the proposed exploration licence to object. Although again the decision of whether to uphold or dismiss the objection lies with the Minister and may only be appealed at the High Court of Uganda within 30 days (Section 55). There is no such process in relation to production licences or other projects. These processes do not constitute effective consultation or grievance mechanisms.

As such, neither the contracts nor the governing laws provide for effective community consultation or an effective mechanism for resolving disputes with local communities affected by licensing decisions. This is a significant weakness which risks creating or exacerbating unnecessary tensions and potential conflicts between affected communities, government and the oil companies as we have seen in other oil producing countries in Africa such as Nigeria. Total has told Global Witness that they have a 'Grievance Management Mechanism'.⁸⁹

Recommendations

The Government should implement an independently run grievance redressal mechanism that aligns with the United Nations Guiding Principles on Business and

Human Rights (UNGPs) and the International Finance Corporation Performance Standards and designed in consultation with the local community.⁹⁰ Future contracts should make provision for these procedures.

6.4 e) **Fines**

THE ISSUE: The ability to impose large fines on companies for breach of contract or environmental or social damage resulting from their activities is a powerful tool for the Government to govern company behaviour.

THE LAW: The 2012 Upstream Law allows the Government to levy fines on companies and individuals for non-compliance in a number of areas.⁹¹ The contracts do not restrict the application of the law. However, Global Witness raised concerns in its analysis of the draft petroleum laws in February 2012 that the fines were not large enough to act as a deterrent for companies. While the size of the fines was increased in the final version of the law they are still too small when it comes to environmental damage. Two areas stand out in particular:

- The US\$1.5 million cap on fines for *work practice failures*. This is likely to include failures which could lead to pollution damage such as those in the Gulf of Mexico (Section 88).
- US\$7 million cap on fines for unauthorised flaring of gas. This penalty should be significantly higher (Section 100).

The Upstream law contains a clause⁹² which means that senior employees can be prosecuted for decisions they have made in relation to the company's activities where those activities are non-compliant or illegal. This is an extremely powerful deterrent if properly applied, however it is likely to affect local staff more than international employees, depending on extradition arrangements.

The law also gives the Government the power to introduce further environmental regulations which should be backed-up by severe fines or criminal sanctions where necessary to help ensure that companies abide by the highest possible standards (Section 183).

Recommendations

The Government should increase its capacity to monitor compliance closely and apply fines where necessary to ensure companies adhere to the laws, contracts, licences and international best practices. The Government should also introduce additional strict environmental protection regulations and increase the size of fines to ensure that they act as a successful deterrent. International donors can also play a role here.

HH Clause 25.3: 'In the event of protest from responsible concerned third parties within or outside Uganda regarding the conduct of petroleum operations in any National Park or Game Reserve and the consequent effects upon the environment or wildlife, the Government and Licensee shall meet to determine what if any action should be taken.'

II Clause 163. Offences committed by body corporate

(1) Where an offence committed by a body corporate is proved to have been committed with the consent or connivance of, or to be attributable to any neglect on the part of a director, manager, secretary or other similar officer of the body corporate or any person who was purporting to act in any such capacity, he or she, as well as the body corporate, commits that offence and is liable to be prosecuted and punished accordingly.

6.4 f) Waste management

THE ISSUE: Waste from drilling and production can be hazardous to people and the environment; its management is key to environmental and social protection. The waste management process is an expert industry in itself and only experienced companies should be selected.

At present companies are required to operate under the June 2012 Operational Waste management Guidelines for Oil and Gas Operations produced by NEMA.⁹² Designated waste consolidation sites at Tangi in Nwoya District, Kisinja (Kaisotonya-Hoima District), and Ngara, Bugungu and Kigongole in Buliisa District, serve as temporary disposal sites as plans for permanent waste disposal are developed. The oil waste has in the past in Uganda been stored in containerised pits lined with thick plastic material.⁹³ According to Tullow's 2013 CSR report, companies have generated over 50,000 tonnes of waste over the past ten years for which a permanent solution has not yet been found.⁹⁴ Tullow has commissioned an expert to address this issue and they are waiting on new waste management guidelines from NEMA. According to Tullow's Environmental Management System Public Statement for 2011 operations, in the same year the company had eight 'uncontrolled releases' highlighting the risks and need for careful and expert waste management.⁹⁵ Unrelated to this or to Tullow, a recent report by the Uganda Human Rights Commission raised a series of concerns about irregular waste dumping in the oil region in Uganda, including the alleged dumping of toxic waste in water sources.⁹⁶

THE CONTRACTS: Waste management is barely addressed by the contracts: Under Clause 25.4(c), a company is required to *"take any further action as may be necessary for the treatment of wastes"* and under Clause 25.11, waste disposal must be addressed in environmental impacts assessments, but there is no indication of the specific standards which will apply.

THE LAWS: The new Upstream law requires NEMA to grant a licence to companies dealing with waste management and to produce new waste management guidelines (Clause 3.6). They should provide the basis for a more sustainable waste management solution. However, these guidelines, which were being drafted by *Green Impact and Development Services (GIDS)* on behalf of the Government of Uganda with support from the Norwegian Oil for Development programme, had not yet been released at the time of print. The law also requires companies to contract a third party to deal with waste management (Clause 3.3).

Recommendations

The Government of Uganda should publish revised waste management guidelines as soon as possible and beef up the capacity of NEMA



Flaring can be extremely environmentally damaging and should be avoided at all costs. © The Access Initiative

so that they can monitor and safeguard the oil sector. Uganda's development partners can also play a role by providing technical support to NEMA and other government agencies charged with overseeing the sector. The Government should consider including further best practice waste management requirements in future contracts.

6.4 g) Flaring and venting of natural gas

THE ISSUE: Flaring of natural gas at well heads can be extremely environmentally damaging, as has been shown in Nigeria.⁹⁷ As such, it should be strictly limited. It is in the Government's interest to ensure that the companies keep flaring to an absolute bare minimum to limit the impacts on local people and the environment, and maximise the benefit from what is a precious raw material for the petrochemical industry. Flaring should only be admissible as an emergency measure. Both Tullow and the Norwegian Oil for Development programme have assured Global Witness that flaring is not taking place in Uganda at present.

THE CONTRACTS AND LAWS: When the law and contracts are considered together the company will be able to vent and flare in quantities needed for 'normal operational safety' under the law only where it has received permission from the Petroleum Authority of Uganda, or in the event of an emergency – after which they should submit a report to the Minister (see endnote for further detail on flaring in the contracts and laws).⁹⁸ Having the necessary capacity and expertise in the Petroleum Authority to analyse these reports will be essential to holding companies to account, and publication of the reports and government responses would act as another barrier to company exploitation.

Recommendations

Companies should be required to capture and either re-inject or utilise natural gas. They should only resort to flaring when strictly necessary for safety purposes as is prescribed in the law. This language should be replicated in future contracts for the avoidance of doubt. Monitoring of company activities and any flaring, and associated emergency reports, should be carefully scrutinised and companies held to account for their actions. The ministry will need to use its authority to keep flaring to a minimum.

6.4 h) Compensation for communities affected by pollution or other activities

THE ISSUE: Extractive industries can cause severe environmental hazards and the resulting damage – such as health problems afflicting local communities, degradation of agricultural land or fisheries, impacts on local wildlife – can take a long time to become clear and, even then, it can be difficult to establish whether the nearby extractive activities were the sole cause. It is vital that the petroleum laws and contracts protect communities living near extractive operations through robust environmental protections and access to justice. Compensation may be necessary not only for those affected by planned works or infrastructure development but also for those affected by unforeseen events and accidents such as spills. Nigeria and Ecuador provides striking examples of the long term impacts of pollution on affected communities and the difficulties of securing compensation.⁹⁹

THE CONTRACTS: The 2012 contracts (Clause 25.5(a)) require the Licence holder to take all necessary and adequate steps to ensure ‘adequate’ compensation for injury to a person or damage to property caused by the effects of petroleum operations. The requirement is vague and limited only to monetary compensation for injury or damage to ‘property’ which could be particularly problematic when it comes to longer term damage to communal resources. Compensation should be “full, fair and just” which might entail not only monetary reparation but also the requirement to help resettled populations resume productive activity and restore land to its former use. The clause also fails to define “adequate” and how a conclusion on what would be deemed adequate would be reached in the event of dispute.

The contracts also require the company to indemnify the Government, by procuring insurance to cover itself, its contractors and sub-contractors, in the event of damage, loss or injury caused by petroleum operations (Clauses 27.1, and 27.2)^{JJ} – including environmental



It is vital that laws and contracts protect communities living near extractive operations. © Greenshoots Communications/Alamy

damage or injury, removal of wrecks and cleaning up caused by accidents.

THE LAWS: Section 139 of the Upstream law deals with compensation for land owners but not the broader population. It goes on to list a series of limitations on the compensation including a four year limitation on any claim. The period commences from when the claim “accrues”, which could be interpreted as meaning from when the damage or pollution occurred, regardless of whether the affected parties were aware of the problem. Compensation disputes are determined by the Chief Government Valuer.^{KK} The section does not ensure that longer term damage and liabilities are the legal responsibility of the licensee and risks leaving land owners and other affected parties without compensation for damage caused.

The Petroleum laws do make companies liable for pollution ‘regardless of fault’ but do not provide for compensation arrangements for people affected by that pollution (Section 130 of the Upstream Law and Clause 58 (1) in the Mid-Stream). As such, citizens are not guaranteed compensation for the range of losses

JJ Clause 1.1.36 Costs incurred by the company, which are not recoverable under this insurance, are not cost recoverable if they relate to instances of ‘gross negligence’ or wilful misconduct’ – protecting the Government against paying for damage caused by company mistakes. However, the definition of these terms in the PSAs only relates to ‘senior supervisory personnel’ which could limit the effectiveness of this clause.

KK Section 132 and 133 also include some limitations on liability.

which may result from poor management of petroleum operations under the oil laws or the PSAs.^{LL} This is particularly true when it comes to longer term broader environmental damage.

Recommendations

1. Companies should be required under the contracts and law to promptly compensate all those who suffer loss as a result of petroleum activities, meaning not only property owners, but also communities whose communal natural resources such as water, land and animal stocks are affected.
2. An effective dispute resolution mechanism (between company and community) should be established and enshrined in future contracts to deal with any future conflicts. Companies should also be required to set aside money for future compensation as part of the decommissioning funds.
3. Future contracts should provide for “full, fair and just” compensation for all affected parties which goes beyond financial compensation. Compensation should not be limited to monetary compensation and companies should be required to offer additional assistance where necessary such as providing clean up services, provision of alternative accommodation and basic services, and resettlement.
4. Future contracts should ensure that the assessment of the ‘adequacy’ of compensation is entrusted to an independent third party. It should also be clear that compensation should be tied to certain specific standards, such as those prescribed in applicable laws. This process could be incorporated into the mandate of a dispute resolution mechanism.
5. Contracts should be backed up by robust environmental regulations which make the companies’ operating standards and environmental responsibilities very clear.

6.4 i) Decommissioning, abandonment, reclamation and restoration

THE ISSUE: Provisions for the ‘abandonment’ and ‘decommissioning’ (where companies abandon their sites due to commercial, financial or external factors such as conflict, or where oil runs dry) of sites set out a company’s obligations and liabilities for cleaning up, making safe and restoring areas where petroleum activities took place. This is particularly important given the environmentally sensitive nature of the oil region in Uganda.

Attributing liability for decommissioning and abandonment can be difficult. The risk is that companies cut and run, or go bust, leaving the Government to foot the bill. As such, countries often require companies to put aside funds for decommissioning early on in the

project. Good international practice is to require the company to submit a decommissioning plan as part of the EIA or within two years from commencement of commercial production, and provide a financial guarantee which is protected from bankruptcy to cover the full costs of decommissioning.¹⁰⁰ It is not uncommon for governments to require companies to put in place plans for compensation for local communities as part of decommissioning.

THE CONTRACTS: Decommissioning and abandonment is one area where the Uganda contracts most obviously fail to meet best practice. Apart from Clause 25.17 of the contracts, which states in general terms that on the expiration or termination of the agreement or relinquishment of part of the contract area, the company shall reclaim and rehabilitate all lands that have been disturbed by petroleum exploration and production, there is no specific provision detailing how oil and gas installations shall be abandoned at the end of their life spans. Nor do they stipulate who bears the costs for such abandonment and rehabilitation.

THE LAWS: The 2012 Upstream Law does require companies to produce a decommissioning plan and pay into a decommissioning fund under Sections 112 and 113. The decommissioning plan is to be produced by the companies before a licence expires or between two and four years before a facility is permanently closed down (Clause 112.7).

The law also provides for the creation of a decommissioning fund for each development area and says that oil companies should pay into it but not until a relatively late stage: when production has reached half the aggregate recoverable reserves, if the licence is surrendered, or five years before it expires (Clause 113.3).

THE PROBLEM: The concern is that leaving the collection of revenue for decommissioning to this late stage may mean that there is not enough money to cover the eventual costs. The exact costs of decommissioning will be determined by the decommissioning plan, which will set out in detail what work the Petroleum Authority of Uganda will require the Licensee to carry out. Under the Upstream law, however, this will only be developed and finalised in the final few years of the contract when the project is generating relatively little revenue. By that point one or more companies may have exited the operation or become bankrupt. Although the Upstream law states that any shortfall will be borne by the Licensee (Clause 113.6), in practice if insufficient money is put aside the Government may end up footing the bill.

There is no obligation on the Minister to make the decommissioning plans public under the law and they

LL Compensation and environmental damage is also likely to be dealt with by other laws and regulations aside from the contracts in question and the petroleum legislation and regulations mentioned here (the Mid-Stream Law makes reference to this in s.57(2)).

may fall under the commercial confidentiality provisions in the Act. As such citizens will not necessarily know what has been agreed or how much money is being put aside. There is no obligation for companies to consult affected communities, who may have given up land to the facilities in the first place and who are most likely to be affected by the petroleum operations.

Recommendations

1. All future contracts, including the model PSA, should be amended in line with best international practice to state that the licensee shall submit a decommissioning plan as part of the EIA or within two years from commencement of commercial production, and include a framework for setting up a decommissioning fund to cover the full costs of decommissioning.
2. Companies should be required to put aside funds at an early stage and provide a financial guarantee.
3. The Government should commit to publishing all decommissioning plans and details of the decommissioning fund or funds along with other key documents for the sector.
4. Companies should also be required to consult with communities as part of the process of developing the decommissioning plans.
5. The Government should also consider amending the petroleum legislation or future regulations to ensure that the companies covered by existing PSAs are also covered by the provisions outlined in 1 to 4 above.

For examples of decommissioning clauses from other contracts please see Annex 2.

6.4 j) Powers to inspect

THE ISSUE: Inspection covers a range of key areas for the oil sector: from financial concerns through to health and safety requirements, and environmental compliance. In all of these areas, effective inspection may well require an element of surprise to prevent crucial facts from being concealed. It is important for the Government to have the power to pay unannounced visits to inspect the site and records to ensure the company is in compliance with required standards.

THE CONTRACT: Under the contracts the Government may enter the contract area ‘at all reasonable times’ to witness operations, test equipment used to measure production and inspect assets, records and data (Clause 8.2 and 15.4). However, the Government must give at least 30 days’ notice to the company ahead of any inspection (clause 8.2). These provisions obstruct public authorities from making unannounced visits at any time to inspect the assets or observe petroleum operations.

THE LAWS: The Upstream law (Section 107) only provides for an officer to ‘enter any place where petroleum activities are carried out and inspect or take samples for testing of any petroleum found in that place’ but only after

notice has been issued in the Gazette. Section 78 in the Mid-stream law, however, gives more far reaching powers to inspectors to inspect mid-stream facilities at any reasonable time. It seems strange that these powers are not also granted to inspectors of upstream facilities. Global Witness was told by NEMA that they have been able to access sites without problem.

Recommendation

Future contracts, including the model PSA, should allow the Government to pay surprise visits to all petroleum facilities. Inspection reports should also be made public.

6.4 k) Security, militarisation, conflict and human rights

THE ISSUE: The extraction of oil in the Albertine Graben risks sparking local conflicts as infrastructure is developed, communities are displaced and, money and people flow into the area creating social tensions and pressure on resources.¹⁰¹ Environmental degradation would be likely to exacerbate these conditions. The Government and companies will need to be extremely cautious of these risks as they develop the petroleum sector and avoid sparking or perpetuating these conflicts inadvertently.

The proximity of Uganda’s oil to the DRC border, and in particular areas controlled by armed groups including the Allied Democratic Forces (ADF), a rebel group which operates on the border with DRC and is opposed to the Ugandan Government, raises particular security concerns.¹⁰² The conflict in South Sudan may also have implications for security in the northern areas of the Graben in future. The Ugandan Government has substantially increased troop numbers in the oil region and established a special police Oil and Gas Operations Unit to guard the area.¹⁰³ The three oil companies have also hired security firms to guard their installations.¹⁰⁴

Global Witness is concerned that the presence of valuable natural resources, a porous border, hundreds of thousands of displaced people, ethnic tensions, armed



Surprise inspections help to ensure local communities are protected from environmental hazards. © Aidan O'Donnell



The Ugandan Government has substantially increased troop numbers in the oil region. © Benedicte Desrus/Alamy

groups and a heavy military presence creates the potential for violence and human rights violations. There is already evidence that ethnic tensions have been triggered by the discovery of oil in this area.¹⁰⁵ There is also a risk that communities or armed groups could seek to benefit directly from the sector through ‘bunkering’ (theft from pipelines), illegal refining, extortion and other illegal and environmentally and socially damaging activities.

State security forces, oil companies and private security contractors can also become directly involved in human rights violations connected with extractive industries. Oil companies can also stoke conflicts in more indirect ways, for example by recruiting from one ethnic group, or by paying off local armed groups in order to maintain security.

To help avoid these problems, contracts and laws can commit companies to the respect and protection of human rights. For example multinational corporations have promised to engage responsible security agents or to provide adequate education, health clinics and housing to local communities.

THE CONTRACTS: The PSAs are silent in relation to human rights and the relationship between the company, the military and private security contractors.

THE LAWS: The laws do not specifically refer to human rights. Nor do they bind the companies to any specific standards. There is nothing identifying limits or requirements of private military security companies hired by the licensees in either law. This is of serious concern given

the well-documented militarisation of the oil region and a company’s obligation under this legislation to provide security for the facilities (Clause 143.1 of the Upstream Law, Section 66 of the Mid-stream Law).

Recommendations

1. The contracts and laws should include obligations and safeguards to check for, and where necessary, to protect against human rights violations perpetrated by private security firms employed by licensees. They should also make licensees liable for the actions of those firms, as well as members of the regular military where they are shown to be acting on the behalf of the company in question. Payments to any regular armies or security firms should be fully transparent.^{MM}
2. Companies should be required to commit funds in advance, or through indemnity, to compensate victims of human rights violations.
3. The Government should create a dispute resolution mechanism which allows for swift and just resolution between individuals, community and the companies and enshrine it in contracts and laws.
4. Companies should be obliged under the contracts or the law to undertake regular risk based due diligence to ensure that their activities do not fund conflict or human rights abuses and to actively participate in conflict mitigation and resolution programmes where instances occur.
5. The Government and the companies will need to work closely with the DRC Government and local communities to ensure that resentment and dislocation does not lead to violence and criminal activity.

6.4 I) Local content

THE ISSUE: Local content obligations in contracts and laws seek to ensure that companies employ nationals, train local staff and procure local services. The intention is that local industries benefit directly from the oil sector and that local people develop the skills to manage the oil sector in future. However, local procurement also comes with its own risks providing an opportunity to corrupt public officials to secure service contracts.

The reality is that the oil industry is a capital intensive, rather than labour intensive, industry. As such, the number of people who will be employed in the sector will always be relatively small when compared with other areas of the economy. It is probably more important that state revenue from the oil sector is re-invested to create employment in more labour intensive industries. Many people who have trained on courses inside and outside Uganda have failed to find employment.¹⁰⁶ Local content comes with its own risks. The obligation to partner with local companies does open the risk that corrupt officials may seek to profit from the sector by creating service companies whom the IOCs are pushed to partner with.

MM Experience from the Democratic Republic of Congo and Sudan would support these safeguards. For further information see Global Witness report, *Oil and Mining in Violent Places*, 2007 available here: <http://www.globalwitness.org/library/oil-and-mining-violent-places>

6.4 l) i **Goods and services**

THE CONTRACTS: Article 20 of the 2012 contracts requires companies to give preference to local goods and services, establish an open and competitive procurement process which provides adequate opportunity for Ugandan suppliers to compete, and report annually on their achievements. However, none of the contracts sets benchmarks or penalties for failure to comply with the obligations.^{NN} Other countries have included stricter provisions for the procurement of local goods and services in their PSAs and required that they are verified by the relevant government agencies.^{OO} Article 20 should be brought into line with more modern practice on local content.

THE LAWS: The Upstream Law (Section 125) also requires that companies, and their contractors and sub-contractors, give preference to local services and goods. It goes on to state that: ‘Where the goods and services required by the contractor or licensee are not available in Uganda, they shall be provided by a company which has entered into a joint venture with a Ugandan company provided that the Ugandan company has a share capital of at least forty eight percent in the joint venture (Section 125). The section also requires companies to submit a report to the Petroleum Authority’ each year detailing its “achievements and its contractors and subcontractors” achievement in utilising Ugandan goods and services.’ It is not clear that this standard is being adhered to yet. Ensuring that development plans are published, as is permitted by the law, would also help local people prepare for opportunities.

6.4 l) ii **Employment and training**

THE CONTRACTS: The contracts obligate the companies to train and give preference to Ugandan citizens in their employment policies, and to establish an annual programme to train personnel of the Government to undertake skilled and technical jobs (Article 21). There is no specific provision for benchmarks or timelines for the employment of local staff however clause 21.1 does provide a mechanism for the Government to monitor this process. Companies are required to deposit with the Government, a sum of money, ranging from US\$100,000 to US\$300,000 at regular intervals of 6 or 12 months, depending on the stage of development, for the training of government employees (Clause 21.3).

THE LAWS: The Upstream Law (Section 126) requires companies to submit a detailed programme for recruitment and training of Ugandans, including those in the ‘host community’, to the Ugandan Petroleum Authority, and a report on its implementation, each year. The law also says (Section 127) that conditions for the

training of Ugandan nationals and knowledge transfer shall be provided in further regulations and the licences. As far as Global Witness is aware these have not yet been produced. The law does not provide a schedule requiring companies to employ a certain number of Ugandan nationals in particular types of jobs by specific dates. This could potentially be provided for in further regulations or the licences. The Government is currently in the process of developing a local content strategy and has committed to consult relevant stakeholders.¹⁰⁷

Recommendations

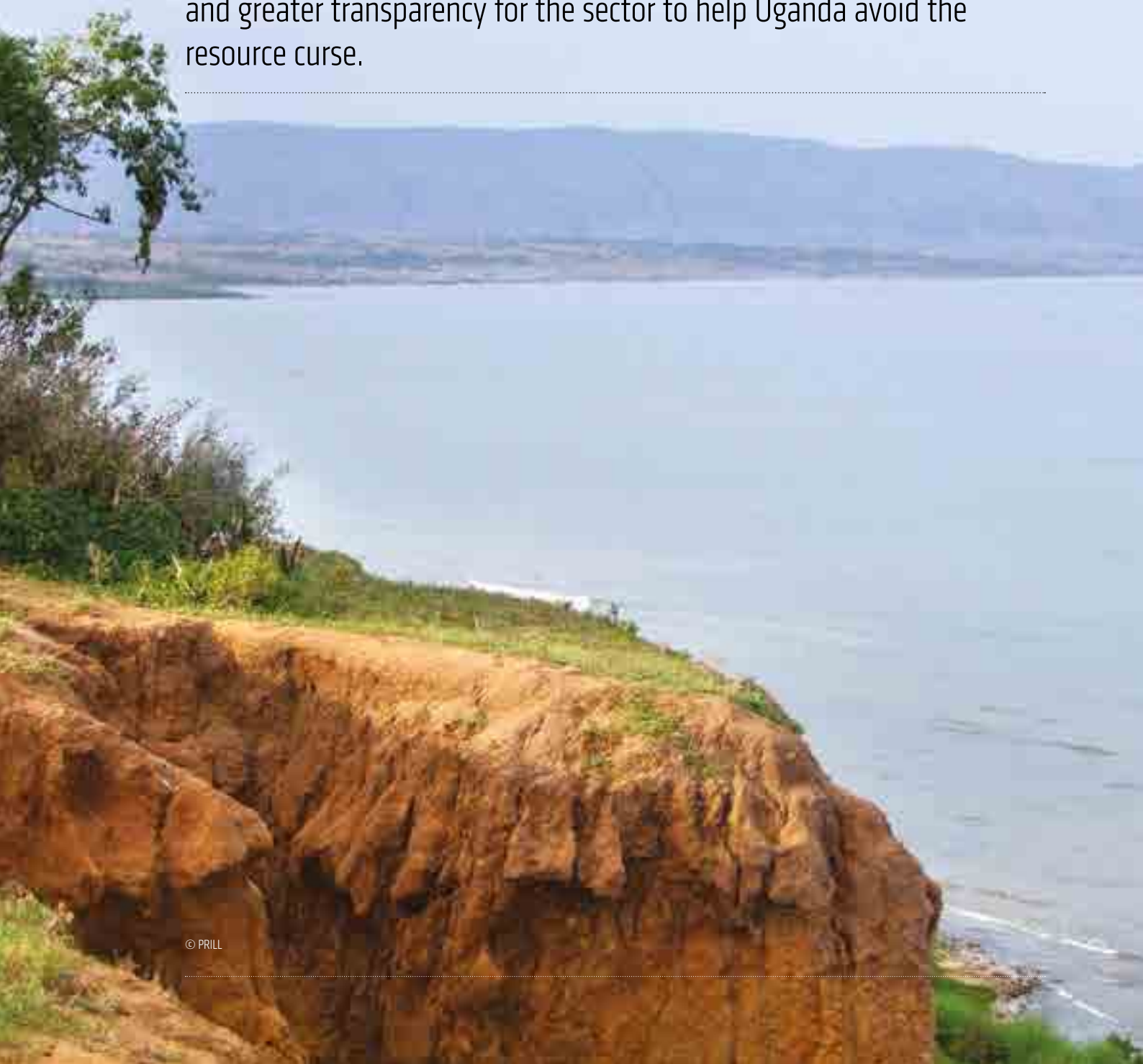
- The Government should provide a timetable of realistic benchmarks for employing local staff and services, and training local employees in future regulations and/ or contracts. The Government should also carefully monitor companies’ compliance with their obligations and support companies to reach these benchmarks.
- Company records in Uganda should be carefully recorded and published online so that citizens and journalists can see who owns which companies. Where those companies are owned by nominee directors or offshore companies then the ultimate beneficial owner should also be declared and published.
- Like all payments by companies, those for training should also be handled with the utmost transparency. Companies should be required to conduct clear and transparent open contracting processes.
- Companies should run fully transparent procurement processes for local companies.

NN Furthermore, there is no obligation for the company to adopt proactive approaches to training and supporting local professionals and contractors in order to enhance their capacity in providing services and goods. See Natural Resources Charter, Precept 12 at P. 4 for further details.

OO See Annex 2 for examples.

7 / CONCLUSION

The next few years are the final chance for Uganda to get its house in order before oil starts pumping. The decisions made now will have far reaching impacts for years to come and dictate whether oil is a curse or a blessing for the country. Global Witness hopes that this report will help policy makers and civil society to put in place robust safeguards and greater transparency for the sector to help Uganda avoid the resource curse.



CONCLUSION

The 2012 contracts open the door for the government to put in place more progressive social and environmental protection measures. The Government is currently developing new regulations and a new model contract ahead of a future allocation round in early 2015.

It is clear that the Government of Uganda has successfully negotiated more favourable financial terms by securing a higher share of revenue for the country, for which it should be congratulated. The 2012 contracts also open the door for the Government to put in place more progressive social and environmental protection measures. But, the current contracts and laws leave people and environment at risk. This may be extremely problematic in areas of such environmental significance where conflict is a real concern.

While the new oil laws do go some way towards mitigating some of the risks, they do not go far enough. Lack of provisions for community consultation and adequate grievance and compensation procedures are particular areas of concern which risk leaving communities marginalised and abused. A failure to introduce clear procedures for decommissioning risks leaving the Government paying for the clean-up and lenient cost recovery rules allow companies to cover the cost of expensive legal battles from the sale of Uganda's oil eating into the Government share of revenues. Companies may still be able to claim compensation for higher costs resulting from the introduction of more robust environmental and social protection measures, in areas still governed by the pre-2008 contracts.

Furthermore, the institutions which are charged with monitoring and enforcing these provisions are woefully underprepared and under-resourced to perform this job. The Government should take urgent steps to ensure that its environment and people are legally protected and that it has credible institutions in place to ensure the Ugandan people's interests are protected in practice. Uganda's development partners should also play a role in bolstering government capacity.

The Government is currently in the process of developing new regulations under the petroleum laws and a new model PSA ahead of a future allocation round in early 2015. It is also working on an "operationalisation plan" for the Strategic Environmental Assessment and a local content policy. This provides the opportunity for the Government



The decisions made now will have far reaching impacts for years to come and will dictate whether oil is a curse or a blessing for Uganda.

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to plug the gaps which are identified in this analysis before oil begins to flow.

The next few years are the final chance for Uganda to get its house in order before oil starts pumping. The decisions made now will have far reaching impacts for years to come and dictate whether oil is a curse or a blessing for the country. Global Witness hopes that this report will help policy makers and civil society to put in place robust safeguards and greater transparency for the sector to help Uganda avoid the resource curse.

KEY RECOMMENDATIONS

Global Witness hopes that this report will help policy makers and civil society to put in place robust safeguards and greater transparency for the sector to help Uganda avoid the resource curse.



KEY RECOMMENDATIONS

The Government should protect people, the environment and the public interest through strengthened contracts, laws and institutions.

Publication of key government documents

The Government of Uganda should:

1. Publish key documents for the oil sector online including:
 - Production Sharing Agreements for the oil and gas sector;
 - Licence agreements;
 - Safety inspection reports;
 - Environmental impact assessments;
 - Decommissioning plans, and;
 - Approved development plans (with tightly defined exemptions).
2. The Government should ensure that company records in Uganda are carefully recorded and published online. The ultimate beneficial owner of companies bidding for contracts or participating in the extractive sector should also be declared and published.

Arbitration

The Government of Uganda and companies should commit to holding future arbitration tribunals in public. This condition should be enshrined in future contracts.

Revenue management

The Government of Uganda should:

1. Publish all material payments received from oil companies on a project by project basis and disaggregated by payment type in line with EU, US and Extractive Industry Transparency Initiative (EITI) reporting standards;
2. Publish sales and production data – so that citizens will know how much money the Government should be earning;
3. Set up a multi-stakeholder committee, including civil society, to oversee revenues from the sector similar to the Public Interest and Accountability Committee in Ghana;
4. Join the EITI without delay;

5. Lock in saving and spending rules (fiscal rule). This will help the Government manage incoming revenue prudently, avoid the politicisation of revenue management, and economic stagnation due to an over dependence on oil revenue;
6. Increase its capacity to accurately assess company costs and lending arrangements through the cost recovery process. Development partners could provide support here;
7. Ensure that measures are in place to accurately track and record production and the value of its petroleum as well as maintaining robust tax collection systems;
8. Maximise recovery rates through its licensing regime by dictating production rates and the technology/ techniques used when approving production licenses as well as consider the impact of future tax policies on field abandonment.

National oil company

The Government of Uganda should put in place regulations so that the national oil company is managed with the utmost transparency and independent oversight.

Accountability

The Government of Uganda should legislate to provide Parliament with an enhanced oversight role.

Stabilisation clauses

1. The companies should agree to amend the stabilisation clauses in the pre-2008 contracts to limit them to tax in line with the 2012 contracts. This will allow the Government to apply stricter social and environmental protection provisions without fear of compensation from oil companies.
2. The Government of Uganda should use the opportunity afforded by the 2012 stabilisation clauses to introduce tighter environmental and social protection measures.



Concerns have already been raised about the impact of oil activities in the Murchison Falls National Park where numerous wells have been sunk. © Prill Mediendesign & Fotografie

Increasing government revenues from oil

1. The Government should exercise its right under the 2012 contracts to introduce a 'windfall profit' tax enabling it to capture a higher percentage of higher than expected profits.
2. Uganda's development partners should assist the Government by providing additional technical assistance for cost recovery, and access to information from their home countries.

Allocation of future contracts

The Government of Uganda should:

1. Carefully consider, and consult on, whether opening up new areas for exploration is ultimately in the best interests of the country;
2. Carefully pre-select companies and allocate further contracts through an open, fair and transparent bidding process in line with the recommendations in our [Allocation briefing](#) on the Global Witness website and the [Global Principles of Open Contracting](#).

Environmental protection

The Government of Uganda should:

1. Make it a legal requirement that companies produce EIAs before receiving both exploration and production licences and ahead of any related infrastructure projects. These should include careful community consultation, including free prior informed consent, and the documents should be made widely publicly available;
2. Classify National Parks and Nature Reserves, and immediately surrounding areas, as prohibited areas for economic activities and excluded from contract areas in future;
3. Carefully review its policies for protecting the environment and tourism industry, bringing environmental agencies closer to the decision making and providing them with additional capacity to oversee the sector;
4. Introduce additional strict environmental protection regulations and increase the size of financial penalties to ensure that they act as a successful deterrent;
5. Publish revised waste management guidelines as soon as possible and strengthen the capacity of NEMA so that it can monitor waste management effectively;
6. Include further best practice waste management requirements in future contracts.
7. Increase its capacity to monitor company compliance with laws and contracts and apply fines where necessary. NEMA, the UWA and other key environmental agencies should urgently boost their capacity to be able to manage the emerging oil sector. Development partners should provide assistance here.
8. Include provisions in future contracts and laws, including the model PSA, that allow the Government to pay surprise visits to all petroleum facilities.
9. Require companies to capture and either re-inject or utilise natural gas. They should only resort to flaring when strictly necessary for safety purposes as is prescribed in the law. This language should be replicated in future contracts for the avoidance of doubt. Monitoring of company activities and any flaring, and associated emergency reports, should be carefully scrutinised and companies held to account for their actions.

Uganda's development partners should:

10. Provide technical support to NEMA and other government agencies charged with overseeing the oil sector.

Decommissioning

The Government of Uganda should:

1. Amend all future contracts, including the model PSA, in line with standard international practice to state that the licensee shall submit a decommissioning plan as part of the EIA or within two years from commencement of commercial production, and include a framework for setting up a decommissioning fund to cover the full costs of decommissioning;
2. Commit to publishing all decommissioning plans and details of the decommissioning fund or funds along with other key documents for the sector;
3. Require companies to put aside funds at an early stage and provide a financial guarantee;
4. Require companies to consult with communities as part of the process of developing the decommissioning plans;
5. Amend the petroleum legislation or future regulations to ensure that the companies covered by existing PSAs are also covered by the provisions outlined above.

Community consultation

The Government of Uganda should:

1. Ensure that communities are thoroughly consulted ahead of every new project. They should have the right to turn down projects;
2. Establish an effective dispute resolution mechanism (between company and community) which should be established and enshrined in future contracts to deal with any future conflicts. This should be in line with the United Nations Guiding Principles on Business and Human Rights (UNGPs) and the International Finance Corporation Performance Standards and designed in consultation with the local community.

Compensation

The Government of Uganda should:

1. Require companies to put aside funds to compensate those affected, directly or indirectly, by petroleum activities;
2. Require companies to set aside money for future compensation as part of the decommissioning funds;
3. Require companies under the contracts and law to promptly compensate all those who suffer loss as a result of petroleum activities, meaning not only property owners, but also communities whose communal natural resources such as water, land and animal stocks are affected;
4. Ensure that future contracts provide for “full, fair and just” compensation for all affected parties which goes beyond financial compensation. Compensation

should not be limited to monetary compensation and companies should be required to offer additional assistance where necessary such as providing clean up services, provision of alternative accommodation and basic services, and resettlement;

5. Amend future contracts so that they ensure that the assessment of the ‘adequacy’ of compensation is entrusted to an independent third party. It should also be clear that compensation should be tied to certain specific standards, such as those prescribed in applicable laws. This process could be incorporated into the mandate of a dispute resolution mechanism;
6. Ensure that contracts are backed up by robust environmental regulations which make the companies’ operating standards and environmental responsibilities very clear;
7. Exclude litigation expenses from the list of recoverable costs in future contracts.

Human rights

The Government of Uganda should:

1. Ensure that future contracts and laws include obligations and safeguards to check for, and respect human rights and protect against human rights violations human rights violations perpetrated by private security firms employed by licensees. They should also make licensees liable for the actions of those firms, as well as members of the regular military where they are shown to be acting on the behalf of the company in question.
2. Require companies to commit funds in advance, or through indemnity, to compensate victims of human rights violations.
3. Require companies, under the contracts or the law, to undertake regular risk based due diligence to ensure that their activities do not fund conflict or human rights abuses and to actively participate in conflict mitigation and resolution programmes.
4. The Ugandan Government should ensure that people’s human rights are fully protected, respected and fulfilled in areas affected by extraction, and that any violation of people’s human rights are treated with the utmost seriousness with appropriate sanctions taken.

Companies should publish any payments made to regular armies and security payments.

ANNEX 1

KEY ASSUMPTIONS FOR OUR FINANCIAL MODELING



ANNEX 1

KEY ASSUMPTIONS FOR OUR FINANCIAL MODELING

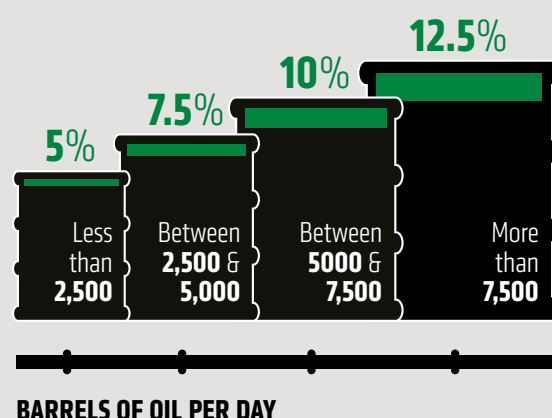
The figures quoted in this report are predictions based on Global Witness modelling. They are by definition estimates. Not all information required to accurately model the PSA is a) known or b) in the public domain. As such, we have had to use the best available information and assumptions. As more information becomes available, such as actual production rates and sales prices, it will be possible to far more accurately predict the revenues the Government is likely to receive. The following is a breakdown of the inputs and assumptions we used in order to generate our findings:

PRODUCTION SHARING CONTRACT: the modelling is based on the 2012 Exploration Area 1 PSA (as the Kanywataba area, to which the second 2012 contract relates, has now been relinquished). However, we have also modelled the 2004 Heritage contract terms for EA1 as a basis for comparison. The modelling provides a comparison of the pre-2008 contract terms and the 2012 contracts, and the likely impacts.

TAXES AND ROYALTIES: these are contained in the contracts and public information on Uganda's tax system in briefings from Deloitte and PriceWaterhouseCoopers.¹⁰⁸ Corporate Income tax is modeled at a standard 30%. We

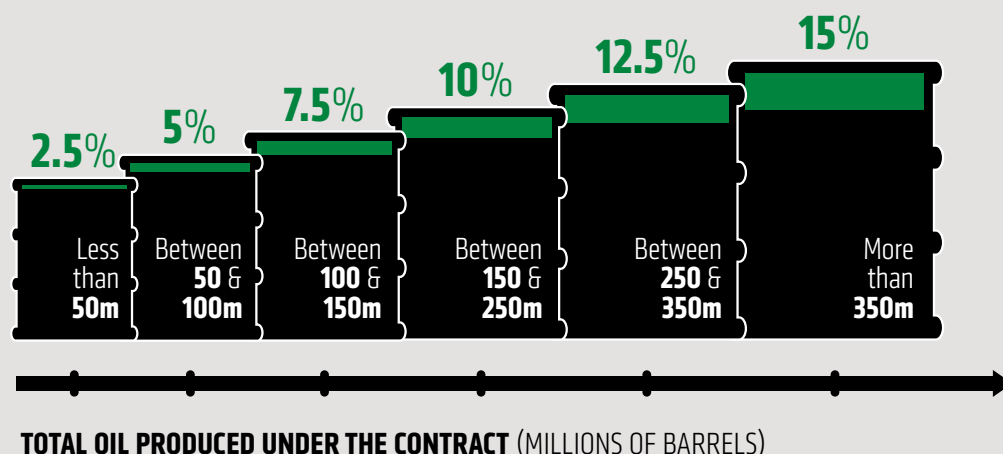
have not modeled secondary taxes and levies such as surface rentals and rental fees which are likely to have a limited impact on the overall values. We have included

DAILY GOVERNMENT ROYALTY



(Royalty payments are tiered, so if daily production was 6,000 barrels then the company would pay, 5% on the first 2,500, 7.5% on the next 2,500 and 10% on the remaining 1,000.)

NEW CUMULATIVE GOVERNMENT ROYALTY



withholding taxes in our modelling (see below for further details on withholding taxes). However, it was reported that the President of Uganda was reported as saying that he may scrap withholding taxes for the extractive sector at a public event in October 2013.¹⁰⁹ Royalty rates vary according to the contracts as outlined in the body of this report in [pages 26 to 32](#). The 2012 contracts contain two royalties, one based on daily production, the second on cumulative production. The higher the level of production the higher the percentage royalty for the Government. Royalties are collected before cost recovery.

OIL PRICE: Oil prices are notoriously volatile. It is impossible to predict the oil price over a thirty year time frame with any degree of certainty. The model created uses a conservative starting oil price of USD\$80 per barrel,^{PP} following the projections of the more conservative case of the United States Energy Information Administration (US EIA) 2013 data.¹¹⁰ The projection begins at US\$80 per barrel in 2013 rising to US\$90 when production commences in 2017, US\$105 at peak production in 2023, US\$125 in 2030 and US\$145 in 2036 when production would be projected to end. The decision to base our model on this projection is based on the advice of industry insiders and futures analysts.

Where we have modeled a higher or lower oil price the figure used will increase at the same incremental rate (2.5%) per year as is projected with the US\$80 per barrel base.

However, Ugandan crude oil will not sell on international markets at the same price as Brent crude. This reflects the type of crude that Uganda is likely to produce and its quantity. We have assumed a US\$12 discount from Brent crude prices.

TRANSPORTATION COST: The oil price, as described above, is not the price that is paid for oil at the well-head. Oil needs to be transported to a refinery or market before it can be sold on at this price. In the case of Uganda some of the oil will be transported to the refinery via pipelines, while the remainder will be transported, through a pipeline, to the Kenyan coast where it will be sold on to international markets and shipped to a refinery. Essentially, Uganda, and the companies will have to bear the costs of this transportation. As such, the sum they get for their oil will be the market value minus the transportation costs. The complication is that as Ugandan crude is waxy in nature the pipeline will need to be heated to keep it flowing. When constructed it will be the longest heated pipeline anywhere in the world.

According to the contracts, the parties agree that the tariff to use the pipeline will be set so that the pipeline company's costs of constructing, financing, operating and maintaining the export pipeline should achieve a reasonable return on the project. The contract acknowledges they may not (Article 16).



As more information becomes available it will be possible for Ugandan citizens to more accurately predict the revenues the Government is likely to receive. © Shutterstock/Black Sheep Media

It is not easy to calculate the upfront or operational costs of such large projects, given the many variables and risks, and therefore the cost of transportation. We have assumed a US\$12 a barrel transport fee based on industry estimates. As such, the price we have modelled for a barrel of oil is US\$56.

REFINERY: The contracts allow for a refinery but they do not create an obligation for one. The Government and the companies have however agreed on a 60,000 barrel per

PP This price is inflated at a very standard rate of 2.5% and the prices quoted in the various studies as reference points also use standard inflation methodologies.

day refinery (Clause 7.10).¹¹¹ The decision to refine could potentially add value for the Government but equally could leave the Government managing an uncompetitive refinery, either pushing up petroleum prices in Uganda, or more likely decreasing the value the Government gets from its oil. Robust and transparent procurement processes will be key to keeping costs down. Corruption could make the project unviable. For the purpose of this analysis we have not modeled the potential impact of a refinery on the sector and government revenue.

OIL PRODUCTION: We do not have accurate figures for oil discoveries in EA-1A which fall under the 2012 contract. For the purpose of this fiscal model, we modelled 200 million barrels, 400 million and 600 million barrels to illustrate how the different contract terms would perform with different production volumes.

The estimates for total ‘recoverable reserves’, e.g. the amount of oil it is possible to get out of the ground and export to market, in Uganda is between 1.2bn and 1.7bn barrels. In reality it is not possible to know how much oil is in the ground and how much will be recovered until a company starts pumping.

The production curve, which charts the likely amount of oil produced each year and varies over the course of the life cycle of the project, is a simplified standard onshore production curve (see previous page). The Model assumes that production will begin in 2017 as predicted by the Government.¹¹² If oil company development plans were available it would be possible to predict production more accurately.

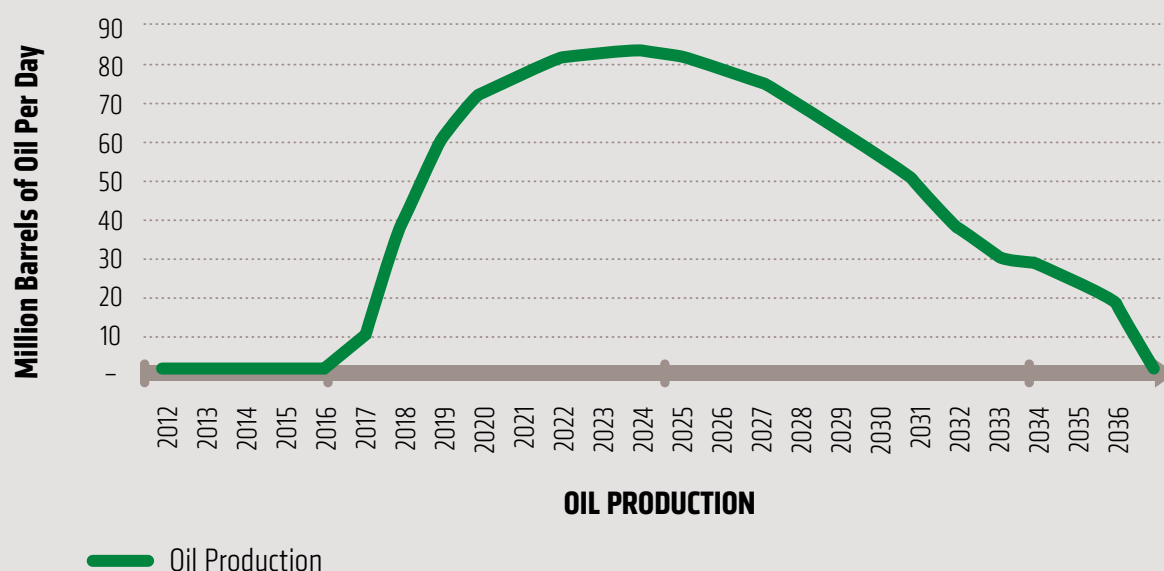
PROJECT COSTS: Production costs and operating costs, that is the amount of money a company has to spend to get

the oil out of the ground and keep pumping it, have a significant impact on the revenues generated from oil production for both the company and the government. This is because the company can re-coup their costs against the money generated from the oil they extract. Across nearly all projects worldwide, project cost estimates and actual costs are difficult to find at a level of specificity that is useful for generating a fiscal model. For this model, data from Tullow’s website and publicly available information was used to form a more precise view of future revenues.¹¹³

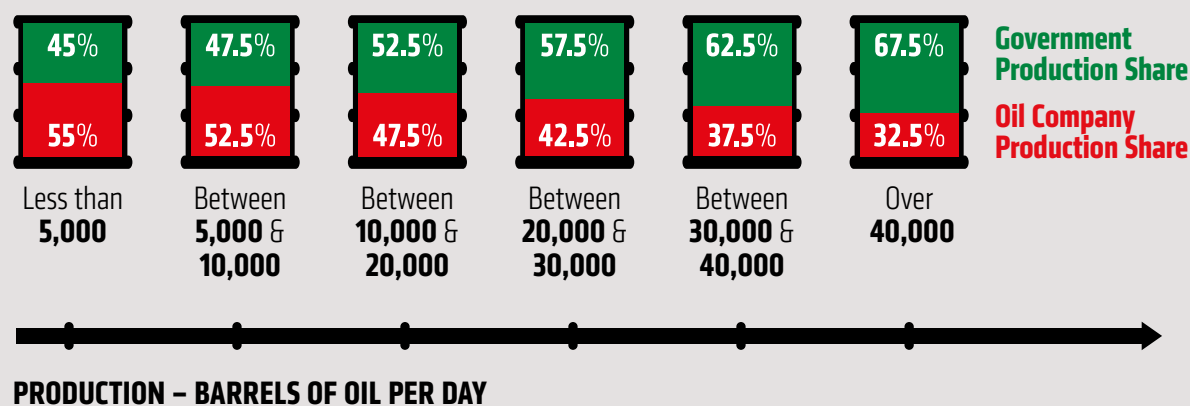
PRODUCTION SHARING AND COST RECOVERY: Production sharing accounts for the most significant share of government take of revenues generated from the oil sector. Typically, an initial quantity of production (known as “cost oil”) is allocated to the company or group of companies to repay costs of development and production (sometimes other costs too, like exploration). The rest (“profit oil”) is split between government and company according to pre-established percentages. The contracts reviewed here contain a 60% cost recovery threshold which means that companies can use up to 60% of production, after royalties have been taken, to repay their initial investment costs. The remaining 40% or more will be shared between the Government and company according to the percentages dictated in the contract. See details of production sharing from the 2012 EA 1 contract below based on Barrels per day (Bopd): As the quantity of production increases the proportion of government share also increases:

This is a fairly standard arrangement. The Government percentage is 1% lower in the EA 1 PSA at each threshold than the 2004 Heritage contract for EA

PRODUCTION CURVE



PROFIT OIL PRODUCTION SHARING



3A and the 2012 Kenyewataba PSA. It is not clear why this is the case but, when considered in conjunction with the additional royalty described on [page 30](#), the contract is still more favorable than the pre-2008 contract.

COST RECOVERY: The Uganda PSAs allow for up to 60% of oil and 70% of gas to be allocated to cost recovery in any given year with the remainder carried forward (Clause 12.2). This means that during the early years of production, while companies are still recouping their costs, 60% of oil, after royalties have been collected, will go to the company until those costs are recouped. This is reflected in our financial analysis. Companies can carry forward unrecovered costs from one year to the next (Clause 12.3), but costs are “ringfenced” meaning that they can only be recovered from production from the same licence area where they were incurred (Clause 12.1). This is important because it stops companies recovering costs for areas where they do not encounter commercially viable quantities of oil, which could run into the hundreds of millions of dollars.

STATE PARTICIPATION: The 2012 contracts under review here allow for a 15% state participation in the production. Essentially this means that the Government becomes a 15% shareholder in the contract alongside the companies and is subject to the same contract terms. The benefit of this kind of involvement is that; the Government can develop expertise in the sector and potentially build their own internationally operating oil company; the Government has a seat at the table with the companies as a shareholder, the Government benefits as a shareholder as well as production sharing partner. However, state participation also carries risks with it including the

creation of a conflict of interest on the part of the Government. This is because the company is at once the regulator and a party to the contracts.

15% is probably a good starting level for Uganda according to industry experts. This ownership is likely to be through the National Oil Company (NOC) created under the Upstream Law. The contract also allows for an ‘advisory committee’ to perform this role in the absence of an NOC. This interest is ‘carried’ by the company, meaning that the IOCs will cover the NOC’s share of upfront costs, which will be recouped from cost oil alongside their own. In practice this means that after the royalties and costs have been deducted, the NOC will own a 15% share of the remaining production from which they will profit through the sale of the oil. Global Witness understands that the Government did take up its 15% interest in the Kingfisher field when it granted the production licence to CNOOC in September 2013 and that it intends to do the same in future licences.¹¹⁴ For the purpose of this model, therefore, we have assumed this and included state participation revenues in our results. In the model it is possible to view the IOC and NOC shares of revenue separately.

DISCOUNT RATE: investors and governments value money now more than money in the future. They therefore apply a ‘discount rate’ to projected future revenues in order to calculate the value of those returns to them at the present time. This does not affect the actual revenues received or the actual share of revenues between companies and government, but allows them to predict value as opposed to alternative investments. Essentially, the more in need of immediate capital a government is the higher they are likely to discount

future returns. Investors will also consider risk and alternative investment opportunities when calculating their discount rate. A 10% discount rate is fairly standard for the industry, the government take percentages in this report are based on this.

Our results show that government take actually increases as a percentage as we increase the 'discount rate' this is because the Government has 'front-loaded' the fiscal terms in the contract to ensure that they begin to receive significant revenues as soon as production begins. As such they will reap the benefits of the investments that they make with this money earlier as long as revenue is managed transparently. This is a result of the royalty rates, cost recovery rate and tax policy.

INTERNAL RATE OF RETURN (IRR): IRR is a figure which describes the rate of return for the investor in a project, it is internal because it does not consider external factors such as interest rates or inflation. Companies use this calculation to decide whether an investment is worthwhile and to compare it against other potential investments to consider which is most viable. As a rule of thumb oil companies will look for a minimum of a 12% IRR in order to invest, but they will also take other factors into consideration such as political risk and alternative investment opportunities. The higher the IRR for the company, the more attractive it is to the investor.

WITHHOLDING TAXES: Withholding tax is a legal requirement for the payer of a payment such as interest or dividend (payable to a creditor or shareholder) to deduct a certain percent of that payment as taxes payable to government. Our model assumes that both the company and the NOC pay withholding taxes at the full statutory rate of 15%. Some models do not include withholding taxes as it is common for international oil companies to avoid paying them by using subsidiaries established in tax havens or other jurisdictions that have agreed tax treaties.

OPEN MODEL: For a more comprehensive explanation of the assumptions and how they have been used, please see the guide to the model. All of these assumptions can be altered in the excel spreadsheet. Members of the public are invited to download the model and change assumptions themselves to draw their own conclusions.

ANNEX 2

ALTERNATIVE SOCIAL AND ENVIRONMENTAL CONTRACTUAL TERMS



ANNEX 2

ALTERNATIVE SOCIAL AND ENVIRONMENTAL CONTRACTUAL TERMS

This Annex highlights some best practice examples of contract terms that can serve as a guideline to improving environmental and social provisions in contracts and regulations as the Ugandan Government creates new regulations and a new model contract.

The fact that countries' model PSAs have strong terms does not mean that they are implemented effectively. This Annex is not an endorsement of the countries' governments named here or their implementation of the contract terms.

Where Global Witness has not identified specific country PSA terms, we are indicating best practice through international guidelines. These include the International Finance Corporation's (IFC) Sustainability Framework,¹¹⁵ the 2002 Association of International Petroleum Negotiators (AIPN) Joint Operating Agreement (JOA),¹¹⁶ the Model Mining Development Agreement (2011) (MMDA) drafted by the International Bar Association,¹¹⁷ the International Council on Mining and Metal's Sustainable Development Framework,¹¹⁸ Natural Resource Charter (NRC),¹¹⁹ the United Nations Guiding Principles on Business and Human Rights (UNGPs)¹²⁰ and the Voluntary Principles on Security and Human Rights.¹²¹

The numbering of this section mirrors the numbering of Section 6 of the report, Protecting Uganda's People and Environment.

6.4 b) Protected areas

It is common in many countries for extractive activities to be banned inside protected areas, such as those of environmental sensitivity.

In Western Australia, per section 24 of the Mining Act, mining is not permitted in national parks and reserves, but the minister can grant permission with the consent of both houses of parliament.¹²² This provides parliamentary oversight.

In Nigeria, the Nigerian Mines and Minerals Act prohibits reconnaissance, exploration or exploitation of mineral resources on any land that is subject to the

provisions of the National Parks Service Act, which in turn provides for the establishment of national parks.¹²³

Where activities are allowed to take place, stringent safeguards should be in place. The Brazil Model PSA 2003 reads:¹²⁴

Clause 21.1, *"The Concessionaire shall adopt, at its own cost and risk, all the necessary measures for the conservation of reservoirs and other natural resources and for the protection of the air, soil and water in the surface or in the subsurface, subject to the Brazilian legislation and rules about the environment and, in their absence or lack, adopting the Best Practices of the Oil Industry in this regard. Within this principle, and without limiting its application, the Concessionaire is obliged to, as a general rule, and not only in respect to the performance of the Operations, but also the relinquishment and abandonment of areas and removal and reversion of assets, to preserve the environment and protect the balance of the ecosystem in the Concession Area, to avoid the occurrence of damages and losses to the fauna, flora and the natural resources, to consider the safety of persons and animals, to respect the historic and cultural heritage, and to repair or indemnify the damages resulting from the its (sic) activities and to perform the environmental recovery acts determined by the competent agencies."*

Clause 21.2 *"The Concessionaire shall also act so that the Operations do not cause any damages or losses which might affect other economic or cultural activities in the Concession Area, such as agriculture, cattle breeding, forest industry, gathering, mining, archaeological, biological and oceanographic research, as well as tourism, or which disturb the well-being of native communities and rural and urban settlements."*

6.4 c) Environmental Impact Assessments (EIAs)

6.4 c) i. Confidentiality

It is common for EIAs to be made widely publicly available. Examples of countries, which publish their EIAs include Cameroon, Chile and Peru.¹²⁵ If both parties agree then there is no reason why EIAs should not be published online. Future contracts should carve EIAs out from the confidentiality requirements.

6.4 c) ii. On timing and process

It is best practice for EIAs to be carried out prior to the commencement of any fieldwork, including both seismographic work as well as drilling. It is generally common for these costs to be borne by the Contractor; however, these are often recoverable.

For example, Clause 14.5.1 and 14.5.2 of the India Model PSC¹²⁶ are drafted as follows:

“14.5.1. The first of the aforementioned [environmental impact] studies shall be carried out in two parts, namely, a preliminary part which must be concluded before commencement of any field work relating to a seismographic or other survey, and a final part relating to drilling in the Exploration Period. The part of the study relating to drilling operations in the Exploration Period shall be approved by Government before the commencement of such drilling operations, it being understood that such approval shall not be unreasonably withheld.

14.5.2 The second of the aforementioned studies shall be completed before commencement of Development Operations and shall be submitted by the Contractor as part of the Development Plan, with specific approval of Government being obtained before commencement of Development Operations, it being understood that such approval shall not be unreasonably withheld.”

Similarly, Clause 6.12.4 of the Equatorial Guinea Model PSC¹²⁷ and Clause 25 (s) of the Tanzania Model PSA¹²⁸ require an EIA to be carried out prior to seismic work in areas of particular environmental sensitivity as specified by the State as well as prior to, during and after major drilling operations. The PSAs further specify that EIAs should be undertaken at the Contractor's expense, but that such costs shall be recoverable.

6.4 c) iii On stakeholder engagement

As outlined in the IFC Performance Standard 1, “stakeholder engagement is the basis for building strong, constructive, and responsive relationships that are essential for the successful management of a project's environmental and social impacts.”¹²⁹ It is an ongoing process that involves elements such as stakeholder analysis and planning, disclosure and dissemination of information, consultation and participation, grievance mechanism, and ongoing reporting to affected communities.

See also the IFC's Performance Standards 1, 2 and 5; Principle 18 of the United Nations Guiding Principles

and Principle 10 of the ICM's Sustainable Development Principles. On environmental issues, refer to Principle 10 of the Rio Declaration¹³⁰ and the Chinese Provisional Measures for Public Participation in Environmental Impact Assessments, which set out robust principles on public participation in environmental protection.¹³¹

It is important that communities are given the support they need to understand the implications of projects documents and, more broadly, what impacts extractive projects can have. CSOs can play a role here.

6.4 d) Grievance mechanism for affected communities

Recommendations for the design of grievance redressal mechanisms are laid out in the UNGPs' Section III Access to Remedy.¹³² For example, community members need to know what rights they have, so that they can bring complaints when these are breached. Contract transparency would help facilitate this. The grievance mechanism should further be accessible meaning that assistance may have to be provided for those who face barriers to access. It should also be predictable in that it provides a clear and known procedure with an indicative time frame for each stage. It is also important that the community sees the mechanism as legitimate, so committee representatives should be trusted and respected.

For a consideration of the investment benefits of community consent and the risks to projects where consent is not gained see Sohn J, Herz S & La Vina A, *The Business Case for Community Consent*.¹³³

6.4 e) Fines

The size of fines in the laws should be increased so that they present a credible deterrent in the face of company profits worth at least hundreds of millions of dollars. This would not require a change to contracts.

6.4 f) Waste management

Clause 17.3 of the Kosmos Ghana PSC 2004 requires that the “Contractor shall provide an effective and safe system for disposal of water and waste oil, oil base mud and cuttings in accordance with accepted international petroleum industry practice in the same or similar circumstances, and shall provide for the safe completion or abandonment of all boreholes and wells”.¹³⁴

Clause 17.4 states that the contractor shall ‘b) Control the flow and prevent the escape or the avoidable waste of Petroleum discovered in or produced from the Contract Area’

Clause 17.5 goes on ‘if Contractor's operations result in any other form of pollution or otherwise cause harm to fresh water, marine, plant or animal life, Contractor shall, in accordance with accepted international petroleum industry practice in the same or similar circumstances, promptly take all necessary measures to control the pollution, to clean up Petroleum or released material, or to repair, to the maximum extent feasible, damage resulting from any such circumstances.’

The American Petroleum Institute recommended practice as outlined in the Environmental Protection for Onshore Oil and Gas Production Operations and Leases states in section 8.3.3:

- “a) Equipment and facilities should be located and designed to minimize the wastes generated by operations and maintenance activities.*
- b) Recyclable products should be used, where possible. Bulk storage, recyclable, and reusable containers should be considered to minimize waste.*
- c) Appropriate methods of collecting and recycling or disposing of waste generated during construction, operation, and maintenance of the facility should be considered.*
- 6.4 d) Operators should develop waste management plans. Refer to API Environmental Guidance Document: Onshore Solid Waste Management in Exploration and Production Operations for additional information.”**¹³⁵

The Government of Uganda should produce new waste management guidelines as soon as possible.

6.4 g) Flaring and venting of natural gas

It is common that flaring is only allowed in emergency. For example, Clause 21.4.6 of the India Model PSC only permits flaring of a small quantity of associated gas and as a last resort.¹³⁶

6.4 h) Compensation for communities affected by pollution or other activities

Article 23 of the Tanzania Model PSC 2008 states that the company should ‘*ensure prompt, fair and adequate compensation for injury to persons or damage to property caused by the effects of Petroleum Operations.*’¹³⁷

Clause 21.5 of the Brazil Model Concession Agreement for the Exploration, Development and Production of Oil and Natural Gas 2008 states:

*“The Concessionaire shall assume full and objective responsibility, for all damages and losses to the environment and third parties which might result, directly or indirectly, from the Operations and their performance, as well as from their relinquishment and the removal and reversion of assets pursuant to paragraphs 18.8 to 18.19, being obliged to repair them and to indemnify the Federal Government and the ANP, pursuant to paragraphs 2.2 and 2.3, for all and any action, appeal, lawsuits or court injunctions, arbitration, auditing, inspection, investigation or disputes of any kind whatsoever, as well as any indemnifications, compensations, punishments, fines or penalties of any nature whatsoever, related to or resulting from such damages or losses.”*¹³⁸

For further information, the International Petroleum Industry Environmental Conservation Association (IPIECA) offers guidance on oil spill compensation¹³⁹ as well as advice on protecting indigenous peoples in cases where they are exposed to the negative impact of oil operations.¹⁴⁰

6.4 i) Decommissioning, abandonment, reclamation and restoration

There are numerous examples of model PSAs in other jurisdictions, which ensure that the company is required to restore the land used for Petroleum Operations and cover the costs for doing so. It is best practice also that a provisional guarantee fund is established in the beginning of commercial production, rather than towards the end when revenue starts diminishing and abandonment becomes tempting.

Under clause 18 of the Brazil Model Concession Agreement the contractor can be obligated to provide an abandonment guarantee by means of insurance, letter of credit, provisional guarantee fund or other forms of guarantee acceptable to the Government. However, it also states that the presentation of such guarantee does not discharge the contractor from completing all operations necessary to inactivate and abandon the field.

Article 22 of the Tanzania Model PSC 2013 states that an abandonment cost Decommissioning Fund shall be established within two years from commencement of commercial production, such funds shall be placed in a US dollar, long term, interest yielding account in a commercial bank in Tanzania designated by the Tanzania Petroleum Development Corporation and the contractor.

Clause 12.7 of the Nigeria Model PSC 2005¹⁴¹ requires companies to provide security for decommissioning costs, one option being to create a decommissioning fund with a reputable commercial bank.¹⁴² Such funds must be used solely for the purpose of paying for decommissioning and abandonment operations.

For more on decommissioning see AIPN model JOA 2012.

6.4 j) Powers to inspect

It is common practice that ministries are given the power to inspect Petroleum Operations at any reasonable time, and contrary to the Ugandan PSAs, no advance notice need be given.

Clause 10.10(a) of the Trinidad & Tobago Model PSC, states that the “Contractor shall enable at all reasonable times the duly authorised representatives of Minister and other agencies of the Government to inspect any part of Petroleum Operations and all facilities, installations, offices, records, books or data related to Petroleum operations.”

See also Article 17.1 of the Ghana – Kosmos Oil PSA¹⁴³ and Clause 6.8.1 of the Equatorial Guinea Model PSC for examples of similar clauses.

6.4 k) **Security, militarisation, conflict and human rights**

The Voluntary Principles on Security and Human Rights are the only human rights guidelines designed specifically for extractive sector companies. They are a set of principles designed to guide companies in maintaining the safety and security of their operations within an operating framework that encourages respect for human rights. They give guidance on risk assessment, interactions between companies and public security as well as interactions between companies and private security.

Clause 9.2 of the Liberian contract for Western Cluster deposits¹⁴⁴ is an example of a contract that requires security forces to be subject to the Voluntary Principles.

Other principles and standards on security to refer to in the drafting of clauses include Section F of the UN Principles for Responsible Contracts¹⁴⁵, and the International Finance Corporation Performance Standard 4 (with Guidance note).¹⁴⁶ The ICMM has further developed a human rights guidance document which deals with security in section 3.2 as well as a tool on implementing the Voluntary Principles.¹⁴⁷

6.4 l) **Local content**

Many African countries, including Ghana, Eritrea, Equatorial Guinea, Nigeria and Sudan, have included requirements regarding local content in their model PSAs; only employ foreign nationals if they cannot find suitable local staff (Clause 23.2.1 of the Equatorial Guinea Model PSC); meet timelines and targets set by the Government in terms of employment of nationals (Article XVII (5) and (6)) of the Republic of Sudan-China National Petroleum Corporation PSA 1997;¹⁴⁸ and employ only nationals for less skilled positions (Clause 13.2 of the Nigeria Model PSC).

With respect to goods and services, One way of giving preference to local goods is exemplified by Clause 20 of the Brazil Model Concession Agreement, which obligates the Contractor to buy a specific percentage (as agreed upon with the government based on regulatory criteria) of goods and services locally during the exploration and development phases of petroleum operations. The performance of this obligation is verified/collaborated by means of certification on local content by the relevant government agency.

ENDNOTES

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