

New Petroleum Law: The Future of Oil & Gas in Mozambique

Due to the significant natural gas discoveries in 2013, Mozambique has become the focus of attention for numerous international oil companies. As a result, the Mozambican legislative regime has been updated. In this briefing, we summarise the key changes made by the new Petroleum Law (Law No. 21/2014) and discuss the potential impact on investors considering exploration, production and LNG processing activities in Mozambique.

The Mozambican market

Mozambique has the potential to be the world's fourth largest source of natural gas and, as a result, the sector has experienced a flurry of activity in recent years. In the Rovuma Basin, for example, the Anadarko-operated "Area 1" and ENI-operated "Area 4" are estimated to contain around 170 trillion cubic feet of gas.

In order to commercialise and transport these significant natural gas discoveries beyond domestic and local markets, a number of LNG processing facilities are being considered, both onshore and offshore.

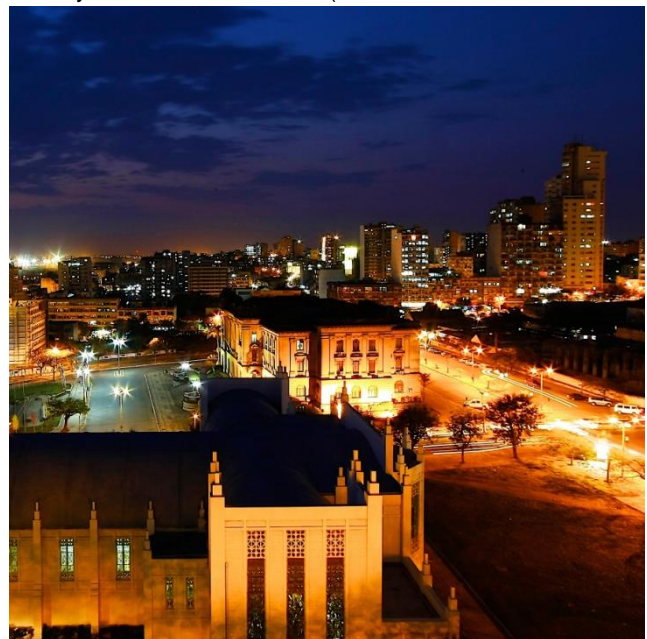
As the previous legislative framework for the oil and gas sector was unsuitable for such rapid developments in the sector (for example, it did not cover LNG processing), the Mozambican Parliament approved Petroleum Law (Law No. 21/2014) on 14 August 2014, which was published in Mozambique's Official Gazette (*Boletim da República*) (1st Series - No. 66) and entered into force on 18 August 2014 (the "**new Petroleum Law**"), repealing the previous Petroleum Law.

Further, 23 October 2014, the National Petroleum Institute of Mozambique (*Instituto Nacional de Petróleo*) ("**INP**") will formally open the competitive bidding process for the *Fifth Licensing Round*, covering approximately 76,800 square kilometres of acreage offshore (Rovuma, Zambezi and Angoche) and onshore (Pande-Temane and Palmeira). The formal announcement will be in London and will be held for invited companies who have successfully registered for

attendance on the INP website.¹ The Fifth Licensing Round will be the first licensing round governed by the new Petroleum Law and is scheduled to close on 20 January 2015.

Regulatory institutions

Several key bodies are currently responsible for regulating oil and gas activities, namely the Council of Ministers, the Ministry of Mineral Resources (*Ministério dos Recursos*



¹ www.inp-mz.com

Minerais) ("**MIREM**"), the Ministry of Energy (*Ministério da Energia*) and the INP. MIREM and INP are relatively new bodies, having been established by Decree in 2005 and 2004, respectively.

The Council of Ministers, the highest Governmental body in Mozambique includes the president, prime minister and other Government ministers and is responsible for creating primary legislation for the oil and gas sector. The Council of Ministers is also technically responsible for the granting of concessions, the process of which is run by the INP.

On a day-to-day basis, the sector is primarily governed by MIREM, which is responsible for overseeing INP. MIREM develops and implements policies relating to the exploration and production of mineral resources, including hydrocarbon products. In the case of petroleum, natural gas and other hydrocarbon products, this is carried out in accordance with the National Strategy for Petroleum Operations Concessions.

The Ministry of Energy is responsible for the regulation of downstream production and distribution operations.

INP was established to manage and oversee Mozambique's petroleum resources and is responsible for, among other things:

- the regulation and control of, research relating to, exploration for and production and transportation of petroleum in Mozambique, including proposing policies and rules for the development of petroleum operations;
- the preservation of public interest and the environment in the sector, which is fulfilled by establishing necessary technical, economical, social and environmental requirements for petroleum operations in Mozambique;
- the administration, maintenance and publishing of technical information and data relating to the activities of the petroleum industry in Mozambique;
- participating in the establishment of concession areas and related concession contracts; and
- overseeing and ensuring legal and regulatory compliance of petroleum operations in Mozambique, including compliance with the terms of concession agreements, when relevant.

Under the new Petroleum Law, a new authority, the High Authority for the Extractive Industry (*Alta Autoridade da Indústria Extractiva*), will be created to oversee the extractive industry. However, the new Petroleum Law is silent as to the powers and role of this High Authority. In

particular, it is uncertain as to whether the new authority will be regulatory in nature or will take the role of ombudsman and/or whether its role will conflict or overlap with the INP.

The new Petroleum Law

Scope

- As per the previous regime, all petroleum resources (defined within the new Petroleum Law as crude oil, natural gas and any hydrocarbons derived from crude oil or natural gas) are the property of the State.
- The scope of the new Petroleum Law expressly extends to infrastructure owned by licence interest holders or third parties used in respect of petroleum operations in Mozambique. This includes moveable infrastructure such as vessels.
- Refining activities, industrial utilisation, distribution and retail sale of petroleum products are not governed by the new Petroleum Law. Gas liquefaction and LNG activities, however, are.

Local requirements

- Under the new Petroleum Law, the Government must promote the Mozambican business community in the oil and gas sector.
- The new Petroleum Law provides that oil and gas companies must be listed on the Mozambican Stock Exchange. It is uncertain as to whether this refers to a specific percentage of a project SPV, as per similar local content requirements in other jurisdictions, or whether all of the shareholding of the company is to be listed on the Mozambican Stock Exchange. In advance of further clarification being provided in subsequent regulations, it is recommended that potential investors should consult directly with the Mozambican authorities to obtain further guidance.
- Under the new Petroleum Law, preference should be given to goods and services purchased or obtained from Mozambican individuals or entities. This preference requirement shall apply if the prices offered by Mozambican individuals or entities do not exceed 10% of the cost of importing such goods and/or services. This extends beyond the previous regime, which contained similar provisions relating only to operators, and now applies to holders of all rights to conduct petroleum operations.
- In relation to the provision of goods and services, the new Petroleum Law requires that goods or services, the value of which exceeds a particular amount (to be determined in subsequent regulations) must be

purchased by way of a public tender. Such public tenders must be published in widely read newspapers in Mozambique and on the website of the relevant interest holder.

- In addition, foreign entities that provide services to petroleum operations in Mozambique are required under the new Petroleum Law to "associate with" Mozambican entities. This extends the scope of the Petroleum Law beyond traditional exploration and production companies to petroleum services companies and EPC contractors. Details of how this obligation is fulfilled remain unclear and we expect this to be detailed in future regulations and/or secondary legislation.
- The new Petroleum Law expressly provides that investors in onshore petroleum undertakings (including LNG) will be liable for all costs of resettlement of any affected populations. Those individuals impacted by resettlement must be guaranteed better living conditions to those they already possess. No further detail is provided within the new Petroleum Law as to how these obligations can be fulfilled.

Investment protection

- The pre-existing Mozambique Investment Law does not provide protection to investments relating to the petroleum sector. To rectify this, the new Petroleum Law expressly provides for the protection of both national and foreign direct investment in oil and gas in respect of the protection of property rights and undue and unfair expropriation. That said, the extent of these protections are somewhat lacking. As a result, foreign investors should also consider utilising protection provided by way of Bilateral Investment Treaties when structuring their investments.

Financial requirements

- The new Petroleum Law requires operators to provide financial guarantees or a performance bond, the details of which are expected in further regulation or secondary legislation. Investors should consider whether this covers clear and express obligations (e.g. environmental and/or decommissioning obligations) or whether discretion is granted to the authorities as to when such guarantees or bonds may be utilised.
- Under the new Petroleum Law, petroleum exploitation companies are now required to publish their results, payments made to the State, and details of the costs incurred for corporate and social responsibility. Details of these obligations, such as whether they should be

provided annually, semi-annually or quarterly, whether they are to be audited and whether they can be incorporated in consolidated group results, are not provided in the new Petroleum Law itself.

Third party access rights

- Access must be provided to third parties to use infrastructure related to petroleum operations, subject to reasonable commercial terms and provided that there is available capacity. The new Petroleum Law now refers to infrastructure generally, rather than just pipelines. As such it is uncertain as to exactly what types of infrastructure this rule applies.
- Further, under the new Petroleum Law, if there is no available capacity to accommodate third parties and the relevant third parties can demonstrate a need for the increase of capacity, the owner must increase the capacity, the costs of which are to be paid by such third parties.
- These provisions are somewhat uncertain in the new Petroleum Law. As a result, investors may be wary of the potential impact this might have, as such expansions may impact the daily operation of producing assets.
- Further, disputes between the infrastructure owner and the relevant third party must now be settled by an independent regulator, rather than by arbitration. The new Petroleum Law is, however, silent as to details e.g. which institutional rules may be used.

Liability

- The new Petroleum Law provides that operators shall be liable for any damage caused to infrastructure, the environment, territorial waters or public health as a result of their operations of handling, transporting, exploring and producing oil and gas.
- In addition, a licence holder shall be required to indemnify injured parties for any losses or damages resulting from petroleum operations.
- The new Petroleum Law does not clarify whether this only applies in circumstances where the operator has acted unlawfully, negligently or below the standards expected of a prudent operator. If not, this rule could constitute a strict liability regime for damages and result in significant liabilities being incurred by operators.
- Further, it is uncertain as to whether these liabilities may be shared with other interest holders through Joint Operating Agreements or otherwise.

Transparency

- The new Petroleum Law now requires that any entity which directly or indirectly holds or controls interests and/or rights under concession agreements must be established in, registered in and managed from a transparent jurisdiction. The new Petroleum Law states that a transparent jurisdiction means a jurisdiction where the Government of Mozambique is able to independently verify the ownership, management and control and financial status of a foreign entity which wishes to participate in petroleum operations in Mozambique. Details of such acceptable jurisdictions are currently not available. Consideration should therefore be given to the tax structuring of operations, in particular in relation to any project finance transactions.
- The new Petroleum Law also provides that companies applying for concessions or licences must provide evidence of incorporation and shareholders, including details of relevant shareholdings.

Licensing regime

Under the new Petroleum Law, by way of public tender, a prospective investor may obtain the following types of concession contracts:

1. **Reconnaissance Concession Contracts** (*contrato de concessão de reconhecimento*) - Reconnaissance Concession Contracts grant the non-exclusive right to carry out preliminary exploration and assessment work. Such Reconnaissance Concession Contracts entered into under the new Petroleum Law:
 - (a) can only be entered into on a non-exclusive basis;
 - (b) shall be for a non-renewable two year term; and
 - (c) may not give rise to a right of first refusal in the granting of Exploration and Production Concession Contracts.
2. **Exploration and Production Concession Contract** (*contrato de concessão de pesquisa e produção*) - Under the new Petroleum Law, such concession contracts grant an exclusive right to conduct petroleum operations, including exploration and production, and a non-exclusive right to build and operate infrastructure required for the production and transportation of petroleum. Exploration and Production Concession Contracts must be granted by way of public tender. Further, for such concession contracts:

- (a) the approval of the Mozambique Government shall be required for joint bidding or Joint Operating Agreements;
- (b) exploration activities cannot be extended beyond eight years, even if such extension is necessary to complete the works;
- (c) there is no specific provision for the extension of exploration activities if reserves are discovered; and
- (d) there is no specific provision for an extension of the concession for the purpose of production.

3. **Oil or Gas Pipeline System Concession Contract** (*contrato de concessão de sistema de oleoduto ou gasoduto*) - An Oil Pipeline or a Gas Pipeline System Concession Contract grants the right to construct and operate oil pipeline or gas pipeline systems for the purpose of transporting crude oil or natural gas, in those cases where such operations are not covered by an Exploration and Production Concession Contract.
4. **Infrastructure Concession Contract** (*contrato de concessão de infra-estruturas*) – Infrastructure Concession Contracts, which are established under the new Petroleum Law, grant the right to build and operate infrastructure for petroleum production, including LNG production activities. These Infrastructure Concession Contracts shall only be required if the relevant infrastructure is not covered by an Exploration and Production Concession Contract.

LNG

In addition to the four types of concession contracts detailed above, the new Petroleum Law also includes a separate Article regarding gas liquefaction. The new Petroleum Law provides that the Mozambique Government may authorise concessionaires that have discovered deposits of oil and non-associated gas to develop projects for the design, construction, installation, ownership, financing, operation, maintenance, use of wells, installations and ancillary equipment, either onshore or offshore, for the production processing, liquefaction, delivery and sale of gas in the domestic or foreign markets.

This now clarifies that liquefaction activities, either onshore or offshore, can be undertaken under Exploration and Production Concession Contracts without the need for a separate licence or concession (albeit subject to further Government approval). Nevertheless, uncertainty still remains in respect of those participants in LNG projects

that do not otherwise have interests under a concession contract.

A project for the construction, operation and management of LNG facilities in the northern Mozambican province of Cabo Delgado is currently being discussed with the Government, which, if developed, is expected to first export LNG by 2018. This LNG project will require an investment of between US\$25 billion and US\$30 billion, which would be by far the largest foreign investment made in Mozambique.

On 23 September 2014, the Mozambique Parliament passed Law No. 25/2014 (published in the Mozambique's Official Gazette (*Boletim da República*), 1st Series - No. 76) (the "**Enabling Law**"), which empowers the Government of Mozambique to be able to establish by decree a special regime for an LNG Project to be developed in Areas 1 and 4 of the Rovuma Basin (the "**Special Regime Decree**").

The Enabling Law expressly states that, among other things, the Special Regime Decree shall set up specific terms and conditions in relation to:

- the project documents to which the Government of Mozambique is party;
- the finance documents (including the security package);
- other project-related agreements;
- the contracting regime, implementation and monitoring of public-private partnerships, large-scale projects and business concessions;
- the acquisition of goods and the contracting of advisory services;
- the use and benefit titles of land, the coastal zone and maritime area;
- the labour regime;
- the authorisation for public entities (such as Mozambique's State-owned exploration and production company, the National Oil Company, "*Empresa Nacional de Hidrocarbonetos, E.P.*" or "**ENH**") to enter into agreements with international arbitration clauses;
- the foreign exchange regime;
- the contracting of insurance/re-assurance policies;
- the applicable competition law regime; and
- the unitisation of Area 1/Area 4 gas deposits.

The Special Regime Decree to be adopted under the Enabling Law is currently under discussion and, although the Government of Mozambique has not announced a date for its publication, is expected to enter into force this year

(otherwise, the legislative power granted by the Enabling Law will terminate).

This suggests some willingness by the Mozambique Government to consider actions that are necessary to make such large-scale LNG projects commercially viable or bankable.

Transfer of rights

The transfer of rights and obligations under a concession contract, whether to an affiliate or a third party, must be in accordance with Mozambican law and subject to the approval of the Government of Mozambique.

The new Petroleum Law expressly provides that indirect transfers of participating interests, notably by way of change of control of any concessionaire, shall be considered as a transfer of rights and obligations under an Exploration and Production Concession Contract, and shall, therefore, require governmental approval.

Such transfers of rights may also be subject to the payment of capital gains tax. As of 1 January 2014, capital gains derived from the sale of shares of a resident company by a non-tax resident are taxable. Further, tax relief depending on the holding period of the shares which was previously available has now been repealed.

Rights acquired under the previous regime

It is noted that all rights obtained under concession agreements entered into under the old Petroleum Law shall remain valid and unaffected by the new Petroleum Law.

State participation

Pursuant to the new Petroleum Law, the State reserves the right to participate in petroleum operations in which any legal entity is involved.

The State may also decide to participate in any given project at any stage under the terms to be established by contract between the State and the holder of the rights.

The new Petroleum Law also provides that the State shall promote a progressive increase of its participation in all oil and gas ventures.

This gives the state a wide remit of powers and rights as against non-state concessionaires. The details of such rights of the State are likely to be provided in subsequent regulations, though it is hoped that a concessionaire will

have the ability to refuse the State's participation if the commercial terms are undesirable.

In addition, the new Petroleum Law provides that:

- ENH will represent the State in petroleum operations;
- it is expected that ENH will participate in both upstream and midstream petroleum operations including exploration, production, refining, transportation, storage and commercialisation of oil and gas and their by-products, including, LNG and GTL, both inside and/or outside Mozambique;
- ENH shall be responsible for managing the required quotas in respect of oil and gas to be channelled to the domestic market; and
- any investor interested in exploiting the petroleum resources of Mozambique must enter into a partnership with ENH, as the representative of the State.

Domestic supply obligations

Pursuant to the new Petroleum Law, the Mozambique Government must ensure that at least 25% of the oil and gas produced in the country is channelled to the domestic market for consumption. The terms under which the acquisition of such quota of oil and gas shall take place shall be provided in future regulations or secondary legislation.

It is uncertain as to whether this requirement will be fulfilled through ENH's participation in petroleum operations. If not, potential investors should consider this when considering exploration and production and/or LNG operations in Mozambique.

Employment of non-Mozambican nationals

Since 7 December 2011, pursuant to Decree 63/2011, restrictions have been imposed on the employment of foreign citizens.

The new Petroleum Law introduces new requirements for petroleum companies regarding the hiring of workers and employees. Adverts shall be published in newspapers with a wide readership, or through radio, television and internet, indicating the place of application, required experience and/or qualifications, and details of the publication of results. This requirement, however, does not seem to apply to sub-contractors.

Fiscal regime

Under the new Petroleum Law, concessionaires shall pay, along with any relevant specific taxes on petroleum operations:

- Income Tax;
- Value Added Tax;
- Municipal Tax, when applicable; and
- any other relevant taxes required by law.

On 23 September 2014, the Mozambique Parliament approved the Specific Regime of Taxation and Fiscal Benefits for Petroleum Operations, which will provide further specifics in respect of petroleum tax and will repeal the current regime (Law 12/2007 of 27 June 2007). The Specific Regime of Taxation and Fiscal Benefits for Petroleum Operations is due to enter into force on 1 January 2015.²

Conclusion

Although the new Petroleum Law was expected to update the legislative and regulatory regime in order to reflect and facilitate the rapidly developing oil and gas sector in Mozambique, unfortunately it is lacking in detail. Many significant uncertainties remain concerning the rules governing the sector, and a number of its provisions may prove difficult for investors to navigate.

Nevertheless, it is likely that outstanding uncertainties will be addressed by subsequent regulations and secondary legislation.

² An additional Client Briefing on the Specific Regime of Taxation and Fiscal Benefits for Petroleum Operations will be published upon its entry into force.

For more information about "Mozambique's New Petroleum Law: The Future of Oil & Gas in Mozambique", please contact:

Clifford Chance

Anthony Giustini

T: +33 14405 5926
E: anthony.giustini@cliffordchance.com

John Wilkins

T: +44 (0)20 7006 2466
E: john.wilkins@cliffordchance.com

Steven Fox

T: +44 (0)20 7006 4827
E: steven.fox@cliffordchance.com

André de Sousa Vieira

T: +44 (0)20 7006 1210
E: andre.desousavieira@cliffordchance.com

Russell Wells

T: +44 (0)20 7006 2628
E: russell.wells@cliffordchance.com

David Lewis

T: +44 (0)20 7006 1903
E: david.lewis@cliffordchance.com

Titus Edjua

T: +44 (0)20 7006 3052
E: titus.edjua@cliffordchance.com

Philip Walsh

T: +44 (0)20 7006 3361
E: philip.walsh@cliffordchance.com

Couto, Graça & Associados

Pedro Couto

T: +258 21 496900
E: pcouto@cga.co.mz

Jorge Graça

T: +258 21 496900
E: jgraca@cga.co.mz

Faizal Jusob

T: +258 21 496900
E: fuso@cga.co.mz

Paulo Ferreira

T: +258 21 496900
E: pferreira@cga.co.mz

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2014

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.