

Mozambique's Rovuma Basin Decree-Law: Key uncertainties and their impact

The much anticipated Decree-Law for the Rovuma Basin Area 1 and Area 4 LNG projects provides a comprehensive legal framework for the development of the projects. However, there remain a number of uncertainties in key areas, the potential impact of which we examine below.

The Mozambican LNG market

Projects for the construction, operation and management of liquefied natural gas (LNG) facilities in the northern Mozambican province of Cabo Delgado are currently being discussed with the Government of Mozambique (GoM). These facilities, if developed, could produce the first export LNG by 2020. The LNG projects will require an investment of US\$25-30 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 Mozambique's Official Gazette (*Boletim da República*), 1st Series - No. 76) (the **Enabling Law**), empowering the GoM to establish by decree a special regime for the LNG projects to be developed in Areas 1 and 4 of the Rovuma Basin. The GoM adopted such a special regime for the development of the Rovuma Basin Projects on 25 November 2014 (Decree-Law No. 2/2014) (the **Decree-Law**) and this came into force on 2 December 2014.



The new Petroleum Law

The background for these legal developments was a new legal framework for the petroleum sector in Mozambique.

In August 2014, the Mozambican Parliament approved a new Petroleum Law (Law No. 21/2014), 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.¹

The New Petroleum Law expressly provides that its scope extends beyond standard exploration and production activities to gas liquefaction and LNG activities. The New Petroleum Law confirmed that

¹ See our Client Briefing on the new Mozambican Petroleum Law ([New Petroleum Law: The Future of Oil & Gas in Mozambique](#)), published in October 2014.

liquefaction activities, either onshore or offshore, can be undertaken under Exploration and Production Concession Contracts (*contrato de concessão de pesquisa e produção*) (EPCCs) without the need for a separate licence or concession (albeit subject to further GoM approval). That said, the New Petroleum Law is somewhat lacking in details on key points, including how liquefaction activities may be undertaken by participants that do not otherwise have interests under an EPCC or any other concession or licence available under the New Petroleum Law.

The New Petroleum Law provides that the GoM is responsible for producing, within 60 days from its publication, regulations that are expected to address the majority of uncertainties arising from the New Petroleum Law.

Although a preliminary draft of such supplementary petroleum regulations was recently circulated by the GoM to various market participants for consultation, to date such regulations have not yet been adopted.

Rovuma Basin Decree-Law

Scope

- The Decree-Law was passed to establish a special legal and contractual regime to be applied to any project developed in Areas 1 and 4 of the Rovuma Basin, including the exploration, extraction and production of natural gas and associated LNG liquefaction activities (each a **Rovuma Basin Project** or **Project**).
- The Decree-Law will apply to any contracts related to a Rovuma

Basin Project to which the GoM is a party, including any EPCCs.

Special Purpose Vehicles

- Special purpose vehicles may be established in Mozambique as project companies for any Rovuma Basin Project.
- Special purpose vehicles for marketing, shipping and financing purposes related to a Rovuma Basin Project may be established in a transparent jurisdiction outside of Mozambique, provided that the GoM's prior approval is obtained.²
- GoM's approval will be required for any exit, transfer of shares or change of control of any project company, though we note that this is not unusual and similar provisions are often found in concession contracts worldwide.

Mega Projects Law

- The Decree-Law acknowledges that the Mega Projects Law (Law No. 15/2011 of 10 August 2011) applies to the Rovuma Basin Projects and includes provisions explaining how the benefit-sharing requirements of the Mega Projects Law are met by the Projects. Unfortunately, the Decree-Law does not address how the requirement of the Mega Projects Law that 35% of all taxable benefits of any project must be shared with the State is

to be met by each Rovuma Basin Project.

Unitisation

- To the extent that any reservoirs with petroleum reserves straddle Area 1 and Area 4 of the Rovuma Basin, the concessionaires of Area 1 and 4 may jointly develop such reserves.
- Such joint development will be subject to the concessionaires presenting an agreed unitisation agreement to the GoM within six months of the Decree-Law entering into force.
- If the parties are unable to provide such unitisation agreement within the six-month deadline, the GoM is empowered to appoint an independent expert to decide upon any matters on which the concessionaires could not come to an agreement, and the expert's decision will be final and binding.
- We note that the time-frame related to the provision of such unitisation agreements is based upon the Decree-Law coming into force, rather than the discovery of reserves. Consequently, uncertainty arises in circumstances where, for instance, a concessionaire discovers further reserves in a new reservoir straddling Area 1 and Area 4, or a reservoir first thought to be solely within one Area is subsequently discovered to straddle both licence Areas. As the Decree-Law provides that whenever a matter is not regulated in the Decree-Law, the relevant Mozambican legislation on such matter shall apply, it is possible that the unitisation regime under the New Petroleum Law may be applicable to any

² 'Transparent jurisdiction' is defined in the New Petroleum Law as a jurisdiction which allows the Mozambican GoM to independently verify the ownership, management, control and finances and accounts of a non-Mozambican legal entity.

future discoveries of additional reserves in Area 1 or Area 4.

- Although not yet official, the Mozambican national news has recently reported that, in an attempt to comply with the six-month time-frame pursuant to the Decree-Law, the concessionaires have submitted a letter to the GoM confirming that they have come to an agreement in respect of the unitisation of the field, though they require further time to finalise the details. It remains uncertain whether the GoM will accept this as fulfilling the requirement under the Decree-Law to submit a binding unitisation agreement within the six-month deadline.

Development Plans

- Concessionaires will be expected to submit to the Minister of Energy and Mineral Resources (*Ministro da Energia e Recursos Minerais*) a development plan regarding any Rovuma Basin Project, detailing expected development and production operations, in addition to any prospective liquefaction, delivery, sales, installation, maintenance and operation activities. An environmental impact assessment will be expected to be included with all development plans.
- The term of any development plans shall be no longer than 30 years from the date of the GoM's approval of such plan.
- Concessionaires may submit new or revised development plans in relation to any Rovuma Basin Project. That said, no new development plan may be submitted later than ten years following the commencement of

the commercial assessment of the reserves pursuant to the relevant EPCC.

Sales

- The concessionaires' right to market and sell natural gas shall be set out in the relevant EPCCs.
- The National Oil Company (*Empresa Nacional de Hidrocarbonetos, E.P.* or **ENH**) shall act as the GoM's authorised representative in matters regarding the sale of natural gas belonging to the Mozambican state in accordance with (a) the Tax on Production of Petroleum and (b) any quota set out in relevant EPCCs, although it is not yet clear how this will work in practice.
- It has recently been reported in the Mozambican national media that the GoM is finalising negotiations with the concessionaires in respect of how much gas from each Rovuma Basin Project should be dedicated to the Mozambican domestic market. Although the New Petroleum Law provides that 25% of all gas produced in Mozambique should be set aside for local consumption, the relevant EPCCs for the Rovuma Basin Projects were executed prior to the New Petroleum Law entering into force and did not include any such domestic market obligations. As such, it is expected that the figure of 25% will be negotiated downwards for the Rovuma Basin Projects, particularly given the importance of the Projects to the Mozambican economy.
- In this regard, we note that the floating LNG (**FLNG**) facilities to be developed by the Area 4

concessionaire have been subject to criticism that they appear to not dedicate any gas for local consumption. This issue will have to be observed by the Area 4 concessionaire in a satisfactory manner in light of the New Petroleum Law, the resolution of the local gas issue for Area 1 and public opinion.

Procurement of Goods and Services

- The procurement of goods shall be in accordance with the national aim of preference for the procurement of goods and services from Mozambican companies, Mozambican persons or in partnership with Mozambican companies or persons, with a view to empowering the Mozambican private sector.
- To that end, concessionaires are required to create a local content plan to establish the participation of Mozambican persons and companies in relation to the procurement of goods and services for the Rovuma Basin Projects.
- Each local content plan must be provided to the GoM for approval and will be reviewed every three years.
- Preference will be given to Mozambican suppliers of goods and services only to the extent feasible and provided that such goods, materials, services and equipment:
 - a) are competitive in terms of quality and deliverability;
 - b) meet international industry standards; and

c) do not cost (including taxes) over 10% more than the price of equivalent imported goods and services.

- No preference to Mozambican suppliers is required in respect of principal contracts and/or goods and services related to technology, patents or specialised supplier equipment, including in connection with the construction, operation and maintenance of infrastructure related to the Projects.
- Contracts concerning the procurement of goods or services valuing more than US\$3 million must be subject to public tender. This threshold amount will be adjusted annually in accordance with the then applicable U.S. consumer price index (CPI).
- That said, notwithstanding the value of the relevant contract, sole source procurement is admissible in certain circumstances – for instance, in the event that only one supplier can provide the relevant products, materials, services or equipment, or if the goods to be acquired need to be uniform to existing goods in any facilities and/or infrastructure.

Land Rights

- Licence holders shall have exclusive rights of access, use, enjoyment and exploitation over all areas where the project infrastructure is to be located. In addition, they are also able to have access, use and enjoyment of coastal and maritime areas necessary for the Projects.
- Concessionaires and/or any project company will have the right to own any structure,



building or facility built on land, subject to a right to use and to enjoy the land on which it is built, including the right to mortgage such structure, building or facility.

- Concessionaires and/or any project company may assign any of their land rights.
- Each concessionaire in respect of a Rovuma Basin Project shall have equal rights of access to and use of those areas where common infrastructure of the Rovuma Basin Projects is located. Further clarification of the nature of such common rights is needed.
- There is ongoing debate as to the validity of the land rights conferred by the Decree-Law. According to local non-governmental organisations (NGOs), the process of granting the land rights did not follow the legal framework in respect of the proper compensation of previous rights holders and local communities. Consequently, the local NGOs suggest that certain land rights provided to the concessionaires may be subject

to legal challenge. The GoM has not yet released any statements on this matter, which will obviously be of concern to the concessionaires and their lenders.

Third Party Rights

- Third party access to infrastructure will be negotiated between any relevant parties and approved by the GoM.
- For these purposes, 'third parties' are defined as entities which own significant quantities of natural gas with specifications similar to the natural gas in Areas 1 and 4, other than the concessionaires of Areas 1 and 4, the Rovuma Basin project companies or the GoM.
- Although the Decree-Law provides that concessionaires must provide third parties with access to infrastructure if there is sufficient capacity and the third parties' use of the infrastructure does not adversely impact the existing owners and users, third party access remains subject to commercial agreements between the relevant parties. This clarifies

some uncertainty in the New Petroleum Law which appeared to oblige owners of petroleum infrastructure (particularly pipelines) to allow third parties to have access rights, regardless of cost.

Foreign Exchange

- Concessionaires, project companies and principal contractors shall have the right to open, maintain and operate onshore accounts in Mozambique denominated in Mozambican Metical (**MZM**).
- Certain payments – e.g. payment of Mozambican taxes, payments to domestic subcontractors and payments of Mozambican workers – must be made with funds from such MZM accounts.
- In addition, concessionaires, project companies and any principal contractors shall be able to open, maintain and operate foreign currency accounts with any bank outside of Mozambique, which shall be used for certain payments, for example payments related to liquefaction services.
- Unless the parties agree otherwise, all payments to the GoM, except the payment of taxes, shall be made in US dollars.
- Subject to the terms of any financing agreements, each concessionaire and any project company may repay lenders located outside of Mozambique directly out of the proceeds of any sale of LNG or natural gas through foreign currency accounts located outside of Mozambique.

- Although the Decree-Law provides some relief that payments may be made in a currency other than local currency and money can be transferred and held offshore, the restrictions of payments set out in the foreign exchange provisions in the Decree-Law could cause some difficulties when it comes to negotiating accounts agreements and payment waterfalls with lenders.

Labour and Employment Regime

- Concessionaires, project companies, principal contractors and subcontractors must employ Mozambican citizens at all levels of their organization on a preferential basis, including specialists in technically complex and managerial positions.
- However, concessionaires, project companies, principal contractors and subcontractors may hire foreign employees in positions other than unskilled work positions.
- The percentage of non-Mozambican workers to be hired by the concessionaires, project companies or their contracted entities to work in Mozambique shall be established in a workforce plan, enclosed as a part of the development plan, and updated on an annual basis.
- In addition, foreign workers may be employed on a short-term basis to perform any type of work for a period of up to 180 days, whether consecutive or not.
- The concessionaires and project companies are required to establish a training program for Mozambican employees across all levels of operations, taking

into account safety requirements and the need to maintain reasonable standards of efficiency in conducting operations.

- In addition, certain labour rules apply to workers in Mozambique, including maximum lengths of working shifts and rest and holiday entitlements. Although these provisions are somewhat confusing, on a practical level, all work practices must comply at all times with Mozambican employment and labour law, international industry work practices and the social, health and safety requirements of any lenders.

Insurance and Reinsurance

- Should the Projects require insurance from outside of Mozambique (which, given their size, is more than likely), the relevant concessionaires must first have attempted to place such insurance with at least three insurance companies in Mozambique capable of underwriting the risks.
- To the extent that at least three insurance companies in Mozambique capable of underwriting the risks (a) refuse to do so or (b) do not provide a response within seven days, the relevant concessionaires may procure such insurance from outside of Mozambique, subject to providing the Institute for the Supervision of Insurances of Mozambique with at least ten working days' notice. Such notice must include evidence of refusal or non-response from relevant Mozambique-licensed insurance companies and detailed information regarding the foreign

insurance company, cover value and the main terms of the policy.

- Concessionaires may procure reinsurance outside of Mozambique without needing the prior approval of the Institute for the Supervision of Insurances of Mozambique or any other public entity.
- Insurance concerning infrastructure related to the Projects must be procured onshore. The Decree-Law does not provide any further details on what infrastructure is intended to be covered.
- Coverage from Mozambican insurers shall only take priority when the coverage is comparable to international insurance standards and the policy can be placed onshore at a price no higher than 10% of the price which such insurance coverage could be obtained from the international market (inclusive of taxes and any fees).
- Should no Mozambican insurance company be able to provide the relevant insurance coverage, concessionaires are entitled to obtain such insurance from the international market.
- The Decree-Law does not expressly provide for situations where a Mozambican insurance company is willing to provide coverage but its credit rating is below a standard required by lenders. We query whether this would fall under the 'comparable to international insurance standards' carve-out.

LNG Marine Terminal

The concessionaires and project companies shall have the right to design, construct, install, own, finance, encumber or mortgage, manage, operate, use and maintain an LNG marine terminal in Afungi, Cabo Delgado (the **LNG Marine Terminal**).

In relation to such development, construction and operations, the concessionaires and project companies shall have the exclusive rights of access and operation over land and related maritime areas.

Once constructed, the port authority, *Portos de Cabo Delgado, S.A. (PCD)*, will be involved in vessel-loading activities and will have access to the LNG Marine Terminal facilities in order to monitor and verify the volume of loaded materials.

Further, in addition to local content requirements, the concessionaires are expected to employ Mozambican citizens at all levels of the operation of the LNG Marine Terminal and shall provide them with relevant training in respect of the functioning of the terminal.

In addition, to the extent that there are multiple entities involved in a Rovuma Basin Project (regardless of whether in Area 1 or Area 4), each concessionaire and/or project company shall have equal rights of access, use and enjoyment of the LNG Marine Terminal throughout the duration of the Projects, whether such joint rights are established by a joint venture arrangement or otherwise.

The Decree-Law is somewhat lacking in detail about the development of the LNG Marine Terminal, particularly regarding risk allocation and remuneration of the developing entity.

Financing and Lenders' Rights

The Decree-Law includes specific provisions in relation to the financing of the Projects.

The Decree-Law provides that the concessionaires and/or project companies may obtain both domestic and international financing for the Projects, provided that the GoM has approved the financing structure (including any hedging arrangements and security to be provided to the lenders).

Host state approval over financing documents is unusual. International lenders may be hesitant to give the State the right to control or veto the structuring of the finance package. In practice, the impact of these provisions will depend on how they are applied, for instance whether by direct GoM participation in the negotiation process (which is unlikely) or delivery to the GoM for its consent of the financing documentation once agreed. That said, having to secure the GoM approval for amendments may be a concern for both borrowers and lenders (see below).

In addition, the Decree-Law provides that, once the financing arrangements have been approved by the GoM, the lenders may exercise their rights and pursue any remedies (including the enforcement of security) without the consent of any GoM authority.

Further, the Decree-Law stipulates that any guarantee, security, debenture or mortgage related to rights *in rem* over petroleum infrastructure shall be registered, maintained and operated by the National Petroleum Institute (**NIP**). We expect that this is simply an obligation to register any security with the NIP, though the use of the



wording 'operated' causes some uncertainty and will require clarification.

As noted above, the Decree-Law provides that the GoM is required to approve the financing structure and that, once approved, no further approvals of the financing structure will be required. Nevertheless, it remains unclear whether approvals required under other laws would continue to be required, for example, the review and approval (*visto*) of the Mozambican Administrative Court (*Tribunal Administrativo*), required in any transactions involving the GoM, public bodies or state-owned companies where public money is to be used, certifying that the transaction is in accordance with the budget and all relevant Mozambican laws.

The situation in relation to subsequent amendments of the financing documents also remains to be clarified.

Dispute Resolution

The Decree-Law provides that, without prejudice to the provisions of any EPCCs, the resolution of disputes related to any matter governed by the Decree-Law shall be in accordance with Mozambican Law.

We note that this language is ambiguous and could be problematic. The Decree-Law does not clarify whether it only applies to those disputes arising between the concessionaires and/or project companies and the GoM, or whether it also applies to third parties.

In addition, the Decree-Law includes Articles on lenders' rights. As such, the dispute resolution provisions in the Decree-Law might result in some uncertainty as to whether the lenders' rights under the financing documents are to be governed by Mozambique law. It would be unlikely that Lenders would accept Mozambique law for all financing documents.

The Decree-Law further indicates that, if no agreement is reached in respect of any disputes relating to any matter governed by the Decree-Law, such disputes may be referred to arbitration in accordance with the dispute resolution provisions referred to in the relevant EPCC.

Again, it is uncertain whether this extends to disputes involving third parties.

That said, the Decree-Law clarifies that this Article does not restrict any public company, including ENH, from entering into any other arbitration agreement to resolve disputes arising from any concession contract or other agreement related to the Rovuma Basin Projects.

This clarification is necessary due to ongoing legal debate on whether

state-owned companies in Mozambique may enter into arbitration agreements. The State Owned Companies Law (Law No. 6/2012), which came into force in 2012, provides that only two bodies are empowered to hear disputes involving Mozambican public companies, namely the Mozambican courts or, where the dispute relates to administrative matters, the Administrative Court (*Tribunal Administrativo*).

Fiscal Support Regime and Stabilisation

Concessionaires and project companies benefit from a specific legal and fiscal stability regime established in the Decree-Law.

This regime incorporates stability provisions including a guarantee in respect of any change in law (subject to a number of carve-outs).

Further, the GoM will compensate the concessionaires and/or project companies for any lost profits due to any change in law.

These provisions will be revised on the tenth and twentieth anniversary of the date of first shipment of LNG, by agreement between the GoM and the concessionaires. To the extent that the parties are not able to reach an agreement within 90 days:

- a) from the date falling 10 years from the first shipment of LNG to the date falling 20 years from the first shipment of LNG, the concessionaires shall be liable to pay 4% of Tax on Petroleum Production; and
- b) from the date falling 20 years from the first shipment of LNG until the end of the EPCC, the concessionaires shall be liable to

pay 6% of Tax on Petroleum Production.

This causes some issues, as the Decree-Law is silent as to how such Tax on Petroleum Production shall apply to LNG sales.

Further, it is unclear whether the intention of these provisions is that:

- a) Tax on Petroleum Production will apply to the Rovuma Bay Projects at a flat rate of 4% or 6%, notwithstanding the tax rate at that time, or
- b) concessionaires will only need to pay 4% or 6% of the Tax on Petroleum Production which would be applicable at the time if it were not for the Decree-Law.

In addition, the concessionaires do not appear to benefit from any reduction in any taxes, including corporation taxes, and the tax in effect at the time of the Decree-Law coming into force shall apply to the Projects. The absence of such provisions related to tax matters is due to the fact that such taxation matters are reserved exclusively and absolutely to the Mozambican Parliament.

Nevertheless, the concessionaires are likely to execute Host Government Agreements with the GoM, which are expected to include further details as to the tax framework for the Projects.

Finally, confusion arises from the drafting of the final paragraph of the Article on Legal and Fiscal Stability, which appears to provide that the fiscal support regime shall not apply to any other fiscal benefits granted to the Projects at the discretion of the GoM.

As the Rovuma Basin LNG Projects are the first LNG facilities to be

developed in Mozambique and are therefore of political and economic importance, it is expected that this regime will be more favourable than future regimes. Nevertheless, the Decree-Law demonstrates the level of commitment that the GoM might be willing to provide for projects of this size and nature.

Conclusion

In conclusion, although the Decree-Law provides further insight into the Rovuma Basin Projects, a significant amount of detail is missing. As such, the Decree-Law raises a number of issues that we consider to be integral to the success of the Projects and could impact future appetite for investment in similar projects in Mozambique; for example, potentially limiting the rights of lenders in respect of the overall structure of the financing.

That said, as the Decree-Law provides that whenever a matter is not regulated in the Decree-Law the relevant Mozambican legislation on such matter shall apply, some of these issues will be addressed or mitigated by the application of the general legal regime (for example, the New Petroleum Law, the Exchange Law (Law No. 11/2009 of 11 March 2009) or the Labour Law (Law No. 23/2007 of 1 August 2007)).

Moreover, it is expected that a number of these issues will be resolved in the Host Government Agreements to be entered into between the concessionaires and the GoM.

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