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Understanding Mozambique's New Oil And Gas Regime

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Mozambique recently enacted Law No. 21/2014 (Hydrocarbons Law) — its new oil and gas legal regime — which aims to provide legal stability for international investors seeking to develop the country's recently proven reserves of 200 trillion cubic feet of natural gas. This new law and the Hydrocarbons Tax Law No. 27/2014 determine the general rule for all oil and gas operations in the country. Other laws could be enacted to determine specific regimes for any exploration areas, such as the Decree-Law No. 2/2014 that stipulates the Rovuma Basin regime.

The new Law No. 21/2014 is not regulated yet, but in essence it introduces some changes to the old Hydrocarbons Law (Law No. 03/2001) maintaining its major principles and aspects. Included in the scope of the new law is the concession of rights to perform oil and gas operations in Mozambique (and beyond its borders), including: oil and gas operations, transportation and any related infrastructure. The new law does not cover refining processes, industrial use, distribution and trading of oil and gas products.

The new law conserves state ownership of prospecting, research, production, transport, trading, refining and transformation of liquid and gaseous hydrocarbons and their products. In addition, under the terms of the Concession Agreement, the state can develop complementary or secondary activities, and it reserves the right to participate (and gradually increase its participation) in oil and gas operations, at any stage.

In the allocation of concession rights, the state must ensure that national interests are protected in relation to: defense, labor, navigation, conservation of marine ecosystems and other natural resources, existing economic activities, and nutrition security of the affected communities. Mozambique's national oil company, Empresa Nacional de Hidrocarbonetos (ENH), remains the state's exclusive representative in all oil and gas operations in the country, and the National Petroleum Institute (INP) also remains responsible for the sector's regulation and promotion. The new law determines the concession regime through which the state will partner with the private sector and Law No. 27/2014 codifies a production sharing mechanism between the state and the concessionaire.

Mozambican entities or foreign entities registered in Mozambique may be holders of rights to conduct oil and gas operations, but holding companies of foreign entities that own concession rights need to be established, registered and administered from a transparent jurisdiction, where the state can verify the ownership, management and tax status of such foreign entities. The law also states that under the same circumstances, Mozambican entities (entities with at least 50 percent of the shares belonging to Mozambicans) or foreign entities in "association" with Mozambican entities have a preemption right in the signing of concession agreements.

Besides, not detailed in the new law, as otherwise it is in the Rovuma Regime Decree-Law, this "association" could generally fill the form of: (1) holding shares of the same incorporated joint venture (e.g. specific purposes entities), or (2) agreeing to an unincorporated JV, which could be a consortium or "associations in participation." In addition, any investor that has an interest in oil and gas exploration in Mozambique will enter into a "partnership" with ENH. On a practical level, as per past cases, this "partnership" means ENH shall hold shares of the concessionaire's JV. As defined in the new law, ENH shall assume the leadership of marketing and trading of oil and gas products.

The concession agreements could be granted by: public tender, simultaneous negotiation or direct negotiation. The types of concession agreements under the new law are: (a) recognition: grants nonexclusive right to conduct preliminary research; (b) research and production: grants exclusive right to conduct oil and gas operations and nonexclusive right to construct and operate infrastructure; (c) construction and operation of pipeline systems: grants the right to build and operate pipeline systems for transportation of crude oil and natural gas; and (d) construction and operation of infrastructure: grants the right to build and operate infrastructure for oil and gas production.

For investors, the concession agreements aim to guarantee security and legal protection of property rights on goods, including industrial property rights comprised in the approved investments made for oil and gas operations. Expropriation may take place only exceptionally and with a public interest justification, being such cases subject to the payment of just compensation.

Other requirements are: the state's property of data obtained; the registration of all activities, including the research carried out; and, the provision of financial performance guarantee to meet the deadlines for the project's implementation. Concessionaires are also required to publish their results and the amounts paid to the state, as well as any costs and expenses related to corporate social responsibility. The transmission of rights and obligations granted under a concession agreement, even if to an affiliate or to a third party, must be made according to Mozambican laws and is subject to the state's approval. Unitization of area agreements, which need to be signed within six months from the declaration of commerciality, shall be preapproved by the state as well.

Legal entities conducting oil and gas operations in Mozambique are subject to the payment of general taxes in addition to the specific taxes as: (a) income tax — IRPC (32 percent on net profits and capital gains); (b) value-added tax — IVA (17 percent on sales, as debt rate being a creditable tax and exempt on exports); (c) local taxes when applied (not significant); d) specific taxes as the hydrocarbons production tax — IPP.

The IPP is similar to a royalty and becomes chargeable from the time the oil or gas produced is extracted from an oil field/gas field and have the current rates of 10 percent for crude oil and 6 percent for natural gas. These rates are reduced by 50 percent when the production is designated for development of local industry. The tax base is the amount of oil and gas produced and the value is determined on the basis of international prices of major international oil and gas export centers.

The IPP payment could be made in cash or in hydrocarbons. The general rules as set in ordinary tax law shall apply regarding the income tax (e.g. amortizations, tax on capital gains in farm-in/farm-out operations, among others), but other specific rules apply for oil and gas operations. Tax benefits were also granted on import duties for operation equipment, and fiscal stability could be granted for a certain period, without affecting the assumptions of feasibility and profitability.

The right to explore oil and gas is separate from the use of land right or other rights established by law. The granting of rights for oil and gas operations shall not necessarily imply the allocation of land rights, and local communities' consent is required to commence oil and gas operations, having the state involved in this negotiation. If resettlement is needed, fair indemnification must be paid to local communities. The areas surrounding the projects are considered zones of partial protection, and if the concessionaires cause any damage to cultures, soils, constructions, equipment or improvements, they have the obligation to indemnify the owners in compliance with the applicable laws, regardless of fault.

As a local content requirement, foreign entities that provide services to oil and gas operations are required to be in “association” with Mozambican individuals or entities. However, as in the case of the concessionaires, the nature of such an association is not pre-defined. Also, the acquisition of goods or services above a certain value to be defined by law must be made by a tender, which must be published through the media, and preference should be given to local products and services to the extent that the price difference does not exceed more than 10 percent of the price of imported products and services.

In addition, concessionaires should be listed on the Mozambique Stock Exchange and a quota of no less than 25 percent of oil and gas produced in the country shall be dedicated to the domestic market. Concessionaires are required to create structures to ensure the organization and participation of the communities that are located in the concession areas; to guarantee the employment and technical-professional training for Mozambicans and to ensure their participation in management positions. General labor legislation in Mozambique and specific labor laws for oil and gas sector establish a quota regime limiting the number of expatriates (up to 10 percent).

Any disputes in connection with concession agreements not resolved by negotiation can be submitted to arbitration or to competent judicial authorities, in compliance with the terms and conditions established by the concession agreement. The arbitration between the state and foreign investors shall be in compliance with: the Mozambican arbitration law and the rules of the International Centre for Settlement of Investment Disputes between States and Nationals of other States (ICSID); and/or the rules of other international arbitration bodies widely recognized, in compliance with the concession agreement.

The new oil and gas legal regime is a legal manifestation of the Mozambique government’s desire to improve the business environment in the hydrocarbons sector. The steady improvement and compliance with this legal framework, together with the willingness of public and private initiatives to develop a safe, efficient and sustainable partnership model, could provide the platform to dramatically boost the Mozambican economy and to consolidate expectations around the discoveries of natural resources in Mozambique.

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