



## *Assessing the Decree Law for Rovuma LNG:*

# Government Concedes to Company Demands

Adriano Nuvunga & Fátima Mimbire

### Introduction

Following negotiations with the American and Italian multinational companies, Anadarko and ENI, the Council of Ministers approved the decree-law establishing the legal and contractual regime applicable to the Liquefied Natural Gas Project (LNG) for areas 1 and 4 of the Rovuma Basin on the 28th November 2014.

The decree provides for a series of guarantees and legal exemptions, which are included in the legal regime applicable to contracts to be signed between the government and the companies, in order to establish the terms and conditions for the design, construction, and installation of the gas liquefaction plants; ownership, financing, operation and maintenance of the undertaking, as well as the use of wells, facilities and associated equipment on land or at sea, among other conditions needed for the processing, liquefaction, storage, transport, delivery and sale of natural gas from the two areas in the Rovuma Basin.

Our analysis focuses on four main issues: fiscal stability, the exchange rate regime, unification of the gas-fields and local labor/content.

Companies managed to secure their objective of 30 years of fiscal stability, even though Parliament authorized stability in only 10-year increments,

by agreeing to a small increase in the production tax in the tenth and twentieth year.

Restrictive national laws on foreign exchange have been relaxed, consistent with normal practice, allowing companies to keep the bulk of the revenue offshore but still subject to oversight/auditing by the Bank of Mozambique.

Anadarko and ENI have been involved in long and unproductive negotiations on how to share gas reserves that cross concession boundaries. The government has now given them a deadline to come to an agreement on unification, or to have the matter decided for them by an independent expert.

Labor and local content provisions have also been relaxed in the Decree Law including the allowing for a twelve-hour workday. The quota system for foreign works has been removed. Local content obligations remain where goods and services are not more than 10% more expensive than imports, and in most cases procurement requires a public tender, but there are important exemptions for larger contracts and cases requiring special technology.

### 30 Years of Fiscal Stability

The 2006 Exploration and Production Concession Contracts provided assurances to Anadarko

and ENI against changes in tax laws throughout the period of exploration and development and for a full thirty years of production. The contracts do not say that the tax laws in place in 2006 are frozen and cannot be changed. Rather, they provide for what is known as “economic equilibrium.” If there are changes in the tax laws, the government commits to making offsetting changes in order that the company retains the “same economic benefits as it would have obtained if the change in the law had not been effected.”<sup>1</sup>

The government and the companies had agreed to lock in the same 30-year stabilization provisions in the Decree Law. Obviously the companies want to retain the very generous terms that were contained in the 2006 EPCCs. Fiscal stability is also important to the financial institutions that will need to provide many billions of dollars in loans in order to develop Rovuma LNG.

Based on this consensus, the Government submitted a legislative authorization bill to parliament. However, Parliament refused to authorize 30 years of stabilization, providing for only an initial 10 years to be renewable over the remainder of the project. Similar provisions have also been included in the 2014 Mining and Petroleum fiscal laws where fiscal stability is offered only for the first 10 years.

Parliament’s decision to authorize contract stability only in ten year increments appeared to be a significant restriction on the Government’s scope for negotiation. In fact, the companies secured their full 30-year stabilization by agreeing only to very marginal increases in the rate of the production tax after 10 and 20 years of exports.

Specifically, the Decree Law requires that the Government and the Concessionaires must meet in the 10th (tenth) and 20th (twentieth) year from the date of the first LNG shipment to review and potentially renegotiate stabilization provisions. The problem is that the Government has virtually no leverage in these negotiations, because the Decree Law also sets out the implications if the Government and the companies fail to agree: a production tax increase of 4% from the tenth

year after the first shipment, and an increase to 6% after the twentieth year.

At face value, this might seem like a significant concession on the part of the companies. In fact it is almost meaningless. A 6% production tax would be entirely appropriate for all the Rovuma projects right from the outset. In fact, the Petronas EPCC for the Rovuma Basin already contains a 6% production tax. Furthermore, increasing the production tax rate over time is an ineffective way to significantly increase government revenue. The production tax exists to guarantee government revenue in the early years when the companies receive the vast share of gas produced (only 85-90% for the Rovuma EPCCs) and are paying no income tax, not in the middle or later stages of the project. And in an unusual provision, production tax payments under the 2006 EPCCs are an allowable deduction against taxable income, further decreasing their value as a source of government revenue.

Assuming that the Rovuma LNG project is an economic success, the overwhelming majority of government revenue will come from profit gas and corporate income tax. These revenues are likely to be modest through the mid-2020s while costs are being recovered. By the 2030s however the revenues should be very significant. The increases to production tax payments, likely to come into effect only in 2032 and 2042 will be only a marginal contributor to government revenues are a very small price for the companies to pay for 30 years of fiscal stability.

## Offshore Foreign Exchange

According to the Foreign Exchange Law and its respective regulations, opening and operating bank accounts abroad requires specific authorization from the Bank of Mozambique. Normally, revenue from the export of goods, paid to foreign accounts, must be channeled to Mozambique within 90 days as from the date of shipment of such goods. Exceptions can be made on a case-by-case basis. Where such exceptions are made monthly bank statement must be provided to the Bank of Mozambique.

The Bank of Mozambique had sought to retain these tight foreign exchange restrictions in the Decree Law in order to encourage the use of the Mozambican banking system. Companies were strongly opposed to the requirement to bring the bulk of the revenues back to Mozambique. Perhaps more importantly, rigid foreign exchange controls as currently imposed by the Bank of Mozambique are almost never imposed on projects of this kind in other jurisdictions.

The results of the negotiations therefore were fairly predictable. Companies are required to bring revenues into Mozambique only to pay taxes and for the payments of goods and services provided within Mozambique (for contracts under US\$25 million) and for the payment of local workers. According to the decree-law, 50% of the total must be converted into Meticals.

The Decree Law also sets the terms for foreign financing of Rovuma LNG. Although Government approval is formally required, it is required only at the outset. Otherwise, there are no restrictions on the type of financing that can be proposed. Furthermore, debt to equity requirement that previously existed in the article 52 of Corporate Income Tax Law (34/2007) was excluded in the Decree Law. So, lenders can be granted “security” over the assets owned by the companies.

In spite of these concessions, the Decree Law for the first time makes the Bank of Mozambique a major institutional player in Mozambique’s extractive sector. Revenue flows in and out of Mozambique continue to require the approval of the Bank of Mozambique, though if the Bank fails to respond within five working days the transfer is deemed to have been approved. The Bank will receive monthly banking statements from company offshore accounts and has the right to audit these accounts. The Bank of Mozambique has even secured the right to on-site visits in Cabo Delgado.

## Unification

The companies Anadarko and ENI discovered natural gas deposits that cross the boundaries

between the concessions (transboundary/straddling deposits) and that must be unified, in order for the two companies to benefit equally from the deposits.

The Government authorized, through the decree-law, the companies to develop the exploration of natural gas in an autonomous and coordinated manner from the transboundary deposits in areas 1 and 4. Thus, initially, each one shall be entitled to exploit 12 (twelve) trillion cubic feet (tcf) of natural gas, according to the master production plan, which must be prepared jointly for these deposits.

Thus, each company must present their declaration of commerciality to the Government, for the part of the transboundary deposits located within the boundaries of their concession areas, and are obligated to present the autonomous and coordinated initial development plan or plans for the 12 tcf.

Anadarko and ENI must enter into a unification agreement by May 2, 2015. This agreement, which must be presented to the Government within the same deadline, will determine the quantities of gas (within each company’s 12 tcf) subject to unification.

The two companies must also present to the Government, jointly, by May 2, 2015, the master production plan for the transboundary deposits, an implementation plan for the liquefaction plant detailing the construction, development and operation of the land facilities for areas 1 (one) and 4 (four), as well as the maritime facilities to be established for each of the coastal areas.

In the event no unification agreement is entered into within the established deadline, the Government shall appoint an independent expert to decide on this matter. This expert shall have 12 (twelve) months, as from the date of entry into force of this decree, i.e., up to December 2, 2015, to make a decision. In this context, each company shall submit its proposal to the expert.

The expert’s decision is final and binding. The implementation thereof shall be done through a unification agreement prepared by the expert. If

one of the companies calls the expert's decision into question, the Government reserves the right to approve any development plan proposed by the other concessionaire, as long as the gas to be exploited refers to the part of the deposit located within the boundaries of the company's concession area.

## Labor and Local Content

The Decree Law reasserts that priority should always be given to Mozambican worker if they possess the relevant qualifications. And companies are required to submit plans for training Mozambicans. Exemptions from existing labor laws have been provided allowing shifts of up to twelve hours (as opposed to the normal eight) and to suspend the normal obligatory days of rest. At the same time, the Decree Law eases restrictions on the hiring of foreign workers. The quota regime that normally applies under Mozambican law has been set aside for the Rovuma Basin projects and the number of foreign workers will be agreed on a "case-by-case" basis.

Greater clarity is also provided on the specific terms that will apply to local content obligations. It remains the case that "preference" must be given to goods and services provided by Mozambican companies where the costs are not more than 10% higher than imported goods and services. In most cases, procurement must be done through a public tender. Companies must submit "local content" plans and these must be updated every three years. The local content obligations however do not apply to contracts worth more than US\$25 million or to contracts that require special technology. Furthermore, the obligations do not apply in cases where the procurement of foreign goods and services may be tied to financing from export credit agencies (ECAs).

### What happens afterwards?

The Decree-Law is one important step towards companies making a Final Investment Decision to advance with the Rovuma LNG project. Companies have stated that they hope to get to a Final Investment Decision in late 2015, though industry analysts are already predicting that it will be 2016 at the earliest.

Following a successful investment decision, companies must submit their detailed development plan, prepared as per the terms of the exploration and production concession contract and the agreements to be established according to the decree-law, to the Ministry of Mineral Resources (MIREM), which shall then submit it to the Council of Ministers for approval.

The analysis and approval process may take up to 9 (nine) months, and during this time, if any irregularity is detected, the Government shall notify the company, which shall have 45 days to correct it, and once corrected, the Government shall have a month to inform the company of its final decision.

The Rovuma Basin project's duration is of 30 years, as from the date on which the respective development plan is approved by the Government.

The decree-law establishes the general terms of the contract to be signed between the Government and the company for the production of LNG.

It is important for both the companies and the Government to be flexible in the decision-making process, in order to guarantee that the construction works on the liquefaction plant begin as early as possible, so that Mozambique can begin exporting the LNG produced in the Rovuma Basin.

### (Endnotes)

<sup>1</sup> (Article 11.9)

# CIP

## Good Governance, Transparency

### FICHA TÉCNICA

**Director:** Adriano Nuvunga

**Coordenadora do Pilar:** Fátima Mimbire

**Pesquisadores do CIP:** Baltazar Fael; Borges Nhamire; Edson Cortez; Fátima Mimbire; Jorge Matine; Lázaro Mabunda; Nélia Nhacume ; Stélio Bila;

**Layout & Montagem:** Nelton Gemo

**Endereço:** Bairro da Coop, Rua B, Número 79,  
Maputo - Moçambique

### Contactos:

Fax: 00 258 21 41 66 25

Tel: 00 258 21 41 66 16

Cel: (+258) 82 301 6391

Caixa Postal: 3266

E-mail: [cip@cip.org.mz](mailto:cip@cip.org.mz)

Website: <http://www.cip.org.mz>

Parceiro  
de assuntos  
de género:



### Parceiros



Schweizerische Eidgenossenschaft  
Confédération suisse  
Confederazione Svizzera  
Confederaziun svizra

Swiss Agency for Development  
and Cooperation SDC



INTERNATIONAL BUDGET PARTNERSHIP  
Open Budgets. Transform Lives.



Koninkrijk der Nederlanden



Department for  
International  
Development



Education for development

DANIDA



ROYAL DANISH EMBASSY IN MAPUTO



PROGRAMA DE APOIO PARA UMA  
GERAÇÃO INCLUSIVA E RESPONSÁVEL



SUÉCIA



ROYAL NORWEGIAN EMBASSY