

## Unprecedented Legal Reform in the Extractive Sector: An Overview of the Five/Six Laws of 2014

Five new extractive sector laws have been passed by the Mozambican Parliament in 2014. A sixth is expected before the end of the year. This final law – to create a special regime for Rovuma LNG – is by far the most important. Given the scale of the proposed project, CIP believes that the negotiation of a Decree Law is inevitable. There remain serious risks, however, that the Decree Law will be flawed due to the private interests of political and government elites, unreasonable pressure for rapid agreement from Anadarko and ENI, and a complete lack of public discussion on the big issues that need to be addressed.

Legislative reforms in 2014 represent the most significant change to the legal regime governing the extractive sector in Mozambique's history. Five laws related to the sector have already been passed, and a sixth is expected before the end of the year.

Over the coming months, CIP will publish detailed analyses of each of these laws. There has however been considerable confusion in the Mozambican press as well as industry reports and about the relevance of these laws to existing and future extractive projects. In this short note we seek to provide an overview of these laws, focused explaining their purpose and scope and how they inter-relate.

### *I. Decree Law for Rovuma LNG Facilities*

The Exploration and Production Concession Contracts signed by Anadarko and ENI in 2006 govern the exploration, development and at least 25 years of production of Rovuma natural gas. These contracts did not anticipate the possibility

of natural gas exports though LNG. A new contract therefore must be negotiated to cover this part of the broader Rovuma project. The government decided that this new contract will have the status of a Decree Law in order to create exemptions from existing laws and regulations and to provide investors with greater confidence that the contract will not be subject to future renegotiation.

In August, Parliament gave legislative approval for the development of a “Special Regime pertaining to Natural Gas Liquefaction Projects in areas 1 and 4 in the Rovuma Basin.” The Government is now authorized to negotiate a contract for Rovuma LNG that will have the status of a Decree Law and will set “the juridical, regulatory, contractual and fiscal regime to be agreed upon, as well as establish the necessary incentives and safeguards for investors and financial providers, to be enforced during the life of the venture.”

Concerns have been raised about whether a Decree Law that provides exemptions from existing Mozambican laws and regulations is appropriate

## Overview of 2014 Extractive Sector Laws

Legislation	Replaces / Purpose	Scope / Applicability
<b>Rovuma LNG Laws</b>		
Decree Law Authorization	Authorizes Government to negotiate Special Regime for Rovuma Basin LNG	Anadarko and Eni's Rovuma Basin LNG project
Decree Law	Special Regime for Natural Gas Liquefaction Projects in Areas 1 and 4 of the Rovuma Basin.	Anadarko and Eni's Rovuma Basin LNG project
<b>Sector Laws</b>		
Mining Law (Law No. 20/2014)	Replaces Law 14/2002	Future mining contracts
Petroleum Law (Law No. 21/2014)	Replaces Law 3/2001	Future petroleum contracts
<b>Sector Fiscal Laws</b>		
Mining Fiscal Law	Law 11/2007 Law 13/2007	Covers Future Mining Contracts Imposes Capital Gains Tax for all Contracts Creates a Mining Resources Rent Tax
Petroleum Fiscal Law	Law 12/2007 Law 13/2007	Future Petroleum Contracts Imposes Capital Gains Tax for all Contracts Establish a 25% minimum share of natural gas produced to be channeled to the national market

– particularly given the reality of weak government institutions and profound conflicts of interest at the highest political levels.

CIP has become convinced that the passing of a Decree Law is necessary given the scale of the Rovuma LNG project. There are however grave risks that the deal currently being negotiated will be flawed due to the private interests of government officials and members of Frelimo, unreasonable pressure for rapid agreement from Anadarko and ENI, and a complete lack of public discussion on the big issues that need to be addressed.

*Fiscal Stability:* In a series of publications, CIP has drawn attention to the generous terms provided to companies in the 2006 Exploration

and Production Concession Contracts (EPCCs). All indications suggest that the fiscal terms in the EPCCs will remain in place. The fiscal terms that will govern the LNG facilities however are not yet known. It is already apparent, however, that there are tensions between the companies and the government on the time period over which the fiscal terms are “locked-in.” Companies were seeking a commitment of fiscal stability for 30 years; Parliament authorized the Government to grant fiscal stability for 10 years only.

Mozambique has painful experience (i.e. Sasol Pande Temane) with the costs of long-term stability arrangements that allow companies to claim the vast majority of profits irrespective of changing circumstances. Parliament should be

congratulated for demanding a balance between long-term fiscal stability and the opportunity to revisit fiscal terms if circumstances warrant.

*The Scope of Exemptions:* Parliament has provided the Government with the power to negotiate a Decree Law based on exemptions from existing national laws and regulations. The full scale of the exemptions allowed will only be known once the Decree Law has become public. The existence of parallel legislation – one set for the whole country and another for Rovuma LNG will undoubtedly cause confusion. Given the scale of the potential investment, however, this legal ambiguity is unavoidable.

Specific areas where exemptions are anticipated include the procurement of goods and services, the terms and conditions for financing, the extension of rights for land, coastal and maritime areas, and a special regime for labor. The Government also sought exemptions from specific laws including mega-projects, competition, civil construction, fuel prices, unitization and administrative procedures. In its final authorization, Parliament granted most of these but rejected others (i.e. civil construction and fuel prices).

*Unreasonable Deadlines from Companies:* Parliamentary authorization for the negotiation of the “Special Regime” is valid for 180 days. By all accounts, the negotiations are essentially complete. A fully developed draft has been circulating among industry representatives since early 2014 and the companies indicate that all major terms have been agreed.

Anadarko and ENI are pressing hard for the final Decree Law to be passed in 2014. The Decree Law is one of several inputs necessary before companies can move towards a Final Investment Decision to proceed with Rovuma LNG; decisions likely to be made in the second half of 2015.

Anadarko and ENI claim that timelines are exceedingly tight to secure investments in the first phase of Rovuma LNG due to competition from other potential LNG suppliers. At the same time, the companies speak confidently about the

expansion of LNG facilities over multiple phases. Pressurizing the negotiations plays to the advantage of the companies who have world-class LNG experts on their side of the negotiating table.

By all accounts, the volume of offshore natural gas combined with the competitive costs of extraction compared with competitors gives Mozambique some time to reflect. Undue delay benefits no one. At the same time, the Government should engage in a methodical process to ensure that the Decree Law best protects Mozambican interests, even if this takes a few additional months.

*Confidential Negotiations versus Transparency:* CIP believes that transparency and open public debate are an essential component of good governance. Obviously, given the complexities inherent in the Decree Law, the negotiations must be held behind closed doors. But there is no reason why the Government cannot publicly identify the main issues that will be covered by the Decree Law and the general approach that they are proposing to take.

The role of ENH in the project provides a good example. The 2006 EPCCs give ENH the right to 10-15% ownership in Rovuma LNG. The Government is on-record indicating that ENH plans to take up their full share of both the offshore gas project and the LNG facilities. Nothing public has been said however about how the Government proposes to fund this ownership stake when the share needs to be paid upfront, long before the government receives any revenue from LNG.

By all accounts, the vast majority of the terms for the Special Regime have already been agreed. CIP calls on the Government therefore to provide Mozambican citizens with details on the general approach for Rovuma LNG that will be contained in the forthcoming Decree Law.

## *II. Mining and Petroleum Law*

The laws that established the broad legal context for the rapid growth of the mining and

petroleum sectors were passed in the early 2000s (Petroleum Law No. 3/2001 and Mining Law No. 14/2002). In 2012 the Government decided to develop new laws and began circulating revised versions. The initial drafts proposed relatively modest changes. The final versions approved on 18 August 2014 contain extensive revisions and additions.

Institutional developments feature prominently in the new laws with the creation of the Alta Autoridade da Indústria Extractiva (High Authority for the Extractive Industry) responsible for both mining and petroleum and the Instituto Nacional de Minas (National Mining Institute) established to oversee mining activity. For Petroleum, the role of INP as the regulator for the sector is reconfirmed, while the role of ENH as a commercial partner in all aspects of the sector is further extended and 25% of production in future contracts will be reserved for the domestic market.

Increasing benefits for Mozambicans is another key theme running through the two laws including: strengthened requirements for local content, a new requirement for association with Mozambican entities to compete in public tenders and an obligation for foreign companies to register on the Mozambique Stock Exchange. The existing requirement to channel an undefined percentage of revenues back to local communities is maintained; while a new requirement for companies to negotiate a “memorandum of understanding” with local communities has been added.

Importantly, the new laws will govern all future contracts in the mining and petroleum sector. The terms of existing contracts however are retained for the full lifespan of the original agreements.

Further legal developments are also anticipated as many of the specifics will be contained in the supporting regulations. According to the laws, these associated “Decrees” must be published within 60 days for petroleum and 120 days for mining.

## *II. Mining and Petroleum Fiscal Laws*

In the past, the fiscal terms for mining and petroleum projects were spread between the specific contract with the company and a series of sector specific and more general national laws and decrees. The two new fiscal laws are designed to consolidate all relevant fiscal terms and will come into effect on 1 January 2015.

The laws are not only a consolidation of existing provisions. They also set new terms that will govern future contracts. Assessing the potential impact of these changes requires a comprehensive review of the two fiscal laws, to be published by CIP in the coming months. The discussion below highlights a few selected issues only.

The changes are most significant for the mining sector, though even here the final version of the law is closer to the previous law than some of the circulated drafts. Proposals for significant increases in royalty rates (production tax) were withdrawn with the final rates remaining quite close to the post-2007 terms. The corporate income tax rate remains at 32%. The main change in fiscal terms is the introduction of a resource rent tax (IRRM) designed to capture a greater share of when company profits are high. Here again the approved law is more cautious than some of the earlier proposals. The IRRM will kick in when company internal rate of return exceeds 18% and the tax itself is set at 20% - rates that compare well with peer countries.

There are fewer changes to the petroleum fiscal regime compared with the 2007 fiscal laws and the model contract released for the 2008 licensing round. The royalty rates remain the same at 10% for oil and 6% for natural gas. As with the mining law, the corporate income tax rate of 32% is retained. Previously biddable elements are now set in law. This includes a 60% cost recovery limit as well as the government share of profit gas (15% at  $R < 1$  up to 60% at  $R > 2.5$ )

Once again the principal focus of these new fiscal laws is on future developments in the mining

and petroleum sectors. The contractual terms for existing projects remain unchanged, with one important exception. As CIP has analyzed in detail, the Government has been highly inconsistent in its taxation on capital gains when rights to petroleum and mining assets have been transferred. Effective January 2014, a 32% tax was imposed on capital gains through the newly revised IRPC. As these two fiscal laws now replace the IRPC for extractive sector projects, the 32% capital gains tax has been reconfirmed as is applicable to all companies, including those with existing contracts.

## FICHA TÉCNICA

**Director:** Adriano Nuvunga

**Equipa Técnica do CIP:** Baltazar Fael; Fátima Mimbire; Lázaro Mabunda; Borges Nhamire; Stélio Bila; Edson Cortez; Jorge Matine; Ben Hur Cavelane; Teles Ribeiro; Nélia Nhacume

**Layout & Montagem:** Nelton Gemo

**Endereço:** Rua Frente de Libertação de Moçambique (ex-Pereira do Lago), 354 r/c, Maputo - Moçambique

### Contactos:

Tel.: (+258) 21 492 335

Fax: (+258) 21 492340

Cel: (+258) 82 301 6391

Caixa Postal: 3266

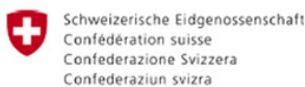
E-mail: [cip@cip.org.mz](mailto:cip@cip.org.mz)

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.



Department for  
International  
Development



Education for development



PROGRAMA DE APOIO PARA UMA  
GOVERNACÃO INCLUSIVA E RESPONSÁVEL



SUÉCIA



ROYAL NORWEGIAN EMBASSY

ROYAL DANISH EMBASSY IN MAPUTO