

Monthly Focus

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Frontier Opportunities in West Africa

Frontier plays in Africa were under the spotlight in the second half of the 2000s and early 2010s, in the aftermath of the Jubilee discovery. Several billion US dollars in drilling operations were spent in the process. The recent steep fall of oil prices has imprinted scathing marks in the petroleum industry worldwide, Africa having been particularly hit. Its high risk frontier plays have been some what off the table as a result. With a rebound in oil prices now on the cards for the medium term, the question one should perhaps be asking is when, and if so where, will Africa's frontier plays climb again to the wave crest as the wheel keeps on turning and it will surely happen at some point.

Most African oil producing countries have been struggling in this low oil price market. Competition to attract investment has become fierce and one could easily say we are living in an investor's market. Opportunities could be out there for the taking. True that adding high risk high reward assets to a portfolio is never an easy task. Still, if there was a time to consider it in the last few years perhaps this is it. No doubt out of consideration if uncertain settings (politically, socially, economically, or financially speaking) are not an option, a pause might be worth it now for those who could bear the risk. For opportunities will fade away once first movers are successful in their endeavors.

In different degrees, the four countries we look into here – Senegal, Guinea-Bissau, Côte d'Ivoire, and São Tomé e Príncipe (STP) – could offer interesting frontier plays, depending on how one weighs the risk/reward equation. All four countries have a prospective basin (albeit with different degrees of prospectivity) and are to one extent or another frontier plays. Differences exist also in respect of the socio-economic development, political history, basic infrastructure, legal setting, and last but not least geological structure. Distinct as these plays may be from a risk/reward perspective, they have in common the fact that they offer West Africa frontier opportunities which, after a discouraging period of hibernation for investors, might make those more adventurous tempted to step out into the wild.

The fact that governments in these countries may hold different knowledge and capacity on how to deal with a nascent petroleum industry and the challenges it brings along should not be taken as a decisive vote against investment. For in these circumstances there is always room to help shaping interactions with public institutions and the very development of the whole local petroleum industry, from licensing to production, or from legal controls to revenue management. This is in and of itself part of the opportunity. What we have attempted here is to provide a terse overview from various angles of these four frontier plays, focusing in broad strokes on its most relevant aspects.



Senegal

In spite of a recognized hydrocarbon potential onshore and offshore, a couple of years ago few would point to Senegal as a choice for investments in the petroleum sector. Exploration commenced in the 1950s, when a program conducted by the then *Bureau de Recherches Pétrolières* showed the first signs of hydrocarbons. Over six decades several IOCs (e.g. Exxon, Shell, Tullow) carried out exploration activities in the country's basin to no avail. Many of them fled the country at the end of their contracts. No significant discovery was made.

All of that changed in 2014 when UK-listed Cairn Energy made two discoveries offshore Senegal, one of which might be the largest global deep water oil discovery for that year. In Senegal since 2013, the Edinburgh-based Cairn currently operates three blocks – Sangomar Deep, Sangomar Offshore, and Rufisque Offshore – that cover approximately 7,500 sq km and holds a 40% stake in a JV that includes ConocoPhillips (35%), First Australian Resources (15%), and the national oil company Petrosen (10%). Cairn and its partners have reportedly completed four other successful appraisal and exploration wells in the SNE area in the first half of 2016. Having drawn the attention of the industry worldwide, this lured other players. Australian Woodside entered into a binding agreement with ConocoPhillips for acquisition, subject to approval by the Senegalese government, of all its interests in the three offshore blocks operated by Cairn. Closing is targeted for the end of 2016. In early 2016, Dallas-based Kosmos Energy, its partners including Timis Corp. Ltd. (30%) and Petrosen (10%), also announced that their Guembeul-1 and Teranga-1 exploration wells, both offshore, had resulted in significant gas discoveries.

Such auspicious findings by independents might become a game-changer for Senegal's hydrocarbons sector. Despite the currently low oil prices, Senegal is already being viewed as a highly prospective



emerging producer, now ranking as one of Africa's hotspots for exploration. With untapped resource opportunities yet to be fully determined, Senegal does combine both a politically stable environment (unlike some of its neighboring countries) and an

investor-friendly regulatory framework. Signs that transparency and sound governance are at the center of the Senegalese government's concerns seem to be encouraging for the industry.

On the legal front, the 1998 Petroleum Code was designed to attract investment, notably by improving on the customs and fiscal benefits provided in the former code. Exemptions from taxes, duties and fees during exploration and development phases, and reduction of the royalty rates levied on crude oil production (2% up to 10%) and on natural gas production (2% up to 6%), are some of the measures implemented as sweeteners for investors. A major tax reform in 2012 led to the new Tax Code, which repealed the tax provisions contained in the Petroleum Code and became the sole repository of the tax regime applicable to the sector. A grandfathering provision ensures the stability of the tax regime by allowing taxpayers entitled to the benefits provided in the Petroleum Code to remain subject to the legal framework in force at the time of execution of the contracts for their entire duration. Bonuses are not provided for.

Guinea Bissau

Across the border to the south, Guinea-Bissau is for some an unpolished gem. Economic potential spreads to mineral, agricultural, and hydric resources. Political unrest, however, has dragged the country into all sorts of difficulties. Full-force economic development has been postponed time and time again. Still, the hydrocarbons sector has had significantly more activity than the remainder of the economic sectors, although Guinea-Bissau cannot boast any decisive discoveries.

The hydrocarbons sector has been gaining momentum, nevertheless. Since the early 2010s it was identified by the Guinea-Bissau government as an area to prioritize investment in. Authorities are fully convinced



of the hydrocarbon potential in the country. Officials, including at the national oil company Petroguin, have been active in boosting the country's visibility before foreign investors. Presence in regional and international

conferences on the petroleum sector, to promote the offshore potential, has been a constant. Recent developments seem to indicate that efforts might pay off.

While majors (e.g. Exxon, Elf, Shell) have in past decades showed interest for the country's potential, players over recent years have been essentially independents (e.g. Premier Oil, Svenska, Supernova, First Australian Resources, CAP Energy, Kesnad Oil, Larsen, and Blackstar). While some drilling has taken place, most work has been focusing primarily on seismic, both 2D and 3D. Some of the surveys led to high expectations in relation to the prospectivity of the Guinea-Bissau offshore areas. Various offshore blocks have been involved, including for example Blocks 1 and 5B (CAP Energy), Blocks 2 and 4A/5A (Svenska), Block 3 (Kesnad Oil), and Block 7B (Supernova). Drilling work is currently expected for 2017 or 2018, but much still depends on various factors, most notably financing conditions.

The successful deep-water exploration off neighboring Senegal's coast, which in essence constitutes the same geological basin on which Guinea-Bissau sits, has provided additional reasons for optimism. Further encouragement stems from Woodside's recent move to acquire a significant interest in the Senegalese AGC Profond Block, located in the area of the Senegal-Guinea Bissau joint development zone. A discovery in areas closer to Guinea-Bissau could thus trigger further interest in exploration drilling.

The legal framework in Guinea-Bissau is rather recent. A new Petroleum Law was enacted in 2014, extensively reviewing the outdated 1982 law. While key ancillary statutes are still to be put in place, this does not constitute a major hurdle. One of the legal innovations is a retention period of up to three years if exploration results in a discovery that is not immediately commercial. In relation to licenses or concessions, they must still be awarded under terms of association with the national oil company Petroguin, whose interest must be no less than 10%. The tax framework is more challenging. There is currently some lack of clarity on the applicable statutes. While this could pose some difficulties, they do not seem insurmountable. Knowledge of the overall legal framework might be required, however.

Côte d'Ivoire

Dubbed the "rising star" in West Africa, abutting to the Gulf of Guinea, Côte d'Ivoire has been quickly moving up the ladder of countries into which investors flock hoping to secure key positions across the various sectors. After years of civil war and political crisis, the country now seems to have turned for good a sad page of its history. Once a stagnated economy, while some neighboring countries thrived, Côte d'Ivoire seems to finally have reclaimed its optimism. Recent peaceful presidential elections filled the country with a renewed sense of confidence in its economic growth, leveraged by investment in infrastructure and in the energy sector. It is noteworthy that Côte d'Ivoire boasts the second largest port in sub-Saharan Africa, as well as a stable communications network. The Ivorian power grid is considered today one of Africa's most reliable, allowing it to export electricity to adjacent regions.

Chief among the various economic sectors to which attention has been drawn is the petroleum sector. With production around 50,000 barrels per day, and with plans to double production by 2020, the country

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could soon become a significant producer in West Africa. Foreign investment in offshore exploration has been promoted, with the national oil company Petroci at the heart of it. In October 2014, during a road show hosted in

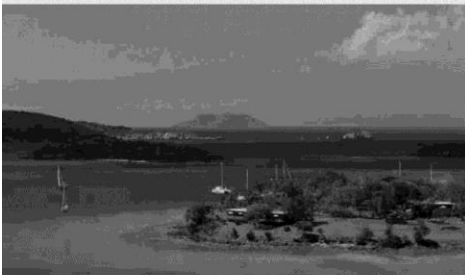
Houston, it was announced that of the nearly 60 blocks under Ivorian jurisdiction, 20 had already been awarded. These campaigns have been met with interest from the industry at large. Not even a maritime boundary dispute with neighboring Ghana diminished the pace of development.

Besides undeniable potential resources, Côte d'Ivoire can also attribute much of its recent success in bringing in investment to a reasonably friendly regulatory framework. In 2012, the government approved a new Investment Code, designed to attract private capital through certain tax exemptions, and currently upholds a no-difference treatment between national and foreign investors. A Center for the Promotion of Investments was set-up, aimed at de-bureaucratizing many of the once onerous procedures and requirements investors had to comply with.

The Petroleum Code is also investor-friendly. It allows for petroleum operations to be carried out under concession contracts, PSCs or other types of contracts. From a practical standpoint, only PSCs have been used to date. Although a model PSC is not imposed by law, and the contractual terms and provisions can be negotiated, the government has relied on a standardized PSC model version. Tax terms and local content rules are also generally acceptable to foreign investors, starting with a rate of income tax at 25%. Exemption from certain general taxes (e.g. VAT, tax on banking operations) is offered. The PSC sets royalty and bonuses terms, which are negotiable to some extent. Foreign companies are only required to give preference to local sub-contractors on equal conditions, and to date no statutory minimums when hiring workers of Ivorian nationality have been set.

São Tomé and Príncipe

Standing in the middle of the Gulf of Guinea, the tiny islands of STP belong to a province where numerous discoveries were made over the years. Its neighbors include some




of Africa's largest producers, such as Nigeria, Equatorial Guinea and Gabon. After decades of numerous unsuccessful attempts to initiate exploration activities, work finally got underway in the early 2000s. Results have not been as

desired. While shows of petroleum have been found, no commercial discoveries occurred, either in the areas under STP exclusive jurisdiction, or in the joint-development zone with Nigeria. Recent new approaches to geological interpretation are apparently being attempted and could lead to a renewed interest in the area.

Some big names (e.g. Chevron, ExxonMobil, Total) have been involved in exploration in the region, specifically in the joint-development zone with Nigeria. Among smaller players, ERHC was very active with a presence in six blocks. Other interested companies over the years have included Oranto Petroleum, Addax, Afren, Equator and, more recently, Kosmos Energy and Galp Energia. Recent M&A transactions could be signs of a reemerging attention to STP areas. Galp Energia and Kosmos Energy are now in Block 6, and Equator and Kosmos Energy are in Blocks 5 and 12. Drilling work is expected in the next few years. Onshore drilling, also, could shed new light on the geology of the islands around them and bring valuable contributions for offshore exploration. The onshore prospecting permit granted in 2014 to São Tomé America Petroleum Corporation (STAPET) has also raised expectations. Various aspects, notably environmental concerns, could nevertheless hamper future drilling activities in the islands.

The legal framework of STP is somewhat developed. In addition to a Framework Law on Petroleum Operations (2009) and a Law on Taxation of Petroleum Operations (2009), there is also a Law on Petroleum Revenues Management (2004). Some of the fiscal terms offered to investing companies are appealing: income tax rate of 30%; 5% royalty or less, depending on PSC terms; exemption from tax on dividends; and customs duties exemption.

Concluding Remarks

Frontier opportunities are not always characterized in the same way. This is what happens with the four countries we looked into. While one is already an oil producer (Côte d'Ivoire), exploration in unknown areas and the uncertainty involved still render it a frontier play. Of the other three, Senegal is already in a different category, given the size and quality of recent discoveries. Truer frontier plays are Guinea-Bissau and STP, where no major discoveries have yet been made. What all four countries have in common are opportunities with a high risk, high reward equation. The fact that M&A activity concerning petroleum blocks in such countries has had a recent surge is a token of it. In times of low oil prices, exploration opportunities can come perhaps cheaper than they would otherwise do, states being typically open to accommodate less onerous terms. All will ultimately boil down to the ability to navigate riskier frontier waters, not only from a technical standpoint but also from a legal angle. Expert maneuvering could be decisive in managing risk in the most efficient manner, with a view to reaping the rewards on offer in these opportunities. 

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