

Angola's Petroleum Regulatory Reform - The Dawn of a New Age?

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Over the last two decades Angola has slowly but persistently climbed in importance on the oil & gas playing field, recently rising to the rank of Africa's top crude oil producer, albeit on the back of Nigeria's struggle with militant attacks which have led to a sudden and dramatic drop in production.

In spite of this evolution, and of the amazing discoveries made in Angola in recent times, the country has been rocked (like many other African producers) by the drop in crude oil prices, which has led the IOCs that have traditionally been active in the Angolan market to question the economic viability of maintaining production in today's market. High production costs, linked to both technical factors (such as average water depth, pre-salt challenges, etc.) and to regulatory aspects (higher costs brought about by strict local content and other requirements) have led boards the world over to question the long-term interest in this previously highly attractive province.

Although initially not directly related to this "new paradigm", the Angolan Executive has been making public its intention to rethink and restructure the country's petroleum sector regulatory model for a number of years. The sharp drop in oil prices since mid-2014, together with the global financial crisis, as well as other endogenous factors have turned this intention into an urgent priority, and new steps towards the envisioned reform have recently seen the light of day.

The creation of a commission responsible for the reorganization of the petroleum sector last October¹, whose goal was to draw up an integrated strategy and organizational model capable of fostering efficiency in the petroleum sector, so as to mitigate the impact of oil prices on the economy was seen as the beginning of a new era in the Angolan petroleum history.

Since then, statutes directly or indirectly related to the petroleum reform have been published, while others are expected to be published in the near future. These new rules appear to be aimed at achieving two crucial, albeit different, goals: on the one hand addressing petroleum sector organizational issues; while on the other improving exploration

and production terms and conditions to make Angola a more attractive oil province in these difficult times.

1. Petroleum Sector Organization

Restructuring of the petroleum sector

The Angolan petroleum sector has been faced with organizational issues for some time which, in certain cases, has led to concerns about the transparency of the regime. While the Ministry of Petroleum has always been the body of the Government responsible for coordinating and supervising petroleum matters, the National Oil Company, Sonangol E.P., has to-date had a major regulatory role. Although, *per se*, this would not give rise to major issues, the truth is that over time Sonangol developed a series of parallel activities (from provision of oilfield goods and services to aviation, insurance, telecoms and banking investments, just to name a few) which were seen by some industry players as capable of giving rise to conflict of interest situations.

In order to deal with this matter the Angolan Executive recently enacted Presidential Decree No. 109/16, of 26 May 2016, which approved the Model for Readjustment of the Petroleum Sector's Organization ("Reorganization Model").

In line with the best international practices (adapted to Angolan reality, virtues and challenges), the new Reorganization Model aims to increase efficiency and promote the sustainable management of petroleum resources and transparency in the sector, with a view to developing and diversifying the Angolan economy. Based on the principles of stability, minimum intervention, transparency and careful management of public resources, the ongoing reform will not affect contracts and other commitments previously undertaken by the Angolan State and Sonangol towards both national and foreign investors, and which are expected to be grandfathered.

According to the information available to-date, the new petroleum organizational framework basically entails: (i)

¹ By means of Presidential Order No. 86/15, of 26 October 2015.

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maintaining Sonangol's role as the National Concessionaire, (ii) the creation of an Agency for the Petroleum Sector ("Agency"), (iii) the creation of the High Council for Monitoring the Petroleum Sector ("High Council"), (iv) maintaining the Ministry of Petroleum's regulatory powers and authority, and (v) maintaining the Ministry of Finance, the Ministry of the Environment and the Ministry of Public Administration, Labor and Social Security as supervising Ministries for sectorial matters.

By remaining the exclusive National Concessionaire for the sector and, as such, responsible for managing and monitoring petroleum contracts, Sonangol will hereafter refrain from intervening or engaging in other activities, whether in exploration, production or operation of oil blocks, and in the oilfield goods and services sector. This will, in principle, add credibility and transparency to the sector, including to the tendering for goods and services.

In turn, the Agency shall be responsible for *inter alia* coordinating, regulating and evaluating the performance of the sector, preparing and negotiating the granting of oil blocks (including licensing rounds), and resolving, by administrative means, conflicts arising between the supervising Ministries and the various industry stakeholders.

This splitting of powers between Sonangol and the Agency did not come as a surprise. In fact, at the time of publication of the National Energy Security Policy and Strategy ("NESPS") back in 2011², one of the priorities of the Angolan Executive was to assess the possibility of establishing a transition period for the development of a new regulatory regime for upstream concessions. The NESPS also determined that operations in the upstream sector would remain open to IOCs, and Sonangol would continue to be the entity responsible for the management of the concessions. The General Strategic Framework for Exploration of Angola's Pre-salt Play³ also envisioned the creation of an independent regulatory entity for the subsector. This role appears to have now been entrusted to the Agency.

As for the High Council, it will be responsible for issuing opinions on multiannual plans for the oil sector, approving investments with a high value and strategic importance, and monitoring the execution of the investment plans. The High Council will also be responsible for assisting the Angolan State in the exercise of its shareholder rights in different companies. This means that it will be entrusted with managing the equity interests the Angolan State holds in several holdings active throughout the oil & gas value chain previously held by Sonangol⁴. Currently it is not clear whether the High Council will directly manage the equity interests of the State, or whether a different company will be entrusted with this task, in which case the High Council would occupy a monitoring and

advisory role.

As regards the role of the Ministries, it appears that their functions and duties will probably need to be adjusted to ensure the required cooperation and coordination with the Agency's functions. However, there is still no guidance whatsoever on the exact adjustments to be made.

In turn, the President of the Angolan Republic, as the Head of the Executive Power, is expected to remain the highest supervising body of the sector, monitoring the activity of the Agency, the Ministry of Petroleum, the High Council and other public entities with authority in the petroleum sector.

Amendment of Sonangol's by-laws

Another recent change that is aimed at bringing efficiency and transparency to the sector is the amendment of Sonangol's by-laws.

Since 1978, Sonangol has been the National Oil Company and the National Concessionaire for the petroleum sector, with supervisory, commercial and *ius imperii* powers. Sonangol's corporate object is the prospecting, exploration, production, transportation, marketing, refining and processing of liquid and gaseous hydrocarbons and related products, including petrochemical activities.

In its capacity of sole concessionaire, over the years Sonangol entered into agreements with foreign companies to carry out petroleum operations (Production Sharing Agreements, Association Contracts, Risk Services Agreements), and foreign companies were only allowed to carry out petroleum operations provided they associated with Sonangol under one of the forms foreseen in the Petroleum Activities Law. Under the existing petroleum contracts and legal framework, Sonangol was given wide supervisory powers and responsibilities, covering all aspects of operations, including in respect of the approval of recoverable costs. Sonangol also plays an active role in the procurement of oilfield goods and services by IOCs.

Sonangol also holds a stake in Angolan blocks (typically 20%, although it has sometimes been higher for various reasons) through its subsidiary and upstream arm "Sonangol P&P". Part of Sonangol P&P's costs are normally carried by the IOCs through the exploration and sometimes development phases, and may typically be recovered from Sonangol's share of cost oil⁵.

Also, in the majority of the petroleum contracts, Sonangol has been to-date responsible for collecting the National Concessionaire's share of profit oil, being also responsible for receiving all bonuses paid under petroleum contracts (e.g. signature bonuses, social contributions, production bonuses, etc.)⁶. One of the most important aspects to be determined in

² Presidential Decree No. 256/11, of 29 September 2011.

³ Presidential Decree No. 243/11, of 7 September 2011.

⁴ For historical reasons, alongside its E&P business, Sonangol's endeavors currently involve other areas such as corporate and finance, distribution and non-core businesses. These ventures include MStelecom for telecommunications services, SonAir for air transportation services, Sonip for real estate, various oilfield goods and services JVs, and participating interests in numerous other companies operating in Angola and abroad.

⁵ Angolan petroleum companies are currently exempt from carrying Sonangol P&P as the result of a 2012 legislative amendment.

⁶ Although these amounts should, by law, subsequently be deposited in the National Treasury account.

the ongoing reform is exactly whether this will remain the practice, or if there will be any changes in this respect.

The refocusing of Sonangol on its role as the National Concessionaire, and the new Agency taking over part of the former's "traditional powers" has entailed the amendment to Sonangol's by-laws⁷. This amendment reflects a change in the company's governance structure, which now includes an Executive Committee made up of members of the company's Board of Directors. Henceforth Sonangol's Board of Directors will comprise up to 11 members, 7 being executive members (one of them the CEO). A new board was recently appointed in accordance with the revised by-laws in early June, including executive and non-executive directors⁸, and having been entrusted with bringing added efficiency and transparency to the sector.

It is still not clear whether Sonangol's by-laws will have to be further amended to reflect other changes in the organizational structure (for instance, in respect of its corporate purpose).

Insurance

The petroleum reform also touched the insurance sector (another area where Sonangol has played a traditional role) with the State-owned insurance company ENSA Seguros de Angola, S.A. ("ENSA") being appointed, on a provisional basis, as leader of the special co-insurance regime for petroleum activities⁹. This transfer of leadership to ENSA entails the transfer of all assets held as collateral for the performance of the obligations now assigned.

The new rules exclude non-petroleum related insurance taken out by petroleum sector companies from their scope of application, and set forth that all insurance policies as well as re-insurance agreements in force on the date of publication of this statute remain in place.

Additionally, within 6 months, the Angolan Regulatory and Supervising Agency for the Insurance Sector ("*Agência Angolana de Regulação e Supervisão de Seguros*") is to prepare an in-depth review of the new co-insurance and reinsurance model for petroleum activities conducted in Angola, which means that additional news are expected on this front in the coming months.

2. Upstream terms and conditions

Another area of crucial importance to the Angolan oil sector is the revision of the upstream terms and conditions so as to make the country more attractive in the low oil price environment. Over recent months, and taking into

consideration feedback received from IOCs and other stakeholders, various reforms have been prepared that are capable of solving some of the issues that companies in Angola have faced over time.

Development areas

Last December, the President of the Republic enacted special rules¹⁰ applicable to oil and gas exploration activities carried out inside existing development areas, so as to allow for the discovery of additional resources within an existing concession. Aimed at maximizing production levels in existing development areas, the new rules include specific percentages and special time-frames for cost recovery of exploration expenses incurred prior to a commercial discovery.

Under the new rules, in case of a commercial discovery, 50% of the costs incurred in connection with petroleum activities leading to the discovery of petroleum deposits and resulting from exploration activities within the development area (exploration costs) shall be recovered within 6 years as from the year following the submission of the General Development Plan. The remaining 50% of such costs shall be recovered within 6 years as from the year following the commencement of production.

Although this statute only currently applies to the development areas in Blocks 14 and 17 expressly identified therein it also foresees the possibility of other development areas (including from other Blocks) being subject to these rules, following Ministry of Petroleum approval.

Marginal fields

Another area of concern that has been on the radar for quite some time is the approval of special rules capable of providing incentives for the development of marginal fields to motivate E&P companies to develop such discoveries.

Following an authorization by the National Assembly¹¹, the President of the Republic recently enacted a statute on the procedures and incentives for the adjustment of contractual and fiscal terms applicable to concessions including marginal discoveries¹².

Many petroleum companies have made marginal discoveries over the years in Angola, whose development with the existing contractual and fiscal terms has proven to not be economically efficient or viable. Prior to the enactment of the new rules, the existing legal framework, together with the use of the most recent technology was not sufficient to make these discoveries attractive to investors. In view of the foregoing, the incentives for the development of marginal discoveries will aim

⁷ Presidential Decree No. 110/16, of 26 May 2016.

⁸ Presidential Decree No. 120/16, of 3 June 2016. <http://www.bloomberg.com/news/articles/2016-06-02/angola-president-appoints-daughter-as-head-of-state-run-oil-firm>.

⁹ Presidential Order No. 39/16, of 30 March 2016.

¹⁰ Presidential Decree No. 211/15, of 2 December 2015.

¹¹ Law No. 4/16, of 17 May 2016.

¹² Presidential Legislative Decree No. 2/16, of 13 June 2016.

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to ensure adjustment of each relevant concession's contractual and fiscal terms, and promote investment by E&P companies in marginal fields. The Angolan State expects that these changes will lead to the tapping of significant resources that have traditionally been left in the ground due to the lack of flexibility of the legal and contractual model for upstream activities.

Under this statute, "marginal discoveries" occur where one or more deposits (even if jointly developed) present at any given moment reduced profitability that does not warrant a declaration of commercial discovery by the National Concessionaire and its associates, considering the existing legal and tax framework. Moreover, the new statute also sets forth the following indicators, based on which a discovery could be deemed marginal (i) reserves under 300 million barrels, (ii) water depth in excess of 800 meters, (iii) revenues for the State of less than USD 10.5/barrel, (iv) revenues for the National Concessionaire's associates of less than USD 21/barrel, and (v) an Internal Rate of Return substantially lower than 10%. In the absence of (at least some) these indicators investors who made the discovery will not be able to benefit from the special incentives. This gives the contractor groups in Angolan oil Blocks certainty as to when they could declare a marginal discovery and, as a result, benefit from the special economic incentives, as is the case in other oil-producing countries.

In terms of procedure, the Ministry of Petroleum is responsible for deciding whether a discovery should be considered marginal, as well as on the exact incentives to be granted, subject to a proposal from Sonangol.

The incentives granted are progressive in accordance with the inclusion of new marginal discoveries in certain areas.

In respect of fiscal incentives, (i) the rates for Petroleum Production Tax and Petroleum Income Tax ("PIT"), and the percentage of Investment Allowance for PIT purposes and of Production Bonus, are to be determined by reference to the volume of recoverable resources, (ii) the amortization period for capital expenditures varies between 2 and 4 years, depending on the volume of recoverable resources, (iii) the assessment of PIT only becomes required as of the 3rd, 4th or 5th year of amortization of capital expenditures, at percentages depending on the volume of recoverable resources, (iv) the period for recovery of development expenses will be determined between 2 and 4 years, based on the volume of recoverable resources, and (v) a full exemption of customs charges and duties on petroleum exports is to be granted for a 5-year period from commencement of commercial production.

The new rules shall apply to marginal discoveries in petroleum contracts in force, as from the financial year commencing after such publication.

The industry has patiently been waiting for the Angolan petroleum sector reform to increase the attractiveness of the sector, particularly in the current low oil price environment, and

has shown openness to cooperate with the authorities in making the reform as smooth as possible for all stakeholders involved.

However, the decision on whether to continue to invest in the Angolan oil sector, or to pack up bags and seek new opportunities elsewhere will ultimately depend on the exact implementation of the reform, and the benefits (notably contractual and economic) that are made available to investors. One area where companies will be keen to see if and how the new changes affect their activities is the interaction between the different decision makers that will henceforth be involved in managing the oil sector. Irrespective of its perceived flaws, the prior system had the advantage of having Sonangol as the main point of contact for the oil companies. Although response time was not always as swift as the IOCs would like, Sonangol always came across as a highly professional organization, with whom the companies could liaise and negotiate. It will also be important to determine if the existing statutes governing the sector, such as the Petroleum Activities Law, the Petroleum Customs Law, the Petroleum Tax Law and the Petroleum Operations Regulations will be amended to be aligned with the new regulatory model (which is highly probable) and, if so, to what extent. Companies value efficiency, but they also highly value stability. Major changes that may hinder operations will most likely raise issues.

Finally, another area of the utmost importance for companies is the definition of clear and transparent rules for the development of gas reserves. The Angolan State's interest in developing the country's natural gas resources should make this the next priority on the list, with various IOCs that have recently made gas discoveries waiting anxiously for the developments. The fact that the government sees natural gas development as a possible driver for the national economy is obvious, with Sonangol being recently awarded direct concessions (some exclusively for gas) to carry out prospecting, exploration, development and production works in gas fields on its own (i.e., without entering into associations with IOCs). This appears to be confirmed by the strategic guidelines to overcome the existing crisis resulting from the oil price drop in the international market¹³, according to which the President of the Republic intends to promote the implementation of renewable power and gas-to-power projects. However, the IOCs that made these discoveries would, in many cases, most likely be interested in being given the opportunity to review these projects and decide whether or not they wish to participate in them.

Angola's petroleum reform is well under way and certainly indicates a major overhaul in the not-so-distant future. These changes will have a direct implication on several areas of the country's economy and business sectors, ranging from the oil industry to the insurance sector and possibly industry and electrical power. These changes also present an opportunity for the Executive to refocus the Angolan economy, making it less dependent on the oil sector. Whatever the path that is followed, however, oil companies will continue to be important pieces of the engine in the years to come.

¹³ Presidential Decree No. 40/16, of 24 February 2016.