

Oil and Gas in Mozambique: Upstream and Midstream



Manuel Santos
Vítor

msv@plmj.pt



Ana Oliveira
Rocha

aor@plmj.pt

PLMJ

SOCIEDADE DE ADVOGADOS



Jorge Graça

jgraca@mga.co.mz



Taciana Peão
Lopes

tpealopes@mga.co.mz



I- Overview: Discoveries and Policies of Economic Sustainability

The first discovery of natural gas in Mozambique goes back to 1961, in Pande. This was followed by the discovery of the Buzi and Temane fields. These discoveries were declared as not commercial, a number of projects having been studied up till the year 2000 when the well-known South African company, Sasol made a commitment over 25 years to buy 120 million GJ¹/a of natural gas for its own consumption and commercialisation in South Africa. This commitment meant that it became viable to produce natural gas from the Pande (2008) and Temane (2004) fields and to build an 865 km gas pipeline between Temane - in Inhambane Province - and Secunda in South Africa. This enabled Mozambique to become Southern Africa's biggest producer and exporter of natural gas.

According to the data provided in the Strategic Plan for the Development of the Natural Gas Market in Mozambique published on 2 November 2009, the value of the natural gas proven reserves in Pande and Temane, is 3.59 TCF² and the probable reserves amount to 4.63 TCF (in the same fields). In the meantime, other discoveries with probable reserves have

also been made in the Buzi and Inhassoro fields and in the areas around the Pande and Temane fields. The discoveries made in offshore blocks 16 and 19, located to the north west of the bay of Bazaruto, are still being evaluated.

The Strategic Plan for the Concession of Areas for Petroleum Operations published on 8 June 2009 states that the sedimentary basins in Mozambique have areas with great potential for the occurrence of oil. The Mozambique basin which is 300 000 km², has a density of around one well per 8 000 km² onshore and one well per 17 000 km² offshore, while the Rovuma basin, which is 60 000 km² has a density of one well per 17 000 km² onshore and none offshore.

Mozambique's great potential is still to be exploited and one of the foundations of the country's energy sector strategy is to incite investment in projects of exploration, appraisal and production of hydrocarbons. This will help to keep on lowering poverty levels in the country specifically through the creation of infrastructures for the supply of energy to population centres and also by seeking to develop the country's refining industry. In this way it will be possible to avoid the high levels of fuel imports which, as has been seen, have a negative effect on the country's trade balance. Mozambique's actions seek to diversify the energy system and the implementation of many other strategic measures will help in meeting

¹ Giga joules

² Trillion Cubic Feet



INTERNATIONAL JOINT VENTURES

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the objectives of the Southern African Development Community (SADC), of which it forms part.

So it is clear that the State intends to escape the "natural resources curse", also known in economic terms as the "Dutch Disease" – a problem which results from the growing dependence of the economy on one single activity, usually related to natural resources, because this activity is more profitable and has a lower cost, but leads to a failure to invest in the other areas.

The Mozambican State is encouraging the race for its natural resources while, at the same time, imposing sustainability through contributions from investors and market agents from the various economic sectors, from tourism to infrastructures, passing through the energy components used in industry. Within this policy, the Mozambican State awards preferential rights to Mozambican legal entities and foreign legal entities with Mozambican associates.

Below, we move on to a summary description of the procedures and requirements for access to the oil and gas sectors, taking into account the widening of the existing applicable legislation.

II – Holders, Activities and Procedures

Law no. 3/2001 of 21 February applies to petroleum operations which are defined by the exclusion of oil refining processes, industrial use and distribution and sale of oil-based products and are thus limited to upstream and midstream activities, without differentiation and exclude downstream activities. This Law is regulated by the Petroleum Operations Regulation approved by Decree 24/2004 of 20 August.

Access to petroleum operations is controlled by the State through its

institutions and public law bodies as it is the owner of all petroleum resources located in the soil or in the subsoil, in inland waters, territorial waters, the continental shelf and Mozambique's exclusive economic zone.

The State: it reserves the right to participate in petroleum operations in which any legal entity is involved and is, even up to its decision to participate in a commercial discovery, exempt from payment of any costs of the said operations (carried forward interest scheme). The decision on participation of the State in any given project may be made at any stage under the terms to be established by contract between the State and the holder(s) of the rights

Rights-holders: any Mozambican or foreign legal entity that can demonstrate that it has the technical competency and adequate financial resources to effectively carry out the operations, according to the requirements set out in the applicable legislation and regulations may hold the right to carry out petroleum operations. Mozambican legal entities enjoy the right of preference in the allocation of blocks, as do foreign legal entities associated with Mozambican legal entities.

It should be noted that for the purposes of meeting the requirements to qualify as a Mozambican legal entity, it is not enough for a company to be incorporated under the laws of Mozambique with its operating headquarters in the country. More than 50% of its share capital must be held by a Mozambican legal entity

Activities and procedures: Petroleum operations covered by the law are subject to the prior celebration of a **concession contract** with the Mozambican State and are divided into (i) exploration, (ii) appraisal and production and (iii) oil and gas pipelines. The concession is awarded, as a rule, through public tender and by simultaneous or direct negotiation in cases exclusively provided for in the Petroleum Operations Regulation.

(i) Exploration: the exploration contract grants the right to carry out preliminary exploration and appraisal work in the area covered by the contract, through aero and space, land and other surveys including geophysical, geochemical, paleontological, geological and topographic studies. This contract is made for a maximum period of **two years** and allows drilling

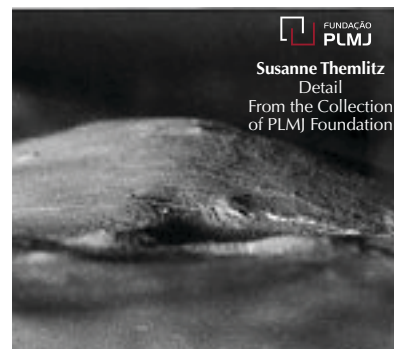
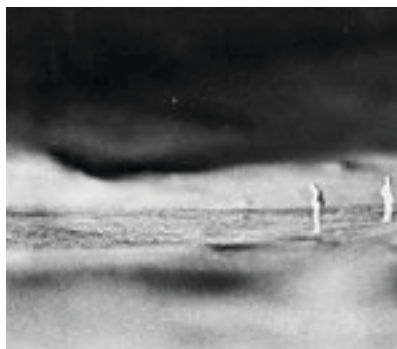
up to 100 metres below the surface or the sea bed. This contract gives the right of preference to the holder of the exploration right in the execution of the contract for appraisal and production on condition that the holder makes their intention to exercise the right known at least 6 months before their right expires.

The Minister of Mineral Resources has the **authority** to approve these contracts and the award of this right is made through an application addressed to the Minister containing information about the applicant including its nationality, the identification of the area in question, the description of the scope and nature of the activities and the proposal for the terms and conditions of the contract to be executed.

(ii) Appraisal and Production: this contract awards the exclusive right to petroleum appraisal and production – crude oil, natural gas and other hydrocarbons produced or capable of being produced from them or from bituminous clay and sand. This contract has the unusual characteristic of also including the non-exclusive right to build and operate oil and gas pipeline systems for the purposes of transporting crude oil or natural gas produced in the area of the contract, except when there is availability for access to an already existing system under commercially acceptable terms and conditions.

The Council of Ministers has the **authority** to approve the execution of appraisal and production contracts.

The right is awarded for a period of **8 years**, except when an application for an extension is made to the Minister of Mineral Resources to be presented to the National Petroleum Institute indicating the area that is subject to extension. The application for an extension may be based on the following grounds: a) if, at the end of the period of appraisal and production, the holder of the right is carrying out drilling works or testing an appraisal well, a time extension may be given for the period necessary to finish the works and evaluate the results. This period may not exceed one year, or b) a discovery is made during the appraisal and production phase, if the holder of the right has met its work obligations, and makes a commitment to carry out the programme of appraisal or a commercial appraisal of the discovery.



The **extension** period may be of up to two years for a discovery of crude oil and up to eight years for a discovery of natural gas. The period will depend on the complexity of the work involved in conducting the appraisal programme or a commercial evaluation of the discovery. If a commercial discovery is declared during the at the end of the initial appraisal and production period or of any extension, a Development Plan must be submitted within a year of the date of the declaration of the commercial discovery.

(iii) Oil and Gas Pipelines: this contract grants the right to construct and operate oil and gas pipelines for the purpose of transporting crude oil or natural gas when these operations are not covered by an appraisal and production contract. The contract must be accompanied by the respective Development Plan which is an integral part of the contract. The maximum period for development and production is **30 years** from the date of approval of the respective development plan. The Council of Ministers has the **authority** to approve the execution of oil and gas pipeline contracts. The holder of the said right is under an obligation to allow third party access, transmitting the oil of third

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parties without discrimination and on reasonable commercial terms, as long as there is capacity available in the pipeline and/or there are no unsolvable technical problems that prevent the use of the oil or gas pipeline system to satisfy the third party requirement. This access obligation also applies to any holder of appraisal and production rights that has included an oil and gas pipeline system in their project under the Development Plan submitted following the commercial discovery declaration.

Assignment of rights: the transfer of the rights and obligations of the holder, even if only partial, must be governed by the respective contract and be authorised in advance by the Minister of Mineral Resources.

Guarantee: a bank guarantee or letter of guarantee from the parent company, in an amount equal to the minimum work obligations, must be rendered in order to guarantee the contractual duties arising from the concession contact.

Insurance: the operator must take out insurance in accordance with the applicable legislation, specifically with coverage for damages to the facilities, damages caused by pollution, third party liability, removal of scrap and cleanup after accidents and work accidents of employees involved in the operations.

Right to use and benefit from land and establishment of easements: the holder must request a right to use and benefit from the land to carry out the petroleum operations for a period compatible with that established in the respective contract. The holder may require the establishment of rights of way for access to the locations where the petroleum operations are carried out,

in accordance with the lands legislation.

Termination: the concession contracts described above may be terminated for the following reasons:

(i) Total Relinquishment of the contract area by the holder to request to the Minister of Mineral Resources no later than three months before the term of the respective contract, on condition that the holder has met all the work and minimum expenditure commitments as set out in the contract. These conditions for termination do not apply in the case of a development and production area (oil or gas pipeline system). Here, the application to the Minister must be made at least one year in advance if it is made after commercial production has begun;

(ii) Unilateral Termination by a communication from the Minister of Mineral Resources to the holder of the right with immediate effect. Such rescission may be based on deviation from the objective of the concession, insolvency of the concession holder, failure to comply with the applicable laws and regulations after earlier sanctions have proved to be ineffective, serious material breach of the contract clauses, serious and wilful breach of the operator's duties, prolonged interruption of activity imputable to the operator or for any other reason established in the respective concession contract.; and

(iii) Abandonment, if the concession holder ceases to carry out petroleum operations in the area without due cause for a minimum period of three months, this results in the termination of the contract and in the area being declared as unoccupied.

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When a concession ends in one of the circumstances set out above, the assets will revert to the State for no consideration, unless the contrary is contractually provisioned.

It is noteworthy to mention the requirement to submit a Decommissioning Plan, in consultation with the National Petroleum Institute, at least two years before the date established for the end of the production operations. The plan, which must be submitted for approval by the Minister of Mineral Resources, includes

an evaluation of the environmental impact of the activities of closing and abandonment. The petroleum operations must follow both good international practices for oil fields and the applicable environmental legislation.

Relevance is given to issues of environmental protection and health and safety in petroleum operations which follow strict parameters, natural gas flaring being only permitted in cases where there is no alternative that ensures the commerciality of the exploration.