21 April 2015

Guinea: New Hydrocarbons Code

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Christophe Asselineau
Paris
+33.1.53.89.70.00
christophe.asselineau@shearman.com

Nicholas Buckworth
London
+44.20.7655.5000
nbuckworth@shearman.com

Laurence Levy
London
+44.20.7655.5717
laurence.levy@shearman.com

Cynthia Urda Kassis
New York
+1.212.848.7969
curdakassis@shearman.com

Patricia G. Hammes
Washington, DC
+1.202.508.8110
phammes@shearman.com

Anthony Patten
Singapore
+65.6230.3892
anthony.patten@shearman.com

Bill McCormack
Singapore
+65.6230.3877
wmccormack@shearman.com

Xiaogang (Sean) Wang
Beijing
+86.10.5922.8168
xiaogang.wang@shearman.com

The Guinean State Minister of Mines and Geology, Kerfalla Yansané, recently announced a possible launch of a bidding round in 2015 for offshore oil blocks in Guinea under the new hydrocarbons code (the "New Code"). Following its adoption by the Guinean Parliament and its promulgation by President Alpha Condé, Law L/2014/034 implementing the New Code entered into force on 23 December 2014. The New Code has not yet been published in the *Journal Officiel*.

The New Code repeals the 1986 Petroleum Code (order n°119/PRG/86 dated 28 September 1986 and its implementing decree n°168/PRG/86 dated 23 September 1986) and all other conflicting laws and regulations.

Petroleum rights and contracts granted before the promulgation of the New Code remain (i) valid for their remaining duration and (ii) governed by their terms. However, provisions of the New Code pertaining to safety, protection of the environment, monitoring of hydrocarbons activities, labor law and anti-bribery might immediately apply to existing petroleum rights holders, unless it can be demonstrated that such application (i) is discriminatory and (ii) disrupts the economic equilibrium of their petroleum contracts.

A model PSC which will form the basis of all subsequent PSCs awarded or negotiated by the State is yet to be issued so that the exact impact of the New Code is difficult to assess at this stage.

An overview of the main provisions of the New Code is set out below.

1. Institutional Framework

- The main institutions of the Guinean hydrocarbon sector are (i) the Minister in charge of Hydrocarbons and (ii) the Petroleum Administration that operates under its authority. They are responsible for establishing and implementing the hydrocarbons policy.
- In the event of a commercial discovery, a State company in charge of the management of the State's commercial interests may be established by presidential decree upon joint proposal of the Minister in charge of Hydrocarbons and the Minister in charge of Finance. This company is to manage the State's participation in petroleum contracts, market the State's share of hydrocarbons and provide technical assistance to the Petroleum Administration.

2. Petroleum Rights

- The State may conduct hydrocarbons and natural gas operations ("**Petroleum Operations**") directly or through a State company or may grant third parties the right to do so under various authorizations ("**Petroleum Rights**") as follows:
  - **Exploration Authorization** (*Autorisation de Reconnaissance*): granted by an order of the Ministry in charge of Hydrocarbons, it gives a non-exclusive right to perform preliminary prospection works for a duration of one (1) year, renewable once for one (1) year. However, it (i) does not confer upon its holder an automatic right to be awarded a production sharing contract and (ii) will be terminated in the event a production sharing contract is entered into (even with a third party) over the same area.
  - **Production Sharing Contract** ("**PSC**"): it gives the exclusive right to perform exploration activities, without depth limit and, when a discovery is deemed commercial, the exclusive right to perform exploitation activities. Contractors are also entitled to construct and operate pipelines within the Guinean territory.
  - **Transportation Authorization** (*Autorisation de Transport*): it authorizes a third party, which does not benefit from a PSC, to build and operate pipelines within the Guinean territory.
- The same area may be covered by both mining titles and Petroleum Rights, provided that new title holders do not damage the operations of existing title holders.

3. Production Sharing Contracts Procedures

PSCs are awarded to contractors following (i) either an international public tender procedure or (ii) direct negotiations in certain circumstances.

3.1 Tender Process

- PSCs are generally awarded following international public tender procedures.
- The Petroleum Administration is to:
  - publish on its website the tender offers and model PSCs approved by presidential decree;
  - issue, for approval by the Ministry in charge of Hydrocarbons, the rules (cahier des charges) of the tender procedures and qualification requirements; and
  - propose, for appointment by the Ministry in charge of Hydrocarbons, the members of a tender evaluation committee which will review the submitted offers. This committee comprise five (5) to seven (7) members, including one (1) representing the Petroleum Administration and the other the Ministry in charge of Finance.

- Following review of the offers, the tender evaluation committee submits to the Petroleum Administration a report summarizing the offers and proposing a preferred bidder or, when applicable, acknowledging that the tender process was unsuccessful as no bidder met the specification requirements. This report is submitted to the Minister in charge of Hydrocarbons who, if applicable, will invite the preferred bidder to enter into a PSC. There is no indication in the New Code whether additional negotiation may still be possible at that stage.

3.2 Direct Negotiations

- PSCs may exceptionally be granted following direct negotiations for so-called "national interest" blocks (this notion not being defined under the New Code) by presidential decree upon proposal by the Ministry in charge of Hydrocarbons and the Petroleum Administration.
- The Petroleum Administration is to:
  - propose for appointment by the Ministry in charge of Hydrocarbons a negotiation team, comprising three (3) to five (5) members, including at least one (1) representative of the Petroleum Administration, one (1) representative of the Ministry in charge of Finance and one (1) representative of the Ministry of Justice;
  - monitor the negotiations; and
  - submit to the Ministry in charge of Hydrocarbons the final draft of the negotiated PSC and a detailed report including its recommendations and any differences between the model PSC (as published on the Petroleum Administration's website) and the negotiated PSC.

3.3 Common Principles of PSC Procedure (Tender Process and Direct Negotiations)

- Before any award procedure regarding areas over which Petroleum Operations have not yet been conducted, a strategic environmental study (which includes consultations with local communities) is carried out by the State.
- The Petroleum Administration is to issue qualification directives (*directives de qualification*) which are to be approved by ministerial decree and which set out the technical, financial, legal, health, security and environmental requirements to be met by the applicants.
- A PSC can only be awarded for one (1) block.
- It must comply with the provisions of the New Code and be based on a model PSC approved by presidential decree and published on the Petroleum Administration's website.
- To enter into force it must be:
  - signed by the Minister in charge of Hydrocarbons and the Minister in charge of Finance;
  - approved by the Supreme Court; and
  - ratified by Parliament.
- Ratification by Parliament is promulgated by presidential decree and published in the *Journal official* upon which the PSC is effective and binding upon the parties.
- Executed PSCs (including their schedules) must be published on the Petroleum Administration's website.

4. Principles Governing Production Sharing Contracts

4.1 Applicable Law

PSCs are governed by Guinean law and general principles of international law.

4.2 Exploration Phase

- The exploration phase comprises three (3) phases (as determined in the PSC) and may not exceed eight (8) years as of the entry into force of the PSC.[1]
- A minimum expenditure program must be set out for each of the three phases and guaranteed by a bank guarantee.
- The area covered by the PSC is relinquished by thirty percent (30%) at the expiry of each of the first two phases. At the end of the exploration phase, the contract area must be surrendered (except areas covered by evaluation or exploitation authorizations).

4.3 Discovery

Contractors must inform the State promptly of any discovery and may request an evaluation authorization for a duration not exceeding eighteen (18) months (exceptionally extended for up to six (6) months) to assess its commercial nature. In the event the contractor is unable to determine the commercial nature of a discovery due to the absence of pipelines or the absence of a natural gas market, such evaluation authorization may be extended for up to two (2) years (four (4) years for dry natural gas). Following such evaluation, a report must be submitted to the Petroleum Administration.

4.4 Exploitation Phase

- Upon commercial discovery, contractors may apply for an exploitation authorization and submit to the Petroleum Administration, for approval by the Ministry in charge of Hydrocarbons:
  - the contemplated perimeter for exploitation;
  - a development plan including information regarding the discovery, development scheme, required works and their schedule, estimated production starting date, estimated development and exploitation costs and financing modalities; and
  - an economical study justifying the commercial nature of the discovery.
- Contractors holding an evaluation authorization may request a temporary exploitation authorization for a duration not exceeding six (6) months in order to collect data required to apply for an exploitation authorization. Please note that production covered by such temporary exploitation authorization is subject to tax and production sharing rules as contained within the New Code.
- Exploitation authorizations are granted by executive order (*arrêté*) of the Ministry in charge of Hydrocarbons for a duration not exceeding twenty-five (25) years (thirty (30) years for the exploitation of dry natural gas), provided that PSCs may set out an extension for a further period not exceeding ten (10) years.

4.5 Joint Development and Cross-Border Operations

- Deposits located in at least two (2) areas covered by distinct PSCs must be developed and operated by the relevant contractors pursuant to a joint plan, subject to approval by the Minister in charge of Hydrocarbons.
- Deposits which extend beyond Guinea's borders must be developed and operated, to the extent possible, by mutual agreement between the relevant States.

[1] The exploration phase may be extended, under exceptional circumstances, for a duration not exceeding six (6) months.

4.6 Production Sharing Mechanism

- Hydrocarbon annual production is shared between the contractor and the State as follows:
  - contractors receive a share of the annual production for the reimbursement of their costs which may not exceed sixty percent (60%) for crude oil and sixty-five percent (65%) for dry natural gas;
  - whilst the PSC defines the recoverable costs and the terms of their recovery, the New Code expressly sets out that:
    - (i) annual contribution to the training of Government agents and the promotion of the Guinean hydrocarbons sector, (ii) site rehabilitation obligations and (iii) costs pertaining to the operation and maintenance of pipelines are recoverable costs; whereas
    - (i) annual ground rents, (ii) production bonuses and (iii) signature bonuses are not recoverable costs.
  - the balance of the annual production is shared between the State and the contractor, in accordance with the principles set out in the PSC.

4.7 Commercialization of Hydrocarbons

Contractors own their share of hydrocarbon production at the valuation point within the exploitation area and are allowed to freely commercialize and export. However, if the State's share of production is insufficient to cover domestic needs priority must be given to supplying the national territory, in accordance with the terms of the PSC and at the request of the Minister in charge of Hydrocarbons.

4.8 State Financing

Petroleum Operations covered by a PSC are carried out solely by the contractors at their own technical and financial risks and the State is under no obligation to finance or guarantee them.

4.9 Liabilities

Contractors are responsible for all damages resulting from or caused by their Petroleum Operations. If a contractor comprises more than one (1) company, all of them are jointly and severally liable for all legal and contractual obligations (with the exception of corporate income tax, which is individually paid by each company).

4.10 Facilities

Upon termination of the PSC, ownership of all infrastructure required for continuation of activities and all material or equipment for which costs have been entirely recovered is transferred to the State, free of charge.

4.11 Transfer and Change of Control

All or part of the interests, rights and obligations under a PSC may be assigned and transferred in accordance with its terms, subject to the prior approval of the Minister in charge of Hydrocarbons and the assignee complying with set out requirements. However, the assignment of interests to an affiliated company or to a company composing the contractor must only be notified to the Petroleum Administration. For this purpose, the transfer of shares in a company comprising the contractor or a company directly or indirectly controlling a company comprising the contractor qualify as an assignment of interests in the event of change of control (except if such change of control results on the stock-exchange).

5. State Participation

- PSCs must include a provision whereby the State may elect to acquire a maximum participation in the rights and obligations of the contractor. Such participation must be at least ten percent (10%) under the PSC.

- The State bears all costs relating to a relevant exploitation area in proportion to its participation.
- The State and the contractors must enter into an association agreement setting out their respective rights, obligations and the conditions of joint operations and, in particular, the creation of a management committee and the appointment of an operator.

6. Access to Land

- Contractors are entitled to access lands, use waters, carry out infrastructure works and use materials extracted from the soil as required for Petroleum Operations.
- Access, occupation and use of private lands is subject to an agreement between the landowners and the contractor. In the event no agreement is reached, contractors may:
  - be granted a temporary access or occupation authorization by the Ministry in charge of Hydrocarbons to prevent delays in Petroleum Operations. Such authorization sets out a provisional occupation indemnity. Landowners must be indemnified for any damage suffered; or
  - request that Petroleum Operations and related facilities be declared of public utility and urgency and proceed with an expropriation. Contractors support all fees, indemnities and charges resulting from such procedure.
- Occupation of the public domain is subject to an authorization granted by decree without consideration payable by the contractor.

7. Tax, Customs, and Financial Contributions

7.1 Tax

- Contractors are exempt from all direct taxes (including tax on dividends and property tax on facilities built for the Petroleum Operations) and all taxes, duties and fees payable in connection with the production or the sale of hydrocarbons except:
  - corporate income tax, at the rate set out in the general tax code (the "**General Tax Code**") as at the execution date of the PSC, but:
    - some charges are deductible, including payroll costs, amortization costs and interests on loans contracted for the financing of Petroleum Operations, under certain circumstances; and
    - it can be paid out of the State share of hydrocarbons as allocated under the PSC.
  - tax on personal assets, such as residential property tax and employees' income tax; and
  - any other tax or duty set forth in the PCS.
- The New Code provides for a simplified tax regime applicable to non-resident subcontractors for a duration not exceeding one (1) year, after approval by the *directeur général des impôts*, as follows:
  - lump sum to be paid as "corporate income tax" in an amount of ten percent (10%) of all amounts invoiced by the subcontractor to the contractor; and
  - exemption from all other taxes in connection with the subcontracted services.

7.2 VAT and Customs

- Value added tax (VAT) applies to Contractors as set out in the General Tax Code. Hydrocarbon exports are subject to a 0% rate.

- Imported materials, equipment, vehicles, spare parts and consumables mentioned in specific lists established by the Petroleum Administration are exonerated from customs duties or granted temporary admission when such assets are to be exported back.

7.3 Ground Rents, Bonuses and Financial Contributions

- PSCs must provide for annual ground rents and production bonuses payable when the annual production reaches a certain threshold as set out in the PSC. PSC may also provide for signature bonuses. These payments are not deductible from corporate income tax, and are not recoverable as costs under the PSC.
- PSCs must also provide for an annual contribution for the training of governmental agents and the promotion of the Guinean petroleum sector. Such contribution is deductible from corporate income tax and is recoverable as cost under the PSC.

8. Foreign Exchange

- Contractors are granted a number of rights in relation to payments and currency exchange, including the right to:
  - open and operate local bank account in foreign currency;
  - open and operate offshore accounts for the purposes of the Petroleum Operations;
  - receive payments abroad (without any repatriation obligation) including for the sale of their share of the annual production of hydrocarbons; and
  - collect or transfer abroad proceeds from hydrocarbon sales, dividends and liquidated assets.
- PSCs may extend such rights to foreign subcontractors and expatriate employees.

9. Local Content

Whilst the New Code sets out local content obligations regarding priority to (i) Guinean companies and (ii) Guinean employees, these are less burdensome than obligations set out under the Guinean mining code L/2011/006/CNT dated 9 September 2011, as modified by Law L/2013/053/CNT, setting out minimum quotas.

9.1 Local Companies

- Contractors and their subcontractors must give priority to local companies for construction, supply and service contracts offered on equivalent conditions as to quality, price, quantity, timeframe and payment facilities.
- Six (6) months following commencement of Petroleum Operations and when submitting the development plan, contractors are required to provide the Petroleum Administration with a local companies support plan subject to approval by the Minister in charge of Hydrocarbons.
- Contractors must submit annual reports to the Ministry in charge of Hydrocarbons (also published on the Petroleum Administration's website) regarding the performance of such local content obligations.

9.2 Employment

- Throughout Petroleum Operations, contractors and their subcontractors must give priority to Guinean (i) qualified employees with required skills and (ii) unqualified workers, residents of communities in which Petroleum Operations are conducted.
- Contractors must implement a Guinean employee training program (set out in the development plan and every five (5) years during the exploitation phase) allowing Guinean nationals to gain necessary expertise to access employment.

- Contractors must submit annual reports to the Ministry in charge of Employment (also published on the Petroleum Administration's website) regarding the performance of such local content obligations.

10. Environmental Protection and Rehabilitation Obligations

- Contractors must comply with specific provisions regarding environmental protection, including obligation to submit environmental and social impact studies and environmental and social management studies, published on the Petroleum Administration's website.
- Contractors must comply with rehabilitation obligations, including:
  - establishing a rehabilitation plan and budget, subject to approval by the Minister in charge of Hydrocarbons (as set out in the PSC); and
  - opening an escrow account in accordance with the terms of the PSC. Such amounts are recoverable as costs under the PSC but are not deductible from corporate income tax.

11. Transportation

- Under a PSC, contractors are entitled to construct and operate pipelines to transport hydrocarbons inside or outside the contractual perimeter for the development and exploitation of deposits. These form part of their production installations. Specifications and route of the pipeline, technical provisions and standards and industrial safety regulations must be authorized as part of the development plan submitted to obtain the exploitation authorization.
- When built and operated by a third party who is not a PSC holder, pipelines requires a Transportation Authorization granted by the Ministry in charge of Hydrocarbons and the Ministry in charge of Domains which will approve the specifications and route of the pipeline, technical provisions and standards and industrial safety regulations.
- Construction and operation of pipelines (whether as part of a PSC or as an independent activity) require (i) environmental and social impact study and development plans to be conducted and (ii) a land occupation authorization.
- Costs pertaining to the operation, maintenance and amortization of pipelines are deductible for corporate income tax purposes. Such costs, except amortization costs, are considered recoverable under the production sharing scheme of the PSC.
- A contractor party to several PSCs may enter into an agreement with:
  - other contractors to jointly ensure transportation of hydrocarbons; and
  - third parties or the State to construct and operate pipelines.
- Under the New Code, contractors, within the limits of their available transportation capacity, may be required to allow transportation of hydrocarbons from other exploitation areas. Transportation rates are established by the contractor – taking into account utilization, amortization and profit margins accepted in the hydrocarbons industry – approved by the Ministry in charge of Hydrocarbons and certified by the Petroleum Administration.

12. Transparency and Corruption

- The New Code sets out specific provisions regarding transparency – including publication requirements – and the fight against corruption.

SHEARMAN & STERLING LLP

13. Protection of Investments

13.1 Stabilization

- PSCs may include a stabilization provision under which any change in law affecting the economic balance of the PSC will:
  - not be applied to the extent its provisions are financially adverse (*dispositions financièrement aggravantes*); or
  - require modification of relevant provisions of the PSC in order to restore its initial economic balance.
- However, stabilization does not apply to additional costs arising from a modification of legislation applicable to safety, environmental protection, control of hydrocarbon operations or labor law, unless such modifications are inconsistent with international standards or discriminate against the contractor.

13.2 Force Majeure

- Breaches by the contractor to obligations set out under the New Code, implementing legislations or the PSC are not considered a breach if caused by a force majeure event. Cases of force majeure and the parties' obligations in such an event are set out under the PSC.
- The duration of authorizations, the PSC and the performance of legal and/or contractual obligations are extended by the delay period caused by such force majeure event and the amount of time required to remedy damages.

13.3 Nationalization, Requisition, Expropriation

The 1987 Investment Code (ordinance n°001/PRG/87 dated 3 January 1987 as amended by law L/95/029/CTRN dated 30 June 1995) or any subsequent legislation is not applicable to Petroleum Rights holders or related activities. However, the New Code protects Petroleum Rights holders against nationalization, requisition or expropriation unless such measure is (i) set out by law, (ii) adopted for the purpose of public interest on a non-discriminatory basis and (iii) subject to prior and adequate compensation.

13.4 Dispute Resolution

Disputes between the State and the contractor relating to the interpretation and/or the performance of a PSC or the application of the New Code and/or implementing legislations will be subject to international arbitration and/or technical expertise in accordance with the principles set out in the PSC.