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Mozambique's Decree Law: Worth the Wait

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The much anticipated Decree Law for Offshore Areas 1 and 4 was published on 2 December 2014 (Decree Law No. 2/2014). It provides a clear and comprehensive legal framework for their development and includes significant concessions on many regulatory issues. An overview of the key terms of the Decree Law is set out below.

Scope of Application

The Decree Law applies to Concessionaires under existing exploration and production concession contracts (EPCCs), any special purpose vehicles (SPVs) formed by such Concessionaires and any persons entering into contracts with Concessionaires or SPVs (such as contractors, financiers and employees) as well as their subcontractors, in each case, in connection with activities relating to the development and operation of Offshore Areas 1 or 4 and which are undertaken under existing EPCCs or any other agreements with the Mozambican Government (Art. 2(3) and 2(4)).

Clarification of Impact of New Laws on EPCCs

Article 5 of the Decree Law clarifies that the terms of any existing EPCCs continue to apply to Offshore Areas 1 and 4 notwithstanding the entry into force of the new Petroleum Law and Petroleum Tax Law in August 2014. This was not clear from the new Petroleum Law and Petroleum Tax Law, which only stated that "acquired rights" would be maintained.

However, the new Petroleum Law and Petroleum Tax Law will apply to any new concessions relating to Offshore Areas 1 and 4 or any amendments or renewals to the EPCCs for these Areas.

SPV Structure and Project Term

- **Jurisdiction of Incorporation:** As a general rule, the Decree Law requires that any SPVs incorporated to develop Offshore Areas 1 and 4 be Mozambican companies. This is consistent with the position under the new Petroleum Law. However, SPVs relating to the financing of the project or sale or shipping of LNG and gas liquids produced from Offshore Areas 1 and 4 can, subject to prior approval by the Mozambican Government, be incorporated offshore (provided the offshore jurisdiction is a "transparent" jurisdiction) (Art. 4(2) and 4(3)).
- **Share Transfer/Change of Control:** The transfer of shares and change of control in SPVs requires Government approval, except if otherwise contractually agreed with the Government. This allows flexibility for the Mozambican Government to pre-approve certain share transfers (e.g., transfers by lenders on an enforcement) (Art. 4(4)).
- **IPO Requirement:** No IPO of shares in Concessionaires or of SPVs will be required, notwithstanding the requirements contained in the new Petroleum Law and the PPP Law (Art. 4(7) and 6(2)).

- **Term:** The term of projects relating to the development of Offshore Areas 1 and 4 is 30 years from the date of approval of the development plan (Art. 8(1)).

Benefit-Sharing Under PPP Law

The Decree Law acknowledges that the PPP Law applies to Offshore Areas 1 and 4, with these projects constituting “large scale projects” for the purposes of the PPP Law.

The Decree Law includes provisions explaining how the benefit-sharing requirements of the PPP Law are met by these projects (such as the sharing of extraordinary direct benefits which is deemed to be met through the production sharing arrangements under the EPCCs) (Art. 6(3)-(6)).

However, there is no provision addressing how the requirement in the PPP Law Regulations that 35% of



all taxable benefits must be shared with the State is to be met by the projects. The PPP Law Regulations require that 35% of the annual taxable profit of a project falling within the scope of the PPP Law be received by the State through: (i) its participation in the company implementing the project; and (ii) taxation. While we understand that it is not the intention for this requirement to limit any tax concessions granted, it is unclear exactly how it is intended to apply.

LNG Sales

LNG sales will be undertaken on a joint dedicated basis in accordance with the terms of the existing EPCCs. However, the Mozambican Government is required to approve the terms of gas sales (Art. 9(1)).

The new Petroleum Law requires the Mozambican national oil company ENH (Empresa Nacional de Hidrocarbonetos, E.P.) to take the lead in marketing gas. The Decree Law does not expand on how ENH is to do this. The Decree Law also does not expand on the proportion of gas to be sold on the domestic market, which suggests that this matter is still under discussion.

Procurement of Goods and Services

The Decree Law clarifies the local content requirements for the procurement of goods and services. While it confirms the principle that

preference should be given to goods and services provided by Mozambican companies or companies affiliated with Mozambican companies, it provides some important exceptions. These include:

- preference need only be given to Mozambican providers where the goods or services are of comparable quality and availability and do not cost more than 10% than imported goods or services (including taxes);
- for contracts worth more than US\$25 million or contracts for the provision of goods and services that require special technology, no preference needs to be given to Mozambican suppliers; and
- no preference needs to be given to Mozambican suppliers in case of procurement of goods and services which are required to be procured offshore due to tied financing from ECAs (Arts. 10(3) and 10(5)).

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Concessionaires and SPVs are required to submit a local content plan to be approved by the Mozambican Government at the same time as the development plan. This local content plan will need to be updated and approved by the Government once every three years (Art. 10(2)).

The Decree Law also confirms that the procurement of goods and services requires a public tender. However, it makes some important exceptions. The exceptions allow the selection of contractors without a public tender, among others, where:

- only one supplier can provide the requisite goods or services;
- consistent standards are required for compatibility with other goods;
- it is necessary to select a particular supplier due to a lack of availability on the market;
- where there were no bids (or no compliant bids) following a public tender; or
- where the value of the contract is less than US\$3 million (Art. 10(6)-(11)).

Financing Structure

The Mozambican Government is required to approve the financing structure proposed for Offshore Areas 1 and 4 (Art. 16(1)). However, there are no restrictions on the type of financing structure that can be proposed. The restraints on the debt:equity ratio that appeared to have been imposed under the new Petroleum Tax Law are specifically disapplied (Art. 16(2)).

The Decree Law states that no further approvals of the financing structure would be required once approved by the Government (Art. 16(6)). It is unclear whether approvals required under other laws (such as the visa of the Administrative Court for contracts entered into by the Government or State-owned entities) would continue to be required. Concerns regarding Central Bank approvals are dealt with below.

The Decree Law clarifies that lenders can be granted security over the assets owned by Concessionaires and SPVs and can enforce such security. In particular, the Decree Law clarifies that Concessionaires and SPVs will be able to create enforceable security over the assets located in “partial protection areas” (such as the seabed) (Arts. 11(5) and 16(3)). Note however, that the creation of security over assets held by State-owned companies (such as shares held by ENH) may still be restricted by the World Bank’s negative pledge on Mozambican state assets.

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Exchange Control

The Decree Law entitles Concessionaires and SPVs to open and maintain foreign currency accounts in Mozambique as well as offshore accounts (Art. 15(1) and 15(2)).

Gas sales revenues can be deposited and held in offshore accounts. Amounts standing to the credit of the offshore accounts can be used to pay (among other things):

- service of senior debt (including the funding of any DSRA);
- capital expenditure and operating expenditure due to non-resident Mozambican companies;
- amounts due to contractors with contracts worth more than US\$25 million;
- salaries to expatriate workers; and

- service of shareholder loans and dividends (Art. 15(2)).

These are very important concessions. Typically the right to open and use offshore accounts is at the discretion of the Central Bank (Banco de Moçambique). The Central Bank does not grant these rights lightly, as one of its key objectives is to encourage the use of the Mozambican banking system. In practice this has meant that the Central Bank generally requires foreign currency of a Mozambican entity to be repatriated and held onshore in Mozambique.

Under the Decree Law, amounts held in offshore accounts must be transferred onshore only to pay Mozambican taxes and for the payment of goods and services provided in Mozambique (other than goods and services provided under contracts worth more than US\$25 million) and for the payment of local workers, and 50% of amounts transferred must be converted into Meticals (Arts. 15(1)(b) and 15(3)-(4)).

Concessionaires and SPVs are entitled to move capital in and out of Mozambique. While this still requires the approval of the Central Bank, this approval must be given within five working days of the request and approval is deemed to have been given in case the Central Bank fails to respond within this five working day period (Art. 15(9)).

Stabilisation

The Mozambican Government undertakes to keep whole Offshore Area 1 and 4 Concessionaires and SPVs in case of changes in law except where:

- the impact of the change in law results in costs of less than US\$5 million; or
- the laws relate to health and safety or environmental protection or to measures required to ensure the continued supply of fuel during a national emergency or civil unrest (Art. 26(1)-(3)).

This change in law protection is provided for the entire term of an Offshore Area 1 or 4 project (Art. 26(1)).



As anticipated in the Enabling Law for the Decree Law, there is scope for amending the stabilisation provisions every ten years, commencing on the tenth anniversary of the first LNG cargo. This is subject to the agreement of the parties and should not affect the viability or profitability of the relevant project (Art. 26(10)). If the parties cannot agree to amendments to the stabilisation provisions, then specific petroleum production tax rates will apply (4% during the period from 10-20 years from the first LNG cargo and 6% during the period from 20-30 years from the first LNG cargo) (Art. 26(10)).

Third Party Access

The Decree Law imposes a less extensive third party access regime than under the new Petroleum Law. For instance the Decree Law only requires access to be given to third parties (other than the Mozambican Government and Offshores Area 1 and 4 Concessionaires and SPVs) where:

- that third party holds significant gas quantities with specifications similar to those of the gas produced by Areas 1 and 4 (Art. 13(2));
- there is excess capacity in accordance with best industry practice;
- such access would not cause any adverse effect on owners or users of the infrastructure; and
- there are agreements in place between the parties (Art. 13(3)).

Labour

The Decree Law allows the Mozambican Government and Concessionaires and SPVs to agree on the number of foreign workers required for each project on a case-by-case basis, avoiding the quota regime that normally applies under Mozambican law (Art. 18(3)). The Decree Law specifies the documentation that needs to be provided for foreign workers to be contracted and the type of visas by which they are to enter Mozambique (Art. 20). This will be very helpful in practice by providing certainty as to documentary requirements.

Concessionaires and SPVs for Offshore Areas 1 and 4 are required to develop and implement a training programme for local workers (Art. 19). The Decree Law allows for extended working hours (from a maximum of 8 hours per day usually prescribed by the Labour Law to 12 hours per day).

Governing Law and Dispute Resolution

The Decree Law allows parties to choose the law applicable to any contract for the supply of goods and services and to allow for dispute resolution under international arbitration (Art. 10(13)). This is important given the requirement under Mozambican law (Decree No. 94/2013) that construction contracts



relating to works in Mozambique be subject to Mozambican law and dispute resolution in Mozambique. However, it is unclear whether this right also applies in respect of contracts entered into with Mozambican companies (i.e., companies whose share capital is owned more than 51% by Mozambicans).

The Decree Law also allows State-owned companies such as ENH to submit to international arbitration (Art. 25(4)). This is useful as there is an existing Mozambican law applicable to State-owned enterprises which appears to prevent them from entering into arbitration agreements absent a specific legal instrument permitting it.

Other Regulatory Considerations

- **Insurance:** Mozambican law usually requires insurance to be placed with local insurers. Given the limited size of the Mozambican insurance market and the size of Offshore Areas 1 and 4, additional flexibility has been given to Concessionaires and SPVs for Offshore Areas 1 and 4. Under the Decree Law, they are free to obtain insurance with foreign insurers to the extent it is not possible to insure with local insurance companies at a cost which is not more than 10% of the cost of insuring with foreign insurers (Art. 23(5)).
- **Competition Law:** Mozambican competition rules are disapplied in respect of Offshore Areas 1 and 4 under a public interest exception contemplated by local competition law (Art. 24).
- **Land Rights:** The Decree Law grants to Concessionaires and SPVs for the Offshore Areas 1 and 4 projects the land rights they require to implement these projects (Art. 11(1)). These land rights are granted through structures similar to usufructs known as DUATs and, for certain areas, special licences.

Conclusion

The Decree Law is a thorough and comprehensive piece of legislation. It provides much needed clarity as to the way in which the new Petroleum Law and other existing Mozambican laws apply to Offshore Areas 1 and 4. It also includes thoughtful clarifications to the regime applicable to these projects which significantly benefit the bankability of projects. For instance, we expect the disapplication of the local sourcing requirements where this would conflict with export credit agency (ECA) financing requirements will be very important where tied ECA financing is being sought. The clarifications as to the rights to create security should also provide comfort to prospective financiers. However, there are a handful of key issues arising from the new Petroleum Law where additional clarifications could usefully have been provided. These include the requirement to allocate at least 25% of gas sales to the Mozambican market and the requirement that ENH take the lead in the marketing of gas and the requirement to share at least 35% of taxable benefits with the State. We expect however that these are still under discussion with the Mozambican Government. It is hoped that the outcome of these discussions will be as positive as that relating to the items specifically provided for by the Decree Law.