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The importance of a transparent, open and fair allocation process for Uganda's remaining oil rights

This briefing highlights some of the risks of poor quality or corrupt allocation of rights to oil, assesses the current situation in Uganda and makes the case for best practice ahead of the expected new allocation round.

Introduction

The enactment of two new petroleum laws paves the way for the Government of Uganda to allocate the remaining rights to the country's oil. This process is expected to begin once new institutions, created under the Petroleum (Exploration, Development and Production) Act, 2013 (henceforth referred to as the 'Upstream Law'), have been established and further seismic testing has been carried out.

This is a critical stage for the future management of the sector. An open, transparent and fair process is absolutely crucial for ensuring that Uganda partners with reputable companies and obtains a good deal for its oil.

The latest indications from the government on timing for a new allocation round suggest it will take place in 2015.[i] However, regulations and procedures must be put in place now to ensure that the process runs smoothly and effectively, and that it is not undermined by negotiations outside the official process.

Selecting the best companies with good track records on environmental and social protection, and the financial and technical capabilities to extract the maximum amount of oil with the minimum of harm is essential. Poor or corrupt allocation processes can lead to companies without the relevant expertise, or with no intention of extracting themselves, gaining rights to exploit a country's natural resources. In the worst cases, rights can be handed to companies which represent corrupt interests leading to poor contract terms, delayed production and lost revenues for the host government.[ii]

Uganda's Upstream Law does state the intention to establish an "open, transparent and competitive process" for the licensing of petroleum activities.[iii] However, the law does not spell out exactly what this process will look like. This should be clearly set out in further regulations under the Act.[iv] Furthermore, the Upstream Law allows the Minister[1] to circumvent the bidding process in certain circumstances, creates the conditions for potential excessive ministerial control, and fails to guarantee adequate transparency to safeguard the process.

It is therefore imperative that the Government establishes and publishes the details of a clear, open, transparent and fair allocation process, and publishes a new model Production Sharing Agreement (PSA), before it negotiates deals with any additional companies. This will help restore faith in the Government's handling of the sector and avoid some of the risks outlined below.

The risks of poor or corrupt allocation processes

Global Witness has documented numerous examples of poor allocation practice in other countries that have led to loss of revenue and corruption. While much focus on improving governance in the extractives sector to date has focused on revenue management, community relations and environmental protection, it is often the allocation phase that sets the tone for the future management of the sector. An un-transparent and unclear allocation process involving direct negotiations behind closed doors is likely

[1] All references to the Minister refer to the 'Minister with responsibility for Petroleum' as per the Upstream act and not to any individual.

to deprive nations of a fair deal for their natural resources and, in the worst cases, become a vehicle for high level corruption.

The Democratic Republic of Congo has seen a number of prize mining assets allocated to offshore companies with hidden beneficial ownership at far below commercial valuations and sold on often at much higher prices. Global Witness has calculated that the DRC has lost out on a potential $1.3 billion in government revenues from these sales.[v]

In Nigeria and Angola, private local companies have been allocated minority shares in oil licences or have been pre-qualified to bid for shares in such licences, even though the people behind these companies (ultimate beneficial owners) remain undisclosed to the public. In some cases the individuals apparently behind these companies had the same names as people who were public officials. This raises serious questions about how these companies and individuals came to acquire these rights.[vi]

Without a transparent and robust allocation mechanism, licences can be awarded on a preferential basis, to the bidders favoured by public officials or the ruling elite rather than in the best interests of the country as a whole. This can lead to a breakdown in accountability as corruption and poor governance become entrenched and companies with no reputations to protect gain access to contracts. These companies will be less likely to uphold high standards of environmental and human rights protection.

Allocation in Uganda

The allocation of rights to Uganda's oil and gas sector has so far taken place on an ad-hoc basis with little transparency. No competitive bidding round has been held and companies appear to have either received their rights from the Government through direct negotiation, or through third parties, which themselves received their rights through direct negotiation with the Government.

A new allocation round

The exact status and demarcation of Uganda's oil blocks is unclear. The Ugandan Government has reportedly demarcated up to 17 oil blocks, and had licensed exploration in at least five, before it imposed a moratorium in 2007. It is widely anticipated that the Upstream Law will pave the way for a further licensing round in 2015.[vii] The acreage to be licensed is as yet unconfirmed, but according to statements made on behalf of the Petroleum Ministry the licensing round could see the allocation of up to 13 oil blocks.[viii]

While we welcome the intention, in the new Upstream Act, to create an 'open, transparent and competitive process' for allocation, the law does not detail the process; furthermore it contains a number of clauses which could leave the process seriously undermined.

Excessive Ministerial control

In particular, the Upstream Law paves the way for an unhealthy concentration of power in the hands of the Minister, which could undermine any allocation process which is ultimately put in place.

The Upstream Law permits the Minister to circumvent the normal allocation process entirely.[ix] In 'exceptional circumstances,' the Minister may receive direct applications for petroleum licences.[x] Although the Minister is required to do so 'in consultation with' the Petroleum Authority of Uganda, there appears to be no requirement for Parliamentary debate or approval. Furthermore, the 'exceptional circumstances' are open to interpretation and in practice will afford the Minister an authority which is worryingly wide.[2] The law, therefore, effectively hands authority to the Minister to make allocation decisions without competitive bidding and with minimal oversight.

[2] The circumstances are (i) following an unresponsive bidding round, (ii) in relation to applications to extend licensed blocks into unlicensed areas and; (iii) where desirable for the "enhancement of the participating interest of the State in the promotion of the National Interest". The second and third exceptions are particularly erroneous and open to abuse. Extension of licences into unlicensed areas should only be possible under strictly defined circumstances, such as when a discovered field is shown to extend into a neighbouring block, and there is no reason why participating interest should not be considered alongside other terms in an open bidding process.

In addition, the Minister is authorised (but not obliged) to introduce regulations by statutory instrument on a variety of areas including licence applications, confidentiality and licence transfers, as well as a range of operational matters.[xi] This leaves the decision of whether or not to introduce allocation procedures, and their content, to the discretion of the Minister.

Such concentration of discretionary power risks creating a parallel allocation process, which lacks the transparency and value-maximisation that competitive bidding should achieve. A transparent, open and fair competitive bidding process would compel the Minister to make a genuine assessment of the bids on their merits and negotiate the best terms for the Government, in the knowledge that the eventual allocation decisions would be open to public scrutiny and criticism. Where the bidding process is opaque or can be circumvented entirely, the incentives for responsible decision making are undermined and there are obvious opportunities for corruption. The commitment to competitive bidding is a key commitment, which must be codified in further regulations before allocation commences.

The legal framework for allocation in Uganda and the case for best practice.

Decision to extract

There has been little, if any, discussion about whether or not to extract in Uganda. While the Upstream law does provide for an objection procedure to a ministerial decision to open up new areas for exploration, it does not provide for an effective consultation process.[xii]

There is a growing international debate around the decision to extract. While oil extraction can generate extensive revenues which could be used for economic growth and development, it can also have severe adverse consequences. These include environmental degradation, loss of alternative livelihoods such as fishing and tourism, and potential conflict. Oil is ultimately a finite resource, which will only last 20 years or so, but its impacts may be felt far longer. Careful consideration should be given to the pros and cons of extraction, preferably coupled with an extensive consultation process. While exploration activities have already been authorised in regards to Exploration Areas 1, 2, 3A, 4B and 5, the Government should consider and consult before re-licencing these areas or opening up new areas for exploration.

Competitive bidding regulations

The Upstream Law does commit the Government to an open, transparent and competitive process but it does not spell out the details. The Minister may, under the Upstream Act, introduce further regulations for the allocation process. This should be done prior to any further negotiation or allocation.

Competitive bidding in the allocation of oil contracts is a powerful tool to secure the greatest possible benefit from the country's natural resources and to ensure the integrity of the allocation process. The Natural Resource Charter states that, where practical, 'auctions are generally the preferred mode (of allocation), both on grounds of transparency and securing maximum value'.[xiii]

Where a country may struggle to attract investment - perhaps because exploration is in very early stages and there has yet to be a commercially viable find as was the case in Uganda prior to 2006 – it may make sense for a government to enter into a strategic partnership with an international oil company (IOC) with the experience to develop the oil resources. However, in these circumstances the government is likely to be at a significant information disadvantage and may struggle to negotiate the most favourable terms for its oil.[xiv] For that reason the Government should be applauded for placing a moratorium on further allocation in 2007. Given that substantial oil reserves have now been discovered in Uganda there is likely to be greater competition and therefore the introduction of sequential auctions of oil blocks would allow the Government to both view a range of competing bids in any one auction, and then take the experience and knowledge forward to future sales.

The bidding process should be open, fair and transparent in order to achieve the best possible deal for the country. In a well-conceived auction, bids will be submitted on the basis of standard form model

contracts with as few variables as possible, creating a framework for government officials to assess and compare competing bids. With this objective in mind the decision, in the Upstream Law, to introduce a new model production sharing agreement in Uganda is a promising start. Ensuring it is well drafted will be crucial:[xv] If all bids for new acreage are based on the same basic contractual framework, public officials will be well placed to compare the bids on their objective merits. The potential for misguided, arbitrary or corrupt decision-making will be significantly reduced.[xvi] The model PSA should be published and debated by Parliament before the new allocation round.

Making the bidding and assessment process transparent will improve the legitimacy of the outcome in the eyes of the public and limit opportunities for corruption. It is particularly important that social and environmental terms are made available to the public, in order to facilitate greater engagement and knowledge among local communities. In addition, a truly transparent and competitive bidding process reduces opportunities for corruption.

Pre-selection of companies

The Upstream Law lacks any mechanism for pre-qualification of companies based on their track records on environmental, tax, corruption and human rights issues. This may result in contracts being awarded to companies whose operational reputations are questionable. Responsible operatorship standards should also be hardwired into the decision-making process for licence renewal, suspension and cancellation.[xvii]

The Government should introduce a rigorous process of pre-qualification for companies, in which all prospective bidders are vetted to assess their operational and financial backgrounds. The Chatham House Petroleum Sector principles state that 'pre-bid qualification is a key process to ensure the most suitable candidates for licences have a chance to bid'.[xviii] If done properly, this will help ensure that only companies with substantial technical expertise, financial backing, and good records in social and environmental protection are eligible for contracts. Companies with a history of corruption, criminality, human rights violations or weak environmental protection will be excluded. The pre-selection process itself should be clear and transparent to ensure public oversight.

Beneficial ownership

Too often, the ownership of companies in bid-consortia is difficult to establish, veiled through the use of companies in secrecy jurisdictions (often referred to as tax havens) which disclose little information, including the names of their owners, to the public. While the Upstream Law contains a requirement that applications for licences include details of owners of more than 5% of any bidding company, this threshold is too high and this information is unlikely to be made public.[xix] The government should reduce this threshold and ensure that all significant shareholders are publicly disclosed.

The ban contained in the Upstream Law against public officials owning interests in petroleum industry participants is welcome. This should be accompanied by careful monitoring of asset declarations and records of public servants' interests against beneficial ownership information for bidding companies to ensure effective enforcement and to avoid corruption.[xx]

It is crucial that the pre-selection process investigates and publishes the beneficial ownership of prospective bidders so that the government and the public know who ultimately controls and owns the bidding company. All too often corrupt officials are able to use shell companies in secrecy jurisdictions to conceal corrupt decision making and business interests. Robust rules are required to prevent government officials from awarding contracts to companies owned by political allies, their families, or themselves.

Transparency requirements and consultation

The transparency requirements in the Upstream Law are insufficiently robust. It permits, but *does not oblige*, the Minister to make details of oil licences, contracts and other significant information available to the public.[xxi] There is even a provision stating that information submitted in bids should ordinarily remain confidential.[xxii] A lack of transparency in the bid process will diminish the ability of Parliament

and the public to identify poor or potentially corrupt allocation decisions and risks delegitimizing the allocation process in the eyes of the public. It is essential that the Ministry takes steps to put this information in the public domain.

The Upstream Law contains limited scope for public consultation on allocation decisions. While "affected parties" are permitted to lodge objections to proposed exploration activities (which can then be escalated to the High Court),[xxiii] the Minister is permitted to withhold from the public information relating to direct applications, on vague and undefined grounds of "commercial confidentiality".[xxiv] In practice, this could severely inhibit the ability of the public or civil society groups to compile an informed and effective objection to a proposed activity.

Recommendations

While the Upstream law does commit the Government to an 'open, transparent and competitive' allocation process it does not clearly set this process out. However, this does not mean that the Government intends to allocate the remaining rights through a direct negotiation process. The Government now has the opportunity to clarify the position and put in place best practice procedures before it allocates the remaining rights.

In summary, the allocation process for the right to exploit Uganda's hydrocarbon and mineral resources should facilitate and provide:

- Genuinely fair, open and competitive bidding for licences and contracts, with clear and transparent criteria and a process for objective assessment of competing bids;
- Objective and transparent criteria and process for pre-selection of companies which assesses environmental, social and ethical credentials as well as financial and technical expertise;
- Robust transparency requirements, including beneficial ownership of prospective licencees to be made public; and
- A role for Parliament in the oversight of licence awards and renewals, and enhanced opportunities for public consultation.

The Government of Uganda should;

- Carefully consider, and consult widely on, the decision to open up new areas for exploration;
- Present to Parliament robust and transparent allocation procedures in line with the recommendations above, allowing plenty of time for Parliamentary approval; and
- Open up allocation processes and documents to public scrutiny.

Uganda's MPs, international donors, media and CSOs should:

- Call for robust and transparent allocation regulations to be put in place prior to any further negotiation on allocation of oil rights;
- Demand transparency of process and documents;
- Analyse the regulations and work with Government to ensure they meet the requirements set out above; and
- Monitor the allocation process closely to ensure that regulations are followed and companies with the best expertise offering the best deal receive government contracts.

[i] Upstream, Uganda round is set to slip, October 11 2013, http://www.upstreamonline.com/hardcopy/news/article1340063.ece

[ii] For examples see: Global Witness' Secret Sales work, http://www.globalwitness.org/campaigns/corruption/oil-gas-and-mining/secret-sales or Rigged: *The scramble for Africa's oil, gas and Minerals, http://www.globalwitness.org/library/rigged-scramble-africas-oil-gas-and-minerals*

[iii] See Recital of the Petroleum (Exploration, Development and Production) Act 2013
[iv] See Petroleum (Exploration, Development and Production) Act 2013 s.52 (6).
[v] See "Secret Sales"; Global Witness, "ENRC must address corruption concerns in Congo and publish findings"; 12 June 2012
http://www.globalwitness.org/sites/default/files/Global%20Witness%20memo%20to%20ENRC%20shareholders%2012.6.12_1.pdf
[vi] Global Witness Report: "Rigged"; the scramble for Africa's Oil Gas and Minerals, January 2012
http://www.globalwitness.org/library/rigged-scramble-africas-oil-gas-and-minerals
http://www.globalwitness.org/sites/default/files/library/RIGGED%20The%20Scramble%20for%20Africa%27s%20oil,%20gas%20and%20minerals%20.pdf
[vii] Platts – East Africa Energy Outlook 14 November 2012 -
http://www.platts.com/newsfeature/2012/oil/eastafrica/2
[viii] Rigzone, 23 January 2013, Uganda to auction 13 oil blocks in 2013
http://www.rigzone.com/news/oil_gas/a/123686/Uganda_to_Auction_13_Oil_Blocks_in_2013
Upstream, Uganda round is set to slip, October 11 2013,
http://www.upstreamonline.com/hardcopy/news/article1340063.ece
[ix] See Clause 53 of the Petroleum (Exploration, Development and Production) Act 2013
[x] See Clause 53.(2) of the Petroleum (Exploration, Development and Production) Act 2013
[xi] See Clause 183 of the Petroleum (Exploration, Development and Production) Act 2013
[xii] See Clause 55 of the Petroleum (Exploration, Development and Production) Act 2013
[xiii] Natural Resource Charter, Precept IV. http://naturalresourcecharter.org/content/about/history
[xiv] Natural Resource Charter, Precept IV. http://naturalresourcecharter.org/content/about/history
[xv] See Petroleum (Exploration, Development and Production) Act 2013 s.6(2), which provides for minister for petroleum activities to develop a model production sharing agreement, to be submitted to Cabinet for approval.
[xvi] See, for example, Precept 4 of the Natural Resource Charter, http://naturalresourcecharter.org/
[xvii] On renewal, see Clauses 62, 64 and 80; on cancellation, see Clause 90. While the Minister may cancel a licence due to the licencee being in breach of Ugandan law, there are no specific termination rights due to poor operational practice.
[xviii] Chatham House, Good Governance of the National Petroleum Sector 2007, page 57
http://www.chathamhouse.org/publications/papers/view/108468
[xix] See Clause 56.3(a)(ii) of the Petroleum (Exploration, Development and Production) Act 2013
[xx] See Clause 162 of the Petroleum (Exploration, Development and Production) Act 2013
[xxi] See Clause 151 of the Petroleum (Exploration, Development and Production) Act 2013
[xxii] See Clause 153 of the Petroleum (Exploration, Development and Production) Act 2013
[xxiii] See Clause 55 of the Petroleum (Exploration, Development and Production) Act 2013
[xxiv] See Clause 54.(c) of the Petroleum (Exploration, Development and Production) Act 2013