Brazil and Uganda: Government Intervention and Oil Development Prospects

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Brazil and Uganda have very similar petroleum industries. Both countries announced one of the largest oil discoveries in the last decade. Brazilian pre-salt discoveries proved the existence of large reserves which could lead to several billions of crude oil to be exploited. Uganda's discoveries involve more than a billion barrels with the potential for more additions to current proved reserves in the future.

Although Brazil has produced oil for a relatively long period of time, it was never self-sufficient, until production was ramped up in 2006. Still today, Brazil's production is relatively small, both in a global perspective and in the context of the size of the country's reserves. Uganda in turn never produced oil in its history. Both countries hence find themselves in a similar situation aiming to develop their oil industries in order to significantly shape their economies in the coming decade.

In this article, we look at the similarities and differences in the two countries' development approach towards their upstream sectors, with a focus on legislative changes made after the significant discoveries. Our two main conclusions are (i) Brazil's more established oil sector is likely to move forward faster than Uganda, and (ii) both countries are losing valuable time by debating legislative changes in view of nationalist rather than primarily economic objectives.

The Brazilian Case

Brazil opened up its upstream market in 1995 with the constitutional change of Petrobras' exclusive right to explore and exploit oil and gas reserves. Two years later the government approved the petroleum law, which created the national petroleum agency ('ANP'). This body had responsibility to regulate and monitor the petroleum industry.

One of the major roles of the ANP is to prepare and organise license rounds.

This represents a significant change from the monopoly regime. The system allows private parties to compete at the same level as Petrobras for new blocks. The first bid round occurred in 1999 and every year ANP would promote a new round to encourage more exploratory work. At that time less than 3 percent of the sedimentary basins had been explored in the fifth largest country in the world. The government was keen to open more blocks and to attract more investments in the upstream sector.

The bid rounds were very successful until 2006 by which time a large variety of players were engaged in the upstream sector, including IOCs, NOCs, independents, local and foreign players. Changes to previous plans for Brazil's upstream sector and its legal framework occurred, however, following the 2006 discovery of what then was seen as possibly large pre-salt reserves. The area is located off the coast of Rio de Janeiro and Sao Paulo and below the salt-layer (i.e. thousand of metres below the sea level). Such discoveries clearly affected the stability and periodicy of the license rounds. More precisely, license round 8 was never concluded, license round 9 excluded some pre-salt areas, and license round number 10 only offered onshore areas. The national interest was clearly behind these decisions as the government was studying and considering a new regime for the pre-salt area.

Moreover, after several years of studies, the Brazilian government decided to replace the license regime by a production-sharing regime. This was another radical change as the license regime had been quite successful after ten bid rounds. However, the key difference is that the license regime was not extinguished but only replaced for the pre-salt area and strategic areas that could be determined in the future. It is important to note that less than 30 percent of the pre-salt area has been awarded and it represents far less than 10 percent of the size of the country. Consequently, the government can continue to issue license rounds outside the pre-salt area (e.g. tenth licence round).

For now, the petroleum industry in Brazil can continue to attract investments as there is no legislation or political movement against offering new areas outside the pre-salt area. However, the indication that a new petroleum law would regulate the distribution of royalties between governmental authorities created unnecessary uncertainty for the petroleum industry. Although this is purely a governmental matter, it is affecting the private sector as the eleventh license round has been delayed for it is not clear whether the new royalty rules will affect only the governmental distribution or if it will increase the private contribution (currently fixed at the maximum of 10 percent for royalties). As long as the governmental authorities cannot reach a reasonable solution to share the future income from the hydrocarbons production, the private sector simply waits. This legal uncertainty has seriously affected Brazil's petroleum industry in the past years, particularly in the pre-salt area. The technical and logistical challenges are high so it is necessary that large investments be attracted to reduce the costs and increase the technical capacity to bring those reserves to the stream.

It is possible to affirm that the political, public and media pressure has clearly harmed the development of pre-salt areas. Since 2006, no other pre-salt block has been offered in any bidding round. The planned PSA regime has never been completed for Brazil's politicians are fighting over the distribution of future revenues as if they were an immediate cash flow. The pre-salt projects should take years of investments before they become fully operational and produce oil to its full capacity. In addition, it is necessary to verify how the cost recovery will be determined as this might delay even longer the profit split and the government take from these areas.

The legislative changes in the petroleum regime were not focused on a risk–reward scheme as announced by the government. If the pre-salt geology favored investment, then higher fiscal terms could be imposed in the industry without any big 'fuzz' and with simple adjustments to the existing regulations. Thus, the political background clearly determined the necessity to change the structure of the petroleum regime so that higher intervention could be arranged and more participation of state companies.

The Ugandan Case

Uganda is estimated to have 2.5 billion barrels of Stock Tank Oil Initially in Place (STOIP) and an estimated 1 billion barrels of recoverable reserves of oil and gas. The discovery is located around the Albertine Graben in the most northern part of the western arm of the East African Rift System. It is close to Uganda's northern border with the Republic of South Sudan and its western border with the Democratic Republic of Congo. The Albertine Graben is divided into eleven exploration areas. Uganda is landlocked and the closest coastline is the port of Mombasa in Kenya approximately 1200 kilometres away. Due to this distance, the transportation of oil and gas to the coast poses an infrastructure challenge.

There is also the need for a secure supply of energy. Uganda relies exclusively on Mombasa for its access to imports and especially petroleum imports. It takes on average 22 days for cargo to reach Uganda from the port at Mombasa. So Uganda's infrastructure challenge is heightened by the desire for a secure supply of energy products.

In addition, the Albertine Graben is an ecological treasure chest. Over 50 percent of birds, 39 percent of mammals, 19 percent of amphibians, and 14 percent of reptiles and plants found in mainland Africa are found in this region. Therefore, maintaining the ecological diversity of the Albertine Graben and simultaneously exploiting the hydrocarbon resources is of paramount importance.

Originally, the geological, political, ecological and infrastructural risks made Uganda unattractive to investors seeking to explore upstream opportunities. Despite the attempts of the various governments between 1938 and 2006, only two exploration wells were drilled. The current government was able, to its credit, to attract investment in the prospective region and the results of the various Production Sharing Agreements have been discoveries that would place Uganda among the top fifty producers in the world.

The aggressive exploration activity carried out between 2006 and 2009 by Tullow Oil and Heritage Oil and Gas established a working petroleum system with a success rate of 90 percent of hydrocarbon potential from the wells that were drilled. It is important to note that only 30 percent of the Albertine Graben has been explored and that is just one of five sedimentary basins in Uganda. The others remain totally unexplored.

Since 2006 the Government has not

entered into any new agreements or held a bid round. The stated concern of Government is to have the necessary laws in place before any licensing can occur. It is also interested in developing both the midstream and downstream infrastructure to ensure the availability of petroleum products in the country. Thus it has presented three bills to Parliament for enactment. One deals with the upstream sector, one with the midstream sector and the third with Revenue Management.

Exploration in Uganda has raised excitement and stirred national debate and political contestations. The term 'resource curse' has gained particular prominence in public discussions. Members of Parliament, civil society and national and international NGOs have all made robust contributions to the debate. The Government is being challenged to be more transparent and there is also a strong demand from certain Members of Parliament to give Parliament an oversight role in managing the petroleum sector. The cultural and traditional institutions around the Albertine Graben are also demanding up to 15 percent of gross oil revenues when the oil starts flowing. The political disputes and debates on how to manage the oil sector in Uganda have led to a freeze in the award of new licenses.

In opting to have the legislation in place before any further licensing rounds, the Government has decided to resolve and settle the political issues or at least to have the questions opened up and explored. As at the time of writing, the Bills are still with Parliament. The Parliamentary process has been long and drawn out. In accordance with the Rules of Procedure of Uganda's Parliament after the Bills were presented to the House they were then referred to a parliamentary committee for scrutiny. The committee first required basic training in oil and gas law. Many civil society actors, international NGOs, academicians and industry players presented the concerns they had with the Bills to the committee, which thus became the centre of political contestations regarding the Bills. Even traditional and religious leaders presented their views on the Bills. Therefore, Parliament has the task of making law. In respect of oil and gas, it must first appraise itself on the basic terminology. As a result, the law has been delayed. The committee is expected to report back to Parliament in the first week of September.

It is submitted that the actions of the Government of Uganda and the debate in the country should take cognizance of developments occurring in the East African region. Significant exploration activity is happening in Kenya, Tanzania, Ethiopia, Mozambique, to mention a few. Uganda is competing with her neighbours for investment capital as they are all net importers of capital. In looking to create the best laws Uganda should not forget a cardinal rule of commerce; time is money.

Conclusion

It is clear that the Brazilian and Ugandan authorities desired to maximise the government take from their new and highly profitable prospective reserves. This is an understandable approach, as they must ensure that the legislation in place provides a fair compensation for the government in relation to the related risk-reward. However, it is important to remember that neither Brazil nor Uganda is comparable to countries like Norway. They cannot afford to spend years discussing what to do with their natural resources, nor to put aside most of their income from the petroleum industry in a reserve fund for future generations. Both countries require investments on the ground to increase their GDP, develop their poor infrastructure, provide more jobs, increase the knowledge of their hydrocarbon reserves, and the like.

Uganda adopted a harsh approach as no block could be offered until the new legislation had been approved. Brazil took a gentler approach as the new legislation focused on a specific location so that the remaining areas were not affected. However, both countries face difficulties to balance the interests of the parliament, media, civil society and the petroleum sector. Nevertheless, it is quite clear that their decisions delayed investments and exploration on their territories.

It is of course important to strike the right balance between the protection of natural resources and developing the economy as both deal with public interest. But what is paramount is that the petroleum industry involves a long process between awarding a block and producing oil and this is particularly true for both Brazil and Uganda. Since it might take several years to start a proper cash flow from an oil and/or gas field, all the parties involved should focus their time and energy to solve the matters in the short term rather than speculating about future income and dealing with problems in a theoretical and inefficient manner. ■