special report

"...we are ready: we have identified all bidders who intend to build this pipeline, who will supply the equipment, and all that; when we have the financing agreement and HGA finalised, then a shareholders' agreement, we'll be ready to launch the project," EACOP PROJECT DIRECTOR, MR MAXIM MARCHENKO

Contrast

OIL EXPORTING. Uganda as the oil exporting country is mostly interested in optimal development: the oil companies are interested in steady crude supply and cheap project: while Tanzania's main concern is taxes and greater leverage on local content, for which they are actually playing hardball.

Pipeline dreams: Inside the Uganda- Tanzania

Timeline: The governments of Uganda and Tanzania, and the Joint Venture (JV) partners, Tullow Oil, Total E&P and Cnooc say they are looking at not later than August as deadline for conclusion of all agreements and announcing Final Investment Decision (FID) for the proposed East African Crude Oil Pipeline (EACOP). Officials from both sides say the timeline is achievable and there is commitment but as **Frederic Musisi** writes in this four-part series, there is more than meets the eye.

Meeting. Front left to right: The minister of Energy, Ms Irene Muloni, President Museveni and Total Group CEO Patrick Pouyanne in 2016 in Uganda. PPU PHOTO

In between the fast-turning news cycle, of terror attacks next door in Nairobi and the merrymaking over Primary Leaving Examinations results in the week of January 18: the French oil major Total's chief executive and chairman, Patrick Pouyanné, jetted into the country for discussions with President Museveni.

Mr Pouyanne's, who was named chief executive of the French multinational oil giant in October 2014, first visit to Uganda was in mid-December, 2015 to among others underpin his company's choice of the southern—Hoima to Tanga—route for the proposed crude oil export pipeline, now known as the East African Crude Oil Pipeline (EACOP).

His recent visit was purposely to review the [slow] progress of operations in Uganda; the issues at hand included closing the Anglo-Irish Tullow Oil's farm down transaction: particularly the contention on paying Capital Gains Taxes (CGT), and resolving some of the sticking issues that clouded the ongoing EACOP negotiations.

The sticking issues included coexistence of Uganda's proposed refinery alongside the pipeline which presented a challenge of crude oil supply and led to shuffling on an agreeable pipeline business model.

Business model

In developing the EACOP business model, initially the government and oil companies were working with recoverable oil volumes between ranges of 1.4 billion and 1.7 billion, out of the confirmed 6.5 billion volumes. However, for purposes of approaching international financers both parties agreed to zero down on "derisked" volumes.

In statistical representation, three models were advanced; Probability (P90)—that the 1.4/1.7 billion barrels are available or could even exceed: P50 for the moderate estimates, and P10 that the volumes could be lower.

Sources familiar with ongoing discussions told *Daily Monitor* that the safest model the both parties decided to work with—the lowest financers are willing to work with anyway—is the P50: in effect bringing down [recoverable] volumes to 1.046 or roughly 1.1 billion barrels.

"The business model helps you to determine how much you can make—invest and make—so you have to work with conservative estimates," one official explained on condition of anonymity given sensitivity of the matter. "It is not that the crude oil disappeared, no! We are continuing with appraisals (improving knowledge of the oil field) so there could be more or less crude, but for now that is treated outside the bracket of P50."

The revision of oil volumes led to reviewing the pipeline business model several times, sources added, including the oil companies one time revising the transit tariff from $12.2 (about Shs44,492) per barrel detailed in earlier feasibility studies which formed

The big question. Whether the timelines can be met. For Uganda, the coming months until 2021 will packed with politics: with the incumbent fighting at all costs to remain. Financiers usually prefer to watch events from an arm's length.

basis for adopting the Tanga route in Tanzania, to $16 (about Shs58,351).

The transit tariff is determined by the amount of crude moving through the pipeline, the capital and operating expenditures, respectively, and the return on investment. The pipeline is a merely a medium to take Uganda's crude oil to the international market, wherever prices are favourable; so the higher the tariff/transport the less benefits, added to other costs of getting it (oil from the ground or cost oil).

In the same regard the oil companies—Tullow, Cnooc, and Total E&P—had wanted the pipeline delayed so the pipeline takes all the crude oil for the pipeline business model to make sense.

When the two parties first signed a framework for commercialisation of Uganda's crude oil in February 2014, the government was nursing ambitions of a smaller refinery of 30,000 barrels per day (bpd), which it was also agreed would get a first right of call to crude, but along the way government changed to 60,000bpd.

This posed a dilemma, but government insisted on both projects being developed simultaneously. This too became a sticking issue as government is already in separate talks with a consortium of Italian and American firms to develop the refinery.

After the Mr Museveni and Mr Pouyanné meeting, it was indicated that the latter's side would put the deliberations into writing as a declaration of commitment and share the communique with President Museveni in Davos, Switzerland the week that followed: when the two principals agreed to meet again on sidelines of the World Economic Forum.

Sources confirmed to this newspaper that the communique detailing Total E&P's commitments was shared with government at the end of January. The commitments include paying some Capital Gains Tax on top of the Shs85 million paid by Tullow out of the $167m (Shs609b) tax assessment; as a result it is expected that Total E&P and Cnooc will pool $82m (Shs302m).

Cnooc told this newspaper "the CGT issue is still under discussion: so far no conclusion has been reached from neither partners nor government."

The matter is still under intense discussions including a payment schedule, but in the likely event that Cnooc balks on payment of the the CGT it means Total E&P will have to go at it alone.

Tullow sold 21.57 per cent of its stake in the upstream/oil fields—Exploration Areas (EA): EA3 (Kingfisher) with one production licence, and EA 3A and EA2 (now called Tilenga) with nine production licences—to Cnooc and Total E&P, respectively, for $900m (about Shs3.4 trillion). The CGT off this transaction is $167m.

Tullow, however, maintained a 10 per cent stake in a non-operator position.

CGT is a tax on the profit when you

1,445km

Pipeline length. The pipeline will run 1,445km from Hoima in mid-western Uganda to Chongoleani terminal in Tanga at the Indian Ocean.

296km

Length of Ugandan section. 296km through 10 districts.

sell (or dispose of) something (for example an asset) that has increased in value over time. Sources indicated that both parties—oil companies and government—are now working on a payment schedule of the CGT.

Other commitments included fixing the transit tariff to $12.77 (Shs46,316), and supporting the Uganda government efforts of developing an oil refinery, including acquiring 11.5 per cent stake in the project.

The same commitments were reiterated by the Total E&P Uganda general manager, Mr Pierre Jessua, in a February 1, memo describing the Museveni-Pouyanne meeting as "warm and fruitful" leading to significant progress on the issues at hand.

In the memo, Mr Jessua reinforced the company's support for Uganda's 60,000 barrels per day (kpbd) refinery: fixing the tariff to $12.77—cannot go above this mark regardless of the project economics: a "pragmatic approach" to finalising Tullow's farm down: and, "smoothly working towards translating all elements of the Inter-Governmental Agreement (IGA) which the governments of Uganda and Tanzania signed in May 2017, "into law to create the necessary framework for the pipeline.

Loosening up

It has also been resolved that the pipeline will take 230,000 barrels per day (bpd), pending the refinery. When the refinery, which particularly President Museveni has remained fervent about despite its debatable economics, comes on board whenever, it will get its share of 60,000 barrels lessened from the 230,000bpd feed to the pipeline.

Both government and industry sources described the January 18 meeting "as a good visit" that loosened up things—to speed up negotiations and conclusion of the Host Government Agreement (HGA).

The HGA— a precursor to other key agreements such as the shareholders agreement, and establishment of a pipeline company (PipeCo), which will in turn negotiate the Project Financing Agreement and Transportation Agreement—details the rights and obligations of each of the parties involved in the multi-billion-dollar project.

The parties are, Uganda through the National Pipeline Company (NPC), and Tanzania through its national oil company— Tanzania Petroleum Development Corporation (TPDC): and Total E&P, Cnooc, and Tullow. NPC is the subsidiary of the Uganda National Oil Company (UNOC), which is mandated to handle the country's commercial in-

80%

PROJECT CAPEX. It is estimated that 80 per cent of the project capex will be spent in Tanzania. 80 per cent of the pipeline, 1,147km, will be on the Tanzanian side

"There are legal regimes in both countries but we have been able to harmonise some of the aspects such as who are you taxing: you need a legal entity—each state wanted to be clear on what is the structure of this entity to be able to maximise returns," THE NATIONAL PIPELINE COMPANY GENERAL MANAGER, JOHN HABUMUGISHA

oil pipeline talks

PIPELINE PROJECT

Phases. The project Engineering, Procurement and Construction tenders have been divided in three lots; the Tanzanian pipeline segment will be constructed in two parts, to be awarded to separate contractors, and one lot for the Ugandan segment.

Construction is expected to take at least 36 months, creating some 10,000 jobs and a lot of local prospects for local content for both countries. The pipeline represents the largest trade deal between Tanzania and Uganda currently comprising $120m (Shs425b) annually in each direction.

terests in the petroleum industry.

Mr Jessua, told *Daily Monitor* in an interview that following January 18 meeting they now have up to "summer"—between June and September—as deadline for negotiating all agreements and announce Final Investment Decision (FID).

"I'm optimistic that the deadline given is feasible, and when I see the momentum I think it is reachable," Mr Jessua, who took up the Uganda job last August and is charged with steering Total E&P's operations through FID and execution, said.

Total E&P backed the Hoima-Tanga route as the least cost route for Uganda to transport its oil to the international market on among other grounds, convenient constructability (flat terrain), highest availability (fully functional), lowest environmental footprint, and provided the shortest schedule for seeing first oil export—earliest mid-2020. This was of course besides Tanzania's convenient land tenure of no freehold system.

The route was concretised in 2017 with signing of the Heads of State Agreement, and the Intergovernmental Agreement (IGA) that binds the Uganda and Tanzanian government on the project; from signing, the IGA took another four months for ratification by both countries.

The IGA deals with horizontal issues that concern the pipeline infrastructure as a whole, such as co-operation, land rights, harmonisation of tax structures applicable and issues relevant to the project implementation while the HGA deals with vertical issues , among others governmental obligations, investor duties, environmental and other relevant standards, liability, and closure of the project.

The pipeline will run 1,445km from Hoima in mid-western Uganda to Chongoleani terminal in Tanga at the Indian Ocean.

Different parties, each with different interests

Negotiations on the HGA commenced in August 2017, but are taking longer than expected.

Technocrats from Uganda and Tanzania convened in Kampala on January 25 for the third round of discussions on the HGA and again in Dar-es-Salaam a fortnight later in an attempt to harmonise the two HGAs but that did not materialise.

In Kampala, the weeklong discussions started with meetings of technocrats and climaxed with the meeting of ministers of Energy, Finance, Lands, and Constitutional Affairs from both sides; the meeting which was earlier scheduled to run up to 4pm run until 9pm. When they eventually came out, disagreement was clearly written on their faces.

Energy minister Irene Muloni and her Tanzanian counterpart Medard Kalemani during the Kampala meeting said the two sides had failed to agree on "certain aspects" such as arbitration which they said had been referred to the Heads of State for more guidance before each side can pronounce itself on the matter.

There are two HGAs for Uganda and Tanzania being negotiated in parallel, but require harmonisation. Once the two have been harmonised, the two sides will negotiate the same with the oil companies and subsequently sign.

The National Pipeline Company general manager, Mr John Habumugisha, told *Daily Monitor* that the HGA details aspects of fiscal regime (taxation), local content, movement of labour/contractors and material, among others.

"The good side here is the shareholders of PipeCO are the state owned companies of Uganda and Tanzania, and the oil companies; the more you develop it with up streamers the better because an external party in the upstream would be looking for the highest possible tariff. What we have is a good structure in that we have a shared goal in terms of what the pipeline is meant for," Mr Habumugisha added.

"So we had to structure a company that allows Uganda as an oil producer to also achieve its interests of maximizing value in the upstream, but for that to happen you needed a low tariff because it's about how much barrel you produce and what is the price of the barrel less cost of the transport, which is called tariff: so the lower the tariff the better."

Mr Habumugisha exuded optimism that the remaining agreements can be concluded and FID announced in the next months within the set deadline.

The capital expenditure for the project is $3.55b (Shs13 trillion), 70 per cent of which will be raised from international lenders. Each of the party has financial transactional advisers—Stanbic Bank for Uganda and Tanzania, Japan's Sumitomo Mitsui Banking Corporation Europe Ltd for Total E&P, and Industrial and Commercial Bank of China Limited (ICBC) for Cnooc—on board.

Cnooc told this newspaper in an email that as partners they will finance the project "at the respective level of their equity in upstream." The composition in upstream/oil fields is Cnooc and Total E&P each 37.5 percent shareholding: Tullow with 10 percent: and Unoc with 15 percent, although the financing structure of the pipeline is yet to be built.

13t

Cost. The capital expenditure for the project is $3.55b (Shs13 trillion), 70 per cent of which will be raised from international lenders.

Questions

Uganda will be taking a 15 per cent stake in the pipeline to match the interests in upstream; the big question, however, is where the money, approximately $230m (Shs838b), will come from. No one has the answer for now.

Officially Tanzania is yet to decide how much stake they will take in the project. But according to the country's lead negotiator on EACOP, Mr Goodluck Shirima they are already in the "initial" process of mobilising their equity.

Sources indicated that the dragging on the HGA is the need to harmonise interests of all parties.

Uganda as the oil exporting country is mostly interested in optimal development: the oil companies are interested in steady crude supply and cheap project: while Tanzania's main concern is taxes and greater leverage on local content, for which they are actually playing hardball.

Eighty [80] per cent of the pipeline, 1,147km, will be on the Tanzanian side, and it is estimated that 80 per cent of the project capex will be spent in Tanzania.

Notwithstanding, the EACOP project director, Mr Maxim Marchenko, separately told this newspaper that all preparatory activities—such as the technical Front End Engineering Design (FEED) studies to define characteristics of the pipeline to evaluate the costs in the schedule of implementation, pipeline designs, mapping of the pipeline corridor from Hoima to Tanga, environmental social impact assessment, resettlement action plan studies, geotechnical and geophysical studies—have been completed.

"The major cornerstone of this project is the Inter-Government Agreement which we are now translating into the Host Government Agreement; one for Uganda, and another for Tanzania, with the aim of giving a stable and harmonised project frame for investors, and shippers of oil from Tanzania, a stable regime; which is being finalised, but hope can finalise everything soon," Mr Marchenko said.

In the second part tomorrow, we look at the uphill task of acquiring land for the pipeline from Hoima to Tanga