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OIL & GAS ALERT

Production sharing contracts and Kenya's Petroleum Act

On 12 March 2019, the Petroleum (Exploration and Production) Act, Chapter 308 of the Laws of Kenya, which came into force in 1984, was repealed as Kenya's President assented to the Petroleum Act, 2019 (Petroleum Act).

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The new Petroleum Act aims to facilitate greater accountability and transparency and to bring the legislative framework, relating to the upstream sector, in line with current industry standards and practices.

What follows is a brief overview of the Petroleum Act, particularly in respect of production sharing contracts (PSC).

The Petroleum Act states that petroleum operations will be regulated by the Cabinet Secretary of the Ministry of Petroleum and Mining (Cabinet Secretary) and the Energy and Petroleum Regulatory Authority. The Act also establishes the National Upstream Petroleum Advisory Committee (Advisory Committee), whose principal role entails advising the Cabinet Secretary on negotiations of Petroleum Agreements with local and international oil companies (referred to in the PSC as "*contractors*"). The Advisory Committee consists of representatives from the relevant government ministries and departments, as well as representatives from the Energy and Petroleum Regulatory Authority and the Council of Governors.

A Model Petroleum Agreement in the form of a PSC, is introduced, as a schedule to the Petroleum Act, and the Act grants the Cabinet Secretary power to negotiate, award and execute Petroleum Agreements on behalf of the Kenyan Government. The Petroleum Act also prescribes two approaches to be followed when negotiating a Petroleum Agreement with a contractor:

1. the Cabinet Secretary may enter into a Petroleum Agreement after the conclusion of bid rounds; and
2. the Cabinet Secretary may negotiate directly with a sole contractor, on the recommendation of the Advisory Committee, if certain conditions are met (such as a lack of bids having been received, no bids satisfying the minimum criteria or a lack of data in relation to a particular block).

A sample Participation Agreement is also attached as Appendix C to the Model Petroleum Agreement, which outlines the general terms and conditions under which the Kenyan Government, by way of the National Oil Corporation of Kenya, would participate in the upstream petroleum operations. The Model Petroleum Agreement sets out the profit sharing mechanism between Kenyan Government and the contractors and stipulates how taxes and royalties will be applied.

Under the Petroleum Act, Petroleum Agreements, together with field development plans, must be reviewed and ratified in Parliament, in conformity with Article 71 of the Constitution of Kenya. The ratification process requires public consultation before approval and effectively provides that all Petroleum Agreements become public documents, to ensure accountability and transparency. The parliamentary ratification process was not, however, required in respect of Petroleum Agreements entered into prior to the commencement of the Petroleum Act.

Production sharing contracts and Kenya's Petroleum Act*...continued*

The Kenyan National Government's share of the profits are apportioned as follows: (i) 75% to the Kenyan National Government; (ii) 20% to the County Government; and (iii) 5% to the local community.

Local content requirements

Local content requirements on petroleum operations, to be procured in accordance with the Petroleum Agreement, aim to ensure petroleum operations carried out in Kenya add value to the local economy by creating jobs and requiring the procurement of locally available goods and services. It is important to note that the cost of such local content is required to be at the prevailing market rate, in order to encourage the procurement of local content, while ensuring that projects remain fiscally viable.

Production or revenue sharing in the Model Petroleum Agreement, aims to ensure that local communities benefit directly from exploitation of petroleum resources located in their counties and sub-counties. The Kenyan National Government's share of the profits are apportioned as follows: (i) 75% to the Kenyan National Government; (ii) 20% to the County Government; and (iii) 5% to the local community, payable to a trust fund managed by a board of trustees appointed locally.

Finally, non-compliance with the provisions of the Petroleum Act attract penalties, and provision has been made to prosecute offenders who participate in vandalism of upstream petroleum infrastructure and installations or who spread fake or malicious information with the intention of causing reputational damage and causing financial losses for contractors. This is a welcome addition.

The upstream petroleum sector in Kenya is expected to undergo significant growth in the coming years and the impact the Petroleum Act will have on the sector should not be understated. Though there is limited production in Kenya at this stage, there are a number of unexplored blocks and these legislative developments will go a long way to providing international investors, contractors and suppliers with confidence as they invest in the sector.

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