

THE OIL AND GAS
LAW REVIEW

SIXTH EDITION

Editor
Christopher B Strong

THE LAWREVIEWS

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PREFACE

2018 has been a transitional period for the international oil and gas industry.

With the industry enduring a fourth straight year of low oil prices, and with no prospects for a significant increase in sight, participants in the industry have been forced to adapt. Oil companies must continue to be disciplined, allocating scarce capital only to their best prospects, and shelving less promising projects for future years. Some in the industry have already started to worry that by reducing capital expenditures the seeds of a future price shock are being sown.

Oil-producing countries have been in a similar pinch. Having become accustomed to triple-digit oil prices, the 'new normal' of US\$50 oil has produced a grim budgetary reality. Producing countries that had only recently tightened fiscal terms in response to high oil prices must now considering loosening them again in order to attract investment. In Saudi Arabia, the world's largest producer, plans are afoot to sell a minority stake in the company to foreign investors in order to raise cash to diversify the country's economy, a move that would have been unthinkable a few years ago.

Yet amid the ongoing turbulence there are opportunities. The necessity for existing companies (many of which are over-leveraged and cash strapped) to offload parts of their portfolios will create opportunities for new, leaner competitors to arise. US shale producers, whom many were prepared to write off in the low oil price environment, have made dramatic improvements in efficiency and learned to calibrate their acreage to different oil price environments, focusing on their richest prospects when prices are low and adding lower-value opportunities as prices escalate. Among the major oil exporting countries, low oil prices have provided the impetus for long-needed structural reforms to diversify their economies beyond the extraction of petroleum.

The international oil and gas industry has always been cyclical. Although the last three years have been eventful, they are by no means the first downturn the industry has faced, nor the last. I have no doubt that the years ahead will continue to present challenges and opportunities for practitioners in this most dynamic of industries.

As always, I would like to thank our contributing authors for their outstanding contributions to this year's edition of *The Oil and Gas Law Review* and also the publishers at Law Business Research for their tireless work in bringing this all together.

Christopher B Strong

Vinson & Elkins LLP

London

October 2018

DEMOCRATIC REPUBLIC OF THE CONGO

*Olivier Bustin and Luiza Savchenko*¹

I INTRODUCTION

The Democratic Republic of the Congo (DRC) is the most populous French-speaking country in Africa and a very attractive prospect for investors owing to the richness of its natural resources, such as cobalt, copper, cassiterite, gold, manganese, diamond and petroleum.

In numerous official and unofficial speeches, it has been emphasised that the DRC has an important upstream oil potential, in particular in three sedimentary basins: the Coastal Basin (located in Kongo Central, extending offshore past the Congo River estuary), the Central Basin and the western branch of the East African Rift. Today, the production is around 25,000 barrels per day. However, experts estimate it could go up to 100,000 barrels per day, once some of the blocks in the east of the country have entered into a production phase. Despite such wealth, the DRC is struggling to sufficiently develop its oil and gas industry upstream (prospecting, exploration and exploitation) and downstream (refine, transport, storage of petroleum products, supply of petroleum products, import and market petroleum products).

II LEGAL AND REGULATORY FRAMEWORK

Since its independence in 1960, the DRC has gradually put in place its oil and gas legal framework. In the Constitution of 2006, the DRC affirms its permanent sovereignty, in particular on the Congolese ground, subsoil, waters and forests, as well as air spaces and territorial sea.

i Domestic oil and gas legislation

The previous legislation regulating activities in the mining and hydrocarbon sector are Act No. 67-231 of 11 May 1967, which was repealed by Ordinance-Law No. 81-013 of 2 April 1981 (the 1981 Ordinance-Law), which in its turn was repealed by Law No. 15/012 of 1 August 2015 (the 2015 Law), since over time, several provisions of the 1981 Ordinance-Law became obsolete and the hydrocarbon legislation needed revising to provide more transparency.

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The 2015 Law gave the hydrocarbon sector a new leap of life, bringing several innovations, and Decree No. 16/010 of 19 April 2016 (2016 Decree) consolidated those modifications and conditions regulating the hydrocarbon sector.

Prior to that, the Regulation of Exchange of 28 March 2014 (the Exchange Regulation), entered into force in September 2014 and ensures some exemption rules for petroleum companies.

Lastly, it is noteworthy that Law No. 11/009 of 09 July 2011 on fundamental principles relating to the protection of the environment sets out certain requirements and procedures that are relevant for those in the oil and gas industry.

ii Regulation

The Ministry of Hydrocarbons is responsible for development, management and implementation of the national policy on the institutional framework for hydrocarbons in the DRC. The mission is carried out through its technical and administrative body, the General Secretariat. The decisions of the Minister of Hydrocarbons must be further approved by the Council of Ministers, the body competent to approve concessions contracts.

The intervention of the Minister of Finance is necessary for the collection of taxes, duties and fees related to hydrocarbon activities.

The state participates in upstream and downstream hydrocarbon activities through the national wholly owned company acting on its behalf (Sonahydroc), which is entitled to a non-assignable participation of at least 20 per cent. Sonahydroc engages in these activities with another company awarded the hydrocarbon licence (the contractor) through a joint venture agreement, governed by the Congolese law, without creation of a separate legal entity.

The DRC has established a public institution to save, manage and delegate the funds for future generations, from a portion of the state's profit from the oil activities.

iii Treaties

The DRC is a member of several conventions, protocols and international organisations, including the following:

- a* International Maritime Organization;
- b* International Convention on Oil Pollution Preparedness, Response and Cooperation (OPRC) of 1990, ratified by the Law No. 11/016 of 15 September 2011;
- c* United Nations Framework Convention on Climate Change;
- d* Kyoto Protocol;
- e* Organization for the Harmonization of Business Law in Africa (OHADA), since 2012 (in this regard, it is worth highlighting that investors can refer to OHADA arbitration, to the Common Court of Justice and Arbitration (CCJA) or another arbitration court. The CCJA judge is competent to grant *exequatur* to arbitration sentences to be enforced in the DRC); and
- f* Common Market for Eastern and Southern Africa (COMESA) to encourage private investment and reduces obstacles for the free movement of persons, goods, services and investment in COMESA area.

Moreover DRC has signed a trilateral agreement with COMESA, Southern African Development Community and East African Community, encouraging, among other things, free movement of investments in the member countries.

The DRC has entered into bilateral investment treaties with other countries, such as France, Germany, Switzerland, the United States, and double taxation treaties with South Africa in 2005 and Belgium in 2007.

Lastly, the DRC has ratified the International Centre for Settlement Investment Disputes (CIRDI), the impartiality of which is viewed as a guaranty for the investments in the DRC, as well as the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).

III LICENSING

i Tendering procedure

Pursuant to the 2015 Law, the Minister of Hydrocarbons is responsible for granting the authorisations based on a specific public tender procedure, which is different from the public procurement procedure in terms of selection criteria, purpose of the contract, managing authority, etc.

Previously, under the 1981 Ordinance-Law, mineral rights for hydrocarbons were granted by a Petroleum Convention, which provided the conditions for the exercise of hydrocarbon rights; it also gave free rein in negotiating the terms of the agreements, including tax and customs provisions, but lacked transparency in granting permits since there were no tender procedures in place.

The 2015 Law provides in its implementing decree, that the Minister of Hydrocarbons shall submit to the Council of Ministers a file containing certain criteria, including the technical and financial, to be met by the candidates. The Minister of Hydrocarbons shall then establish an *ad hoc* committee to organise and overview the tender for the allocation of hydrocarbon rights. As a general rule, any oil and gas company can apply to participate in the tender, unless the tender is restricted by the Council of Ministers.

Applications that do not meet the criteria indicated in the request for expression of interest are rejected and the applicants are notified in this respect. Applications that meet the criteria are preselected and the applicants receive the preselection notification. The Minister of Hydrocarbons prepares a final report of the tenders and submits it to the Council of Ministers.

The preselected companies are provided with specification books for a non-refundable fee (the amount is indicated in the letter of invitation). Such specification books contain everything necessary for the potential oil contract, including an invitation letter, technical offer, financial offer and terms of reference.

After a series of verifications, the *ad hoc* committee draws up and submits the evaluation report to the Council of Ministers. The Minister of Hydrocarbons notifies the bidding companies of its decision to select or reject 15 days after the evaluation report is submitted. Non-selected companies may appeal the decision. The tender is followed by the negotiation with an inter-ministerial commission composed of experts from the Ministries of Hydrocarbons and Finance and, upon agreement, signing the contract.

ii The types of petroleum contract in DRC

The production sharing contract

The production sharing contract provides for the sharing of hydrocarbon production between the state and the company or group of companies in which state-owned Sonahydroc holds shares. Sonahydroc first enters into a joint venture agreement with other private companies

under Congolese or foreign law. Under the 2015 Law, the participation of Sonahydroc of at least 20 per cent is compulsory and non-assignable, unlike under the 1981 Ordinance-Law, when it was optional. The production sharing contract must contain information relating to the block, duration of the various phases, commercial, socioeconomic and environmental obligations of the parties, any renegotiation clauses by the way of amendments, bonus sharing mechanics and termination events. The production sharing contract covers two phases: exploration phase and operating phase.

The block service contract

The block service contract allows a third party on behalf of the state or Sonahydroc to carry out petroleum activities at its own risk and expenses. Such third party may be financed by the state in the case of a contract for technical assistance in realisation of the petroleum works for the development of a block for adequate remuneration in cash. The block service contract may take the form of a service-at-risk contract or a technical assistance service contract, and, among other things, determines the execution terms and applicable tax regime. As a general rule, the exploration and operating expenses are paid without interest; however, expenses related to the development investments are remunerated with interest. The block service contract also has two phases: exploration and exploitation.

Typically, a special operating committee is created for each contract, which is responsible for examining and validating the orientation, programming and execution of petroleum works.

The penalties for breach of contract obligations

For upstream activities, the contractor's breach of obligations may result in:

- a* invalidity of the contract, in particular, if it was assigned without prior approval of the Minister of Hydrocarbons;
- b* termination of the contract in accordance with the terms of the contract, provided that the Minister of Hydrocarbons sends 15 days prior notice;
- c* refusal to renew the right; or
- d* compensatory allowances of at least 35 per cent of the costs of the unrealised works.

The contractor may also renounce its rights, for example, abandoning the works, which will be ascertained by the Minister of Hydrocarbons.

IV PRODUCTION RESTRICTIONS

The DRC in its 2015 Law and 2016 Decree imposes certain restrictions with respect to permits granted to companies in oil and gas industry, as discussed below.

The prospection permit is non-assignable and non-transferable and valid for a period of 12 months, renewable only once for a period of six months. To obtain a prospecting permit, the contractor shall fulfil all technical and financial criteria of the invitation to tender, submit to the Minister of Hydrocarbons (with a copy to the Secretary General) an application form together with the specifications (as set out by the Minister of Hydrocarbons) and environmental impact assessment subscribed to the specifications, drawn up by the Minister of Hydrocarbons, and present an environmental impact assessment. Generally, in the case of an invitation to tender, the beneficiary of a right to prospect is preselected if he or she has already complied with the specifications.

The exploration right is granted for a period of three years, except for the exploration in the Sedimentary Basins, where the duration of the permit is four years from the date of entry into the relevant contract, and is renewable twice for the same period (i.e., three years for blocks category A and B, and four years for blocks category C and D), which can be further extended for six months. The exploration permit may be transferred (partially or totally) or transmitted with the prior approval of Sonahydroc. For any assignment, Sonahydroc has a pre-emptive right.

The exploitation right is granted for a maximum duration of 20 years, renewable once for a maximum period of 10 years, and is transmissible or transferable under the same conditions. Capital gains on disposals are taxable.

All financial and technical documents of all contractor's entities relating to the petroleum works are subject to periodic audits by the Ministry of Hydrocarbons, with 30 days' prior notification to the contractor before any audits. An additional period of 20 days may be granted upon reasonable request by the contractor. The contractor is required to keep its accounting and financial records up to date, in French and in Congolese francs or US dollars.

Any petroleum company operating in the DRC is also subject to certain obligations, including the obligation to ensure the conformity of its installations, obtain an insurance policy for the installation of its equipment, acquire the necessary means to meet the demand and develop means in order to respond to the increase in national demand, and realise financial conditions in priority with Congolese land and banking institutions.

For each downstream petroleum activity, companies must obtain the following authorisation from the Ministry of Hydrocarbons:

- a* refining contracts to be entered into by the companies and the government, with prior approval of the Ministry of Hydrocarbons (with a copy to the Secretary General) and payment of a fee;
- b* for transportation and storage of the product, the licence for a volume of petroleum product quantity more than 10m³ (for quantities less than 10m³, the Secretary General grants the licence according to Articles 152.2 and 152.4 of the 2016 Decree); and
- c* supply contracts are estimated every year based on the volume, and are granted for a renewable term of four years (renewal is unlimited). Petroleum products are priced on the basis of the Oilgram Price Report (Global Market Report-Platts) or another review specialised in petroleum price determination (Article 187 of the 2016 Decree). Only supply contractors are permitted to export or import petroleum products from a foreign territory from or to the DRC territory.

The import and marketing of petroleum products permits are granted for a renewable term of 12 months, including:

- a* a marketing permit to purchase petroleum products acquired from an importer,
- b* an import permit is a title granted for self-consumption; and
- c* an import and marketing permit allows import and sale by the same operator of petroleum products.

Any breach of obligations in the exploration or exploitation phase is punishable by fines fixed by ministerial decree and in accordance with the terms and conditions of the contract.

For downstream activities, the breach of obligations is punished by withdrawal of exploitation rights and refusal of its renewal. Civil law sanctions will also apply.

The contractor may also be subject to certain penal sanctions if it acts in a way as to pressure or cause the officials of the Ministry of Hydrocarbons to act in violation of the law.

V ASSIGNMENTS OF INTERESTS

Contracts settled before the entry into force of 2015 Law are executed under the previous law, however, any renewal of such contract, including the assignment of interest, is subject to the 2015 Law.

The state has the power to grant the exploitation permits and its renewal. A notification is sent to the person concerned and, if the permit is rejected or not renewed, an appeal is always possible.

VI TAX

From tendering period to the work completion, the contractor shall be subject to the payment of several costs, in particular the cost of providing the specifications, appraised fees, costs of transporting petroleum products, environmental audit fees in the event of an assignment, costs associated with environmental damage, persons and their property, at the renewal fee.

Without prejudice to other taxes, determined by law, the contractor and its subsidiaries, consultants and subcontractors shall be exempted from the corporate income tax. The Tax Directorate and Custom Department issues the exemption certificate to such parties.

i Taxes

Tax for exploration

The registration fee for an exploration permit is determined by the Ministry of Hydrocarbons according to the fiscal zone, as described below. The same system of taxation is applied for the renewal of exploration licence.

VAT is free in the exploration phase.

Assignment rate is 40 per cent. There are no exemption rights, obligations and responsibilities before the assignment enters into force.

Tax for exploitation

The renewal fee for an exploitation permit is determined according to the production.

VAT is payable in the operation phase.

Assignment rate is 30 per cent. There are no exemption rights, obligations and responsibilities before the assignment enters into force.

Other customary royalty and costs

For general upstream activities, the blocks are categorised into four tax zones because of their geological and environmental characteristics: zone A, zone B, zone C, zone D.

For any petroleum activity, the contractor shall be subject to the following taxes, duties, fees and charges:

Royalties are paid in kind or in cash to the state by the contractor, levied on the amount of hydrocarbons produced after certain deductions. Rates vary by the tax area and may not be lower than the following:

a tax area A at 12.5 per cent;

- b* tax area B at 11 per cent;
- c* tax area C at 9.5 per cent; and
- d* tax area D at 8 per cent.

The state's share of the oil profit is fixed according to a progressive scale that shall not be less than the following:

- a* tax area A at 45 per cent;
- b* tax area B at 40 per cent;
- c* tax area C at 40 per cent; and
- d* tax area D at 35 per cent.

The state's share of the excess oil is the excess of the stop-over recoverable costs during the contract. The cost of oil is the fraction of production withheld by the contractor as a reimbursement of costs incurred. The following costs also apply:

- a* the cost stop is the percentage of hydrocarbon production limiting the level of recovered costs incurred by the contractor;
- b* the superficial fee is a fixed fee payable annually in Congolese francs equivalent to US\$100 per square kilometre for an exploration phase and US\$500 per square kilometre for an exploitation phase, and is non-refundable;
- c* the statistical tax;
- d* payment for any administrative document;
- e* the exceptional tax on remuneration of expatriate staff;
- f* the professional tax on the remuneration of nationals;
- g* internal value-added tax on local consumption in the operating phase;
- h* tax on any form of assignment of rights or interests during exploration and exploitation phases; and
- i* at the time of the contract signing, from the rider adds to the renewal of the exploration and exploitation rights, a non-refundable fee is paid to the state by the contractor during the first production. The amount of the fee is defined by ministerial decree and negotiated by the contractor.

Customs

Export and re-export of goods such as core samples, raw oil samples, oil and chemical samples, as well as goods imported under the franchise regime, are free of customs duties and taxes.

The contractor shall also benefit from full exemption from duties and taxes on the export of hydrocarbons produced in the DRC.

The contractor shall also benefit from a customs exemption for the importation of goods exclusively used for the petroleum operations in respect of which they are imported.

The contractor must provide a performance guarantee in a first-class bank approved by the state.

Capital gains on disposal are taxable. The exchange rate is determined by the DRC Central Bank.

VII ENVIRONMENTAL IMPACT AND DECOMMISSIONING

The contractor shall establish an emergency plan to prevent the pollution of petroleum products and is also required to present the environmental and social impact assessment with its rehabilitation plan.

A special provisional fee for possible abandonment work is set up at the operating phase and is paid into an escrow account opened with the DRC Central Bank. This fee cannot be seized or pledged. The cost of abandonment is a cost of the site restoration on completion petroleum operation, and is recoverable for costs providing petroleum activities. In the event of abandonment, the contractor must submit an abandonment plan for approval to the Minister of Hydrocarbons. At the end of restoration works, the Minister of Hydrocarbons grants a certificate of execution to justify the end of rehabilitation works.

As a general rule, exploration or exploitation is prohibited nearby the DRC's towns and villages, wells and water pipes, public buildings and public works, places considered sacred, communication routes and civil engineering structures, unless the concessionaire and the owners or their beneficiaries sign a prior agreement with an agreed compensation.

The contractor may be held responsible for any environmental damages that are caused by activities to persons or the environment and subject to penalties, as well as civil and criminal liabilities.

VIII FOREIGN INVESTMENT CONSIDERATIONS AND SOCIAL SECURITY

LAW

i Incorporation and investment

Any foreign company wishing to enter into a production sharing or block service contract must establish a company under Congolese law for the purpose of carrying out exploration and exploitation activities.

The Exchange Regulation provides certain measures for petroleum companies to control the production, sale and import of oil products. The contractor is allowed to export its entire production, but must sign a declaration model (EB) with an approved bank in the DRC. A beneficiary-company of exploitation and production permits shall sign a specific model of import declaration (IB) for importation of goods with an approved bank.

In certain cases, companies can hold an account in foreign currency in any national bank. They can also hold an account in a foreign international bank to manage the funds that they are allowed to hold outside the DRC.

Companies should pay to the DRC Central Bank or any mandated person fees at the rate of 0.2 per cent for all payments made to or from outside the country.

ii Social obligations

The contracting company is subject to the provisions of Congolese labour law in relation to its staff and is bound by certain social obligations, in particular, contributing annually to the training of administrative agents in the hydrocarbons sector. As a general rule, hiring priority is granted to nationals with equal competence over foreigners.

iii Employment restrictions

Subject to specific derogations, for specific occupational categories in the business sector, the labour administration ensures compliance with the rule that all employers are prohibited

from having foreign nationals form more than 15 per cent of their workforce. However, if there is an exemption provided by bilateral treaties with other countries, investors from such countries may not face such restrictions.

In case of employment of foreign persons, the National Committee decides on the issue and renewal of work cards for such employees. This card-issuing operation is taxable.

Subcontracting or outsourcing the works to other companies is permitted and priority shall be given to Congolese companies.

Legal entities are subject to the provisions of Congolese law and the norms and practices in force in the international petroleum industry.

IX CURRENT DEVELOPMENTS

Despite currently having few petroleum companies in the operational phase, the Congolese oil and gas sector is evolving, and the commitment to establish a stable legal and fiscal policy is a key factor that will enable the country to attract more investors. Introduction into the legal framework of an exemption from corporation tax for contracting companies and their subsidiaries (Article 254 of Decree No. 16/010 of 19 April 2016), exemption of certain export and import activities are measures to boost investment in the oil and gas industry. The transparency policy aimed by government should also encourage investors in this regard.

In a nutshell, the DRC is a big country with huge natural resources from mining and oil, and investing in the DRC can be complex but not impossible. A thought-through approach and well-structured legal advice will help to manage sound petroleum investment.

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Olivier is managing international adviser of the OHADA jurisdictions practice where he has been involved in several transactions. His practice is focused on production sharing contract negotiations, mergers and acquisitions, finance, public-private partnerships and infrastructure projects mainly in connection with the Energy and Natural Resources Sector in Francophone Africa.

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