

Hydrocarbons Law in Madagascar

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During the last 10 years, relatively few companies have performed hydrocarbons exploration and exploitation activities in Madagascar. However, international oil companies (IOCs) have recently expressed an increased interest in both the onshore and offshore territory of the 'Great Island'.



Indeed, the **Office des Mines Nationales et des Industries Stratégiques (OMNIS)**, the agency in charge of the upstream sector, announced the launch of a bid round¹ in the Morondava basin, offshore Madagascar one year ago. Meanwhile, 10 licences have already been granted to IOC from all over the world, including the US, the UK, China, Malaysia, India and Dubai.

The legislation governing exploration, exploitation and transportation of liquid, solid and gaseous hydrocarbons in Madagascar is relatively recent: the law is dated September 23, 1996² (Petroleum Code), completed by a decree on June 23, 1997³. Such activities are placed under the authority of an *organisme technique* (technical body) and a *société nationale* or national company (NOC), which is awarded the necessary hydrocarbons permits and enters into a partnership with IOC for the purpose of hydrocarbons exploration, exploitation and transportation activities in Madagascar.

Regulatory framework

Designated the technical body by decree on November 7, 1999⁴, OMNIS is in charge of hydrocarbons in Madagascar. OMNIS is a state-owned entity under the

authority of the Prime Minister and the technical supervision of the Minister of Energy & Mines. It is managed by a general manager, who is appointed by the government on the proposal of the Minister of Energy & Mines, and supervised by a board consisting of representatives of various ministries.

The exploration, exploitation and transportation of liquid, solid and gaseous hydrocarbons in Madagascar may only be entrusted to the NOC. Therefore, an IOC may only carry out the aforesaid activities through a partnership with the NOC. However, the NOC has not been established yet and, pursuant to the Petroleum Code⁵, the technical body is authorised to act for and in the name of the NOC until it is actually established.

We understand that the government intends to proceed with the creation of the NOC as soon as a hydrocarbons discovery is proven to be commercially viable. In the meantime, OMNIS is therefore the keystone of the hydrocarbons regime in Madagascar and acts in the capacity of both the technical body representing the state and the representative of the NOC. This may cause some legal confusion in the management of hydrocarbons activities in Madagascar and particularly with regard to the relationship between OMNIS, the NOC and the IOC.

The hydrocarbons permits

There are three kinds of hydrocarbons permits in Madagascar: the exploration permit, the exploitation permit and the transportation permit. Hydrocarbons transformation is subject to the Petroleum Code⁶; however no provision of the Petroleum Code specifically deals with this activity.

1 The exploration permit is granted for an initial period

not exceeding eight years. It may be extended several times, each time for a maximum period of two years. There is no compulsory acreage relinquishment obligations set forth in the Petroleum Code.

- 2 An exploitation permit is 'automatically' granted in the case of a commercially viable discovery within the area covered by the exploration permit. The exploitation permit is granted for an initial 25-year period (35 years in respect of gas production). It may be extended in five-year periods.
- 3 Transportation through pipelines from an oil field to a storage, a loading or a transformation facility located in Madagascar, requires a permit, which is granted for an initial 25-year period (35-year in respect of gas production). It may also be extended in five-year periods.

Hydrocarbons permits are awarded by a presidential decree on the proposal of the general manager of OMNIS. For the reasons explained above, the hydrocarbons permits, which may only be granted to the NOC⁷, are currently issued in the name of OMNIS in its capacity as a representative of the NOC. However, it should be emphasised that the Petroleum Code does not provide for the transition between OMNIS and the NOC upon the establishment of the NOC, and hydrocarbons permits do not include any reference to the NOC. However, we assume that the said hydrocarbons permits will be transferred to, or re-issued in the name of the NOC once it is established.

Madagascar is a rich and fragile ecosystem and the protection of the environment constitutes a real concern for the Malagasy authorities. Pursuant to the *Charte de l'Environnement* (environment charter)⁸ and its implementing regulations⁹, each stage of the hydrocarbons activities is subject to the prior delivery of an environmental permit by *Office National de l'Environnement* (national environmental agency). It should be emphasised that the procedure pertaining to the delivery of the relevant permit is relatively sophisticated and demonstrates the extended interest of the Malagasy authorities in the protection of their environment.

Contracts with the NOC

The Petroleum Code is very flexible on the type of partnerships that may be entered into by the NOC and

the IOC for the purpose of hydrocarbons exploration, exploitation and transportation activities in Madagascar. Indeed, the Petroleum Code refers to any kind of contract usually entered into in the international petroleum industry and in particular *contrat de partage de production* (production sharing contracts, PSCs) and *association en joint-venture* (joint venture contracts).

The most common type of contract in Madagascar is the PSC, although all other types of petroleum contracts would be valid. Indeed, according to the information disclosed by OMNIS, all contracts signed by OMNIS after the adoption of the Petroleum Code but one are PSCs¹⁰.

Article 15 of the Petroleum Code provides a list of issues to be addressed in the PSC. The most relevant issues are the following:

Management of the operations

As a common practice, the IOC is entrusted with exploration and exploitation operations under the supervision of an operating committee consisting of members appointed by the NOC and the IOC. The appointment of the operator shall be approved by OMNIS.

Exploration period

The IOC must procure a bank guarantee (standby letter of credit) issued by a bank of a good standing in Madagascar. The amount of the bank guarantee should reflect the minimum work commitments set forth in the PSC. The Petroleum Code does not provide for a penalty mechanism in case of breach by the IOC of its minimum work commitments.

Costs sharing

The Petroleum Law does not provide any particular requirement or rule governing the share of exploration, development and exploitation costs between the NOC and the IOC. To our knowledge, some PSCs provide for the full responsibility by the IOC of all exploration, development and exploitation costs on behalf of the NOC.

Production sharing

The Petroleum Law does not provide any particular requirement or rule governing the allocation of the production between the parties to the PSC, neither as cost oil, nor as profit oil. However, the Petroleum Code indicates that the IOC share in the production is determined taking into account: "*the ratio between the cumulative gross revenues and the cumulative petroleum costs*".

Arbitration

The parties may agree to submit any dispute in relation to the PSC to an international arbitration institution according to the "terms and conditions set forth in the contract". However, the Petroleum Code contains quite detailed provisions with respect to conciliation and arbitration proceedings. It could be argued that these provisions are mandatory in the event that the parties to a PSC have agreed to resolve disputes through arbitration proceedings.

Governing law

PSCs are subject to and must be governed by the laws in force in Madagascar.

The parties may agree on any other additional provisions that they consider relevant for the purpose of hydrocarbons exploration, exploitation and transportation activities in Madagascar. However, the parties to the PSC (including the NOC) have no authority to decide on matters that are governed by laws and regulations, including, but not limited to, the Petroleum Code. For instance, the tax regime applicable to the IOC does not fall within the scope of the PSC.

The PSC is signed by the NOC and must be 'ratified' by a presidential decree. For the reasons explained above, the PSC is currently signed by OMNIS in its capacity as a representative of the NOC. However, the Petroleum Code does not provide for the transition between OMNIS and the NOC upon the establishment of the NOC and it is anticipated that this may raise some issues.

In the meantime, it should be noted that the PSC provisions must be interpreted in the light of the dual capacity of OMNIS, as technical body representing the state on the one hand, and as the NOC representative on the other. Therefore, the assignment of a participating interest in a PSC, for example, will be approved by OMNIS as representative of the NOC on the one hand¹¹ and by OMNIS in its technical body capacity on the other hand.

Fiscal regime

Pursuant to the Petroleum Code, hydrocarbons exploration, exploitation and transportation activities in Madagascar are subject to the following taxes:

1. *Redevance* - a royalty, which is based on the value of the production calculated on the basis of international market prices and after deduction of the transportation costs from the well head to the export

loading facilities. The royalty rate is set forth by tax laws in force in Madagascar and range from 8% (25,000- bopd) up to 20% (130,000+ bopd).

2. *Impôt direct sur les hydrocarbures IDH* - a specific direct hydrocarbons income tax, which is considered inclusive of *impôt sur les bénéfices des sociétés IBS* (corporate tax), *impôt sur les revenus de capitaux mobiliers IRCM* (dividend tax) and *taxes forfaitaires sur les transferts TFT* (money transfer tax), and which is calculated on the basis of net profits at the rate of 30%. The rules for the determination of the taxable income and deductible expenses are set forth by tax laws in force in Madagascar. It is interesting that losses incurred during the exploration period may be carried forward without any time limit while losses incurred during the exploitation period may only be carried forward during seven years.

3. All other taxes generally applicable in Madagascar.

The Petroleum Code does not provide any tax stabilisation mechanism. In addition, for the reasons explained above, it is not possible to provide for such a mechanism in the PSC. Therefore, the tax regime governing hydrocarbons exploration, exploitation and transportation activities in Madagascar is not stabilised, which is regrettable from an investor's perspective. However, Madagascar has adopted a mining code dated July 30, 1996¹² providing for a clear and detailed stabilisation mechanism pursuant to which no modification of the "legal, fiscal and custom regime as well as the exchange control regulations would be applicable" during the stabilisation period.

Conclusion

Taking into account the strategic importance of hydrocarbons activities in Madagascar, as demonstrated by the recent increasing interest in this area, we believe that the laws governing hydrocarbons exploration, exploitation and transportation activities in Madagascar need to be more comprehensive and sophisticated, such as those governing mining activities. Indeed, the Petroleum Code should provide more detailed legal, contractual and tax regimes, including *inter alia* provisions pertaining to each form of contract, an integrated tax regime, a legal and tax stabilisation mechanism and a procedure for the transfer of the hydrocarbons permits and the PSCs from OMNIS back to the NOC.

Notes:

- ¹ Bid closing on November 15, 2006
- ² Loi n° 96-018 portant Code pétrolier
- ³ Décret n° 97-740 relatif aux titres miniers d'exploration, d'exploitation et de transport d'hydrocarbures
- ⁴ Décret n° 96-1133 portant désignation de l'OMNIS comme organisme technique chargé de la gestion du domaine minier national d'hydrocarbures à titre transitoire
- ⁵ Article 96 of the Petroleum Code
- ⁶ Article 1 of the Petroleum Code
- ⁷ However, in the case of a joint venture contract between the NOC and the IOC, the exploration permit "might" be delivered jointly to the joint venture members
- ⁸ Law #90-033 dated December 21, 1990 as modified by laws #97-012 dated June 6, 1997 and #2004-015 dated August 19, 2004
- ⁹ Decree #99-954 dated September 19, 1999 as

modified by decree #2004-167 dated February 3, 2004

¹⁰ Situation as of April 2006.

¹¹ OMNIS shall also waive the statutory pre-emptive rights of the NOC

¹² Loi n° 99-022 portant code minier

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