Supporting Inclusive Resource Development (SIRD)
East Africa
TRAINING PROGRAM
2019

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THE EXTRACTIVE SECTOR IN KENYA

- Mineral
- Oil and Gas

INTRODUCTION

- The Extractive sector consists mainly of oil, gas and mining activities.
- Extractives in Kenya contribute approximately 1% to gross domestic product (GDP).
- Kenya's extractives sector is characterized by a wide range of minerals including soda ash, limestone, barite, fluorspar, gypsum, carbon dioxide, salt, manganese, soapstone, graphite, copper, gold, chromite, and nickel, among others.
- The Country has also recently discovered a range of extractive resources, including niobium and rare earths, mineral sand deposits (including titanium ores such as retile, clementine and zircon), coal, as well as oil and gas deposits.

Legal frameworks governing the Extractive Sector in Kenya

- The extractive sector in Kenya is founded in a number of legislations. They include:

    a) The Constitution of Kenya 2010,

    b) The Petroleum (Exploration and Production) Act,

    c) The Mining Act,

    d) The Income Tax Act,

    e) The Environmental Management and Coordination Act,

    f) The Public Finance Management Act, and

    g) The Land Act.

(a) The Constitution of Kenya, 2010

Land is defined to include all minerals and mineral oils as defined by law.

- **Article 60 of the Constitution-** sustainable and productive management of land resources including protection of ecologically sensitive areas and sound conservation
- **Article 69 (1) (a) of the Constitution-** bestows on the State the responsibility to ensure sustainable utilization, management and conservation of the environment and natural resources, and ensure the equitable sharing of the accruing benefits between present and future generations.

(a) The Constitution of Kenya, 2010

- **Article 42 of the Constitution-** all people have the right to benefit equally from the use of natural resources. Entitlement to a clean and healthy environment.
- **Schedule IV of the Constitution of Kenya -**provides for the allocation of roles between the National and County governments.
- The National government is allocated roles including:

    a) international trade,

    b) national economic policy and planning,

    c) energy policy,

    d) transportation including pipelines,

    e) protection of the environment and natural resources.

- The County governments deal with County Planning and development which includes electricity and gas reticulation and energy regulation.

b) The Petroleum (Exploration and Production) Act of 2012.

- This legislation regulates the petroleum sector in Kenya. It includes:

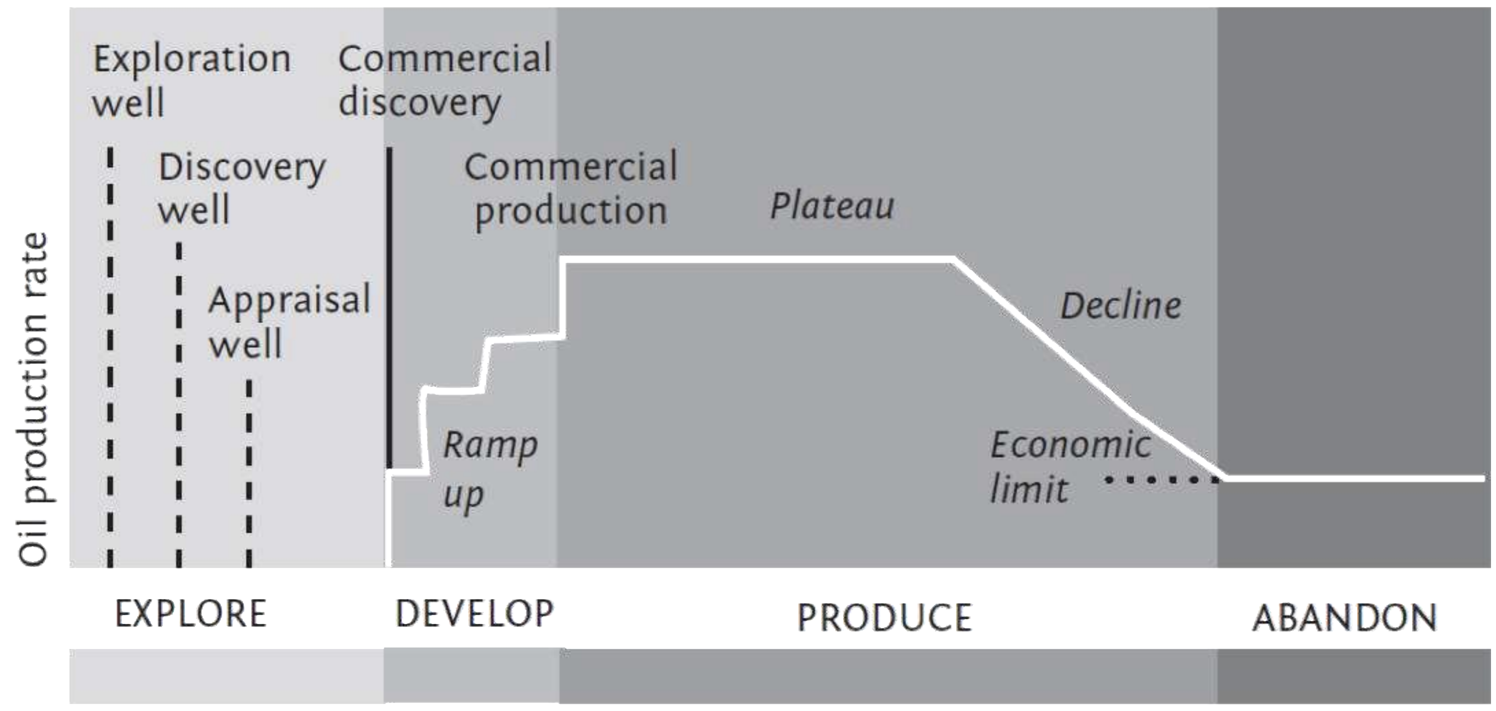
1. **The Petroleum (Exploration and Production) Act.**
2. **The Petroleum (Exploration and Production) Regulations;**
3. **The model Product Sharing Agreement (PSC).**

- This is the overall law that regulates the negotiation and conclusion of petroleum agreements by the Government
- Key aspects include exploration, development, production, storage, transportation, sale or disposal of oil and gas product
- The Act provides that petroleum operations may be carried out thro **National Oil Company of Kenya (NOCK)** or through **Contractors**.

(b) The Petroleum (Exploration and Production) Regulations

- **The Petroleum (Exploration and Production) Regulations** provide for notice notice to the effect that oil blocks are open for concession applications from contractors.
- Negotiations are conducted on the basis of the model **Production Sharing Agreement (PSC)**.
- State participation is done through a **NOCK**.

COMPONENTS OF PRODUCTION SHARING CONTRACT



Example of an oil project timeline

COMPONENTS OF PRODUCTION SHARING CONTRACT

- All contracts are based on a Model Production Sharing Contract (PSC) issued as a schedule to the Regulations. The signed Production Sharing Contracts have the following key component:

a) Signature Bonus: This is a one-off fee payable to the Government by the Company upon signing of an oil exploration contract. It depends on the area of the Block and previous data acquired on the Block.

b) A **surface fee** is also payable and is calculated on the basis of the surface area of the Contract Area on the date those payments are due .

c) Work programme and expenditure: The contractor guarantees the agreed work programme and minimum expenditure. Initially pegged at 15% bank guarantee and 85% parent company guarantee. The Ministry has improved this to a 50% bank guarantee and 50% parent company guarantee.

d) Cost oil: This is the percentage of crude produced allowed for recouping investment costs incurred during exploration and production of oil. It is normally 60% of all the oil produced for about five years.

COMPONENTS OF PRODUCTION SHARING CONTRACT

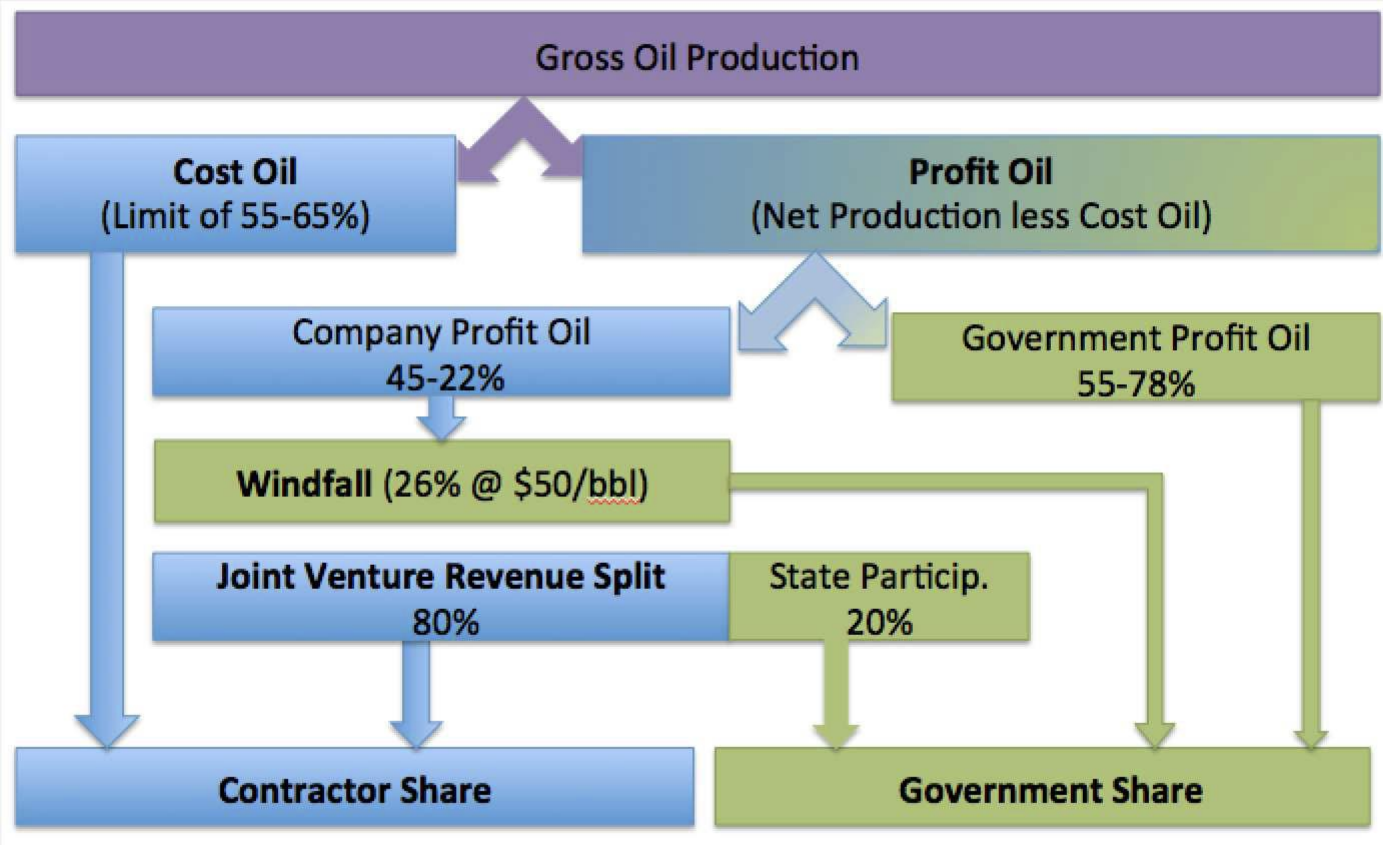
e) Profit oil: This is the remaining oil after deducting cost oil and is shared between the Government and the contractor.

f) Windfall profit: Where oil prices are higher than the negotiated threshold, the Government creams off contractors take above the threshold crude oil prices by 26%.

g) Exploration phases – there are three exploration phases of two years each, the initial period, first additional period and second additional period. For ultra deep offshore blocks, the initial period is extended to three years due to extra logistical challenges in the deep water acreage.

h) Relinquishment – is 25% of the area of the block for each period. The PSC has the license rental fee and training fee included. In Block 12B for exampl license rental fee is set at $40,000 during the first year (2012-2013) and $8 during the second year, training fee is $100,000 per annum. During the production phase the training fee is set at a minimum of $200,000 in Block 1 with Lion Petroleum.

COMPONENTS OF PRODUCTION SHARING CONTRACT



Dispute Resolution Mechanism

- Dispute resolution mechanism is not addressed in this Act. But the model PSC makes provision for the settlement of disputes under the **UN Convention on International Trade Law (UNCITRAL)** rules
- With regard to contract compliance and administration, the CS through NOCK is authorized to supervise petroleum operations carried out under the PSCs.

d) The Mining Act, CAP 306

- The Mining Act regulates the Mining Sector.
- The Act states that all minerals are vested in the National government and may only be issued to any other person subject to processes established under the Act.
- Any authorization for the exploitation of minerals is granted through the Commissioner of Mines and Geology or an officer duly authorized by him.
- The Commissioner has powers to grant, refuse, suspend, cancel or extend prospecting and mining rights. The Act confers a wide discretion upon the Commissioner in making such decisions.

d) The Mining Act, CAP 306

- The nature of rights awarded to a person includes prospecting and mining rights.
- Prospecting rights confer a number of privileges to the holder to prospect for all minerals except diamonds.
- Any minerals obtained during prospecting are the property of the government and may not be disposed.
- The rights are not transferable without the consent of the Commissioner.

Issuance of Mining License

Step 1
- Feasibility Study & Approved Cadastral Survey of Deposits
- National Environmental Management Authority (NEMA).

Step 2
- Formal Application
- Compensation Agreements payable to Landowners
- Published in the Kenya Gazette and local daily for any objections

Step 3
- Registration of Mining lease-the Mining Act
- Registration of Documents Act
- Issuance of formal **mining lease**

Mining (Safety Regulations)

- Health and safety under the Mining Act regulated by the Mining (Safety) Regulations
- Prescribe rules relating to general precautions, surface protection, underground workings, winding and hauling, raising or lowering persons by mechanical power as well rules on ventilation and sanitation, workmen, explosives, machinery and mine plans as well as procedures in cases of accidents.
- The inspector of mines (or the government mining engineer) has authority to effect the regulations and grant exemptions on any rules.

e) The Environment Management and Coordination Act, 1999

- It is the primary law for environmental management and supersedes any other law on the same.

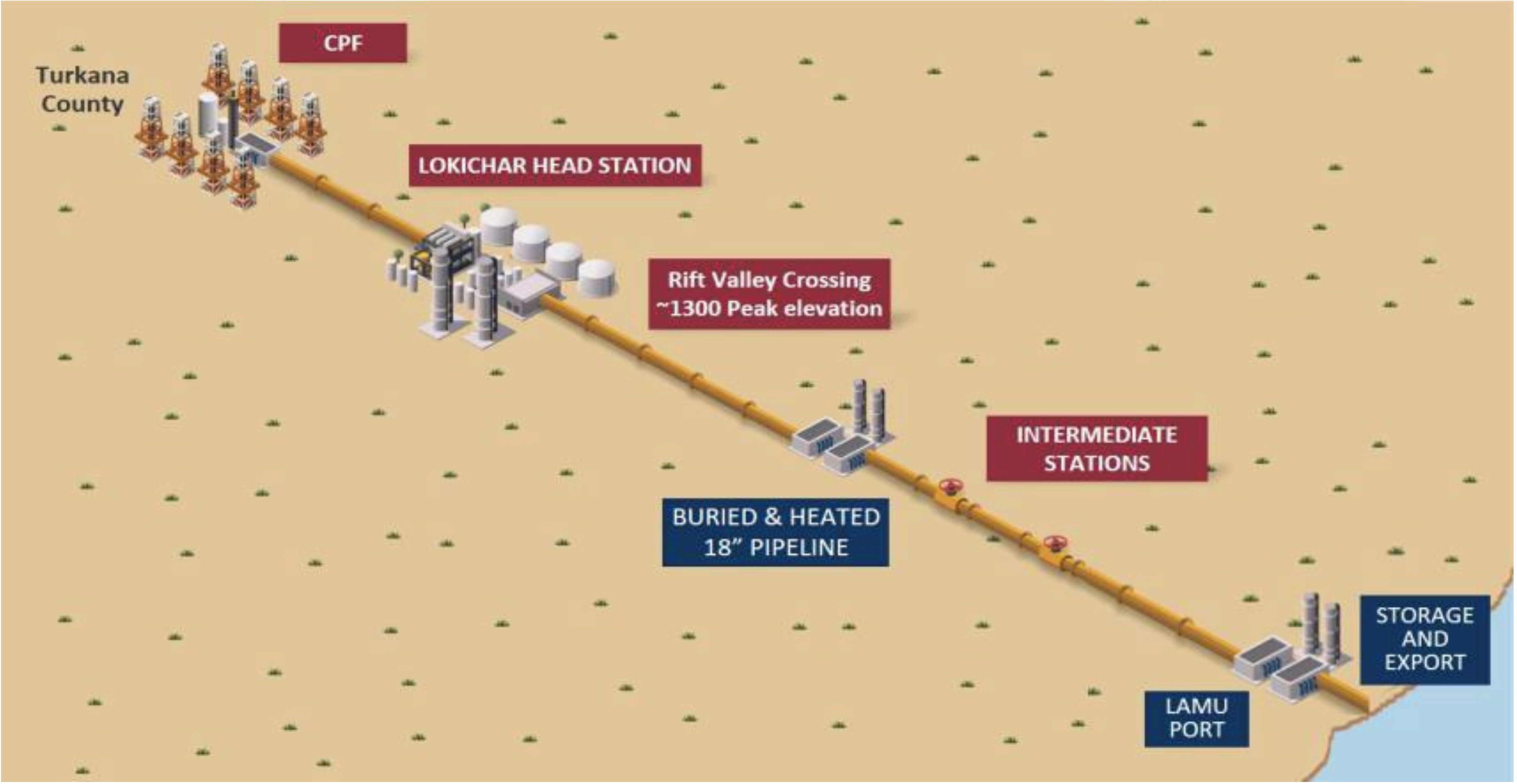
- The law establishes

  (i) the **National Environment Council** to be responsible for policy formulation and the

  (ii) National Environmental Management Authority (NEMA) to exercise general supervision and coordination over all matters relating to the environment.

  (iii) **Standards Enforcement and Review Committee-** water quality, air quality, etc.

- The Act is buttressed by the **Environmental (Impact Assessment and Audit) Regulations of 2003.**


CPF
Turkana County
LOKICHAR HEAD STATION
Rift Valley Crossing
~1300 Peak elevation
INTERMEDIATE STATIONS
BURIED & HEATED
18" PIPELINE
STORAGE AND EXPORT
LAMU PORT

Environmental Impact Assessment (EIA)

- The Act provides for the procedure for conducting an Environmental Impact Assessments (EIA).
- The second Schedule of the Act lists the nature of projects that require an EIA. These include

  a) mining;

  b) mineral processing;

  c) reduction of ores and minerals;

  d) smelting and refining of ores and minerals; as well as

  e) the exploitation of the production of petroleum in any form.

Environmental Regulations

These include:

a) Environmental (Impact Assessment and Audit) Regulations, 2003, Legal Notice No. 101.

b) The Environmental (Prevention of Pollution in the Coastal Zone and Other Segments of the Environment) Regulation, 2003.

c) Environmental Management and Coordination (Water Quality) Regulations, 2006 Legal Notice No.120.

d) Environmental Management and Coordination (Waste Management) Regulations, 2006 Legal Notice No. 121.

e) Environmental Management and Coordination (Conservation of Biological Diversity and Resources, Access to Genetic Resources and Benefit Sharing) Regulations, 2006 Legal Notice No. 160.

Environmental Regulations

f) The Environmental Management Coordination (Fossil Fuel Emission Control) Regulations, 2006 Legal Notice No. 65.

g) The Environmental Management and Coordination (Wetlands, River Banks, Lake Shores and Sea Shore Management) Regulations, 2009 Legal Notice No. 19.

h) The Environmental Management and Coordination (Noise and Excessive Vibration Pollution Control) Regulations, 2009 Legal Notice No. 61.

i) The Environmental (Impact Assessment and Audit) (Amendment) Regulations, 2009.

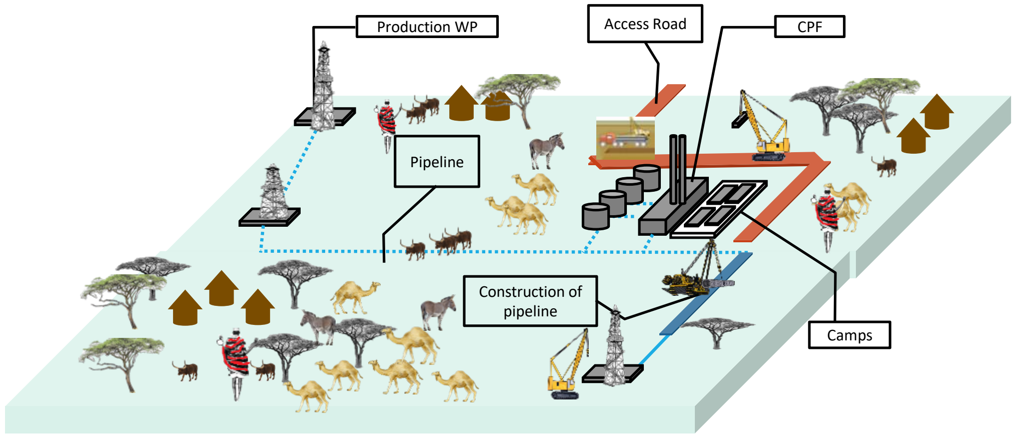
f) The Land Acts

These laws were enacted in 2012 to give effect to the Constitution of Kenya 2010.

They apply to public, private or community land.

1. **the National Land Commission Act,**
2. **the Land Act and**
3. **the Environmental and Land Court Act**

EXAMPLE OF OIL DEVELOPMENT



LAND ACT 2012
LAND ACQUISITION PROCESS

STATUTORY PROCEDURES AND PROCESSES OF COMPULSORY LAND ACQUISITION PROGRAMME

1

Written request from CS of parent Ministry of Acquiring Body or CECM of County Government.

- *Submit six copies of survey plan of affected area.*
- *List of Affected Parcels.*
- *State purpose of acquisition.*

2

National Land Commission

- *Review, approval or comments.*
- *Official searches to ascertain owners, sub-divisions etc.*
- *Reconnaissance*

3

Gazettment of Intention to acquire (30 day lapse period)

- *Distribution of Notices to Project affected parcels/persons*
- *Sensitization- Local administration, resident committees, lobby groups, NGOs and etc.*
- *Site Inspection and Data Collection*

4

Gazettement of Notice of Inquiries (Lapse Period 15 days)

- Distribution of Notices and publicity of Inquiry
- Inquiry on rights, interest on affected parcels of land

5

Awards

- Valuations
- Acceptance or Rejection of Awards
- Prompt Payment

6

Notice of Taking Possession (lapse period 15 days)

7

Vesting

- Vesting of Land to the Acquiring Body.

LAND ACQUISITION PROCESS

(g) Taxation in Extractives

- ***Corporation tax:*** All resident and non-resident corporations in Kenya are liable to pay the corporate tax rate at 30 % of all income, while subsidiary of a foreign company is 37.5%.
- Mining operations are allowed to make capital deductions in the first year of 40% and this is reduced to 10% between the 2nd and 7th years.
- ***Taxation of Dividends****:* Dividends that are paid by resident companies to non-resident shareholders are subject to a withholding tax at a rate of 10 per cent.
- ***Capital Gains Tax****:* The imposition of this tax was suspended in 1985. It is, however, being reintroduced under the Finance Bill 2014 and will be discussed in more detail at a later stage in this paper.
- ***Withholding Tax on Transfer or Assignment of PSC Rights****:* The transfer or assignment of rights under a PSC is taxed as income. The law imposes a 10 % tax on the total value of consideration for residents and 20% in the case of non-residents.

(g) Taxation in Extractives

- ***Income Tax on Employment***: Income tax on employment relates to service-related oil and gas contracts and is levied as "Pay As You Earn" (PAYE) tax with a marginal rate of 30 per cent. Employers are further required to collect certain social security contributions.
- ***Offsetting of Losses***: Petroleum companies are allowed to carry back losses arising from the final year of production for up to four years. Any loss incurred by operators may be offset in the year in which the same is incurred and any of the following three years.
- ***Depreciation of Capital Expenditure***: For the purposes of taxation, the Schedule provides that capital expenditure is to be depreciated at the rate of 20 per cent per annum (straight line).
- ***Thin Capitalization Rules for Petroleum Companies***: With regard to capital formation, the Schedule has rules that apply to both branches and residents. It restricts interest expenses if the loan amount or interest rate exceeds the "arm's-length amount." The rules do not set a specific debt-to-equity ratio.

(g) County Taxation in Extractives

- Constitutional Right of Counties to charge for various activities within their Jurisdiction;
- Cess and Levies Claims for sand, earthworks, stones, limestone, landfill, etc. e.g. Magadi Soda, SGR Quarry works, etc.
- Land Rates and Leases for Community Land under Community Land Act e.g. Kes 1 Million/Acre claim by Turkana County Government.

h. HIGHLIGHTS OF NEW AND PROPOSED LAWS

- Policies and laws aim towards maximization of the national value creation by means of the oil and gas value chain through

i. employment,

ii. value addition,

iii. technology transfer and

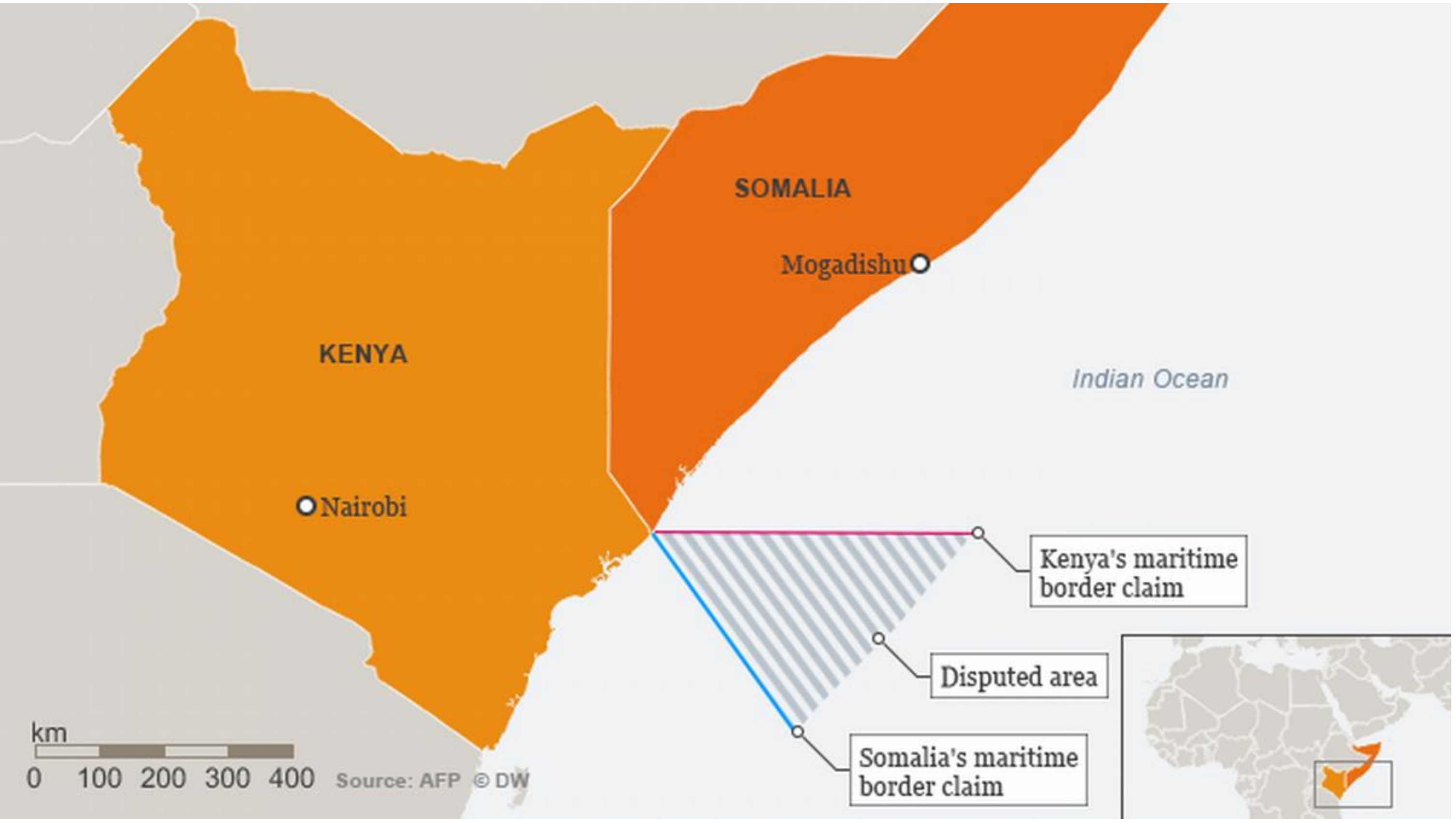
iv. the acquisition of knowledge.

- Policies and laws aim towards maximization of the national value creation by means of the oil and gas value chain through

h. HIGHLIGHTS OF NEW AND PROPOSED LAWS

- **Natural Resources (Classes Of Transactions Subject To Ratification) 2016- Article 71 Of The Constitution Of Kenya**
- **The Local Content Bill - Article 71 Of The Constitution Of Kenya**
- **The Petroleum Exploration And Production Bill - Upstream Petroleum Authority, Local Content, Concession Terms, Revenue Share, etc.**

KENYA-SOMALIA DISPUTE



Q & A Sessions