Local content in Kenya's oil and gas industry

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The spate of major oil and gas discoveries in Kenya, Tanzania, Uganda and Mozambique in recent years has seen much talk of East Africa becoming a key player in this industry in the coming years. Uganda and Kenya have an estimated 4 billion barrels of crude oil while Tanzania and Mozambique have an estimated 200 trillion cubic feet of natural gas. As the oil and gas industry ramps up in these countries, their governments have striven to create local content policies to benefit local people and the local economy.

However, all the optimism of these oil and gas finds and the transformational potential have been tempered by the fall in the price of oil. In 2014, crude oil prices fell by close to 50 per cent and in 2015 (so far), they have dropped a further 8 per cent.

In an environment of falling prices, lack of skilled labour and poor infrastructure, local content laws and policies affect this nascent industry in East Africa. The challenge, as always, is to create the right balance to promote investment but at the same time develop the local economy and share the wealth created.

An evolving concept

Local content is an evolving concept in East Africa with different countries taking different approaches and being at different stages of the local content evolutionary cycle. When I wrote about local content in West Africa almost a year ago ("Think global but act local: local content rules in the oil and gas sector" – published in the March 2014 edition of this journal) I made a mental note to look into what was happening in the emerging oil and gas economies of East Africa. Shortly after I wrote that piece (as luck would have it) I met Cindy Oraro – a bright young Kenyan lawyer working with the Dentons associate office in Kenya, HHM Oraro. We discussed many things including what was happening in the oil and gas sector in East Africa. So we pulled together our thoughts on local content in Kenya.

Currently, there is no definition of the phrase ‘local content’ under Kenyan law. However, there is an overarching constitutional requirement for Parliament to enact legislation that ensures investments in property benefit local communities and their economies. In addition, Section 9(1)(g) of the Petroleum Act provides that one of the implied terms of a petroleum agreement (Production Sharing Contract or PSC) is an obligation on the contractor to give preference to the employment and training of Kenyan nationals in petroleum operations.

Local content and PSCs

Section 9(1)(h) of the Petroleum Act provides that a PSC should contain an obligation on the contractor to give preference to the use of products, equipment and services that are locally available. The intention of this is to allow local businesses to be given an advantage in the procurement process in the petroleum industry.
However, this provision has had various issues including the following:

- local content provisions in the PSC are left to be negotiated between the State and private sector, so different PSCs have different provisions;

- the absence of an independent regulator to monitor and enforce the relevant provisions has meant that it has been difficult to keep track of the extent to which contractors are complying with the requirements in their PSCs;

- the lack of uniformity in all PSCs also means that it is difficult for investors to understand what provisions will be included in a PSC and the extent to which it can be negotiated; and

- local communities have felt disenfranchised where they are not party to the negotiations of the PSC.

### Using local labour, goods and services

The theory behind local content laws and policies is to encourage the use of local labour, goods and services. However, there is often a gap between theory and practice. Unfortunately, this gap currently exists in Kenya with:

- poor infrastructure and lack of skills being two of the practical stumbling blocks in building local content; and

- oil and gas companies having to invest time and resources in training local populations and building infrastructure to handle logistical issues.

Section 11 of the Petroleum Act does recognise the skills gap issue and provides for the establishment of a training fund to train Kenyan nationals in petroleum operations. Contractors are required to contribute to this fund in accordance with the provisions set out in the Petroleum (Exploration and Production) (Training Fund) Regulations.

### Local communities

The issue of local communities feeling disenfranchised and the lack of clarity on the extent to which they will benefit from oil and gas discoveries has come to a head on a number of occasions. The most high profile case being the issues Tullow Oil has had in Northern Kenya.

In November 2013, unrest and protests in the Turkana region were so severe that it forced Tullow to halt its operations there. It is not certain whether the company entered into any direct negotiations with the local community as a result of this. However, Tullow did enter into an agreement with the Government in relation to its operations in the region. There has been speculation that this agreement (which has never been made public officially):

- imposed new local content obligations on Tullow; and

- required the Government to provide security for Tullow’s operations to prevent recurrence of this unrest.

In October 2014, Tullow suspended drilling operations across blocks 10BB and 13T citing security concerns for their employees after the local population protested by asking for more jobs and better benefits. These protests included violent acts that resulted in Tullow evacuating some staff.

Tullow eventually held meetings with local leaders, reaching an agreement to build a local office to handle the community’s concerns. The fact that Tullow sought to negotiate first with the Government was probably as a consequence of local content currently being an entirely contractual matter.
Incidents such as these illustrate the need for local content to be driven by sensible policies that take account of local concerns backed by specific legislation and regulatory oversight.

New approach to local content

Perhaps spurred on by incidents such as those experienced in Turkana, the Kenyan Government is proposing to overhaul the entire regulation of the extractive industries, including local content laws and policy. For the upstream oil and gas industry, a two-pronged approach is proposed.

The first is through statutory obligations contained in a new law – the Energy Bill – which in turn will be supported by a new Energy Policy that mandates the creation and sustenance of a local content regime. It would seem that this is meant to sit alongside the PSC contractual approach described above. A potentially confusing scenario.

Proposed laws and policy on local content

In 2013, a draft Energy Bill 2013 (Draft Energy Bill) was published which provided that the:

- proceeds realised from the exploitation of petroleum resources must be shared proportionately between the national government, county government and the local community; and
- local community shall receive an amount equivalent to one quarter of the amount due to the county government, and this shall be paid out through the county government (i.e. held in trust by the county government for the benefit of the local community).

However, the problem with the provision providing the local community with a quarter of what is due to the county government is that it is not clear what revenue the county government is entitled to in the first place. This changes from year to year, as the Constitution mandates that county governments shall be allocated an “equitable share”, being at least 15 per cent, of revenue collected by the national government each financial year. In addition, the Draft Energy Bill does not currently provide an administrative and institutional framework to support implementation of local content. This uncertainty is detrimental to both investors and the local community, as neither party knows where they stand.

National Energy Policy

In 2014, the Kenyan Government published a Draft National Energy Policy which:

- states that there should be the sharing of benefits accruing from energy resources;
- recognises the need to develop local talent and capacity in energy resource exploitation and infrastructure development;
- requires the Government to enhance manpower, technical capacity and local content in energy-related projects;
- promotes the need for training programmes to be established in conjunction with local industry associations, local training institutions and international institutions; and
- promotes the need for opportunity being given to locals for the provision of goods and services in the exploitation of natural resources and infrastructure development.
All good and laudable aims but this still requires a framework, specificity, milestones and teeth to back it up. Absent these, it is difficult to see how this well-intentioned policy will translate into the benefits that local content can bring. Whilst the Draft Energy Bill and Draft National Energy Policy are a step in the right direction, there is still more that needs to be done.

Lessons from Nigeria

Between August and September 2014, there was a lot of talk about Kenya adopting the form of Nigeria’s local content policy. In August 2014, Nigeria’s local content implementation body, Nigerian Content Development and Monitoring Board (NCDMB), reported that Kenya had extended an invitation to NCDMB towards adopting the Nigerian Local Content Policy for its oil and gas sector.

It is arguable that Nigeria’s local content policy has had mixed success. Unrest in the Niger Delta over the course of the country’s oil-rich status is evidence of this. Nonetheless, in 2010, Nigeria enacted the Local Content Act that created a structured approach to local content by creating the NCDMB, whose functions include:

- ensuring implementation and compliance with the 2010 Local Content Act;
- assisting local contractors and Nigerian companies in developing their capabilities and capacities in the oil and gas industry; and
- supervising, co-ordinating, administering and monitoring the implementation and development of Nigerian content.

More to be done

Notwithstanding the good intentions of the Kenyan Government, the legal and regulatory framework on local content in Kenya is still weak because:

- neither the current nor the proposed regulatory framework on local content provides for clear roles of the various stakeholders in the petroleum industry;
- timelines for the implementation of local content legislation or policy statements have not been provided;
- monitoring and evaluation mechanisms to ensure compliance have not been factored in; and
- no definite goals have been set for the achievement of the identified local content objectives.

So despite the National Energy Policy being in its sixth draft and consultations having taken place for over a year, it is still unclear what form Kenya’s local content policy will take. It is hoped that all stakeholders will recognise the importance of getting local content laws and policies right and calibrated to take account of Kenya’s nascent petroleum industry whilst at the same time taking account of lessons learnt from other jurisdictions (including Nigeria).

However, the challenge for Kenya today is how to create local content laws and policies that work for all stakeholders in the oil and gas industry and which promotes development of the country as a whole. Until next month.... Kwaheri!

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Your Key Contacts

Raj Kulasingam
Senior Counsel, London
D +44 20 7246 7596
raj.kulasingam@dentons.com