A CRITICAL ANALYSIS OF FISCAL STABILITY AGREEMENTS AS OFFERED IN THE TENTH SCHEDULE OF THE INCOME TAX ACT FOR ENERGY COMPANIES IN SOUTH AFRICA IN LIGHT OF RECENT OIL AND GAS FINDS IN SOUTH AFRICA

Dissertation submitted in partial fulfilment of the requirements for the degree

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ABSTRACT

South Africa remains reliant on a number of countries to sustain its energy requirements. The acute shortage and unreliable supply of electricity, requires that South Africa consider other energy sources, more specifically, that it considers the use of oil and gas as an alternative or complementary energy source to the main energy sources currently used in the country. The recent announcement of oil and gas discoveries in South Africa could see less reliance on other countries for the importation of crude oil and petroleum products.

Despite newly discovered oil and gas resources in South Africa, the country will continue to remain reliant on the industry's international investors since South Africa does not have the requisite expertise, skill and capital to operate efficiently in this industry. The shortage of capital to further develop the industry means that the country will need to continue to compete with other emerging markets to secure international investment. One such way of being an attractive investment destination has been touted through the offering of a tax regime with incentives which, more importantly, provides certainty and stability (Mausling, 2017: iv).

South Africa introduced the Tenth Schedule to the Income Tax Act No.58 of 1962 ("Income Tax Act") which aims to provide incentives that stimulate industrial and economic growth in the oil and gas industry. Against the backdrop of recent oil and gas finds, the Minister of Finance announced in the 2019 Budget Speech that changes to the Tenth Schedule would be considered. This has brought about the need to consider the role of fiscal stability agreements ("FSA"). Under the Tenth Schedule, South Africa offers FSAs which allows for the "freezing" of the Income tax provisions when the FSA was signed i.e. even if there is a new tax regime, the investor may elect to continue to use the old tax regime.

Firstly, this dissertation considers whether there is a need for FSAs. To achieve this aim, the dissertation considers the reasons for fiscal instability and considers these within the South African context. These reasons are used to substantiate whether there is a need for FSA's as

a remedy for fiscal instability. The current incentives offered by the Tenth Schedules are examined in order to determine the reasons as to why oil and gas companies would find FSAs advantageous. Secondly, the dissertation examines the types of FSAs typically offered, including freezing clauses (currently used in the FSA offered by South Africa), economic balancing clauses and, finally, hybrid clauses. In critically reviewing these different clauses, the most preferred clause is suggested. A further review of this preferred clause is enhanced through the consideration of the types of FSAs offered by comparable countries. Ghana and Mozambique have been identified and selected for comparison for the purposes of this study. The paper further considers aspects of the FSA such as the legality and legal effectiveness of FSAs. Such issues are critical in light of the challenges that have been identified in the use of FSAs, particularly that such instruments limit the State's sovereignty. Furthermore, the costs associated with FSAs are considered. Lastly, the remedies available should the state elect not to adhere to a FSA once in force are considered.

The findings of the study suggest that there remains a need for FSAs in South Africa. However, the findings indicate a need to change the current fiscal stability clause into an economic balancing clause, in particular a negotiated economic balancing clause.

LIST OF ABBREVIATIONS

Abbreviation	**Meaning**
AEB	Automatic Economic Balancing
Boe	Barrel of oil equivalent
Cf	Cubic feet
CIA	Central Intelligence Agency
Draft Bill	Draft Upstream Petroleum Resources Development Bill 2019
DTC	Davis Tax Committee
EM	Explanatory Memorandum
IMF	International Monetary Fund
JV	Joint venture
MPRDA	Mineral and Petroleum Resources Development Act 28 of 2002
NDP	National Development Plan
NEB	Negotiated Economic Balancing
NSEB	Non-stipulated Economic Balancing
OECD	Organisation for Economic Co-operation and Development
PAJA	Promotion of Administrative Justice Act 3 of 2000
PSC	Production Sharing Agreement
Royalty Act	Mineral and Petroleum Resources Royalty Act 28 of 2008
Tcf	Trillion cubic feet
The Income Tax Act	Income Tax Act 58 of 1962
The Tenth Schedule	The Tenth Schedule to the Income Tax Act 58 of 1962

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CHAPTER 1 – INTRODUCTION

1.1. Background

The oil and gas industry is an evolving one within the South African economy. The importance of the industry is outlined in the National Development Plan ("NDP") as forming a critical part of the energy sector (Deloitte, 2019:11). The NDP sets out various mechanisms to be implemented by government in the aim of securing fuel supplies for the country (SAMSA, n.d.:5). The NDP commits to the use of gas as an alternative to coal and further recommends exploratory drilling for shale gas reserves. The use of gas will diversify the energy mix and further reduce carbon emissions (Davis Tax Committee ("DTC"), 2016:16&17). The reduction in carbon emissions will be aligned to the recently introduced carbon tax legislation. Currently, South Africa generates 5% of its fuel requirements from gas, 35% from coal, 50% from crude refined locally and 10% from imported refined crude (Government Communications, 2018:6).

The importance of a significant discovery of oil and gas reserves in South Africa is illustrated by the import/export ratio that the country has of these commodities. South Africa currently derives 60% of its oil-products from crude oil imports (Energy Forecast, 2019). The balance is sourced from Sasol Ltd which converts South African coal and gas imported from Mozambique into motor-fuel products and chemicals (Energy Forecast, 2019). This is contrasted with zero exports of crude (2015) and natural gas (2017) (CIA World Factbook, 2020). This is evidence that South Africa is a net importer which means, as stated by Moolman and van der Zwan (2016:227): "*the country is vulnerable to volatility in global fuel prices and dependent on foreign exchange to cover the country's domestic energy needs (Amigun, Musango & Stafford, 2011)."* The authors further note: "*The development of domestic energy resources is therefore of utmost strategic importance to reduce this dependency as far as technically (Amigun et al., 2011)". (*Moolman and van der Zwan (2016:227).

In 2011, the US Department of Energy reported technical recoverable shale gas resources of 485 trillion cubic feet ("Tcf") in South Africa (DTC, 2016: 74). These resources have yet to be found commercially viable. Econometrix indicates that should there be shale gas production of

50 Tcf in the Karoo Basin the total value added could between 3.3% and 9.6% of South Africa's total GDP at 2010 levels and between 1.1% and 2.8% of projected 2035 GDP levels (Econometrix (n.d.:10)). To date, the projected shale gas prospects in South Africa have not progressed as anticipated. There is now a renewed interest in the oil and gas industry brought about *Total SA* ("Total"). The announcement made by Total regarding the discovery of a potential one billion barrels of wet gas in February 2019 (Wasserman, Feb 2019) affirmed that South Africa may have other significant (deep water) oil reserves. The Total discovery is equivalent to approximately 35 million cf when converted. Although this is far less than the anticipated shale gas potential, Wasserman contextualises this discovery by comparing it to that of ExxonMobil's (which was the most successful explorer) 2018 worldwide oil and gas discoveries of 895 million barrels. This discovery could assist in providing feedstock to the State-owned oil and gas company PetroSA, which has been running at least 50% below capacity for more than two years (Tshwane, 2019).

Authors acknowledge that even though the Total discovery may be a "game-changer" in South Africa (Africa Oil Week, 2020) or "revitalise" (Vella, 2020) the oil and gas sector, there is still much work to be done. Vella (2020) attributes the significance of the discovery to "opening up the deepwater" oil and gas exploration in South Africa. This is echoed by Africa Energy President and CEO Garrett Soden who notes: *"This discovery opens a new world-class oil & gas play with significant follow-on potential. The success at Brulpadda significantly de-risks four other similar prospects already identified on existing 2D seismic data.* (Africa Oil Week, 2020). Vella (2020) notes the announcement is good news for South Africa's upstream oil and gas production which has fallen by more than half in the past decade. The author also quotes Justin Cochrane (*associate director for African regional research at IHS*) who notes that the estimated reserves in the Brulpradda field could be smaller than anticipated at 200-250 million boe (barrel oil equivalent) . Cochrane adds*: "[...] he doesn't think the discovery is economic yet, he believes it has a lot of follow-on potential."* (Vella, 2020).

South Africa has had other notable gas finds in the past. One such find is the Ibhubesi Gas field. This gas field has over half a trillion cubic feet of proven gas reserves and has the potential to provide electricity to a city of 1 million people for about ten years (ESI Africa, 2016). ESI Africa (2016) also notes that, with added investment, 16 times the proven reserves could be obtained. This find has not had the anticipated success due to the lack of a suitable gas market or commercialisation strategy (DTC, 2016:43).

Shortly following the announcement of the gas finds by Total, the Minister of Finance announced, among the tax proposals contained in the South African Budget Speech 2019 (National Treasury, 2019:6), a review of the current oil and gas tax regime as governed by the Tenth Schedule to the Income Tax Act No. 58 1962 ("the Tenth Schedule") and the fiscal stability agreements ("FSAs"). It was noted that no FSAs had been concluded in the past 5 years.

The current oil and gas tax regime was first introduced in 2006. The need for the introduction of the Tenth Schedule is contained in the Explanatory Memorandum ("EM") to the Revenue Laws Amendment Bill, 2006. The 2006 EM noted that the introduction of the Tenth Schedule was due to the pending termination of the OP26 agreement tax regime. Treasury anticipated that the pending termination of the OP26 tax regime would cause uncertainty around the tax provisions provided in the OP26 agreements and would lead to companies postponing investments until the uncertainty was resolved. The termination of OP26 agreements further arose as a result of the introduction of the Minerals and Petroleum Resources Development Act No. 28 of 2002 ("the MPRDA").

OP26 agreements contained fiscal stabilisation clauses which froze the Income Tax provisions to those of 1977. The fiscal regime offered under OP26 was meant to incentivise investment in the "high risk" oil and gas exploration activities as such activities required large upfront capital investment.

The Tenth Schedule has been amended since it was introduced. The government has refined the tax regime and explained the reasons for these refinements in EM over the years. It was found important, some 7 years after the introduction of the Tenth Schedule, to re-emphasise the reason the Tenth Schedule was introduced. The 2013 EM noted that, like the OP26 agreements, the Tenth Schedule was geared to incentivising exploration and production but that the introduction of the Tenth Schedule was meant to simplify the tax provisions.

The 2006 EM noted that South Africa's exploration of oil and gas over the last 30 years had revealed smaller deposits of oil and gas in comparison to world standards. Moolman (2012:16) further explains: *"The aim of the Tenth Schedule is to provide these investors with the necessary incentives and stability required, while simultaneously forwarding a profit take to the government (National Treasury, 2006b)".* The mechanism of encouraging investment in the oil and gas industry through tax incentives, is not unique to South Africa as it has been as it been used in several countries (DTC, 2016:12).

Any changes to be made to the Tenth Schedule should encompass the long-term objectives of the State as outlined in the MPRDA (Moolman & van der Zwan 2016:230). The purpose of the MPRDA is to *"[…] make provision for equitable access to and sustainable development of the nation's mineral and petroleum resources […]"*. The preamble of the MPRDA acknowledges that the State is the custodian of these natural resources and has an obligation to protect these resources as they belong to the nation. This statement also acknowledges that there should be sustainable development of these resources. This ascribes responsibility to ensure that these resources are exploited for adequate compensation and that the benefits from these resources will be reaped by current and future generations. Additional proposed legislation to be considered is the Upstream Petroleum Resources Development Bill, 2019 ("Draft Bill") which will be discussed chapter 2.

Moolman (2012:16) notes that the aim of the Tenth Schedule was to provide the necessary incentive and stability to the investor while providing government with adequate compensation. Moolman (2012:26) emphasizes the importance of finding a balance to address the risks and benefits for both the government and the investor. Moolman (2012:26) further notes that in some instances governments lower the tax burden for investors so much so that it erodes the country's resources without adequate compensation.

As South Africa is a developing country, consideration should be given to the extent that the country places reliance upon foreign investors for capital. These investors are typically looking to maximise returns by investing in the oil and gas industry, helping the industry develop further until the energy finds are realised into full production. South Africa needs to be attractive to foreign investors and competitive enough relative to its emerging market counterparts in bidding for the same foreign investment. Foreign investors consider multiple factors before establishing whether they wish to invest in a host country. These include: market size, level of skill, infrastructure, political stability, trade policies and natural resources (Mausling, 2017:9).

Mausling (2017:10) notes that in the United Nations Conference on Trade and Development ("UNCTAD") (2000:11) it was perceived that changing any of the abovementioned factors could be difficult for a government. The author notes*: "Governments would therefore prefer to provide tax incentives than correcting any deficiencies that would hinder foreign direct investment (OECD 2007:5)."* Moolman (2012:15), citing Pouris, indicates that, as a result of the risks associated, oil and gas investors require tax discounts and fiscal stability to reduce the economic risk. Moolman (2012:15) confirms that tax incentives have been a preferred method to provide the tax discount suggested.

Therefore, any changes that are made to the Tenth Schedule following the 2019 Budget Speech announcement should provide a balance between: (1) the State needing to be adequately compensated and (2) foreign investment being encouraged through incentives and stability (Moolman, 2012:19).

DTC (2016:15) outlines guidelines for the characteristics that should be encompassed in an oil and gas tax regime. The objectives of the two parties are:

> *"From the government's standpoint, this means the design of a tax system that:*
>
> *(i) promotes economic growth;*
>
> *(ii) supports macroeconomic stability by providing predictable and stable tax revenue flows;*

(iii) permits capturing a greater share of the revenue during periods of high profits;

(iv) avoids the introduction of distorting effects through the fiscal instruments;

(v) maximizes the present value of revenue receipts by providing for appropriations during the early years of production; and

(vi) is neutral and encourages economic efficiency as a yardstick.

From the investing company's standpoint this means the search for a tax system that provides for:

(i) a minimum number of front-end loaded non-profit-sensitive taxes in order to facilitate recovery of capital before being laden with heavy taxes.(Companies only invest where reasonable IRR is identified);

(ii) the ability to repatriate profits to shareholders in their home countries; and

(iii) an overall policy environment that is transparent, predictable, stable, and based on internationally recognized industry standards and the rule of law, so that decisions can be made with reasonable confidence."

From the above it can be seen that a tax system is not stagnant and changes are expected to occur. In his 2019 budget speech, the Minister did not provide reasons for proposed changes to the Tenth schedule, however, Chapter 2 of this dissertation, which speaks to fiscal instability, ventures possible reasons.

Several countries have amended their oil and gas tax regimes over time. An example is the United Kingdom. In 2014, the United Kingdom issued a call for a revision of its tax regime to incentivise economic recovery of the oil and gas industry (HM Treasury, 2014 (July):7). HM Treasury 2014 (July):17 notes: *"A stable fiscal regime needs to ensure a fair share of returns between industry and government not just now but for decades to come, during which time prices and costs will continue to vary"*. It also acknowledged that there should be some level of flexibility. After consultation with various oil and gas stakeholder, it was concluded that there was a strong case for a change in the United Kingdom's fiscal regime to achieve the set out objectives (HM Treasury, (2014(December):22).

As noted above, changes to the oil and gas tax regime in South Africa are imminent. Often changes which have taken place in other hydrocarbon rich countries in the past based upon oil discoveries, have been seen to be less favourable to the investor – an aspect explored in Chapter 3. This study focuses on the need for Fiscal Stability Agreements in light of anticipated changes to an oil and gas tax regime.

FSAs are tools utilised mainly in developing countries with high oil and gas reserves. Mansour (2014:1) reports that 85 out of 111 surveyed developing countries have fiscal stability clauses in their oil and gas agreements. These agreements are preferred by foreign investors, providing assurance that amendments made to the tax regime will not impact them negatively. Given that South Africa has not issued FSAs in the last 5 years, there may be concerns from foreign investors in light of the budget speech announcement made. Additionally, South Africa is faced with uncertainty and political risks with respect to issues such as possible nationalisation of private enterprises (e.g. mines and banks) and talk of expropriation of land without compensation.

FSAs tend to freeze or limit the government's ability to change the tax regime for parties bound to that agreement. Paragraph 8 of the Tenth Schedule currently states that a fiscal stability agreement that is entered into in terms of that provision will guarantee the investor the current provisions of the Tenth Schedule. The investor would have to opt out of the FSA to benefit from future tax changes that provide for a more favourable dispensation, the impact of which is examined in more detail under Chapter 3. The choice provided to the investor may put government in a peculiar situation amidst the high degree of volatility that characterises the oil and gas environment. Roe (2018:17) notes that flexibility is seen as a means to retain a degree of fairness in the balance of sharing revenue. Some have argued that these agreements provide the investor enhanced protection as they would have been negotiated at a time when the bargaining position of the country was weak (Roe, 2018:17).

1.2. Main Research Problem

South Africa is in the process of transforming its oil and gas tax regime. This could lead to some uncertainty for investors, which may lead to loss of investor confidence, Moolman (2012:36). When investors lose confidence, they may not be incentivised to carry out large infrastructure / capital projects, as their returns are not guaranteed in the long run and this may negatively impact burgeoning industries in their infancy such as the energy industry in South Africa.

A balance needs to be found in the potential changes to the tax regime, to make the country attractive and competitive relative to other hydrocarbon rich countries but also progressive such that it also compensates South Africa adequately for its oil and gas reserves.

South Africa has not granted a fiscal stability agreement over the last 5 years (2019 Budget review, 2019:46). There are no public domain readings or publications to be found as to why FSAs have not been granted.

This study seeks to critically evaluate whether FSAs are required in light of the current events in the South African oil and gas industry. Moolman (2012:54) states: *"A fiscal stability clause is viewed as important to facilitate future oil and gas investment, given the high costs of initial sunken capital, combined with high risk and delayed potential profit (National Treasury, 2006b:23). Sunley et al. (2002:8) confirmed the assurance provided by a fiscal stability agreement as an incentive, and stated that the costs of the reduced flexibility to the government will be carried by the increased tax on a given project in the future."* From this it can be seen that FSAs could be instrumental to the future of oil and gas companies albeit with concerns around government's flexibility. Consideration should be made as to whether the current FSA should not be improved upon.

1.3. Key Research Questions

To address the main research problem articulated above, the following aspects will be examined:

1.3.1 Whether there is a need for fiscal stability agreements in South Africa;

1.3.2 The current state of fiscal stability agreements in South Africa and how these compare to the fiscal stability agreements as previously provided for under OP26;

1.3.3 An examination of the current state of fiscal stability agreements in other parts of the world, including a review of the types of fiscal stabilities clauses which are available, and how these may be translated for use in South Africa, and

1.3.4 The potential pitfalls or restrictions for FSAs and how these can be overcome.

1.4. Research method

The research method adopted for this paper is qualitative in nature and typical of doctrinal research. A literature review will assist with establishing why there is a need for FSAs. Thereafter, an analysis of the current FSAs available in South Africa will be performed. In addition, the FSA currently offered under the current legislation is compared to FSAs offered by countries with similar oil and gas positions to determine whether any changes to the South African FSA are required.

The research analyses both primary and secondary information on this topic. Reliance will be placed upon material including legislation, academic papers, and research by academic bodies as well as internet sources.

1.5. Limitations

This study will be limited to the use of the FSAs as a tool for tax stability with regard to the corporate income tax of oil and gas companies. This dissertation will not consider the use of FSAs for other taxes which may impact oil and gas companies, such as Value Added Tax, Employee's Tax and Royalties Tax

1.6. Outline of the study

Chapter 1 provides the introduction to this study.

The need for fiscal stability agreements in the context of South Africa's oil and gas industry will be addressed in Chapter 2. It will include the factors which may lead to changes in the tax regime, and detail the reasons why both the state and investors require these agreements.

Chapter 3 will address the current state of the fiscal stability agreement in South Africa. The chapter also contrasts the FSA as offered by the Tenth Schedule to FSAs which were included in OP26 agreements.

The fourth chapter examines the different types of FSAs. The chapter includes an analysis of FSAs offered by comparable countries, namely Ghana and Mozambique. The chapter concludes on the FSA typically recommended for South Africa.

Chapter 5 details the obstacles and opportunities the FSA type recommended may have in South Africa. The legality and effectiveness of FSAs is also examined.

Finally, the last chapter offers a conclusion to the study as well as recommendations.

CHAPTER 2 – THE NEED FOR THE USE OF FISCAL STABILITY AGREEMENTS IN THE CONTEXT OF SOUTH AFRICA’S OIL AND GAS TAX REGIME

2.1. Introduction

Before looking at the most suitable FSAs for South Africa and the potential obstacles and opportunities for FSAs, one should consider the need for FSAs. Chapter two discusses the primary reasons for FSAs and analyses reasons for fiscal instability in the context of South Africa.

2.2. Need for fiscal stability agreements

“A fiscal regime is the set of instruments or tools (taxes, royalties, dividends, etc.) that determine how the revenues from oil and mining projects are shared between the state and companies.” NRGI Reader (2015:1). Mausling (2017:3) notes*: “There are two types of generic legal designs that are implemented in a variety of forms in the oil and gas industries around the world.”* These legal designs are: i) Concessions and ii) Contracts which includes product sharing contracts (“PSC”) and service contracts (Mausling, 2017:3). Based on the legal design chosen, the revenue collection methods will differ. Both of these legal designs assume government ownership of the land where they merely give the oil and gas companies the right to the minerals for a limited period of time. Under the concession agreement as described by Mausling 2017: 4 *“[…] ownership of the oil or gas will remain with the state until the point where the oil or gas reaches wellhead*.” With a PSC “*the oil and gas company will receive ownership of its share of the production at the “export point”. This point would be defined in the production sharing agreement*” (Mausling, 2017:5). Lastly, in a service contract the title to the reserves remain with the government (Mausling, 2017:6).

The fiscal regime should encourage investment in the short and long term. It should be stable and reliable (Rammutla, 2017:18). When the host country recognises that any of these objectives are not being met, the country is likely to change its fiscal regime.

Daniel and Sunley (2008:6) state that a healthy fiscal regime is one which is adaptable and progressive as it recognises that government's share in revenue should increase as the projects become more profitable. Due to the length of oil and gas projects, the likelihood of changes in fiscal policy is high as significant unknowns, for both the investors and the State, occur during the life of the projects which could not be known at the time of introducing an initial fiscal regime. The length of oil and gas projects and the changing fiscal circumstances make the design of oil and gas tax regimes difficult. Governments must balance between (i) taxing too lightly, thereby not getting a fair compensation from the exploitation of oil and gas resources and (ii) taxing too heavily and potentially losing investors able to exploit such resources (Roe, 2018:15).

Continuously changing taxation regimes tend to lower investor confidence, which leads to lower investment (Rammutla, 2017:17). In support of this statement, Agulliu (2011:75) notes: *"According to a recent competitiveness review conducted by the Alberta Department of Energy, investors placed a great deal of value on fiscal stability and predictability*".

FSAs are tools which can be used to mitigate the risk of changes in fiscal policy. Polkinghorne (2015:1) describes a FSA's function as *"[...] to preclude the application to an agreement of any subsequent legislative (statutory) or administrative (regulatory) act issued by government or administration that modifies the legal situation of the investor".* Roe (2018:17) notes, per the 2009 International Council on Mining and Metals, that FSAs are meant to safeguard companies against future (arbitrary) legislative changes. Roe (2018:17) further adds that FSAs can become a contentious issue as they are often seen to be too favourable to companies. This will be explored in detail later in the chapter.

There are other risk mitigating tools available to a foreign investor to mitigate fiscal instability namely, law-based stabilisation tools and treaty-based stabilisation tools (Kakembo, 2014:3-4). These will not be examined in detail for the purpose of this study as the focus of the study is to deal with the current fiscal stability agreement offered. Briefly to explain these concepts, the former provides for specific guarantees set out in legislation and the latter can be done through bilateral and multinational investment treaties where the contracting states provide procedural action through arbitration should any grievances arise.

2.3. Reasons for changes in fiscal policy

Mansour and Nakhle (2016: 7-12), supported by other authors, have outlined instances which may cause fiscal instability. Applied in the context of the current state of South Africa's oil and gas industry, the following can be observed:

1. **Oil price** – A number of governments will change their fiscal regimes as a result of changes in the oil prices. More than 30 countries were noted, by the World Bank, to have changed their petroleum contracts during 1999 and 2010 during major changes in oil prices. Generally, when the oil price is higher, this gives government an upper hand and the inverse is also experienced when oil prices are lower. When the government has the upper hand, there is likely to be an increase in the tax rates applied to oil and gas activities. This was seen in 2002-2008 period when there was a boom in oil prices and countries such as Angola, Chile and Nigeria increased oil tax rates.

   2018-2019 saw an improvement in oil prices, from being limited in range between 40USD and 50USD per barrel to trading above 70USD per barrel (Biscardini, et al, 2019:1). Linked to the oil price is the supply crunch anticipated by the end of the decade as noted by CEOs of Total, Eni and Saudi Armaco (Biscardini et al, 2019:1). 2020 has however seen a turn, a decrease in oil prices to an average price of US37USD per barrel with the lowest price in 2020 being 11USD per barrel (Macrotrends, 2020)

   In the context of South Africa, given the fact that most licences are still in exploration phases, the oil price would not be a significant factor to necessarily trigger a change in the fiscal regime. It would potentially be a significant trigger when licences are moved to the production phase.

2. **Investment** – Investment trends are also key drivers of change in fiscal regime with the exploration phase being the most impacted by these trends. An increase in investment

may cause government to believe an increase in tax burdens will be met with little resistance from the investors and the inverse with a decrease in investment, with government believing a decrease in tax burdens in this context will relieve some pain for investors.

It is also observed that a good time, from government's perspective, to introduce a tax change is when large-scale investments have been confirmed. This gives the government control and the investor less bargaining power as it may be too late to cancel the project.

Government may also change the fiscal regime in instances where the investment is not going as planned and not contributing to the fiscus as anticipated. This was the case for the Kashagan project in Kazakhstan where the government changed the fiscal regime when they saw that the investment in that field was not advancing at the rate that they had anticipated. The government in Kazakhstan attempted "forcing" the oil and gas company to progress with the investment through penalties/ for delays in the project.

Biscardini et al (2019:6) notes: *"[…] global upstream capital expenditure, which dropped nearly 45 percent between 2014 and 2016 is now forecast to rise 6 percent year-on-year in the medium term".* The author goes further to conclude that exploration is increasing since the global recession. This outlook has however changed in 2020 with the COVID 19 outbreak which has seen a down turn in some economic activities.

This is a global trend and the announcement of sizable gas finds in South Africa by oil company Total, may cause the South African government to anticipate an increase in project investment and to increase the tax burden on oil companies in South Africa. It should be noted that in light of the COVID 19 outbreak and the restrictions caused by it, there have been delays in the wells planned to be drilled in Brulpradda (Tshwane, 2020).

3. **Production life cycle** – At the beginning of the exploration phase of a licence, governments typically provide the most attractive tax regime to encourage investment but once commercial discoveries have been made, the government has the upper hand in terms of bargaining power.

This can be seen to be the trend followed in South Africa. The introduction of the Tenth Schedule was to incentivise exploration and exploitation of unexplored South African fields. Upon the announcement made by Total, which is looking to go into advanced exploration, government has now indicated its intention to re-examine the tax regime applicable in South Africa.

4. **Price in asset sales** – The real value of an oil and gas right is usually known when the asset is sold, based on its selling price. This could serve as a driver for a change in the fiscal regime for government.

   In South Africa, an oil and gas right is not subject to the normal rules of the Eighth Schedule (capital gains tax) to the Income Tax Act on disposal (this will be explained further later in the chapter). In this regard, the Tenth Schedule "shields" the gains derived on sale of an oil and gas right under the participation and roll over options available.

5. **Regional trend and neighbourhood effect** – Governments benchmark their tax regimes with other countries. A change in a fellow country's tax regime with similar characteristics could prompt a similar change by another government of its tax regime. The comparison of similarities are done based on countries with similar potential, geography and cost structures.

   In the past, South Africa was not comparable with fellow neighbouring countries as it was under-explored with little hydrocarbon success in comparison to its peers. This is illustrated by neighbouring Mozambique which had natural gas exports of 4 162 billion cubic metres in 2017 whereas South Africa had nil during the same period (CIA Wold Factbook, 2020). This could change with the discoveries in South Africa announced by Total in 2019. Mozambique is now a comparable country.

   Mozambique is also comparable to South Africa due to the following:

   - Mozambique is a developing country which has stressed the economic impact of oil and gas finds on the country;

- Mozambique passed new petroleum legislation in 2014. This arose following the discovery of commercial quantities of gas in the Rovuma Basin in 2001. This discovery has the potential to make Mozambique the third largest LNG exporter globally (Advogados, Castelo Branco & Associates, 2014).

- Under the abovementioned tax regime, Mozambique offered tax stability agreements for a period of 10 years. The tax stability may be extended for more than 10 years, until the end of the concession in return for payment of two per cent additional to the rate of Petroleum Production Tax or Tax on Mining Production from the 11th year onwards (Roe, 2018:17);

- South Africa's income tax oil and gas regime is not significantly different from the incentives offered under Mozambique's tax regime;

- Similar to South Africa, the Mozambique oil and gas industry requires significant foreign investment; and

- Mozambique, like South Africa, acknowledges that that petroleum resources can contribute significantly towards national development. (Gqada 2013:17).

As noted above, in 2014, Mozambique introduced a new oil and gas tax regime after the vast discoveries in commercial quantities of gas in the Rovuma Basin (Advogados, Castelo Branco & Associates, 2014). This appears to be the same approach South Africa is taking, as suggested by the announcement made by the Minister of Finance in the 2019 Budget Speech.

6. **Changes in political conditions** – Change in government can be a driver of fiscal instability. New ideologies and government policies can lead to a change in the tax fiscal regime.

   Over the past few years, South Africa has seen numerous changes in Ministers, including Finance Ministers where there have been five changes over five years. South

Africa is a developing country and as such changes in political conditions, including changes in government leadership, are ever - present.

Linked to a change in political conditions is the fact that governments may be misinformed about the costs of oil and gas projects and therefore only look at getting a fair share of the natural resources based upon the commodity price, rather than the profitability thereof (Agulliu, 2011:75).

7. **Deteriorating government finances –** Governments may look to the extractive industry to get increased revenue since the investor companies cannot just 'up and leave' as the resources are immobile.

   South Africa has seen a deterioration in government finances in recent years which has resulted in government looking at ways to fill the deficit.

2.4. Further reasons for the need of fiscal stability agreements

FSAs are required in the oil and gas industry to reduce the risk of fiscal instability, as explained above. Other reasons for the use of FSAs have been highlighted by Mansour (2004:2) and are confirmed by Daniel and Sunley (2008:4) as follows:

1. FSAs are justified for large projects with large investment costs. Offshore oil and gas activities are estimated to consist of: exploration costs amounting to 280 million USD, appraisal costing one to two billion USD and development costs between two billion and 4.5 billion USD (DTC, 2016:33). In light of these large costs it can be seen that FSAs are justifiable. These large costs point lend to the "Obsolescing bargain" theory where a government's bargaining power increases over time as the investor would have spent significant sunk costs from which they cannot simply walk away (Howse. 2011:4). FSAs could protect the investor in instances where the government were to change tax regimes which incentivised investment through tax savings, after seeing the viability of the projects, to changes in the tax regime which no longer provide tax savings.

2. FSAs are required for oil and gas projects which typically take a long time to recover the investment costs and earn a reasonable return. It would appear that South Africa acknowledges that oil and gas projects can take 36 to 40 years from licensing to the end of production, based on the period (years) from exploration to production phase.[1] Again, in this case, FSAs would provide protection against arbitrary changes to the tax regime which could have initially provided the investors with reasons to invest and, in the absence of a FSA, be changed to be less favourable as time goes by.

3. FSAs are needed when there is lack of credibility on the part of the host country government, which may be the case in developing countries. In the case of South Africa, there have been talks of expropriation of land without compensation, which casts some doubt over the government's credibility from an investor's viewpoint. In addition, the reputation of the country has also been impacted by political issues including commissions such as *"The State Capture Inquiry"*, which outlines instances of corruption. Lastly, there have been proposals from opposition parties for nationalisation of private businesses. Land (2009:2) notes that fiscal stability plays a key part in offering fiscal packages which incentivise investment when there is an uncertainty with regard to natural resources.

Daniel and Sunley (2008:4) further discuss that a FSA will be less needed if the following is apparent:

1. History of sound fiscal management;
2. Statutory and effective corporate rates are in line with the international standards;
3. Low tariffs rate;
4. Low levels of corruption;
5. Transparent tax policy processes; and
6. Reasonably efficient tax administration.

[1] Exploration rights issued under the MPRDA provide for 3 year initial period and 3 x renewal period of 2 years. Production rights issued under the MPRDA provide for 30 years.

South Africa is not immune to lapses in any of the above and would therefore not be absolved from the need to have FSAs.

2.5. The benefits for both inventors and government for having fiscal stability agreements in place

The need for FSAs has been established due to inherent fiscal instability that exists. It would appear, in most instances, that the FSAs generally serve the interests of investors rather than governments. In this regard, FSAs give investors the advantage of being shielded from discretionary and sometimes arbitrary changes in the fiscal regime and, considering that there may be significant costs which they have incurred on a project, this would seem justified.

Daniel and Sunley (2008:7) raise the point that an increase in future taxes may cause investors to make sub-optimal investment decisions at the risk of paying more taxes. Decreased or sub-optimal investments are counter-productive for governments which are looking for investors to invest more, particularly in exploration and production phases. The use of FSAs provides reassurance for investors to make optimal decisions.

Daniel and Sunley (2008:8) further explain that providing FSAs can bring about the following hypotheses:

1. The "commitment" hypothesis. By entering into a FSA, government has given itself an incentive to uphold the current fiscal regime.

2. The "signalling" hypothesis. It signals to the investor that government is serious about its commitment to the current fiscal terms. It also signals the willingness of government to offer FSAs. This indicates promotion of an attractive investment climate. Lastly, it could be signalling to investors that it is a good time to enter the industry (Cottarelli, 2012:35).

3. The “smokescreen” hypothesis. FSAs could contain loopholes which allow the government to circumvent the FSAs through using devices which are not covered by the FSAs.

Investors view FSAs as valuable if they are “commitment” devices rather than “signalling” or “smokescreen” devices. Providing FSAs lends credibility to the host country. The host country can use this as a bargaining chip to attract investment in the country and to compensate for other existing risks in oil and gas projects (Rammutla, 2017:23).

Investors have indicated that when making the decision on whether or not to invest in the oil and gas industry of a host country their focus is on the stability, transparency and simplicity of the tax laws and tax administration, as opposed to special tax incentives (Mausling, 2017:16). FSAs provide stability FSAs and as such could influence the investor’s decision to invest in the host country.

2.6. Incentives offered in the Tenth Schedule

The oil and gas tax regime in South Africa currently offers tax incentives in the Tenth Schedule. The current oil and gas right holders would likely not want to lose these incentives should there be any changes. The tax incentives in the Tenth Schedule include the following:

- Paragraph 6 provides that a company is deemed to be carrying on a trade, and expenditure and losses in respect of the oil and gas right are deemed to be incurred in the production of income, by virtue of holding an oil and gas right as defined. This allows expenditure to be claimed as a deduction by a company in the determination of its taxable income. In the absence of this provision, an oil and company would not be allowed to claim expenditure as a deduction for tax purposes if requirements within the Income Tax Act (for example, the requirement of “trade” or “in the production of income”) have not have been met.

- Paragraph 3(1) allows for a reduction in dividends tax to nil for dividends derived from oil and gas income. Without this provision, the withholding tax charged could reach 20% had this provision not been in place.

- Paragraph 3(2) states that withholding tax on interest is nil for interest paid on loans used to fund expenditure which is capital in nature, in relation to an oil and gas right. If this provision was not in place, the withholding tax payable could be 15%.

- Paragraph 4(1) states that an oil and gas company will determine its foreign gains and losses with reference to the functional currency of that company and that the translation rate method used will be based upon what the company uses for financial reporting purposes. Without this provision, companies would be required to account for their transactions in South African Rand (ZAR) and translate it based on the ZAR spot rate.

- Paragraph 4(2) states that an oil and gas company will determine its income and expenditure in its functional currency and translate it to ZAR at the average exchange rate for the year. In the absence of this provision, translations would have to be performed at spot rates (this would be difficult to calculate based on the number of transactions for the year and considering that oil and gas companies are likely not to have ZAR functional currencies).

- Paragraph 5 allows for certain "super deductions" which could reach 200% of the expenditure incurred in relation to the oil and gas right where the expenditure is of a capital nature, which is not allowed in any other provision in the Income Tax Act.

- Paragraph 7 stipulates the rules to be applied on disposal of an oil and gas right. Essentially, there are two methods which can be used namely the participation treatment or rollover treatment. These methods give an advantageous result (for example, no tax is payable) which would not be possible if other provisions such as Capital Gains Tax rules in the Eighth Schedule to the Income Tax Act were applied.

2.7. Further reasons to preserve the incentives offered in the Tenth Schedule

The South African government currently uses two main methods for obtaining revenue from oil and gas activities, namely Royalties and Income tax. The government has now issued a new draft Upstream Petroleum Resources Development Bill 2019 ("Draft Bill") for public comment where it seeks another revenue stream in the form of State Participation.

Section 3(4) of the Draft Bill provides that the Minister of Finance will determine any *"[…] royalties, production bonus and performance resources rent tax […]"*. The two latter taxes are not currently place in South Africa and suggest that the oil and gas fiscal regime could change. In light of this the need to preserve the incentives under the Tenth Schedule are even more important.

Another section of interest of the Draft Bill is section 39(1) which is calling for a 20% carried interest in exploration and production rights. In addition to this, section 38(1) of the Draft Bill requires that black persons, as defined, should share a minimum of 10% participation in the right. These two provisions have the effect of diluting the investors' share, in most instances, at least by 20% with the State carry if they already have black ownership in the right. State carries are not unique to South Africa, with other countries also having this as part of requirements for an oil and gas right. The requirement for part ownership by black persons is to promote section 9 of the Constitution of Republic of South Africa, 1996 (Department of Justice) by providing the right of equality for all South Africans to share in the economy, in this case by advancing previously disadvantaged groups (black persons).

Whilst these proposed changes are in line with international norms and other measures meant to promote equity in South Africa, they place more emphasis on investors being compensated through the current incentives offered by the Tenth Schedule. Mausling (2017:64) warns that South Africa should guard against being over-generous when it comes to tax incentives as, at that point, Income tax was the main source of revenue from oil and gas activities. However, given the proposed carried interest, production bonus and petroleum resource rent under the Draft Bill, one could argue that the need for generous tax incentives are warranted.

The announcement of new rules under the Draft Bill causes more uncertainty as to changes anticipated in the Income Tax provisions, providing FSAs would help ease investor fears. Burkhardt (2019) mentions that companies such as Royal Dutch Shell have slowed their investments due to uncertainty in legislation. The remaining uncertainty with the Income Tax would only make investors more sceptical.

2.8. Criticism for the use of fiscal stability agreements

FSAs can be perceived as restricting the State's right to change laws as and when required. Howse (2011:3) describes FSAs as being a trade-off for government. There is a need for government to attract foreign investors which leads to them providing commitments to investors. This is achieved at the cost of the State losing, to an extent, their autonomy to implement new laws as and when required. Howse (2011:3) further notes that through negotiation, FSAs should look to strike a balance between providing the stability required by investors and protecting the power of the State to amend policies.

It should also be noted that even though FSA's are legislatively enforced (Burns, 2012), through paragraph 8 of the Tenth schedule, the principle of parliamentary sovereignty means that this provision in the Income Tax Act can be overridden by a later Act enacted by Parliament (this will be explored in detail in later chapters).

Bernardini (2008:100) notes that FSAs are seen to protect investors through restricting the legislative and administrative power of the State. Bernardi (2008:100) further notes that this protection dispels doubt that the contracts/agreements may be seen as administrative contracts with the view that it is pursuing public interest by the State i.e. *"(the exploitation of its natural resources for the country's benefit)"*.

2.9. Chapter conclusion

The use of FSAs are required based on various risks associated with oil and gas projects. As noted in the analysis above, South Africa is subject to fiscal instability and based on the current announcement made by the Finance Minister, it is likely that more changes to the tax regime will take place. Investors are more likely to want to keep the current provisions of the Tenth Schedule in place, based on the incentives provided in the Tenth Schedule. The value of FSAs seems to be acknowledged by the legislator through FSAs provisions being present in both the OP26 regime and the Tenth Schedule.

The Tenth Schedule allows for FSAs to be entered into. However, it is important to establish whether the current provisions under paragraph 8 of the Tenth Schedule are adequate to provide the necessary risk mitigation to fiscal instability. Chapter 3 will evaluate paragraph 8 of the Tenth Schedule. In a recent study (2015) a number of uncertainties were raised by the International Monetary Fund regarding this provision. Chapter 3 will also look at the FSAs offered under the OP26 regime in comparison to the Tenth Schedule.

CHAPTER 3 – EVALUATION OF CURRENT FISCAL STABILITY AGREEMENTS AS OFFERED BY THE TENTH SCHEDULE

3.1. Introduction

In previous chapters, it was highlighted that a FSA is a tool used to assure fiscal stability. South Africa currently has tax incentives contained in the Tenth Schedule which could adversely change if there is a change in the fiscal regime, as highlighted in the preceding chapter.

The 2006 EM (2006:15) explained that one of the main reasons for the introduction of the Tenth Schedule was to provide certainty and transparency in relation to oil and gas exploration and production tax rules. Under the OP26 regime, there was a level of uncertainty regarding the renewal of the fiscal provisions which caused some oil and gas companies to postpone further investment. This was one of the reasons for the introduction of the Tenth Schedule (Moolman & van der Zwan, 2016:236).

Chapter 2 concluded on the reasons FSAs are required in the South African context. As indicated in the 2006 EM, as part of the Tenth Schedule, FSAs are meant to encourage certainty and transparency in the oil and gas tax regime

However, in order to determine whether FSAs achieve the intention set out in the 2006 EM, it is necessary to look at paragraph 8 of the Tenth Schedule which governs FSAs, to see the extent to which certainty and transparency is actually provided by FSAs under this provision. In order to establish whether these objectives are achieved, a review of issues and uncertainties raised by different stakeholders regarding FSAs will be reviewed.

The certainty provided by the FSAs as offered under the Tenth Schedule will also be contrasted to that provided under the OP26 regime.

3.2. Fiscal stability agreements as offered by the Tenth Schedule

3.2.1. Granting of a fiscal stability agreement

The Income Tax Act allows for the Minister of Finance to enter into a FSA with an oil and gas right holder. Paragraph 8(1)(a) of the Tenth Schedule reads: "*The Minister may enter into a binding agreement with any oil and gas company in respect of an oil and gas right held by that company, and that agreement so entered into must guarantee that the provisions of this Schedule (as at the date on which the agreement was concluded) apply in respect of that right as long as the right is held by the oil and gas company".* [my emphasis added]

Based on the above wording, the International Monetary Fund (IMF, 2015:28) noted that a potential shortcoming of a FSA is that the FSA will only be applicable to the Tenth Schedule and changes to other provisions in the Income Tax Act which may be applicable to the oil and gas right holder would not be covered by the FSA. The IMF seems to imply that this may be detrimental to the investor, however, upon further reading, one observes that the current wording in paragraph 8 is seemingly in line with what the legislature intended. This is based on what is stated in the 2006 EM that accompanied the introduction of the Tenth Schedule, in which it is stated that that oil and gas specific provisions would be limited to the Tenth Schedule.

Section 26B(1) of the Income Tax Act notes that the taxable income of an oil and gas company will be determined in accordance with the provisions of the Income Tax Act but subject to the provisions of the Tenth Schedule. Therefore, for an oil and gas company, the Tenth Schedule overrides most provisions in the Income Tax Act.

Moolman & van der Zwan (2016:235) note that a shortcoming of this FSA provision is that these provisions do not protect against amendments made to the body of the Income Tax Act. However, based on the intention outlined in the EM, the current approach is in line with the objective. By limiting changes to the Tenth Schedule, the current wording of paragraph 8(1)(a) with respect to FSAs can also be seen to encourage flexibility for the State, to allow the State to change provisions affecting oil and gas companies, should this be required. This is in line with the characteristics of a progressive tax regime.

Secondly, it is noted that this provision grants the Minister of Finance discretion to issuing FSAs. The discretion that is enjoyed by the Minister of Finance to issue FSAs provides flexibility for the State to enter into FSAs on a right-by-right basis and prevents the State from being locked in on all projects (Moolman & van der Zwan, 2016:236). Moolman & van der Zwan (2015:235) also noted that the current provisions of the Tenth Schedule may be difficult to maintain should there be significant oil and gas discoveries in South Africa. Therefore, the discretion enjoyed by the Minister will prove beneficial, from the perspective of the State, as it provides sufficient flexibility for the State to not enter into FSAs where it thinks this is the appropriate course of action.

However, other authors have analysed the choice of word "may" as meaning that the Minister has a discretion in issuing FSAs but his exercise in that such discretion should follow due process. De Lange & van Wyk (2017:1) analyses the discretionary powers by the Commissioner in terms of a similar discretionary section, section 164(3) of the Tax Administration Act, No. 28 of 2011 ("TAA"). The section in question reads: *"A senior SARS official may suspend payment of the disputed tax or a portion thereof having regard to relevant factors, including—[….]"* [my emphasis added]. The SARS official, in this case, is exercising their discretion as to whether or not to suspend payment (De Lange & van Wyk 2017:5). The authors note that a request cannot be instantly dismissed without exercising proper discretion by considering all the relevant facts (De Lange & van Wyk 2017:7). Section 164(3) makes the discretion simpler, as at includes a list of factors to be considered. This is not the case in paragraph 8 of the Tenth Schedule, as there is no guidance in the factors to be considered by the Minister in granting an FSA. De Lange & van Wyk conclude that as a recommendation guidelines of the process and factors considered when applying this discretion should be issued by SARS (2017:21). The authors suggest this can be done by of a guide or interpretation and this will encourage transparency and ensure that the taxpayers' rights are upheld. This would make the process transparent and provide certainty to the investors.

The discretionary action should be in line with Promotion of Administrative Justice Act No.3 of 2000 (“PAJA”). Should the taxpayer feel prejudiced by the discretion of the Minster, recourse is available items of PAJA (De Lange & van Wyk, 2017:21).

A criticism against the discretion afforded to the Minister to provide FSAs on a right-by-basis is that it does not provide transparency and certainty which were stated in the 2006 EM as being the intention of the Tenth Schedule. In particular, the Minister’s discretion brings uncertainty as to what criteria apply in determining whether a FSA is to be offered and there is uncertainty with respect to different versions of FSAs that exist. These agreements are not available to the public and what is contained in FSAs that have been signed is not widely known. This may create the risk that FSAs that are in existence are not uniform, which what is seen with the FSAs for Forest Oil and BHP (Futter, 2010:9). The recommendation of providing guidelines on the process used to apply discretion, as recommended above will solve this criticism.

The current FSA provisions have been criticised for lack of transparency but have also been commended for the ability to provide flexibility. From this it can be seen that the wording of the provision is not necessarily against the intention of the legislature as indicated in the EM but the approach, or how it is has been administered, could be improved upon.

3.2.2. Part assignments of fiscal stability agreements

The National Treasury of South Africa in the 2014 Budget review (2014:172) suggested refinements to the FSA provisions, more specifically relating to the transfer of FSAs. In this regard, National Treasury noted concerns regarding the assignment of FSAs in the case of oil and gas companies which entered into a joint venture (“JV”). A suggestion by National Treasury was that FSAs should be shared by parties to the JV. JVs are common amongst oil and gas companies. They are a preferred method of investment as they allow for the sharing of risk and pooled capital as oil and gas projects are highly capital intensive. Ernst & Young (2015:1) highlighted that as much as 71% upstream oil and gas investments are done through JVs in a research done over 365 megaprojects. As the preference for JVs is driven by the need to share risk, it is understandable that such parties would also want to share in risk mitigating tools such as FSAs.

As a result of this concern, in the 2014 EM it was explained there would be a change to the FSA provisions of the Tenth Schedule to clear up ambiguity regarding companies which enter in joint ventures being allowed to share in the FSA of the original oil and gas right holder, if the original party had in fact entered into a FSA. Based on this, paragraph 8(1)(c) of the Tenth Schedule was amended to read as follows: *"If an oil and gas company <u>jointly holds with another oil and gas company an exploration right</u>, as defined in section 1 of the Mineral and Petroleum Resources Development Act, <u>and any one of those oil and gas companies has concluded an agreement as contemplated in subparagraph (1) in respect of that right</u>, <u>all of the fiscal stability rights in terms of that agreement relating to that exploration right</u> apply in respect of both of those companies."* [my emphasis added]

A criticism of the updated provision is that the coverage only applies to exploration rights. The provision does not cover JVs which are in production phase. Although this is not an immediate issue as there are minimal production rights held in South Africa at the moment, this may Hbecome a point of concern when more companies enter into the production phase.

3.2.3. <u>Application of fiscal stability agreements</u>

IMF (2015:28) notes that the conclusion of a FSA may be to the benefit and detriment of an oil and gas company. This is based on paragraph 8(5) which reads: *"The portion of taxable income and profits of an oil and gas company derived from all the oil and gas rights governed by the version of the Schedule applicable to an oil and gas right covered by a binding agreement referred to in subparagraph (1), <u>must be determined in terms of that version of the Schedule.</u>"* [my emphasis added]

This provision provides that the holder of the FSA has to apply all of the provisions of the Tenth Schedule that are applicable under the relevant FSA. That is to say they cannot apply provisions partially when there has been a change in the Tenth Schedule. The detriment can be seen when there are more favourable provisions in a newer version of the Tenth Schedule and the company either needs to terminate the FSA or use the less favourable provisions. The company will need to go one route or the other.

The application of the provisions which apply on conclusion of a FSA also brings provides complexity for companies which have multiple oil and gas rights. Companies in this situation may need to perform separate tax calculations on different licences due to different provisions of the Income Tax Act being applicable depending on when the FSAs were concluded. This increases the administrative burden on the company and the revenue authorities as multiple tax calculations may need to be performed on a licence by licence basis.

3.2.4. Transfer of fiscal stability agreements on disposal of an oil and gas right

The Tenth Schedule provides that FSAs can be transferred to the buyer of that oil and gas right in certain circumstances. The transfer of the FSA rights can be done with any buyer when there is a disposal of an exploration right as defined in the MPRDA. Whereas if it is a production right, the transfer of the FSA can only be done if the buyer and the seller form part of the same group of companies as defined in section 1 of the Income Tax Act.

The IMF (2015:28) and DTC (2015:63) note a shortcoming in this provision is that the transfer of FSA rights on the sale of a production right is limited to companies in the same group of companies. This is seen as a disadvantage as it does not put new entrants to a licence that is in the production phase on an equal level and may discourage new entrants if they are not in the same group of companies (Mausling, 2017:32). The DTC further explains that the lack of transferability of the rights impacts the marketability of the production right, which would not be in line with the objective of increasing production activities in South Africa.

The 2007 EM explains that the need to allow for the unrestricted transfer of FSAs relating to exploration rights is to assist smaller oil and companies that actively engage in exploration but sell to larger companies before the production phase has been reached. The EM does not offer any guidance as to why the transfer of FSAs relating to production rights is limited.

The concern raised by Futter (2010:58) in relation to restricting the transfer of FSAs related to production rights, is that South Africa competes with other countries and such restrictions are not in place in those countries. As there are no such constraints on other countries, this could make South Africa a less favourable jurisdiction in which to invest.

3.2.5. Other concerns in relation to fiscal stability agreement current legislation

IMF (2015:27) noted that another shortcoming of the current FSAs offered for oil and gas companies is that it does not apply to all taxes. South Africa allows for a FSA for the Income Tax provisions under the Tenth Schedule and a FSA for royalty taxes in terms of Mineral and Petroleum Resources Royalty Act, No. 28 of 2008 ("Royalty Act"). The FSA granted for royalty taxes is also granted by the Minister of Finance and binds the State to the rate formulae applicable under the Royalty Act at the time of conclusion of the FSA.

There is no general framework for the conclusion of FSAs which cover all or most taxes. IMF (2015:27) notes this is unlike the situation in many other countries where these agreements are often concluded when an oil and gas right is issued. IMF (2015:27) also notes that the debate regarding proposed amendments to the MPRDA shows the limited nature of the FSAs currently available in South Africa. Even though the MPRDA is not directly connected to FSA provisions in the Tenth Schedule, there are definitions in the Tenth Schedule which reference the MPRDA. This shortcoming was also confirmed by Futter (2010:57).

From the above it can be seen that the current segregated FSAs may cause a lack of investor confidence with respect to the possible introduction of new laws or with amendments in existing laws that are not covered by a FSA but impact the investor. Additionally, this also brings about an administrative burden for both the investor and the State with maintaining separate FSAs for income tax and royalty tax purposes.

According to Mansour (2004:4), negotiations leading up to the conclusion of a FSA often attempt to encompass all taxes, with investors using the opportunity to lobby for tax incentives which do not generally apply to the investor. Mansour (2004:10) acknowledges that FSAs which cover all taxes could restrict government's ability to change their share in the resources intake, should it be required. It is suggested that FSAs identify specific taxes rather than be "all-inclusive" applicable to all taxes. It is preferable for FSAs to be limited to direct taxes, which includes corporate taxes and royalties, Mansour (2004:10).

3.3. Contrast of fiscal stability offered under the Tenth Schedule to that offered in the OP26 regime

Fiscal stability was provided under the previous South African Mining Lease regime, OP26 prospecting lease. All of the rights held under the OP26 agreements are no longer applicable, as all OP26 rights were converted into MPRDA rights. On conversion of these rights to MPRDA rights, the OP26 fiscal stability provisions lapsed and new fiscal stability had to be sought under the Tenth Schedule.

Even though the OP26 agreements have lapsed, it is worthwhile to consider the terms offered by OP26. The fiscal stability clauses included in OP26 agreements, in contrast to the Tenth Schedule, provided for fiscal stability over all the taxes. The clause included freezing the provisions of the Income Tax Act as at 1977 (DTC, 2016:44), similar to the Tenth Schedule approach. The clause further allowed for oil and gas companies to elect the use of a current regime if it was more favourable (Moolman, 2012:43).

As mentioned above, under OP26, a comprehensive fiscal stability clause covered all taxes applicable to oil and gas companies. The current fiscal stability as offered under the Tenth Schedule has been criticised for not providing cover over all taxes and also not covering new taxes which could be introduced. OP26 also limited the right holder's tax liability to income tax and saw oil and gas taxpayers being shielded from the introduction of new unfavourable tax legislation such as Capital Gains Tax and Secondary Tax on Companies ("STC") (Futter, 2007:5).

The IMF (2015:28) suggests that the overall approach of the assurance offered by FSAs needs to reviewed. The IMF (2015:28) proposed providing a uniform approach to fiscal stability assurance by means of an Act covering all fiscal aspects.

3.4. Chapter conclusion

The current state of FSAs has been criticised by the IMF and the other academic writers. In the IMF's closing statement, there is a call for the overall approach to fiscal stability in South Africa to be reviewed (2015:29).

A comparison of the FSAs offered by OP26 revealed that those provisions were more favourable than the current FSAs. It is however acknowledged that there have been changes in circumstances and legislation should not be stagnant as mentioned in Chapter 2.

Chapter 4 will look at best practices concerning FSAs, and will evaluate what the obstacles and challenges are of introducing these FSAs to South Africa.

CHAPTER 4 – TYPES OF FISCAL STABILITY AGREEMENTS, FISCAL STABILITY AGREEMENTS OFFERED BY COMPARABLE COUNTRIES AND CONSIDERATION OF WHICH ONE IS MOST SUITABLE FOR THE SOUTH AFRICAN OIL AND GAS TAX REGIME

4.1. Background

In the Tenth Schedule to the Income Tax Act, South Africa has implemented a "freeze" approach to FSAs. The "freeze" approach aims to preserve the provisions of the Income Tax Act at the time the FSA is concluded. There are shortcomings to this approach which have been dealt with at a high level in Chapter 3.

This chapter aims to evaluate the types of FSAs available. In addition, this chapter evaluates the FSAs offered by comparable countries. Lastly, this chapter provides suggestions as to whether the current approach in South Africa should be amended and, if so, to which method. The evaluation will look at the mechanisms of each approach and consider the challenges/constraints that these provide.

According to Rammutla (2017:12), there are three main FSA approaches namely, the "Freezing stability clause", the "Economic balance clause" and the "Hybrid clause". There are also variations to these approaches which will be explained in detail below.

4.2. Types of clauses

4.2.1. Freezing stability clause

This approach is known as the traditional approach and has been commonly used in the past. Under this clause, the taxpayer is "immune" to changes in the tax regime which may apply subsequent to entering into this contract. In most cases, the agreement/clause takes precedence of over subsequent legislation which may be to the prejudice of the investor (Bernardini, 2008:100). Bernardini (2008:100) notes that an example of such a clause can be seen in the *Kazakhstan, 1997 Model Contract for Oil & Gas (Decree 108 of 17 January 1997)* where is it noted *"Amendments and additions to legislation which cause a deterioration in the status of the Contract adopted after its conclusion shall not be applied to the Contract': Barrows, 'Basic oil laws and concession contracts'"* [my emphasis added]. The author also notes that these types of agreements are also present in Egypt, Qatar, other Middle East countries and the Republic of Azerbaijan.

The wording of freezing clauses differs from contract to contract. Another variation to this clause can be seen in a Production Sharing Contract between Pertamina and Agip SpA of 10 October 1968, art XVI.1.2 where the contract cannot be "annulled, amended or modified" without the mutual consent of both parties (Bernardini, 2008:100). This suggests there is an element of negotiation/collaboration required making this is a hybrid clause. This will be explored in more detail later in the chapter.

South Africa currently has a freezing clause in the Tenth Schedule, as explained in Chapter 3. Under this legislation, the taxpayer may elect to "unfreeze" the FSA if the provisions under any new law are more favourable. This approach has been criticised by some as it is seen as asymmetric as it only protects the investor's interest. According to Amoako - Tuffour and Owusu-Ayim (2010:26), the most important argument against the criticism of this asymmetric approach is that the clause is meant to protect against arbitrary changes which would be to the detriment of investors.

The use of a freezing clause has become less common due to the criticism that it limits the State's sovereign powers. However, it has been pointed out that there is no guarantee that a freezing clause will prohibit the State from exercising its sovereign rights when it is in the public's interest (Gehne and Brillo, 2017:8). This will be explored further in chapter 5.

4.2.2 Economic balancing clause

The economic balancing clause, also known as an “adaption clause”, states that should any hardships arise due to circumstances that were not present at the time the contract was concluded, to either the State or the investor, adaption/renegotiation should take place (Bernardini, 2008:101). This can be limited to hardship experienced by the investor in some instances. This clause allows for the application of new provisions in the tax regime to prevail but provides that the investor and/or State will be compensated for changes in the provisions should these impact such party adversely. This method maintains the economic equilibrium of a project at the date when the FSA was signed (Rammutla, 2017:31). This has become what has been referred to as the “modern day” approach (Kakembo, 2014:6). Bernardini (2008:102-103) notes that these clauses are more in line with public international law. Bernardini (2008:102-103) also notes that the economic balancing clause does not infringe upon the State’s sovereign rights. The economic balancing can be done in three ways:

(1) Automatic Economic Balancing (“AEB”) – As the name suggests, this clause aims to restore economic equilibrium automatically in terms of a stipulated manner should there be a change in legislation. An example used by Maniruzzaman (2018:125) is the readjustment of the ‘profit petroleum split” in a PSC. The example used by this author from the Ecaudorian Model Contract reads as following:

> *“In case of modifications to the tax regime, including the creation of new taxes, or the labor participation, or its interpretation, that have consequences on the economics of this Contract, <u>a corresponding factor will be included in the production share percentages to absorb the increase or decrease in the tax burden</u> or in the labor participation of the previously indicated contractor. This correction factor will be calculated between the Parties and approved by the Ministry of Energy and Mines”*

Another method AEB can be achieved is to the guarantee the total investor’s take. This approach requires that if there is an increase in Income Tax, a reduction in another tax will take place (Futter, 2010:55).

(2) Non-stipulated Economic Balancing ("NSEB") – This clause requires an adjustment to restore economic equilibrium but the agreement/clause does not specify the nature of the adjustment (Rammutla, 2017:34). This method is not a preferred method as it creates uncertainty with no method stipulated and is in contradiction to the primary reason for having a FSA which is to provide certainty.

(3) Negotiated Economic Balancing ("NEB") – This clause requires both the State and investors to negotiate and come to an agreement regarding the adjustments which will be required to give economic equilibrium (Rammutla, 2017:34/35).

An advantage in the using an economic balancing clause is that it allows for an ongoing relationship between the State and the investor unlike with a freezing clause. When there is a breach in a freezing clause (for example, the government does not honour that clause), in most instances, it is stipulated that there will be a lump sum compensation paid to the investor by the government. Paragraph 8(6) of the Tenth Schedule stipulates this approach. The paragraph reads:

> "*If the State fails to comply with the terms of the agreement contemplated in subparagraph (1) and that failure has a material adverse economic impact on the taxation of income or profits of the oil and gas company that is party to that agreement, that oil and gas company is entitled to compensation for the loss of market value caused by that failure (and interest at the prescribed rate calculated on the compensation from the date of non-compliance) or to an alternative remedy that otherwise eliminates the full impact of that failure".*

Breach of an FSA under a freezing clause is more likely to result in the termination of the agreement whereas with an economic balancing clause, there will be continued negotiations and the FSA may be kept in place.

4.2.2.1. Analysis of Negotiated Economic Balancing ("NEB")

Rammutla (2017:350) notes that the NEB is the most preferred of the three economic balancing clauses explained above, as it has the benefit of making FSAs symmetric i.e. not only beneficial to the investor which is one of the criticisms levelled against freezing clauses. When there is a favourable change to the law from the investor's perspective, the government can negotiate to restore its position to when the FSA was initially concluded (for example, to be in the same position as if a tax rate had not decreased). Rammutla (2017:36) notes that an example of such a clause is in Kazakhstan's Profit Sharing Agreements (2005) article 25(2) which read:

> *"If during the effective term of the production sharing agreement other norms are established by legislation of the Republic of Kazakhstan which deteriorate or improve commercial results of the activity of the contractor within the framework of the production sharing agreement, amendment shall be introduced to the production sharing agreement which secure commercial results to the contactor which might have been obtained by the contractor in the event of application of the Republic of Kazakhstan in effect as of the moment of execution of the production sharing agreement".* [my emphasis added]

Another advantage of a NEB clause is that it encourages harmonious relations between the State and the investor. It addresses some of the main concerns of each of the parties in that it allows the State's sovereignty/flexibility to remain intact whilst still protecting the investor (Gehne and Brillo, 2017:8). Bernardini (2008:102) notes that with this clause, the State binds itself to not make changes unilaterally that would alter the economic conditions of the agreement. This allows investors to be part of decisions which would affect them, bringing a sense of inclusion on the part of the investor.

In order for NEB clauses to be used effectively and efficiently, the following factors need to be considered:

1. The change of circumstances that are triggering events for renegotiation:
   Some argue that a NEB clause should not include an exhaustive list of what "change in circumstances" would lead to invoking the clause (Bernardini, 2008:103), whilst

others argue that the events or triggers could be more precisely defined (Bernardini, 2008:104). It is also noted that in order for these clauses to be effective, the clauses should only apply in exceptional circumstances, Bernardini (2008:104). Rammutla (2018:37) supports this and notes that in order for the NEB to be efficient, the trigger events should comprise significant or material changes. This is because it would be inefficient to negotiate on all changes. Bernardini (2008:105) echoes that the changes which "*cause a disproportionate prejudice or substantial detriment or substantial economic imbalance to the interests of one of the parties"* should be targeted.

2. The objectives of the renegotiation should also be known before the negotiations commence:

   A clear objective of the clause should be restoring the economic balance. An example of this clause can be seen in the Qatar Model Exploration and Production Sharing Agreement of 1994. The clause reads:

   > *"Whereas the financial position of the Contractor has been based, under the agreement, on the laws and regulations in force at the Effective Date, it is agreed that, if any future law, decree or regulation affects Contractor's financial position, and in particular if the customs duties exceed . . . percent during the term of the Agreement, both Parties shall enter into negotiations, in good faith, in order to reach an equitable solution that maintains the economic equilibrium of this Agreement. Failing to reach agreement on such equitable solution, the matter may be referred by either Party to arbitration pursuant to art 31...''* [my emphasis added]. Bernardini (2008:110).

   Other examples of contacts with economic equilibrium agreements are included in the Annexures 1 to 3 (Bernardini, 2008:110-111).

As the two factors highlighted above may sometimes lack clarity and leave greater flexibility than may be intended, some clauses provide for a consultation process to take place periodically i.e. every three years to discuss whether modifications are required in light of the parties' expectations (Bernardini, 2008:103).

3. The procedures for the renegotiation should be known:
   This includes the manner of communicating a request for renegotiation, the timeframe to conclude the renegotiation and the remedies available should an agreement not be reached in a negotiation. Such remedies would include arbitration, which is more be preferred in order to avoid costs, or court litigation, which will be explored further in chapter 5. It is important that negotiations are done in good faith. In addition, consideration needs to be given as to what is meant by the "original equilibrium". It should be considered whether this may result in full compensation payable to the aggrieved party or whether consideration should also be given to the public interest, in order to enhance an equitable solution. (Bernardini, 2008:105)

4.2.3. Hybrid clause

The last type of fiscal stability clause is a hybrid clause. This a combination of the freezing clause and the economic balancing clause. This clause provides that some provisions will be "frozen" whilst other provisions will not automatically be exempt from changes to legislation but rather will be subject to compensation.

4.3. Fiscal stability clauses used by comparable countries

Now that the types of FSAs available have been considered, it is useful to consider which FSAs are used by countries comparable to South Africa. It is also useful to look at the progression of FSAs in these countries.

The analysis of the comparable countries' FSAs will be focused on Ghana and Mozambique. In considering how these countries are appropriate for comparison, the following factors were considered:

- South Africa, Ghana and Mozambique are all developing countries that are reliant on foreign investment to grow their oil and gas sector. These countries' tax authorities provide oil and gas companies with tax incentives in order to advance their competitive position to attract foreign investors.

- All three of these countries have had oil and gas finds. Mozambique saw a discovery of commercial quantities in Rovuma Basin in 2001. Ghana had its first commercial oil find in 2007 in the Jubilee fields (Mausling, 2017:14). South Africa has followed with the Brulpadda discovery announced in 2019. These three countries, together with Niger, Uganda, Kenya, Senegal and Mauritania, have seen the number of African countries with proven oil and gas reserves rise to 28 based on successful exploration over the last decade (ESI Africa, 2019).

As noted above, these countries are reliant on foreign investment to advance their oil and gas industry and are therefore in competition with each other to attract investors. One of the tools to attract these investors would be FSAs.

4.3.1. Fiscal stability offered by Ghana

The Ghana government has a model concession agreement, the GNPC Model Petroleum Agreement Ghana (2002) (Resource Contracts). This agreement included a fiscal stability agreement clause which reads:

> *Article 12.1 – "No tax, duty, fee or other impost shall be imposed by the State or any Political Subdivision on Contractor, its Subcontractors or its Affiliates in respect of activities related to Petroleum Operations and to the sale and export of Petroleum other than as provided in this Article.".*

The article above is a freezing stability clause. Article 12.9 goes further to include a clause that changes it to a hybrid clause. This next article is a negotiated economic balancing stability clause. The article reads as follows:

> *Article 12.9 – "It is the intent of the Parties that the payments by the Contractor of tax levied by the Petroleum Income Tax Law qualify as creditable against Contractor's United States federal income tax liability. Should the United States Internal Revenue*

> *Service determine that the Petroleum Income Tax Law does not impose as creditable tax, the parties agree to negotiate in good faith with a view to establishing a creditable tax on the precondition that no adverse effect should occur to economic rights of GNPC or the State".*

The above two articles acknowledge that the tax regime will be fixed at the time the agreement is reached. If there they are changes to the tax regime, the State may, however, seek to negotiate if the tax laws are seen as adverse to the economic rights of the State. Here are a few examples of how the Articles in the Model clause were used or not used in the concession agreements in place:

The Kosmos Energy Ghana HC, E.O. Group, West Cape Three Points Block, Concession, 2004 (Resource Contracts) concession agreement includes the Articles noted in the model agreement above, see Articles 12.1 and 12.11 in this agreement. It also includes another Article which reads:

> Article 12.12 –*"Contractor shall be entitled to economic and fiscal stability according to the rights and benefits as defined in this Agreement."*

This clause further reiterates that fiscal stability is offered to the oil and gas company.

The *Heliconia Energy Ghana Limited, Offshore Cape Three Points Basin, Concession, 2005* (Resource Contracts) concession agreement is different to the Model agreement as it does not include Article 12.9 per the model contract. This contract only contains a freezing clause. It would be interesting to understand why the State included a freezing stability clause in this agreement since this was not the trend, as outlined in the other quoted agreements at the time.

The next set of agreements examined were, The *Tullow Ghana Limited, Sabre Oil and Gas Limited, North, South and West Tano Fields, Concession, 2006* and The *Tullow Ghana Limited, Sabre Oil and Gas Limited, Kosmos Energy Ghana HC, Deepwater Tano, Concession, 2006* (Resource Contracts). These agreements had the same fiscal stability clauses as the Ghana Model agreement (see Article 12.1 and 12.11 in aforementioned agreements). There are a few variations to the fiscal stability arrangements, contained in Article 26.3, 26.4 and 26.5 which read as follows:

> Article 26.3 -*"This Agreement and the rights and obligations specified herein may not be modified, amended, altered or supplemented expect upon the execution and delivery of a written agreement by the Parties. Any legislative or administrative act of the State or any of its agencies or subdivisions which purports to vary any such right or obligation shall, to the extent sought to be applied to this Agreement, constitute a breach of this Agreement by the State; provided, however, where a new income tax rate comes into force as a result of the promulgation of the new Petroleum Income Tax currently before Cabinet, Contractor shall have the option of either applying the new income tax rate to this Petroleum Agreement or remaining the Petroleum Income Tax, 1987, PNDC Law 188."*
>
> Article 26.4 - *"Where a Party considers that a significant change in the circumstances prevailing at the time the Agreement was entered into, has occurred affecting the economic balance of the Agreement, the Party affected hereby shall notify the other parties in writing of the claimed change with a statement of how the claimed change has affected the relations between the Parties."*
>
> Article 26.5 – *"The other Parties shall indicate in writing their reaction to such representation within a period of three (3) Months of receipt of such notification and if such significant changes are established by the Parties to have occurred, the Parties shall meet to engage in negotiations and shall effect such negotiations in, or rectification of, these provisions as they may agree are necessary to restore the relative economic position of the Parties at the date of the Agreement."*

The above agreements still contain hybrid clauses, however, the agreements are leaning towards becoming NEB clauses as Article 26.3 allows for a change in legislation. The other two clauses do however allow for negotiation between the parties, should either party feel aggrieved.

The *Ghana National Petroleum Corporation, Vitol Upstream Ghana Limited, Cape Three Points South, PSA, 2008* (Resource Contracts) concession agreement has similar clauses to those discussed above but it does not contain Article 12.9, as included in the Model Agreement.

More recent petroleum agreements in Ghana have shown a shift in the fiscal stability provided. The earliest, per the Resource Contract, to show this shift is the *Medea Development Limited, Cola Natural Resources, Ghana National Petroleum Corporation, East Cape Three Points, Concession Agreement, 2013* concession agreement which no longer provides a freezing clause. There only seems to be a negotiated economic balancing clause. This is seen with a change in Article 12.1 which reads:

> *"Subject to applicable laws and regulations as the same may be amended from time to time, the tax, duty, fee and other imposts that shall be imposed by the State or any other entity or any political subdivision on Contractor, its Subcontractors or its Affiliates and shareholders in respect of work and services relates to Petroleum Operations and the sale of exports of Petroleum shall include, but not be limited to, the following:*
>
> *a) Tax in accordance with the Petroleum Income Tax Act Tax Law 1987 (PNDC L188) and Income Tax shall be levied at the rate of thirty-five percent (35%); […]"*

This Agreement provides negotiated economic balancing clauses in Articles 26.2(b), 26.2(c) and 26.2(d), which are similar to Article 26.4 and 26.5 in the *Tullow Ghana Limited, Sabre Oil and Gas Limited, North, South and West Tano Fields, Concession, 2006* discussed above.

The agreements which follow have similar variations in their wording. More recent agreements, which include the *ENI Ghana Exploration & Production Limited, Vitol Upstream Tano Limited, Woodfields Upstream Limited, Ghana National Petroleum Corporation, Explorco, Cape Three Points Block 4, Concession Agreement, 2016* and *Swiss African Oil Company Limited, Pet Volta Investments Limited, Ghana National Petroleum Corporation, Onshore Offshore Keta Delta Block, Concession Agreement, 2016 (*Resource Contracts) to mention a few (not all), contain NEB clauses.

One of the possible reasons for a change in the FSAs offered over the years, is a shift in the production cycle in Ghana. Commercial production in Ghana started in 2010 in the Jubilee Field (PWC, 2019:139). This resulted in a spike in the oil and gas production. As noted in chapter 2 above, the stages of exploration and exploitation, often result in changes being made to the tax regime, which includes change in the fiscal stability provided.

From clauses set out above, it can be seen that fiscal stability is no longer always provided by way of a freezing clause. The agreements now typically include NEB clauses, allowing for any party which is aggrieved by changes to enter into negotiations. As mentioned, Ghana saw its first commercial oil find in 2007 and it can be seen that the agreements changed post the discovery of commercial oil and gas. In this context, one could look at the progression of the FSAs based on the changes in proven oil and gas reserves in the country.

4.3.2. Fiscal stability offered by Mozambique

The petroleum agreements offered in Mozambique are in mostly in Portuguese and therefore have not been examined in detail for the purposes of this paper. Instead, the focus has been on the Model Petroleum Agreement in Mozambique as representative of the agreements offered.

The earliest model agreement is the Mozambique Exploration and Production Concession Contract (2006) (Resource Contracts). The Articles relating to fiscal stability are as follows:

Article 11.6 states:

> *"The Government warrants that in respect of the Petroleum Operations or income derived from Petroleum Operations, on the Effective Date there were no taxes, duties, levies, charges, fees or contributions other than the listed imposts and taxes in respect of the Concessionaire an its Subcontractors exempt under Articles 11.2 and 11.3."*

This is a freezing clause. The agreement goes further to include additional Articles which make it a hybrid clause.

Article 11.8 reads:

> *"Nothing in the provisions set out in Article 11 shall be read or construed as imposing any limitation or constraint on the scope, or due and proper enforcement, of*

Mozambican law of general application which does not discriminate, or have the effect of discriminating, against the Concessionaire, and provides in the interests of safety, health, welfare or protection of the environment for the regulation of any category or property or activity carried on in Mozambique; provided, however, that the Government will at all times during the life of the Petroleum Operations ensure in accordance with Article 28, that measures taken in the interest of safety, health, welfare or the protection of the environment are in accordance with the standards generally accepted from time to time in the international petroleum industry and are not unreasonable."

Further, Article 11.9 reads:

"In the event that after the Effective Date, any other tax is introduced in the Republic of Mozambique which is not of the type set out in Article and, as a result, there is an adverse effect of a material nature on the economic value derived from the Petroleum Operation by the Concessionaire, the Parties will, ensure the Concessionaire obtains from the Petroleum Operations, following such changes, the same economic benefits as it would have obtained if the change in the law had not been effected."

These two articles are economic balancing clauses, with the result that the model agreement adopts a hybrid clause approach.

The most recent Model Petroleum Agreement issued in 2016 was written in Portuguese. The Model Contract, PSA, 2016, shows a change in the fiscal stability provided. All the Articles, or similar Articles in the previous model agreement are not included in this agreement. Translated to English the new article relating to a fiscal stability agreement in Article 11.9 reads as follows:

"For the purposes of this PSA, a ten-year fiscal stability may be negotiated from the approval of a Development Plan, without affecting viability assumptions.

The fiscal stability period provided for in this article may be extended until the end of the initial concession by paying 2% additional to the production tax rate from the eleventh year of production, as per the applicable law."

This clause is in line with the Mozambique Law No 21/2014 (Hydrocarbons Law) to provide fiscal stability for certain periods (Rage, 2015).

One of the more recent Petroleum Contracts, signed in 2018, *Eni Mozambico, Sasol Petroleum Mozambique Exploration Limitada, Empresa Nacional de Hidrocarbonetos, Block A5-A, PSA, 2018* (Resource Contracts) shows that fiscal stability is in line with the Model agreement. Article 11.8 in this agreement reads as follows:

> *"The fiscal stability in Article 40 of the Law No. 27/2014 of September 23, as amended by Law 14/2017 of 28 December, is applicable for this EPCC. The option to extend the period of fiscal stability established in Article 40(3) of Law 27/2014 of September 23 shall be exercised not later than the end of the eighth year after commencement of Commercial Production."*

In support of the above, Article 43 of the Law No. 27/2014 (Instituto Nacional De Petroleo) reads:

> *"Tax stability for a ten-year period can be negotiated to begin on the date of approval of a development plan for commencement of the exploitation of mineral resources, in regard to the following parameters:*
>
> *a) Rates set out in this law;*
>
> *b) Collection rules, and*
>
> *c) Annual fixed rate of concession.*
>
> *2. The tax stability period foreseen in the foregoing paragraph can be extended until the end of the initial concession period against payment of additional 2% of Production Tax from the eleventh year of production."*

The current tax regime in Mozambique provides for the *"Possibility to negotiate a tax stability for a period of ten years, effective upon a proven investment of 5 million United States dollars (USD)"* (PWC, 2019).

From the above, it can be seen that Mozambique has a freezing stability clause in place. This is restricted for a certain period and is only afforded to investments with a minimum investment spend. This is line with Rodriguez-Yong & Martinez-Muñoz (2013:78) who note that a feature in the FSA's offered in the most of the Andean countries is that they are only offered to investors with a minimum investment spend.

4.4. Chapter conclusion

With critics of FSAs noting that these agreements may be biased towards the investor, as mentioned in chapter 2, it can be seen from the above that the most fair and equitable treatment towards both parties would generally be the use of an economic balancing clause. In particular, the use of a NEB clause would be the interests of both parties.

In addition, from the above comparable countries, Ghana and Mozambique, it appears that the NEB approach is preferable, for the advantages discussed above. Ghana shows a progression of fiscal stability approaches, to the more preferred NEB. Mozambique shows that there is a shift to providing FSAs for a limited period of time.

Now that the preferred FSA has been considered, the following chapter will look at the practicalities of offering FSAs.

CHAPTER 5 – CONSIDERATION OF THE LEGALITY OF FISCAL STABILITY AGREEMENTS AND THE RELATED PRACTICALITIES ASSOCIATED WITH FSAs

5.1. Background

Chapter 2 of the dissertation addressed the need for FSAs followed by an evaluation of FSAs in South Africa under the Tenth Schedule. Chapter 3 included a comparison of how the current FSA provisions in South Africa compare with the FSAs offered under the OP26 oil and gas tax regime. From these two chapters, it was concluded that there is a need for FSAs, which left the question of which type of FSA would be most appropriate for South Africa. This was explored in chapter 4, where the different types of FSAs were looked at, to see what the advantages and disadvantages were. In addition, Chapter 4 also included a look at that fiscal stability as offered by other comparable countries, namely Ghana and Mozambique.

Chapter 4 concluded that the negotiated economic balancing clause was the most preferred as it encourages fair and equitable provisions, which is one of the main reasons FSAs were criticised in the first place.

Stemming from the above conclusion, there are still challenges posed by the suggested preferred clause. This chapter will look at the legality and validity of these FSAs, and will look at other practical issues and how these could be overcome in the context of South Africa.

5.2. Other considerations to be considered for fiscal stability agreements

5.2.1. Legality of FSAs

Even though FSAs are allowed in terms of domestic law, i.e. the Act, and provide for the freezing of laws on the date they are concluded, FSAs are still subject to the constitution of the country. Oshionebo (2010:11) notes that South Africa's Constitution allows for the National Assembly, the legislative authority, to "pass any legislation in relation to any matter" per section 44(a)(ii) of the Constitution of the Republic of South Africa (1996). Under current legislation, it can be seen that Parliament may amend paragraph 8 of the Tenth Schedule to nullify or void the use of FSAs. A stabilisation clause which limits the power of the legislature could be deemed as unconstitutional (Oshionebo, 2010:11). Oshionebo supports this position with reference to a Nigerian Federal High Court case, *Nigeria LNG (Fiscal Incentives, Guarantees and Assurance)* which ruled that freezing the law was unconstitutional because it hindered the right of the legislature to make laws. The provisions in Nigeria's Constitution as cited by Oshinebo are similar to provisions in South Africa's Constitution. Therefore, should there be a case in South Africa such as the *Nigeria LNG* matter referred to above, a similar argument could be used.

Some commenters have also introduced a concern that FSAs are in conflict with the international doctrine of *Permanent Sovereignty over Natural Resources* which provides that a State should be allowed to deal with its natural resources in the best interest of the public (Oshinebo, 2010:8). This doctrine was introduced through United Nations General Assembly resolutions. Per Adonisi-Kgame & Berman (2020): *"The sovereignty principle provides that all states exercise permanent sovereignty over their natural resources, which places rights and duties on the state to exercise such resources in the interests of its people and communities."* The argument that FSAs are in conflict with the sovereignty principle is however refuted by the fact that FSAs typically cover a certain period and that FSAs only protect the investor from alterations to the existing tax regime and do not generally prevent the State from introducing new laws. The existence of FSAs therefore do not interfere with legislative sovereignty (Oshinebo, 2010:10). Oshinebo (2010:10) cites from the *Texaco v Libya* case in which the tribunal noted: *"a State cannot invoke its sovereignty to disregard commitments freely undertaken through the exercise of this same sovereignty and cannot, through measures belonging to its internal order, make null and void the rights of the contracting party which has performed its various obligations under the contract."* This further supports the view that having a FSA does not take away the country's sovereignty. To the contrary, it shows that the country has exercised its sovereignty in having a FSA and therefore should be bound by it.

The *Duke Energy v Peru* case found that stabilisation agreements should not be limited to covering changes in the text of legislation but should also extend to covering changes in legal interpretation (Gehne & Brillo, 2017:24). There have been no cases in South Africa relating to the use or breach of FSAs and, as a result, one would need to look at international case law, should a disagreement ensue. In this regard, there is uncertainty regarding some of the provisions of the Tenth Schedule, including the interpretation of what constitutes *"expenditure of a capital nature…. in respect of ...an exploration and post exploration of an oil and gas right"* as intended in paragraph 5. If FSAs are entered into before such ambiguities are resolved, the interpretation at the time of entering into the FSA will apply as suggested in the Duke Peru case, which might cause difficulties considering that the ambiguities in the Tenth Schedule as explained.

Some commenters have contended that FSAs are invalid on the basis that sovereignty overrides international law principles. Rodriguez-Yong & Martinez-Muñoz (2013:70) note that *"stabilisation clauses that freeze the legal framework of a country are not valid because it affects the sovereignty of a State to enact laws and the international doctrine of State's permanent sovereignty over natural resources."* However this position was disputed and ruled out in the *Texco Overseas Petroleum Co. and California Asiatic Oil Co v The Government of the Libyan Arab Republic* where the arbitrator *"found that the stabilization clause had not impaired the legislative sovereignty of Libya. In fact, Libya had used its sovereign power "to commit itself internationally, especially by accepting the inclusion of stabilization clauses entered into with a foreign private party."*

Rodriguez-Yong & Martinez-Muñoz (2013:72) note that even though FSAs provide legal stability for investors, it should not be mistaken with the State losing its power to regulate or pass new laws.

It can be seen from the above that there is some ambiguity regarding the validity of FSAs in terms of domestic law and international law, as a FSA will be concluded between the State and a foreign investor. This is also supported by Rammutla (2017:30) who notes that the legal validity of FSA clauses is still debateable.

5.2.2. Legal effectiveness of FSAs

As the argument on the legality of the FSAs has not yet been settled, even if the FSAs are seen to be legal, based on arguments in international law, consideration also needs to be given as to whether FSAs are legally effective. Oshionebo (2010:12) notes that there are two opposing views as to whether a FSA is legally effective or not. The first view is that a FSA binds a country irrevocably, thereby making it effective. The other view is that FSAs are ineffective because FSAs do not prohibit the government from changing its fiscal regime. Oshinebo (2010:14) supports this second view by referencing other commenters noting that 'what the legislator has given in the FSA, the legislator can also take away' – subject to other legal consequences and the constitution in some instances.

Oshionebo (2010:15) also notes that tribunal arbitration has shown that a state can change a fiscal regime regardless of a FSA, if it is in the public's interest, as shown in *BP Exploration Co. (Libya) Ltd. v. Government of the Libyan Arab Republic.* Oshionebo (2010:15) adds that some authors are of the view that the legal effect of a FSA depends on the scope and duration thereof. Such an author is Subrata Chowdhury who notes that FSAs will be ineffective if they attempt to bind the State for a long time (Oshionebo 2010:15). This observation is illustrated by the tribunal arbitration of *Kuwait v American Independent Oil Company* where the tribunal did not want to read a clause which was granted for an "especially long" time, being 60 years in this case.

Bernardini (2008:101) notes that the effectiveness of FSAs may be doubted when FSAs appear to limit the States' inalienable rights, as would be the case when the stabilisation relates to a prohibition of nationalisation or expropriation. The author further goes on to note that under public international law, the State cannot renounce its sovereign rights. This is not the case for South Africa, as FSAs relating to the tax regime would not infringe on the State's ability to achieve nationalisation or to expropriate natural resources.

In considering the above legality and legal effectiveness of FSAs, it is observed that it is unlikely that the State would breach these agreements, in particular with a NEB clause which is both to the benefit of the State and the investor.

5.2.3. Costs related to FSAs

A breach of a FSA can be costly to the government as breaches by government could lead to large claims for compensation being made in response to changes in the legislation (Gehne & Brillo, 2017:8). In addition, FSAs usually include an arbitration clause which means that should an agreement not be reached in the negotiation phase in the NEB agreement, arbitration will follow and this could lead to additional costs.

Another challenge posed with regards to "compensation" under a FSA, is the determination of what "adequate" compensation would be. In the context of South Africa, paragraph 8(6) of the Tenth Schedule notes that compensation is the loss in market value caused by the failure to comply with the FSA concluded. The NEB approach that is proposed in this paper, depending how the clause is ultimately structured, might have the same problem of determining market value and appropriate compensation. This could be encountered particularly where the market for exploration oil and gas projects is not very active and determining market value is therefore difficult.

Not only will the State have to pay compensation should it fail to adhere to FSAs, the State may also forego future profits as prospective investors and even current investors may lose confidence (Ng'ambi, 2015:154)

5.2.4. Remedies available for breaches of FSAs

Notwithstanding the debate around the legality and legal effectiveness of FSAs, there are remedies available for investors in the event that a FSA is breached. FSAs are entered into in accordance with legislation and, in the context of a FSA entered into in South Africa, the State is bound to the agreement in terms of paragraph 8 of the Tenth Schedule. There may be other remedies included in a particular FSA or under law but if the South African authorities do not adhere to their obligations under a FSA, there are remedies currently available in terms of the TAA. The remedial action under the TAA can be summarised as follows:

1. Objection under section 104 of the TAA;
2. Appeal under section 106 of the TAA;
3. Alternative dispute resolution; and
4. Tax Courts

In line with international norms as noted by Bernardini, (2008:101) breaches in FSAs are dealt with through arbitration. Rammutla (2017:48) notes a provision for international arbitration is seen as a source of stability between the host state and investor. Rammutla (2017:48) notes: "*Being able to have a dispute referred to international arbitration takes the matter out of the hands of the local courts and/or arbitrations which be manipulated against the investors interest."* This will be particularly important should the NEB process be taken as this will be less costly and time consuming than taking the matter to the courts (Rammutla, 2017:40).

5.2.5. The role of an arbitrator

Following the above, it is important to establish what the role of the arbitrator should be. With the use of a NEB clause, should the renegotiation not be successful, the matter may be resolved through arbitration. One of the roles of the arbitrator will be to come to their own findings as to what an "economic equilibrium is". Bernardini (2008:106) notes that should the parties be in disagreement with the arbitrator's finding as to what an economic equilibrium is, the following alternatives for further solutions are available:

1. The arbitrator may invite the parties to renegotiate based on his/her findings.

2. In the case that no solution is found from the renegotiations per point one, the arbitrator could find that the contract/agreement should be set aside and a new revised agreement be entered into. Where it is found that one party failed to act in good faith, the aggrieved party should be compensated.

3. The arbitrator could determine the manner in which economic equilibrium will be restored.

These three options will only be available if the powers of the arbitrator are included in the agreement. It is therefore important to include these as part of the agreements.

5.3. <u>Chapter conclusion</u>

This chapter highlighted some of the practicalities involved with FSAs. The first issue considered was the legality and legal effectiveness of FSAs. Even though there is still some debate on these two matters, reference can be made to international case law for guidance if required. The second issue highlighted was the complexity surrounding compensation, should there be a breach of a FSA. This issue is particularly complicated in the context of projects which are in the exploration phase. The last issue highlighted was dispute resolution. The preferred method of dispute resolution in the context of FSAs is arbitration, with the role played by the arbitrator being a key issue.

CHAPTER 6 – CONCLUSION AND RECOMMENDATIONS

6.1. Introduction

The importance of oil and gas for South Africa has been highlighted with the need for the introduction of new sources of energy and the reliance South Africa has on imports to meet its energy requirements. With the announcement made by Total of a significant hydrocarbon discovery, it is anticipated that there will be an increase in interest by investors in the South African oil and gas industry. Considering further, the announcement by the Minister of Finance to re-examine the current oil and gas tax regime in South Africa and the new draft Upstream Petroleum Resources Development Bill, 2019 which was recently introduced, there is a level of uncertainty from investors which could cause a reluctance to invest in the oil and gas industry.

With this uncertainty in mind, the purpose of this dissertation was to consider whether there is a need for FSAs in South Africa. The fiscal stability highlighted in this paper was limited to provisions in the Income Tax Act, specifically the provisions offered under the Tenth Schedule and the analysis in this paper does not cover any other taxes or any other parts of the Income Tax Act. Further to this question, if a need for fiscal stability was determined to exist, the paper aimed to assess what type of fiscal stability clause (which could be acceptable to both the needs of the State and investors) is recommended. Finally, the paper aimed to look at other considerations required in ensuring FSAs are effective.

This chapter concludes on the research objectives, as highlighted above, which formed the structure of this dissertation and how each objective was accomplished.

6.2. Achievement of research objectives

The four research objectives as set out in chapter 1.3 of this dissertation and how these objectives were accomplished are discussed below.

6.2.1. Is there a need for fiscal stability agreements in South Africa?

The first question to be answered in the paper was if there is a need for FSAs in South Africa.

Chapter 2 looked at reasons why there is fiscal instability in the oil and gas tax regime. The main reasons were: oil prices; investment; production life cycle; price in asset sales; regional trends and neighbourhood effect; changes in political conditions; and deteriorating government finances. It was concluded that South Africa was not immune to these factors and therefore fiscal instability could be a reality.

The chapter then discussed other tools, apart from FSAs, which could be used to mitigate fiscal instability. Included in the discussion was criticism of the use of FSAs which mainly revolved around the fact that FSAs are asymmetric in that they favour the investor more than the State. There was also a discussion of the benefits of offering FSAs and how investors view the willingness of governments to issue FSAs.

Lastly, the chapter looked at the current incentives offered by the Tenth Schedule to show the tax incentives which investors would like to enjoy should they enter into a FSA. A further factor that was examined to highlight the need for FSAs was the introduction of the new Draft Upstream Petroleum Resources Development Bill 2019 which requires a government stake in the investors' share. It was concluded the assurance of provisions in the Income Tax Act by way of a FSA would be warranted.

6.2.2. The current state of fiscal stability agreements in South Africa and how these compare to the fiscal stability agreements as previously provided for under OP26.

This was dealt with in Chapter 3. Firstly, this dissertation looked at the current wording of FSAs as provided for in the Tenth Schedule. This included a critical examination of paragraph 8 of the Tenth Schedule and evaluating whether it meets the objective of certainty and transparency as was the intention of legislature when it was introduced as explained by the EM for the introduction of the Tenth Schedule.

The chapter then went on to discuss the fiscal stability which was offered under the previous tax regime, OP26. There were differences the fiscal stability offered under OP26 in comparison to that offered under the Tenth Schedule.

The chapter then concluded that there were gaps in the current FSA offered under the Tenth Schedule, which lead to chapter 4 which discussed which FSA would be most suitable for South Africa, the next objective of the dissertation.

6.2.3. An examination of the different types of fiscal stability agreements and which clause is suitable for use in South Africa.

Chapter 4 started with a discussion on the types of fiscal stability clauses available. These can be broken down into three categories, namely:

1. Freezing clause. This FSA freezes the tax regime applicable to the time when the agreement is entered into, regardless of any subsequent changes to the tax regime.

2. Economic balancing clause. This clause allows for changes made to the tax regime to be applied by oil companies but provides a mechanism to restore the economic equilibrium back to the time the agreement was entered into, for whichever party experiences an adverse change. The various methods used to restore this equilibrium include Automatic Economic Balancing, Non-stipulated Economic Balancing and Negotiated Economic Balancing.

3. Hybrid clause. This is a mixture of a freezing clause and economic balancing clause.

Further consideration was given as to the advantages and disadvantages of these clauses in order to determine which clause would be most suitable for South Africa.

The chapter then looked at FSAs offered by comparable countries, namely Ghana and Mozambique. This discussion included an analysis of the progression of the FSAs offered by these countries showing that FSAs, like tax regimes, are not stagnant.

The result of this chapter was that an economic balancing clause was recommended, with the preferred mechanism being NEB clause. It was seen that this clause is the most equitable clause for FSAs with reference to the rights of the State and investors.

6.2.4. <u>What are the potential pitfalls or restrictions for FSAs and how can these can be overcome?</u>

Firstly, chapter 5 discussed the legality and legal effectiveness of FSAs. Even with the most suitable FSA in place, if it is not legal or is not legally effective, this would not offer the investor the certainty they seek from FSAs. Based on the discussion in that chapter, it was noted that there may be some debate around the legality and legal effectiveness of FSAs, however, it is observed that it is unlikely that the State would breach these agreements, in particular with a NEB clause which is both to the benefit of the State and the investor.

The chapter then goes on to discuss the costs associated with FSAs. Such considerations include what would be regarded as “adequate compensation” should the State choose not to adhere to the FSAs. The difficulty is establishing what the market value for compensation would be, particularly in the current South African oil and gas industry considering that projects are primarily still in exploration phase.

Lastly, the chapter discussed dispute resolution mechanisms relating to FSAs. Currently, resolution of disputes are undertaken in accordance with the TAA. The use of independent arbitrators was also looked at and suggested.

6.3. Benefits of this research

This dissertation aimed to establish a need for fiscal stability agreements in South Africa. In addition, to establishing a need for FSAs, the paper sought to find the most appropriate fiscal stability clause to be offered. This clause had to be the most equitable for both the investor and the government.

The dissertation was aimed at examining FSAs in the specific context of South Africa in order to make them acceptable to all stakeholders involved. It was also meant to highlight the challenges/practicalities involved with FSAs.

6.4. Chapter conclusion

This paper has highlighted the need for FSAs in South Africa. Due to fiscal instability and the current tax incentives offered by the Tenth Schedule, FSAs are required. Even in the previous tax regime, OP26, fiscal stability clauses were offered which shows that government recognises the importance of FSAs in making the oil and gas industry attractive to investors.

ANNEXURES

Annexure 1

Petroleum production sharing agreement of 10 November 1995 between the State Oil Company of Azerbaijan and a Consortium of Oil Companies

‘‘The rights and interests accruing to Contractor (or its assignees) under this Agreement and its Sub-contractors under this Agreement shall not be amended, modified or reduced without the prior consent of Contractor. In the event that any Government authority invokes any resent or future law, treaty, intergovernmental agreement, decree or administrative order which contravenes the provisions of this Agreement or adversely or positively affects the rights or interests of Contractor hereunder, including, but not limited to, any changes in tax legislation, regulations, or administrative practice, or jurisdictional changes pertaining to the Contract Area, the terms of this Agreement shall be adjusted to re-establish the economic equilibrium of the Parties, and if the rights or interests of Contractor have been adversely affected, then the State entity shall indemnify the Contractor (and its assignees) for any benefit, deterioration in economic circumstances, loss or damages that ensue therefrom. The State entity shall within the full limits of its authority use its reasonable lawful endeavours to ensure that the appropriate Governmental Authorities will take appropriate measures to resolve promptly in accordance with the foregoing principles any conflict or anomaly between any such treaty, intergovernmental agreement, law decree or administrative order and this Agreement.’’ (Bernardini, 2008:110)

Annexure 2

Supplemental agreement of 1961 between the Government of Kuwait and American Independent Oil Company (art 9)

‘‘If, as a result of changes in the terms of concessions now in existence or as a result of the terms of the concessions granted hereafter, an increase in benefits to Governments in the Middle East should come generally to be received by them, the Company shall consult with the Ruler whether in the light of all relevant circumstances, including the conditions in which operations are carried out, and taking into account all payments made, any alterations in the terms of the agreements between the Ruler and the Company would be equitable between the parties.’’ (Bernardini, 2008:111)

Annexure 3

<u>Petroleum production agreement between the Government of Ghana and Shell Exploration and Production Co of Ghana Ltd of 1974 (clause 47b)</u>

"It is hereby agreed that if during the term of this Agreement there should occur such changes in the financial and economic circumstances relating to the petroleum industry, operating conditions in Ghana and marketing conditions generally as to materially affect

the fundamental economic and financial basis of this Agreement, then the provisions of this Agreement may be reviewed or renegotiated with a view to make such adjustments and modifications as may be reasonable having regard to the Operator's capital employed and the risks incurred by him, always provided that no such adjustments or modifications shall be made within 5 years after the commencement of production of petroleum in commercial quantities from the production area and that they shall have *no retroactive effect''* (italics added)." (Bernardini, 2008:111)

Annexure 4

"Long-term crude oil supply contract (art V(12))

''12. HARDSHIP. – If at any time during the term hereof either party shall by notice in writing to the other claim upon reasonable grounds stated in the notice that owing to changed circumstances including, but not limited to, changes in monetary values or discriminatory Governmental actions or regulations (such as differential customs duties unduly is criminating against the origin from which X are then supplying crude oil or petroleum products, as the case may be, to Y) the continued operation hereof is causing undue hardship or inequity and shall require the other party to participate in a joint examination of the position with a view to determining whether revision or modification of the provisions hereof is required (and if so what revision or modification would be appropriate and equitable in the circumstances) then the parties shall (*but without reference to the arbitration*) participate in such joint examination accordingly'' (italics added)." (Bernardini, 2008:111)

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