Uganda: Russian Firm Speaks Out on Failed Refinery Talks

By Frederic Musisi and Mark Keith Muhumuza

KAMPALA, Uganda, July 10, 2016 (The Monitor) — Just days after the government announced publicly it had suspended negotiations with a Russian consortium, RT Global Resources, for the development of the proposed 60,000 barrels per day (Bpd) refinery; the consortium has said it is still interested and open to talks for the project.

The coordinator of the consortium, Rostec, a Russian State corporation in a statement to the Russian news agency Interfax.Ru, also said they had offered "to renew negotiations" on the current conditions until September, a proposal that government shot down.

Rostec also blamed government authorities for failing to fulfil obligations under the tender for construction, which they said put them in a difficult situation.

Some of these conditions that remain unfulfilled include granting production licenses to the international oil companies; Total, Tullow and China National Offshore Oil Corporation (Cnooc) to be able to guarantee crude oil in time, and have not been granted tax benefits and conditions of the stabilisation project, accepted in international practice.

Owing to the circumstances, Rostec said it "decided not to extend the bid security for refinery construction, which expired on 30 June".

"Thus came the end of the warranty period for the fulfilment of obligations on the conclusion of major agreements between the consortium and the government of Uganda."

Other partners in the RT consortium include VTB Capital, the investment banking unit of Russia's second-largest lender VTB as lead financiers, and South Korea's GS and Telconet Capital Partnership for provision of engineering services.

The refinery is estimated to cost about Shs12 trillion ($3.5b), according to recent estimates published during studies for the crude export oil pipeline.

Negotiations between RT and government were concluded and an agreement reached on May 11. The two parties then gave themselves a deadline to secure approvals, seal the deal, and make it public by-end of June.

On April 27, RT's bosses had visited the country and held back-to-back meetings with President Museveni and the oil technocrats over the deal.

Complications

But just prior to the expected signature date at the beginning of last month, the ministry said, RT made additional demands from government, seeking to reopen and renegotiate issues that had already been agreed between the parties. They then returned the documents unsigned.

Consequently, government was left with no choice but to halt negotiations and withdraw the bid bond. A senior government official said they immediately cashed-in the bond which RT had executed with one local bank and the money is already in a Consolidated Fund.

RT said: "After the expiry of the tender security, government sent to the address of the Custodian Bank bid security (bid bond) instruction on the implementation of the security deposit in the amount of $2 million, without good reason and without notice of the consortium."

Unrefined business

The Rostec suggested that Uganda continues the talks on the project without collateral. The firm also said it was consulting "on the legal effects" on the side of other partners, should they

be willing to continue with the project under revised conditions.

Initially, the Ministry of Energy said it had aimed at clinching all the principle agreements within 60 days. Negotiations, however, prolonged over a period of 14 months, which in essence, could and will affect government's target of starting commercial oil production by mid-2020 to possibly 2020.

The bargaining between two parties centred on the project framework agreement, shareholders agreement, implementation agreement and the Escrow agreement, after which both parties would constitute a refinery company to take forward the engineering and finalise the financing aspects for the development of the project.

Contention in the project revolved around the Escrow Agreement--which defines a contractual arrangement in which a third party receives and disburses for the primary transacting parties, with the disbursement dependent on conditions agreed to by the transacting parties, and the shareholders agreement.

Government sources claimed the Russians wanted to have access to cash reserves in Bank of Uganda but one Russian official familiar with the deal said government wanted RT to put at least 60 per cent of the investment money in the Escrow account which both parties had access over, a proposal which Rostec rejected.

Sources in the Ministry of Energy, who broke the story to this newspaper on Thursday, said RT had failed to negotiate in good faith and had mainly "failed to execute" the shareholders agreement.

In essence, government and the consortium couldn't agree on the terms and conditions of sharing responsibilities.

"In short, each party wanted to safeguard themselves and pass a lot of risk to the other. That is the easiest interpretation," one oil and gas lawyer said.

Officials in government, however, defended that they had gone about each and every clause in the agreements in detail and reached consensus on all.

On our part, an official close to the negotiations said we had already secured the requisite approvals and final nod from the Solicitor General. Rostec representatives had also gone back to Moscow to seek approvals.

"I cannot explain to you what happened then," the official said, adding that the company returned the documents unsigned "with demands to reopen" the closed agreements for renegotiation.

The Energy ministry permanent secretary Kabagambe Kaliisa told this newspaper in an interview last week that "at this point we were left with no option but to suspend negotiations with RT and reach out to SK," adding that: "If RT comes back, the doors are still open; but we are going to start negotiations with SK".

The risk the development poses, according to industry watchers, is that it puts government in a less bargaining position where they will have to adjust a lot more to the demands made by the new darling.

However, a technocrat close to the discussions told Daily Monitor "this was not going to be necessary because we already had a structured arrangement with them [SK]".

"We wrote to them initially that they are the alternate bidders, and that the principal agreements are the same. Where adjustments are required definitely will have to be discussed."

Asked when negotiations with SK are likely to begin, the technocrat said it was yet unclear indicating that since they are back on the drawing board, a new timeline has to be drawn.

As if preparing for such scenario in advance, the ministry, at the announcement of RT on February 17 last year indicated expressly that "if at the end of the negotiations" RT are not satisfied that the major issues in the agreements do meet its satisfaction, it would then exercise its option to commence negotiations with the alternate bidder.

RT Global Resources was a surprise. The venture beat three others in the last round, Japan's Maruben Corporation, China's Petroleum Pipeline Bureau (CPPB) and SK.

In 2013, the Energy ministry invited bids for the construction of the refinery. About 75 companies and individuals expressed interest and requested for a document with full details about the project; the Request for Qualification document. However, only eight submitted when it came to the final submission.

The government, with the help of their Norwegian counterparts recommended a consultant, hired a US based transaction advisers, Taylor-DeJongh, to support the entire process from submission and final selection.

In the bid to rid the process of the Ugandan bureaucracy, commission agents and the connected corrupt fixers, the Petroleum Directorate then known as Petroleum Exploration and Production Department (PEPD)requested for permission from the Public Procurement and Disposal of Public Assets Authority (PPDA) and other bodies to move all activities relating to the investor selection to Washington.

The receipting, the submission and evaluation was done in Washington.

Sub-contractors

Taylor-DeJongh brought on board sub-contractors such as Eversheds, a legal firm based in Paris, a technical consultancy called Jacobs Consultancy from Houston Texas to advise on the refining business, Katende, Ssempebwa & company advocates to advice on the local taxation and Arcmirs a local firm for social economic advisory. Final submissions all by consortiums were downsized from eight to six and finally to four.

The final bidder was expected to be announced by October 2014, but was pushed ahead and materialised in February 2015--with RT Global Resources as preferred bidder - and SK as alternate preferred bidder.

The SK venture included SK Engineering and Construction as the coordinator; SK KBD Global Investment Partnership, a Private Equity Fund for finance; China State Construction Engineering Corporation for the engineering work and Haldor Topsoe A/S and Maestro Oil and Gas.

The group had a solid submission but towards the last minute, their lead financier SK-KDB pulled out leaving it all naked and concerns of how funds would be raised to finance the deal abound. The other partner, Haldor Topsoe, a Danish petrochemicals company could not also give equity assurance.

Their last attempt, Mogas, who was intended to demonstrate off taking ability, could only raise $60m of the total project cost. They, too, did not have the money.

They also did not attract somebody who would construct a refinery.

Citing the dwindling oil price, the Koreans said they could not get required team and financing together, which government dressed down.

SK's final mistake was addressing the project with a government guarantee approach requiring an assurance of profit after investment yet government was looking for a merchant refiner because it did not want to risk guaranteeing a lead investor of any assured profits.

Final bids were assessed on the benchmark of, among other indicators technical parameters of the project, advanced technologies utilisation, composition and quality of finished products, financial productivity of the refinery, details of commercial and financial plans, technical, financial and organisation opportunities of the participants, availability to finance the project, and

crude oil buying plan. On the other hand, RT besides solid partners in the venture also had the Russian state backing and the money to convince the evaluators. So it snapped the deal.

To some insiders, however, this choice was just a feeder into the government's unofficial foreign policy balancing act. The industry already has diverse players, UK's Tullow Oil PLC, French Oil Major Total SA, and Cnooc in oil exploration and development.

The obsession with Russia

The choice of RT, some geopolitical analysts believed, was to cement the underground but warm affection between the Kremlin and Kampala.

President Vladimir Putin hosted President Museveni in December 2012, a visit which coincided with the 50th anniversary of relations between Russia and Uganda, and the two discussed prospects for bilateral cooperation in energy, engineering, geologic exploration, construction, finances and military supplies.

Accompanying the President on this trip, among others, were Energy ministry officials. In early 2013, Energy minister Irene Muloni and his Russian counterpart met and signed MoU on energy cooperation.

From 2010 until mid-2014, global oil prices had been fairly stable, at around $110 a barrel. From mid-June prices started taking a downward trend-currently Brent crude oil trading at $50.

Russia, one of the world's largest oil producers, was among the some of the hard-hit countries since its economy is heavily reliant on energy revenues, with oil and gas accounting for 70 per cent of export incomes.

The World Bank reported last year the country lost about $2b in revenues for every dollar fall in the oil price, and the country's economy would shrink by at least 0.7 per cent throughout the

year if prices do not recover.

The tumultuous oil prices, coupled with heavy US sanctions--slapped in 2014 following the country's annexation on Ukraine, all made it worse. Some industry watchers believe this could have also sparked off concern by the lead financers.

A diplomat familiar with the matter separately told this newspaper that "at first they [Russians] were very excited about the prospects of the project but after being announced and eventually getting close, everything started getting clear to them".

In the run up to the February 18 elections, the source explained that, like any other investor there was concern of the political atmosphere in the country and especially the aftermath, "a matter that came to pass, then came the projects economics".

The refinery is to be financed/owned under a Public Private Partnership (PPP) arrangement with government in a 60:40 equity ratio. Regional governments, Kenya, Rwanda and Tanzania, were allowed a 10 per cent.

At the estimated cost of $3.5b or even $4b the investor has to pool about $2b "in an economy that is not only small but also less appealing".

A similar school of thought was held by oil companies which before the signing of the framework for the commercialisation of oil in February 2014 described refinery project economics as "marginal" and urged government to tread cautiously.

The framework compels oil firms to feed the refinery with crude oil to run but the refinery investor recoups his money depending on its performance.

President Museveni, on the advice of technocrats, stood ground arguing that there is ready market in Uganda (27,000 barrels of petroleum per day as per the URA figures of December

2014), and a captive market in Rwanda, East Congo and other neighboring countries--making Uganda's refinery viable.

This conception is premised on a government sponsored feasibility study by British consultancy, Foster Wheeler, which projected that development of 60,000 barrels per day (Bpd) refinery was commercially viable with a Net Present Value of $3.2 billion at a 10 per cent discount rate and an Internal Rate of Return of 33 per cent.

Costs for projects

-Shs12 trillion ($3.5b) for the 60,000 bpd refinery; including a 210 km pipeline to transport refined products to the central processing facility in Buloba, Wakiso.

-About Shs34 trillion ($10b) for development of the 17 oil fields. Government has already secured 29Sqkm of land in Hoima for the refinery.

-About Shs13.5 trillion ($4b) for the crude export pipeline to Tanga port.

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