AN ANALYSIS OF THE BENEFITS OF FOREIGN CAPITAL IN PROJECT FINANCING OF UGANDA'S OIL AND GAS SECTOR

BY

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A DISSERTATION SUBMITTED TO THE FACULTY OF LAW OF UGANDA CHRISTIAN UNIVERSITY MUKONO IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A MASTER OF LAWS IN OIL AND GAS AT THE INSTITUTE OF PETROLEUM STUDIES KAMPALA IN AFFLIATION TO UCU.

April, 2021

DECLARATION

I, **ADAMS RAJAB KIBWANGA,** do hereby declare that this Dissertation entitled "**AN ANALYSIS OF THE BENEFITS OF FOREIGN CAPITAL IN PROJECT FINANCING OF UGANDA'S OIL AND GAS SECTOR**." is entirely my original work, except where acknowledged, and it has never been submitted to any other University or any other institution of higher learning for the award of a degree. I also certify that this Dissertation was particularly prepared by me for the partial fulfilment for the award of Master of Laws in Oil and Gas of Uganda Christian University.

SIGNATURE**:** ____

DATE**:** ____

APPROVAL

This is to certify that this Dissertation entitled "**AN ANALYSIS OF THE BENEFITS OF FOREIGN CAPITAL IN PROJECT FINANCING OF UGANDAS OIL AND GAS SECTOR.**", has been done under my supervision and now it's ready for submission.

SIGNATURE: ________________________________

NAME: EMMANUEL ELAU

DATE: ____________________________________

DEDICATION

I dedicate this effort to my wife - Sakina Adam Kibwanga,

and

Our children; Rajab Adam Onono-Kibwanga Jr., Annan Okeng Makmot - Kibwanga, Mariam Awor Kibwanga, Sofia-Mae Kibwanga, Kayla Kibwanga, Alaysha Kibwanga, Rania Akia Kibwanga and Radia Akila Kibwanga.

ACKNOWLEDGEMENT

The work of this nature cannot be effort of one person. It is a product of many but above all I must thank the Almighty God, the source of knowledge and wisdom, for having seen me through it.

I also wish to acknowledge all the people who made this thesis possible. I cannot mention all their names here without leaving out others but there are a few I cannot resist mentioning. I thank my kind and sagacious supervisor, Mr. Emmanuel Elau, my father – Mr. Rajab Shaban Kibwanga for a giving me a good academic foundation, my wife –Sakina Adam Kibwanga for being patient with me as I study, my classmates for sharing knowledge and experiences, and my workmates for standing in for me as I take this course.

All the shortcomings in the final text, if any, remain mine.

LIST OF ACRONYMS

AfDB	African Development Bank
AICD	Africa Infrastructure Country Diagnostic
CAA	Civil Aviation Authority
CFF	Contract Financing Facility
CNOOC	China National Offshore Oil Corporation
DAC	Development Assistance Committee
DFI	**Direct Foreign Investment**
DRM	Digital Rights Management.
DSCR	Debt Service Cover Ratio
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
EDF	External Development Finance
EIB	European Investment Bank
EITI	Extractive Industries Transparency Initiative
EP	Equator Principles
EPC	Engineering, Procurement and Construction
ERA	Electricity Regulatory Authority
EU	European Union
FDI	Foreign Direct Investment
FY	Financial Year

GDP	Gross Domestic Product
GoU	**Government of Uganda**
ICAMEK	International Centre for Arbitration and Mediation in Kampala
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
ING	International Nederland Group
	(International Netherlands Group)
IOC	International Oil Companies
IPOs	Initial Public Offerings
MAAIF	Ministries of Agriculture, Animal Industry and Fisheries
MDAs	Ministries Departments and Agencies
MEMARTS	New Memorandum & Articles of Association
MEMD	Ministry of Energy and Mineral Development
MFPED	Ministry of Finance, Planning and Economic Development
MTIC	Ministry of Trade, Industry, and Cooperatives
NGO	Non-governmental Organization
NOGP	National Oil and Gas Policy
NSSF	National Social Security Fund
NTR	Non-tax revenue

O&M	Operation and Maintenance
ODA	Official Development Assistance
ODF	Official Development Financing
OECD	Organization for Economic Co-operation and Development's
OGRMP	Oil and Gas Revenue Management Policy
OOFs	Other Official Flows
PAU	Petroleum Authority of Uganda
PEPD	Petroleum Exploration and Production Department
PF	Project Financing
PFI	Private Finance Initiative
PFMA	Public Finance Management Act
PL	Production License
PPI	Private Participation in infrastructure
PPP	Public–Private Partnership
PRIR	Petroleum Revenue Investment Reserve
PSA	Production Sharing Agreement
SPE	Special Purpose Entity
SPV	Special Purpose Vehicle
UCC	Uganda Communications Commission
UCU	Uganda Christian University

UDB	Uganda Development Bank
UGX	Uganda Shillings
UNECA	United Nations Economic Commission for Africa
UNOC	Uganda National Oil Company
URA	Uganda Revenue Authority
USD	United States Dollars
VAT	Value Added Tax

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Companies Act 2012.

Foreign Exchange Act 2004

Income Tax Act, (Cap. 340)

Investment Code Act, 2019 (replaced the Investment Code Act, Cap 92).

National Social Security Fund Act

Petroleum (Exploration, Development and Production) Act 2013 (Upstream Act)

Petroleum (Refining, Conversion, Transmission and Midstream Storage) Act, 2013 (Midstream Act)

Public Finance Management Act, 2015

Tax Procedures Code Act 2014

Trade Licensing Act (Cap. 101)

Uganda Citizenship and Immigration Control Act,

Value Added Tax Act, (Cap. 349).

REGULATIONS

Midstream General Regulations; 2016

Midstream HSE Regulations; 2016

Midstream National Content Regulations; 2016

Petroleum Supply (General) Regulations; 2009

Upstream General Regulations; 2016

Upstream HSC Regulations; 2016

Upstream Metering Regulations; 2016

Upstream National Content Regulations, 2016

POLICIES

National Oil and Gas Policy (NOGP); 2008

National Local Content Policy for the Petroleum Subsector in Uganda; 2017

GOVERNMENT PUBLICATIONS

Model Production Sharing Agreement

ABSTRACT

This study sets out as an investigation into the conceptualization, application and harvesting of benefits of project financing in Uganda's oil and gas sector. It is prompted by the dearth of information on big project financing in the country and it is further catapulted by the need to trace the linings of the intricate lay-outs of international project financing and its domestication in Uganda. It looks at the major players in project financing, sources of project financing, major challenges and mitigation, advantages of project financing and ways of sustaining project financing in Uganda's oil and gas industry.

The study looked at the deep meaning of project financing and the justification for its existence. To achieve this, it explored the legal and conceptual framework relating to project financing while using Uganda's jurisdictional territory both as a yard stick and a springboard. A yard-stick becausethese projects must measure up to the legal requirements of countries in which they are rolled out.A springboard because it is only from the laid-out municipal legal and conceptual regime that a meaningful and relevant conversation is sustained and a customized discourse is attained.

It is therefore of no surprise that in pursuit of the deeper understanding of variables that influence the optimization, or lack of it, of the benefits of project financing in Uganda this research qualitatively delves into statutes, rules, regulations, standards and existing literature to mention but a few. It projects out an inquisitive topic which manifests a clear research problem and as well as generates objectives and questions which questions themselves are juxtaposed against the justifications. It is a flowing process which is occasionally, and for good measure, punctuated with the review of the existing *status quo*.

Finally, this effort aimed at providing answers to the stated research questions while at the same time contributing towards the body of knowledge on optimizing the benefits of project financing in Uganda. All these is done on the backdrop of presenting the final product as an effort needed to fulfill an academic requirement for the award of a master of laws degree –this does not mean watering down the other usefulness of the research effort but rather strengthening and augmenting its quality and purpose.

CHAPTER ONE

GENERAL INTRODUCTION

1.0. Introduction

Efforts to find oil in Uganda started as far back as the 1980s. However, the initial efforts were not successful in establishing commercially viable deposits in the country. Renewed and consistent exploration efforts commenced in 1980 which culminated into confirmation of commercially viable oil in 2006[1]. The companies currently licensed to explore, develop and produce petroleum in Uganda are; China National Offshore Oil Corporation Uganda Limited (CNOOC), Total and Total E& P[2]. All these are aimed at facilitating investments in the oil and gas sector.

These company had to seek foreign capital to facilitate the major projects of oil exploration and development and to ensure a steady cash flow of funds to cater for the projects through project financing. This is very critical for the success of any project undertaken by the parties.[3] Most developing countries looking for capital and the only way how they can finance their projects is through project financing in which they receive the continuous flow of cash for the life of the project after guaranteeing the bankability of the project through risk mitigation and other forms of security.[4]

1.1. Background to the Study

The background to the study was presented in four perspectives: the historical, theoretical, conceptualand contextual.

1.1.1. Historical perspective

Following the first commercial discovery of petroleum in Uganda in 2006, government considered putting swift measures in place to address comprehensive and efficient aspects of exploration, development, production and commercialization of the country's oil and gas resources.[5] These

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[1] The Oil & Gas sector Uganda: Frequently asked questions. Ministry of Energy and Development, December 2014.
[2] Ibid
[3] Helge Switala (2020). Project finance and obtaining sufficient funding for the successful completion of a project. Project Manager: Development Bank of Southern Africa
[4] Helge Switala (2020). Project finance and obtaining sufficient funding for the successful completion of a project. Project Manager: Development Bank of Southern Africa
[5] Ministry of Energy and Mineral Development (2020): Uganda's Second Oil and Gas Licensing Round.

strategies included enacting the National Oil and Gas Policy in 2008, formulation of the petroleum upstream and midstream laws in 2013 and attendant regulations in 2016, and formation of the Petroleum Authority of Uganda to regulate the different players in the sub sector and Uganda National Oil Company to handle commercial interests of the state and state participation in 2016.

The history of foreign investments dates back to many centuries of business innovations. Capital flow investments outside national boarders first began as individual activities which involved only the activities of family business and it was later followed by economic entities in the companies of model sizes which grew into international large multinational corporations[6]. Mira Wilkins states that the Sumerians were the first ones to hire people abroad to do business for them at around 2500 BC for the purpose of selling their trading goods followed by the Italian bankers of Brand and Peruzzi in England representing the papacy and later joined by the Dutch and the British in India. However, in Uganda, foreign trade is traced back to the period before the coming of the British colonialist. Kingdoms like Buganda and Bunyoro used to trade with each other and other entities and even in the long-distance trade[7]. After the coming of the British, foreign investments through trade in agricultural products and later investments were intensified after independence.

In today's Uganda, there are many efforts aimed at attracting more investments in the country and this has led to the creation of the Uganda Investment Authority. Investments in oil and gas were started by the Rockefeller family in 1870s after the discovery of oil of which they used to create the standard oil company which was broken down by the USA anti-monopoly laws to create more players in the oil sector[8].

The fall in oil prices may, however, affect petroleum investors in the oil and gas sector due to the large amount of capital invested in exploration activities. During the period of high oil prices, the investors now tend to focus on the country's fiscal regimes with regard to the valuation of oil and gas exploration and production[9]. An effective and attractive petroleum fiscal regime is vital and challenging in some developing counties. Uganda is a resource rich developing country with

[6] Mira Wilkins, the history of foreign investment in Europe 1992.
[7]Rwakakamba M & Lukwaga D (2013) Farmers in Uganda's oil economy, deal or no deal, Kampala, Uganda, Agency for Transformation
[8]Mira Wilkins, the history of foreign investment in Europe 1992.
[9]
Carol Nakhle, Petroleum, sharing the oil wealth, a study of petroleum taxation yesterday, today and tomorrow (London, Rutledge, 2008) 149-150.

estimated proven natural gas and oil reserves of 500 billion cubic feet and so far with 6.5 billion barrels respectively. As a developing country, petroleum exploration in Uganda is mainly carried out by overseas investors[10] African Development Bank (ADB)[11].

Therefore, it is vital to ensure that the projects undertaken becomes attractive to petroleum investors through reforms that will lead to economic growth. In the inevitable relationship between governments and the oil industry, two broad systems of granting rights to investors have developed over the years: that is, the concessionary system and the contractual scheme which are essential in the formulation and design of the fiscal regime according to Phillp D, Michael K and Charles M.C. Person. These can also be done through a set of laws, regulations, and agreements in a country which govern the benefits derived from petroleum exploration and production.

1.1.2 Legal Framework on Oil and Gas Exploration Project Financing in Uganda.

The primary source of regulation of the Ugandan oil sector is the 1995 Constitution of Uganda, which *inter alia* requires the Government to ensure that resources are used for the benefit of all Ugandans.[12]

From the 1990s onwards, more serious efforts were devoted to exploration of hydrocarbons in the Albertine area in the north-western part of the country. However, no petroleum exploration or production took off in Uganda until 2000 which culminated into the pronouncement of oil and gas discovery in sufficient quantities in 2006.[13] It is therefore not surprising that Uganda lacked a comprehensive legal framework to regulate her oil sector for so long. The law applicable to the management of all activities in Uganda's oil and gas sector was the Petroleum (Exploration and Production) Act, No. 20 of 1985.[14]

Act No. 20 of 1985 covered exploration, discovery, and production, the obligations of licensees, and the registration, transfer and cancellation of licenses, restrictions and surface rights, and financial

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[10] Khine African Development Bank report 2018.
[11] African Development Bank Report maximizing the benefits from Africa's Oil and Resources.
[12] See Objective XIII of the National Objectives and Directive Principles of State Policy, and Article 244(1) of the 1995 Constitution of Uganda.
[13] Bainomugisha, A., H. Kivengyere and B. Tusasirwe (2006). 'Escaping the Oil Curse and Making Poverty History: A Review of the Oil and Gas Policy and Legal Framework for Uganda'. ACODE Policy Research Series, No.20. Retrieved from: https://www.africaportal.org/publications/escaping-the-oil-curse-and-making-poverty-history-a-review-of-the-oil-and-gas-policy-andlegal-framework-for-uganda/. Accessed on 12th Nov 2020. All use subject to https://about.jstor.org/terms.
[14] Since repealed by the Petroleum (Exploration, Development and Production) Act 2013.

matters. However, given that no oil had yet been discovered in exploitable quantities, that legislation was barely used.

The Parliament of Uganda is mandated to make laws regulating the exploitation of petroleum and minerals,[15] and the sharing of royalties arising from petroleum exploitation and other related activities. As a result, Uganda currently has a number of laws, policies and regulations in place to govern the oil and gas sector. Some of these include the National Oil and Gas Policy (NOGP) 2008.

Recently enacted laws in Uganda that affect project financing include: Data Protection and Privacy Act 2019, Investment Act, 2019, National Environment Management Authority Act, 2019, Security Interests in Movable Property Act, 2019, Civil Aviation Authority (Amendment) Act, 2019, African Export Import Bank Agreement (Implementation) Act, 2019 and Human Rights Enforcement Act, 2019, the Oil and Gas Revenue Management Policy (OGRMP) 2012; the Petroleum (Exploration, Development and Production) Act, 2013 (the 'Upstream Act'); the Petroleum (Refining, Conversion, Transmission and Midstream Storage) Act, 2013 (the 'Midstream Act'); and the Public Finance Management Act (PFMA) of 2015 and all these were aimed at improving attracting project financing and investments in Uganda's oil and gas sector due to the many risks involved in financing big oil and gas infrastructural projects and also trying to ensure continuous cash flow for the projects.

1.2. Conceptual perspective of the study

The conceptual perspective is informed by the benefits of foreign capital in project financing of projects in Uganda's oil and gas sector as a way of improving more foreign direct investments in the industry. For example, looking at the risk mitigation mechanism put in place which may increase the bankability of Ugandan oil projects which will in turn attract more foreign investments due to the advantages associated with projects financing of oil and gas projects. Since there is a lot of under-investments and capital issues in Uganda's oil and gas sector which has crippled production for years due to limited foreign investments in the industry.

The study will seek to analyze whether there are sufficient benefits of foreign capital in project financing by looking at the advantages and disadvantage of the project financing in Uganda's oil and gas industry.

[15] Article 244(2) of the Constitution

1.2.1. Contextual perspective of the study

Uganda is found in East African region and, like many other countries in Africa that are empowered with natural resources and in particular oil and gas, it is likely to suffer from limited foreign capital investments. In 2006, Uganda discovered commercially viable quantities of proven oil reserves estimated to be 6.7 billion barrels of crude. This meant that Uganda needed more foreign capital to be able to start-up its oil exploration and development. It then became clear that undertaking project financing may be the easiest solution to tackle this problem. There, however, emerged challenges for example the ensuring of the bankability of the project through risk mitigation mechanism and other forms of insurance to the lenders to make sure that there is a steady flow of cash up to the completion of the oil and gas projects. These projects are capital intensive in nature whereas local and developing countries lack capital to handle them on their own.[16]

This explains the continued delays of oil and gas production in Uganda's oil and gas industry. Therefore, this study will investigate the benefits of foreign capital, in relationship to project financing and how bankable can a project be to be able to attract foreign investors in Uganda's oil and gas sector.

1.3. The Statement of the Problem

Project financing is one the key elements of financing projects in the oil and gas sector and this is done through attracting foreign capital to ensure the continuous flow of the funds to the projects to ensure their completion and also return on their investments. The advantages of these foreign capital to the projects are very critical in ensuring the success of the oil and gas sector. Therefore, without capital the project would totally collapse like a house of cards.

Accessing equity from foreign investors is the easiest and most used ways of gathering capital in project financing since it ensures the mitigation of risks to the project. However, presence of foreign capital may not necessarily mean that the project will have a steady cash flow of monies to finish it and to ensure the returns of investments to the investors due to many factors which are normally associated with project financing and major one is risk management and mitigation. if the risk is not well mitigated, then this can create a big problem for the project despite having foreign capital in

[16] Helge Switala (2020). Project finance and obtaining sufficient funding for the successful completion of a project. Project Manager: Development Bank of Southern Africa

place. The concept of project financing entails the transmission of capital from one point -of -concentrate to another point -of -scarcity whereby the capital is intended to be employed in viable projects to generate more money from which the point –of- concentrate is repaid its initial investments plus interests and/or profits[17].

However, the stakeholders are always taken up by the need to make the project work that they hardly measure the benefits of foreign capital in project financing. All major projects are undertaken through international project financing; however, the project lenders and promoters are always profit oriented not benefit oriented. It therefore follows that the Government of Uganda (GoU) needs to measure the benefits of foreign capital in project financing when it comes to recouping the benefits of foreign capital in project financing in Uganda. This study therefore, assesses whether these assumed benefits are actually being realized and if so, how they have been enhanced in the oil and gas project finance so that Ugandans may benefit from them through financing of the oil and gas sector.

1.4. Purpose of the Study

The main purpose of this study is to carry out a critical analysis of the benefits of foreign capital in Project Financing in Uganda's oil and gas sector.

1.5. OBJECTIVES OF THE STUDY.

These objectives are divided into main and specific objects of the study

1.5.1. Main Objectives of the study

The general objective of this study was to analyze the benefits of foreign capital in Project Financing in Uganda's oil and gas sector.

1.5.2. Specific Objectives of the Study

This study is intended to achieve the following specific objectives:

[17] Third Amended and Restated Credit Agreement (16th October, 2018). Oasis Petroleum Inc., as Parent, Oasis Petroleum North America LLC, as Borrower the other Credit Parties Party hereto, Wells Fargo Bank, N.A., as Administrative Agent and the Lenders Party hereto Sole Lead Arranger and Sole Bookrunner Wells Fargo Securities, LLC.
From https://www.sec.gov/Archives/edgar/data/1486159/000148615918000039/oasispetroleum-3rdarcredit.htm on 19th November, 2020.

1. To explore the major risks and mitigation measures in project financing of Uganda's oil and gas sector.
2. To identify the various forms of project financing available in Uganda's oil and gas sector.
3. To identify the effectiveness and benefits of project financing to Uganda's oil and gas sector.
4. To offer recommendation on how foreign capital can be used to boost project financing in Uganda's oil and gas sector.

1.6. Research Questions

1. What are the major risks and mitigation measures in project financing of Uganda's oil and gas sector?
2. What are the various forms of project financing available in Uganda's oil and gas sector?
3. What and how effective are the benefits of project financing in attracting foreign capital in Uganda's oil and gas sector?
4. What are the recommendations on how foreign capital can be used effectively in project financing in Uganda's oil and gas industry?

1.7. Scope of the Study

The scope of the study was divided into three perspectives, these include content, time and Geographical scope.

1.7.1. Content Scope

The content of the study was based on a critique of the oil and gas legal regime in recouping the benefits of foreign capital in project financing in Uganda. Risks and mitigation measures in project financing, legal and regulatory framework of project financing, types of project financing, sources of funds for project financing, advantages and disadvantages of project financing.

The study has finally focused on project financing, the legal aspects of project financing and areas for legal reform and institutional improvement in project financing. It has also analysed the conceptual framework for project financing, legal and regulatory framework for project financing in Uganda, international project financing and traced the benefits of project financing in Uganda.

1.7.2. Time scope.

The study considered a period of 10 years spanning from 2010 up to 2020, the time period from 2020 when the discovery of commercially viable quantities of Oil and Gas reservoirs up to since most of the project that involved financing were kick started during these period of time for example, the establishment of the Uganda Development Bank Limited (UDB) which was the first national development finance institution (DFI) in Uganda established under Decree No. 23 of 1972 (later the Uganda Development Bank Act Cap. 56 of 1972),[18] which Act sought to "establish the Uganda Development Bank and the Credit Guarantee Fund and for other matters connected therewith".

1.7.3. Geographical scope.

This study was carried out in Uganda since the research focused on Uganda's as country in terms of assessing its oil and Gas industry in terms of foreign capital and project financing. Uganda is found in East Africa neighboring Kenya in the East, Tanzania in the south, and D.R. Congo in the west, South Sudan in the North and Rwanda in the south Western part of East Africa. It's located in the heart of Africa in the central sub-Saharan region of Africa. Its Oil and Gas fields are located near the part of Uganda and D.R. Congo. The total current population of Uganda is 46,256,510.[19] The latest GDP figures of Uganda is USD$21.49 billion.[20] Uganda's economy has expanded steadily over the past decade with a marked growth in the construction, oil and gas and telecommunicationssectors. The economy is highly dependent on agriculture and natural resources. Although Uganda ismainly covered by Precambrian metamorphic and igneous rocks, 20% of the country is underlain by sedimentary rocks, which have the potential for generating and accumulating petroleum deposits.[21]

1.8. Justification of the study.

Earlier research on project financing have not stated how project financing affects a developing economy like Uganda which is struggling to attract more foreign capital to kick start its oil and gas

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[18] The main objective of UDB was to promote and finance investment in various commercial sectors of the economy with particular emphasis on agriculture, industry, tourism, housing and commerce. In order to achieve its objective, UDB was empowered, by its statute, to provide financing in the form of loans and by way of equity participation using funds borrowed from both local and foreign sources. As per the decree that established it, UDB was required to finance projects that were technically feasible, commercially and economically viable and socially desirable. Priority was given to: Existing projects requiring small assistance to improve their operations; Projects with a scope to maximize utilization of the country's resources and add value to local products; Projects aiming to produce quality products at internationally competitive prices targeted for export; and Projects creating new job opportunities.

[19] Based on Worldometer elaboration of the latest United Nations data. Accessed 13th November, 2020.

[20] Angualia Busiku & Co. Advocates (2020). Guide to Establishing and doing Business in Uganda; Uganda Law Firm Website: https://lawyers-uganda.com/. Accessed 12th November, 2020

[21] Ministry of Energy and Mineral Development (2008). National Oil and Gas Policy for Uganda

production which has been idle due to a numbly of factors including limited foreign capital. This research is quality in nature where by it relied on literature review by reviewing documents and both primary and secondary sources. This was analyzed to find out the efficacy and the relationship between foreign capital and the bankability of any project under project financing in Uganda's oil and gas sector. This research is justified on helping to find out how beneficial foreign capital is to project financing in Uganda's oil and gas sector.

The effectiveness and benefits of project financing to Uganda's economy and economic development lacks clear documentation. The various forms of project financing available in Uganda's economy and their impacts on local investments in Uganda also lacks documentation. It is important to obtain an understanding of project financing to address the risks involved in its execution. The need for appropriate recommendations on project financing in Uganda and whether the expectations attached to project financing are being met in Uganda justifies carrying out the study.

Furthermore, the study has answered whether there are ways that project financing can be made more useful to Uganda than it is already and the challenges being faced by project financing. Finally, the study has addressed itself on the similarities and differences between foreign and local project financing and the mechanisms in place, or that can be put in place, to ensure that benefits of project financing are measurable.

1.9. Significance of the Study.

1.9.1. To the Researcher.

The study helps the researcher to acquire knowledge on the effectiveness of project financing. Also, University researchers are expected to benefit by adding knowledge on project financing in Uganda specifically the developing countries generally. Scholar stakeholders and academicians on the subject of project financing uses the study as a point of future reference in their academic endeavors.

Finally, this study benefits the researcher by enabling the researcher fulfil the award of a Master of Laws of Uganda Christian University (UCU). The report serves as a reference for other future University researchers in a similar subject.

1.9.2. To policy makers.

This study helps to recommend and illustrate practical solutions to policy makers. Policy makers are able to learn new practical approaches pertaining to the benefits of foreign capital in project financing of Uganda's oil and gas sector.

The various stakeholders in project financing are expected to benefit by having known the effectiveness of project financing. The policy-maker stakeholders are expected to get a basis of encouraging organizations in project financing.

1.9.3. To students.

This study is of importance in that it is used by students who would want to learn more about the issues concerning the efficacy of the benefits of foreign capital in project financing of Uganda's oil and gas sector. Pertinent issues that are discussed are not only for the oil and gas sector but the knowledge acquired can be used for other extractive industries at large. This study will further be used as a source of information from which students can refer in case of any serious issues pertaining to the study in question.

1.10. Framework.

They are two types of frameworks, the theoretical which deals with the ideal and real situation of the research problem and the conceptual framework which deals which how the research variable interacts to form the existing problem and upon that basis I will use the theoretical framework because shows how the dependant, independent and intervening variables interacts which makes it easy to solve the research problem

The conceptual framework identifies the variable in the study. Benefits of Foreign capital in Uganda's oil and gas sector.is the independent variable whereas the project financing as the dependent variable.

1.11. Theoretical Framework

Theoretically foreign capital is very beneficial to any project under project financing due to the mitigation measures undertaken by parties involved in the oil and gas project. It's expected that if a project is bankable, then it is able to attract foreign investments or capital. However, in reality, project financing in Uganda's oil and gas sector has been slow and little foreign capital has been

registered and it's what this researcher is trying to investigate the crippling foreign direct investments in Uganda's oil and gas industry and this has led to delays in explorations and development due to limited cash flow.

The project can be thought of as a box, walled off pursuant to the lender requirements, into which financing is advanced, from which a product is sold, back into which proceeds of those sales are received, and out of which loans, and interest, are repaid.[22] The project debt is either non-recourse or limited recourse to the project sponsors, so the sponsors' risk is limited to their equity investment in the project.

Because of its reliance on project cash flow for loan repayment, a project financing arrangement intrudes deeply into the operation of the project.[23] Each material contract is reviewed and signed off on by the lenders, and changes will require lender approval. The need to assure cash flow generally leads to requirements to hedge prices during the loan term, where a commodity is involved, and to hedge currency risk during the loan term, where proceeds received by the project are in a different currency from the loan. Project cash flow is controlled through a requirement that proceeds received by the project be deposited into a series of accounts controlled by the lenders, from which funds are disbursed in accordance with a predetermined 'waterfall' (priority) scheme.

1.12.0. Chapter synopsis.

Structure of the Research paper.

The study is divided into six chapters.

1.12.1. Chapter one. Introduction.

This chapter introduces the study, presents a general introduction, historical background, problem statement, justification, Research Objectives and Questions, scope of the study, significance of the study, frameworks of the study, chapter synopsis and the operational words and definitions of the study.

[22] Sidley A. (2020). What is Project Finance? Global April 2020.
[23] Ibid

1.12.2. Chapter Two. Literature Review.

Contains a review of the relevant literature on project financing and the benefits it has on oil and gas projects, risks involved and the mitigation measures contract structure, refinancing deals, various forms of project financing, benefits of project financing in oil and gas industry, risk distribution, revolving financing disorder, refinancing regulatory costs and the conclusion.

1.12.3. Chapter Three. Methodology.

This part looked at the research methodology, research design, study population, data sources, way of analyzing data and research, ethical considerations and limitations of the study.

1.12.4. Chapter Four. Benefits and disadvantages of foreign capital in project financing and foreign investments in Uganda's oil and gas sector.

Ways of resource motivation, concept of project financing, types of project financing, advantages and disadvantages of projects financing, effectiveness of the benefits of foreign capital to project financing Uganda's oil and gas projects, ways of financing oil and gas projects, sustainability of foreign capital as a way of improving projects and conclusion

1.12.5. Chapter five. Recommendations on Mitigation measure.

This section includes summaries and conclusions, recommendations as well as outlines areas for future research.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter is particularly concerned with the review of literature on project financing and the legal aspects of project financing as well as areas for legal reform and institutional improvement in project financing. The empirical literature reviews literature on project financing and the legal aspects including the identification of gaps needed for legal reform and institutional improvement. The literature review gives a critique and research gaps of each component and conclude with a brief conclusion.

According to Hart[24], literature review is “the selection of available documents on the topic which contain information, ideas, data and evidence written from a particular standpoint to fulfil certain aims or express certain views on the topic and the effective evaluation of these documents in relation to the research being proposed.” This chapter therefore presents the theoretical framework of the research and review of relevant previous research.[25]

Library and desk research methods was also employed to review national policy, international and regional legal framework that provides for proper management of the petroleum revenues. In the review, the strength and weaknesses of the legal framework were analysed. Also, important textbooks and articles were reviewed to obtain and contextualize scholarly opinions for the guidance of this paper. The paper also relied on some internet sources for secondary or tertiary information to support the study especially in ascertaining current global trends in the industry so as to find out the efficacy of Uganda’s compliance with international environmental law of health and safety in Uganda’s oil and gas sector.

As Christopher McCrudden comments, ‘if legal academic work shows anything, it shows that an applicable legal norm on anything but the most banal question is likely to be complex, nuanced and contested’.[26]However, if we take legislation as an example, the laws are passed by parliament and the words are written down. In that sense there is a positive statement of the law. It is at the next step

[24] HART, C., Doing a Literature Review: Releasing the Social Science Research Imagination. London: Sage Publications 1998

[25] Barifaijo, K., Basheka, B. and Oonyu, J. How to write a good Dissertation Thesis, 1st Edition, The New Vision printing and publishing Company Limited, Kampala. 20100

[26] Christopher McCrudden, ‘Legal Research and the Social Sciences’ [2006] (October) Law Quarterly Review 632, 648.

where the law or rule is interpreted and analyzed within a specific context that the outcome becomes 'contingent' or conditional on the expertise, views and methods of the individual researcher.

Having located this wealth of documents, the second step is more nebulous. Is it actually possible to plan and describe this second aspect of the doctrinal research methodology in an intelligible way for an 'outsider'? As Geoffrey Samuel has queried, 'Can legal reasoning be demystified?'[27] Can the legal researcher describe what it is to undertake the distinct form of analysis involved in thinking like a lawyer? Perhaps it is simply the case that the 'medium is the message',[28] so that the doctrinal discussion and analysis of the law encapsulates and demonstrates the extent of research that has taken place and on which the arguments are.

Therefore, the purpose of this literature is to examine the extent of benefits of foreign capital on project financing in Uganda's oil and gas sector.

2.2. Project Financing

Project financing is the long-term financing of infrastructure and industrial projects based upon the project cash flows of the project rather than the balance sheets of its sponsors. Usually, a project financing structure involves a number of equity investors, known as 'sponsors', and a 'syndicate' of banks or other lending institutions that provide loans to the operation.

According to Scott, they are most commonly non-recourse loans, which are secured by the project assets and paid entirely from project cash flow, rather than from the general assets or creditworthiness of the project sponsors.[29] The financing is typically secured by all of the project assets, including the revenue-producing contracts. Project lenders are given a lien on all of these assets and are able to assume control of the project if the project company has difficulties complying with the loan terms. However, Scott did not discuss how effective are the benefits of project financing, or the impact of project financing on local investments in a developing economy like Uganda which this study critically addresses.

[27] Geoffrey Samuel, 'Can Legal Reasoning Be Demystified?' (2009) 29(2) Legal Studies 181; Larry Alexander and Emily Sherwin, Demystifying Legal Reasoning (Cambridge University Press, 2008); Geoffrey Samuel, 'Does One Need an Understanding of Methodology in Law before One Can Understand Methodology in Comparative Law?' in Van Hoecke, above n 77, 177.
[28] Marshall McLuhan, Understanding Media: The Extensions of Man (Mentor, 1964).
[29] Scott Hoffman (2007). The Law & Business of International Project Finance (3rd 2007, Cambridge Univ. Press).

Graham Vinter[30] has given an analysis of project financing basing on the practical needs of the beneficiaries. He also looked at the various forms of investment vehicles and their effectiveness to the benefitting economies. He did not, however, analyze the actual benefits to the host country which this study intends to address.[31]

Denton Wilde Sapte[32] has explained the history and the rationale of project financing from a hard and cold legal perspective. The interest of the authors was to give a procedural understanding of project financing but in the process did not tackle the interest of the benefitting country whether the expectations attached on project financing are being met or what, and how relevant, are project financers in Uganda? This has left a gap which this research intends to fill by answering the questions left unanswered.

According to Gatti[33] the project finance technique makes it possible to raise the financial resources needed to develop an economic initiative primarily through a bank loan that is repaid from the cash flows generated by the project itself. In this sense repayment is secured by these cash flows. Describing the legal aspects of project finance means outlining how financial and economic or industrial planning for the development of the project is reflected in a system of legal or contractual relationships that are binding for the participants. If this system is not possible or is not reliable, the project finance deal itself is not possible.

However, Gatti[34] did not analyse the various forms of project financing available in a developing economy like Uganda or the challenges being faced by project financing? This study critically analyses these gaps. It is probably fair to say that the legal issues inherent to project finance essentially revolve around two basic concepts or groups of concepts that is the project company and its economic/legal function and the network of contracts (first and foremost, the credit agreement) that regulate the relationship between the different players in the project.[35]

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[30] Graham Vinter (1998). Project Finance: A Legal Guide, pp.3, 2nd Edition, Sweet and Maxwell (London) 1998
[31] Ibid
[32] Denton Wilde Sapte (2010). Guide to Project Finance. Denton Wilde Sapte LLP (informally Dentons) was an international law firm headquartered in London, United Kingdom. It merged with the United States-based law firm Sonnenschein Nath & Rosenthal in September 2010, forming SNR Denton.
[33] Gatti S. (2008). Project Finance in Theory and Practice: Designing, Structuring, and Financing Private and Public Projects. Academic Press Advanced Finance Series. ISBN 13: 978-0-12-373699-4.
[34] Ibid
[35]Ibid

Addressing legal issues also means contending with (or at least delineating) an initial structural complication. The legal framework of project finance originated in common law systems. Within the framework of codified legal systems (for example the civil law systems), the legal construction of project finance becomes a search for the available legal instruments that are fit for the purpose of project finance. This means taking notions born in contexts other than project finance and adapting them to the specific needs of this technique.

In many circumstances this is just not possible, and, as a consequence, market practice has come to accept financing projects on the basis of ‘‘legal structures’’ much less suited to the purpose than what would be possible in a common law context.[36] This is a sign of the vitality of this financing technique, for it rises above and beyond the possible structural rigidity of the legal environment to which it has to be adapted. Fundamentally, project finance is a financing technique or a financing structure as opposed to a legal concept in the strict sense.[37]

A legal analysis of project finance, therefore, basically consists of studying a specific example of a typical project finance deal and how it takes shape around the project company and the contracts relating to the project and their interconnections.[38]

2.3.1. The Project Company

According to Peter K, et al, in project finance, an initiative is developed ‘‘in’’ or ‘‘through’’ a project company, which is actually the borrower of the financing. From this perspective, the project company is defined as a new company and a special-purpose vehicle (SPV). This latter expression is not exclusive to project finance and in fact is normally is used in all structured finance deals that require a company for a single purpose (for reasons that are in part the same as those regarding project finance).[39]

According to Clifford Chance, there are particular reasons why the project has to be developed in an SPV, either in terms of the economic or the industrial nature of the project or the bankability of the investment in abstract terms. This study critically analyses the reasons why a project has to be developed in an SPV and whether there are ways that project financing can be made more useful to

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[36] Ibid
[37] Denton Wilde Sapte (2010). Guide to Project Finance. Denton Wilde Sapte LLP (informally Dentons) was an international law firm headquartered in London, United Kingdom. It merged with the United States-based law firm Sonnenschein Nath & Rosenthal in September 2010, forming SNR Denton.
[38] Ibid
[39] Christopher McCrudden, ‘Legal Research and the Social Sciences’ [2006] (October) Law Quarterly Review 632, 648

Ugandans than it is already? A possible exception is a project with several sponsors, which would give rise to the opportunity and/or the need to create a joint venture company in which sponsors participate as shareholders. Choosing a corporate structure in which to develop an investment project could entail applying the ‘‘usual’’ standards of corporate and tax optimization, which is normally how it is done.[40]

There are legal implications of what it means to develop a project ‘‘in’’ or ‘‘through’’ a project company. The project company acts as the formal entity that runs and is the owner of the project: Civil law systems normally use the notion of ‘‘entrepreneur’’ to describe this position with respect to the project. The project company owns, develops, and operates the project (or at least these activities are legally attributable to it). Therefore, the project company is entitled to use the site (as owner or lessee), the industrial plant and its several assets, and all legal relationships with third parties needed to build and operate the project. There are generally two categories of reasons why a project has to be developed in a special-purpose company so that it can be financed on a without-recourse basis: defensive reasons and positive reasons.[41]No limitations or exceptions are allowed, beyond those cases specifically established by the law.[42]

Underlying any legal analysis of project finance are the positive reasons why the project company and the project finance transaction have to coincide. Just as the project has to be defended from liabilities that predate the financing and that would alter the financial base case, without recourse lenders have to be able to establish the allocation area of the cash flow generated by the investment project a priori. This way they can implement the most suitable legal mechanisms to ensure that these funds are allocated and applied in accordance with the financial model.[43]

2.3.2. The Contract Structure

The contract structure focuses on the system of contracts by which the project finance deal is organized and a description of their structure and content. The key legal problems linked to drafting these agreements are also identified. Before the financing there is need for the due diligence report and the term sheet. These documents are particularly important in the context of project finance. These documents come before the project finance contract system is put in place, so they are

[40] Christopher McCrudden, ‘Legal Research and the Social Sciences’ [2006] (October) Law Quarterly Review 632, 648
[41] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[42] Christopher McCrudden, ‘Legal Research and the Social Sciences’ [2006] (October) Law Quarterly Review 632, 648
[43] Christopher McCrudden, ‘Legal Research and the Social Sciences’ [2006] (October) Law Quarterly Review 632, 648

preliminary and instrumental to it. Due Diligence Report is a summary of the project from a legal standpoint. A complete and exhaustive due diligence report is an essential tool for lenders in valuing a project. Any and all its critical aspects have to be described and explained in this document.

According to Edwin F et al,[44] In addition, the essence of the project finance transaction—risk analysis/risk mitigation—is systematically outlined for the benefit of potential lenders. The due diligence report constitutes the basic document of analysis for the project and for its bankability on a without-recourse basis. In light of this purpose, the due diligence report is actually made up of two documents, each with distinctive characteristics and objectives, but that are combined on every single page of the report: a description of the legal context of the project and an analysis of its risk.[45]

The term sheet can be described in much simpler terms as a document containing a schematic summary of the key terms of a contract document and is agreed on by the parties in light of the forthcoming drafting of the same document by legal advisors. This document summarizes the key aspects of the loan and therefore lays the documentary groundwork for building the contract structure of the financing itself. In this sense, it is a summary of what shall be included in the contract; it does not summarize a contract that has already been drafted. [46]In some cases, certain specific points are addressed that are particularly relevant within the framework of the project finance deal in question and that the parties consider essential in order to progress the development of the deal.[47]

2.3.3. Refinancing Project Finance Deals

According to Graham, Refinancing, like several other issues addressed in this chapter, is not exclusive to project finance. From a commercial standpoint, the possibility and/or opportunity for refinancing is inherent in every structured finance deal, beginning at a specific moment in the lifetime of the deal. In project finance this issue is magnified by the weight of the financial costs in the context of each individual transaction. The more aggressive the debt-to-equity ratio of the transaction, the more this weight increases.[48]

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[44] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

[45] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

[46] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

[47] Graham D. Vinter, Project Finance, 3rd Edition, (London, UK, sweet and Maxwell Limited 1996)

[48] Africa Infrastructure Country Diagnostic (AICD) (2008) “Financing Public Infrastructure in Sub-Saharan Africa: Patterns and Emerging Issues”, The Africa Infrastructure Country Diagnostic, The World Bank

According to Scot L., another factor of magnification is the peculiar evolution of project risk, which makes the project extremely different as it goes through its various stages. Generally speaking, refinancing means simply restructuring the existing debt by substituting it with another loan with more advantageous terms for the borrower. [49] These amended terms might be a lower interest rate, a longer tenor, and/or more favorable contract terms for the borrower. Usually, refinancing isrequested by the borrower and is made up of a comprehensive package that includes a number of these features.[50]

2.4. The various forms of project financing available.

The findings identify various options for financing development outcomes, particularly in low-income countries and specifically in Uganda. According to The Africa Infrastructure Country Diagnostic (AICD)[51] provides a survey of emerging issues and patterns in financing projects in Sub-Saharan Africa, arguing that resources for financing project investments could be substantially improved by addressing the substantial inefficiencies that usually characterize project implementation.[52] The United Nations Economic Commission for Africa (UNECA)[53] has evaluated innovative financing sources to unlock, among others, the deficits in project financing, energy and human capital development for the economic transformation of Africa. Although recognizing the role of external financing, the following are proposed as sustainable alternatives for financing development projects in Africa: unlocking the constraints to domestic resource mobilization, controlling illicit financial outflows, tapping into private equity and forging new forms of partnership.[54]

According to Edwin et al,[55]Private participation in infrastructure (PPI) financing, particularly from international capital markets and pension funds, has vast financing potential that remains largely

[49] Africa Infrastructure Country Diagnostic (AICD) (2008) “Financing Public Infrastructure in Sub-Saharan Africa: Patterns and Emerging Issues”, The Africa Infrastructure Country Diagnostic, The World Bank
[50] Africa Infrastructure Country Diagnostic (AICD) (2008) “Financing Public Infrastructure in Sub-Saharan Africa: Patterns and Emerging Issues”, The Africa Infrastructure Country Diagnostic, The World Bank

[51] Africa Infrastructure Country Diagnostic (AICD) (2008) “Financing Public Infrastructure in Sub-Saharan Africa: Patterns and Emerging Issues”, The Africa Infrastructure Country Diagnostic, The World Bank
[52] Economic Policy Research Centre (EPRC) (2017). Financing Infrastructure Development in Uganda: Towards sustainable development. Research Series No. 130, February 2017.
[53] United Nations Economic Commission for Africa (UNECA) (2015) “Innovative Financing for the Economic Transformation of Africa”, United Nations Economic Commission for Africa
[54] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)

[55] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

untouched[56]. The arguments in favour of PPI financing are premised on the seemingly abundant and readily available funds in international markets and the very low long-term interest rates. However, there are obstacles that explain the limited use of private financing in infrastructure development, particularly friction in matching potential suppliers of private sector financing with bankable/investable projects.[57]

Collier[58] raises a number of issues that must be addressed for African governments to tap more effectively into international financing. In particular, he argues that attracting private investment has been hampered by the limited capacity of African governments to design the types of projects that would attract private investors. This issue usually arises when infrastructure projects are undertaken in an environment in which elites in government capture the intended benefits of the projects to amass personal political capital. These challenges, coupled with organizational impediments, needlessly raise perceived risk to unreasonably high levels.[59]

Gutman *et al*.[60] provide a detailed analysis of the three major sources of external financing: private participation in infrastructure (PPI) investments; official development financing (ODF) from multilateral institutions and most of the OECD-DAC donors; and official Chinese financing. Their analysis also considers the governance issues that are critical for ensuring the economic, social, and environmental sustainability with respect to these investment outcomes.

Many African countries including Uganda that traditionally relied upon development assistance from the OECD-DAC donors to support infrastructure and other development interventions are increasingly finding new and innovative financing mechanisms.[61] The issuance of sovereign bonds in international markets, for example, is one option that many developing countries, including in

[56] Wentworth, L., and Makokera, C. G. (2015). "Private sector participation in infrastructure for development", South African Journal of International Affairs, 22(3); Gutman, J. Sy, A. and Chattopadhyay, S. (2015)." Financing African infrastructure: Can the world deliver?", Brookings. Global Economy and Development; and Collier, P. (2014), "Attracting international private finance for African infrastructure", Journal of African Trade, 1(1), 37-44.

[57] Ehlers, T. (2014). "Understanding the challenges for infrastructure finance. Bank for international settlements", Monetary and Economic Department. Working paper No. 454

[58] Collier, P. (2014), "Attracting international private finance for African infrastructure", Journal of African Trade, 1(1), 37-44.

[59] Collier, P., and Cust, J. (2015), "Investing in Africa's infrastructure: Financing and policy options", Annual Review of Resource Economics, 7(1):473-493.

[60] Gutman, J. Sy, A. and Chattopadhyay, S. (2015)." Financing African infrastructure: Can the world deliver?", Brookings. Global Economy and Development

[61] Ratha, D., Mohapatra, S., Plaza, S. (2008). "Beyond Aid: New Sources and Innovative Mechanisms for Financing Development in Sub-Saharan Africa", World Bank Policy Research Working Paper No. 4609

Africa, are increasingly taking advantage of.[62] Among African countries, Ghana, Gabon, Tanzania, the Democratic Republic of the Congo, Zambia, Côte d'Ivoire, Senegal, Angola, Nigeria, Namibia, Kenya, and Ethiopia have all mobilized substantial resources by issuing sovereign infrastructural bonds between 2007 and 2014.

2.5. The effectiveness and benefits of project financing

According to Edwin et al, [63]The financial evaluation of infrastructure and capital-intensive projects is complex.[64] The implementation of project financing means the use of a specific technique of risk and uncertainty, which is what makes the design of the monetary flow report extremely complex. Project financing is an applicable financing model even in the low credit worth countries, in case the project earns enough hard-currency income to regularly service the liabilities to creditors and in case there are a legal and other guarantee that thus earned income is used to service the debts incurred in project financing. The aim of project financing is not to conceal the debt from the creditors, credit rating estimating agencies or shareholders, but to share the project risk.[65]

Project financing should be applied each time it is possible to reduce the post-tax capital costs, and each time the sponsor's credit is unacceptable, and therefore does not ensure the funds required for the project financing with acceptable funds. The advantages of such a project financing are reflected in:[66] achieving economic rent; achieving economy of scope; risk distribution; increase in debt capacity; reduced overall assets costs; arbitrary placement of free cash flow; reducing the cost of solving the financial deviations from what was planned and agreed upon; and reducing regulatory costs.

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[62] Platz, D (2009). "Infrastructure finance in developing countries—the potential of sub-sovereign bonds", United Nations Department of Economic and Social Affairs (DESA). Working Paper No. 76.
[63] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

[64] Sla|ana Benkovi & Milo Milosavljevi (2007). Advantages and Disadvantages of Project Financing. UDC: 005.8 - Fakultet of Organizational Sciences, Belgrade.
[65] Chen A.H; Kensinger J.W and Martin J.D, (1989). Project Financing as a Means of Preserving Financial Flexibility, "Working Paper, Austin, Texas: University of Texas, 1989.
[66] Finnerty D. John (2007). "Project Financing ", John Willey & Sons, New Jersey.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0. Introduction

Research methodology focused on the manner in which the research planned, structured, and executed in order to comply with scientific criteria. It therefore, explains the research process and the research tools and procedures that were employed in the research.[67]

This chapter discussed the methodological procedures that were used in the research and it was typically desk research which reviewed both primary and secondary data which was analyzed and reviewed to come up with the definite conclusion of the research outcome.

This research was purely a qualitative approach. It was conducted using library and desk research methods. These desk research methods were used to review government published data such as laws and policies which were very helpful in the entire research process. Also, important textbooks and articles were reviewed to obtain and contextualize scholarly opinions for the guidance of this paper. The paper also relied on some internet sources for secondary or tertiary information to support the study especially in ascertaining current global trends in the industry.

This chapter presented the methodology that was used in the study. It covered the research design, data management and analysis procedures, reliability, validity and the ethical considerations.

3.1. Doctrinal legal research method

The study was conducted through a mainly qualitative doctrinal legal research method which provides a systematic exposition of the rules governing a particular legal category, analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments. A doctrinal legal research was suitable research design for this study because this study was based on legal concepts and principles of law, statutes, cases and rules concerning environmental aspects in the oil and gas industry in Uganda and henceforth allowed the researcher to adequately address and discuss the legal concepts relating to environmental health and safety.

[67] Mouton, J. & Marais, H.C. (1998): 'Basic concepts in the methodology of the social sciences. Cape Town. See also Mouton, J, (2006). 'How to succeed in your Masters and Doctoral studies; Pretoria, (Van Schaik Publishers, 2006).

3.2. Doctrinal Method as a Two-Part Process

Doctrinal method is normally a two-part process, because it involves first locating the sources of the law and then interpreting and analyzing the text. In the first step, it could be said that the researcher is attempting to determine an 'objective reality', that is, a statement of the law encapsulated in legislation or an entrenched common law principle.[68] However, many critical legal scholars would be quick to contest whether any such objective reality exists, as the very concept of objectivity is based in a liberal theoretical framework. Most would argue that the law is rarely certain.

3.2.1. Research Design

The research design has enabled the legal researcher to take the theoretical framework and focus of the research objectives.[69] This conventional legal research has taken place in the library to locate authoritative decisions, applicable legislation and any secondary discussion, reads and analysed the material, formulates a conclusion and written up the study results.[70]

The benefit of a cross-sectional study design is that it allowed the researcher to compare the many different variables at the same time. The researcher for example, looked at the analysis of the benefits of foreign capital in project financing of Uganda's oil and gas sector. It's legal and regulatory framework, its risks and mitigation of projects and how foreign capital can be attracted in the oil and gas sector as a way of improving investments.

The study was qualitative in nature aiming at analysing the benefits of foreign capital in project financing of Uganda's oil and gas sector. Furthermore, it was selected to describe in-depth, the measures taken by government in designing the fiscal regime. A qualitative research approach was adopted, in order to exploit the synergies offered by this kind of research methodology. [88] Secondary data were collected through document review.

3.3. Research Method

Data was collected using a qualitative doctrinal legal research method. A doctrinal legal research was a suitable research method because this study was based on legal concepts and principles of law, statutes, cases and rules concerning project financing. This research method enabled the legal

[68] Hutchinson, Researching and Writing in Law, above n 66, 37.
[69] Hutchinson T. & Duncan N. (2012). "Defining and Describing what we do: Doctrinal Legal Research" Vol.17 No 1 2012
[70] Ibid

researcher to take one legal proposition as a starting point and focus on the research objectives. Conventional legal research method takes place in a law library to locate authoritative decisions, applicable legislation and any secondary discussion, reads and analyses the material for formulating a conclusion and writing the study results.

This method is justified because the legal aspects of this research such as laws, statutes, case law didn't require the researcher to undertake field data collection as this is knowledge that shall be acquired through desk and library research methods. Henceforth, being of legal nature, the researcher chose qualitative method as the best method to collect and review data.[71] The research also relied on internet sources for secondary information to support the study especially in ascertaining current global trends in resource governance and fiscal performance.

3.4.1 Document Instrument

Documentary instrument related the study to the larger, on-going dialogue in the literature, filling in gaps and extending prior studies.[72] Furthermore, documentary review provides a framework for establishing the importance of the study as well as a benchmark for comparing the results with other findings.[73]

3.4.2 Sources of Data

The required data related to this study were from both primary and secondary sources. Secondary sources refer to legal instruments, and available data in literature, journals, publications andcompany annual reports on any of the areas of interest in project financing while primary data was collected from respondents.

3.4.3 Data Analysis Plan and Presentation

Data is usually collected in a raw format and thus the inherent information is difficult to understand. Qualitative data analysis involved the researcher interpreting observations, words, and symbols in the data, which consists of written texts[74] in vast array of document types, ranging from rule of law

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[71] Manderson D. & Mohr R. (2002). 'From Oxymoron to Intersection: An Epidemiology of Legal Research' (2002) 6(1) Law Text Culture 159, 161. For a breakdown of empirical and doctrinal PhDs in Australia see Desmond Manderson, 'Law: The Search for Community' in Simon Marginson (ed), Investing in Social Capital (University of Queensland Press, 2002) 152.

[72]Marshall, C., & Rossman, G. B. (2006). 'Designing Qualitative Research (4th ed.); (Thousand Oaks; 2006).

[73] Creswell, J. W., & Plano C.V. L. (2006). Designing and Conducting Mixed Methods Research. (Thousand Oaks, CA: Sage, 2006).

[74] Kristina S. (2016): Qualitative and Quantitative Approaches to Rule of Law Research. INPROL—International Network to Promote the Rule of Law. Practitioner's Guide July 2016.

donor reports, to minutes of donor meetings, laws and regulations, maps, personal and public letters, transcripts of speeches, and organizational memos.

The analysis included a range of processes and procedures whereby the researcher analyzed the qualitative data that have been collected and gave explanation or interpretation of the data to understand the research context.[75] Data analysis followed four basic steps: (1) prepare the data for analysis; (2) explore and code the data; (3) identify themes in the data; and (4) validate the accuracy of the findings.[76] The data was validated for accuracy of content, using other secondary information methods. Content analysis is the procedure for the categorization of data for the purpose of classification, summarization, tabulation and writing.[77] Data which were analyzed and written were presented in text format. Text was the main method of conveying information as it is used to explain results and trends, and provide contextual information.

3.4.4 Ethical Consideration

The research such as this was focused on topic that was sensitive and it was difficult to illicit honest responses to some of the questions posed when a participant did not feel secure in knowing that their identity is protected. Privacy matters had to be addressed from the inception of the research to the publication of the results. There were safety nets put in place to guarantee confidentiality from sources of information and documents reviewed.[94] Ethics is a moral philosophy which deals with one's conduct and serves as a guide to one's behavior.[78] The Researcher took the study as a personal gain with negative effects on others but was a person of integrity.

3.5.0 Limitation

3.5.1. Limitations of the Study

While carrying out this study, the researcher encountered the following challenges;

3.5.2 Cost of the Research:

The research involved a lot of travelling and facilitation in order to get materials needed in research and sometimes it involved paying some monies to those who had the information and this necessitated financial cover. The researcher had to dig deeper into his pockets to facilitate the

[75] Ibid
[76] Creswell, supra note 17 at 237-38.
[77] Qualitative Data Analysis http://writing.colostate.edu/guides/research/content/pop2a.cfm 40 accessed 25th January 2020.
[78] Mugenda, O.M. and Mugenda, A.G. (2003). Research Methods: Quantitative and Qualitative Approaches. Acts Press, Nairobi.

completion of the research.

3.6. Chapter Summary

The chapter is basically considered to be the backbone of the research. This is so because it tackles the issues of why is the research study undertaken, how the research problem was formulated, the particular method that has been used and why a particular technique of analysis of data from the documents reviewed used in order to come up with the different research findings.

3.7. Conclusion

This short examination of research methodology highlighted the need for an increased analysis and description by researchers of the doctrinal methodology they are using. The conclusion is that the doctrinal research methodology is a discrete method. It is more than simply scholarship or an elaborate literature review of primary materials. However, it is not sufficiently delineated for the current research environment. This chapter has not attempted to fully explain the method, or even to provide a model for researchers to follow in setting out their methodologies. It has simply proposed the groundwork for the development of such an explanation, in drawing attention to the distinctive characteristics of doctrinal legal research and the characteristics it shares with other research methods. It has argued the need for a thorough examination of the current legal research record and context.

CHAPTER FOUR

EFFECTIVENESS OF BENEFITS OF PROJECT FINACING OF THE OIL AND GAS SECTOR

4.0 Introduction

They are various forms of project financing available in Uganda's economy, the effectiveness and benefits of project financing to Uganda's economy, the impact of project financing on local investments in Uganda, and appropriate recommendations on project financing in Uganda which are detailed in the next chapter.

4.1. The effectiveness and benefits of project financing to Uganda's economy

Financing infrastructure projects through the project finance route offers various benefits such as the opportunity for risk sharing, extending the debt capacity, the release of free cash flows, and maintaining a competitive advantage in a competitive market. Project finance is a useful tool for companies that wish to avoid the issuance of a corporate repayment guarantee, thus preferring to finance the project in an off-balance sheet manner. The project finance route permits the sponsor to extend their debt capacity by enabling the sponsor to finance the project on someone's credit, which could be the purchaser of the project's outputs. Sponsors can raise funding for the project based simply on the contractual commitments.

Project finance also permits the sponsors to share the project risks with other stakeholders. The basic structure of project finance demands that the sponsors spread the risks through a network of security arrangements, contractual agreements, and other supplemental credit support to other financially capable parties willing to assume the risks. This helps in reducing the risk exposure of the project company.

The project finance route empowers the providers of funds to decide how to manage the free cash flow that is left over after paying the operational and maintenance expenses and other statutory payments. In traditional corporate forms of organization, corporate management decides on how to use the free cash flow - whether to invest in new projects or to pay dividends to the shareholders. Similarly, as the capital is returned to the funding agencies, particularly investors, they can decide for themselves how to reinvest it. As the project company has a finite life and its business is confined

to the project only, there are no conflicts of interest between investors and the management of the company, as often happens in the case of traditional corporate forms of organization.

Financing projects through the project finance route may enable the sponsors to maintain the confidentiality of valuable information about the project and maintain a competitive advantage. This is a benefit of raising equity finance for the project (however, this advantage is quite limited when seeking capital market financing (project bonds). Where equity funds are to be raised (or sold at a later time so as to recycle capital) through market routes (for example, Initial Public Offerings [IPOs]), the project-related information needs to be shared with the capital market, which may include competitors of the project company/sponsors. In the project finance route, the sponsors can share the information with a small group of investors and negotiate the price without revealing proprietary information to the general public. And, since the investors will have a financial stake in the project, it is also in their interest to maintain confidentiality.

4.2.0. Advantages and disadvantages of Project Financing

The initial decisions on the project involves many issues of great importance. The decision complexity is derived from the fact that compound and financially demanding projects are acceptable only if expected social and economic benefits are more influential then costs associated with the project operationalization.[79] Project financing comes up as a potentially useful method that governments use for development and promotion of the most important resources, or better still,for establishing new independent facilities at the places of major importance. Project financing is a financing model which is becoming increasingly important and attractive, due to the scope and the complexity of the projects that can be funded in this way and this maximizes more benefits in the oil and gas sector from foreign capital in project financing. [80]

It is a very useful and attractive technique used in a large number of industries worldwide. Project financing is a model long implemented in the developed countries and is used to maximize the results within the financial means available. In the developing countries, this method of financing infrastructure facilities is by all means present in a broadest sense, however, it is expected to yet gain

[79]Benkovic S. & Milosavljevi M. (2007). Advantages and disadvantages of Project Financing. Fakultet of Organizational Sciences, Belgrade.
[80] Ibid

popularity and importance, since, as a rule, the developing countries do not command enough financial resources to start large scope projects, nor to complete them in a proper way.

Project financing is defined as financing a certain project, most often an infrastructure or a financial one, where the lenders rely on cash flow and project returns as monetary sources to pay the invested funds back. Basically, this means that the investor has an insight into the monetary flows, and that the profit earned is the only way to pay the debts off, i.e., that the "project assets are to ensure the financing of the project itself,[81] therefore it is the only guarantee that the project will be completed and this will guarantee continued benefits from the projects undertaken.

The project financing is a form of contracting that means firm contractual relations between/among the participants, and, as such, can be applied only in the projects that are capable of supporting such a form of firm contract and sustain it on an acceptable cost level. Basically, the project financing requires the presence of a real "joint interest "among the parties included in the project execution. Only when each of the parties is really interested in a successful of the project financing will all the participants do their best to ensure that the project is actually completed. Simultaneously, project financing requires that the financial engineers should design such a financial framework that would contribute to forming of a set of contracts, which will in turn provide benefits from the contracts to all the parties concerned.

4.2.1. Advantages of project financing

The financial evaluation of infrastructure and capital-intensive projects is complex. The implementation of project financing means the use of a specific technique of risk and uncertainty, which is what makes the design of the monetary flow report extremely complex. Project financing is an applicable financing model even in the low credit worth countries, in case the project earns enough hard-currency income to regularly service the liabilities to creditors and in case there are a legal and other guarantee that thus earned income will be used to service the debts incurred in project financing. The aim of project financing is not to conceal the debt from the creditors, credit rating estimating agencies or shareholders, but to share the project risk.

Non-recourse:

[81] Euromoney (2008). Institutional Investor PLC, London, 2008.

The typical project financing involves a loan to enable the sponsor to construct a project where the loan is completely “non-recourse” to the sponsor i.e., the sponsor has no obligation to make payments on the project loan if revenues generated by the project are insufficient to cover the principal and interest payable on the loan. This safeguards the assets of sponsors. The risks of new projects remain separate from the existing business.

Maximizes leverage:

In project financing. The sponsors typically seek to finance the cost of development and construction of project on highly leverage basis. Frequently such costs are financed using 80 to 100 percent debt. High leverage in a non-recourse financing permits a sponsor to put less in funds at risk, permits a sponsor to finance a project without diluting its equity investment in the project and in certain circumstances, also may permit reduction in cost of capital by substituting lower cost, tax deductible interest for higher cost, taxable return on equity and this in turn will create more benefits from foreign capital in project financing.

Off balance sheet treatment:

Depending upon the structure of project financing the project sponsors may not be required to report any of the project debt on its balance sheet because such debt is non-recourse or of limited recourse to the sponsor. Off balance sheet treatment can have the added practical benefit of helping the sponsor comply with convenient and restrictions related to the board. Borrowings funds contain in other indentures and credit agreements to which the sponsor is a party and this creates more benefits from the project in the long run.

Maximizes tax benefits:

Project finance is generally structured to maximize tax benefit and to assure that all available tax benefit is used by the sponsors or transferred to the extent possible to another party through a partnership, lease or vehicle.

Diversifies risk:

By allocating the risk and financing need of the projects among a group of interested parties or sponsors, project financing makes it possible to undertake project that would be too large or would pose too great a risk for one party ion its own.

Project financing is a specialized form of financing that may offer some cost advantages when very large amounts of capital are involved It can be tricky to structure, and is usually limited to projects where a good cash flow is anticipated. Project finance can be defined as: financing of an industrial (or infrastructure) project with myriad capital needs, usually based on non-recourse or limited recourse structures, where project debt and equity (and potentially leases) used to finance the project are paid back from the cash flow generated by the project, with the project's assets, rights and interests held as collateral. In other words, it's an incredibly flexible and comprehensive financing solution that demands a long-term lending approach not typical in today's market place.

Whether expanding manufacturing facilities, implementing new processing capabilities, or leveraging existing assets in new markets, innovative financing is often at the core of long-term projects to transform a company's operations. Akin to the underlying corporate transformation, the challenge with innovative financial structures such as project finance is that the investment is made upfront while the anticipated benefits of the initiative are realized years later.

Infrastructure is the backbone of any economy and the key to achieving rapid sustainable rate of economic development and competitive advantage. Realizing its importance governments commit substantial portions of their resources for development of the infrastructure sector. As more projects emerge getting them financed will continue to require a balance between equity and debt. With infrastructure stocks and bonds being traded in the markets around the world, the traditionalist face change. A country on the crest of change is India. Unlike many developing countries India has developed judicial framework of trust laws, company laws and contract laws necessary for project finance to flourish.

In addition to reducing the project and the financial risks, there are still a number of other important advantages of project financing, among which are:[82] the sponsor has the opportunity to obtain the required capital to complete the project which he himself cannot ensure; it is easier for the project to get the guarantees the sponsor would otherwise have difficulties in obtaining; in case of the

[82] Fabozzi J. F. & Peterson P. P. (2003). Financial Management and Analysis. John Willey & Sons, Inc, New Jersey, 2003.

creditor's low credit worthiness, and the project is good, chances are better that financial funds and more favourable conditions for the project are obtained; the financial load per investor related to the debt servicing is considerably smaller; the project can comply with certain investment regulations that the sponsor himself would find hard to satisfy; it is easier for the sponsor to avoid certain problems (e.g., blame in case of failure, etc.); the costs per investor are considerably lower, etc.

An extremely important characteristic of project financing is the firm belief that the investment funds will be earned back, with a due return on investment. This usually stems from the guarantees, both direct and indirect, issued by a third party, most commonly the state itself. The need for these projects to be insured comes from the fact that they are capital-intensive, i.e., that they most often require that a high amount of borrowed funds be invested. In such a case all the above-mentioned sources of funds are possible, however, each brings its own costs and risks.

Companies make use of project investment when investing into large projects, where they most commonly use the so-called structural financing. The structural financing is one that allows the investors to track the monetary flows due to having formed a project organization, as a unit responsible for the achievement of the defined financial goals. Project financing is a special focus of interest of both the manufacturing companies, and those in the field of power processing and transport. The reasons are normally their limited capital sources, but also:[83] avoiding the burdening of their balance sheets; avoiding to disclose the debt so that it does not affect the share price, i.e., avoiding financial reaction; avoiding the fall in the sponsor's credit worthiness due to the concrete debt; limiting direct responsibility in the risk laden stages of the project execution and putting into effect.

As far as the project investors are concerned, it is important to point out that there is an increasing interest in joint ventures worldwide. The factors influencing entering the project execution with partners are numerous, the most common being the following: the project is beyond the financial or management capacities of only one company; the financing risk is lower for each of the participants in the execution of the project; it is financially more justifiable to enter the joint venture with another company; one or a number of partners enjoy tax relief.

[83] Fabozzi J. F. and Peterson P. P. (2003). Financial Management and Analysis. John Willey & Sons, Inc, New Jersey, 2003.

Project financing should be applied each time it is possible to reduce the post-tax capital costs, and each time the sponsor's credit is unacceptable, and therefore does not ensure the funds required for the project financing with acceptable funds. The advantages of such a project financing are reflected in:[84] achieving economic rent; achieving economy of scope; risk distribution; increase in debt capacity; reduced overall assets costs; arbitrary placement of free cash flow; reducing the cost of solving the financial deviations from what was planned and agreed upon; and reducing regulatory costs.

In spite of these advantages, project finance is quite complex and costly to assemble. The cost of capital arranged through this route is high in comparison with capital arranged through conventional routes. The complexity of project finance deals is due to the need to structure a set of contracts that must be negotiated by all of the parties to the project. This also leads to higher transaction costs on account of the legal expenses involved in designing the project structure, dealing with project-related tax and legal issues, and the preparation of necessary project ownership, loan documentation, and other contracts.

4.2.2. Disadvantages of project financing

Complexity of risk allocation:

Project financing is complex transaction involving many participants with diverse interest. If a project is to be successful risk must be allocated among the participants in an economically efficient way. However, there is necessary tension between the participants. For e.g. between the lender and the sponsor regarding the degree of recourse, between the sponsor and contractor regarding the nature of guarantees, among others. which may slow down the realization of the project.

Increase transaction cost:

It involves higher transaction costs compared to other types of transactions, because it requires an expensive and time-consuming due diligence conducted by the lenders lawyer, the independent engineers etc., since the documentation is usually complex and lengthy.

[84] Finnerty D. J. (2007). Project Financing, John Willey & Sons, New Jersey, 2007.

Higher interest rates and fees:

The interest rates and fees charged in project financing are higher than on direct loan made to the project sponsor since the lender takes on more risk.

Lender supervision:

In accordance with a higher risk taken in project financing the lender imposes a greater supervision on the management and operation of the project to make sure that the project success is not impaired. The degree of lender supervision will usually result into higher costs which will typically have to be borne by the sponsor.

Whether expanding manufacturing facilities, implementing new processing capabilities, or leveraging existing assets in new markets, innovative financing is often at the core of long-term projects to transform a company's operations. Akin to the underlying corporate transformation, the challenge with innovative financial structures such as project finance is that the investment is made upfront while the anticipated benefits of the initiative are realized years later.

There has been a rise in number of companies that need innovative financing to satisfy their capital needs, in a significant number of instances they have viable goals but find that traditional lenders are unable to understand their initiatives. And so, the need emerged for project finance.

Project financing does not result in a less expensive capital under all conditions and in all projects, therefore the costs of contracting are also very important. It is those costs and the negative effects accompanying them that may prevail over all the advantages of the project financing. Therefore, it is important that some of the disadvantages of project financing be also pointed out.

Complexity: Project financing is founded upon a set of contracts that require the negotiations with all the participants engaged in the project. The negotiations themselves may be rather complex and hence expensive to conduct. An important feature of negotiations in the analysis of project financing is the time necessary to negotiate, and it is by a rule by far longer than with the traditional direct financing.

Indirect credit support:

The debt costs in project financing are higher compared to those in direct financing, for all the borrowers, without exemption, which is the result of an indirect credit support. More precisely, the credit support in project financing is carried out through obligations stipulated in the contract, not through direct payments, therefore the lenders of project financing are deeply concerned about having to continually answer the contractual obligations and service debt. Cautious about what might happen in some unexpected conditions, the creditors often require a premium of 50 to 100 percent basis points, depending on the contract between the borrower and the lender and this may hamper benefits in project financing from foreign capital.

Higher transaction costs: Due to its high complexity, project financing requires higher transaction costs compared to those incurred in direct financing. The higher transaction costs reflect the contracting costs that are part of the project financial structure designing. They result from the analysis and introduction of different taxes characteristic of the project, as well as from numerous legal issues, such as the documentation dealing with the stock issue and a consequent ownership of the project, the documentation related to borrowings, etc.

The end goal of project financing is to raise enough assets necessary for the project to be operationalized and a high enough profit so that the invested funds can be easily paid back. One way of achieving this goal is the insurance provided by a third party. The projects supported by a third party without that party earning a direct benefit from the project are, however, rare.

4.3. An overview of benefitting Local Content and Companies

The failure to exploit resources sustainably and to ensure that citizens take part in decision making and employment greatly contributes to conflicts emanating from natural resource endowments.[85] Furthermore, the lack of involvement of citizens in the exploitation and use of the natural resource sector greatly hinders the trickle-down effect of a resource like oil, resulting in negative effects to the economy.[86] Placing an emphasis on local content ensures that non-tax benefits stay in-country or in the backyard of resource regions, and local ownerships and capital are guaranteed in the long

[85] Mushemeza, E.D., & J. Okiira (2016). 'Local Content Frameworks in the African Oil and Gas Sector: Lessons from Angola and Chad'. ACODE Policy Research Series, No.72. Retrieved from: https://www.acode-u.org/.
[86] Gwayaka, P.M. (2014). 'Local Content in Oil and Gas Sector: An Assessment of Uganda's Legal and Policy Regimes'. ACODE Policy Briefing Paper Series, No.28.

term and this will help Uganda to maximize these benefits through local content to boost incomes of Ugandans in the oil and gas industry.[87]

Objective 7 of the NOGP aims at ensuring optimum national participation in oil and gas activities through strategies such as promoting state participation in production-sharing agreements (PSAs); promoting use of the country's materials, goods and services in the oil and gas sector, and promoting the employment of Ugandans in the sector, among others. In the same spirit, Objective 8 of the NOGP seeks to support the development and maintenance of national expertise through strategies such as the provision of goods and services to the sector by national enterprises and entrepreneurs and broadening the national education curricula to prepare the necessary workforce for engagement with the sector so as to make sure that more benefits accrue to Ugandans in the oil and gas sector.

These objectives are reflected in both the upstream and midstream laws such that, while applying for a licence, the application must contain a statement on how the applicant intends to employ and train Ugandan citizens.[88] However, there is no strategy listed in the Acts to ensure that licensees follow up this training. Section 125 of the Upstream Act provides that licensees and their contractors shall give preference to goods produced or available in Uganda and to services rendered by Ugandan citizens and companies. Although well-intentioned, this section has been criticized for its ambiguity. The law does not define what a 'Ugandan' company is, thereby leaving a gap for exploitation. Strict interpretation of the word 'company' versus 'business entity' limits the application of the section only to companies. This leaves out other well-recognized commercial entities such as partnerships and cooperative societies, among others.[89] This creates more benefits from foreign capital in project financing of Uganda's oil and gas sector.

The Midstream Act attempts to correct the ambiguity by providing that the licensee and its contractors shall give priority to citizens and registered entities owned by Ugandans in the provision of goods and services. Unlike the Upstream Act, the Midstream Act therefore considers other business entities in addition to companies. However, both Acts lack provisions to ensure that Ugandans employed by the oil companies receive the same treatment, pay and opportunities at the

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[87] Avocats Sans Frontiers (2015). Business, Human Rights and Uganda's Oil and Gas industry: A Briefing of Existing Gaps in the Legal and Policy Framework. Kampala: ASF.
[88] Sections 56(3)(f) of the Upstream Act and 10(6)(s) of the Midstream Act.
[89] Gwayaka, P.M. (2014). 'Local Content in Oil and Gas Sector: An Assessment of Uganda's Legal and Policy Regimes'. ACODE Policy Briefing Paper Series, No.28.

workplace as their foreign counterparts.[90] The legislation is also silent on other forms of inclusion and equity including gender, ethnic and social status.

An estimated 996 Ugandan-owned companies prospected in 2018 to provide oil-related services by registering with the Petroleum Authority's national supplier database for the oil and gas sector, a register of service providers in the oil and gas sector.[91] It is also estimated that the sector will create 150,000 jobs at peak oil production, and 30,000 at the start of production, which is expected to occur in 2022 based on revised forecasts.[92] Most Ugandan entities are expected to participate extensivelyin the sectors reserved to promote local content: logistics, clearing and forwarding, supply chain management, catering, light air transportation, and security and camp management. If legislation is strengthened and practice is made to accord with the rules contained in that legislation therefore, the benefits accruing from the resulting effective promotion of local content will be valuable for meaningful growth and development. All these interventions are aimed at ensuring maximum benefits by Ugandans from foreign capital in Uganda's oil and gas industry.

[90] Avocats Sans Frontieres (2015). Business, Human Rights and Uganda's Oil and Gas industry: A Briefing of Existing Gaps in the Legal and Policy Framework. Kampala: ASF.
[91] Musisi, F. (31st August, 2018). 'Firms Scramble to Cash in on Oil Cash', Daily Monitor. Retrieved from: https://www.monitor.co.ug/News/National/Firms-scramble-cash-in-oil-cash/688334- 4736932-lmcjanz/index.html.
[92] Uganda Radio Network (URN) (20th December, 2018). 'Uganda's First Oil Production Now Pushed to 2022', The Observer. Retrieved from: https://observer.ug/news/headlines/59510-uganda-s-first-oil-productionnow-pushed-to-2022.

CHAPTER FIVE

ANALYSIS, SUMMARIES, CONCLUSIONS, AND RECOMMENDATIONS:

5.0 . Recommendations how Major Risk Categories Can Mitigated to Enhance Benefits of Foreign Capital in Project Finance of Uganda's Oil and Gas Industry.

Introduction.

This chapter will present an Analysis, findings, summary, Recommendations and conclusions.

5.1. Analysis.

Uganda aspires to reach the middle-income category by 2040 as stipulated in both the NDP II and Vision 2040. Adequate and timely provision of quality infrastructure is an important input into Uganda's development agenda. Although Uganda has made progress in infrastructure development, the country still faces huge deficits across all sectors, including in the transport, energy, water and information technology sectors, which require financing beyond the public budget ceilings. Specially in the oil and gas sector, Uganda aims to attract more foreign direct investments in Uganda's oil and gas industry. If Uganda's is to achieve more benefits from the foreign investments, more is needed to be done and implemented, for example on the issue of risk mitigation mechanisms in Uganda's oil and gas sector to ensure that the citizens can equally benefit from the sector.

5.2. Findings.

Findings indicate that the prioritization of domestic revenue mobilization efforts remains the primary available option for financing infrastructural development in Uganda. Therefore, efforts to improve domestic revenue mobilization should be scaled up. These efforts include, among others, decisively addressing weaknesses in the legal, regulatory, and institutional frameworks; expanding the tax base; unlocking the potentially large contributions from the informal sector; and reducing tax exemptions. This is despite the efforts made by the government to attract more foreign investments in Uganda's oil and gas industry through project financing, Uganda's still reaps fewer benefits from oil and gas sector as from the literature reviewed above. Uganda has failed to diversify on its sources of project financing so has to increase on it benefits from increased investments in the sector. It has failed to promote internal mechanism of financing projects which will increase more benefits for Ugandans in the oil and gas industry.

5.3. Gaps.

The foregoing arguments establish that the essence of project financing is the identification of all key risks associated with the project and allocating these risks to parties participating in the project and best placed to handle them can help to maximize benefits in Uganda's oil and gas industry. Uganda still lags behind in reaping benefits from foreign direct investments from its oil and gas industry due to limited investments and limited project funded through project financing as discussed above.

Without an extensive analysis of key project risks at the outset, the parties would not have a clear understanding of what obligations and liabilities they may be assuming in connection with the project and, therefore, will not be in a position to consider appropriate risk mitigation measures at the appropriate time. Delays and cost overruns would afflict the project should unmitigated risks arise and lack of clarity as to who shoulders the risk arises[93]. This creates a big problem for Uganda since its main aim is to attract more foreign investments through project financing which is very crucial to the survival of the economy.

Having established that Project finance is of no or limited recourse and primarily looks at generated cash flows to ensure; debt repayment, operation costs and return on equity, any risk that affects the generation of cash flow affects the bankability prospects of the project, hence the need to mitigate the assessed risks.

These gaps in infrastructural provision affect the business climate and increase the cost of doing business, with implications for enterprise growth and jobs. In addition, infrastructural deficits exacerbate poverty and inequality and could therefore hinder the attainment of development outcomes. Consequently, over the last decade, the country has prioritized spending on infrastructure as a means of unlocking productivity in the economy and improving competitiveness. Therefore, there is a need to improve the bankability of the projects in oil and gas so that we can gain more from capital investments in Uganda's oil and gas sector so that the country can be benefit from foreign capital investments through project financing.

[93] Graham D. Vinter, Project Finance, 3rd Edition, (London, UK, sweet and Maxwell Limited 1996)

5.4. General introduction.

The core of any project financing is the identification of all key risks associated with the project and developing a mitigation strategy through apportioning of those risks among the various parties participating in the project. Without a detailed analysis of these project risks at the outset, the parties would not have a clear understanding of what obligations and liabilities they may be assuming in connection with the project and, therefore, will not be in a position to consider appropriate risk mitigation exercises at the appropriate time'[94] Lenders would in turn not approve financing, where the above is not efficiently handled, any threat to cash flows in form of risks not assigned would directly affect the bankability prospects of a project[95].

The following paragraphs will present how technical and professional advisors may assess; legal, technical, environmental and financial issues (risks) that could lead to the project's failure at different stages of the life cycle of the project which may hinder benefits of project financing and these recommendations may lead to the success of the project financing in Uganda's oil and gas sector.[96]

5.5.1. Risks and mitigation in Project Financing aimed at maximizing benefits from foreign capital in project financing.

A successful project financing initiative is based on a careful analysis of all the risks the project will bear during its economic life. Such risks can arise either during the construction phase, when the project is not yet able to generate cash, or during the operating phase. Risk is a crucial factor in project finance since it is responsible for unexpected changes in the ability of the project to repay costs, debt service, and dividends to shareholders. Cash flows can be affected by risk, and if the risk has not been anticipated and properly hedged it can generate a cash shortfall. If cash is not sufficient to pay creditors, the project is technically in default.

Most of the time allocated to designing the project before it is financed is, in fact, dedicated to analyzing (or mapping) all the possible risks the project could suffer from during its life. Above all, focus lies on identifying all the solutions that can be used to mitigate the impact of each risk or to

[94] Denton Wilde Sapte, A guide to project Finance.
[95] Denton Wilde Sapte, A guide to project Finance
[96] Denton Wilde Sapte, A guide to project Finance

eliminate it. There are three basic strategies the SPV can put in place to mitigate the impact of a risk: Retain the risk; Transfer the risk by allocating it to one of the key counterparties; and transfer the risk to professional agents whose core business is risk management (insurers).

The first strategy 1 is quite common in a corporate finance setting. An industrial firm may retain a given risk because it considers risk allocation to third parties too expensive or the cost of insurance policies excessive compared to the effects determined by that risk. In this case the firm usually tries to implement internal procedures for the control and prevention of the risk. On the other hand, the same risk is likely to have a lower impact compared to a project finance setting. If a firm must close a plant that has caught fire, production can continue in other premises of the firm. Technically speaking, the risk is not idiosyncratic.

This is not true for project financing. If the plant burns down, the SPV doesn't have other premises where production can continue, and the project is technically (and economically) in default. This explains why Strategy is implemented in SPVs, but it is not enough. Lenders would never accept financing an SPV subject to risks that are completely internalized. Strategy 2 is the cornerstone of the project finance design, a strategy that is implemented through extensive work performed by the legal advisors of sponsors and lenders. The principle is intuitive. Since the key contracts revolving around the SPV (construction, supply, purchase, Operation and Maintenance) allocate rights and obligations to the SPV and its respective counterparties, such agreements can be used as an effective risk management tool. Every counterparty will bear the cost of the risk it is best able to control and manage. In this way, each player has the incentive to respect the original agreement in order to avoid the negative effects determined by the emergence of the risk in question. If a risk arises and it has been allocated (transferred) to a third party, this same party will bear the cost of the risk without affecting the SPV or its lenders.

Finally, Strategy 3 is implemented as a residual mitigation policy. Some risks are so remote or so difficult to address that any one of the SPV counterparties is open to bear them. Insurers are in the best position to buy them from the SPV against the payment of an insurance premium. These companies can do so because they manage large risk portfolios where the joint probability of emergence of all the risks in the portfolio at the same time is very low.

On the left-hand side, a classification of risks is proposed based on the different phases of the life cycle of the project. It is particularly important to stress that the risks common to the pre- and post-completion phase are hedged by an almost exclusive use of insurance contracts or derivative contracts. Special attention is dedicated to market risk (the risk arising from a drop in sales) given the paramount importance of this risk in determining the future cash flow generation of a project. Mechanisms such as off take agreements are analyzed, and information is also provided for the use of such contracts in Public–Private Partnerships (PPPs).

Risks inherent to a project finance venture are specific to the initiative in question. Therefore, there can be no exhaustive, generalized description of such risks. This is why it is preferable to work with broader risk categories, which are common to various initiatives. The criterion used to identify risk is chronological, an intuitive choice, seeing as this parameter is generic enough to be usable across different sectors of application. A project goes through at least two phases in its economic life: the construction, or pre-completion, phase and the operational, or post-completion, phase. These phases have very distinct risk profiles and impact the future outcome of the initiative in question in different ways. In keeping with our chosen criterion, the risks to allocate and to cover are: Pre-completion phase risks; post-completion phase risks and risks common to both phases.

International project financing transactions tend to be riskier than ordinary corporate finance deals. Because of the risk exposure, allocating the risk in the deal is often critical for approval of the project finance loan. Risk allocation, which is accomplished in the project documents, attempts to match risks and corresponding returns to the deal participants most capable of successfully managing them. For example, engineering, procurement and construction contract, which are fixed-price, turnkey contracts for construction that include severe penalties for delays put the construction risk on the contractor instead on the Special Purpose Entity (SPE), the project sponsors or the lenders. Risks inherent in typical project financings and mitigating factors are covered in this section.[97]

Project financing is generally sought for infrastructure related projects. Its linkages to the economy are multiple and complex, because it affects production and consumption directly, creates negative and positive externalities, and involves large flow of expenditure. Project finance is typically defined as limited or non-recourse financing of a new project through separate incorporation of vehicle or Project Company. Project financing involves non-recourse financing of the development and

[101] Denton Wilde Sapte, A guide to project Finance

construction of a particular project in which the lender looks principally to the revenues expected to be generated by the project for the repayment of its loan and to the assets of the project as collateral for its loan rather than to the general credit of the project sponsor.[98]

In project finance, the lenders finance the project looking at the creditworthiness of the project, not the creditworthiness of the borrowing party. Project Financing discipline includes understanding the rationale for project financing, how to prepare the financial plan, assess the risk, design the financing mix, and raise the funds. In project finance, a team or consortium of private firms establishes a new project company to build, own and operate a separate infrastructure project. The new project company to build own and operate a separate infrastructure project. The new project company is capitalized with equity contributions from each of the sponsors. In contrast to an ordinary borrowing situation, in a project financing the financier usually has little or no recourse to the non-project assets of the borrower or the sponsors of the project. The project is not reflected in the sponsors' balance sheets.[99]

5.5.2. Extension of credit (credit risk)

In considering the viability of the project, the lenders will consider the credit risk rather than the viewpoint of the equity or venture capital risk since they seek to minimize their expose to the project. Debt coverage is one of the important considerations of the lenders to the project. This represents the cash flow available to meet the principal and interest payments of the project[100].

The lender will be assessing the credit risk of the project and it will undertake a feasibility and reserve analysis study of the project to ensure that the projected cash flow meets the expected revenue stream capable of repayment of the principle plus the interest as well as ensure rate of return to the shareholders and sponsors. In the extractive industry the feasibility and reserve analysis of any project should detail the size of the resource, economic viability and recoverable quantities, development cost as well as the revenue stream bench mark[101] profile.

[98] Denton Wilde Sapte, A guide to project Finance

[99] Denton Wilde Sapte, A guide to project Finance
[100] Denton Wilde Sapte, A guide to project Finance
[101] Denton Wilde Sapte, A guide to project Finance

In the extractive industry lenders never finance the exploration phase of most project due to the high risk. The lenders shall attempt to spread the risk among the several participants. To achieve this a thorough analysis will cover namely; Borrower and any guarantor guarantee

Contractors- bonds may be required to secure payments of liquidated damages for failure to perform in respect to the construction contracts

Project sponsors- their role if any and the management of the project, equity injection

Product Purchasers- take or pay and take and pay, medium- and long-term sales contracts

Project suppliers-put or pay or other medium- and long-term supply contracts

Project operator- technical operation skill and experience will be assessed**.**

Insurance carriers- ability to insure or re-insure the project and premiums [102]

5.5.3. Development of the project (FEED) stage or Pre- completion or construction stage

This stage is characterized by; planning, construction of project facilities, purchase of working equipment and technology identification. The risk assessment of the design, engineering and construction phase of the project needs detailed analysis and study in order to consider the project viable and bankable. Due to the high level of uncertainty and exposure in the extractive industry the project sponsors, lenders and participants before making the Final Investment Decision (FID) will normally independently carry our as assessment of the FEED that would cover; Availability of work force and materials (mobilization, Delays in completion or failure to complete, Cost overruns , Engineering and suitability of the design , Defective performance upon completion, Shortfalls in the expected material reserves

5.5.4. Risks arising at this stage fail the project at the onset and may include;

5.5.4.1. Activity/ planning risks

A comprehensive and thorough planning process, delineating time and resources for various activities pertinent to the project set up in the projected time frame is crucial, as delays in one activity could affect the whole project, for example; a project for cogeneration in the power sector, (a plant

[101] Denton Wilde Sapte, A guide to project Finance

producing power and steam), any delays in building a deasulphating plant, that treats tar so it can be used as fuel for generating power, would mean that power could not be generated due to lack of fuel[103]. Hence completion of the power plant without the fuelling facility would lead to failure of the project to deliver power on agreed times to off takers.[104] Failure to meet contractual obligations to off takers could lead to cost overruns in paying off 3rd party suppliers and penalties. This directly affects cash flows and would be a concern to lenders.

This risk can be avoided through Turnkey (Engineering, procurement and construction) agreements, wherein the risk is transferred to a contractor who in turn guarantees Plant performance in the agreed time, considering he hands over a completed ready to function plant.[105]

5.5.4.2. Construction (completion Risk)

The risk herein arises;

- Where construction is not completed on time
- Performance deficiencies are discovered upon completion;
- Construction is completed with overrun costs;

These scenarios always form the major worries to lenders, the delivery of a completed, functional facility, at the estimated cost of completion is fundamental to the financial viability of the project, considering most financial projections are dependent on completion of the project, financiers need insulation against cost overruns, loss of revenue in fines to off takers for failure to deliver on time[106].

This risk herein is often also mitigated by Turnkey agreements, where the sponsors engage a contractor who ensures that the construction is delivered on time, at the agreed cost and performance guaranteed. Performance is usually guaranteed through testing exercises and a warranty period (performance bond), enshrined in the Turn key agreement also known as an Engineering, procurement and construction Agreement[107].

5.5.4.3. Technological risk

[103] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[104] Denton Wilde Sapte, A guide to project Finance
[105] Denton Wilde Sapte, A guide to project Finance
[106] Denton Wilde Sapte, A guide to project Finance
[101] Denton Wilde Sapte, A guide to project Finance

Lenders are often suspicious of Projects using innovative or novel technologies, for example, as seen in many emerging renewable energy projects. The risk is where the technology does not pass performance standard tests or is a risk to occupational health and safety of workers or the environment.

Turnkey agreements are the best mitigation strategy to be used. The contractor is enjoined by clauses that provide for; defect liability, payment of liquidated sums, performance tests and warrant (**performance bonds**)[108].Gatti.

5.5.4.4. Post completion/operation phase or Operation and Commercial Risk of the project

The operational risk assumes that the cost of the project shall not exceed the budgeted estimates and the project shall perform to expectation and deliver the required results. Once the development and construction phase of the project have been completed and the project has passed the commencement and completion test, the project is deemed to be ready and operational. The lenders will seek long-term commitments from a credible operator with the financial and technical capacity to manage and operate the project within the projected and budgeted costings with the desired output production.

In summary, the lenders and project sponsors may mitigate the operating risk by employing several methods like;[109] Negotiating strong O&M agreements and guarantees, employing experienced and creditworthy operators and contractor, providing economic incentives to the operator for efficient service, requiring performance bonds, providing for reserves and standby commitments to fund the O&M and Maintaining adequate insurance policies

The risks in this phase are mainly associated with supply of inputs, sale of the product or service and performance of the plant compared to the project standards and may include:

5.5.4.5. Regulatory risks[110]

The oil and gas sector are normally regulated by a national regulatory authority that regulates and monitors the petroleum sector[111]. A bank hoping to engage in the project financing of the oil and gas

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[108] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.
[109] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[110] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[111] Supra note 5

sector in terms shall face or be exposed to regulatory risk where by the regulator in managing the sector may pass regulations that have an adverse effect on the project[112].

The regulation may range from controlling the production output limits/levels, composition of ownership of the companies like requirements that national's own majority or some shares in the all Companies involved in the Oil and gas sector[113], subsidy provision, Environmental aspects, Domestic Market Obligations requirements, caps on the market price of the crude or refined product, the payment for capacity and or the unit charge of power as well as the duration of the generation license. These among others have the impact of changing the projections and cash flows of the project upon which the banks rely on in project finance in assessing the bankability of a project[114].

5.5.4.6. Performance Risk/Operation Risk.

In the evaluation of a project to access its bankability the operation and performance of the project/machinery is key as to whether the project shall operate/perform at the expected capacity and also be able to comply with the regulatory requirements and licence. If the project machinery under performs and is below the expected performance/capacity, this signals that not only is the project failing to raise the funds or revenue to repay the lenders/bank but also that the project is incurring higher operating costs and affecting the finance mix[115].

The banks in project financing the oil and gas sector are exposed to the performance risk of the project/machinery not meeting up to the required standards, the said situation may arise even after the project has passed the completion test. It is important to note that the performance risk arises during the life span of the project and is only extinguished once the facility is paid[116]. However, once the facility is paid and the banks have released all the guarantees and obligations and the project performance declines, it's the project sponsor to bear the risk as the banks would have already been paid.[117]

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[112] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.
[113] Uganda cannot allow companies of countries that are hostile to the government to take part in its oil development. President Yoweri Kaguta Museveni address to Parliament. http://www.newvision.co.ug/news/638095-museveni-addresses-parliament-today.html (Last visited on the 20th December 2012)

[114] Supra note 48
[115] Supra note 3
[116] Supra note 3
[117] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

5.5.4.1. Commercial Risk/Currency Risk

In project finance, the project is valued and monies are disbursed in dollars because of its widely used currency and exchange mode the banks in financing a project in the oil and gas sector are equally to get exposed and face not only a currency risk but also a conversion and devaluation risk in operating in a country[118].

If the country law dictates that all transactions are affected in their local currency then the project and bank would face a conversion risk of the rate of exchange, obligation for international payments in foreign currency as well as losing revenue on the exchange of the two currencies. These commercial risks pose serious threats to the project and banks that deal in large sums of money and have the exposure and potential of making large losses on the currency by the government[119].

5.5.4.8. Credit Risk

Although project finance concept focuses in the creditworthiness and performance of the project and the cash flows are the security for the payment of the facility, the project is exposed to the credit risk of the sponsors of the project, the suppliers, off-takers, Contractors, and other participants in the project matrix to ensure the project success[120]. The reliability and creditworthiness of the various parties to the project is a concern that if not ably address has the capability of affecting the project.[121]

5.5.4.9. Financial risks

When the project is on stream and cash flows are being generated, financial advisors should anticipate and mitigate risks that may occur outside the scope of the project sponsors' control.

a) **Interest rate risk;** while this risk might be addressed with financing obtained at fixed rate, advisors must assess the ability of generated cash flows to service financing obtained at a floating rate, the use of derivative tools, such as **interest future contract** and **interest rate swaps**, which create a source of lower cost debt should be explored according to fight,[122].

[118] Supra note 54
[119] Supra note 23
[120] Supra note 54
[121] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.
[122] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

b) **Foreign exchange risks.** This often occurs in international projects where cost and revenues are computed in different currencies, this may however present in domestic projects where a counterparty wants to bill the SPV in foreign currency.

c) **Forward contracts on foreign exchange** might be used for hedging existing or anticipated currency exposures. Long term foreign exchange agreements can be used by project companies to manage currency risk emanating from multi-currency transactions.[123]

5.5.4.10. Supply risks;

The risk here emerges where the project fails to find input or where input prices overrun planned projections, for instance in an Industrial thermal generations project, spiking fuel prices would affect the cost of producing electricity, this is compounded where there are long standing contracts with host Governments as off takers, with fixed power prices which would affect the project cash flows as cost of production per unit could be higher than the off-take price per unit. Any serious lender would want this risk mitigated to ensure sufficient cash flows.

The risk of supply can be covered with long term contracts, such as; **put or pay agreements or throughout agreements**, that enjoin the suppliers to deliver input at predictable prices, the lenders focus on the sufficiency of credit of the supplier to meet his contractual obligations and when in default pay for alternative source at a higher price. (Fight 2006).

5.5.4.11. Operation (performance) risks.

This mainly emerges where the project plant is in operation but technically underperforming, for example in the power industry there could be a deterioration of input/output ratio, or as seen earlier, inputs prices such as fuel prices could spike creating cost overruns in the input budgets or affect projected outputs, hence affecting the project's ability to meet contractual obligations to off-takers. This creates risks of cancelled contracts or increased costs in paying 3rd party suppliers to help meet obligation to the buyers. [124]

To mitigate this risk, reputable and experienced operators should be identified to handle technical operations. More still **fixed price contracts,** where operators shoulder the price fluctuations in

[123] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.
[124] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.

operation costs and **pass-through contracts** where operators are assured of bonuses when optimal performance is maintained and penalized in sub optimal performance could be relied on. [125]

5.5.4.12. Market (Demand) risk.

Oil being an international product is characterized by price volatility that can affect the projections of the cash flows of the project and its bankability. In the case of Uganda being land locked would still have to export the crude, refine it and these have a cost implication of almost USD 45 per barrel before the crude gets to Mombasa as a result of pipeline cost and tariff charges hence though the current price is USD 110 per barrel by the time crude realizes the cost the best price is worth USD 62, [126] and this will affect the projections and the expected revenue of the project and its bankability.

In the unlikely event of selling the crude/product of the domestic/regional market the banks would still face the market risk of the final end cost of crude/product being higher than the imported product and would affect the market for the local refined product[127]. If the produced product cannot compete with the imported product price, then the project will not be able to dispose of the product and pay the facility or offer price discounts that would affect the cash flows and payment duration of the project.

5.5.4.13. Off-take or sales risk, is essentially a risk that the project will fail to generate sufficient cash flows, because of an insufficient market for the product or service. Lenders critically look at this risk because it directly affects cash flows, the source of repayment of debts extended and earned return on equity. Project advisors usually look at the following as mitigation measures. [128]

Off take agreements, where SPVs sell goods or services to a single large counter party, known as the off taker, such as long-term electricity purchase agreement at fixed prices with Host Governments, greatly mitigates this risk. These agreements decrease the volatility of future cash flows from operations which is basis of the lender's assessment as to the sustainability of the deal.

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[125] Edwin F Feo David Lamb Robert Lawrence, Project Finance, The Guide to Financing International Oil and Gas Projects.
[126] Supra note 8
[127] Supra note 51
[128] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)

Off take agreements set up on **take or pay basis**, where the off taker is obliged to paying for the goods or services even when they fail to take the product, as long as the SPV is in position to supply is the most secure in mitigating market risks.[129]

5.5.5.0. Risks common to both pre- and post-completion (construction) stages

There are risks that systematically arise during the life cycle of the project but are not specific to pre- or post-construction phases, for example environmental concerns, affect oil and gas projects from the drilling stage, to decommissioning (post construction) stage. Financial market risks (interest rate risks, foreign exchange risks), Country political changes and changes in legal regimes all pose risks to the projects at any stage of the life cycle. The following paragraphs will analyse these risks.

5.5.5.1. Construction and Completion Risk

As a bank finances a project the objective is that the project is fully constructed as per the license given and satisfies the project requirements. The bank/ lenders expect the SPV to use the said revenue for what they were sought and the project is constructed and completed within the stipulated time frame. [130] A Completion test is a test carried on to confirm that the project complete. The completion test signifies that the projects can start earning money, start paying the loan and that the guarantees held by the bank in respect to construction can fall aside as well as the change of the project from recourse to limited recourse. [131]

Since the finance mix involves debt and equity, the bank is equally exposed to construction and completion risk if the SPV/sponsors are not able to raise the required equity contribution and or perform the minimum work obligations that the Syndicating or lending bankers would have required of the company to carry out as part of their equity contribution[132]. This risk and failure by the SPV/Sponsors equally have the potential of failing the project bankability.

5.5.5.2. Environmental Risk.

Environmental matters are an emerging Global concern, many countries are enacting legislation to control adverse effects, and certain projects have on the environment. Emissions, industrial waste

[129] Denton Wilde Sapte, A guide to project Finance, 2018.
[130] Project Finance, the guide to Financing International Oil and Gas Projects, Edwin Feo, David Lamb, Robert Lawrence
[131] Ibid
[132] Supra note 55

and hazardous by-products disposal have been of great concern in the oil and Gas sector. International legislation such as UNCLOS have been enacted and ratified by oil producing countries and those on continental shelves to mitigate effects of oil production on the environment. Project advisors need to appreciate the relevant legal frame work of a Host Government vis-à-vis the environment and its impact on project feasibility, and an evaluation of risks that may arise from the project site, supplies, waste disposal, and plant emissions should be done.[133]

Lenders must be satisfied that relevant environmental regulatory issues are mitigated, Advisors should also demonstrate that future environmental regulatory challenges are anticipated and addressed.

5.5.5.3. Country/Political Risks

This is mainly exposure to risk in Cross Border lending due to events more or less under the control of the Host Government.[134] Political risks are most prevalent in developing economies, and projects in these jurisdictions are prone to these risks. Although most through Laws provide for security of property and have tried to encourage both international and local investors to enter the oil and gas industry and making provisions for private sector participation, political risk open to the bank is both in terms of change or the Laws, expropriation of the investment by the host government, Nationalization[135]. The oil and gas sector being sensitive and with the potential huge revenues from the sector leaves the banks exposed to political risk of the government changing the laws in respect to the sector even after the parties have already compiled and disbursed funds to the SPV/sponsor.[136]

political risk affects projects at different stages of a project's life cycle, for example: during the planning and construction phase – delayed construction permits, and community opposition pose a threat to the project, during the operating phase – changes to various asset-specific regulations, and outright expropriation; towards the end of a project, the non-renewal of licenses, and tightened decommissioning requirements in the oil and gas sector, other issues that could present as a risk to project stability may include changes to sector regulation or taxation laws.[137]

[133] Denton Wilde Sapte, A guide to project Finance, 2018.
[134] Denton Wilde Sapte, A guide to project Finance, 2018.
[135] Project Finance, Clifford Chance, IFR Publishing Ltd
[136] Denton Wilde Sapte, A guide to project Finance, 2018.
[137] Denton Wilde Sapte, A guide to project Finance, 2018.

Political risk also emerges where, there is;

a) Change of Government or Government policy, where the new Government or policy departs from the core interests of the project, for example in nuclear energy, a new government may enact a law or formulate policies that cease nuclear energy sources of power.
b) Political manoeuvres i.e., international sanctions or Trade embargos present political risks.

Political risks are difficult to mitigate, however lenders most be insulated against these risks before financing is approved, some measures engaged before include.[138]

a) **Joint Ventures** with Local companies in Host Countries; local companies have a better working knowledge of the political systems, legal regime and markets, this insulates the foreign lender. [139]
b) **Co-financing**. Foreign lenders could opt to engage local Financing institutions, with greater capacity and understanding of the Host Government.[140]
c) **Consultation with Host Governments and political leaders**, which enables lenders assess The Host Governments national development plans, policy changes and infrastructure development plans.[141]
d) **Government support agreements**, agreements with host governments wherein, the Government makes contractual assurances to ensure to maintain a non-discriminatory environment for sponsors and SPVs. other measures such as tax holidays, sovereign guaranties can be enclosed to show fiscal support of the Government.[142]

5.5.5.4. Legal Risks

Due to the complexity of the documents and the legal agreements that are signed between the various parties and sponsors in arranging the facility, there may arise legal complications if the agreements are not closely supervised and executed to mirror the intension of the parties.[143] This risk canters around lenders ascertaining whether the commercial Legal Regime of the Host Government offers

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[138] Denton Wilde Sapte, A guide to project Finance, 2018.
[139] Denton Wilde Sapte, A guide to project Finance, 2018.
[140] Denton Wilde Sapte, A guide to project Finance, 2018.
[141] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[142] Denton Wilde Sapte, A guide to project Finance, 2018.
[143] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)

contractual enforceability should problems arise in the construction and operation phases. [144] More still legal risks may arise where the application of Laws in the Host Government is not necessarily consistent with the lenders home country, for example legal tradition; common law vs civil law grounding.[145]

Legal risk also presents around the question of whether lenders are able to take effective security which could be crucial in project finance that is of limited recourse, questions on whether lenders are able to take and enforce security such as moveable assets, cash flows, and contractual rights e.g., receivables must be asked and answered before financing is approved.

The structuring of the Project finance contractual matrix may present a legal risk commonly referred to as structural risks. Clear interpretational obligations of the project parties must be clear to avoid shift allegiances and ‘free riding ‘of parties that use legal lacunas to avoid their obligations.

Changes of laws both at national and local levels may adversely affect the project. Mitigation in these circumstances rests with legal advisors who should adequately advise lenders on whether, security can be enforced, acquisition and renew of permits and licenses is guaranteed, Judicial regime of host country's effectiveness with competent and corrupt free judicial processes.[146]

Further still legal advisors should push for stabilization clauses most especially with Exploitation of natural resources projects to guard against change in Laws, nationalization and expropriation. This help in renegotiation of contractual fiscal terms (**renegotiation clauses**), or outright stop the change of Laws affecting the project (**freezing stabilization).[147]**

Force Majeure

Force Majeure being "Acts of God" these are risks that are beyond the control of the parties like drought, war, natural disasters that would affect the project and banks even though the parties in the matrix and syndicate group were to try and hedge or transfer the risk. These are best described as unforeseeable circumstances that affect the cash flows of a project finance and whose cause is outside the control of the project sponsors or contractors.eg. Floods, coups, earthquake or civil

[144] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[145]Denton Wilde Sapte, A guide to project Finance, 2018.
[146] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)
[147] Peter K Nevitt, Frank Fabozzi, Project Financing 7th Edition, (London, UK, Euro money books, 2000)

disturbances. While force majeure provisions will be found in many commercial agreements, they are very rarely found in project financing documents on the simple basis that an obligation to repay a loan is absolute and should not be excused in any circumstances [148]

The force majeure clause in project finance is mostly enforced by ensuring that once events that triggered the force majeure and suspension of activities passes, the party affected reinstate the original terms of the contractual obligation. Most force majeure provisions are drafted to create an obligation on the party seeking to rely on the force majeure clause to use reasonable efforts to mitigate or overcome the effects of the event. In some project Finance agreements, force majeure clauses specify on those that are natural, including acts of God as enumerated above and those that politically motivated force majeures, such as Government interference, or war. This enables advisors to absolve affected parties of natural force majeures, whilst in ‘’political’’ force majeure scenarios, the parties may be able to agree to have the concession period extended rather than just relieving a party of their obligations[149].

In project financings it’s imperative for mitigation purposes to ensure that force majeure provisions are consistent across the whole of project contracts, to avoid inconsistencies where for example, relief under force majeure afforded to an input supplier should also be claimed by the contracted off taker who would not off take his product due to the inability of a supplier to deliver and thus would increase more benefits from the projects.

5.5.6. General Recommendations

Based on the findings, the following recommendations can be made:

MFPED and GoU need to devise means to provide timely funding for these oil and gas projects as they have a high return on investment and are beneficial to the economy at large. Traditionally, Uganda has relied on external development assistance to deliver crucial public investments. However, the increased discourse on financing investments in Uganda must be cognizant of the changing global dynamics with respect to global cooperation. Traditional development assistance from members of the Organization for Economic Co-operation and Development’s Development

[148] Graham D. Vinter, Project Finance, 3rd Edition, (London, UK, sweet and Maxwell Limited 1996)

[149] Graham D. Vinter, Project Finance, 3rd Edition, (London, UK, sweet and Maxwell Limited 1996)

Assistance Committee (OECD-DAC) has gradually decreased as developed western economies begin to have a more inward-looking focus due to challenges with the global economy, terrorism and immigration issues. Therefore, Uganda should now turn to other emerging sources of development assistance – non- DAC donors, such as China and India, and the potential role of new modes of private finance such as infrastructure bonds and pension funds.

There is urgent need for curtailing capital flight and leveraging the contributions of non-tax revenues to boost domestic revenue mobilization.

Findings indicate that the prioritization of domestic revenue mobilization efforts remains the primary available option for financing infrastructural development in Uganda. Therefore, efforts to improve domestic revenue mobilization should be scaled up. These efforts include, among others, decisively addressing weaknesses in the legal, regulatory, and institutional frameworks; expanding the tax base; unlocking the potentially large contributions from the informal sector; and reducing tax exemptions.

With respect to external development financing, Uganda should carefully examine the options offered by non-DAC donors such as China, South Korea, Turkey and India. In the new financial landscape, Uganda will be able to enjoy a larger pool of development partners and a higher threshold for borrowing. Uganda has an opportunity to negotiate for better loans by leveraging its larger pool of development partners.

However, Uganda should be cognisant of the increasing vulnerabilities of debt stress and the constraints posed by the East African Community macroeconomic convergence requirements. The mobilization of private financing continues to attract little attention from the government despite the existence of the requisite policy and law to facilitate the design, construction, maintenance, and operation of infrastructures and services under PPP arrangements.

Pension funds are another source of long-term domestic private financing. In particular, investing a proportion of pension funds in national development would allow for matching funds of long-term infrastructure that are best financed in local currency. Other sources of private capital for financing infrastructure investments include the domestic capital market and infrastructure bonds.

However, leveraging such domestic private financing would require a thorough review of the institutional, legal and regulatory instruments to create an enabling environment with appropriate

checks and balances to avoid misappropriation. In addition, the study cautions the government on mobilizing domestic private financing because of the high cost of borrowing, particularly at a time when Uganda's credit rating is unfavorable, signifying increased perceived risk.

Uganda should continue focusing on building institutions, ensure strict adherence to the rule of law, and eliminate rent seeking and political and elite capture to ensure prudent use of natural resources wealth.

Involvement of UDB in project financing needs to be backed by guarantees of the Government of Uganda, so that UDB can obtain large credits from external financiers, notably African Development Bank, International Development Association, European Investment Bank, European Economic Community, Kuwait Fund, Organization of Petroleum Exporting Countries (OPEC Fund) and Arab Bank of Economic Development in Africa (BADEA).

5.5.7. Areas for Future Research

During the course of the study, the researcher encountered several gaps closely related to the subject under study that require future research. There is need for future studies to explore the relationship between the concept of bankability and the 2021 agreement between Total, GOU and GOT. There is also need for a study on the adequacy of Uganda's petroleum fiscal regime to address the risk profile in the petroleum industry. There is need for a study on relationship between petroleum investments and the project financing regime in Uganda.

All these issues come up in the course of the study; however, the researcher side lined them because they were outside the scope of this research paper.

5.5.8. Conclusion

This chapter presented an analysis, findings, recommendations and conclusion on the best ways of enhancing benefits of foreign capital in project financing of Uganda's oil and gas industry by looking at how risk mitigation can be used to enhance benefits of foreign capital in Uganda's oil and gas industry. An analysis of major categories of risk that affect bankability prospects of a project and how these categories of risks can be mitigated to boost foreign capital in Uganda's oil and gas

industry and also need for Uganda to diversify on its sources of project financing if it's to achieve and reap more benefits from project financing in its oil and gas industry.

A look at risks that arise at different phases of the project life cycle was made; pre-completion (construction) risks, such as; activity risk, technological and construction risks. post completion (operational) risks, such as; supply, performance and market risks, and Risks presenting to both stages, such as; financial risks (interest rate, foreign exchange risks), environmental, legal and political risks plus force majeures and how the mitigation of these risks Can enhance benefits of foreign capital in Uganda's oil and gas sector.[150]

[150] Graham D. Vinter, Gareth Price, Project Finance: A Legal Guide (Chapter 6) F http://www3.weforum.org/docs/WEF_Risk_Mitigation_Report_2015.pdf). World Economic forum: Mitigation of Political & Regulatory Risk in Infrastructure Projects Introduction and Landscape of Risk

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