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This Report represents the Platform’s efforts at setting an agenda for civil society’s engagement in the oil and gas sector. The discoveries of oil and gas pose new opportunities and challenges and it is incumbent on all stakeholders to work in concert to ensure the best possible outcomes for our citizens.

The development of oil and gas has now become a key preoccupation for Kenya and her neighbours, with the discovery of oil in Uganda and gas in Tanzania. Previously an unknown in the extractives sector, Kenya may now even be poised to be the first country to reach production in the region.

However, like other so-called frontier countries, Kenya faces considerable challenges in developing the sector such that it maximises benefits for Kenyan citizens. The challenge for civil society is threefold, firstly, building its capacity in the new sector, secondly, participating in the ongoing development and reform of policy and legislation in the sector, and thirdly, ensuring that communities, its key constituency, have access to information about the sector.

This report identifies the critical areas which form key building blocks in ensuring the sustainable development of the resources. It also highlights the need for the Government of Kenya, parliament, oil companies, donors and civil society to work together in developing the appropriate policies, and legal and institutional frameworks for the efficient and transparent management of the country’s oil and gas resources.

The report concludes that the critical areas for civil society engagement are: institutional framework, petroleum revenue management, transparency and accountability, local content, and land and environmental rights.

As we launch this report, the Platform would like to thank all who contributed towards the preparation of this report. Dr Mohammed Amin Adam for the invaluable insights in the drafting of the report. Cross Border Information for initial research on the report. The Platform would also like to thank its members and its steering committee for their guidance, and thank partners who provided peer reviews of the report. Oxfam staff Ian Gary, Emily Greenspan, Ndanga Kamau and Joyce Kabue who provided significant knowledge and expertise in the development of this report. Platform secretariat staff Elaine Mungai and Charles Wanguhi for their diligence and hard work in the development of the report.

John Ochola
Platform Chairman
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<tr>
<th>Acronym</th>
<th>Definition</th>
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<tr>
<td>AOC</td>
<td>Africa Oil Corporation</td>
</tr>
<tr>
<td>CLO</td>
<td>Community Liaison Officer</td>
</tr>
<tr>
<td>CRA</td>
<td>Commission for Revenue Allocation</td>
</tr>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<td>EI</td>
<td>Extractive Industries</td>
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<td>EIA</td>
<td>Environmental Impact Assessment</td>
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<td>EITI</td>
<td>Extractive Industries Transparency Initiative</td>
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<td>EMCA</td>
<td>Environment Management and Coordination Act</td>
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<td>ERC</td>
<td>Energy Regulatory Commission</td>
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<td>ESIA</td>
<td>Environmental and Social Impact Assessments</td>
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<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>FPIC</td>
<td>Free, prior and informed consent</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IFI</td>
<td>International Financial Institutions</td>
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<td>IOC</td>
<td>International Oil Company</td>
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<td>Kenya Civil Society Platform on Oil and Gas</td>
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<td>Kenya National Commission on Human Rights</td>
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<td>Kenya Police Reserves</td>
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<td>Ministry of Energy and Petroleum</td>
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<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
</tr>
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<td>NAFFAC</td>
<td>National Fossil Fuels Advisory Committee</td>
</tr>
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<td>NEMA</td>
<td>National Environmental Management Authority</td>
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<td>NOC</td>
<td>National Oil Company</td>
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<td>NOCK</td>
<td>National Oil Corporation of Kenya</td>
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<td>NRC</td>
<td>Natural Resource Charter</td>
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<td>National Upstream Advisory Committee</td>
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<td>Production Sharing Contract</td>
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<td>PWYP</td>
<td>Publish What You Pay</td>
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Introduction

Background

There is no doubt that the discovery of crude oil in commercial quantities creates significant potential for a country to transform its economy. For some countries oil has been a blessing, but for others, it has weakened state institutions, collapsed the traditional sectors of agriculture and manufacturing, caused violent conflicts and increased poverty levels.

With the discovery of oil in 2012, Kenya is about to join the league of oil-producing countries. However, what is not certain is whether Kenya will join the elite on the continent who have managed to use their natural resources to ensure inclusive and sustainable growth. The issues confronting resource rich countries are quite complex and require a systematic, comprehensive and inclusive approach in designing the frameworks that address those complex issues. The frameworks include the appropriate policies, legislation, regulations and institutions for the sector.

The development of these frameworks comes with its attendant problems particularly for frontier countries like Kenya with no previous experience in oil production. There is a temptation to adopt frameworks from other countries despite contextual differences, but the Government of Kenya has a responsibility to adopt frameworks that are consistent with the prevailing social, economic, political and cultural circumstances in the country. Only this approach can facilitate the appropriate development of the oil and gas industry and unlock the transformative potential of the sector.

As Kenya begins the journey of becoming an oil producing country, civil society organisations and citizens alike have expressed worry at the haste with which the country is developing its frameworks for the sector. There is also unease about the low level of public consultations, the potential for vested interests to be rooted in the frameworks, and the potential for oil to divide the people. Concerns have also been raised about the threat that oil poses to the environment, livelihoods of communities and security.
The Kenya Civil Society Platform on Oil and Gas (KCSPOG) was established to mobilise civil society and citizens to play their rightful role of ensuring that the process for the development of the policy and legal frameworks is inclusive and participatory. That there is a need for effective engagement between civil society and the authorities to build consensus on major issues that will form the contents of such frameworks cannot be gainsaid. To facilitate this process, this report, “The Civil Society Agenda Setting Report” has been developed.

The report is intended to provide a common advocacy platform for civil society stakeholders in Kenya, as they articulate key demands to the national government and oil companies concerning the exploration, development and production of hydrocarbon resources. A comprehensive overview of policies, legislation and institutions that are central to the industry’s development, and to the wider evolution of the Kenya’s economy and society, reveals priority areas that must be addressed.
The report addresses six fundamental subjects:

i. Petroleum exploration and production
ii. Petroleum revenue management and distribution
iii. Local content
iv. Transparency and accountability
v. Community and environmental rights
vi. Policy and Legislation

Generally, the report made significant findings.

a. Kenya is at a rudimentary stage of developing what will become an oil industry which therefore requires the development of initial conditions around which the industry will be managed.

b. The governance regime for managing oil resources and revenues is inadequate in light of existing and ongoing progressive governance reforms being pursued by frontier countries like Kenya.

c. The existing policies and legal frameworks have important gaps relating to licensing, revenue sharing, institutional development and environmental sustainability.

d. The Government and its agencies have capacity challenges which could affect the effective exploitation of the resources for the benefit of the people.

e. Citizens who are the primary owners of the resources are not aware of the benefits and dangers associated with oil development.

The report also proposes a number of measures that could address the challenges identified in the findings above.

This report was compiled independently by analysts who canvassed the views of a number of informed individuals and institutions. These include stakeholders from government agencies, international oil companies (IOCs), civil society, regulatory actors, legal institutions, community engagement specialists and private security agents.

Comparing Kenya with other emerging oil and gas industries, and drawing from lessons learnt in similar jurisdictions, this report analyses the Kenyan experience in comparison with international best practice, with the aim of helping stakeholders to benchmark policies and performance.

The report presents detailed analyses of the initial conditions in Kenya, the policy, legal and regulatory environment and the potential social and economic contributions of oil and gas in Kenya. Section 1 provides an overview of the oil and gas sector; Section 2 analyses the legal framework; Section 3 deals with the institutional framework; Section 4 deals with revenue management and distribution; Section 5 deals with local content; and Section 6 focuses on transparency and accountability. Section 7 addresses land and environmental rights.

**Kenya: A Political and Economic Overview**

Kenya's economy is already well diversified, and a future government windfall from oil revenues could provide the opportunity to drive growth, and propel the country towards achieving goals set out in its developmental blueprint, Kenya Vision 2030. Commentators have argued that Kenya's divergent economy and relative stability shall ensure it escapes the resource curse. However, reduction in foreign receipts from the sale of horticulture, coffee and tea as well as the effects of a downturn in tourism caused by terrorism-related incidents may see the natural resources sector become a dominant part of the economy.
In illustration, Kenya’s tea and coffee industries are susceptible to global market price changes—fluctuating global tea prices saw a drop in revenue earned through tea and coffee exports in 2013. Kenya reported foreign exchange earnings of Ksh. 94.6 billion in 2013 down from Ksh. 122 billion in 2012 despite an increase in the amount of tea sold, up to 432.4 million kilograms in 2013 from 369.04 million kilograms in 2012. Additionally, coffee earnings dropped from Ksh.15 billion in 2012 to Ksh.10.4 billion in 2013.

The tourism industry has seen a decline in the number of visitors coming to Kenya with 1,780,768 tourists in 2013 compared to 1,785,382 in 2012. This resulted in revenues earned from tourism dropping from Ksh. 97.90 billion to Ksh. 96 billion in 2013. This drop was mainly attributed to pre-election anxieties, negative publicity, increased taxes and a rise in the cost of flying. With increased security concerns and terrorism incidents, the number of European visitors to Kenya has decreased. Indeed a number of western capitals have issued advisories against all but essential travel to Kenya.

Agriculture is the backbone of Kenya’s economy. It contributes to 26% of the Gross Domestic Product (GDP) directly, employing 78% of the available labour force—60% formally and 18% informally. While the extractives sector may be able to plug some of the losses in foreign exchange it cannot bridge the employment gap if other sectors continue to suffer downturns.

The macroeconomic profile in Kenya has improved significantly in recent years, even if levels of poverty, lack of access to clean water, sustainable modern energy and other key indicators remain far from satisfactory. Faced with a crisis of investor confidence following the violence that accompanied the elections of 2007, the implementation of economic reforms has tamed inflation and encouraged steady GDP growth of around 5%.1 In consequence, the country has taken significant steps towards meeting targets set out in Kenya Vision 2030. According to the World Bank, Kenyans now live two decades longer than they did at independence, infant mortality has fallen by 50%, and primary school enrolment is now almost universal.2

In 2010, Kenyans overwhelmingly voted in favour of adopting a new constitution, which devolves some government functions to the country’s 47 counties, introduces a bill of rights and seeks to limit the enormous powers previously vested in the presidency. Gradually the country is adapting to this new framework, but the process of devolution has been slowed by teething problems as county governments familiarise themselves with their new responsibilities. The amount of money allocated to the counties has also proved a thorny political issue, and lead opposition party the Orange Democratic Movement (ODM), as well as county governors, have argued that devolved governments require more funding to fulfill their roles.3 If the pace of discovery of oil and gas resources continues, the future revenues gained from these resources may become key points of conflict between national and county governments. A key discussion currently absent is the revenue management and use of the oil and gas resources. While provisions exist on percentages share of revenues between national and county governments in the constitution and other laws, there is no policy on ring-fencing revenues at either the national or county levels.

In a region marked by instability—with AU intervention in Somalia, which remains an extremely fragile state, and South Sudan becoming overrun by domestic conflict—Kenya faces major security challenges. The September 2013 terror attack on the Westgate shopping centre by a group affiliated to the Somali Islamist movement Al-Shabaab highlights Kenya’s vulnerability to revenge attacks for its involvement in Somalia—notably in taking Kismayo Port in 2012. The Westgate attack also highlighted failings in the Kenyan security apparatus, damaged the tourist industry and brought millions of Kenyan-Somalis under increasing security scrutiny. There is also a

1 See ‘Kenya at the Economic Frontier: Challenges and Opportunities’, Christine Lagarde (Kenya Private Sector Alliance Forum, International Monetary Fund, 6 January 2014.
3 “Governors pitch for more funds, insist that devolution must work at all costs”, Daily Nation, 3 April 2014; “Give counties more money, Raila demands”, Daily Nation, 24 August 2013.
risk to operators in the blocks close to the Somalia border. Indeed operators in Blocks 3A and 3B in Northern Kenya cited insecurity as one of the challenges that led to delays in operations.  

Despite the economic upturn, as reflected in GDP growth, and Kenya’s ability to tap international bond markets, the government is fighting a running battle against a runaway public wage bill and there remains a perception (rooted in reality) that graft permeates even the higher echelons of government. Among high-profile recent developments, government plans to issue free laptops to Kenyan school children, a mainstay of the Jubilee Alliance’s election manifesto was undermined when it emerged that Ksh. 1.4bn (US$16.2m) had been added to the tender after it had been awarded to Indian company Olive Telecommunications.

In late June, the Ethics and Anti-Corruption Commission announced it was investigating several parliamentary committees over their alleged mishandling of funds for public projects. Among these is the Transport Committee which cleared the awarding of a US$4bn contract to the China Roads and Bridge Corporation for the Standard Gauge Railway Project, linking Mombasa and Nairobi, in February. According to the Kenyan press, the investigations are focusing on alleged bribes paid to members of the committee prior to the contract being awarded.

In view of the susceptibility of oil and the broader extractive sector to corruption, the above illustrations are causes of concern. It is therefore crucial that steps are taken to ensure that the rent-seeking behavior that is so prevalent in other sectors does not hamper development in the emerging oil and gas sector. In the absence of an efficient legal framework the sector can be mostly opaque and could foster grand corruption. This would greatly undermine the development promise of oil for the Kenyan people. Paul Collier argues that while initially the resource curse was viewed through the economic lens of Dutch disease, it has now become clear that the interplay between politics and valuable natural resources is a big factor in the resource curse. Collier goes on to argue that the interplay between natural resources and politics does not only run one way—politics can affect natural assets and natural assets can affect politics.

Grand-scale corruption mixes politics with oil, making a minority mega-rich, whilst the majority remains impoverished. Examples abound in the Gulf of Guinea region—in states such as Gabon, Angola and Equatorial Guinea—a dependence on oil revenue has underwritten autocratic rule, eroding citizens’ democratic rights. Kenya is not likely to depart from its current democratic path, but corruption could reduce the dividends of democratic governance.

Kenya could become a model of good governance in the oil and gas sector. The new Constitution of Kenya has laid a strong foundation for managing natural resources including oil and gas, dealing with revenue sharing challenges in the context of devolution, and providing a platform for public accountability. These attributes when mainstreamed into sector specific legislation and regulations will no doubt enhance the credibility of the government in its relationship with industry and citizens.

**Oil: A Window of Development Opportunity?**

Poised to become a crude oil producer, Kenya, stands at a crossroads. Having struck oil in January 2012, Tullow Oil and its partner Africa Oil Corporation, estimate their resources could be 600 million barrels of crude oil;
however, this figure could increase to 1 billion barrels within two years if further exploration is successful.\textsuperscript{8} This would put Kenyan resources on a par with Uganda’s, and one-fifth the size of Ghana’s. While this is not huge compared to the world’s biggest resources, production would nevertheless provide a substantial economic input into the economy.

The estimates of proven crude oil resources indicated above are located in the South Lokichar Basin, and there are discussions between the contractor, Tullow Oil and the Government of Kenya to reach project sanction in the period 2015/16.\textsuperscript{9}

The revenue contribution from oil could provide fiscal relief to the government to finance development interventions. With 600 million barrels of recoverable resources, produced at 100,000 barrels per day, and based on a sale price of US$100 per barrel, our estimates of expected revenues to the government could reach approximately US$1 billion annually with the potential to increase when the development costs are fully recovered. The government expected revenues will come from taxes, profit oil computed at US$50 per barrel and windfall profits. If these estimates hold, the earnings would bring the revenues at just below par with key sectors such as tourism and coffee, as discussed earlier.

Apart from revenues, there are also non-fiscal benefits such as leveraging on the oil and gas resources to add value to the economy. This can be achieved through a “local content” policy. However, the implementation of local content is very difficult and countries that have promoted it have faced challenges such as capacity, finance and institutional weaknesses. If local people are not provided with the requisite technical training, they cannot be absorbed by the oil sector. Similarly, if local firms do not have the financial strength to invest in the oil sector, they cannot compete. Above all, the country will not achieve local content objectives if the institutions given the mandate to enforce the requirements are weak.

There are good examples of how oil could be transformative and bring tangible development to the people when the revenues are invested productively and efficiently. In this regard Malaysia, Indonesia and Trinidad and Tobago provide important lessons for Kenya.

Oil could however come with dangers such as widening inequality, increasing poverty levels, weakening traditional sectors (Dutch disease) and violent conflicts. Particularly, with a struggling manufacturing sector and Kenya’s over-reliance on agriculture-fed economy, an occurrence of the dreaded “Dutch disease” could cause major setbacks to the economy. The collapse of Nigeria’s ground-nut industry and Angola’s coffee industry are good examples of how oil can adversely affect traditional economies.

Kenya, whose oil industry is still in the exploration phase, has the opportunity to avoid such elements of the ‘resource curse’, and harness its oil wealth to drive economic growth and reduce poverty. However, while exploration continues apace, Kenya’s government, lawmakers and other stakeholders must not delay in putting in place the regulations, institutions and other structures to make the advent of oil and gas production an essentially positive experience in which the industry develops in a sustainable manner.

For the sector to develop in a way that benefits all citizens, input from civil society is vital — those voices must be heard to speak unanimously and clearly. This Agenda Setting Report lays out a common advocacy platform for Kenyan civil society groups focused on oil and gas. It identifies critical areas of concern requiring improvement and development, and makes policy suggestions where necessary as a contribution to creating a more equitable and prosperous Kenya. The report also highlights good and bad examples of countries that have travelled the journey Kenya is embarking on. These examples can help guide the government to avoid pitfalls and adopt good practices for the sustainable exploitation of Kenya’s oil and gas resources.

SECTION 1

OVERVIEW OF KENYA’S OIL SECTOR
1.1. History of Kenya’s Oil and Gas Sector

The search for oil in Kenya started as far back as the 1950s.10 However, early wells drilled turned out to be dry. Between 1960 and 1984, 16 wells were drilled mainly in the Lamu and Anza basins. To accelerate the search for oil, the Government established the National Oil Corporation of Kenya (NOCK) in 1981. The first comprehensive law to govern the industry, the Petroleum (Exploration and Production) Act was enacted in 1984. The Act was revised in 1986 when royalties were replaced by Production Sharing Contracts (PSC). From 1985 to 1992, a further 14 wells were drilled.

The Government decided at this point to undertake studies to establish the potential of some of the hydrocarbon basins. In 1995, a study on the Lamu basin was completed, and another on the Tertiary Rift completed in 2001. Renewed attention on exploration commenced from 2000, during which offshore PSCs were awarded. A significant milestone in the development of the oil sector was the drilling of the deepest offshore well by Woodside energy and the deepest onshore well by CNOOC in 2006 and 2009 respectively.

After decades of failed efforts, which significantly reduced investor interest in Kenya’s oil industry, Kenya became an area of intense exploration activity after the discovery of offshore gas in Mozambique and onshore oil in Uganda—both of which are believed to have the same geological characteristics as Kenya.

In 2007 several companies signed PSCs for acreage in areas covering the counties of Mandera, Marsabit, Wajir and Garissa. These included Vancouver-based Simba Energy, which also has acreage in Guinea and Liberia, Canadian Lion Petroleum, owned by Toronto Venture Exchange-listed Taipan Resources, and Vancouver-based Vanoil which took Blocks 3A and 3B in Garissa County, covering parts of the Anza Basin.

Kenya continues to be a frontier—a region with potential for eventual oil and/or gas finds, but without the necessary level of discoveries or geophysical indicators and information to be constituted a new ‘hydrocarbons province’. However, hydrocarbons finds made within the last five years by London Stock Exchange-listed Tullow Oil plc and partner Africa Oil Corporation (AOC) have turned Kenya into what is described as ‘one of the most exciting exploration plays in East Africa’.11 Recent discoveries have fostered investor confidence in the country, and a number of larger firms have signed production-sharing contracts (PSCs) in recent years, boosting exploration activity, both onshore and offshore12.

1.2. Recent Developments

Prior to 2012, only 33 wells had been drilled across Kenya’s four sedimentary basins: Anza, Lamu, Mandera and Tertiary Rift. While 16 of these had made hydrocarbons finds (showing reservoirs containing oil or gas), none of these were considered ‘commercial’ (sufficiently large to merit investment in production). To date, the total number of wells drilled stands at 39.

The discovery in the Lokichar basin shows that Kenya has a significant hydrocarbon potential but this cannot be exploited without upstream investment. As can be seen from the following table, a large proportion of the total area of 491,396 square kilometers of the sedimentary basins have unknown potential. As at February 2014, only 80,000 square kilometers of 2D seismic data and 6,300 square kilometers of 3D seismic data had been acquired, a total of 86,300 square kilometers constituting only about 18% of the total basin area.13 The investments required to unearth this massive potential resource could run into several billion US dollars, which the government is unable to invest.

12 See Appendix for full licence details and exploration activity.
SETTING THE AGENDA FOR THE DEVELOPMENT OF KENYA’S OIL AND GAS RESOURCES
– THE PERSPECTIVES OF CIVIL SOCIETY

Table 1: Summary of Wells Drilled

<table>
<thead>
<tr>
<th>Basin</th>
<th>Area (km²)</th>
<th>Wells drilled</th>
<th>Average Sediment thickness (m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lamu</td>
<td>261,000</td>
<td>19</td>
<td>12,000</td>
</tr>
<tr>
<td>Mandera</td>
<td>43,404</td>
<td>2</td>
<td>10,000</td>
</tr>
<tr>
<td>Anza</td>
<td>81,319</td>
<td>11</td>
<td>10,000</td>
</tr>
<tr>
<td>Tertiary Rift</td>
<td>105,673</td>
<td>7</td>
<td>4,000</td>
</tr>
<tr>
<td>Total</td>
<td>491,396</td>
<td>39</td>
<td>36,000</td>
</tr>
</tbody>
</table>

Ecobank estimates that Kenya’s upstream sector requires funding in the tune of US$16 billion to cover cost of new well development of the Lokichar find, the pipeline from North Turkana and completion of the Lamu Port.14

The government must therefore create an environment that can attract upstream investments into exploration and development of infrastructure. This must be expressed in industry legislation and regulations. To this end, the government has developed the Petroleum Exploration, Development and Production Bill 2014 with the objective of providing an updated legal framework in tandem with its frontier country status.

The entry of Tullow Oil in 2011 has radically altered the investment prospects in Kenya’s oil and gas industry and it is believed that the discovery by the company would open the interest of more investors in Kenya’s basins in the near future. Following the success it had enjoyed in several African countries, notably Ghana and neighbouring Uganda—where Tullow Oil discovered oil under Lake Albert in 2006 and now sits on an estimated 1.7 billion barrels of recoverable oil resources—the company sought to test its theory that its finds beneath lakes in western areas of the East Africa Rift System might be replicated around lacustrine areas to the east, particularly in Kenya and Ethiopia.

Within 18 months of Tullow Oil acquiring a 50% interest in Block 10BB, which was licensed to Africa Oil Corporation (AOC), the partners discovered 200m of net oil pay.15 Subsequently, Tullow Oil has made a further six finds in the South Lokichar Basin.16

There is also increased exploration activity in the north and northeast, near the Ethiopian and Somali borders, and the Kenyan government needs to ensure that it creates an environment that assures security and profitability and promotes economic development in the country. As at June 2014, of the 46 blocks gazetted, 44 had been licensed to oil exploration and production companies and operated by 23 oil companies as detailed in Table below.

**Table 2 : Licensed Petroleum Exploration Companies as at June 2014**

<table>
<thead>
<tr>
<th>No</th>
<th>Exploration Companies</th>
<th>Exploration Block Nos.</th>
<th>No. of Blocks</th>
</tr>
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<tbody>
<tr>
<td>1.</td>
<td>Tullow Oil Corporation</td>
<td>10A, 10BB, 10BA, 13T, 12A, and 12B</td>
<td>6</td>
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<tr>
<td>2.</td>
<td>Anadarko</td>
<td>L-5, L-7, L-12, L-11A, L-11B</td>
<td>5</td>
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<tr>
<td>3.</td>
<td>BG Group</td>
<td>L-10A, L-10B</td>
<td>2</td>
</tr>
<tr>
<td>4.</td>
<td>Ophir/Dominion</td>
<td>L-9, L-15</td>
<td>2</td>
</tr>
<tr>
<td>5.</td>
<td>Apache (now withdrawn)</td>
<td>L-8</td>
<td>1</td>
</tr>
<tr>
<td>6.</td>
<td>Vanoil Resources</td>
<td>3A, 3B</td>
<td>2</td>
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<tr>
<td>7.</td>
<td>Africa Oil Corporation</td>
<td>9</td>
<td>1</td>
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<tr>
<td>8.</td>
<td>Zarara</td>
<td>L-4, L-13</td>
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<tr>
<td>9.</td>
<td>FAR/Flow Energy</td>
<td>L-6</td>
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<td>10.</td>
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<td>13.</td>
<td>Afren</td>
<td>L-17/L-18, 1</td>
<td>3</td>
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<td>14.</td>
<td>A-Z Petroleum</td>
<td>L-1A &amp; L-3</td>
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<td>16.</td>
<td>Rift Energy</td>
<td>L-19</td>
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<td>17.</td>
<td>Imara Energy Corp.</td>
<td>L-2</td>
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<td>18.</td>
<td>Adamantine Energy Ltd</td>
<td>L-11A</td>
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<td>19.</td>
<td>Pacific Seaboard Investments Ltd</td>
<td>L-20</td>
<td>1</td>
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<td>20.</td>
<td>ERHC Energy Inc.</td>
<td>L-11B</td>
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<td>21.</td>
<td>Lamu Oil Exploration</td>
<td>L-14</td>
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<td>22.</td>
<td>Total Exploration &amp; Production Kenya B.V.</td>
<td>L-22</td>
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<td>23.</td>
<td>ENI Spa</td>
<td>L-21, L-23, L-24</td>
<td>3</td>
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</table>

These recent developments raise several questions. For instance, can the government and its partners raise the capital for the development of the discovered fields? To what extent can the government finance other infrastructure projects such as the Lamu Port, the proposed refinery and the pipelines required to support upstream operations and increase the commercial prospects of the discovery?

These questions impose on the Kenyan government and its partners the need to confirm projects and make crucial investment decisions to bring the country’s hope of becoming an oil producer to reality. In Kenya, there remain important stages to be completed before first oil. These include declaration of commerciality, submission of Plan of Development, financing and the development of the fields.
1.3. Future Development

1.3.1. Oil Exploration and Production

During the next two years, Tullow Oil plans to drill 19 exploration and appraisal wells in the country. Seven will be located in Block 13T, two in Block 10BA and nine in Block 10BB. As this report was being compiled, AOC was drilling the Sala prospect in the north-eastern corner of Block 9.

It is expected that the government and Tullow Oil will work towards making project decisions in the next few years. So far, Tullow Oil has been able to resist being drawn into confirming when oil production will start. A company spokesman told our research team, “no firm decisions on any aspect of production in Kenya have yet been made,” and the company has still to declare commerciality, although the project is well beyond the threshold for development.

Substantial milestones, including regional government alignment and support, approval of route, land acquisition and securing of financing need to be achieved before the pipeline becomes a reality. That said, the ministry has set an ambitious date of November 2016 for completion of the pipeline. All other infrastructure necessary to get the oil to market needs to be developed, although Tullow Oil has said it could begin exporting an initial 10,000 barrels per day via road or rail.

In the next few years Kenya will see sustained exploration activities and many companies have announced plans to shoot seismic and drill exploratory wells. Many of the prospecting companies will carry out planned activity. Some of these plans are outlined as follows:

i. Alongside Block 1’s operator, Afren, in the Mandera Basin on the Somali border, Lion plans to drill the Khorof prospect.

ii. FAR, which operates Block L9 in the Lamu Basin, plans to drill an exploration well into late 2014.

iii. At the time of writing, Vanoil is locked in a dispute with the government over revoked licences.

1.3.2. Gas Development

Developments have been slower for gas exploration. Australia’s Woodside Energy drilled the unsuccessful deep-water Pomboo well in 2006. Indeed, until mid-2010 development of the country’s offshore was slow, with only a few Australian independents, including Flow Energy, Pancontinental Oil and Gas and Origin Energy undertaking any activity.

Since 2010, interest in the Kenyan offshore has picked up, following significant (potentially major) gas discoveries to the south in Tanzania and Mozambique. This has attracted a number of larger companies into the country including US independents Anadarko, Apache and the UK’s BG Group.

The interest in offshore exploration has prompted the Ministry of Energy and Petroleum to demarcate new deepwater blocks, some of which are licensed to Italy’s ENI and France’s Total.

There have not yet been any significant gas finds in the country, but commercially viable finds could enhance Kenya’s position as a regional economic hub. Indeed, Kenya’s Vision 2030—which aims to see Kenya transform into a middle-income country by 2030—recognises energy’s central role in driving development.


18 Ibid.
A recent announcement of discovery of gas offshore has raised expectations that the gas revolution in Eastern Africa could be extending to Kenya. BG group and its partners have confirmed they encountered an oil column possibly 14 metres thick beneath a gas column of 29.6 metres offshore in the Lamu basin. Africa Oil also announced it made a gas discovery in block 9 and is currently drilling Sala 2 appraisal well to ascertain reserves in the basin. Following this discovery the ministry plans to build a power plant in Wajir.19

SECTION 2

LEGAL AND REGULATORY FRAMEWORKS
2.1. Existing and New Legal Frameworks

Kenya’s existing legal framework in the oil and gas sector includes the following laws:

ii. The Energy Act, No. 12, 2006
iii. The Petroleum Development Fund Act 1991
v. The Petroleum (Exploration and Production) Regulations.
vi. The Environmental Management and Co-ordination Act, 1999
vii. The Environment and Land Court Act No. 19 of 2011
viii. The Geothermal Resources Act No. 12, 1982
ix. The Commission of Revenue Allocation Act, 2011
x. The Land Act 2012
xi. The Income Tax (Amendment) Act which specifies the fiscal regime applicable to petroleum operations

Since the discovery of oil in 2012, new laws have been proposed, including:

xii. The Energy Bill, 2014
xiii. The Petroleum Exploration, Development and Production Bill, 2014 (also known as the Upstream Bill)—intended to repeal the Petroleum (Exploration and Production) Act 1986.

The Energy Bill is an integrated bill that covers the entire energy sector and does not cover the upstream sector in great detail. In contrast, the Upstream Bill is specific to the upstream sector, and attempts to address key issues in that sector. This section reviews some of the proposals in the bill and analyses the extent to which they can address the major challenges facing the upstream sector in Kenya.

2.2. The Petroleum Exploration, Development and Production Bill 2014

The highlights of the bill include a new model PSC, previously absent fiscal and contractual terms for natural gas, and provisions for local content.20

The bill also defines the cabinet secretary’s powers, the operations of the National Oil Company, provisions on environmental management, among others. The sections below examine the Upstream Bill’s key features.

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20 It is worth noting that in recent statements regarding the Petroleum (Exploration and Production) Act amendments, the Government has used the phrase “national content”, rather than “local content”. According to a statement on the MEP website: “the term ‘national content’ has been adopted instead of ‘local content’ since ‘local’ may be misconstrued to mean particular communities where oil and gas operations are being conducted.”
2.2.1. **Key Features of the Upstream Bill**

a. A national policy for upstream petroleum operations that should be reviewed every 5 years.

b. Reiterates that petroleum resources are vested in the state in trust for the Kenyan people.

c. Integrated development of oil fields and common use of infrastructure, which allows discoveries in two adjacent, but separate, blocks to be developed as one unit using common infrastructure.

d. Distribution of the government share of petroleum revenues: 75% to the central government, 20% to the county government and 5% to the local community where oil and gas have been discovered.

e. Provisions for "local-local content" which means that communities near the discovery areas are given first preference to provide services to the operations in these areas. The bill also proposes a Training Fund, which would be used to train Kenyan nationals in petroleum operations.

f. Environmental provisions include the Polluter Pays Principle (PPP) in which oil companies are fully liable for any pollution or damage caused by their petroleum operations.

g. Community rights including the right to be consulted before the commencement of an oil project, and the right to adequate compensation where appropriate.

h. Stipulates oil concessions should be licensed through competitive public tender—this limits the influence of politicians and bureaucrats in the award of Petroleum Agreements.

i. Transparency in the oil industry, including a commitment to publish production volumes, petroleum revenues, and other relevant data, on a project-by-project basis.

These features are not exhaustive and the Platform will publish a detailed analysis of the bill as it undergoes review and final enactment.

2.2.2. **Shortcomings of the Upstream Bill**

The Platform's review of the bill has revealed serious shortcomings. These must be mitigated through the constructive engagement of all stakeholders before the bill becomes law.

Key areas of concern are that:

i. It combines petroleum exploration, development and production with petroleum revenue management and local content. The result is that the bill’s provisions are not as detailed as they should be to ensure clarity, regulatory certainty and smooth enforcement.

ii. It does not make provision for an investment framework for managing petroleum revenues as well as clear rules for petroleum receipts and withdrawals from the Sovereign Wealth Fund which the government plans to create.

iii. It gives the Cabinet Secretary too much discretionary power.

iv. It does not contain important provisions on gas development, e.g. pricing and utilisation, which are necessary in a potential gas boom country such as Kenya.

v. It does not contain a comprehensive transparency regime in the Bill. The types of disclosure that would enhance the bill reporting on winning bids after a public tender, disclosure of beneficial ownership information, and disclosure about expenditure from oil revenues—these are contained the reporting requirements of the EITI.

vi. It does not provide a mechanism for financing the National Oil Corporation of Kenya (NOCK) from the government’s share of oil/revenues. A transparent financing policy is necessary in countries that limit their NOCs to commercial operations that require capitalisation.
vii. It is silent on the domestic supply obligation of oil companies. Since the government is considering building an oil refinery, it must recognise that its share of petroleum may not be sufficient for domestic consumption and may require oil companies producing oil in the country to commit their share to the domestic market.

viii. It does not make provision for joint development zones when oil basins straddle Kenya's borders. Kenya's borders with South Sudan, Somalia and Uganda all have promising oil basins. This is despite the fact that Kenya borders equally promising oil basins on the side of South Sudan, Somalia and Uganda and there may be compelling cases for joint development of the reservoir between Kenya and any of these neighbours. Even though the Bill provides for unitisation, its coverage is limited to contract areas within Kenyan jurisdiction and not across jurisdictions.21

ix. In spite of the high risks of corruption in the oil and gas industry, the Bill does not incorporate anti-corruption clauses consistent with major international benchmarks such as the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions; the United States of America Foreign Corrupt Practices Act 1977; and the United Kingdom Bribery Act 2010.

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21 At the time of writing, Kenya was locked into a dispute with Somalia at the International Court of Justice (ICJ) about the shared maritime boundary.
SECTION 3

INSTITUTIONAL FRAMEWORK
3.1. **Existing Institutions**

This section examines the key institutions responsible for the oil and gas sector and assesses whether they are adequate for governing the sector.

### 3.1.1. **Ministry of Energy and Petroleum (MEP)**

The Cabinet Secretary for Energy and Petroleum is the head of the MEP. His power and functions are defined in the 1986 Petroleum Act and include policy-making and supervising departments and agencies under the Ministry. In the upstream sector specifically, the cabinet secretary also negotiates and grants petroleum agreements and has some regulatory powers.

The cabinet secretary’s role in granting petroleum agreements is the most critical area of governance in the petroleum sector. Granting petroleum agreements creates room for rent-seeking behaviour and corruption through abuse of discretion. In some cases, there arise serious conflicts of interest where the cabinet secretary may have a personal interest in the process he administers. In such circumstances, unlike members of commissions or boards, cabinet secretaries do not recuse themselves from managing the process. This undermines the interest of the state as the terms of negotiated petroleum agreements can be used to seek personal favours from oil companies, which can compromise national interest in favour of individual interest. This is one clear reason why there is a need for checks and balances to the power of the cabinet secretary.

### 3.1.2. **National Oil Corporation of Kenya (NOCK)**

NOCK represents and holds the Government interest in all petroleum operations. In the past, it performed both regulatory and commercial roles but in recent times, it does not exercise any regulatory powers. Its principal role is now that of a mainstream oil company taking part in oil and gas exploration.

It is important to state however that even though policy-making in the upstream petroleum sub-sector is the responsibility of the cabinet secretary, NOCK retains some policy influence by providing ‘policy advice and support to government by making recommendations’ according to Sumaya Hassan-Athmani, CEO of NOCK.

Despite its existence for some time now, there is evidence of limited capacity in NOCK to harness the full potential of the hydrocarbon basins in the country. Thus, in order to fulfil its function as the commercial arm of the government in petroleum activities and to make recommendations to the ministry, NOCK’s internal capacities require upgrading. This lack of capacity was a concern mentioned by several interviewees who offered their experience and opinions for this report.

NOCK has a capacity-building programme under way, but the consensus among interviewees – both Kenyan and international – is that there is much room for improvement.

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22 The cabinet position prior to the implementation of the 2010 Constitution was “Minister”, so it is to the powers of the Minister that this section refers.
23 Research Team interview, Nairobi, 12 March 2013.
24 Research Team interview, MP for Wajir East Mohamed Elmi, Nairobi, 11 March 2014; Research Team interview, KCSPOG representative, Nairobi, 12 March 2014.
3.1.3. Energy Regulatory Commission (ERC)

The ERC was established by the Energy Act 2006 and is responsible for regulating the energy sector. As the regulator, the ERC approves operational permits and enforces compliance and has wide-ranging power to “issue, renew, modify, suspend or revoke licenses and permits for all undertakings and activities in the energy sector.”

As mentioned earlier, the cabinet secretary in the Ministry of Energy and Petroleum has some regulatory power in the upstream sector. This duplication curtails the ERC’s regulatory power and inhibits its ability to act as a check and balance on the ministry's decisions. Further, the ERC’s independence is compromised because the president appoints its chair and the cabinet secretary of the Ministry of Energy and Petroleum appoints all other commissioners, including one from the ministry itself.

3.1.4. National Fossil Fuels Advisory Committee (NAFFAC)

The National Fossil Fuels Advisory Committee (NAFFAC) is the licensing arm of the government. Created largely to assist the cabinet secretary for energy and petroleum in negotiations with would-be contractors, NAFFAC is an inter-ministerial committee comprised of the ministry’s principal secretary as chairperson and NOCK’s managing director as secretary.

NAFFAC’s other members are the Attorney General, Principal Secretary of the National Treasury, Commissioner of Petroleum, the MEP’s Chief Geologist, National Environment Management Authority (NEMA) Director General and Commissioner of the Kenya Revenue Authority.

3.1.5. Parliament

Parliament has an important role to play in the oil and gas sector by providing oversight of the executive's actions.

In the petroleum sector, as already stated, the responsibility for formulating policy and negotiating and granting Petroleum Agreements is conferred on the cabinet secretary. The existing petroleum act does not provide for parliamentary ratification of Petroleum Agreements. However, Article 71 (1) a of the new Kenyan Constitution, stipulates that “A transaction is subject to ratification by parliament if it involves the grant of a right or concession by or on behalf of any person, including the national government, or another person for the exploitation of any natural resource of Kenya.”

It should be noted that as the upstream sector is new in Kenya, parliament is yet to master the expertise to understand the complex and technical matters involved in the sector, including scrutinising Petroleum Agreements. This capacity challenge limits parliament’s current oversight power and gives the cabinet secretary and agencies of the state the opportunity to undermine the licensing process.

3.2. Institutional Reforms in the Upstream Petroleum Sector

Following the discovery of oil in the country, the Government embarked on institutional reforms with the aim of building a strong institutional environment for regulating the upstream petroleum sector. The proposed reforms have been outlined in the new Upstream Bill, 2014. The proposals seek to create new institutions and to realign the role of some existing institutions. Two new institutions have been proposed - a National Upstream Petroleum Authority (NUPA) and a National Upstream Advisory Committee (NUAC). The roles of these institutions are explored below.

3.2.1. National Upstream Petroleum Authority (NUPA)

The authority shall be the regulator of upstream operations. The main functions of the Authority shall include:

a. regulating upstream petroleum operations in Kenya;
b. providing such information and statistics to the Cabinet Secretary as may be required from time to time;
c. collecting, maintaining and managing upstream petroleum data; and
d. doing or performing all other acts for the furtherance of the provisions of the upstream act which may lawfully be done or performed by a body corporate.

Unlike the ERC which has regulatory oversight on the entire energy sector, the Authority’s role is limited to the upstream sector—the ERC will therefore stop its coverage of upstream operations. Since the upstream sector is very challenging and requires specialised knowledge and closer attention, the practice in oil-producing countries has been to establish an industry regulator to oversee its operations. The proposal in the Bill is therefore consistent with modern trends in petroleum regulations but as is explained later, the structure and functions of the regulator may be such as to reduce it to an appendage of the political establishment.

3.2.2. National Upstream Advisory Committee (NUAC)

This Committee will take the entire role of the National Fossil Fuels Advisory Committee (NAFFAC). The primary role of the Committee is to:

a. participate and advise the Cabinet Secretary in the negotiation of petroleum agreements and in the granting and revocation of licenses;
b. submit a report to the Cabinet Secretary on the terms negotiated with contractors;
c. advise the Cabinet Secretary on upstream petroleum operations;
d. participate in the evaluation of the bids and applications for awarding petroleum blocks;
e. conduct all due diligence and investigate all the affairs of contractors prior to entering into petroleum agreements;
f. advise the Cabinet Secretary on the grant of non-exclusive exploration permits, in respect of areas specified therein, under which a person may enter upon an area to prospect and/or carry out geological, geochemical and geophysical surveys as may be provided in the permit.

NAFFAC is relegated to a purely advisory role. Given the expertise contained in the body, the proposed reforms will likely miss the opportunity of making the Committee another layer of governance. In its current form, the proposal for an upstream advisory committee does not appear to be appropriately established by statute since in most jurisdictions the establishment of such advisory committees is purely administrative.
The composition of the Committee will also differ from that of NAFFAC as follows.

a. Principal Secretary or alternate in the Ministry responsible for Petroleum who shall be the Chairperson;
b. Chief Executive or an authorised representative of the National Oil Company who shall be the Secretary;
c. Attorney General or an authorised representative;
d. Principal Secretary of the National Treasury or an authorised representative;
e. Director General, National Environmental Management Authority or an authorised representative;
f. Commissioner General, Kenya Revenue Authority or an authorised representative; and
g. Principal Secretary in charge of mining or an authorised representative.

The new Committee will have a representative from the Ministry of Mining but will exclude the Commissioner of Petroleum and the MEP's Chief Geologist.

3.3. Institutional Best Practices for Managing the Oil and Gas Sector

The reason for establishing an independent industry regulator is to insulate ministerial powers from regulatory powers, limit the minister to policy making, protect the process of a fair licensing regime, and to limit undue political influence in petroleum regulations. This is often called the Norwegian model, but is practised in other countries such as Nigeria.

In spite of this progressive proposal, the proposed regulatory authority is likely to face some challenges in executing its operational functions partly because its role is limited to post licensing operations. The Authority does not have a role in the licensing process and even one of its major responsibilities as practiced in other countries—the conduct of due diligence on applications for petroleum licences—has been given to the proposed Upstream Advisory Committee, which advises the Cabinet Secretary on grant of licences. Moreover, the Cabinet Secretary shall exercise operational regulations, thus usurping the primary role of the proposed Authority. Furthermore, the Director-General of the Authority shall be appointed by the Cabinet Secretary for Energy and Petroleum. These proposals do not intend to provide the upstream regulator any iota of independence as done in most progressive jurisdictions.

In Ghana for example, the Petroleum Commission, which is the industry regulator, is fully responsible for upstream regulations, it is the only advisor to the Minister of Energy and Petroleum on upstream petroleum matters, and conducts due diligence on applications for petroleum licences. The commission's Chief Executive Officer is appointed by the President.

In Sierra Leone, the regulator has a similar role as in Ghana. The difference is in the appointment of the head of the institution. Sierra Leone's Petroleum Act of 2011 requires that the appointment of the Director General of the Petroleum Directorate (industry regulator) must be ratified by parliament.

The main observation here is that whilst in theory, the proposal in Kenya's new Bill is in line with the more progressive models, in character, the proposal falls short of what makes a regulator independent. Therefore, there are significant governance risks associated with the proposal with the likelihood of conflict of interest on the part of the political head. Further, the danger associated with this proposal is that the National Upstream Petroleum Authority will be reduced to a department under the Cabinet Secretary, and with his powers, the potential for rent seeking, corruption and abuse of discretionary powers will be very high.
It is clear from the institutional reforms being proposed in the Upstream Bill 2014 that Kenya is not likely to improve on good governance in the petroleum sector if the Bill is passed into law in its current form. Already, worrying signs from previous licensing of oil blocks may confirm the theory that a country with a weak institutional framework could be the destination for “rogue companies”. The licensing saga of Block 10BB with allegations of impropriety by a then Cabinet Minister serves as a pertinent example of how opportunistic companies can use political connections to rapidly accrue undeserved benefits.

In addition, the government’s hesitation to issue licenses through bid rounds is a cause for concern. Kenya has licensed 44 blocks, but never held an auction, which has encouraged business among middlemen in the country. Whilst the involvement of middlemen in the licensing process is not necessarily illegal, it certainly does not constitute best practice and the interests of Kenyans in obtaining a fair deal from their oil and gas resources would be better served through the holding of an open and competitive bid round.

A criticism of the current system is that it could favour smaller but politically connected companies – and that, consequently more experienced and well-resourced explorers might lose out to companies less able to fulfill their work commitments. This would be against the interest of Kenyans.

SECTION 4

REVENUE MANAGEMENT
4.1. Revenue Management

Oil revenues have the potential to stimulate economy-wide growth if managed appropriately. However, if managed badly, oil revenues can cause economic challenges of inflationary pressure, weak export industries, and cyclical government expenditure, not to mention the challenges of corruption, patronage and conflict. “The potentially substantial revenues from the oil and gas sector will come with significant challenges, that require careful management”, said Diariétou Gaye, World Bank Country Director for Kenya. “Kenya has a window of opportunity of a few years to take the right steps that will determine the shape of the oil and gas sector for decades to come”.

4.1.1. In Search of a Model for Petroleum Revenue Management

There are different models of managing petroleum revenues productively and ensuring the transformation of revenues into visible development outcomes. These models attempt to answer the following political economy questions:

i. How much to spend and save?

ii. Where to spend or invest?

(i) How much to spend and save?

The non-renewable nature of petroleum revenues means that the amount of petroleum revenues that is spent is dictated by a number of factors including the level of absorptive capacity, macroeconomic stability and need for fiscal sustainability. Petroleum revenues therefore must be managed in the context of an overarching macro-fiscal framework that recognises the volatility, uncertainty and cyclical nature of prices. Over time, this framework must also consider the exhaustibility of oil resources. The most common models on how much to spend are those based on the hand-to-mouth rule, the bird-in-hand rule and the permanent-income rule.

The hand-to-mouth rule requires that the government spends all revenues generated. This rule is used mostly by countries where the size of revenues is insignificant, or where development challenges are enormous. Norway adopted this model until 1990 when it set up a savings fund.

The bird-in-hand rule requires that petroleum revenues are put in a Petroleum Fund and invested in financial instruments whilst the government spends only the returns on the investments. This is the current spending rule in Norway. The Fund invests its assets abroad to reduce the appreciation of the real exchange rate, but rules regarding inflow and outflows remain flexible.

The permanent-income rule allows the spending of discounted net revenues annually computed over the lifespan of an investment project. This ensures that a permanent proportion of the size of the petroleum wealth is spent every year into eternity, whilst the balance invested through a Sovereign Wealth Fund continuous to grow beyond the life of the project.

Most resource-rich countries have adopted one model or the other depending on the stage of development of the oil and gas industry and the size of revenues being generated. Deciding what Kenya should do with its petroleum revenues is a political decision, which is linked to legal, economic and social considerations.

The Government of Kenya proposes to establish a Sovereign Wealth Fund to which the Central Government share of petroleum revenues will be transferred. This Fund will be used for budgetary support, stabilisation of the budget and for future generational equity. However, it is not clear yet what fiscal rule the Government will adopt to determine the size of annual spending from the Fund.

(ii) Where to spend and invest?

On the question of where to invest petroleum revenues, the three most common investment priorities include the agricultural development model, the industrial development model and the human capital model. These models are defined by the development priority that receives the largest proportion of petroleum revenues. For instance, Indonesia applied the agricultural development model because it is believed that it facilitates faster redistribution of revenues.

On the other hand, Malaysia focused on industrial development by spending its petroleum revenues in industrial infrastructure such as roads, electricity, water and ICT. Industrial spending speeds up economic growth, and when this growth is sustained over a long timeframe, it translates into development.

Trinidad and Tobago on its part invested heavily in education, skills and innovations. This model helps to build an educated workforce capable of generating wealth through value addition. This model injects growth in the economy whilst maintaining the social development objective of human capital development.

In the Petroleum Exploration, Development and Production Bill, the government has expressly articulated its priority in infrastructure development, but whether the focus will be on social infrastructure like education and health—like Botswana—or economic/commercial infrastructure—like Malaysia—remains uncertain.

Most of the countries cited above legislated their models for petroleum revenue management. However not all countries have the same high level of fiscal discipline, hence the outcomes of these models have been mixed. One example of fiscal indiscipline is Chad, which had an excellent piece of legislation developed at the insistence of the World Bank as condition for funding the Cameroon-Chad export pipeline.

The legislation required strict withdrawals of revenues as well as provided for investment and savings rules. The legislation introduced by the Government in 1999, provided that 10% of the total revenues would go towards a fund for future generations, held in an account at a development finance institution, 80% was to be spent on priority sectors of public health, social affairs, education, infrastructure, agriculture, livestock and water, with the remaining 10% split equally between the oil-producing region and normal government expenditure.

Box 4. Sovereign wealth fund

Petroleum funds are designed to protect the economy from overheating, safeguard against excess volatility in government spending, and enhance the scope for transparency and oversight. Petroleum funds, in their many guises, are increasingly popular in oil economies, but have a mixed record of success.

Kenya’s Sovereign Fund is provided for in s.136 (1) of the Energy Bill. “The Cabinet Secretary shall determine, with the approval of parliament (a) the amounts payable into the Fund; (b) the asset manager to manage the Fund; and (c) the withdrawals made from the Fund – provided that the mount payable into the fund shall be at least 5% of the government share of proceeds” (s.136(3)). The asset manager has broad powers to invest the funds as he/she sees fit, providing they are in line with broad objectives.

While funds can provide for positive revenue management arrangements (in Norway for example), if they are managed poorly, they can raise corruption worries (in Angola for example). To ensure Kenya resembles the former, rather than the latter, strict powers of oversight must be devised. In Sao Tome and Principe, for example, a rigid formula determines the maximum annual withdrawals from the fund and requires the signature of four officials from different parts of the government.
In addition, whenever the government wanted to allocate expenditure, it had to seek approval of the Collège de contrôle et de surveillance des ressources pétrolières (The Petroleum Revenue Oversight and Control Committee), an independent body comprised of representatives from government and civil society. However, by 2006, the government had abolished provisions directing 10% of revenue towards the fund for future generations, directing it instead towards its priority areas. To these, it added energy, justice, security and territorial administration, allowing it to effectively spend the money on whatever it wanted, but mostly to buy weapons. This indeed also demonstrates that legislation alone is insufficient to guarantee successful management of petroleum resources.28

The lesson from the Chad example is that a revenue management model is a necessary, but not sufficient, condition to ensure the transformative effect of revenues. Transforming petroleum revenues into development also requires a sustained fiscal discipline and strong institutions capable of enforcing the restrictions on withdrawals, spending and savings.

As already observed elsewhere in this report, the government is perhaps paying less attention to the complexities of petroleum revenue management and its potentially devastating impact on the economy such as Dutch disease, non-productive spending, inflation and corruption. Kenya should enact standalone legislation on petroleum revenue management with clear transfer and withdrawal rules as well as investment and savings rules.

4.1.2. Revenue Management in the Context of Devolution

Through devolution, the new Kenyan constitution hopes to improve the capacity of local government institutions to provide for citizens.

Revenue from central government is distributed to the counties via a special government formula, which aims at equitable distribution of funds, taking into account criteria such as poverty levels and population.

Yet despite this formula, many counties, particularly those in the impoverished north, such as Turkana, Marsabit, Mandera and Garissa (all counties with oil exploration activity), have struggled to balance their budgets, despite the additional funding they receive courtesy of the government formula. In part, this is due to a combination of county governments’ inability to raise its own revenue through taxation and the need for increased funds from central government—this year’s allocation will be Ksh. 58 billion (US$667 million) less than last year—however, a lack of capacity, corruption and economic mismanagement also play a role in the shortage of funds.

In some oil-producing countries, a proportion of petroleum revenue is ceded to local areas especially where oil and gas resources are being extracted. This is based on the principle that although natural resources are the property of all citizens and benefits must be shared by all, those who are affected more by extraction must be allocated more benefits to compensate against the negative effects of extraction.

Different revenue sharing mechanisms have therefore been employed in different jurisdictions. Nigeria has the derivative formula, which allocates 13% of total petroleum revenues to producing states. In Chad, 5% of total petroleum revenue is distributed to the producing regions. The proposal in Kenya is to distribute 20% of the government’s share of petroleum revenues to the county government and 5% to the local communities where there is extraction of oil.

The adoption of this principle is in line with best practices as it helps with managing community dissent and conflicts that arise from the disaffection by communities who feel their rights to their heritage, livelihoods and environmental sustainability have been infringed upon. Where the development needs of such communities are not addressed, it could lead to violent conflicts and production disruption, with grave consequences for revenue inflows to the National Treasury. The case of Nigeria’s Niger Delta is a good example.

However, as expressed earlier, some counties have low absorptive capacity to manage ceded revenues and are therefore likely to invest revenues in non-productive areas or used for recurrent expenditure. Also, patronage in the distribution of benefits at the county level could increase contestations among the people over resources leading to internal conflicts.

In the context of existing issues concerning county governments’ budget management, the lack of procedure over how local governments spend ceded petroleum revenue is a cause for concern. Add to this the fact that oil production, when it starts, will take place in areas where historically, strong ethnic and community rivalries increase competition around strong resources, and the potential for conflict is greatly increased.

Aside from exacerbating local conflict, distribution of revenue to county governments, if improperly legislated for, also runs the risk of shifting corruption from central government to devolved government, as has been the case in Nigeria.

National government must be vigilant about designing a revenue allocation system that is sensitive to the challenges at the county level. It is imperative that the national government is involved in building the capacity of county governments so that they are able to manage and spend revenue that is rightfully allocated to them.

### 4.2. Financing the National Oil Company from the Government Share of Petroleum Revenues

Clearly, one of the contentious issues in oil revenue management is financing oil investments by the National Oil Company from the Government share of petroleum revenues. Apart from the genuine desire for investments, NOCs in most cases operate under secrecy and are often not subject to public scrutiny or parliamentary oversight. Corrupt governments therefore transform them into slush funds, transferring a lot of oil money to them and returning through the “back door” to draw the funds for non-productive spending including for political projects.

Although NOCK is playing an important role in the oil and gas industry and aims to become a competitive commercial entity, there is no known proposal on how the company’s operations and investments will be financed from petroleum revenues.

There are different models for financing NOCs. In Liberia, NOCAL, the National Oil Company of Liberia, is required to receive the state’s share of petroleum revenues, hold back not more than 25% and transfer the balance to the Government Treasury. This does not promote transparency and accountability since the company can inflate its budget through unnecessary spending and waste in its quest to retain a substantial share of the revenue even if it cannot justify it.

In Ghana, all petroleum revenues go to the Petroleum Holding Fund before the NOC’s share is transferred to it. For purposes of good governance, Ghana’s option is preferable since the transfer is done through a transparent budget process and approved by Parliament.

### 4.3. Revenue Assessment and Collection

Revenue collection is one of the biggest challenges of resource rich countries. The oil and gas sector is associated with huge illicit financial outflows from countries that do not have sufficient mechanisms and capacity to address them. Tax avoidance schemes that reduce the tax base for most countries include trade mis-invoicing through transfer pricing, and base erosion through thin capitalisation. This is often compounded when parent companies are incorporated in tax havens.
Global Financial Integrity reports that from 2002-2011, Kenya lost tax revenues of about US$9.64 billion through trade mis-invoicing, which constituted about 8.3% of total tax revenues and 288.6% of Official Development Aid received by Kenya over the period. The revenue losses were mainly from export over-invoicing. This is notwithstanding that Kenya has anti-tax avoidance instruments including transfer pricing and thin capitalisation rules.

The entry of many multi-national oil companies in Kenya’s oil and gas industry, most of which are incorporated in tax havens raises the prospects of further revenue losses to the country. For instance, Tullow Oil draws 84% of its revenues from Africa, but only 4 out of the 81 companies it lists as subsidiaries are registered in African countries. Most of the subsidiaries are registered in tax havens including British Virgin Islands, St. Lucia, the Channel Islands and the Netherlands.

With oil exports likely to commence in a few years, export under-invoicing will likely feature in the oil industry. There is no doubt that Kenya will be confronted with further revenue losses from oil export unless the right mechanisms are put in place through tax authorities to ensure that the state maximises its collection of oil revenues.

The institutions of State involved in revenue collection must be supported to prevent the erosion of the oil company tax base by effectively conducting cost and profit audits on the operations of oil companies. The Kenyan Government must therefore begin to review its tax-avoidance rules to make them compatible with global rules and more so to make them effective tools for addressing illicit capital outflows through the oil industry.

30 The Guardian “UK’s top companies condemned for prolific use of tax havens” Sunday, 12 May 2013.
This section assesses the extent to which Kenya has taken the necessary steps, both legislatively and institutionally, to manage oil contracts and revenues in a way that encourages sustainable growth, and equitably distributes income to counties and communities which have been affected by the processes of exploration and exploitation.

The section also considers the extent to which Kenya’s oil industry is formally committed to principles of transparency, and how transparency can be guaranteed by existing and proposed legislation governing the sector.

Transparency shines light on secrecy and unearths the cost of opaque deals to the state, communities and citizens.

In this section, three levels of transparency benchmarks are reviewed – contract transparency, revenue transparency and international transparency initiatives.

5.1. The Need for Transparency and Accountability in the Oil and Gas Sector

Oil is a lucrative business. However, the African experience has been such that resource wealth does not spur inclusive and sustainable development, unless partnered with rigorous good governance, transparency and accountability. This so-called ‘resource curse’ is not linear.

In the 1950s, oil-rich Indonesia and Nigeria were both newly independent states with similar GDP per capita. By 2000, Indonesia’s per capita income was four times that of Nigeria; today, 46% of Nigerians still live in poverty, compared to 14% of Indonesians. Learning from these mixed experiences, principles of transparency and accountability are considered a paramount ingredient in ensuring that oil is a blessing, rather than a curse.

Without transparency, citizens cannot ensure that oil revenues contribute to socio-economic development.

A proliferation of global initiatives, summarized below has emerged to drive transparency in the oil industry. International norms increasingly require that the terms of oil contracts are made public, and that companies publish what they pay.

However, whilst transparency can arm citizens with information about government finances, it cannot by itself create the constituencies or mechanisms of accountability that are critical in ensuring oil revenues drive development. The need to set up accountability mechanisms to make transparency meaningful is therefore imperative.

5.2. Contract Transparency

Contract transparency requires that the process for licensing oil blocks must be open and competitive, contract disclosure must be mandatory; and the product of contracts (oil production data, sales price, revenues, costs) must not be held confidential. Several emerging oil producers in Africa have embarked on ambitious governance reforms particularly on improving contract governance. For example, Sierra Leone, South Sudan and Liberia have mandatory contract disclosure requirements in their Petroleum Laws. They also have provisions for the application of an open and competitive bidding process in the award of oil concessions. Others such as Ghana and Nigeria rely on administrative fiat to publish petroleum contracts.

Either way, there is a fundamental departure from the era of wide confidentiality scope to a more progressive regime in which contract disclosure no longer exposes investments to potential risks or what is commonly called “competitive risks”.

This is because, there is abundant evidence that contract disclosure does not reduce the competitiveness of an oil company because what are considered commercially sensitive secrets are rarely contained in the primary contracts signed between the State and the Contractors.  

Even before first oil drops, Kenya has already set a strong foundation in the Constitution to uphold contract transparency. Article 35 of the constitution establishes the right of every Kenyan to access information when required for the exercise of a fundamental freedom. However, Kenya’s PSCs have non-disclosure agreements as provided for in the industry law on petroleum exploration and production (1986), which bars any party in a petroleum contract from disclosing any information, material or not. Whilst PSCs stipulate the scale of revenues which flow to the government, the non-disclosure agreement means that there cannot be any kind of non-governmental oversight of government receipt of oil revenues. Therefore, ensuring that oil revenue contributes to socio-economic development is extremely difficult.

The Constitution is the fundamental law of the country and is superior to the Act of 1986, but industry laws have often emboldened contractors who insist the legal frameworks governing their contracts are the industry laws and not the general laws of application. Perhaps this brings to the fore the urgent need to harmonise legal frameworks in order not to create room for oil companies to exploit the gaps.

The Constitution also supports transparency in another way. Article 71, as mentioned above, requires parliamentary ratification of any transaction which involves exploitation of Kenya’s natural resources. Clearly, if the government is unwilling to disclose payments it receives from oil companies or specific details of PSCs, there can be no parliamentary scrutiny over transactions regarding natural resources. The Government’s current position on transparency, may therefore be deemed, unconstitutional, and this should be used as an advocacy tool by civil society.

Box 5.1 Freedom of Information Bill

Article 35 of the Bill of Rights establishes the right of access to information for all Kenyans. Currently, the Ministry of Information, Communications and Technology is in the process of drafting legislation introducing a framework through which information held by public bodies can be accessed. The Freedom of Information Bill is progressive, and was described by one expert as “a very good bill”, but despite numerous promises that it would be considered a priority, its passage has stalled.

If passed, the Bill could provide civil society groups with a powerful tool through which to hold government accountable in the oil and gas sector. The Platform should, therefore, lobby strongly for the Bill to become a government priority.

Uganda provides an example of how freedom of information laws can be used to hold government accountable in the oil and gas sector. Uganda’s Constitution, like Kenya’s, establishes the right of information for all citizens. This is reinforced by the country’s Access to Information Act. In 2009, following extensive lobbying by parliament and civil society organisations, the Ministry of Energy agreed to grant parliament access to Tullow Oil’s PSC, although not to the general public. The PSC was then reviewed by an independent expert and judged to be a good deal for the country. Kenya’s Freedom of Information Bill could provide a similarly powerful tool.

Kenya’s model PSC also leaves a great deal to confidential negotiation with oil companies. Timeframes, development plans and profit sharing are not set out in the model PSC, meaning most stakeholders are excluded from knowing exactly how much revenue is being generated. The PSC employs a sliding scale linked to daily production targets to determine profit sharing, but otherwise specific details are kept private.

Tullow Oil has already taken steps towards publishing its payments to government in the country, and an ERHC senior manager confirmed to the author of this report that the company had no issue declaring the terms of its PSC. During consultations for this report, an IOC’s senior manager said the company’s ultimate goal was to publish its payments to government, but that it could not currently do so because provisions included in the model PSC proscribed it from doing so without government permission.

The source said that it seemed there was an unwillingness to publish the terms on the part of the government because it feared losing its competitive edge in negotiations with oil companies. This fear seems misplaced. Terms in earlier contracts, prior to Kenya’s first significant oil discovery, were more generous to companies owing to the greater need to encourage new contractors to develop the sector amidst high levels of risk. However, following recent finds, any company looking to enter the sector would undoubtedly expect altered terms.

Additionally, the licensing regime in Kenya does not promote transparency in the contracting process. For instance, there is neither a framework for the application of open and competitive bidding nor the disclosure of beneficial ownership information.

These non-disclosures increase governance risks around petroleum contracts by strengthening the perception of “too lucrative legal benefits for firms”.

In the following example, South Sudan’s Petroleum Act 2012, Section 79, provides a comprehensive framework for contract transparency.

Example: South Sudan

*The Minister shall make available to the public, both on the Ministry’s website and by any other appropriate means to inform interested persons:

a. All key oil sector production, revenue, and expenditure data, petroleum agreements and licenses;
b. Regulations and procedures related to the petroleum sector;
c. Justification of award of petroleum agreements, the beneficial ownership information for the contractor and document proof of the requisite technical competence, sufficient experience, history of compliance and ethical conduct and financial capacity of the contractor;
d. Annual production permit;
e. Any model petroleum agreements;
f. The key parameters of each petroleum agreements to the extent such parameters differ from an already published model petroleum agreement, including the cost oil management and limits, the production sharing formulas and mechanism, any bonuses, taxes or fees, royalties, any exemptions or favourable tax treatment any stability clauses; and

g. Except for the information and data referred to in Section 76(5), information relating to petroleum activities, including information on petroleum agreements and relevant treaties as prescribed in the regulations*.

37 Section 76(5) provides that “Information received pursuant to this section shall not be made public if such information: a. contains proprietary data belonging to the government, license of contractor; or b. must be kept confidential in order to maintain a climate of competition between the licenses and contractors participating in petroleum activities.” Thus, the only information that cannot be disclosed is one that has proprietary implications.
Box 5.2 Diffusing Objections to Contract Disclosure

<table>
<thead>
<tr>
<th>Objections</th>
<th>Reality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies Need to protect commercially</td>
<td>Most commercially sensitive information is not included in</td>
</tr>
<tr>
<td>sensitive information</td>
<td>primary contracts. Plus, within the industry, most competitors</td>
</tr>
<tr>
<td></td>
<td>are familiar with comparable contract terms, regardless of the</td>
</tr>
<tr>
<td></td>
<td>official transparency. The perceived risk of a ‘race to the bottom’ is</td>
</tr>
<tr>
<td></td>
<td>therefore unlikely.</td>
</tr>
<tr>
<td>Contract confidentiality is a long-standing</td>
<td>Until the turn of the century, there was no incentive for companies</td>
</tr>
<tr>
<td>practice</td>
<td>to risk diverging from the practice of confidentiality.</td>
</tr>
<tr>
<td></td>
<td>However, there is now a vocal global lobby advocating transparency.</td>
</tr>
<tr>
<td></td>
<td>Weak commitment to the principles of transparency now affects</td>
</tr>
<tr>
<td></td>
<td>companies’ reputation the world over.</td>
</tr>
<tr>
<td>Governments Contracts are too complex for</td>
<td>The public, via civil society, should develop understanding as</td>
</tr>
<tr>
<td>the public to understand</td>
<td>industries develop. Even in the absence of understanding though,</td>
</tr>
<tr>
<td></td>
<td>failure to publish contracts sparks scepticism and lack of trust over</td>
</tr>
<tr>
<td></td>
<td>the government’s handling of negotiations and revenues.</td>
</tr>
<tr>
<td>Publication risks renegotiation</td>
<td>Natural resources contracts are some of the most oft renegotiated</td>
</tr>
<tr>
<td></td>
<td>contracts that governments enter into. While it may be a procedural</td>
</tr>
<tr>
<td></td>
<td>headache, government could also stand to benefit from this process.</td>
</tr>
<tr>
<td>Disclosure will erode bargaining power</td>
<td>Governments get their bargaining power from the fact that</td>
</tr>
<tr>
<td></td>
<td>resources are finite and location-specific. This will be unchanged</td>
</tr>
<tr>
<td></td>
<td>by the publication of contracts.</td>
</tr>
</tbody>
</table>

There have been calls for contract transparency to become a part of Kenya’s general governance framework. For instance, Mohamed Elmi commented: “It is very hard for government to sustain its opposition to payments disclosure. The Constitution makes the right to information very clear.” The World Bank has also recommended that Kenya modifies the current confidentiality provision to provide a clause for public disclosure. Additionally, international legal regimes by home countries have resulted in the publishing of key terms of PSCs through the Securities and Exchanges Commission (SEC).

Contract transparency also exposes rent-seeking public officials and oil companies who try to capture regulators and politicians. Corrupt acts have been investigated under either the US Foreign Corrupt Practices Act or the UK Bribery Act. National efforts at investigating such deals have been largely ineffective or at worst viewed to legitimise the deals.

“To compel oil companies to eschew bribery, Ghana has become one of the first countries in the world to introduce an anti-corruption clause in petroleum contracts. It reads in part as follows:

“Each contractor party warrants that neither it nor any of its Affiliates or any of its subcontractors, their officers, directors or employers has made, offered, or authorised and will not make, offer, or authorise with respect to the matters which are the subject of this Agreement, any payment, gift, promise or other advantage, whether directly or through any other person or entity, to or for the use or benefit of any public official (i.e. any person holding a legislative, administrative or judicial office, including any person employed by or acting on behalf of a public agency...”

38 Research Team interview, MP for Wajir East Mohamed Elmi, Nairobi, 11 March 2014; Research Team interview, KCSPOG representative, Nairobi, 12 March 2014.
40 See for example, the PSC between the Government of Kenya and CAMAC Energy.
5.3. Revenue Transparency

Revenue transparency is important for several reasons. On the supply side, it enables Governments to become accountable to their citizens in accordance with the social contract that exists between them. It also builds trust for the government, ensuring its legitimacy to manage the resources of the people as a trustee. On the demand side, it empowers citizens to track their resources, the performance of their government and the value such revenues add to the economy or community.

Revenue transparency was first built around payment disclosure under EITI standards. In fact, one of the main criticisms of the EITI was its focus on revenue transparency. This criticism influenced the new EITI standards, which now require more disclosures beyond payments and receipts.

To date, many countries have adopted more comprehensive reporting standards on revenues ranging from country-by-country reporting to project-by-project level reporting. This has ensured that communities that are directly affected by oil extraction are able to monitor and track the size of ceded revenues.

In Ghana, the government passed the Petroleum Revenue Management Act, 2011 (Act 815), requiring publication of information on receipts from petroleum companies, online and in national newspapers, four times per year. The law also requires the government to submit reports to parliament and to the public every quarter and for audited statements of Ghana’s oil accounts to be made public. In addition, it establishes a Public Interest and Accountability Committee including civil society activists. Enactment of the law has been seen as a particularly progressive step towards more accountable management of the country’s petroleum revenue, and the government has since been declaring its revenue from the sector.

In Alaska, the state government instituted the Permanent Fund dividend; a regular cash transfer from the petroleum fund’s interest earnings to state residents. The relevance of Alaska’s model of revenue distribution to the subject of transparency and accountability is borne out of the fact that government becomes more transparent and accountable for its management of the resources. When petroleum revenues are distributed among the people through direct cash transfers, they become committed to asking questions regularly about the size of revenues received by the government as well as their entitlement. Government is therefore constantly providing information to the people about production level, revenues and use of the revenues.

These examples each show that natural resources can drive pro-poor growth if managed appropriately, but differ in their policy mechanisms. They are however all united in their commitment to transparency and accountability.

Ghana provides a useful lesson in establishing accountability mechanisms over revenue management. But Ghana is far from a perfect oil economy because the watchdog committee is starved of resources, budget transparency is poor, and infrastructure projects reportedly lack value for money. However, in principle, Kenya could benefit from establishing similar mechanisms. Much like Ghana, Kenya has the benefit of reasonably well-established institutions, like the Committee for Revenue Allocation (CRA).

Box 5.3 Ghana’s Accountability Mechanisms in Oil Revenue Management

- The Public Interest and Accountability Committee, established by law, independently monitors spending and provides platforms for public scrutiny.
- The finance ministry discloses payments received, down to the barrel, and provides information on revenue distribution to the various accounts, including information on oil-funded projects.
- The Bank of Ghana, which manages the petroleum funds, is required to issue semi-annual reports on the funds, available to Parliament and to the public.
5.4. Global Transparency Initiatives

Issues of resource governance have become a focal point for discussion in the transnational arena. The sophistication of global commodity markets and the role of financial actors in swaying market fundamentals calls for stronger regulation in the global trade of natural resources, so governance is no longer only a national policy issue. In this regard, Kenya’s national legislation on transparency and accountability is falling behind developing global norms.

5.4.1. Voluntary Standards: the Extractive Industries Transparency Initiative (EITI)

EITI compliance requires the publication of payments between companies and governments in the extractive industries (EI). Kenya is not EITI compliant, nor is it a candidate country.

Kenya’s candidacy for EITI has never moved beyond initial stages. EITI’s Kenya-focused adviser told the research team for this report that the country had been approached since 2006, with only limited response.41

The adviser said that the oil companies he had spoken to in Kenya had shown enthusiasm for the progression of Kenya’s EITI application, but that the government had deep-seated sentiments against transparency. According to the adviser, the closest indication that EITI had that the government was willing to push ahead with the application was in July 2013 when Cabinet Secretary for Mining Najib Balala said on a visit to London that he would like to see Kenya join the EITI. Following his return to Kenya, Balala has made scant reference to the initiative.42

Beyond tracking royalty payments, EITI’s new transparency principles cover exploration contracts, beneficial ownership, the national oil company, and social expenditure by companies, each of which is a crucial policy area before oil or gas are produced.

In addition to the dividends of transparency, Kenya stands to gain from commitment to the initiative. EITI develops a country’s reputation for probity, signalling to investors and international finance institutions that the country is committed to good governance.

There is nobody driving Kenya’s EITI application. A brainchild of Publish What You Pay (PWYP), most EITI applications are driven on a national level by the lobbying of PWYP national coalitions, but in Kenya, this body is woefully underdeveloped. Compared to neighbouring Tanzania’s PWYP coalition 28 members, Kenya’s has but three.

However, whilst Kenya does stand to benefit from achieving EITI compliant status in terms of good governance, the programme should not be mistaken as a panacea for all the potential ills of a mismanaged oil economy. In the last five years, 43% of Africa’s EITI Compliant countries have slipped down Transparency International’s corruption rankings. Evidence such as this fuels the argument that EITI is a distracting box-ticking exercise, which acts as a reputational tool for governments and companies, without tackling the drivers of corruption. The impact of EITI depends on implementation. If the initiative produces annual reports in the absence of public debate and scrutiny, it is unlikely to inspire accountability. If, however, EITI principles inspire genuinely open, transparent and thorough auditing, which in turn informs meaningful multi-stakeholder scrutiny, the initiative can be an invaluable tool in guaranteeing that oil revenues contribute to socio-economic development.

41 Researcher Team telephone interview, 8 April 2014.
42 Ibid.
5.4.2. Statutory Requirements

EITI is a voluntary initiative and is often criticised for lacking teeth. However, the gradual trend towards legally-enforced transparency standards received a significant push in 2010, when the US passed the Dodd-Frank Wall Street Reform Act. Section 1504 of the Act requires that EI companies registered with the US Securities and Exchange Commission (SEC) produce annual reports detailing payments made to foreign governments (national and sub-national), agencies and state-owned enterprises. The statutory disclosure covers taxes, royalties, license and acreage fees, production entitlements and bonuses. There are no grounds for exemption.

The European Union (EU) has approved corresponding guidelines, and member states now have until mid-2015 to transpose these directives into national law. The UK has committed to implementation of the directives, which will have direct implications on London Stock Exchange-listed EI companies, such as Tullow Oil and AOC. The Hong Kong Stock Exchange and the Tokyo Stock Exchange are also expected to follow suit, drawing yet more companies into legal stipulations that they must publish what they pay.

In the absence of EITI compliance and local provisions, international legislation is the sole mechanism for ensuring citizens can track governments’ oil receipts. Campaigners celebrate these developments because they empower citizens to hold their governments to account and ensure oil revenues drive development. Without domestic legislation, however, the developments will not benefit oil-producing countries universally. Further, company-level disclosures in a system characterised by secrecy is limited; citizens will know how much Kenya receives, but will not know how the funds are spent.

The development of these international laws provides the civil society with a powerful advocacy tool to challenge the government’s argument that publication of payments and Petroleum Agreement terms weakens competitive advantage, particularly as a US court has ruled in favour of transparency on the matter.

Box 5.5 US Court rules on Dodd-Frank Act

Some US companies complained about Dodd-Frank Act, claiming it would damage the competitiveness of American companies. “The rule requires business-sensitive information to be shared with America’s global competitors, giving state-owned companies in China and Russia an advantage since they are not required to disclose similar information,” said API executive vice president Marty Durbin at the time.

However, in July 2013, the Washington DC Circuit Court of Appeals District Court ruled on a case brought by the American Petroleum Institute and others (American Petroleum Institute v. Securities Exchange Commission). Section 1504 remains law but the SEC was told to review the most effective way of implementing the law. The court determined that the SEC did not adequately justify its rejection of industry demands for an exemption from disclosure, which would allow companies to keep their payments secret in countries that supposedly have laws prohibiting disclosure.

SECTION 6

LOCAL CONTENT
6.1. Local Content – Policy, Regulatory and Implementation Challenges

Legislated local content provisions are becoming commonplace in oil and gas regulation across developing economies. Such provisions aim to add value by creating jobs, developing skills and fostering development of local business and ensuring that a country’s oil and gas industry contributes broadly to the national economy, rather than simply in terms of revenue.

Local content has often been expressed in terms of national content, that is, the amount of national goods and services used by foreign oil and service companies.

Some countries have developed specific laws and/or regulations to implement local content. Nigeria for example passed the Nigerian Content Act 2010. Ghana also passed its Petroleum (Local Content and Local Participation) Regulations (LI2204), detailing minimum requirements for local employment, as well as use of local expertise, goods and services and company ownership.

Kenya’s Model PSC as contained in the Petroleum (Exploration and Production) Act of 1986 contains two clauses on local content. They stipulate that, “the contractor, where possible, shall employ Kenyan citizens in petroleum operations, alongside training those citizens,” (s.13.1) and providing for, “a contribution on the part of the contractor for a negotiable sum to be contributed to the Ministry’s training fund” (s.13.3).

Kenya’s draft National Energy Policy (NEP), recognises “the need to develop local talent and capacity in energy resource exploitation and infrastructure development. It is also important that the opportunity is availed for provision of services and goods by locals in the exploitation of natural resources and infrastructure development.” (s.9.1.2.5). Development of local content regulation is a work in progress, and the NEP envisages this evolving over the medium-term (to 2023) and long-term (to 2030).

The Upstream Bill 2014 reflects this policy and contains local content provisions which call for (i) contractors to submit local content plans, (ii) creation of a Local Content Development and Monitoring Unit, and (iii) the creation of a Training Fund to train Kenyan nationals in Petroleum Operations.

The Upstream Bill also calls for first consideration to be given to services provided within the county. That said, the provisions are skeletal and leave out important components that make local content a strategic tool for facilitating the integration of the oil sector with the non-oil sector of the economy. Kenya should draft a standalone local content law which fleshes out important provisions—the draft should be developed and passed soon so that Kenyans can benefit as the oil and gas sector develops, and not once the sector is already well developed. Delay harmed Ghana where local content regulations were delayed for three years so the country lost significant opportunities during the development phase of the Jubilee project.

During consultations for this report, several representatives of CSOs advocated the need to establish clear and detailed stipulations regarding local content. One civil society representative likened Kenya’s provisions on the issue to a “moving target”, criticising the way in which employment issues were left to the discretion of oil companies.44

Hon. Mohamed Elmi suggested that the lack of detailed provisions on the issue actually causes problems for oil companies: “One of the main problems for Tullow is there is no information about how many people to employ from Turkana – expectations must be clear,” he said.45

44 Research Team interview, KCSPoG member, Nairobi, 12 March 2014.
45 Research Team interview, Nairobi, 11 March 2014.
Complaints regarding employment constitute a primary catalyst for conflict in exploration regions, as local protests in Turkana in October 2013 demonstrated. In response to the protests, Tullow Oil, its partner, Africa Oil, and the government drew up a memorandum of understanding (MoU) agreeing to work together to resolve issues that had caused the protests as quickly as possible in order to avoid a declaration of force majeure. The MoU remains unpublished. However, a leaked document details Tullow Oil’s pledges; to provide government with a breakdown of its employment and utilisation of goods and services, to agree on a formal grievance resolution procedure, to commit to a doubling of social investment budget for 2014 to US$2 million, from US$1 million in 2013, and to ensure that Tullow Oil refines its local content programme.46

Tullow Oil has also subsequently published a report on its local content programme detailing levels of employment by level of skills and by locality of employees (see Table 3 below).

**Table 3. Tullow Oil Workforce and Local Content Compliance in Kenya**

<table>
<thead>
<tr>
<th>Sub Contractors Employed through Tullow’s Supply Chain (as of 31 December 2013)</th>
<th>Kenyan Nationals</th>
<th>% Expats in total workforce</th>
<th>% Nationals in total workforce</th>
<th>% Turkanas in total workforce</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contractor Level</td>
<td>Non-Turkana</td>
<td>Turkana</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Director</td>
<td>1</td>
<td>4</td>
<td>0</td>
<td>20%</td>
</tr>
<tr>
<td>Management</td>
<td>53</td>
<td>18</td>
<td>2</td>
<td>73%</td>
</tr>
<tr>
<td>Skilled</td>
<td>201</td>
<td>476</td>
<td>217</td>
<td>22%</td>
</tr>
<tr>
<td>Semi-skilled</td>
<td>18</td>
<td>92</td>
<td>308</td>
<td>4%</td>
</tr>
<tr>
<td>Unskilled</td>
<td>12</td>
<td>4</td>
<td>677</td>
<td>2%</td>
</tr>
<tr>
<td>Total</td>
<td>285</td>
<td>594</td>
<td>1276</td>
<td>13%</td>
</tr>
</tbody>
</table>

The figures above do not include Tullow employees


The report shows that by the end of 2013, Tullow’s total workforce stood at 2155, of which only 285 personnel, about 13%, were expatriates. The rest 1,870 were Kenyan citizens. Also, Turkanas in the total workforce stood at almost 60%.

In this same report, Tullow Oil disclosed that in addition to spending the Ksh.4.1 billion on local suppliers in 2013 (2012: Ksh.2.4 billion), its contractors also spent Ksh.4.1 billion on Kenyan businesses in 2013, Ksh. 259 million of which was on Turkana businesses47.

These figures demonstrate Tullow’s commitment to the fulfilment of the terms in the MoU but whether there is a mechanism to verify the figures remains a big question. Thus, the necessity for developing a comprehensive local content law or regulations with targets and compliance mechanisms cannot be over-emphasised.

It should be noted that some quarters have dismissed the MoU as nothing more than a quick fix. For one thing, the document provides for “a forum of state officers and key opinion leaders in Lodwar to garner broad-based support for the resumption of operations”. Civil society organisations were not consulted during the drafting of the MoU, so there is little oversight into how opinion leaders are chosen. In addition, without publishing the document, and in the absence of clear and detailed stipulations regarding local employment, the MoU leaves a great deal to government and company discretion.

46 Available at http://s3.documentcloud.org/documents/900069/oil-mou.pdf (The provisions of this document are consistent with stakeholders’ understandings).
Civil society representatives remain aware of the dangers of legislating too much too quickly. Too stringent regulations, which do not reflect services and labour pool constraints, will not be useful for sector development. For example, the exploration stage requires more skilled labour than the production stage. This must be accounted for.

In Ghana, companies have struggled to find local staff because education levels lagged behind local content laws. In Nigeria, local content laws regarding company ownership fostered the emergence of hollow companies, fronted by locals, but actually owned by foreign interests.

The capacity challenge of local content could be addressed through a programme targeting skills training for young people who are either absorbed by oil and service companies or by other industries. The example in Ghana where the Jubilee Partners, with Tullow Oil as the Operator, set up a US$15 million training centre for this purpose could be replicated in Kenya.

However, there is a need for detailed requirements to be drawn up so that companies’ employment practices and use of local services can be scrutinised. During consultations for this report, one civil society representative argued for an ascending scale, detailing certain stipulations for the first three years after a contract is signed, after which local content levels would be increased, on the assumption that companies are undertaking their own training of local people. In Kenya, Tullow Oil and AOC, have established a polytechnic in Lodwar to provide local training. AOC envisages that the facility would require investment of between US$5 –6m in the long run.

Advocacy on local content should highlight Kenyan legislative shortcomings regarding local content in comparison with other jurisdictions whose oil industries are in a similarly young state. In this regard, Ghana provides a pertinent example. The country’s Petroleum (Local Content and Local Participation) Regulations (LI2204), referred to above, provides extensive stipulations aimed at guaranteeing oil wealth trickles down through local employment, use of local services and companies, as well as use of local banks.

6.2. Local Content; Politically Contentious

Weeks before the passage of Ghana’s local content law the cabinet was approving deals that did not apply and the influence of powerful trade unions, ministerial politicking and significant vested interests have all blighted the passage and implementation of Ghana’s local content laws.

The passage of local content laws in Kenya is likely to prove no less political. As outlined above, issues of local employment have already sparked local protests, forcing IOCs to halt operations in Turkana in October 2013. Kenya needs to guard against the risk of corrupt practices in meeting local content requirements. Such practices include the appearance of local oil companies owned by powerful politicians. Also, there should be vigilance to guard against small local companies being granted exploration rights—such companies are unlikely to have the capital for exploration and it is likely they are simply speculating and waiting to sell their interests to foreign companies at a high price.

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48 Research Team telephone interview, AOC senior manager, 27 February 2014.
49 Research Team telephone interview, AOC senior manager, 27 February 2014.
SECTION 7

LAND AND ENVIRONMENTAL RIGHTS
7.1. Land Rights

7.1.1. Oil Industry and Land Needs

Land issues are extremely potent in Africa, and Kenya is no exception. Transforming communal land rights, derived from customary ownership principles, into formalised structures of land tenure has proved a source of conflict between indigenous populations, national governments, and foreign developers. So introducing the lucrative oil industry into this equation compounds already difficult issues.

In Kenya, the challenge of adequately protecting land rights is complicated by the fact that some 66% of the country’s land mass is customary land, including much of the land in northern Kenya that host’s oil and gas exploration.

Kenya has proved progressive in recent years by committing to institutionalised customary land rights, but these structures and policies are in their infancy, and their ability to negotiate citizens’ entitlements with oil-hungry developers and revenue-hungry authorities is yet to be tested.

The oil and gas sector places a burden on the environment and intensifies the threat of disputes. The environmental impact of oil and gas development may impact certain segments of society differently in illustration women may have to go farther to collect firewood and water, as they are traditionally the members of community who carry out these tasks.

While the oil industry is now acutely aware of its environmental impact, the environment remains a highly pertinent issue for new producer states to guarantee that global standards are upheld.

The oil industry’s footprint at the exploration stage is quite limited. During consultations for this report, several explorers made the point that the idea of huge swathes of land being taken over by the oil industry is simply a misconception. The average size of an exploration platform is 200x200m, perhaps accompanied by a 500m-broad no-entry zone around the perimeter and a 400x800m airstrip.50

However, as the sector grows, so too will the amount of land required. In February 2014, the MEP announced its intentions to invite international bids for the design and construction of a crude oil pipeline linking the oil fields in Turkana to the planned port of Lamu51, which forms a crucial component of the LAPSSET corridor. The pipeline is in the pre-development phase, but the ministry has targeted a completion date of November 2016. Further, as mega projects like the pipeline take shape, corresponding infrastructure developments will emerge. Indeed, as Kenya’s oil industry moves from exploration to production, infrastructure will become more land intensive.

Box 7.1 Conflict in Isiolo County

In Isiolo County there are historical and socio-political dimensions to the land conflict, in which ethnic groups fight over scarce resources. Violent banditry and cattle-rustling have long plagued pastoralist areas.

However, Isiolo town’s planned ‘Resort’, which forms part of the government’s Vision 2030 flagship LAPSSET project, adds a new dimension. Rising land prices have exacerbated long-standing disputes and fanned ethnic tensions.

Further, a dispute has emerged between local leaders of Isiolo county and Meru county over land boundaries, as both authorities scramble to benefit from the LAPSSET developments.

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50 Research Team interview, corporate affairs officer at Africa Oil Corporation, Nairobi, 11 March 2014.
Based on past experiences of large infrastructure projects in Africa, the completion dates of these projects are probably ambitious. Nevertheless, given the pace at which legislation moves, and the requisite consultation process, it is necessary to ensure the land regime is in place well before construction begins. The conflict in Isiolo County exemplifies the potential problems if land issues are not addressed from the outset.

7.1.2. Legislated Land Rights

The 2010 decision by the African Commission on Human and People’s Rights in the Endorois case guarantees indigenous communities’ right to land.\(^{52}\) Kenya’s legal regime surrounding land issues is in a state of transition and as it stands, the legislation is incomplete. A key provision of the Constitution is the re-registration of all land, including community land. However, the Community Land Bill, designed to provide substantive provisions for facilitating re-registration, is yet to be passed.

The Bill, which replaces the Trust Land Act 2009, creates Community Land Management Committees, which are tasked with the administration and management of community land. The Land Development and Governance Institute, which conducted a technical audit of the Bill, questioned the extent to which these legalised institutions satisfy the constitutionally-guaranteed communal ownership principle.\(^{53}\) Nevertheless, the new committees, which echo Botswana’s Land Boards, in principle provide for legislated community rights and institutionalise customary entitlements.

The fact that the committees have not yet been created, and the Bill not yet enacted, is important. A leading African land law expert described the delay as “ominous”\(^{54}\). Oil exploration is currently taking place on land which is not legislated for. This presents two direct issues:

- There is no legislation in place by which communities can seek compensation;
- In the event of a problem—loss of grazing land due to an oil spill, for example—there is no clarity over who would be entitled to compensation, because there is no clarity over who owns the land. The vacuum of rights that emanates from stalled legislation is therefore an urgent issue.

A crucial aspect is the Gender dimensions of the Oil and Gas sector—women have lower access to the benefits of the sector, and yet bear a disproportionate amount of the risks associated with the sector.\(^{55}\) Women are often left out of discussions and consultations between the oil companies and the community and between the government and the community because community elders—with whom the private sector and government consult—tend to be men.

This marginalisation of women is particularly acute in the exploration stage of the development of the oil and gas sector—if women are left out at this stage, it is unlikely that they will be included in later stages of the sector development cycle, which leads to complete marginalisation of women.

\(^{52}\) For more information, see “Landmark ruling on indigenous land rights,” Human Rights Watch, 4 February 2010.


\(^{54}\) Research Team telephone interview, 24 February 2014.

Kenya Civil Society Platform on Oil and Gas

The presumption that oil and gas exploration is in the public interest, and therefore the government has the right to expropriate requisite land for its operations, is typical. However, in Kenya, there are limited checks and balances over the government’s authority to exercise this right. Constitutionally, the National Land Commission can make recommendations to the appropriate authorities related to land and the use of natural resources (s.67.2.d) but these recommendations are not binding.

In instances of expropriation, the Bill provides for a “(a) an environmental, social, cultural and economic impact assessment; (b) continuous monitoring and evaluation; (c) payment of royalties to the community; (d) requirement for the investor to build capacity and transfer technology to the community” (s.53). These provisions are progressive, however, the practical undertakings and procedural stipulations are comparatively weak, which makes for difficult implementation of the broad principles. These issues, which are usually addressed in petroleum laws, are poorly addressed in Kenya’s current legal regime.

The second issue, the compensation question, is similarly speculative. While the Constitution, Upstream Bill and Community Land Bill all make reference to the necessity of compensation in instances of enforced land acquisition, the legal regime is vague on the specifics. Kenya is not unusual in this regard, and there have been multiple instances where land has been woefully undervalued so as to offer low compensation. According to the National Energy Policy, compensation will be determined by a registered land valuer.

Box 7.2 Overview of land legislation

- The Constitution guarantees “(a) equitable access to land; (b) security of land rights; (c) sustainable and productive management of land resources” (s.60.1). It also grants the government the authority to exercise this right.
- The Energy Bill vests ownership of petroleum resources to the state (s.133).
- The Community Land Bill, in its current format, recognises community land rights and provides powers to country governments for its administration.

7.1.3. Sub-Surface Rights: Eminent Domain

The issue of eminent domain defines the relationship between mineral rights and surface rights. Of specific concern to the oil and gas industry, the Community Land Bill only concerns surface rights. It does not extend to what is below the ground, and petroleum rights are vested in the government. The Community Land Bill sets out that “no right on community land may be expropriated or confiscated, save by law in the public interest and consideration of payment in full, of just compensation to the person or persons” (s.7.2).

The main issue surrounding the principle of eminent domain is its implementation. Firstly, under what circumstances can the government expropriate land, and secondly, how much, when, to whom must compensation be paid?

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56 According to s.62.1.f of the Constitution, and s133 of the Energy Bill.
57 It is important to note that compensation paid at the start of development for the acquisition of land, is different to the compensation owed in the event of damages inflicted. The latter, according to the model PSC, is the sole responsibility of the contractors.
58 See, for example, Nzekwu v Attorney-General East-Central State (1972).
Box 7.3 Procedural Stipulations on the State’s Right to Acquire Land for Petrol Operations

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Elsewhere</th>
<th>In Kenya</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulating where operations can be installed</td>
<td>Petroleum laws in Liberia and Uganda, for example, stipulate that operations cannot be developed on land within 200m of occupied buildings, 50m from cultural reserves, or 5m of agricultural crops.</td>
<td>Kenyan law makes no such provisions.</td>
</tr>
<tr>
<td>Providing land owners with warning</td>
<td>Petroleum laws in Ghana, for example, stipulate that the minister must provide written notification of a pending license to the landholder, chief and local government a minimum of 45 days prior to allocating the license.</td>
<td>Kenyan law makes no such provisions.</td>
</tr>
<tr>
<td>Compensation prior to the acquisition</td>
<td>Typically, compensation is guaranteed prior to the start of construction.</td>
<td>Kenyan law makes no such provisions.</td>
</tr>
</tbody>
</table>

The Natural Resource Management Project, funded by the World Bank and completed in 2006, includes a Resettlement Policy Framework, designed to meet the needs of local people in instances of involuntary physical or economic displacements. To date, the policy and its related Resettlement Action Plans (RAPs) have held greatest relevance for the land-intensive power sector. However, as the oil industry progresses and related infrastructure expands, ensuring these principles apply will become essential. The nascent oil industry can learn from the experience of the Kenyan power sector, by undertaking RAPs and other initiatives that favour equitable land management.

7.2. Environmental Rights

Environmental issues are so important that they now reside in the transnational domain and a wealth of guidelines on industry best practice has emerged. Conforming to conceptions of international best practice, the protection of Kenya’s environment is governed by the Environmental Management and Coordination Act (EMCA) of 1999.

The EMCA is broadly considered robust. However, it was enacted prior to significant oil and gas developments. Reconsidering the EMCA in this context concludes that Kenya’s legal regime is strong, but its enforcement has often been weak.

Article 42 of the Constitution, guarantees all Kenyans the right to “a clean and healthy environment, which includes the rights to have the environment protected for the benefit of present and future generations through legislative and other measures”, as well as Article 69 (1) a, which reads, “The State shall ensure sustainable exploitation, utilisation, management and conservation of the environment and natural resources, and ensure the equitable sharing of accruing benefits,” provide useful advocacy tools for better enforcement of the EMCA.
As per the EMCA, the central mechanism used to enforce environmental safeguards is the use of environmental impact assessments (EIAs), which are required by any company wishing to launch a project that has significant environmental impacts.

The EIAs are to be submitted to the National Environment Management Authority (NEMA) before the project begins, in line with the Environment (Impact and Assessment) Regulations 2003.

### 7.2.1. Implementation of Environmental Rights

As mentioned, NEMA is tasked with enforcing the provisions of EIA reports, and if a company breaks such terms, NEMA can bring all activities to a halt by terminating the licence. As priority projects of high importance, oil industry projects are managed centrally by NEMA in Nairobi.

The source at the Kenyan environmental-protection organisation queried the extent to which NEMA followed up on implementation of its recommendations.59 Two oil companies reported that NEMA had not visited their sites. One executive commented that the onus was on IOCs to provide evidence to NEMA that they are compliant.60

NEMA says it does try to follow up, but according to a director: “The reality of the matter is that NEMA does not have adequate resources. In many areas, there is only one person.” It is hoping that, with World Bank support, it can build capacity.61

In addition to the enforcement of the EIA, the content of the report itself is vulnerable to conflicts of interest. A member of a leading East African environmental lobby group raised the issue that oil companies must select third party consultants to compile the report from a list of NEMA-licensed experts. “Given that the oil company is paying the consultants, there is considerable room for pressure to be put on the consultants who are providing the service. If the consultants identify significant environmental concerns, the costs of the project will rise, thus it is in everyone’s interests to ensure there aren’t any.”62

This risk is heightened by the scale of political connections in the industry. The source from the prominent Kenyan environmental-protection organisation said “companies with strong political connections find it easier to obtain EIA licenses, and political pressure makes it difficult for NEMA to revoke licenses in the event of a breach.”63

### 7.2.2. Oil Spills and Gas Flaring

Oil spills and gas flaring are common features of the oil and gas industry in most oil-producing countries. Effective mechanisms for addressing oil spills on water and land remain a serious challenge to the industry. Even countries with a zero gas flaring policy have not escaped from the effects of flaring because often there is no elaborate programme for the utilisation of associated gas.

Oil companies have been required in most cases to set up Oil Spill Response Funds, and Emergency Preparedness Plans to provide security against spills or accidents. In most petroleum legislations, the scope of liability to pollution or damage from oil operations is also clearly defined with the view to putting responsibility on oil companies to adopt mechanism that prevent spills. The liability is based on either the “polluter pay principle” or “exclusive liability principle.”

59 Research Team interview, Nairobi, 11 March 2014.  
60 Research Team interviews, Nairobi, 11 & 13 March 2014.  
61 Research Team telephone interview, 10 April 2014.  
62 Research Team interview, Nairobi, 11 March 2014.  
63 Ibid.
The environmental effects of oil spills and gas flaring could be damaging to communities near oil extraction and this could put communities in conflict with oil companies who are often accused of destroying the environment. This has the potential of disrupting oil operations.

Again, spills and flaring of gas adversely affect livelihoods. Especially in offshore operations, polluted water could be harmful to human health through fish or other marine food. Therefore communities who rely on fishing as their main occupation face the danger of losing their livelihoods under such circumstances. In Kenya, oil operations in the Lamu area could be vulnerable to these problems if appropriate safeguards are not put in place.

Both the state and oil companies are at the risk of losing substantial revenues during oil spills as a result of committing large amount of resources to compensate affected communities. Compensation against damage or pollution from spills could run into several millions of dollars in a lifetime. This is why a “preventive policy” is preferred to a “response policy”.

It is important to mention however that, Kenya’s environmental laws and regulations have not been updated yet to address oil-related environmental challenges. Also, Kenya’s environmental institutions have limited capacity to deal with both onshore and offshore oil waste and other environmental hazards. The capacity challenge ranges from training deficits to logistics constraints.

7.3. Addressing Community Concerns

7.3.1. Community Engagement

The only way to mitigate land and environmental risks, is to ensure that local community groups participate meaningfully in investment decisions and project development via the implementation of well-thought out community engagement processes.

Oil companies stress the need to obtain community support for their operations. Protests in Turkana discussed above demonstrate the dangers of inadequately incorporating community voices in operations.

As the senior manager at AOC put it: “We are not doing it through a sense of altruism but because it is crucial to operating in the country. It provides us with a social licence to operate. There are a wide range of stakeholders, and they all have to have a role to play if we want this to work in Kenya”.

These sentiments were echoed by Tullow Oil chairman Simon Thompson: “From our perspective consent isn’t really enough, we actually need the support of the local community”, speaking at the Brookings Institution’s conference on East Africa’s oil and gas boom – promise or peril event, held in March 2013 in Washington.

Yet companies are the first to concede community engagement processes in the country are imperfect. Owing to the fact that they are at the most advanced stage of development, the Tullow Oil /AOC process is the most advanced. Both companies have employed large community liaison departments.

AOC engages with local communities through Barazas, Swahili for community meetings, and Kamatis, Swahili for committee, which represents the local community. Through these local institutions the company aims at constant engagement, explaining what it is doing to communities at Barazas and using Kamatis to provide any updates, such as changes to timeframes.

64 Research Team telephone interview, 27 February 2014.
65 Ibid.
66 Research Team interview, Tullow Oil community engagement officer, Nairobi, 13 March 2014.
Tullow Oil posts community liaison officers (CLOs), who speak the local dialect, on the ground to represent the company. These handle most community engagements and pinpoint key stakeholders at different political levels.

These structures are relatively well set up to work to diminish inflated local expectations. By communicating with community leaders through Kamatis or through CLOs, companies can facilitate the trickle-down of reliable information about oil project developments through all levels of society.

These structures also aim to incorporate community voices in investment decision-making. AOC uses Kamatis to manage its local tendering processes in a way which is sensitive to local community interests, as well as to draw up budget plans and proposals for CSR projects, although no money actually goes through the Kamatis. Similarly, Tullow Oil uses its CLOs to obtain community input in drawing up CSR budgets and programmes.

However, in terms of encouraging meaningful participation in investment decisions, these processes are incomplete. There are no mechanisms in place through which civil society can verify that community suggestions and complaints are incorporated into oil company plans.

Community consultations are an important way of managing community expectations so it is vital for both the private sector and for government to make sure that women are involved in these discussions.

In this regard, companies like AOC and Tullow Oil are not necessarily behind the curve. Oxfam America’s Community Consent Index has only five companies out of a representative sample of 28 in the extractives sector which have met the ‘gold standard’ of committing to FPIC in their engagement with local communities. Only one of these, Talisman Energy, is an oil company. According to the index report, several other companies incorporate a commitment to community consent and achieving a social licence to operate in their rhetoric, but provide scant details of what these terms actually mean, and how exactly they are to be achieved.

7.3.2. Corporate Social Responsibility

Developing in parallel with these emerging dynamics is the danger that oil companies, through their corporate social responsibility (CSR) programmes, take over where central government has been absent for decades. This can have some positive impacts—companies tend to talk up their CSR initiatives to show their positive impact on a region—but there is also some downside.

CSR-driven beneficence threatens to foster a dependency on company hand-outs among local communities.

In addition, by taking a lead role in implementing developmental projects, as well as in providing basic local services that would normally be supplied by the state, CSR programmes may undermine county governments’ ability to provide for the citizens they in theory represent.

CSR programmes are common practice all over the world. However, in rural parts of Kenya, their inclusion in IOC operations is made all the more vital by the absence of the state. During consultations for this report, oil companies were at pains to point out that regularly, they had little choice but to step in where the state is absent. Two prominent examples stand out:

Tullow Oil’s vice president for safety, sustainability and external affairs Sandy Stash pointed to provision of water in Turkana, a region suffering heavily from water scarcity, as an example. With the state providing “very little help”, the company currently hauls vast quantities of water to its operations site, which it then stores in large tanks for community use. This solution is not sustainable, but with the government doing nothing in terms of water provision, communities rely on Tullow Oil for water.


68 Research Team telephone interview, 17 April 2014.
Similarly, according to the AOC senior manager, both it and Tullow Oil pledged US$1m to combat drought in Turkana at the request of the county governor. In this case, the company had little choice but to step in. Oil companies are quick to point out that in such cases, they are fulfilling a government role which goes above and beyond their requirements in the country.

CSR policies have been criticised for de-legitimising the state. This is perhaps a little strong given that in many cases, the state is almost absent anyway, and CSR programmes often fulfil vital emergency requirements.

However, two negative consequences could emerge from oil companies’ replacement of the state. First of all, there is a danger that local reliance on CSR programmes can cause local communities to become dependent on oil companies. There is already some evidence of this. In turn, this could undermine capacity development in Kenya’s county governments. The purpose of devolution was to strengthen local government institutions, making them better able to provide for those they are supposed to represent. County governments are at an early stage of their development, yet if oil companies take too much of a lead in terms of development projects, local government will be slow to strengthen capacity.

7.3.3. Managing Expectations

Inflated expectations have played a lead role in fomenting conflict in oil producing regions. There have been a few signs of this happening in Kenya.

In October 2013, Tullow Oil and AOC halted their operations in Blocks 10BB and 13T, and were forced to evacuate staff, following local protests over employment. These were led by the Member of Parliament (MP) for Turkana South, James Lomenen. Discussing these events, a senior manager at AOC told an author of this report: “the biggest problem is expectations. How can they be managed?”

Aside from unrealistic expectations regarding immediate oil revenue, local demand for companies to employ large amounts of local labour also causes problems. The senior manager at AOC said expectations about employment far outstrip the actual number of jobs that companies are able to create. “There may be job numbers in the thousands, not commercial well engineers, but pipefitters, welders and mud-samplers requiring technical qualifications, rather than professional qualifications. The oil and gas industry cannot be the game changer in the country’s north. At best, it can be the stimulus,” he added.

The influx of expensive equipment, such as trucks and aeroplanes, combined with the arrival of foreigners and Kenyans from elsewhere, exacerbates the perception that communities are being excluded from oil wealth.

In these circumstances, teething problems relating to the country’s adaptation to the new constitution can trigger conflict. A civil society representative who is focused on conflict prevention in Kenya’s arid and semi-arid lands observed that IOCs must now deal with two government agents: a county governor and the MP for the relevant constituency. Both have competing – and equally valid – claims to the local community, and often conflicting interests of their own. The protests against Tullow Oil and AOC were led by local MP James Lomenen, and at least in part were a consequence of competing interests.

IOCs interviewed for this report insisted that they take strong precautions to engage with local communities on a broad-based level—to avoid speaking only with local chiefs or politicians. They argue that such an approach has the disadvantage of missing out “the middle tier”, as one civil society representative put it. While collaborating only with these “middle tier” politicians and community leaders

69 Research Team telephone interview, 27 March 2014.
70 Research Team telephone interview, 27 February 2014.
71 Ibid.
72 Research Team interview, representative from international NGO focused on conflict prevention, Nairobi, 14 March 2014.
73 Ibid.
might not be the best way to engage with the entire community—particularly as they often have personal business interests at stake—they are important community leaders who people turn to for strength against the encroachment of alien companies. Their neglect is a certain trigger for conflict.

*If steps are not taken now to address issues of inflated expectations, the situation will only get worse as oil and gas-related infrastructure expands across the region.*

According to a civil society source, a worrying dynamic is emerging: local communities have realised that if they can push a company a little, for example by protesting, the company will give in, rather than shut down production.74

One civil society representative suggested, oil company communication, *“should not be confined to the county executive, but should go through the county assembly”*.75 This is compatible with the constitution, which provides that the *“county assembly may receive and approve plans and policies for […] the management and exploration of the country’s resources”*.76

There are indications that county assemblies might take a lead in oversight of oil company and community engagement processes. Following Tullow Oil and the government’s signing of an MoU agreeing to take steps to resolve issues which caused the protests of October 2013 (see below, section 4.e, Local Content), 30 ward representatives from Turkana County criticised the agreement, saying they would table a bill before the county assembly to obtain a deal which better reflected local interests.77

### Box 7.4 The Problem of Weak institutions; Case Study of the Niger Delta

The seemingly implacable and intractable Niger Delta crisis is rooted in the underdevelopment of the region. Weak local institutions in the Niger Delta and imbalances between federal/local authorities explain, in part, why the region’s development has been stifled, despite the volume of oil trade. Local government arrangements have changed on multiple occasions in the last 50 years, with the creation of new states and the introduction of Local Government Authorities (LGA).

Nigeria’s revenue allocation formula is often criticised for its imbalance, but even the revenue that does make it through to local government has been ill-managed. LGAs and state authorities, who typically derive their authority from patronage and clientelism, have been unable to effectively spend the sums they receive. Plus, they lack transparency in their budgetary allocations, and ‘development’ projects tend to benefit local ‘elites’ at the expense of the needs of the community.

The Niger Delta Development Commission was set up in 2000 to address these issues, but the same problems – corruption, low technical capacity, and lack of accountability to the citizenry – simply transferred to a new institution.

Poverty-stricken communities and weak local governance make for difficult operating environments for IOCs. Companies lament that the failings of local government mean they are often called upon to provide basic services to their host communities. Companies’ role in basic service provision is much-criticised, because they lack the development expertise to do so successfully, and because their involvement weakens citizen relationships with local government.

74 Ibid.
75 Research Team interview, representative from international NGO focused on conflict prevention, Nairobi, 14 March 2014.
76 See Constitution, pp. 113, s.185(4.a).
77 “County ward rep dismiss deal between Tullow Oil and Government”, *The Standard*, 14 January 2014.
KENYA CIVIL SOCIETY PLATFORM ON OIL AND GAS AGENDA FOR KENYA’S OIL AND GAS DEVELOPMENT

The Kenya Civil Society Platform on Oil and Gas, having reviewed through a comprehensive report the state of development of the country’s emerging oil and gas industry, having understood the benefits and dangers that come with oil and gas production, aware that the country’s preparedness for the coming boom is in deficit; and appreciating our responsibility as civil society organisations and citizens of Kenya, have identified the following observations as depicting the true state of development of the oil and gas sector; and that they need to be highlighted for consideration by the appropriate authorities to facilitate the development of the sector and ensure that it contributes to the development of our country.

Institutional Framework

a. The Cabinet Secretary wields excessive power ranging from licensing of petroleum contracts, appointments of heads and boards of regulatory agencies and performance of regulatory functions. There is no clear separation of roles between the Cabinet Secretary’s policy-making and regulatory roles.

b. There is evidence of limited capacity in NOCK to harness the full potential of the hydrocarbon basins of the country. This will likely affect its operations as the commercial arm of the government in petroleum activities. NOCK also continues to have strong influence on policy-making creating another conflict of roles.

c. There is no independent agency responsible for regulating petroleum operations. The structure and appointments of the Energy Regulatory Commission which regulates the entire energy sector including upstream petroleum does not give it the independence to check and balance political decisions.

d. Parliament’s role of ratifying Petroleum Agreements is well articulated in the Kenyan Constitution, but as oil and gas is a new industry Parliament cannot over a short period of time master the expertise to understand the complex and technical matters involved in the petroleum sector, let alone effectively scrutinise Petroleum Agreements. The capacity challenge in Parliament therefore limits its oversight power giving the Cabinet Secretary and Agencies of the State free license to undermine the licensing process.

Petroleum Revenue Management

e. There are high expectations among the people in oil exploration areas and this could translate into tensions when the expectations are not met before and during oil production.

f. The Government of Kenya proposes to establish a Sovereign Wealth Fund but it is not clear yet what fiscal rule the government will adopt to determine the size of annual spending from the Fund.

g. Government is perhaps not paying enough attention to the complexities of petroleum revenue management and its potentially devastating impact on the economy such as Dutch disease, non-productive spending, inflation and corruption. Rather than enact a specific legislation on petroleum revenue management with clear transfer and withdrawal rules as well as investment and savings rules, Government has included a few sections on revenue management in the Petroleum Exploration, Development and Production Bill 2014.

h. Government is committed to the constitutional provisions on revenue sharing with County Governments. However, County Governments continue to demonstrate weak absorptive capacity to manage ceded revenues and are therefore likely to invest revenues in non-productive areas or used for recurrent expenditure. Also, patronage in the distribution of benefits at the county level could increase contestations among the people over resources leading to internal conflicts.
i. Although NOCK is playing an important role in the oil and gas industry and aims to become a competitive commercial entity, there is no known proposal on how the company’s operations and investments will be financed from petroleum revenues.

j. Illicit financial outflows have caused considerable revenue losses to the Country through transfer pricing, weak thin capitalisation rules and other tax avoidance scheme. With oil exports likely to commence in a few years, export under-invoicing will likely feature in the oil industry and thereby affect the ability of the government to maximize revenues from petroleum. Also, companies including local firms that are incorporated in tax havens will contribute to increased base erosion and deny the state tax revenues.

**Transparency and Accountability**

k. Transparency shines light on secrecy and unearths the cost of opaque deals to the state, communities and citizens. Without transparency, citizens cannot ensure that oil revenues contribute to socio-economic development.

l. The Constitution of Kenya has a strong provision on the right of access to information. However, the industry legislation provides for non-disclosure agreement which is not only inconsistent with the Constitution but also provide convenient avenues to perpetuate secrecy in the oil and gas industry.

m. The current licensing regime for oil and gas concessions in Kenya does not promote transparency in the contracting process. There is requirement for the application of open and competitive bidding in licensing for oil concessions, no mandatory contract disclosure and also no requirement for the disclosure of beneficial ownership information. These non-disclosures increase governance risks around petroleum contracts by strengthening the perception of “too lucrative legal benefits for firms”.

n. There is no framework for disclosure of petroleum revenues, as well as other relevant information relating to accounting for and managing revenues such as crude oil production volume, petroleum receipts, sales price and expenditure from petroleum revenues.

o. Kenya has not acceded to the EITI process. EITI principles will inspire genuinely open, transparent and thorough auditing, which in turn informs meaningful multi-stakeholder scrutiny. The government therefore does not see the initiative as an invaluable tool in guaranteeing that oil revenues contribute to socio-economic development.

**Local Content**

p. The local content provisions in the existing legal frameworks have limited scope and leave out important components that make local content a strategic tool for facilitating the integration of the oil sector with the non-oil sector of the economy.

q. There is capacity challenge to meet local content objectives. This is compounded by the lack of a comprehensive local content policy, strategy and legislation to ensure effective implementation of local content as a critical platform for adding value to the economy.

r. There are no safeguards against rent-seeking and local content related corruption such as fronting and bid rigging. There is a likelihood of local firms being imposed on foreign companies as condition for securing petroleum contracts; and this could provide room for politicians to perpetuate their interest in the oil industry at the expense of the nation.

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Land and Environmental Rights

- Lack of a Community Lands Act will compound the complex land management system in the country. This exposes oil investments to security risks as oil companies will constantly be confronted with community dissent.
- The right to Free Prior and Informed Consent is not legalised. Apart from compensation in exchange for community surface rights, there exist no other forums for aggrieved communities to seek redress.
- The burden that the oil and gas sector places on the environment risks further complications, and intensifies the threat of disputes. There is no legislation in place by which communities can seek compensation for losing grazing land due to an oil spill, because there is no clarity over who owns the land. The vacuum of rights that emanates from stalled legislation is therefore an urgent issue.
- Oil spills and gas flaring will adversely affect livelihoods and the health of communities especially those near offshore activity. Polluted water could be harmful to human health through fishes or other marine food. Communities who rely on the land or water for their livelihoods risk the danger of losing them.
- Kenya’s environmental laws and regulations have not yet been updated to address oil related environmental challenges. Also, Kenya’s environmental institutions have limited capacity to deal with both onshore and offshore oil waste and other environmental hazards. The capacity challenge range from training deficits and logistics constraints.

RESOLUTIONS

Following our analysis of the status of Kenya’s oil and gas development and conscious of the need for the Government of Kenya, Parliament, oil companies and civil society to work together in developing the appropriate policies, legal and institutional frameworks for the efficient and transparent management of the country’s oil and gas resources, we recommend as follows:

For the Government

Institutional Framework

1. There should be clear separation of roles between policy making, regulation and commercial operation.
2. The Cabinet Secretary should focus on policy making, sponsoring bills in Parliament, developing regulations and granting licensing rights.
3. There should be an independent Authority to regulate petroleum operations including conducting due diligence on application for licensing rights. The Director General of the Authority should be appointed by the President, subject to the approval by Parliament.
4. NOCK should focus on commercial operations and the financing of its operations and investments should be clearly defined by law. Financing of NOCK should be done through a transparent budgetary process and approved by Parliament. The Corporation must be required to submit an annual programme of activities for approval by Parliament. The NOCK must also publish its annual financial statements.
5. Parliament’s oversight role should be strengthened through capacity building. Parliament must submit petroleum Agreements to public hearing or invite public comments before their approval.
Petroleum Revenue Management

6. The Government should develop a comprehensive spending, investment and savings policy and legislate it. Spending of petroleum revenues should be guided by a Long-Term National Development Plan to prevent ad hoc spending. Spending priorities must reflect national consensus.

7. Government should establish separate frameworks for spending petroleum revenues through the Budget (Budget Fund), and saving for stabilisation against crude oil price volatility (Stabilisation Fund) and for future generations (Future Generations Fund). There should be clear rules for transfers and withdrawals of revenues to and from the Funds.

8. There should not be borrowing against petroleum reserves or revenues under any circumstances. A clear statement prohibiting oil revenue-backed borrowing should be put in the law;

9. In line with the Constitution of Kenya, the Government should develop by law a formula for sharing petroleum revenues between Central Government, Counties and local areas.

10. The capacity of County Governments must be developed to ensure efficient utilisation of ceded petroleum revenues. In addition, there should be formulated regulations to guide the use of ceded revenues to prevent Counties from using it for recurrent or non-productive spending.

11. Government should review the tax avoidance regulations to make them compatible with global rules and more so to make them effective tools for addressing illicit capital outflows through the oil industry. State revenue collection agencies must be supported to prevent the erosion of oil company tax base by effectively conducting cost and profit audits on the operations of oil companies.

12. While safeguarding investments government should limit use of stabilisation clauses to enable regulatory flexibility and maximise benefits from the oil and gas sector. As good practice Environmental concerns should not be included in stabilisation clauses and clauses should be limited to maintaining economic equilibrium.

Transparency and Accountability

13. There should be a legal framework for transparency across the oil and gas value chain. This includes contract transparency, revenue transparency and expenditure transparency.

14. Confidentiality clauses should be removed from petroleum agreements

15. The Government must adopt open and competitive bidding processes in oil and gas concessions;

16. Government should legislate and establish a register for the disclosure of beneficial ownership information in all petroleum transactions. The disclosure of beneficial ownership information should be a qualifying condition for granting licensing rights.

17. Mandatory disclosure of petroleum contracts, crude oil production volumes, sales price, petroleum revenues, withdrawals from petroleum funds and expenditure from petroleum revenues. Reporting should be time-specific preferably on a quarterly basis.

18. Government, as a matter of urgency, must take steps to subscribe to the EITI and reach candidate status in the next two years and compliance status in four years.

19. Government should introduce anti-corruption clauses in all petroleum agreements.

Local Content

20. Government must develop separate law and regulations on local content and spell out realistic targets and conditions for achieving local content in the oil and gas industry.

21. The National Oil Company of Kenya should be given first preference in granting oil concessions.
22. Government must establish a Local Content Development Fund with contributions from 1% of the value of all contracts and sub-contracts. The Fund should be used to support capacity building such as skills training and supporting small and medium scale enterprises providing goods and services to the oil and gas industry.

23. There should be a Committee established within the Upstream Regulatory Authority to monitor local content implementation.

24. Government should adopt a local content segmentation scheme to prevent cartelisation by foreign oil companies. This ensures that subcontracts are divided into smaller parts to meet the funding and technical capacity of local firms and protect them from being out-bidded by foreign companies. Government should further adopt preferential pricing rules to protect local firms.

25. A comprehensive programme for transferring technology by foreign companies to local firms through training and mentoring should be developed.

26. There should be provisions that criminalise fronting for foreign and local firms, bid rigging, cartelisation and any form of corruption by a foreigner or a local firm through local content.

27. There should be a requirement for transparent reporting on local content covering the number of local personnel employed, goods and services procured by foreign and local companies, and beneficiaries of the proposed Local Content Development Fund.

28. Government should also ensure that its local content policies are gender-conscious. Supporting training of women to acquire skills and gain employment in the oil and gas sector, including in professional roles such as geologists and engineers.

**Land and Environmental Rights**

29. The Community Lands Bill that protects the rights of communities affected by oil and gas operations should be passed into law as a matter of urgency to prevent land related conflicts in the oil and gas sector. The Bill should include the right of communities to be heard, the right to Free Prior and Informed Consent, the right to fair and adequate compensation and the right to seek redress when they are aggrieved.

30. There should be areas declared as ‘no exploration zones’ and these areas should include small water bodies, grazing lands and other strategic locations.

31. County Governments and communities should be supported with technical capacity programmes to effectively participate in discussions on Oil Field Development Plans and Environmental Impact Assessment processes.

32. Government should introduce the exclusive liability principle in petroleum agreements to hold oil companies fully responsible for any pollution or damage arising from petroleum operations.

33. Oil companies must be required to develop and publish Emergency Response and Oil Spill Response Plans.

34. Gas flaring must be prohibited except for operational purpose. There should be allowable limits on operational flaring and companies should be surcharged heavily or put before the Courts when they exceed the limits.

35. Government must also, as a matter of urgency, review and update the environmental laws of the country to respond to the new environmental threats the oil and gas sector poses to the country.

36. Also, Kenya’s environmental institutions should be supported with financial and technical capacity to monitor environmental management plans of oil companies and to ensure that oil companies comply with the highest environmental standards.
For Parliament

37. Incorporate good governance principles including transparency and accountability standards in all petroleum and revenue management legislations.

38. At all times put the national interest above partisan and individual interest in their consideration of petroleum agreements and in all other matters related to oil and gas development in the country.

For Companies

39. Develop, publish and implement policies on voluntary disclosure of payments, corporate social responsibility, human rights, anti-corruption and anti-bribery, and Environmental Social Impact Assessments (ESIAs).

40. Proactively state their willingness to participate in the EITI process, competitive bidding for oil contracts, to disclose their petroleum agreements and sub-contracts, and to adopt the principle of Free Prior and Informed Consent.

41. Establish a participatory community dialogue process to develop Community Development Agreements and Environmental and Social Impact Assessments; and to implement such agreements jointly with County Governments and Communities.

42. Protect and safeguard the rights of communities to their land, livelihoods, compensation and security.

For Donors

43. Require the adoption of full transparency by the Government in the oil and gas value chain including the adoption of EITI.

44. Require active participation of citizens in decision making on matters related to the development of the oil and gas sector.

45. Provide technical assistance to the Government, its Agencies, Regulatory Institutions, Parliament and Civil Society Organisations.

For Civil Society and Media

46. Monitor activities in the oil and gas sector including activities by Government, Oil and Service Companies and Regulatory Agencies.

47. Support independent institutions and Parliament to actively exercise their oversight responsibilities in the oil and gas sector.

48. Develop sensitisation programmes and to actively carry out such programmes at national, county and community levels to raise consciousness about the effects of oil and gas exploitation, appropriate remedies; and to develop a constituency for public oversight in the oil and gas sector.