



Albania's regulatory and fiscal hydrocarbons regime

Hasan Cerhozi

Abstract

This paper deals with Albania's fiscal and regulatory petroleum regime and aims at providing a brief comprehensive understanding of the current legislation. It provides an up-to-date overview of the evolution of the regulatory system for the upstream petroleum sector including the recent developments and the most significant challenges to come.

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1 INTRODUCTION

Albania has a long history of oil and gas production however the lack of investments and know-how lead the country's oil and gas industry at a terrible state during the last decades of the communist regime. Up until today, the transition road towards a liberalized democracy has not been ideal. The country has been knocking for years the door of the EU however it was only by the end of 2014 that Albania managed to get the candidate status for EU accession.

Since the “opening of the Albanian gates” in the early 90s a number of international upstream oil and gas companies have entered the country. Today the upstream sector consists of Albania's national oil company (Albpetrol) and a hand of independent producers with Bankers Petroleum Ltd, being the biggest player. The key milestones of the international oil companies (IOCs) has been the successful rehabilitation of some of Albpetrol's fields and the late discovery of light crude oil in the Blocks 2-3 by Royal Dutch Shell and Petromanas Energy Inc.¹ Following this development, this year the government proceeded into opening for bids 7 new blocks, both onshore and offshore.²

Since the 90s, the policies adopted by the Albanian governments have been aiming at attracting foreign investments. Thus, it can be said that the creation of an attractive fiscal and legal regime for hydrocarbons has been the main goal. However, Albania cannot be characterized at all as an oil economy since the state's income from oil activities is not significant, representing only 2.5% of the total revenue in the State budget in 2012³.

In 2014, the Albanian government aiming at increasing its revenues introduced a reform in the fiscal, legal and contractual regime across the energy sector which also encompassed the upstream oil and gas activities. Still the main fiscal incentives were maintained but measures for the payment of Albpetrol's debts were adopted while the company increased production and paid dividend to the State⁴.

¹ November 4th, 2013, Petromanas Energy Inc. and Royal Dutch Shell Plc. announced discovery of light crude oil following positive results of the test conducted on the well - Shpiragu 2 Blocks 2-3.

<http://petromanas.com/Uploads/News-Releases/122551.pdf>

² See Ministry of Energy and Industry of Albania, Order Nr.150, 05.06.2015 and Nr.132, 15.06.2015

http://www.energija.gov.al/files/userfiles/Publikime2/Investimet/ORDER_NO_150_DATE_05_06_2015.pdf
http://www.energija.gov.al/files/userfiles/Publikime2/URDHER_Ministri_nr_132_date_15_05_2015_PER_FILLIM_IN_E_PROCEDURAVE_PER_BLLOQET_E_LIRA.pdf

³ See Deloitte – EITI Extractive Industries in Albania (2014), Report for the year 2012

https://eiti.org/files/EITI%20Report%202012_English_SITE.pdf

⁴ See Albpetrol's report on the company's payments: <http://www.albpetrol.al/debitoret/>

2 THE PETROLEUM LAW AND THE INSTITUTIONS

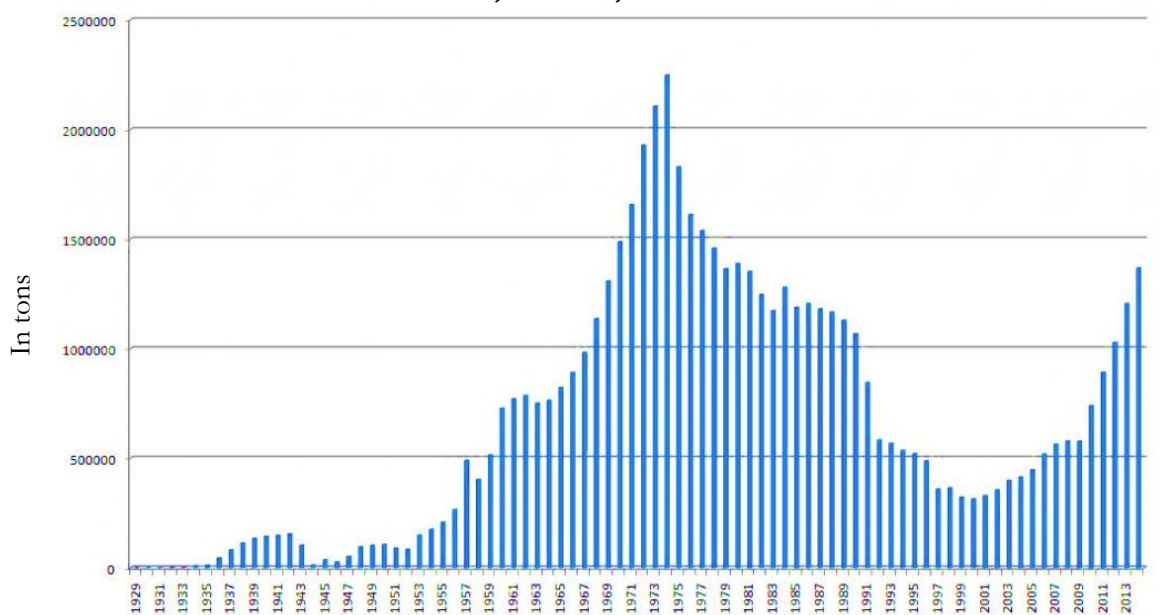
Background

Oil and gas activities in Albania date back in the years 1903-1913, when the first geological studies were carried out and the first wells were drilled. The first successful drilling was performed in 1918 in the south of the country⁵ and soon Albania's geology attracted the attention of major international players of the time, such as the Anglo-Persian Oil Company (APOC), Azienda Generale Italiana Petroli (AGIP). By 1925 the first concessionary agreements were signed and exploration activities kicked off⁶.

After the end of World War II, exploration activities continued to a greater extent, this time though under Albania's national oil company Albpetrol. Thanks to the import of know-how and equipment from the Soviet Union a series of oil and gas discoveries took place. The most significant one was the Patos-Marinza field, which is the biggest onshore oil field in continental Europe (191 million barrels of crude oil 2P reserves)⁷.

Oil production reached its peak in 1974 at 38.408 bpd⁸ but since then, the production curve was in a constant decline and it took a decade after the first licensing round (1991-1992) with the return and commence of operation of international oil companies (IOCs) for production start growing once again.

Chart 1. Production of Crude Oil, Albania, Annual



Source: Albpetrol

⁵ The fields of Drashovica, Vlora.

⁶ The results of these activities was the discovery of Kuçova field (490mbbls original oil in place) in 1928 by Azienda Italian Petroli Albanesi (AIPA) subsidiary of AGIP.

⁷ See Bankers Petroleum reserves: <http://www.bankerspetroleum.com/operations/reserves>.

⁸ See Albpetrol's production levels data: <http://www.albpetrol.al/prodhimi-i-naftes/>.

The Laws

Albania introduced its first legislation for hydrocarbons back in the 90s along with the country's commence of transition towards liberal democracy. In four years (1991 -1995), Albania held three licensing rounds for petroleum exploration⁹. Today's contractual status consists of 9 PSA's¹⁰ with foreign independent oil companies while the production rates do not resemble at all those of the mid 70s with current production being at 21,000b/d¹¹, mostly heavy oil from the Patos – Marinza. On the other side natural gas production is insignificant at 13 thousand tons of oil equivalent (ktoe) in 2012¹².

Petroleum Exploration, Development and Production in Albania is regulated by three main laws: a) "Petroleum Law (Exploration and Production)", No.7746 dated 28 July 1993 as amended, b) the law 7811 dated 12 April 1994 "On the Fiscal System in the Hydrocarbons Sector (Exploration and Production)" as amended, and c) the Law No. 9975, dated 28.07.2008 "On the National Taxes". The current legal framework has been clearly drafted to provide considerable flexibility to both the government and the producing companies and also incentivize investments in oil exploration and production activities.

According to the "Petroleum Law" all petroleum deposits existing in their natural condition within the jurisdiction of the Albanian state are the exclusive property of the Albanian State. The law authorizes the Ministry of Industry and Energy to enter into a Petroleum Sharing Agreement with an oil company to which exclusive rights for exploration and production can be granted.

The Institutions

In Albania's effort to become an attractive destination for IOC's the creation of a one "stop shop" institution was necessary. In 2006 the Council of Ministers decided the creation of the AKBN (National Agency of Natural Resources)¹³. As a state institution the agency is attached to the Ministry of Energy and Industry (MEI) and is responsible with monitoring and regulating the upstream oil and gas industry. The AKBN is not an independent hydrocarbon focused regulatory agency, which is the case in other countries, but has a larger portfolio including minerals and hydropower. Nevertheless the AKBN does function as a one stop shop institution since any interested entity has to submit its application for the rights of a Block to AKBN and the latter submits it to MEI.

⁹ In 1991 took place the first offshore licencing round. All offshore area was divided into 5 blocks and 5 Production Sharing Agreement were eventually signed with – Deminex & OMV, AGIP, Occidental, Chevron and Hamilton Oil. In 1992 took place the first onshore licencing round (PSA's were with Shell, INA Naftaplin and Coparex International. No commercial discoveries were made. Second onshore licencing round in 1995, PSA's signed with Occidental, OMV, Hellenic Petroleum and Coparex. Occidental makes first onshore discovery after 1990 in Block (Shpiragu 2). In 2004 PSA signed with Bankers Petroleum for the Patos Marinza oilfield.

¹⁰ See Production Sharing Agreements, Ministry of Energy and Industry: <http://www.energija.gov.al/al/baza-ligjore/industria-hidrokarbure/marreveshje-hidrokarbure/kompanite1430995797>

¹¹ See EIA database: <http://www.eia.gov/countries/country-data.cfm?fips=AL>

¹² See IEA Energy Statistics Albanian, Energy Balance:

<http://www.iea.org/statistics/statisticssearch/report/?year=2012&country=ALBANIA&product=Balances>

¹³ Under the Article 100 of the Constitution and the article 10 of the law Nr 9000, 30.01.2003.

For certain blocks that are under Albpetrol's administration, the same procedure is followed by Albpetrol which is also able to enter in a joint operation agreement. However, the final draft of the agreement either negotiated by the AKBN either by Albpetrol has to be submitted for approval to the MEI and then in case that the MEI judges it necessary it might also be sent for consultation to the Ministry of Finance and the Ministry of Justice. Finally, the draft agreement has to be certified by the Council of Ministers.¹⁴ It has to be mentioned that any later change of the terms in the agreement signed due to a request for renegotiations has to be approved once again by the Council of Ministers, which de facto is the institutional body holding the supreme authority. Nevertheless, contrary to what exists in other oil producing countries, the Albanian regulatory regime does not require for the PSA to be discussed and seek approval in the parliament.

¹⁴ According to the "Regulation for approval procedures of hydrocarbon agreements and licensee agreements and respective timelines" as published by the AKBN: <http://akbn.gov.al/wp-content/uploads/2015/05/Regulation-for-the-procedures-of-approval-of-Hydrocarbon-Agreements-and-License-Agreements-20-05-2015.pdf>.

3 THE CONTRACTUAL AND FISCAL REGIME

The contractual regime

Before entering into the details it is necessary to clarify that there is only one type of contract offered by the Petroleum Law which foresees drilling and production activities, that of a Production Sharing Agreement (PSA). There is also the option of applying for a Reconnaissance Permit, however the holder of that Permit can only perform seismic exploration activities in the area covered by the Permit for a period of two years while he is not authorized to drill any exploration wells.¹⁵ Also, this specific permit does not confer on the holder a preferential right to lately enter into a PSA with MEI.

The mainstream procedure ordains the announcement of free blocks by the MEI and the call for applications. Any interested entity should apply to AKBN or else to Albpetrol for blocks that are under Albpetrol's administration. Certain application deadlines are appointed by MEI to each block or group of blocks.

The PSA offered by the Albanian government is quite flexible and can offer very competitive terms since not all terms are strictly predetermined, but are subject to negotiations between the interested party and the AKBN or Albpetrol respectively. Nevertheless the exploration period is set at 5 years which can be extended up to 7 years, while in case of commercial discovery the period for development and production is 25 years, with possible extension depending on the circumstances.

The Albanian upstream hydrocarbons regulatory system does not provide a model contract designed for each area (onshore or offshore) and/or each quality of crude, hence it demands the company which files the application to propose the main terms of the agreement with respect to the major aspects of the PSA model as defined in the Petroleum Law. Almost all terms are open to negotiation (see table 1)¹⁶. The basis for the negotiations of these terms are not disclosed but the type of the specifics of the field, the quality of the crude and the oil price of international benchmarks are definitely some of the main points.

Table 1. Terms of Production Sharing Agreement (PSA)

Predetermined	Open to negotiation
Exploration Period (5 – 7 years)	Minimum work obligation and financial commitments
Duration of the Development and Production Period(25 years)	Training and administration funds
	Cost recovery and petroleum sharing
	Production and signature bonus

¹⁵ According to then Law No 7446 (1993) "Petroleum Law (Exploration and Production)" under a Reconnaissance Permit the exploration is restricted only to seismic exploration activities.

¹⁶ In accordance with the Petroleum Law Nr.7746, 28.07.1993 "Terms and Conditions for Application under Production Sharing Agreement" <http://akbn.gov.al/wp-content/uploads/2015/06/Binder1.pdf>.

Despite the fact that AKBN is entitled with the representation of the Ministry, when the negotiations take place, by order of the Minister representatives of the MEI and external experts can be appointed to take part in the negotiating group.

Of course, under the PSA despite the signature bonus a production bonus is paid in various stages down the way. The signature and production bonus can vary depending on the type of block and type oil they are subject to negotiation.

Finally, it's worth mentioning that since the collapse of the communist regime and the opening of the country in the early 90's the economic model of Albania is based on foreign investments, hence the country has adopted a series of measures to strengthen the feeling of security to international investors. Foreign investors in the upstream petroleum sector are fully protected by the law¹⁷. In case that a company decides to go for international arbitration then the arbitration shall be in accordance with UNCITRAL arbitration rules and preferably under English Law. However, the road so far has not been all smooth for foreign investors since there has been a case where the AKBN has cancelled a PSA, as it was the case with Sky Petroleum which in December 2011 proceeded with international arbitration against MEI and AKBN.

The fiscal regime

Corporate income tax or else profit tax

Upstream petroleum companies in Albania, as it happens in many producing countries, are subject to a fixed corporate income tax or as it is commonly named a profit tax. The oil and gas companies are obliged to pay a 50% tax on their profit depending the quantity produced which can be characterized as a relatively moderate amount when compared to what is applied in other countries¹⁸.

In case that the contractor is Albpetrol or Albpetrol is part of a consortium holding a higher than 50% interest in the agreement then the profit tax is calculated as illustrated in table 2 can vary from 30% to 55%.

Table 2: Profit tax – Albpetrol Contractor or holds >50% of interests ¹⁹	
30%	For fields put into production before 31/12/1993
30%	For profits realized in zones put on production after 31/12/1993 and up to 20.000bb/d
50%	From 20.000bbl/d up to 50.000bbl/d
55%	From 50.000bbl/d up to 65.000bbl/d ²⁰

¹⁷ As are all foreign investors pursuant to Law No.7764 of 22.11.1993 "On Foreign Investments".

¹⁸ As regulated by Law nr.7677, 3.3.1993 "On the tax on profit" & Decree Nr.782, 22.2.1994 on the "Fiscal System of Hydrocarbons (Exploration – Production)".

¹⁹ According to decree Nr.782, 22.2.1994 "On the Fiscal system of Hydrocarbons".

²⁰ Bbl/d stand for barrels of crude oil per day.

Areas under Albpetrol's administration

The Right of Pre-Existing Production is Albpetrol's right to obtain 65% – 80% percentage of the average production realized in the last 6 months from wells transferred to the contractor. The exact percentage is negotiated and agreed between Albpetrol and the contractor. This percentage has an annual decrease from 5% – 15%. The contractor is not obliged to provide this percentage if Albpetrol does not require to do so, since by definition this is a right that Albpetrol has and not a predetermined obligation.

Under all Petroleum Sharing Agreements the contractor during the period that is recovering its costs, must transfer a portion of the oil produced to Albpetrol. The part transferred to Albpetrol, which is called as “**Albpetrol Share**”, is calculated according an R factor which varies accordingly to each agreement from 1% to - 5% of the available petroleum.²¹ For example if R=2 then the Albpetrol Share is 5%.²² Concerning natural gas depending on the R factor the Albpetrol share fluctuates at much smaller percentage ranging from 0% to 0.5%.

Last but not least, except from the Albpetrol Share the contractors are obliged to transfer to Albpetrol another oil portion after deducting their investments. This is a particular provision which is named “**Profit Petroleum**” and it is enforced only on some specific fields.²³

Royalty

The Law No.9975, dated 28.7.2008 on “National Taxes” provides the application of the Mining Tax or else the **Royalty**. The royalty rate applied in Albania, has no particularities, the contractor must pay a royalty of 10% of the revenues from the sales of petroleum. Albpetrol even though is a state company is also obliged to pay royalties to the state.

The method of payment can vary as the AKBN which is also responsible to collect the royalties and takes the governments tax and or/its share of profit in cash either in kind or even in both forms depending on the PSA²⁴.

Other fiscal and contractual provisions

The fact that the PSAs are not approved by the Parliament means that any changes to the fiscal legislation can directly affect the contractors. Since 2014 though, the newly elected government undertook a fiscal reform which also touched on the upstream hydrocarbons sector. The aim was to some extent reorient the fiscal environment for hydrocarbons. The VAT exemption on imports of petroleum by products was lifted from the goods and services needed in the development phase but it was maintained for the exploration phase as the government realizes the higher risks associated with this phase.

²¹ R factor = Accumulated Revenues/Accumulated Expenses.

²² See Bankers Petroleum Corporate Presentation, May 2015:

<http://www.bankerspetroleum.com/sites/default/files/presentations/pdfs/BNK-2015-May%20Corporate%20Presentation.pdf>.

²³ For the fields of Cakran-Mollaj, Gorisht-Kocul and Ballsh – Hekal

²⁴ According to the decree 782, 22.02.1994 "On the fiscal system in the petroleum sector"
http://www.energija.gov.al/files/userfiles/Hidrokarbur/Dekret_782_22.02.1994.pdf .

Also, an excise tax was introduced on the imports of petroleum byproducts, used in both exploration and development phases. The income of foreign individuals realized from hydrocarbon operation ended its tax free regime and also became subject to Albania's tax legislation²⁵. Moreover, the contractor and its subcontractors were exempted from custom obligations in importing equipment, machinery and any material that is used in exploration and production activities²⁶. Nevertheless the right of the oil companies to export capital earned from hydrocarbon activities in any currency of their preference was maintained tax free while no rental fee for land which is under the state's ownership and where exploration or production activities take place was imposed.

²⁵ Pursuant to Law No. 180, 28.12.2013 on VAT exemptions.

²⁶ All imported goods used for exploration and production activities need certification by the AKBN to get tax exempted.

4 THE CHALLENGES AHEAD

All in all, Albania has indeed an attractive fiscal and contractual regime. The creation of AKBN was a big step towards the constitution of a functional institutional framework. However there is still a lot of work to be done in a number of issues.

The current legislation on profit tax needs to be updated while administrative guidelines need to be adopted to as to avoid misalignments between the AKBN and the tax authorities. Moreover, in Albania there does not exist a Local Content Act. The contribution of the extractive industries as a whole (oil, gas and mining) can be characterized as insignificant since it counts for less than 1% of the total employees in the country.²⁷

Environmental protection and conservation is another issue that needs to be dealt with. There is no clear regulation or environmental standards governing the sector however it is highly possible that regulations entailing these issues will be adopted soon since the country is a member of the Energy Community and is moving forward on its path towards EU integration.

Finally, the obsolete infrastructure for both oil and gas transportation is another challenge, as up until today most of transportation is done by truck. This though is expected to change in the long term since the new discovery of light crude oil in the Molisht-2 Blocks 2-3 from Shell and Petromanas coupled with the selection and the commence of the construction of the Trans Adriatic Pipeline has brought a lot of international attention to the country. Plans for the gasification of the country are being drafted and discussed foreshadowing that new heavy investments will take place in infrastructure.

²⁷ See Delloite – EITI Extractive Industries in Albania (2014), Report for the year 2012
https://eiti.org/files/EITI%20Report%202012_English_SITE.pdf.