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The Adequacy of the legal framework in guaranteeing the equitable distribution of profit oil to the local community in the oil and gas sector in Turkana, Kenya.

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Declaration and Approval

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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Abstract

The discovery of minerals and petroleum in a country is often a cause for celebration to its citizens. This is rightly so as it is expected that trading in these resources will result in growth of an economy and improve livelihoods for the nation at large. Kenya's oil and gas sector is a relatively new sector, but the journey towards ensuring equity is well on course. The interests of communities in profit oil are a murky area, considering that the Constitution of Kenya, 2010 declares all minerals and mineral oils to be public and not community land ousting any individual or community ownership. The Constitution and statutes enacted thereunder guarantee local communities rights to a share of profit oil. They also cater for other related interests of the local communities such as the right to compensation with respect to upstream petroleum activities.

This study employs a review of the law and relevant secondary materials to analyse the share and interests of local communities in the oil and gas sector, whether local communities have a stake in profit oil, and to what extent. The study proceeds on the understanding that the interests of local communities in the petroleum activities are realized through sharing of profits and the relevant aspects of compensation accruing to the community in the process, hence substantial reference is also made to compensation aspects. While profit sharing and compensation are distinct concepts, they constitute the local community' interests in the oil and gas activities.

Additionally, a comparative analysis with Nigeria, Papua New Guinea, Venezuela and Norway is carried outThe study identifies gaps in the Kenya's compensation mechanisms in compulsory acquisition and argues that ultimately, communities have a stake in profit oil that needs to be identified and upheld.

Table of Contents

List of Figures

List of Tables

List of Abbreviations and Acronyms

ACHPR	African Charter of Human and Peoples' Rights
AfDB	African Development Bank
BDG	Business Development Grants
BOPD	Barrels a Day
BSA	Benefit Sharing Agreement/Arrangements
CLA	Community Land Act
DPE	Department of Petroleum and Energy
EAC	East African Community
EITI	Extractives Industries Transparency Initiative
EPRA	Energy and Petroleum Regulatory
ERC	Energy Regulatory Commission
FET	Fair and Equitable Treatment
FIEM	Investment Fund for Macroeconomic Stabilization
FONDEN	National Development Fund
GDP	Gross Domestic Product
IDG	Infrastructure Development Grants
IOC	International Oil Company
K	Kina (Currency in PNG)
KPC	Kenya Pipeline Company
KPRL	Kenya Petroleum Refineries Limited
LA	Land Act no.6 of 2012
LHL	Liquid Hydrocarbons Law 2001
LNG	Liquified Natural Gas
MC	Marginalized Communities
MOU	Memorandum of Understanding
MPSC	Model Production Sharing Contract
MRA	Mineral Resource Authority
NBC	Nigerian Bitumen Corporation
NLC	National Land Commission
NOC	National Oil Company
NOCK	National Oil Company Kenya
NOK	Norwegian Kroner

NPFG	Norwegian Pension Fund Global
NRGI	Natural Resource Governance Institute
NUPAC	National Upstream Petroleum Authority
OECD	The Organisation for Economic Co-operation and Development
OOB	Orinoco Oil Belt
OPEC	Organization of Petroleum Exporting
PA	Petroleum Act, no.2 of 2019
PEPA	Petroleum (Exploration and Production) Act 1984
PdVSA	Petroleos de Venezuela SA
PLC	Public Limited Company
PNG	Papua New Guinea
PSA	Production Sharing Agreement
PSCs	Production Sharing Contracts
SCs	Service Contracts
SCF	Standard Cubic Feet
SLO	Social License to Operate
SWF	Sovereign Wealth Fund
UBSA	Umbrella Benefit Sharing Agreement
VIF	Venezuela Investment Fund

List of Cases

Baker v Carr, 369 U.S. 186, 204(1962)

County Government of Turkana v National Land Commission & another [2019] Eklr.
Isaka Wainaina v Murito (1923) 9 (2) KLR 102.

Kelly Malenya v Attorney General and another; Council of Governors (Interested Party) [2019] Eklr

Mohamud Iltarakwa Kochale & 4 others v Lake Turkana Wind Power Ltd & 4 others; Aaraon Iletele Lesiantam & 4 others (As representatives of the residents of Loiyangalani District, Marsabit County) (Interested Paries) (2022) Eklr

Mui Coal Basin Local Community & 15 Others v Permanent Secretary Ministry of Energy & 17 Others, (2014) Eklr.

Patrick Musimba v National Land Commission & 4 others (2016) Eklr

Richard Owuor & 2 others (suing on behalf of Busia Sugarcane Importers Association) v Cabinet Secretary, Ministry of Agriculture, Livestock, Fisheries & Cooperatives & 7 others (2020) Eklr.

Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd (1973) England Court of Appeal

List of Constitutions

Constitution of Kenya (2010)

Constitution of the Federal Republic of Nigeria (1999)

Constitution of the Independent State of Papua New Guinea, 1975

Constitution of Venezuela, 1999

Constitution of the Kingdom of Norway, 1814 (with Amendments through 2015)

List of Statutes, Rules and Regulations

Community Land Act (No. 27 of 2016) (Kenya)

Crown Land Ordinance (Repealed)

Energy Act (2019) (Kenya)

Deep Offshore and Inland Basin Production Sharing Contracts Act, 2004 (Nigeria)

Land (Assessment of Just Compensation) Rules, (2017) (Kenya)

Land (Conversion of Land) Rules (2017) (Kenya)

Land Act (No. 6 of 2012) (Kenya)

Land Use Act, Nigeria (No. 6 of 1978) (Kenya)

Petroleum (Exploration and Production) Act, Cap 308 Laws of Kenya (1984)

Petroleum Act (29 November 1996) (Nigeria)

Petroleum Act (No.2 of 2019) (Kenya)

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Convention of Biological Diversity, 1993 Treaty Series, 1760

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Dedication

This work is completely dedicated to God Almighty my creator, my strong pillar, my source of inspiration, wisdom, knowledge and understanding. He has been the source of my strength throughout this program and on his wings only have I soared.

I also dedicate this work to the memory of my late mother, Esther Nyambura Mithamo Waigwa. Although she is no longer of this world, her memories continue to regulate my life. She was my inspiration to pursue my Master of Laws degree. As an educationist, she not only enlightened me with academic knowledge but also gave me valuable advice whenever I needed it the most. To date, her push for tenacity ring in my ears. This is for her.

Oil is like a wild animal. Whoever captures it has it. No one can possibly achieve any real and lasting success or 'get rich' in business by being a conformist

-Paul Getty

Chapter One
Introduction and Research Background

1.1. Introduction

This Chapter provides an introduction to the study. It also provides a research background to the study. In this Chapter, the author discusses the petroleum sector in Kenya, establishes the research problem, reviews some of the relevant literature on this topic, and formulates the relevant research questions and a hypothesis that will anchor this study. It also provides a justification of the study.

1.2. Background of the Study

Oil and gas are often termed as "hydrocarbons." Hydrocarbons are described as strings of carbon and hydrogen which form organic material that has been compressed over millions of years. In most cases oil and natural gas are collectively referred to and commonly known as petroleum, because the two are often discovered together.[1]

When referring to the oil and gas industry it is best described as divided into three stages of operation namely the *upstream, the mid-stream and the downstream stage*. Fig 1.1. below demonstrates this in a simple diagram of what each stage entails.

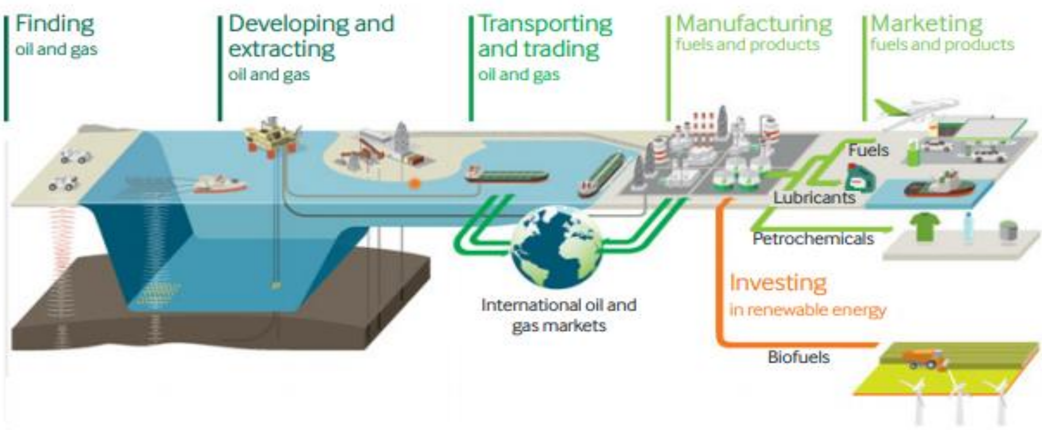

Fig 1.1. The Stages in Oil and Gas operations **"Source NRGI"**

[1] The Oil and gas industry: Overview and trends, Natural Resource Governance Institute (2015) https://resourcegovernance.org/sites/default/files/nrgi_Oil-and-Gas-Industry.pdf on14 November 2021

As demonstrated in Fig 1.1, the oil and gas process is separated into three stages. First is the upstream stage which refers to the exploration and production stage (finding, developing and extracting crude oil and gas). The process of conversion of natural gas to liquefied natural gas (LNG) is a transition phase between upstream and midstream stage. The second stage is the mid-stream stage, where crude oil and gas is transported and traded to plants and refineries (transporting, trading and manufacturing) before it reaches the third and final stage known as the downstream stage where a final product of oil and gas is transported to markets for sales and marketing.

Oil exploration in East Africa began early in the last century, originating with Anglo-American's Dudley Expedition to Abyssinia in 1920. However, more intense and large scale shallow drilling activities were conducted in Uganda and the Eritrean Red Sea oil seeps. However, more structured exploration did not begin until the 1950s.[2] The figure below entails a map highlighting the wells drilled in Eastern Africa over the years.

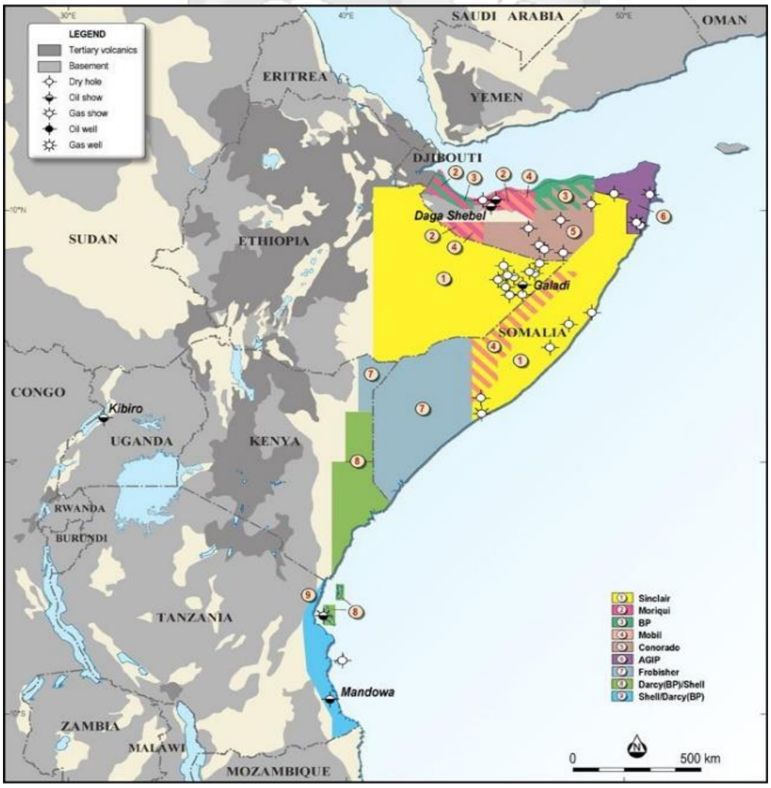

Fig 1.2. Wells Drilled in Eastern Africa over the years **"Source GeoExpro"**

[2] Purcell P, 'Oil and gas exploration in East Africa: A brief history' *GEO ExPro Petroleum Magazine*, 23 November 2021

In Kenya commercially viable oil reserves were discovered in 2012 in the northern part of the country known as Turkana. The Turkana community found in the northern part of Kenya is recognized as one of the minority communities in Kenya with a population of approximately nine hundred and twenty-two thousand two hundred and ten (922,210) as of 2019.[3] This is quite a significant reduction from nine hundred and eighty-eight thousand five hundred and ninety-two (988,592) that was recorded ten years prior, in 2009 and which illustrates a downward trend that is an added disadvantage to an already vulnerable group.[4]

The vulnerabilities that the Turkana face have occurred over a number of years and for a variety of reasons. Firstly, the Turkana are regarded as a marginalized community because its people encounter a number of challenges that have led to their systemic underdevelopment over a long period of time. This began in the colonial era due to their exclusion from development; as Turkana is located on the periphery of the epicentre of political and economic decision making which resided and still resides in Nairobi which over time led to the minimal representation of their interests on a national scale. Following the attainment of independence, the same alienation was and has been maintained over time, and is reflective of the government's inability to do away with the administrative failures of the colonial government.[5]

Moreover, the Turkana people face harsh environmental conditions such as an arid climate, inconsistent rainfall and a resultant shortage of water, famine and minimal government support in their main economic activity of Pastoralism.[6] The discovery of oil in the region thus seems like an economic and developmental silver lining for the Turkana community. This is the background underpinning this study and the problem it seeks to interrogate in Chapter 3.

[3] Kenya Bureau of Statistics, *Volume I: Population by County and Sub- County, (*2019), at 9.
[4] National Gender and Equality Commission, *Flares of Marginalization among selected Minority Communities of Kenya*, 2013, at 7.
[5] Shanguhyia M. 'Insecure Boderlands, Marginalization, and local perceptions of the State in Turkana, Kenya, circa 1920-2014' *Taylor and Francis Online*, 15(1), 85.
[6] Obongo J, *The influence of oil exploration on the livelihoods of the Turkana community: A study of Tullow Oil Company in Lokichar Location of Turkana South Sub-County,* Unpublished Thesis, University of Nairobi (2018), 24.

Commercially viable oil in Kenya was discovered by Tullow Oil PLC (Public Limited Company) a large oil corporation from the United Kingdom.[7] This was discovered in its Ngamia 1 wells, as well as other subsequent oil wells such as Block 10BB and Block 13T within the Turkana region. At the time of discovery, Kenya had an overall estimate of 600 million barrels of oil; which was a 100% increase from the previous 300 million barrels[8] and an overall number of 40 oil wells that have been drilled; which is inclusive of both on and offshore wells.[9] A noteworthy fact is that at the time of the discovery, Tullow Oil was only one of the twenty-three licenced petroleum exploration companies; and its discovery of Ngamia 1 significantly contributed to a change in the investment viability of the Turkana region; as it was de-risked and viewed to be a more lucrative investment.[10]

However, Kenya's discovery of oil is at a significantly later stage unlike other African countries like Nigeria[11] and Angola[12] who discovered oil in the mid-1950s. This late discovery of oil in Kenya has ensured Kenyan economy is not predominantly dependent on oil, thus Kenya may not be vulnerable to *resource curse',* which will be discussed further in Chapter 4 of this study.

Below is a map of Kenya highlighting the position Turkana area/county.

[7] Patey L, 'Kenya: "An African Oil Upstart Transition", *Oxford Institute for Energy Studies* (2014) on 14 November 2021, iii.
[8] Patey L, 'Kenya: "An African Oil Upstart Transition", 12.
[9] Patey L, 'Kenya: "An African Oil Upstart Transition", 8.
[10] Patey L, 'Kenya: An African Oil Upstart Transition, 12
[11] Nigerian National Petroleum Company https://nnpcgroup.com /NNPC-Business/Business-Information/Pages/Industry-History.aspx on 14 November 2021
[12] U.S Energy Information Administration, *Background Reference: Angola, (*2019), at 2.

Fig 1.3. Map of Kenya highlighting Turkana Area (Source: World Bank)

The discovery of more oil and gas in Kenya has ignited interest and discussions on the economic prospects as well as the consequent challenges and reforms in its legal framework. A majority of the debate centred on the balance between the benefits that should be allocated to the national government vis-a-sis that which is allocated to the community of Turkana.[13] The complex debate was due to one faction alleging that the national government ought to take up a majority of the share as Turkana County did not have the capacity for such a large uptake of revenue. Their opponents alleged that the local government would likely take up the revenue and very little would trickle back to Turkana, on whose soil the revenue was generated, implying that the same would go against the equitable sharing of resources. Additionally, it has been implied that the national government may underrepresent Turkana's interests in the distribution of revenue[14]

[13] ILEG Kenya 'Give Turkana its fair share of oil revenues,' 2016, <http://ilegkenya.org/wp-content/uploads/2019/02/Voices-No2-GIVE-TURKANA-ITS-FAIR-SHARE-OF-OIL-REVENUES-HR.pdf> on 18 December 2021.

[14] West J, Gugu S, *Turkana Oil Field, Kenya: Narrative Report,* (2018) ,5.

Later, following the robust debate among politicians and leaders in the county government and the national government, it was agreed and resolved that the national government will keep 75% of the revenue accruing from oil sales while the host county government and community members would take 20% and 5% respectively.[15] The aforementioned rates are mirrored in the Petroleum Act of 2019 which states that the national government's share of profits derived from petroleum production shall be apportioned between itself, the county government and the local community; whereby the county's share shall be 20% of the national government's takings and the local community's share shall be equal to 5% of the national government's share.[16]

The field of oil and gas is known for experiencing profit margins much higher than other industries. This is partly because it is an industry with relatively little competition and which has players who have control over various stages of production; and who can generally lower the costs of production and raise the price of the final product. It is for this reason, that this study seeks to unpack the adequacy of the legal framework in ensuring that the local community receives an equitable amount. Profitability in the field has been defined by Standard Oil as follows: '*Profitability, is a measure of a company's net income relative to the equity (or capital) provided by its investors'*. [17] In the context of this study, profits and profit sharing are incidental to the final revenues obtained by the state from the mining of crude oil in Kenya in Turkana County.

Key actors or stakeholders in the petroleum activities in Kenya include the national government, International Oil Companies (IOCs), county governments and local communities. IOCs are involved in the initial petroleum exploration activities and they operate through concessions and contracts with host states.[18] In the extractives industry, international companies are legally obliged by the Mining Act to collaborate with the local government in generating a community development agreement as part of their obligations upon securing a mining licence.[19] In this vein, a Community Development Agreement was entered into by the

[15] Lutta S, (2018) 'Turkana agrees to oil revenue sharing ratios,' Daily Nation, 22/5/2018, <https://www.nation.co.ke/counties/turkana/Turkana-agrees-to-oil-revenue-sharing-ratios/1183330-4573278-xkeexo/index.html> on 19 December 2021.
[16] Section 58, *Petroleum Act*, 2019.
[17] Bougrine H., *Oil: Profits of the chain keepers*, International Journal of Political Economy, 35(2), 2006, 7-8.
[18] Manley D, Mihalyi D and Heller P, 'Hidden Giants it's time for more transparency in the management and governance of national oil companies', *Natural Resource Governance Institute*, (2019), 3.
[19] Section 110, Mining act, 2016.

Titanium mining company Base Titanium and the county government of Mombasa and Kwale where they undertake mining activities. The said agreement states that the company shall pay 1% of the profits to the county government for the sake of facilitating sustainable development in the communities where it mines.[20] In a similar fashion, the same practice could be transplanted in the petroleum industry.

One of the key instruments that is used to govern Kenya's upstream petroleum operations is the Model Production Sharing Contract (the "MPSC") found in Part A of the Appendices to the Petroleum Act, 2019. This contract lays out the contractual foundation through which Kenya as a state and an oil and gas contractor will collaborate to commercialise these natural resources by authorizing a contractor to explore, develop and produce petroleum within a specific area or areas.

The MPSC has provisions that speak to various contractual clauses between corporations and the state. Part I of the instrument gives various definitions pertinent to the industry while part II enumerates further on the contractual term, exploration in the regions necessary and obligations of the parties. Part III details on the rights and obligations of the contractor. These lay the foundation for the expectations between the parties in the course of the contract. Part VII makes provisions on cost recovery, product sharing, taxation, government participation and domestic supply obligations. This section shall be the focus of this study in this particular section.

Clause 37 (1) of part VII of the MPSC provides for what is commonly known in the sector as profit oil sharing which is referred to as '*profit petroleum'* in Kenya. It states that each category of the total petroleum produced and saved from the contract area and not used in the upstream petroleum operations or commercial production less the cost petroleum as specified in sub-clauses 36(1)[21] and 36(2),[22] shall be referred to as the profit petroleum. Further, it states that each category of profit petroleum shall be shared, taken and disposed of separately by the Government and the contractor on a quarterly basis, according to the value of the R-Factor in

[20] Kenya News Agency, Firm sings Cooperation Agreement with Communities, see https://www.kenyanews.go.ke/mining-firm-sign-cooperation-agreement-with-communities/.

[21] The provision is that the contractor shall be entitled to recover the petroleum costs incurred and paid by them pursuant to the contract and duly entered in the contractor's books of accounts.

[22] The provision is for various methods by which costs may be recovered. The priority of recovery is production costs, exploration costs, development costs, uplift, and decommissioning costs respectively.

respect of the contract area as determined at the end of the preceding Calendar Quarter. The R-Factor is a ratio that is used to determine not only profit oil shares, but also the cost recovery ceiling and the shares of excess cost oil (cost oil not required for cost recovery). It connotes cumulative revenues (cost oil plus profit oil) divided by cumulative costs.[23]

Cost oil refers to a portion of produced oil that the operator applies on an annual basis to recover defined costs specified by a production sharing contract[24]; while profits oil refers to the he amount of production, after deducting cost oil production allocated to costs and expenses, that will be divided between the participating parties and the host government under the production sharing contract.[25]

Under the MPSC, as under production sharing contracts or agreements (PSCs) in general, the government's primary entitlement from the extractives venture is embodied in its share of profit oil as represented by the PSA. However, each PSC is separately negotiated and it is the signed PSC that becomes enforceable in specific circumstances, not the MPSC which is just a model.

A PSC is awarded by the host state. It provides licenses to operators or a consortium of operators who will be responsible for operating the oil block allocated to them. The group awarded with the license, will bear the risk and any associated costs of exploration and production. The consortium will retain a part of the production to cover whatever costs they have incurred (also known as Cost Recovery or Cost oil) and the remainder is known as the profit oil, the focus of this study, which is divided between the consortium and the host state as will be determined by the PSA.[26] Such an entitlement could be on an annual basis or other stated period or duration, whichever is provided in the agreement.

[23]The Law insider, https://www.lawinsider.com/dictionary/r-factor#:~:text=Remove%20Advertising-,R%2DFactor%20is%20the%20ratio%20of%20cumulative%20Cash%20Receipts%20to,in%20Article%2019.5(d) .
[24]Schlumberger Energy Glossary, https://glossary.slb.com/en/terms/c/cost_oil#:~:text=1.%20n.%20%5BOil%20and,production%20sharing%20contract%2C%20profit .
[25] Schlumberger Energy Glossary, https://glossary.slb.com/en/terms/p/profit_oil .
[26] Shaik V.J, *'Selling the Citizen's Oil- How Governments Sell Their Oil',* Revenue Watch Institute, (2012).

In Kenya, this is done on a quarterly basis. However, most PSAs do not provide further detail on additional access to the share of profit oil between various stakeholders with a fiscal or other interest in relation to the state's profit oil. It would be outside the scope of any PSA to direct parties to it, on how to apply their share of profit oil.

Nonetheless, there is a need for a definitive statement on the extent to which profit oil should be applied to compensate stakeholders in oil and gas extractives and, more generally, how it should be applied to resolve outstanding distributional problems after the division of profit oil. It therefore relies on legislative sources and other instruments to fill this gap, particularly stakeholders.

As noted earlier, one of the main stakeholders in Kenya's petroleum industry is the national government. Within Kenya's national government, there are several institutions that govern the oil and gas sector. Key among them is; the Ministry of Petroleum and Mining, the Petroleum Directorate; the Energy and Petroleum Regulatory Authority, Kenya Pipeline Company, Kenya Petroleum Refineries Limited, the National Oil Corporation of Kenya and the Energy and Petroleum Tribunal. Table 1.1 below briefly outlines these key institutions.

Government Institution	Role
Ministry of Petroleum and Mining	Provides leadership in the management of the extractives sector by developing *inter alia* petroleum policies, creating regulatory framework for investments and building capacity for effective management of petroleum programs and projects.
Directorate for Petroleum	A department in the ministry of petroleum and mining that spear heads all petroleum operation programs in Kenya and its functions include: formulation on policies; reviewing the legal, regulatory and fiscal

	framework; supervising and monitoring exploration of oil and gas; production and development of petroleum activities.
Energy and Petroleum Regulatory Authority (EPRA)	Regulates and monitors *inter alia* upstream petroleum operations in Kenya among other energy related functions.
Kenya Pipeline Company (KPC)	Provides the means of transporting petroleum products from Mombasa to interior parts of the country.
National Oil Corporation of Kenya (NOCK)	Kenya's state /national oil company involved in all areas of the petroleum processes including; the upstream petroleum supply chain, the area of exploration, mid-stream petroleum infrastructure development and in the downstream sector handling the marketing of petroleum products.
Kenya Petroleum Refineries Limited (KPRL)	Originally established to provide the East African region with a supply of a wide variety of oil products. Currently the company provides for product handling and hospitality, laboratory services and fuel loading services.
Energy and Petroleum Tribunal	Hears and determines disputes in the energy and petroleum sector under the Energy Act, 2019 and appeals against the decisions of the Energy and Petroleum Regulatory Authority.

Table 1.1. Key Institutions governing the Petroleum Sector in Kenya

Just like the Kenyan case of NOCK, National Oil Companies play a vital role in influencing oil and gas activities in many oil producing countries. In some countries they are more focused on profits and thus prioritize commercial efficiency. While in other countries they are considered '*cash cows'* because they mainly focus on collection of revenues from investors carrying out majority of the petroleum related operations.[27]

For the purpose of this study, stakeholders also refer to the local communities, individual proprietors of the relevant land and the general public, who have an equitable interest as a result of the provisions of Article 62(1)(f) of the Constitution. This provision states that *"all minerals and mineral oils as defined by law"* fall under the scope of public land to be held by the national government in trust for the people of Kenya. A similar position was affirmed by the Supreme Court of Kenya in the established ***Mitu Bell case***. The Court held espoused on the public trust doctrine as follows:

'The *2010 Constitution* has radically transformed land tenure in this country by declaring that all land in Kenya belongs the people of Kenya collectively as a nation, communities and individuals. It also now creates a specific category of land known as public land. Therefore, every individual as part of the collectivity of the Kenyan nation has an interest, however indescribable, however unrecognizable, or however transient, in public land.'

Kenya's current constitutional regime thus gives priority to the fact that property held by the state is done so in trust for the people of Kenya. Thus, the same is the case for the minerals and the profits generated from them which form part of the public land of Kenya.[28] In this case, profits oil should be distributed equitably to the local community and the same should be based upon laws and policies that have a solid foundation.

Additionally, in the case of ***County Government of Tana River v Dakane Shake Bocha***, the Court upheld the position of the County Government as the trustee of unregistered community

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[27] Manley D., Mihlayi D, Heller P, 'Hidden Giants', International Monetary Fund, Finance & Development, see https://www.imf.org/en/Publications/fandd/issues/2019/12/national-oil-companies-need-more-transparency-manley.

[28] Article 62(1)(f), *Constitution of Kenya*, 2010.

land as per Section 6 of the Community Land Act; and therefore any transfer of title of such land ought to be carried out according to the same or else it shall be considered null and void.[29]

When it boils down to profit oil and cost oil many local communities and other stakeholders feel 'cheated.'[30] It is important to mention that the host state's NOC plays a big role in the PSA negotiation process as well.

Upstream petroleum activities affect local communities directly and indirectly in terms of the environmental impacts and other related socio-economic consequences.[31] In consequence, such communities have moral and legal entitlements to a share of benefits from the natural resources. Local communities are also entitled to adequate compensation for what happens to them as a consequence of the disruption. The Petroleum Act, 2019 defines "community rights" to include the right to adequate compensation for land taken over for upstream petroleum operations, as well as the right to be compensated by any contractor who causes environmental damage or pollution.[32]

This study explores the framework on the application of profit oil and whether it addresses the attendant problems, especially the interests of local communities as stakeholders in the industry. Is the current framework for petroleum profit sharing adequate in addressing local community concerns? While attempting to address this pertinent question, this study also attempts to address the equally related issues of compensation of the stakeholders affected by petroleum activates, especially the local communities who are part of these.

[29] County Government of Tana River v Dakane Shake Bocha & 10 others (2021) Eklr.
[30] Mtuku K, Mdee A, 'Conservancies, Conflict and Disposession: The Winners and Losers of Oil Exploration in Turkana, Kenya', *African Studies Review,* 63(4), 846.
[31] Amoasah G, 'The Potential Impacts of Oil and Gas Exploration and Production on the Coastal Zone of Ghana: An Ecosystem Services Approach,' MSc Thesis in Environmental Sciences, Wageningen University 2010.
[32] Section 125, *Petroleum Act,* 2019.

This study attempts to identify the relationship between profit oil and the compensation processes of key stakeholders. It investigates whether the compensation processes adjudicated under the relevant judicial processes should have any implication on the government's complete entitlement to, and the application of, its share of profit oil in a specific venture.

The study will focus on profit oil and its application, as a part of the fiscal system of Kenya's upstream oil and gas industry. The "fiscal system" here means the payments which are to be received by the host government in return for allowing an oil company to operate on state's land to explore and produce hydrocarbons. These would include:[33]

(i) Royalties paid to the state;

(ii) Up front bonuses paid to the state;

(iii) Income taxes remitted by the contractor;

(iv) Production sharing wherein oil and gas is allocated between the parties to MPSC for the purposes of recovery of costs; or

(v) Government share of the remainder after recovery of cost (profit oil).

(vi) Infrastructure development for the host country.

This study's main focus will be on the sharing of the petroleum remaining after cost recovery which is commonly referred to as "profit oil." In addition, the study analyses the related interests of the local communities in oil and gas through the framework for compensation.

1.3 Statement of the Problem

The legal and policy framework for the oil and gas sector should secure interests of all stakeholders including local communities. Sharing of profits in the petroleum sector should take into account the rights of communities where the resource has been discovered.

[33] Gallun R, Wright C, Nichols L, Stevenson J, *Fundamentals of oil and gas accounting*, 4Ed, PennWell Corporation, Tulsa, Oklahoma, 2001, 74101.

The upstream oil and gas industry involves a wide array of interests from various stakeholders. Key among these stakeholders are local communities whose rights and proprietary entitlements are affected in some way or another by oil and gas ventures. The foundation of this idea is the constitutional public trust through which the state holds and exploits oil and gas resources.

Sharing and application of profit oil is challenging in two ways: First, there is the question of who is entitled to a share of profit among the national and the county government and communities and in what proportion. In this regard, the public trust vested in the state has often been questioned as insufficient in addressing local interests as has been demonstrated in the Turkana community negotiations. Secondly, how much share of the petroleum is adequate for each of these categories of stakeholders? Are the proportions set out in the law sufficient of arbitrary?

Although a framework has been created to deal with this problem under the Petroleum Act, 2019 there is no clear method of implementation to actually follow through with the framework provided.

The national government, county governments and local communities are expected to share profits derived from upstream petroleum operations by the national government in the ratio of 75%:20%:5%.[34] The local community share is expected to go to a trust fund established by the relevant county government. It is however not clear how the amount that is expected to go to local communities is to be applied, whether the local community shall receive them in form of monies or through funding of projects. Notably, this question of how the local community practically gets its share of profit oil is a wide and extensive topic which is not within the scope of this study.

[34] Section 58(3), *PA*, (2019)

Second, local communities have equally related and significant interests in oil and gas as they are entitled to the right to compensation as a community. However, there are challenges associated with this right. How do local communities get their compensation especially for land compulsorily acquired and utilized for petroleum activities where such land is largely community land? The Community Land Act provides that County governments shall hold in trust all unregistered community land on behalf of the communities for which it is held.[35] Most of what is known as community land in various parts of Kenya (such as Turkana county) is unregistered, and therefore vests in the County Government. In such circumstances, community interests are likely to be compromised and rights violated for lack of a direct mechanism for their involvement in compensation.

In settling communal compulsory acquisition matters based on the Turkana region, the Court seems to be in favour of the pursuit of alternative dispute resolution mechanisms which are flexible and through which negotiations are more plausible than in litigation. This was the case in ***County Government of Turkana v National Land Commission & another*** whereby the petitioners were seeking for a stay of a compulsory acquisition of Turkana's communal land which is predominantly communal land; and that the same was conducted without due regard to their consultation and without just compensation. The court ruled that it would stay the matter for one year during which the parties would be afforded the opportunity to conduct negotiations.[36]

1.4. Hypotheses

This study seeks to assess and address the following hypotheses:

a) The legal and policy framework governing the Kenyan oil and gas sector does not adequately take into consideration the interests of the local communities.

b) Rules on restriction of the application of the government's take of profit oil are essential to addressing pre-division problems tied to oil and gas ventures.

[35] Section 6, *Community Land Act*, (2016).
[36] County Government of Turkana v National Land Commission & another [2019] Eklr.

1.5. Research Objectives

The general objective of this study is to analyse the adequacy of the legal and policy framework governing profit-sharing and the related local community interests in the oil and gas sector in Kenya. This study hopes to achieve the following specific objectives:

a) To assess whether the current legal framework on the distribution of funds at the upstream level in oil and gas ventures in Kenya is adequate in securing the interests of local communities.

b) To explore the framework on the application of profit oil and whether it addresses the attendant problems.

c) To propose a framework for the utilisation of petroleum resources in addressing local community problems through the comparison of other countries with a more developed oil and gas governance framework.

1.6.Research Questions

a) Is the current legal framework on the distribution of funds at the upstream level in oil and gas ventures in Kenya adequate in securing the interests of local communities?

b) Should there be mandatory rules dictating the use and distribution of profit oil by the government?

c) Do the laws on distribution of profit oil take into consideration challenges experienced by communities, land owners and the general public at the pre-division stage?

1.7.Research Methodology

This study will be conducted through a review of literature, policy, law, and statistics from secondary sources. The method to be used to gather information for this study will be qualitative. Qualitative methodology which will entail the use of the library as well as desktop literature review will be employed.

Secondary sources of data are used, including books, articles, journal articles, government and institutional reports, and relevant internet sources on the subject. Secondary sources of information also include international law, constitutions, relevant statutes, case law, anecdotal illustrations, and other available legal literature materials on the subject.

The study will also involve a comparative analysis of the legal and policy frameworks of Norway and Nigeria, both already having vibrant offshore upstream oil and gas industries and also briefly analyse the onshore upstream oil and gas industries of Papua New Guinea and Venezuela.

Overall, these countries were selected based on their perceived levels of success in the oil and gas stage industry, the time at which petroleum was discovered and the level at which they are today in terms of legislation development. It is imperative to note that the same shall not be carried out as a copy and paste exercise but as a manner of learning from more established countries in order to address the gaps in the Kenyan experience.

Nigeria has been selected because it is Africa's largest oil producer and also home to the second-largest proven oil reserves in Africa.[37] It is also among the top 10 largest oil producer in the world.[38]

For Papua New Guinea, the choice is partly informed by the contribution of its extractive industry to GDP (approximately 26%) and its framework for benefit sharing that is entrenched in the Constitution.

[37] Herman K, 'Top 5 Oil Producing Countries in Kenya,' <https://pumps-africa.com/top-5-oil-producing-countries-in-africa/> on 20 December 2021.
[38] Ibid

Venezuela has been chosen because it is one of the founding members of OPEC and it was at one point considered to be a major oil and gas producing company.[39] Venezuela's oil revenues account for about 99 per cent of export earnings.[40] The perceived decline in Venezuela's oil and gas industry is partly attributed to change of laws and policies that increased government control over the sector.[41] The country also lacks specific laws for sharing of petroleum profit with local communities, and instead relies on general laws on revenue sharing between the national government and the subnational units.

The study also settled on Norway as a comparator because its petroleum sector entails the country's single largest industry, accounting for 10% of GDP. Norway is also the world´s 3rd largest exporter of natural gas, and the 13th largest exporter of oil.[42]

In this study, the stakeholder theory analysed and applied as the theoretical basis for evaluating fairness and other aspects of the sharing of petroleum revenues.[43]

1.8. Literature Review

1.8.1. Introduction

In this section the study will analyse the research that in already in place for benefit and profit sharing in local communities. Firstly, we will delve into a discussion of how the oil industry works and the various contracts that are involved in the process in general and later delve deeper into the meaning of equitable distribution and local community in general. This will also be covered in more detail in the upcoming chapters.

1.8.2. History of Oil and Gas in Africa

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[39] ICLG, 'Venezuel: Oil and Gas Laws 2021,' <https://iclg.com/practice-areas/oil-and-gas-laws-and-regulations/venezuela> on 20 December 2021.
[40] OPEC, 'Venezuela facts and figures,' <https://www.opec.org/opec_web/en/about_us/171.htm> on 15 December 2021.
[41] *Ibid.*
[42] International Trade Administration, 'Norway: Country Commercial Guide, <https://www.trade.gov/knowledge-product/norway-offshore-oil-and-gas> on 20 December 2021.
[43] See part 2.3.1 of this study.

It is important to understand when oil and gas was first discovered in Africa in order to better understand why the legal framework is so unsteady and thus needs a stronger foundation in order to be successful.

In his research on oil and gas in Africa, Ariweriokuma explains that Africa in general is abundantly blessed with oil, gas and other energy resources. Exploration of these resources in the continent can be said to have commenced in the 1900s. However, commercial discoveries were only documented in the 1950s.[44]

In the early phases of exploration carried out in Eastern Africa by major companies before the 1980s revealed only small finds on a scale that was not thought at the time to be commercially viable.[45] In Kenya, commercially viable oil reserves were discovered in Turkana, the north-western part of the country in 2012. It is estimated that the main basin contains more than 750 million barrels of oil.[46]

It was anticipated that upon discovery, Kenya would benefit from "oil bonus" that would support development projects for decades. However, there are already signs that the fragility of regulatory authorities throughout the region and the all too familiar problems of rent-seeking by governments and their officials may undermine the development potential that oil could bring.[47]

According to Agade, the discovery of oil in Kenya could boost the economy at the national and local levels.[48] On the other hand Shilling *et al* have argued that the exploitation of oil will above all impact people who reside near oil sites, the local communities. The authors concede that the literature on the effects of oil exploration and exploitation on local communities in Kenya is scarce.[49]

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[44] Ariweriokuma S, 'Oil and Gas in Africa' (1st ed) *The Political Economy of Oil and Gas in Africa,* (2009,) 22

[45] Anderson D M, 'The Politics of Oil in Eastern Africa', 5(2), *Journal of Eastern African Studies,* 2011, 369-410.

[46] Shilling J, Locham R & Scheffran 'A local to global perspective on oil and wind exploitation, resource governance and conflict in Northern Kenya, 18(16), *Conflict Security & Development*, 2018, 571-600.

[47] Anderson DM, *'The Politics of Oil in Eastern Africa'*, 23.

[48] Agade K, 'Ungoverned Space' and the oil find in Turkana, Kenya' Vol 103 (2014), https://www-tandfonline-com.ezproxy.library.strathmore.edu/doi/full/10.1080/00358533.2014.966497 20 November 2021

[49] Shilling J, *'A local to global perspective on oil and wind exploitation'*, 571.

Relatedly, Vasquez has argued that with the devolved system of government ushered in by the Constitution of Kenya, 2010, local government structures would be closer to the constituents than central government authorities in Nairobi the country's capital.[50] These governments would then be able to meet local needs in a more efficient way and also be directly answerable to the local communities. Furthermore, Vasquez argues that the 15% budget allocation given to these local governments by the national government as well as the additional funding provided to the fourteen most poverty-stricken counties through the equalization fund is not enough to meet all county needs. Turkana County is among the fourteen counties that benefit from the equalization fund. The Constitution takes this into account and allows for each local government to generate its own additional revenues.[51]

Vasquez is also of the line of thought that to avert the misuse of oil proceeds, counties should adopt clearly defined collaborative resource management mechanisms ahead of the generation of oil revenues[52] as this will provide a clear guideline for these future revenues. It is then important to understand the various arrangements that are part of the petroleum upstream process that shall be discussed below.

1.8.3. Delineation and Application of Profit Oil

Figure 1.4 below is a flow chart demonstrating petroleum legal arrangements**.**

[50] Vasquez P I, 'Kenya at a Crossroads: Hopes and Fears Concerning the Development of Oil and Gas Reserves'. *International Development Policy Analysis* 4(3), (2013) at p,24

[51]Vasquez P I, 'Kenya at a Crossroads: Hopes and Fears Concerning the Development of Oil and Gas Reserves'. 24.

[52] Vasquez P I, 'Kenya at a Crossroads: Hopes and Fears Concerning the Development of Oil and Gas Reserves', 29.

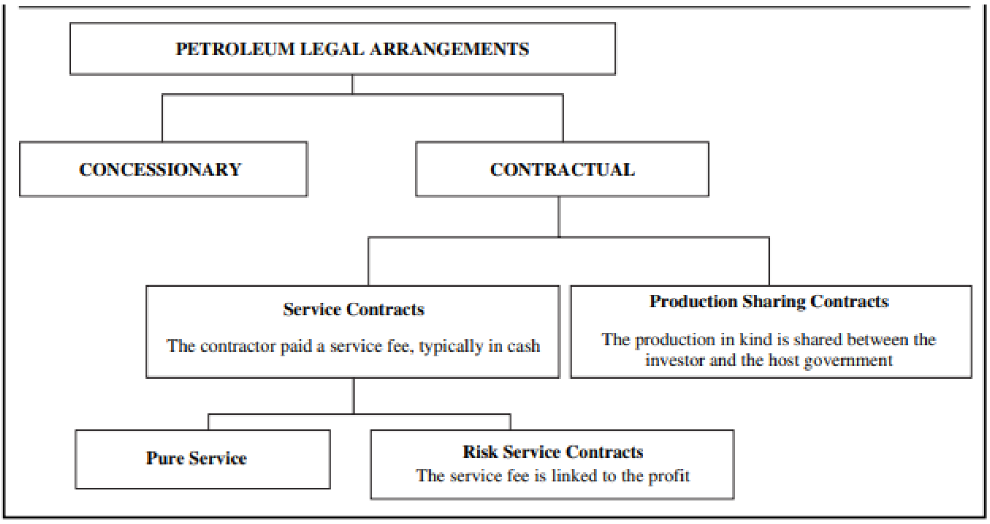

Fig 1.4. Flow chart for Petroleum Legal Arrangements[53]

In the petroleum industry as is demonstrated in Fig 1.4 above, there are different types of contracts entered into by the contractor (also known as the investor or foreign oil company) and the Host State. The contractual agreements are either Service Contracts (SCs) which are paid in cash and are considered the contractors service fee or Production Sharing Contracts (PSCs) (also referred to as Petroleum Sharing Agreements) where the production of oil is shared between the investor and the host state.

Tordo explains that under concessionary arrangements the natural resource will be passed on to the investor and the state will receive royalties and taxes in compensation for the use of the resources by the investor. On the other hand, under a contractual arrangement the investor will acquire ownership of its share of production only once it is delivered.

Through the PSA, the government and the contractor agree on how to share profit derived from crude oil.[54] Bindemann[55] explains that the states National Oil Company is usually the

[53] Tordo S, 'Fiscal Systems for Hydrocarbons Design Issues,' World Bank Working Paper, No. 123, Washington D.C, 2007, 8.
[54] Johnston D, 'International petroleum fiscal systems and production sharing contracts, *PenWell Publishing Company*, Tulsa, Oklahoma, 1994, 74101.
[55] Bindemann K, 'Production-Sharing Agreement: An Economic Analysis', Oxford Institute for Energy Studies, 1999, 1.

government's representative when it comes to engaging with an investor. In discussing the nature of the profit-sharing bargain in oil ventures, Penrose has noted that the sharing of oil revenue is basically a matter of bargaining between the parties interested and that the bargaining is influenced by political and economic considerations.[56]

In discussing the nature of oil and gas revenue, Sunley, Baunsgaard and Simard[57] focus on designing a framework that ensures that the state, as the resource owner receives an appropriate share. In a report by the Natural Resource Governance Institute (NRGI) on Revenue Sharing in Bolivia, it was noted that before 2005 the only revenue sharing from the oil and gas sector was only received from Royalty payments in Bolivia.[58]

Nonetheless, the authors do not precisely address the contribution of profit oil in addressing pre-division challenges. Their findings are that, ultimately, the market test for each country's fiscal regime is whether the country can attract investments in its oil and gas sector.

For the purposes of this study, this finding is important in the sense that it sets the benchmark for any proposals regarding division of profit oil: will the proposed application of profit oil have any adverse implications on the commitment of investors to continue operations in the domestic market? If the answer is in the negative, the proposals would have a place in strengthening the oil and gas sector in question. If the answer is in the affirmative, then, according to Sunley, Baunsgaard and Simard, the fiscal regime may be inappropriate for the country in question, given its exploration, production and development costs, as well as other risks, such as those of a political nature.[59]

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[56] Penrose E, 'Profit sharing between producing countries and oil companies in the Middle East,' 69(274), *The Economic Journal*, 1959, 238-254, 238.
[57] Sunley E, Baunsgaard T, and Simard D, 'Revenues from the oil and gas sector: Issues and country experience', 2002, <http://siteresources.worldbank.org/INTTPA/Resources/SunleyPaper.pdf>, 18 November, 2021.
[58] Natural Resource Governance Institute (NRGI), *Revenue Sharing*, 2016, 6.
[59] Sunley E, Baunsgaard T, and Simard D, 'Revenues from the oil and gas sector: Issues and country experience', 19.

In Kenya, the lack of a clear framework on division of profit oil has been a pet topic amongst various commentators.[60] Squabbles between the national and county government have highlighted the clear need to have a definite framework to guide the process. Even more significant for this study is the realization that a clear division framework can go a long way in solving pre-distribution problems that are unique to the oil and gas sector.

Under the Kenyan Petroleum Act 2019,[61] section 58 provides for the sharing of revenue of petroleum resources. It provides that the national government's share of the profits derived from upstream petroleum operations are to be apportioned between the national government, the county government and the local community. Under this provision, the County Government is entitled to a 20% share, and the local community is entitled to a 5% share of revenues while the national government is entitled to the remainder. This provision has not been without controversy as commentators have questioned the rationale for these percentages. .[62]

These criticisms are further indicative of the fact that the Petroleum Act does not resolve the various challenges tied to the question of how best state profit oil should be applied to satisfy the interests of various stakeholders.

1.8.4. Profit Sharing and Compensation Problems in the Extractives Industry

The distinction between profit sharing and compensation in the context of the oil and gas sector has been laid down in part 1.8 of this study.

[60] Miriri D, 'Kenya oil production on course after agreement on Revenue Share' Thomson *Reuters,* <https://af.reuters.com/article/investingNews/idAFKCN1IK0IR-OZABS>, on 20 November, 2021.

[61] Section 58, *Petroleum Act* (Act no. 2 of 2019)

[62] Kenya Civil Society Platform on Oil and Gas, 'Memorandum on the Petroleum Bill, 2017,' Submitted to the Senate Committee on Energy on 21st August 2018, 3.

Derri explores the litigation problems in compensation claims for oil and gas operations in Nigeria.[63] Derri notes that in the process of adjudication of compensation concerns, claimants will be faced with issues of *locus standi*, pre-action notice, burden and standard of proof, time limitations, inordinate delays, measures of damages and jurisdiction problems.

Generally, the test for *locus standi* is whether the individual or group instituting the action can demonstrate some pecuniary interest or physical damage, sustained or imminent, which must not be remote, speculative and insubstantial.[64] In oil and gas claims, the author notes, it is difficult for claimants to demonstrate proper standing as the claims will be of a broader, more public in nature. In Kenya, however, it may be argued that the Constitution has avoided this problem by giving a wide latitude for petitioners approaching the courts on a public interest basis.[65]

Hamilton[66] addresses the causes of community-oil companies' crises in the Niger Delta. The conclusion reached is that the key feature of these crises can singularly be attributed to exploration of oil and the unequal appropriation of what accrues from the oil.[67] As a recommendation, he observes that oil and gas companies in the Niger Delta ought to take up community relation strategies through community development projects.[68]

Elendu[69] argues that the resistance by local communities, such as those in the Niger Delta is threatening the growth of the energy sector. He gives the example that from 2008-2018 Nigeria's oil output has reduced significantly due to the resistance from host communities in the region. He furthers talks about the Social License to Operate (SLO) granted by local

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[63] Derri K, 'Litigation problems in compensation claims for oil and gas operations in Nigeria,' in Emiri F and Deinduomo G (eds), *Law and petroleum industry in Nigeria: current challenges, Essays on honour of Justice Kate Abiri*, 11-34.

[64] *Baker v Carr,* 369 U.S. 186, 204(1962).

[65] Article 22, *Constitution of Kenya* (2010).

[66] Hamilton D, '*Oil and gas companies and community crises in the Niger Delta'*, *American Review of Political Economy*, 2011, 3-17.

[67] Hamilton D*, 'Oil and gas companies and community crises in the Niger Delta'*,6.

[68] See, generally, Hamilton D*, 'Oil and gas companies and community crises in the Niger Delta*.'

[69] Elendu K, '*Social Licence to Operate: A Solution for Community crises with Oil Companies'*, (2018)

communities. The SLO is the community's perception of the acceptability of a company and its local operations. This license highly depends on the community's trust of the companies in several areas such as community health and safety, economic growth of the community, environmental conservation and negative footprints in the community.[70] The SLO is an important aspect that many oil and gas companies should take into consideration to avoid the wrath of many local communities.

Ogedengbe[71] conducts research on the position of compulsory acquisition ventures in relation to oil and gas projects in Nigeria. The methodology utilised involved interviewing former landowners, as well as interviewing estate surveying and valuation firms. Based on the data, the research reaches a conclusion that the compensation paid to residents, in the Niger Delta specifically, is "grossly inadequate."[72]

Kakulu reaches a similar conclusion[73] in relation to the compensation situation in the Niger Delta. The research finds that ambiguity and inconsistency in the interpretation of relevant statutes are partly responsible for inadequate compensation at the conclusion of compulsory acquisition ventures. Therefore, it proposes that statutory reforms should be accompanied by a compensation code that would help provide clarity in the interpretation of different statutes in a logical and coherent way. In Kenya, this is important considering that compulsory acquisition in general has not been particularised for oil and gas-related takings of land.

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[70] Elendu K, '*Social Licence to Operate: A Solution for Community crises with Oil Companies'*, (2018)

[71] Ogedengbe P, 'Compulsory acquisition of oil exploration fields in Delta State, Nigeria: The compensation problem,' 25(1) *Journal of Property Investment and Finance,* 2007.

[72] Ogedengbe P, 'Compulsory acquisition of oil exploration fields in Delta State, Nigeria: The compensation problem,' 1.

[73] Kakulu I, 'The assessment of compensation in compulsory acquisition of oil and gas bearing lands: The Niger Delta experience,' 2008, 57-65.

In a study on compensation problems in Nigeria, Kakulu has noted that there is an urgent need for reforms in various enactments regarding compulsory acquisition and the assessment and payment of compensation.[74]

This problem is compounded by the fact that the law on compensation upon compulsory acquisition of real property under land law is well-established. Under Article 40 of the Constitution,[75] owners of property that is required for public interest are to be availed just and equitable compensation. However, under Article 62(1)(f), land under which mineral (or in this case oil and gas) resources occur forms part of public land. Therefore, the basic principle of the law of compulsory acquisition which is government acquiring land from a private citizen does not fully reconcile with the phenomenon in oil and gas, where title to public land does not vest in any one person.

In this particular study, the focus will be on the adequacy of the legal framework in covering the interests of local communities in the oil and gas sector. Despite the apparent nature of the aforesaid issues, there exists a dearth in literature on how, if at all, distributional problems in the upstream sector can be addressed by the state at the post-division stage.

While you have addressed a fair bit of literature in review, eventually you fall short of demonstrating the actual gaps in knowledge that justify your research.

1.9.Theoretical framework

1.9.1 The Stakeholder theory

The term *'stakeholder'* originated as a re-statement of organizational responsibility, challenging the previously held notion that firms were only accountable to stockholders.[76] This

[74] Kakulu I, 'The assessment of compensation in compulsory acquisition of oil and gas bearing lands: The Niger Delta experience,' 64.
[75] Article 40, *Constitution of Kenya*, 2010.
[76] Freeman *et al*, 'The Stakeholder theory: The state of the art', *The Academy of Management Annals*, 4, (2010).

kind of limited thinking led to the development of various theories to assist in explaining management that involved high levels of uncertainty and change. This new development was to address three problems that were interrelated in business, namely; *the problem of value creation and trade, the problem of the ethics of capitalism* and *the problem of managerial mindset*.[77]

Problems addressed by term 'Stakeholder'	
The Problem of value creation and trade	In a rapidly changing and global business context, how is value created and traded?
The Problem of the Ethics of Capitalism	What are the connections between capitalism and ethics?
The Problem of Managerial mindset	How should managers think about management to; (1) Better create value; and (2) Explicitly connect business and ethics?

Table 1.2. Problems addressed by term 'Stakeholder'

The definition of a 'stakeholder' is pivotal, as it is intertwined with the obligations and duties owed to each stakeholder.[78] However, a singular definition has proved elusive. Instead, the concept has evolved. Even Freeman, who has been cited extensively on the theory and is regarded as its 'father', has been noted to have gradually changed his definition of who a stakeholder is,[79] and further, what the stakeholder theory is.[80] For clarity, therefore, this discussion will begin by studying Freeman's initial conception and trace its development from there.

Freeman's pioneering work came about as a response to a growing need for new strategic approaches in a rapidly changing market, with unprecedented needs. The solution he proffered was that management teams needed to be cognizant of *'groups or individuals that can affect, or are affected by' activities of the firm'*.[81] This initial definition was not bereft of criticism.

[77] Freeman *et al*, 'The Stakeholder theory: The state of the art', *The Academy of Management Annals,* 4, (2010).
[78] Freeman E, 'The politics of stakeholder theory: some future directions', *Business Ethics Quarterly,* (1994), 412.
[79] Fontaine A, Haarman A & Schmid A, 'The stakeholder theory of the MNC', 3.
[80] Freeman, 'The politics of the stakeholder theory', 411.
[81] Freeman E & Reed D, 'Stockholders and Stakeholders: A New Perspective on Corporate Governance' *SAGE Journals*, (1982), 25.

Prominently, the diction resulted in ambiguity, as people who 'can affect, or can be affected' seemed an all-inclusive class of people, causing challenges similar to the floodgates doctrine.[82] In subsequent works, Freeman grounds his conception in morality,[83] denouncing a separationist view of business and ethics.[84] He states that as business always involves human beings, an attempt to remove ethics from the discussion on business relationships and their ensuing duties is misguided.[85]

Additionally, however, Freeman states that the *'stakeholder theory'*, is in fact, a genre that encompasses different narratives, and that the normative approach is one of several subsets.[86] Others are descriptive, instrumental, and metaphorical. For Freeman, therefore, there are several stakeholder theories and not one central theory. Each can be a guide on how we think and therefore, how we live. The goal in that exposition appears to be to prescribe a rejuvenated understanding of *'the human process of joint value creation'*,[87] an excellent point for consideration for this study. Freeman proposes an ethical classification of fairness, equality and equity thus:

a. That basic equality among shareholders should take prominence in any contract entered by the firm;
b. That inequalities are only justifiable if they yield an improvement in conditions of the least advantaged shareholder;
c. That the freedom to contract for each shareholder should be exercised toward their value addition, and that there is a unity created amongst different shareholders through this goal.[88]

Freeman proceeds to propose several principles which he christens *'ground-rules'* that can be applied to maintain fairness amongst the different stakeholders, who, each being rational is consequently self-seeking.[89] Briefly, the ground- rules are: *The Principle of Entry and Exit, the Principle of Governance, the Principle of Externalities, the Principle of Contracting Costs, the Agency Principle and the Principle of Limited Immortality* (See Table 1.3). The most

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[82] The floodgates principle is often applied in tort law, to limit claims in cases were, as per Denning, 'there would be no end in claims. *Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd* (1973) England Court of Appeal.
[83] Laplume, 1158.
[84] Freeman, 'The politics of stakeholder theory', 414.
[85] Freeman, 414.
[86] Freeman, 415.
[87] Freeman, 416.
[88] Freeman, 417.
[89] Freeman, 419.

relevant of these Principles to this study is the Agency Principle. It states that agents must see to it that all shareholder interests are upheld, and that any conflict is resolved in respect to all principals and not a privileged one.

Principles of Fair Contracts	Explanation
The Principle of Entry and Exit	A stakeholder must be able to determine when an agreement exists and has a chance of fulfilment. A contract must contain methods for determining whether or not it is valid.
The Principle of Governance	Each stakeholder should never give up its right to participate in the governance of the corporation or even the existence of stakeholder governing boards.
The Principle of Externalities	If there is a contract between A and B that imposes a cost on C, then C has the option to become a party to the contract and the terms can be renegotiated. Each stakeholder will want insurance so they do not become C.
The Principle of Contracting Costs	All parties to the contract must share in the cost of contracting.
The Agency Principle	Any agent must serve the interests of all stakeholders. It must adjudicate conflicts within the bounds of the other principles.
The Principle of Limited Immorality	The corporation shall be managed as if it can continue to serve the interests of stakeholders through time. Under this principle it would be rational to hire a manager who are fiduciaries to their interest and the interest of the collective. If the 'collective interest' is null and void then the principle collapses into the Agency principle.

Table 1.3 Doctrine of Fair Contracts[90]

For years after Freeman's exposition, the literature displays a vibrant discussion aimed at achieving a unified, convincing definition of the stakeholder. Mitchell *et al*, provide a comprehensive list of these definitions, they report that the desired fruit of this extensive debate is slight.[91] Instead, scholars seem to either subscribe to a broad or narrow conception of the stakeholder. Definitions falling under the 'narrow' category are premised on the finiteness of resources, necessitating a stakeholder view that is limited to those that have a direct bearing on the core business of the organization. Conversely, 'wide' definitions are receptive of the idea that a seemingly overwhelming number of people may affect or be affected by the organization. In response, managers are to be equipped in ways of dealing with this reality. The possibility that anyone may then be a stakeholder, raises a normative consideration: who ought to be considered by the firm?[92]

1.9.2. Applying the Theory to Identifying Stakeholders in Oil and Gas Ventures

The stakeholder theory has subsequently diffused beyond the corporate marketplace and has been applied to various sectors beyond that.[93] The theory has also been applied to the manner in which public governance is carried out; where the local communities and citizens are viewed to be the stakeholders.[94] Gomes observes that the stakeholder theory is double-sided, invoking both the organization's approach towards its shareholders, and the shareholders' mode of staking a claim against the organization.

Mitchel *et al* provides a theory of stakeholder identification based on power, legitimacy and urgency, which this study now adopts as an analytical tool for the three groups identified. Power is said to be a party's ability- latent or active- to enforce their will. It is however not fixed, as power can be gained or lost at different stages. Stakeholders that only possess this

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90 Freeman, 417.

91 Mitchel R, Agle B and Wood D, 'Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts', *The Academy of Management Review*, 4 (1997), 22, 853.

92 Laplume A, Sonpar K and Litz R, 'Stakeholder theory: Reviewing a theory that moves us', 6 *Journal of Management*, 34, (2008) 1161.

93 Such as health: Schiller C, Winters M, Hanson H, Ashe M, 'A framework for stakeholder identification in concept mapping and health research: a novel process and its application to older adult mobility and the built environment' *BMC Public Health*, (2013).

94 Gomes RC, 'Stakeholder Management in the Local Government Stakeholder Management in the Local Government Decision-Making Area: Evidences from a Decision-Making Area: Evidences from a Triangulation Study with the English Local Triangulation Study with the English Local Government', *RAC*, (2006).

attribute are termed dormant. This is because though they have power, they are unable to channel it through a legitimate process, neither do they have an urgent claim.[95] Secondly, legitimacy arises out of moral or legal rights of a stakeholder.[96] Stakeholders that only possess legitimacy are called discretionary stakeholders. They lack the power to enforce it and the urgency to necessitate action from those in power. Action is therefore reliant on the discretion of managers.[97]

Lastly, urgency is said to exist where the claim is time-sensitive and critical to the stakeholder. *'Critical'* claims include ownership and expectation of the stakeholder. However, whether or not these concerns are acted on depends on the firm's willingness.[98] Stakeholders who only possess this attribute are termed as *'demanding'*, and are seen as *'barking, toothless dogs*. For their claim to merit the attention of management, they need to be elevated either by legitimacy or power.[99]

Stakeholder Identification	
Power	• The party's ability either latent or active to enforce their will. • Not fixed as power may be gained or lost at different stages. • Dormant Stakeholders
Legitimacy	• Arises out of a moral or legal right of a stakeholder. • Discretionary Stakeholders
Urgency	• This is where a claim is time sensitive and critical to stakeholders. • Demanding Stakeholders

Table 1.4. Attributes of Stakeholder Identification

[95] Mitchel, Agle, & Wood 'Toward a Theory of Stakeholder Identification and Salience', 860, 864.
[96] Langtry B, 'Stakeholders and the moral responsibilities of business' *Business Ethics Quarterly*, 4 (1994) 431-443.
[97] Mitchel, Agle & Wood, 875.
[98] Neville & Menguc, 'Stakeholder Multiplicity: Toward an understanding of the interactions between stakeholders', *Journal of Business Ethics* (2006), 66, 377–391.
[99] Mitchel, Agle & Wood D, 864, 875.

Furthermore, these three attributes are said to interact differently, bringing about several types of stakeholders. The interplay between power and legitimacy is such that power may be exercised legitimately or illegitimately, and that one may have a legitimate claim but lack power and therefore be rendered inconsequential.

Combined, power and legitimacy bring about authority, stakeholders possessing both attributes are referred to as dominant.[100] Though their authority is often well asserted, it is important that there are established processes that pay credence to their position. Urgent claims combined with legitimacy bears a category of stakeholders called dependent stakeholders. Dependent stakeholders are prone to encounter disadvantage as, the urgent resolution of their claim, though legitimate, is dependent on others who have more power than them. Claims can therefore only be addressed if a dominant stakeholder steps in as a sort of trustee or advocate for the non-dominant one.

The Stakeholder identification classification if applied to the Kenyan context can be interpreted through local communities as they can be construed as having the legitimacy attribute because they have a legal and moral right of a stakeholder. However, they do not have the power to implement as the same is vested in the state as seen in the public trust doctrine.

Article 10 of the Constitution provides for the national values and principles of governance that bind all state organs. These includes the principle of equity, participation of the people and sustainable development; all of which are pertinent to this study, albeit to different extents. In the same vein, the Petroleum Act, 2019 provides for the rights of citizens to be informed and to participate in the affairs of government that affect them directly and indirectly. Public participation has been widely litigated upon and the courts have consistently affirmed its importance. In ***Richard Owuor & 2 others (suing on behalf of Busia Sugarcane Importers Association) v Cabinet Secretary, Ministry of Agriculture, Livestock, Fisheries & Cooperatives & 7 others,***[101] the Court held as follows regarding public participation:
'Public participation therefore refers to the processes of engaging the public or a representative sector while developing laws and formulating policies that affect them. The processes may take different forms. At times it may include consultations…. Consultation is, hence, a more

[100] Mitchel, Agle & Wood D, 876.
[101] Richard Owuor & 2 others (suing on behalf of Busia Sugarcane Importers Association) v Cabinet Secretary, Ministry of Agriculture, Livestock, Fisheries & Cooperatives & 7 others (2020) Eklr.

robust and pointed approach towards involving a target group. It is often referred to as **stakeholders' engagement.' (emphasis mine).**

Additionally, in ***Mui Coal Basin Local Community & 15 Others v Permanent Secretary Ministry of Energy & 17 Others;***[102] the Court addressed the concept of consultation in the following manner: -

"…. A public participation programme, must…show intentional inclusivity and diversity. Any clear and intentional attempts to keep out bona fide stakeholders would render the public participation programme ineffective and illegal by definition. In determining inclusivity in the design of a public participation regime, the government agency or Public Official must take into account the subsidiarity principle**: those most affected by a policy, legislation or action must have a bigger say in that policy, legislation or action and their views must be more deliberately sought and taken into account. (emphasis added)"**

In light of the above, there is a typical recognition of communities as stakeholders in the oil and gas industry. The constitutional right to information and to public participation[103] have been included in the Petroleum Act as one of the community rights. Prior to the commencement of upstream petroleum activities, communities have a right to be informed about the activities within their county and sub-county.[104] They also have a right to *participate in planning for corporate social responsibility projects that are to be implemented within the contract area by the contractor in consultation with the national government and a county government.*[105]The above provisions are an acknowledgement of the place of local communities in the oil and gas sector as stakeholders. This brings about the relevance and applicability of the stakeholder theory to this study.

1.10. Justification of the Study

The magnitude of the challenges relating to compensation and distribution of profits in view of the public trust in oil and gas activities would demand a comprehensive assessment of all the legal mechanisms that could be utilised in solving them.

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[102] Mui Coal Basin Local Community & 15 Others v Permanent Secretary Ministry of Energy & 17 Others, (2014) Eklr.

[103] Article 10, Article 133, *Constitution of Kenya*, (2010).

[104] Section 125(a), *Petroleum Act*, (2019).

[105] Section 125, *Petroleum Act*, (2019).

The study will attempt to plug this gap by examining the viability of utilising the government's take of profit oil as the last frontier of addressing distributional problems, especially challenges in sharing the profits with local communities.

This is important in forestalling controversies or related obstacles to the oil and gas venture in its relatively later stages, as well as fulfilling all constitutional standards. If the study is able to address the issues discussed it could be a way for local communities to finally see eye to eye with investors and better understand the petroleum industry and its potential benefits.

1.11. Chapter Breakdown

The study will begin with Chapter one which is the proposal to the study. It discusses the problem and formulates the relevant research questions and hypotheses to anchor the study in its progression to later chapters.

Chapter Two will be constituted of the conceptual framework of the study. It explores the regional and international framework on profit sharing in the sector and benefit of stakeholders that may have been overlooked in the pre-division stage. The key concepts to be discussed will include the present state of local communities in the oil and gas industry, as well as any other stakeholders entitled to compensation. It will also consider the stakeholder theory and the importance of identifying stakeholder in the sector. This inquiry will explain what will appear to the study as a limited concern for stakeholders with less bargaining power in the oil and gas political marketplace.

Chapter three will examine the Kenyan legal and institutional framework on the division of profit oil and the application of the government's take. It will also include a discussion on pre-division problems that may need to be addressed after the division stage is completed.

Chapter four will contain the comparative analysis of jurisdictions. It will discuss the legal framework of Norway, Nigeria, Papua New Guinea and Venezuela in terms of profit oil appropriation. It will explore the techniques used by these jurisdictions in the areas of profit oil appropriation. While also discussing the concepts of the Resource Curse and Sovereign Wealth Funds.

The final chapter will contain the conclusions reached and recommendations proposed by the study in view of its findings. It will offer insight on the desirability of the application of the government's take of profit oil in addressing pre-division problems, especially those on compensation.

Chapter Two

Regional and International Framework on Profit-Sharing in Oil and Gas Sector & the Stakeholder Theory

2.1. Introduction

This chapter delves into discussions centred around the regional and international framework on profit sharing in the oil and gas sector, the term 'local community' and the identification of stakeholders. The stakeholder theory is applied to the scenario at the profit-division stage in order to determine whether individual land owners, communities and the general public have a stake in the government's share at this level, even though compensation is presently done at the upstream stage. Profit and equity are then examined with a view of establishing the oil and gas sector as a business endeavour whose participants are desirous of profit, but while maintaining the government's position as an agent and trustee of its citizens.

2.2. Criterion for Local Community

For this study it is important to investigate what exactly is meant by *'local community'* as this is an important attribute of this study.in terms of the local community there are many definitions or criteria used to explain which parties are considered the local community in a specific sector, for the purposes of this study the oil and gas industry.

Wilson[106] refers to the local community as the indigenous communities that are directly affected by the resource development. She further states that the lack of influence of indigenous people over the critical players that are external to local indigenous communities, regularly results in less than equitable benefit sharing outcomes for those communities. Local community is described under the Natural Resources (Benefit sharing) Bill 2020, as 'a people living in a ward within which a natural resource is situated.'[107] This definition is similar to that of Wilson as they both agree that the local community are those residing within the natural resource area. Kenya's petroleum Act, 2019 also defines local communities to refer to those who reside within the sub-county where the natural resource is and are affected by its activities.

[106] Wilson E, 'What is Benefit Sharing? Respecting Indigenous Rights and Addressing Inequities in Arctic Resource Projects' Resources. (2019); 8(2):74. <https://doi.org/10.3390/resources8020074> on 20 November 2021

[107] Section 2, *The Natural Resources (Benefit Sharing) Bill* (2018).

Those along the pipeline route cannot claim to be local communities as per the above definition. This is justifiable in the sense that pipelines rarely affect those who live along it and that if everyone living along the line is to be included in the category, the number would be too high and unsustainable as far as profit sharing and compensation is concerned.

When exploration activities take place in isolated indigenous territories, they are likely to affect those populations or communities whose upkeep is directly dependent on their natural surroundings those who interact primarily through communal tenure systems and non-market forms of exchange; and who have limited access to external markets, services and resources.[108] The benefits to the locals tend to sometimes go unnoticed as in some case these communities may be stripped of their traditional lands and resources with little to no recourse availed to them which then reflects their marginal position within the national political economies and the alliances shared between the government bodies and extractive industries.[109]

In terms of benefits to the community it has been argued that any welfare or efficiency consequence of an oil resource depends on how it is extracted, managed, shared and how its proceeds are distributed.[110] Under the Natural Resources (Benefit Sharing) bill 2020 'benefit' is defined to mean any 'gains, proceeds or profits from the exploitation of natural resources' and benefit- sharing is referred to as 'the sharing of any benefits arising from the exploitation of natural resources in a and equitable manner.'[111]

2.3. Regional Framework on Profit Sharing in the Oil and Gas Sector

For the purposes of this study regional refers to the EAC. The Petroleum industry in the EAC has been growing rapidly in recent years. Research has suggested that in order to achieve economic development and growth in the EAC that it is necessary to rapidly develop its energy infrastructure.[112]

108 Bozigar M, Gray C.L, Bilsborrow R E, 'Oil extraction and indigenous livelihoods in the northern Ecuadorian Amazon', *World Dev,* (2016)
109 Bozigar M *et al*, 'Oil extraction and indigenous livelihoods in the northern Ecuadorain Amazon', (2016)
110 Mwabu G, 'Kenya's Oil Governance Regime: Challenges and Policies' in Langer A, Ukiwo U and Mbabazi P, Oil Wealth and Development in Uganda and Beyond: Prospects, Opportunities, and Challenges', *Leven University Press*, 2020, at 351-372
111 Section 2, *The Natural Resources (Benefit Sharing) Bill* (2018)
112 Nyamongo J, and Nyamongo L.K, 'Energy infrastructure investment in East Africa and the relevance of the energy charter treaty', Energy Charter Secretariat (2019), at 1

Before the 2000s the region had no quantifiable reserves of hydrocarbons, however a discovery of large reserves of oil and gas in Tanzania (2010), Uganda (2006) and Kenya (2012) have uplifted the regions' position in the sector.[113]

The EAC, in 2008 sanctioned a strategy for the regional refinery to amplify existing distribution networks and storage capacities for better structured delivery of oil products throughout the region. This strategy identified key stakeholders and acknowledged that the execution of the project would boost the EAC'S capacity to refine hydrocarbons therefore obtaining its supply at low costs while contributing to the region's growing needs.[114]

The EAC member states each have their own unique laws and policies that govern petroleum and energy. In the countries where a committed petroleum policy has been developed, the policy mostly provides more transparency for the directions that should be adhered to at the decision gates in the value chain.[115]

The table below presents the petroleum laws and policies in EAC. It provides a summary of the national legislation that the partner states in the region have in the sector of petroleum legislation. With the exception of Burundi, most partner states have taken initiative to legislate on petroleum within the last decade or so, this signals that they have felt an incentive for them to update and keep their national laws and policies up to speed given how lucrative the oil business is.

Country	**Policy**	**Petroleum Law**
Tanzania	• National Energy Policy 2015 (July 2015)	• The Petroleum Act, 2015- Supplement (18 September 2015)
Kenya	• National Energy and Petroleum Policy- 16 June 2015	• The Petroleum Act, 2019

[113] Nyamongo J, 'Energy infrastructure investment in East Africa and the relevance of the energy charter treaty',11

[114] Nyamongo J, 'Energy infrastructure investment in East Africa and the relevance of the energy charter treaty',12.

[115] African Development Bank Group, Study report on harmonization of petroleum policies, legal, regulatory and institutional frameworks in the East African Community, 15 February 2018, at 8.

Uganda	• National Oil and Gas Policy for Uganda- October 2008	• The Petroleum (Exploration, Development and Production act, 2013 • The Petroleum (Refining, Conversion, Transmission and Midstream storage) Act 2013(26 July 2013) • The Petroleum Supply Act, 2003 (20 October 2003)
South Sudan	• Petroleum Policy- 2013	• The Petroleum Act- 2012
Rwanda	• National Upstream Petroleum Policy Rwanda- (April 2013)	• Law governing Petroleum Exploration and Production Activities, 13/2016 (2 May 2016)
Burundi		• Code minier et petroiler de la Republique du Burundi, 1/138 (17 July 1976)

Table 2.1 Policies and Petroleum laws in EAC

A report by AfDB in 2018 found that petroleum policies in the region have some similarities. Some of the key provisions that are reiterated across the board as is pertinent to this study include the provision stating that petroleum resources should be managed and utilized in a manner that benefits the society as a whole[116]. This reflects that across the regional board, there is an adoption of the public trust doctrine in which the partner states are to hold petroleum resources in trust for their people. This includes distributing profit oil amongst key stakeholders is a manner that is both just and equitable, rather than arbitrary.

[116] AfDB, '*Study report on harmonization of petroleum policies'*, at 8.

2.4. International Framework on Profit Sharing in the Oil and Gas Sector

Research indicates that the extractives sector in a country can provide significant contributions to a government's fiscal revenues, while still creating economic opportunities that benefit their citizens, however the local population tend to bear an unreasonable share of the costs attached to extractive activities. When the extractives sector is managed poorly it can aggravate the inequalities and social exclusion already faced by local communities especially if there is no indigenous representation in the sector's management and oversight.[117]

Article 21(1) of the African Charter of Human and Peoples' Rights (ACHPR) states that; "All peoples shall freely dispose of their wealth and natural resources. This right shall be exercised in the exclusive interest of the people. In no case shall a people be deprived of it."[118] The Charter further states that state parties to the charter shall individually and collectively exercise the right to free disposal of their wealth and natural resources with a view to strengthening African unity and solidarity.[119] These two articles could be argued to be the basis on which profit or benefit sharing in the oil industry is determined in terms of the local communities involved.

The Extractive Industries Transparency Initiative (EITI) has created the EITI standard for countries in the extractive sector. It has set out the global voluntary standard for good governance of oil and gas and mineral resources in the EITI standard 2019. It currently has a membership of fifty-seven countries.[120] The standard makes an assessment of the various levels of compliance achieved by the member countries in the following manner. Member countries are required to demonstrate government commitment to the standard, execute company engagement within itself, to encourage civil society to participate in the extractive process as stakeholders and to then submit an application to the EITI Board for review and assessment.[121] Requirement 5 of the standard provides for revenue allocations. Under this requirement revenues includes; distribution of revenues, subnational transfers and revenue management and

[117] Extractives Industries Transparency Initiative International Secretariat, *Empowering communities in EITI implementing countries to participate in the oversight of the extractive sector: Summary of findings from scoping reports in Colombia, Ghana and Indonesia*, October 2020, at 6.
[118] Article 21(1), *African Charter on Human and People's Rights, 27 June 1981 entered into force 21 October 1986.*
[119] Article 21(4) *ACHPR*, 27 June 1981.
[120] The EITI website, See https://eiti.org/countries.
[121] The EITI website, See https://eiti.org/collections/eiti-standard.

expenditures.[122] Countries are required to disclose a description of revenues from the extractives industries by indicating which extractive industry revenue whether in cash or in kind are recorded in the national budget. Each revenue allocation must be explained and links to the relevant financial reports must be provided, for example, sovereign wealth funds, sub-national governments and state-owned enterprises.[123] Furthermore implementing countries are required to submit a revenue sharing formula from revenues transferred from the national government to the subnational government entity.[124]

The Natural Resource Governance Institute (NRGI), a non-profit organisation founded in New York in 2013. It breaks down the basics of local government revenue distribution.[125] NRGI explains that national government often share the responsibilities of governing with local governments. The local government receives resource revenues through direct payment from oil companies or from the revenue transfers received from the national government. The decisions on whether or not the local government should receive revenues is often complicated due to the competing objectives such as promoting national cohesion, inter regional equity, effective national fiscal management and optimizing resource exploitation.[126]

2.5. Maintaining Attractiveness of the Host State to Extractives Investors

In ordinary contracts, the doctrine of privity precludes third parties from enforcing rights under contracts to which they are not a party. It is desirable to protect unsuspecting individuals from liabilities they did not agree to and to protect the gains of an enterprise from being diminished by interlopers.[127] However, an agreement concluded between the government of a constitutional democracy and an extractives investor is inherently intended to benefit the people that the state represents.

[122] The EITI Standard, *Requirement 5*, (2019).
[123] The EITI Standard, *Requirement 5.1*, (2019).
[124] The EITI Standard, *Requirement 5.2*, (2019).
[125] NRGI Website, see https://resourcegovernance.org/about-us/what-we-do.
[126] 'The natural resource governance institute, Primer: Subnational revenue distribution', 27 April 2015, <https://resourcegovernance.org/analysis-tools/publications/primer-subnational-revenue-distribution> on 24 November 2021.
[127] The Law Commission, *Privity of contract: Contracts for the benefit of third parties*, 23 October 1991, 2.

Following the previous discussion on profitability, the benefits accruing to the government as a party to such an agreement are ultimately destined to benefit the people. As such, the government is not a party in the traditional sense but is, instead, a broker between the investor's interests and the public's interests. The associated agency costs[128] ultimately narrow the margin of profitability as they must be offset to make the enterprise beneficial to the host state and the citizens it represents.

Fiscal regimes can be used to translate a government's policy into economic signals to the market, and influence investment decisions, provided that the framework is clear, is not charged retroactively and does not discriminate among the parties. Many countries have used favourable taxation of oil and gas to support the development of the sector in addition to relevant sector reforms. One of the key challenges of an efficient fiscal system is to receive paramount effort from the oil companies while ensuring that the host government is satisfactorily compensated.[129]

Petroleum activities tend to have special provisions in their fiscal regimes in order to modify the timing or magnitude of the revenue appropriations. Provisions such as these are designed to incentivise or attract investors to the host state[130].

Although the Host state and the investor aim to achieve the same goal of obtaining high levels of revenue, their other objectives are not the same. The host government's goal is to obtain maximum value for the country over the agreed time period. They aim to maximize their wealth from natural resources while still attracting foreign investment. Host state's also need to

[128] Chrisidu-Budnik A and Przedańska J, 'The agency approach to the public procurement system', 7(1) *Wroclaw Review of Law, Administration & Economics*, 156. The authors distinguish agency costs in three categories: costs the principal incurs in their control over the agent, in this case being concessions made in advocating a particular interest; costs the agent incurs in inspiring the principal's confidence, in this case being concessions made in accommodating multiple interests; and the opportunity costs or inefficiencies arising from a divergence in the objectives of the agent and the principal, in this case being obligations to find alternative solutions to compensate public interests not directly catered for by the contract itself.
[129] Tordo S, World Bank Working Paper, no, 123, *Fiscal Systems for Hydrocarbons Design Issues*, (2007), Washington D.C, 1.
[130] Tordo S, *Fiscal Systems for Hydrocarbons Design Issues*, 11

consider other objectives such as; job creation, transfer of technology and development of local infrastructure.

On the other hand, the main aim of investors or oil companies is to ensure that the return on capital is compatible with the risk in line with the project as well as the strategic objectives of the company.[131] The Host state has a tremendous amount to consider when dealing with investors and this may be why sometimes they are short-changed when it comes to production sharing contracts as they cannot hope to please all parties that are affected.

A fiscal policy challenge arises as the government must negotiate with the investor for a share of the profit oil that is adequate to offset these costs. Sunley, Baunsgaard and Simard warn that such a negotiation would be improper if it increases the price of extracting the resource so as to deter the investor.[132] Where the government requires a large share of profit oil to offset its multiple costs and ensure profitability, the remaining share that accrues to the investor may just turn out to be unattractively small. This could be from the perspective of comparative advantage, where the investor prefers the profit potential in working with a less demanding host state, or of absolute advantage where the investor's potential share is too low to make the enterprise worthwhile. Without its own alternative, losing investor interest means that the host state will not be able to extract and monetize, its oil.

The benefits that accrue to a host state from entering into an extractives enterprise with an investor are not solely those from the profit oil. The gains that a new industry adds to a nation's economy include: a wider and richer tax base; a larger and more stable labour market; lower dependence on government subsidies; increased market activity; and increased capital mobility.[133] These trickle-down benefits, although difficult to predict and guarantee, are

[131] Tordo S, *Fiscal Systems for Hydrocarbons Design Issues*, 13.
[132] Sunley E, Baunsgaard T, and Simard D, 'Revenues from the oil and gas sector', 2002, 1.
[133] Anaman KA and Osei-Amponsah C, 'Analysis of the causality links between the growth of the construction industry and the growth of the macro-economy in Ghana', 25(9) Construction Management and Economics, 951.

conceivably a form of consideration paid to the state as they serve some of the interests of the citizens—the ultimate beneficiaries of government administration of natural resources.

The benefits decrease the citizen's reliance on public expenditure as they become better able to access private alternatives. This allows public expenditure to be increased in areas that are not adequately satisfied by private means. The trickle-down benefits, if properly forecasted, can allow the government to proffer a profit-sharing agreement that finances selected public expenditures, generates private wealth, and is at the same time attractive to extractives investors.

Qureshi reports that although the benefits that trickle-down economics brings to disadvantaged portions of the public are dubious, increased and concentrated public spending in such areas as health and education has a positive income on human development.[134]

2.6 Conclusion

A criterion has been set out in these discussions as to who exactly is being referred to when discussing the local communities in petroleum activities. The chapter breaks down that the local community are those affected directly by the extractive activities and those directly dependent on the natural surroundings in the extractive or production area. The chapter deduce that the benefits these communities experience depends on the manner in which they extracted, managed, shared and how the proceeds are distributed to them.The chapter summarises both the regional and international framework governing profit sharing in the petroleum industry. The research demonstrates that in the EAC collectively have many similarities in their petroleum policies the main one being that management of the resources so as to benefit their respective societies as a whole. The international framework that is covered in this chapter discusses the various requirement of governments in how revenue is shared between the national and local governments and ensuring that distribution is fair and equitable.

[134] Qureshi MA, 'Challenging trickle-down approach: Modelling and simulation of public expenditure and human development – the case of Pakistan', 35(4) International Journal of Social Economics, 280.

Broadly speaking, individual land owners, communities and the general public can affect the oil and gas sector in one way or another. More specifically, at the profit-sharing level, they remain to be relevant as the government's share of profit oil is expected to trickle down to them, and it therefore performs a trustee role. All three categories possess legitimacy derived from the constitution. Power which has been seen to be transient in some cases, may be enforced through court based on the legal claims.

However, whether or not these stakeholders indeed have authority to enforce their interests is yet to be seen, and an examination of the legal procedures available is necessary to completely answer this. Having established that these groups hold a stake in the profit oil, this chapter argues that the oil and gas industry though being an enterprise that should yield a profit, must inherently be equitable and fair to the relevant stakeholders. The next chapter will delve into the Kenyan legal and policy regime and how it deals with the division of profit oil while also discussing the pre-division problems that need to be addressed after the completion of the division stage.

Chapter Three

Legal and Institutional Framework for Oil and Gas in Kenya

3.1. Introduction

This chapter discusses the legal and regulatory guidelines on the division of profit oil and the subsequent division of the government's take in Kenya. By doing so, the chapter attempts to answer the first research question: *"whether the legal framework on the distribution of the government's share of profit oil is equitable.*" It also includes a discussion on pre-division problems; namely compensation challenges for land acquired through compulsory acquisition. That discussion addresses the research questions on *whether the distribution of profit oil should be governed by mandatory rules, and whether those rules should be guided by, amongst others, events occurring at upstream level*.

The main laws governing the division of funds obtained from oil and gas ventures and land matters relating to the same are illustrated in Table 3.1A and 3.1B below and consists of; *Constitution, the Petroleum Act 2019 and the Energy Act 2019, the Land Act (No.6 of 2012 and the Community Land Act (No.27 of 2016).* However, contracts entered into under the now-repealed Petroleum (Exploration, Development and Production) Act of 1984 are to be governed by it- necessitating its study as well in this chapter. This chapter will therefore scrutinise the oil and gas sector in Kenya as governed by the 1984 Act, its successor and other policy documents, noting the changes so as to identify whether the new Act addresses the issues identified in this research, and to what extent.

The tables below show the laws that govern the oil, gas and land sector in Kenya.

Laws governing Oil & Gas and Land in Kenya	
The Constitution	The supreme law of the land. All laws are derived from the constitution and no law shall be passed if it is in contravention of the Constitution.

The Kenyan Model Production Sharing Contract (MPSC) 2015	This contract provided a guideline for the government and the contractor in governing the production sharing from upstream oil activities. It has been superseded by the Model Production Sharing Contract, 2019 under the Petroleum Act of 2019.
The Petroleum (Exploration and Production) Act 1984 (repealed)	This is an act of Parliament that regulated negotiation and conclusion of agreements on exploration, development, production and exploration of petroleum.
The Petroleum Act 2019	An act of Parliament that governs all matters pertaining to contracting, exploration, development and production of petroleum, among others.
The Energy Act 2019	A statute that consolidates the laws relating to energy, provides for for National and County government functions in relation to energy, establishment, powers and functions of the energy sector entities; among others.

Table 3.1A Laws Governing Oil, Gas and Land in Kenya

Laws governing Oil & Gas and Land in Kenya	
The Land Act 2012	This Act gives effect to Article 68 of the Constitution of Kenya. Its objective is to also revise, consolidate and rationalize land laws, among others.
The Land (Conversion of Land) Rules (2017)	These are the rules created to govern the conversion of Land in Kenya under the powers conferred under Section 9(5) of the Land Act. Among other purposes, the rules are created for prescribing substantial transactions requiring approval of the National Assembly.

The Community Land Act (no. 27 of 2016)	The Act is meant to give effect to Article 63(5) of the Constitution; to provide for the recognition, protection and registration of community land rights; management and administration of community land; among others.

Table 3.1B Laws Governing Oil, Gas and Land in Kenya (continued)

3.2. Constitution of Kenya (2010)

The Constitution is the supreme law of the land in Kenya making its provisions binding on all persons, including the state. Moreover, any law that is in conflict with the constitution is void to the extent of the inconsistency. The Constitution states that any act or omission in contravention with the constitution is invalid.[135] The constitution provides for the obligations of the state as regards natural resources in Kenya. Any activities, laws, regulations and contracts in oil and gas ventures contrary to the constitution would therefore be void.

The constitution sets out inter alia, the general principles that guide Kenyan citizens and other economic agents in pursuit of their private and social objective. The principles that relate to natural resources and public affairs ensure the following; *fair land tenure and efficient land use; environmental preservation and protection; citizen participation in the management of natural assets; fair benefit sharing from natural resources and associated fiscal revenues; transparency in the management of public services and assets and access to information of a public nature.*

The above principles were employed by the Kenyan government in 2013 to enact a law that establishes the instruments required for implementing Vison 2030, that is, among other things that oil development is for the benefit of the people with priority to be given to local communities. [136]

[135] Article 2 (4), *Constitution of Kenya* (2010).
[136] Mwabu G, 'Kenya's Oil Governance Regime: Challenges and Policies' in Langer A, Ukiwo U and Mbabazi P, Oil Wealth and Development in Uganda and Beyond: Prospects, Opportunities, and Challenges, *Leven University Press*, (2020,) at 351-372.

In matters of governance, the national values and principles as espoused under Article 10 are to be upheld in the enactment, application or interpretation of law and in the creation and implementation of policy. [137] They include equity, social justice and inclusivity, equality and the protection of the marginalised communities.[138] Equity demands that different stakeholders have equal access to resources and opportunities.[139] This principle is further applied to land in Article 60 among the principles of land policy.

The other principles outlined in Article 60 that are of importance apart from equity include; security of land rights, sustainable and productive management of land resources, transparent and cost effective administration of land, sound conservation and protection of ecologically sensitive areas.[140] As noted earlier in this study, the Turkana community is a marginalized rural group whose rights may easily be overlooked if not intentionally protected. Additionally, the state bears an added layer of responsibility regarding addressing the needs of a marginalised group. Article 56 of the Constitution states that the State shall put in place affirmative action programmes designed to ensure that the minorities and marginalised groups interests are taken into consideration and given priority.[141] This is due to their relative vulnerability in the grand scheme of property ownership, let alone in the absorption of revenue from profits oil

The case of ***Mohamud Iltarakwa Kochale & 4 others v Lake Turkana Wind Power Ltd & 4 others;*** demonstrates the said vulnerability. The case was founded upon the fact that the plaintiffs were part of the Marsabit community which was a pastoral community that held its land communally and they alleged that their land was illegally transferred to the first defendant for the development of wind turbines. They further alleged that if the said titles were upheld, the same would greatly prejudice their interests as a pastoralist community; because the land was measuring approximately 110,000 acres, and was nearly the size of Nairobi County. The court held that the process was unprocedural but did not cancel the titles; instead it gave the defendants a year to regularise the process. [142] In this case, this study critiques the fact that the court did not void the titles, as it directly prejudices the community's right to communal land

[137] Article 10 (1), *Constitution of Kenya* (2010).
[138] Article (10) (2), *Constitution of Kenya*, (2010).
[139] Kenya Institute for Public Policy Research and Analysis, 'National values and principles of governance', 12.
[140] Article 60 (1) (a)-(f), *Constitution of Kenya*, (2010)
[141] Article 54, *Constitution of Kenya*, (2010)
[142] Mohamud Iltarakwa Kochale & 4 others v Lake Turkana Wind Power Ltd & 4 others; Aaraon Iletele Lesiantam & 4 others (As representatives of the residents of Loiyangalani District, Marsabit County) (Interested Paries) (2022) eKLR.

ownership and to some degree mirrors the historical land injustices practiced in Kenya's history.Kenya has experienced historical land injustice at different stages in history .

One of the most impactful invasions was carried out by the British through the alienation of fertile agrarian land from Africans by the British settlers coupled up with the pushing of Africans into infertile and crowded reserves.[143] The formalisation of land tenure led to the subjugation of the customary rights of marginalised communities whose land tenure is based upon traditional communal land ownership. Thus, their rights lacked the adequate legal protection as a by-product of not having formal title to land.[144] This was due to the legislation of the Crown Lands Ordinance through which all the land was vested in the crown and the Africans were regarded as mere tenants at the will of the crown.[145]

The effects of the Crown Lands Ordinance are succinctly captured in the case of ***Isaka Wainaina v murito*** whereby the plaintiffs in the case claimed ownership of a tract of land that they had purchased from the Ndorobo community. Due to the fact that they were of African descent, the then Chief Justice Barth held that his ownership rights were extinguished due to the enactment of the Crown Lands Ordinance which vested all the property in the colony in the crown, leaving him as a tenant at the will of the crown.[146] This case affirmed the full subversion of the customary land rights that the Africans enjoyed.

Secondly, Kenya has a problem of security of tenure whereby many people have acquired fraudulent titles to land of both private, public and communal land. This resulted in an inequitable distribution of land and resources and generated impetus for major land reform; part of which occurred through the Constitution of Kenya, 2010. [147] Part of this reform was the recognition of different types of land tenure systems. Article 61 classifies land as public, community or private land[148]. In light of this study, we shall focus on communal land rights.
Public land includes all minerals and mineral oils, and this it to be vested in the national government in trust for the people[149]. Article 62 of the Constitution defines public land to

[143]Ogendo Okoth H, 'The tragic African Commons: A century of Expropriation, suppression and subversion' *University of Nairobi Law Journal* (2003).
[144] Kariuki F., Ouma S., Ng'etich R, *Property Law,* Strathmore University Press, 186.
[145] Kariuki F., Ouma S., Ng'etich R, *Property Law*, 165.
[146] Isaka Wainaina v Murito (1923) 9 (2) KLR 102.
[147] See Ministry of Lands, Sessional Paper No.3 of 2009 on National Land Policy.
[148] Article 61 (2), *Constitution of Kenya*, (2010).
[149] Article 62(f), *Constitution of Kenya*, (2010).

include natural resources contained on or under the surface[150]. That makes oil and gas exploration a land matter and consequently, a property matter. As aforementioned, oil and other minerals form part of what constitutes public land, however the government has been allocated the right to make use of such land on behalf of the people.

Community Land under the Constitution is held by certain communities who are identified through their ethnicity, culture or similar community of interest[151]. Community land as defined in the Constitution, is land that has been registered in the name of group representatives, land that has been lawfully transferred to a specific community, any other land declared that has been declared community land by an Act of Parliament.[152] The meaning of community land was contested in the case of ***Kelly Malenya v Attorney General and another; Council of Governors*** [153] whereby the courts held that the meaning of community land as stated in section 2 of the Act was convoluted and as such declared the section unconstitutional. The court also inter alia held that the Act was intended to facilitate the registration of community land from being held in trust by the county to being registered for the community. This studies contends that such registration would form a good basis for the distribution of profits to the community in question.

Private land under the Constitution is specified as land registered under a freehold tenure, land held under a leasehold tenure and any other land declared private land under an Act of Parliament[154]. It is important to distinguish the various categories on land in Kenya so as to gain e a better understanding of the study's motive. The Constitution places a duty on the State to ensure sustainable exploitation and management of natural resources coupled with equitable sharing of their accruing benefits. There is also a requirement that investments in property benefit relevant local communities and their economy.[155]

Moreover, according to the constitutional provisions on public finance, revenue raised nationally is to be shared equitably among the two levels of government, and some of the

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[150] Article 62 (k) &(l), *Constitution of Kenya*, (2010).
[151] Article 63(1), *Constitution of Kenya*, (2010).
[152] Article 63(2), *Constitution of Kenya*, (2010).
[153] Kelly Malenya v Attorney General and another; Council of Governors (Interested Party) [2019] eKLR.

[154] Article 64, *Constitution of Kenya*, (2010).
[155] Article 66(2), *Constitution of Kenya*, (2010).

considerations to be made include: developmental and other needs of counties and, the economic disparities within and among counties[156].

Article 40 which forms part of the Bill of Rights protects the right to property. It states that every person has the right to acquire and own property individually or in association with others in any part of Kenya[157]. It also prohibits the deprivation of property, an interest in property or the right over a property, with an exception for compulsory acquisition provided[158].

Compulsory acquisition refers to the power of the state to convert private or protected property to the needs of the state[159]. Even so, compulsory acquisition is to be conducted within the parameters of Chapter five of the Constitution or legislation and prompt compensation should be provided. This study will delve into more detail on the issue of compulsory acquisition in the next section, alongside the conversion of community and private land into public land for purposes of oil and gas ventures.

Access to land has been a problematic issue in Kenya's land discourse from the colonial period. Before the advent of colonialism, Kenya was inhabited by numerous autonomous communities. There existed a discernible system of land ownership and administration where land was held trans-generationally, managed at different levels of the societal structure and used for varying but definitive purposes.[160]

3.3. Issues at the Upstream Level: Marginalisation, Conversion of Land and Compulsory Acquisition

3.3.1. Marginalisation

Marginalisation is multi-faceted, impacting different groups in varying ways.[161] It has been argued to be both a current condition and a dynamic process. As a condition, it excludes individuals or groups from participating fully in society. While, as a multidimensional and dynamic process, it channels the social relations and organisational barriers that block the

[156] Chapter 12, *Constitution of Kenya,* (2010).
[157] Article 40(1), *Constitution of Kenya*, (2010)
[158] Article 40(3), *Constitution of Kenya,* (2010)
[159] Ondili. M, 'Eminent Domain: The Perpetual Rights of the Indigenous People of Kenya to Land Ownership' *Strathmore Law Review* (2017), 22.
[160] Ogenda O, 'The Tragic African Commons A century of expropriation, suppression and subversion'.
[161] Virk K and Cook J, 'The rights of vulnerable and marginalised groups in South Africa', 41 Policy Brief, 2018.

attainment of livelihoods, human development and equal citizenship. It can therefore, be described as both a process and a condition that halts individuals or groups from participating fully in social, economic and political life.[162]

In Kenya, a *'marginalised community'* is defined by the constitution as one that: has been unable to participate in the integrated social and economic life of Kenya as a whole, due to having a relatively small population or any other reason; a traditional community not integrated into the socio-economic life of Kenya as a measure to preserve its identity; indigenous communities that practice a traditional way of life dependent on hunting and gathering; or, pastoral persons and communities. The Constitution further describes a *'marginalized group'* of people as those who because of laws or practices before, on, or after the effective date, were or are disadvantaged by any discrimination described in Article 27(4).[163]From these definitions, it is evident that marginalisation always has an aspect of preclusion.

Marginalization in Kenya of certain communities began during the colonial period. The colonial government adopted a western mode of governance disregarding the original systems. Upon independence, the new government used colonial laws to centralize political and economic power.

The colonialists had created boundaries in line with the ethnic disposition of Kenyans though division into seven political regions each lead by ethnic or tribal leaders[164]. The manner in which communities interacted with the colonialists was also used to determine the degree of inclusion of these communities in the governments' development structure.[165]

The colonial regime set about to entrench itself politically, socially and economically in the region, and land was a key factor in this mission. One way of achieving this was to invalidate the established method of land ownership, which Okoth-Ogendo terms the '*African*

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[162] Alakhunova N *et al*, *'Defining Marginalization: An Assessment Tool'*, the George Washington University the Elliot School of International Affairs, released May 2015,8.
[163] Article 27(4)0, *Constitution of Kenya*, (2010).
[164] Murumba M, *Addressing Socio-economic Marginalization in Turkana County through effective Devolution: A Comparative Legal Approach,* Unpublished LLLM Thesis, Central European University, 2014, 10.
[165] Murumba M, *Addressing Socio-economic Marginalization in Turkana County through effective Devolution: A Comparative Legal Approach*, 11.

Commons'.[166] Specifically, the British achieved this using three *'legal'* mechanisms: claiming jurisdiction, entrenching English law as the central law applicable to persons within the colony and lastly, rendering the African Commons *terra nullius*[167] thus vesting it into the Crown.[168] Kameri-Mbote and Musembi report that under this system, community land rights were regarded as being inferior to private ownership. This led to community land rights managed with no legal protection, and those affected the most included pastoralists and communities that practiced hunting and gathering.[169]

The private land ownership regime that was introduced in Kenya was disruptive, given the dependency that local economies had on land.[170] This led to dispossession of land and poverty. Indeed, the return of land was one of the core claims in the clamour for independence. While this affected most parts of the country, further marginalisation of areas that were far-off and mostly arid or semi-arid led to a systemic disenfranchisement that lasted decades and curbed economic growth enjoyed by the rest of the country.[171] This is because the marginalisation trend was carried-on post-colonization where development projects were rolled out not as a matter of right but as political rewards to areas allied and politically strategic to the ruling regime.

Marginalised areas carrying scant populations and minority communities consequently did not carry enough weight to warrant much government attention.[172] Marginalised communities (MC) have been faced with unique challenges that did not abate at independence as would be expected. Topping a long list of unjust practices against them has been land alienation and being locked out from benefitting from natural resources.[173]

Turkana, Mandera and Lamu counties have been identified as being among the most marginalised counties in Kenya due to both environmental factors, access to development and

[166] 'Historians have established that at the end of the 19th Century, land resources in Africa were held, managed and used primarily as Commons. Ogenda O, 'The Tragic African Commons A century of expropriation, suppression and subversion', 108.
[167] A Latin expression meaning "nobody's land". It was a principle sometimes used in international law to justify claims that territory may be acquired by a state's occupations of it.
[168] Ogenda O, 'The Tragic African Commons A century of expropriation, suppression and subversion', 110.
[169] Musembi C and Kameri-Mbote P, 'Mobility, marginality and tenure transformation in Kenya: Explorations of community property rights in law and practice', *Nomadic peoples,* 1(2013), 17, 6.
[170] Ministry of Lands, Sessional Paper No.3 of 2009 on National Land Policy, 6.
[171] Syagga P, 'Public land, historical land injustices and the new constitution', Technical report, 2012, 10.
[172] Task Force on Devolved Government, 'Interim report of the Task Force on Devolved Government', 2010, 47.
[173] Korir AS, 'Kenya at 50: unrealized rights of minorities and indigenous peoples',

other economic factors.[174] Coincidentally, these hold three of the four oil exploration basins in Kenya namely; *Lamu Basin, Anza Basin, Mandera Basin and Tertiary Rift Basin*[175] The already existing historical injustices in these areas need to be accounted for when determining how to best go about resource distribution. Failing to take them into account will be a replay of the alienation and discrimination that has befallen these communities since colonial times. Therefore, the current legal foundations of community land tenure ought to be given more legal competence for them to ensure that the people in those communities enjoy economic equity.

Alternately, it has been determined that when states take over the running of certain natural resources, there is reduced access to these resources by indigenous communities, therefore curtailing their economic practices.[176] Successfully countering harmful effects of reduced access is dependent on the application of equity through distributive justice and procedural fairness.[177] Failure to do so would result in a scenario where communities that are already disadvantaged become even more so.

The historical marginalization of communities such as that of Turkana have led to the locals being sceptical of the government and these relatively new oil and gas ventures. Members of these communities do not trust the oil companies or the government and this has led to a series of disputes and hinderances to oil activities in the Turkana region.[178] In Turkana County, marginalization could be argued to have led to some of the more prevalent problems faced by the local community such as; poor or non-existent community consultation, problems with local leaders' involvement, limited technical and organizational capacity for consultation, problems with information sharing and the poor quality of engagement agreements.[179]
Candidate needs to delve deeper into marginalization. There is a claim that Turkana, Mandera and Lamu counties are the most marginalized. It is important for candidate to delve deeper into these – with examples, review of scholarly articles on the nature of marginalization and impact

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[174] Commission on Revenue Allocation, 'Survey report on marginalised areas/counties in Kenya', Working paper No 2012/03, 2012, 10.
[175] Kenya Pipeline Corporation, 'The petroleum sector' https://www.kpc.co.ke/petroleumsector/ on 12 April 2019.
[176] Siciliano G & Urban F, 'Equity-based Natural Resource Allocation for Infrastructure Development: Evidence from Large Hydropower Dams in Africa and Asia', Ecological Economics, (2017), 134, 130.
[177] Siciliano G & Urban F, 'Equity-based Natural Resource Allocation for Infrastructure Development', 130. These principles are embodied throughout the constitution, including the provision of fair administrative action and access to justice as human rights in Articles 47 and 48, *Constitution of Kenya* (2010).
[178] Wanguhu C, 'Oil Politics' and stoppages in Kenya', Issues 117, The Oxford Institute for Energy Studies (2019), 14.
[179] Cordaid, *Oil Exploration in Kenya: Success requires Consultation Assessment of Community perceptions of Oil Exploration in Turkan County Kenya*, (2015), at 9.

– and link to article 56 CoK on affirmative action. Importantly at the conclusion – does this give a stronger basis, legally at least, to such local communities on sharing of profit oil?

3.3.2 Conversion and Compulsory Acquisition

Both the classification of land and compulsory acquisition is constitutionally mandated as discussed above. These two are further governed by the Land Act (LA) and the Community Land Act (CLA). However, when compulsory acquisition conflates with or leads to the conversion of community land to public land, an issue arises in objectively identifying the compensation payable.[180]

Conversion of land under Kenyan law can be found under Section 9 of the Land Act which states that the conversion of land is when land is converted from one category to another.[181] It states that private land may be converted to public or community land by way of compulsory acquisition, reversion, transfer or surrender. Community land may be similarly converted as per the Community Land Act.[182] Compulsory acquisition is provided for under the Constitution as the state acquisition of private property for public use subject to the just compensation that is done in good faith. Compulsory acquisition of community land however, is to be done as per the Land Act.[183] In order for the state to licence communal land to IOCs, they are required to carry out just compensation to the community whose land is to be utilised for the public interest. Thus, the community land would be converted to public land in order to be used for a public use.

Part VIII of the Land Act (LA) provides the procedure for compulsory acquisition. Both the National and the County government may carry out compulsory acquisition for a necessary and public purpose. Under the LA the process in which this is done is through the relevant cabinet secretary or county executive who is to request the National Land Commission (NLC) to acquire the land on the government's behalf. The NLC is then to make public the intention to compulsorily acquire the land, as well as deliver such notice to anyone that has an interest in the land. Full and just c compensation is to be paid for land compulsorily acquired. The reason

[180] Extractives Baraza, 'Land access and acquisition for extractives projects: Balancing different interests', Meeting report, 2017, 4.
[181] Section 9, *Land Act* (No. 6 of 2012).
[182] Section 22(1), *Community Land Act,* (no. 27 of 2016).
[183] Section 22(2), *CLA*, (no. 27 of 2016).

used for compulsory acquisition must be clear and adequate as was outlined in the case of *Patrick Musimba vs National Land Commission & 4 others (2016) eKLR* where the court stated that land that is compulsorily acquired must be done for a public purpose or public interest as is stated under Article 40(3) of the Constitution[184]. The reason for the acquisition must not be *'remote or fanciful'*.[185]

Presently, the Land (Assessment of Just Compensation) Rules 2017 provide guidance for just compensation.[186] The market value is defined as the value of the land at publication of the Gazette notice. An increase in land value realized after the Gazette notice is not to be factored into calculating the amount of compensation payable, together with any disinclination of the person to part with the land. However, damage arising from the diminution of the value of land as a result of the Gazette Notice is to be factored into assessment of compensation.[187]

The rules provide for certain factors to be taken into consideration when calculating the amount of money to be paid out as compensation. Among these factors is the market value of the land, and expenses arising out of relocating from the land.[188] Rule 5 also provides for a clear guideline as to the factors that should be considered by the Commission when awarding compensation to parties involved in the transaction. These include the degree of urgency which has led to the acquisition; any disinclination one may have in parting with the land; damages likely to be caused to the land after the gazettement of a notice of intention to acquire the land; any increase in the value of the land after the publication of the gazette notice and any improvements made on the land after the publication of the notice.[189] These considerations breathe life into the meaning of just and fair compensation.

Land is central in the socio-economic welfare of marginalised communities. The Ogiek experience bears witness to this. The Ogiek are known to be among the few remaining hunter gather peoples of East Africa and the largest hunter-gather community in Kenya. The Ogiek have always resided in the Mau Mountain Forest that overlooks Kenya' Rift Valley.[190] The

[184] Article 40 (3), *Constitution* (2010)
[185] *Patrick Musimba vs National Land Commission & 4 others* (2016) eKLR
[186] *The Land (Assessment of Just Compensation) Rules*, (2017)
[187] Rule 3, *The Land (Assessment of Just Compensation) Rules*, (2017)
[188] Rule 4, *The Land (Assessment of Just Compensation) Rules*, (2017)
[189] Rule 5, *The Land (Assessment of Just Compensation Rules*, 2017),
[190] Mbote. P, *'Following God's Constitution: the gender dimension in the Ogiek claim to Mau Forest Complex', International Environmental Law Research Centre (2006),1.*

Mau Forest, covers approximately 400,000 hectares of land and is located approximately 250 kilometres form the capital city of Kenya, Nairobi.[191] In the1980s the government commenced the selling of parts of the forest to the more dominant Kenyan tribes. The government also allowed for charcoal burning, logging, tea and flower farming in the Mau Forest.[192] There have over the years been attempts to evict the Ogiek from the Forest through compulsorily acquisition as the government claims that the Mau Forest is being destroyed and they are unable to afford such a risk as the Forest is one of the largest water catchment areas in Kenya.[193]

Upon their land being compulsorily acquired, the people submitted a memorandum showing that this had resulted in a decline in their socio-economic welfare.[194] In a subsequent memorandum, the Ogiek submitted the following: *'That Ogiek will resist any form of eviction for compensation since the ancestral land cannot be compensated. No one can value a birth-right'.*[195] The Ogiek experience has demonstrated that in some instances such as this, there is no amount of compensation that would be able to satisfy the community as the land in question is their ancestral land and a price cannot be put on history.

The compensation process though comprehensive and fairly sympathetic to the original land owner's rights, fails to take into account the precarious position faced by local communities in oil producing areas. It neither factors in the value of the land to the communities, nor the benefit that is to be derived as a result of taking it away. Thus, the standard of just compensation in this context can be used to justify the compensation of a marginalised community using profits oil such as Turkana.

On market value, such areas being arid and semi-arid ordinarily have very low market value before the discovery of oil, and such discovery would seem a stroke of luck for the communities, a way out of national obscurity and years of poverty, yet the regulations seem to

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191 See Kenya Forest Service, < http://www.kenyaforestservice.org/index.php?option=com_content&view=article&id=699:mau-forest&catid=183&Itemid=695> on 06 February 2022.
192 Mbote. P, *'Following God's Constitution: the gender dimension in the Ogiek claim to Mau Forest Complex',2.*
193 Ochien'g D, 'The rights to land of indigenous people in Kenya: A case study of the Ogiek Community and the Conflict of Articles portrayed in the Constitution of Kenya' Unpublished Dissertation Bachelor of Laws, Strathmore University Law School, January 2017, 8.
194 Ogiek Community, 'Help us live in our ancestral land and retain both our human and cultural identities as Kenyans of Ogiek origin', 1996, 9.
195 Ogiek Community, 'Mau Forest is our home' Ogiek Peoples Development Programme, 2009, 2.

be set up to precisely avoid this. It should be noted that these regulations are of a general nature and no specific ones exist for the acquisition of land for oil and gas purposes.

Some of the community rights defined under the Petroleum Act, 2019 include the community's right to just compensation for land taken over for upstream petroleum operations, as well as the right to be compensated by any contractor who causes environmental damage or pollution.[196] This study notes that the compensation referred to here is not that of compulsory acquisition but a matter of compensating the local community with profits oil. This study notes that there is no clear provisions in the Act on how local communities directly get their compensations in this context of profits oil. The Community Land Act provides that County governments shall hold in trust all unregistered community land on behalf of the communities for which it is held.[197] Most community land in counties such as Turkana county is unregistered, and therefore vests in the County Government. Vesting the same in the county government means that the members of the local community are at the mercy of the county government in as far as the enjoyment of proceeds of profits oil resulting from the mining of petroleum on their land.

It is not clear in the law how the national government, county governments and international oil companies are to ensure the local community benefits from such acquisition, given the direct loss suffered. In the context of Turkana, studies have revealed that no formal land acquisition was undertaken when petroleum activities commenced.[198] Select community leaders only signed land access consents on the promise that the projects would bring development and revenue for the community's benefits. No open negotiations were done with the communities except social ceremonies to signify the start of a cordial relationship with investors. Consequently, the local communities never received any formal compensation except tokens in form of social investments like boreholes, schools and hospitals.[199]

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196 Section 125, *Petroleum Act*, (2019).

197 Section 6 of the Community Land Act, 2016.

198 Makathimo M, 'Assessment of Policy Frameworks and Practices Affecting Land Access for Oil and Gas Projects on Community Land in Turkana County, Kenya,' Land Development and Governance Institute, 2019, https://www.ldgi.org/index.php/our-research-2/95-assessment-of-policy-frameworks-and-practices-affecting-land-access-for-oil-and-gas-projects-on-community-land-in-turkana-county-kenya-2/file on 29 December 2021. See also:

199 Makathimo M, 'Assessment of Policy Frameworks and Practices Affecting Land Access for Oil and Gas Projects on Community Land in Turkana County, Kenya.'

3.4. Profit Oil Division

The figure below illustrates the fiscal system for Kenya oil.

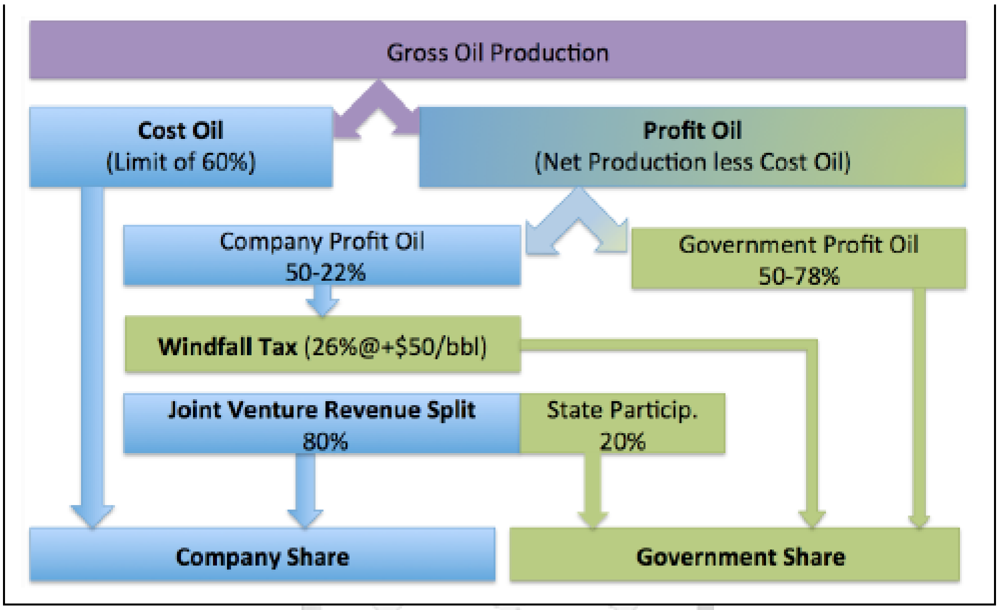

Fig. 3.1. The Fiscal System for Kenyan Oil **"Source: Oxfam"[200]**

As was described in the previous chapters profit oil is the amount of revenue remaining after the contractor has dealt with their cost recovery (see fig 3.1.). Having discussed the unique factors that ought to be considered at the pre-division level, this section will now briefly discuss the division of profit oil. The goal here is to determine whether the factors deliberated on above are considered in the division of profit oil. The regulatory framework that captures the division of profits are; the Petroleum (exploration and production) Act,[201] now repealed, and the Petroleum Act, 2019.[202] It is also worth mentioning the enactment of the County Allocation of Revenue Act that commenced in July 2021. The act was created in pursuance of Article 218(1)(b) of the constitution. The Act is set to provide for the allocation of an equitable share of revenue raised nationally for the financial year 2021/22 among the county governments and to facilitate the transfer of the allocations made to counties.[203]

[200] Oxfam, Mapping risks to future government petroleum revenues in Kenya: a framework for prioritizing advocacy, research and capacity building, March 2016, at 9.
[201] Petroleum (Exploration and Production) Act, (1984).
[202] Petroleum Act No. 2 of (2019).
[203] Section 4, *The County Allocation of Revenue Act*, (2021).

3.5. Petroleum (Exploration and Production) Act (PEPA) 1984

The Petroleum (Exploration and Production) Act, together with its regulations, was the guiding law for the Kenyan Petroleum industry from 1984 to 2019. It regulated government agreements on the exploration, development and production of petroleum.

As regards making provisions on the treatment of concerned local communities, the Act did not state much on matters related to pre-division, or local communities and communal land. Furthermore, compensation in this instance was limited to disturbance and damage incurred, with no interest being granted in possible resources discovered.[204] It is important to note that this Act was assented to during a time in which the country did not know that there were commercially viable natural resources within its borders thus not much attention was given to the governance of Petroleum at the time. The act is therefore very limited in its provisions and does not consider many particulars of Petroleum operations such as; midstream and downstream operations, environmental and safety provisions and transparency and accountability provisions.

PEPA was a very short and frank act, enacted at a time when the country was unaware of the commercially viable oil deposits that was within its borders. This was captured in the sheer lack of consideration for those communities residing on land with natural resource deposits and the non-inclusion of several significant aspects of the petroleum industry. The act was very vague and seems to have been more favourable to the contractor and not the state. This may be because at the time of its inception Kenya may have been promoting foreign investment into the country and this could have been seen as a way of providing favourable terms for investors.

3.6. The Petroleum Act (2019)

Similar to its predecessor, the Petroleum Act (2019) regulates the exploration, development and production of petroleum in Kenya. It was assented to mid-2019. As indicated above with PEPA there were many key areas in the petroleum industry that needed to be addressed and this Act was brought forth in order to properly and efficiently handle these issues' Act addresses upstream, midstream and downstream operations.

[204] Section 10, *PEPA*, (1984).

The Act operates to breathe life into the constitutional provisions enumerated above and effectively repeals the 1984 Act. The new act among other things, introduces the National Upstream Petroleum Advisory Committee (NUPAC),[205] it contains provisions for revenue sharing[206] and provides for reporting, transparency and accountability[207]. These are just some of the many new provisions the act provides. It is much more comprehensive and, in this section, the study shall attempt to identify whether this Act succeeds in addressing distribution inequalities of revenues generated in oil and gas ventures. The Act further provides for local content measures,[208] environmental, health and safety measures[209] and among others the use of land for petroleum operations. [210]

Prior to its ascension this was a topic of much debate as the marginalized community of Turkana saw their compensation as being thwarted and thus the government and the community was is disagreement as to the profit sharing of the oil.

The Act introduces numerous provisions and considerations absent in the previous Act. As mentioned above Section 12 establishes the NUPAC tasked with providing advice on upstream operations, negotiations and termination of contracts. Refusal of such advice must be communicated with reason and must be in writing. Members of the NUPAC are to be drawn from various relevant bodies such as the National Treasury, the Ministry of Energy and the Council of Governors.[211]

Under this new Act an elaborate system has been put in place for upstream operations covering important areas such as; licensing and permits, unitization, petroleum production and petroleum field decommissioning. Among these are provisions for public participation by the affected community in reviewing and awarding permits.

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[205] Section 12, *PA*, (2019).
[206] Section 58, *PA*, (2019).
[207] Section 119, *PA*, (2019).
[208] Section 50-52, PA(2019).
[209] Section 59-72, *PA*, (2019).
[210] Section 108-116, *PA*, (2019).
[211] Others are: NEMA and, the Upstream Petroleum Regulatory Authority- which is not established under the Act, though there were proposals to establish it as the national regulator in previous Bills. <https://www.standardmedia.co.ke/business/article/2001288394/national-oil-to-lose-powers-as-new-regulatory-unit-is-mooted> on 06 February 2022.

The act further provides that the national government shall enter into petroleum agreements fairly, equitably, transparently, competitively and cost effectively.[212] Furthermore the act provides for the contractor's obligations under the petroleum agreements set out in MPSC and include; presentation of a field development plan, presentation of a work programme, keeping accurate books of accounts and records of upstream petroleum operations and to give preference to the use of locally available raw materials, products, equipment, manpower, services and continuously transfer technology and build local capacity.[213]

3.7. The legal position on the model resource distribution

On resource distribution, the Petroleum Act, 2019 has provided for the manner in which profits derived from petroleum operations are to be shared. Twenty percent (20%) shall go to the county government[214]; five percent (5%) to the local community[215] and the remaining seventy-five percent (75%) will go to the national government and these percentages shall be reviewed within the time space of ten years.[216]

The five percent that is due to the local communities will be from post-production profits. In section 58(1), the Petroleum Act, 2019 contemplates the sharing of the "national government's share of the profits," implying that the share that goes to the county governments and to local communities is derived from the national government's profit oil. This provision (section 58) however falls under Part VIII of the Act which is entitled "payments and revenues." The proviso to section 57 of the Act is also captioned "petroleum revenue" while its body provides that *the profit derived from upstream petroleum operations shall be shared between the contractor and National Government in accordance with the petroleum agreement*. It would seem from a holistic reading of the Act that the sharable cake is to be drawn from the revenue gained from the industry (royalties, duties, income taxes or bonuses) as well as the government's profit oil.

The above position is partly augmented by the definition ascribed to the term "revenue" under section 2 of the Commission on Revenue Allocation Act, 2011 which provides that *"revenue"*

[212] Section 17 (1), *PA, (*2019).
[213] Section 19 (1), *PA*, (2019).
[214] Section 58(2), *PA*, (2019)
[215] Section 58(3), *PA*, (2019)
[216] Section 58 (5), *PA*, (2019)

means all taxes imposed by the national government under Article 209 of the Constitution and any other revenue (including investment income) that may be authorised by an Act of Parliament...." The inclusion of "investment income" as part of what is called "revenue" suggests that the use of the term "revenue" under the Petroleum Act is meant to encompass both petroleum profit and the taxes, duties and bonuses derived from the petroleum sector. Indeed, scholarly papers and articles analysing the relevant sections of the Petroleum Act and this theme in general have not established any distinction between "sharing of petroleum profit" and "sharing of petroleum revenue." Both terms have been applied as though they refer to the same thing.[217]

As mentioned earlier, the share that goes to local communities will not be paid directly to the communities but to a trust fund established by the relevant county government.[218] As at this writing, the framework on the five-percentage share was to yet to be established. It is unknown as to whether it will be monetary or in the form of projects for the community. Moreover, there is no framework on how the affected members will be determined or how they shall benefit.[219]

Under the Act the local community's apportionment is to be held in a trust fund by a board of trustees established in legislation by the county government in consultation with the local community.[220] The principle of intergenerational equity is to be applied in the utilisation of these funds is similar to concept behind Norway's resource distribution.

The first step in ensuring that the revenue distribution is fair and equitable was the enactment of the Petroleum Act, 2019. There are still more aspects to be covered to ensure that adequate distribution is achieved.

3.8. The Kenyan Model Production Sharing Contract (MPSC) 2015

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[217] Oxfam Kenya, "Sub-National Payments In Kenya's Oil Industry," <https://cng-cdn.oxfam.org/kenya.oxfam.org/s3fs-public/file_attachments/Sub%20National%20payments%20in%20Kenya's%20oil%20industry-%20Discussion%20Paper.pdf> 8 January 2022.; Senelwa, K. 'Row Brewing Over How Turkana Oil Revenue Will be Shared,' 3 January 2017, *The East African*, <http://www.theeastafrican.co.ke/business/Row-brewing-over-how-Turkana-oil-revenue-will-be-shared/2560-3505470- sqvlpd/index.html> on 8 January 2022

[218] Section 58(3), *Petroleum Act*, 2019.

[219] Moranga E, 'Where is our money? Benefit sharing for local communities in the oil and gas sector,' Kenya Civil Society platform on oil & gas, 02 August 2021, <https://kcspog.org/where-is-our-money-benefit-sharing-for-local-communities-in-the-oil-and-gas-sector/> on 25 November 2021.

[220] Section 58 (3), *Petroleum Act*, (2019).

The Kenyan MPSC is one of the legal instruments used to govern the upstream oil and gas sector and is enumerated in Part A of the Appendices to the Petroleum Act, 2019 where it forms part of the schedules. It is worth mentioning the various aspects of the instrument. The document provides a guideline for the government of Kenya and the contractors. The parties can agree on the manner in which the production of the oil resources will be shared amongst them, that is the cost oil and the profit oil as well as the various taxes that the contractor must pay to the government.

Part VII of the MPSC discusses among other things the cost recovery, production sharing and taxation. Clause 37[221] of the contract stipulates the manner in which petroleum profits should be calculated. The clause states that 'each category of profit petroleum shall be shared, taken and disposed of separately by the government and the contractor on a quarterly basis…'

The calculation of Profit petroleum is demonstrated as follows under the MPSC;

Petroleum Profit = Commercial Production – Cost Petroleum[222]

The above illustrates to users the specific way in which profit oil in Kenya should be calculated therefore offering some guidance on specific profit sharing. It may be argued that the negotiations that are conducted during the signing of the PSC determine the amount that will go to the national government.

As noted earlier, the Petroleum Act, 2019 provides that the national government's share of the profits derived from upstream petroleum operations is split among the national government, the county government, and the local community in the ration of 75% : 25% : 5% respectively.[223] The amount received by the national government. It therefore follows that the respective amounts received by the national government, county government and local communities is determined by the amount negotiated between the contractor and the national government.

[221] Clause 37, MPSC, Schedule, Act No.2 (2019).
[222] The Kenya Model Production Sharing Contract, 2015.
[223] Section 58 of the Petroleum Act, 2019.

3.9 Conclusion

This chapter has discussed the factors that ought to be taken into consideration at the profit division stage. The vulnerable condition of communities has been discussed in view of marginalisation and the intrinsic and economic value of community land. The compensation mechanism as laid out in the regulations has been found to be lacking as it does not take the factors highlighted into consideration.

The legal mechanisms for profit division provisions have been discussed in great detail for a better understanding of the flaws and how they might be remedied. The chapter notes that the new Petroleum Act highlights profit division more elaborately than the previous 1984 Act and highlights key aspects of petroleum operations that were not previously dealt with. This reveals the strides Kenya has made in the development of a more elaborate framework for their newly discovery petroleum deposits.

The Petroleum Act 2019 has been found to be more aware of communities, having provisions on public participation and apportioning five percent of the profit oil to communities. It also provides for more aspects of the upstream oil and gas activities and provides for a more comprehensive form of legislation than before. However, there is no methodology provided in the Act as to how this percentage of profits shall be determined.

The study shall now proceed to do comparative analysis on the oil and gas sector in Nigeria, Papua New Guinea, Venezuela and Norway countries with more developed oil and gas sectors which Kenya might hope to learn from.

Chapter Four

Comparative Analysis between Nigeria, Papua New Guinea, Venezuela, Norway and Kenya

4.1. Introduction

This Chapter features a comparative analysis of different jurisdictions. It discusses salient techniques used in these jurisdictions in the appropriation of revenues received from oil and gas ventures. The chapter discusses the various methods adopted by each jurisdiction for appropriation of revenue. It further discusses the concept of "resource curse" and why it affects certain countries while it is non-existent in others such as is the case for Norway. It also discusses the appropriation of Sovereign Wealth Funds and why they are important when dealing with oil revenues.

The chapter reviews the experience in countries with onshore oil and gas reserves and offshore oil and gas reserves allowing for a broader analysis on the matter. These countries were selected based on the stage at which petroleum was discovered and the level at which they are today in terms of legislation development. All the selected countries are at very different stages in their petroleum life cycle and all have different effects on their respective local communities and revenue sharing which provides an interesting research analysis for the study.
Here, candidate shoud clearly begin by indicating whether this is a comparative study, or case study. If the former, the basis, if the later, the reason as well.

4.2. Nigeria

The Federal Republic of Nigeria, found in Africa's west coast, spans nine hundred and twenty-three thousand seven hundred and sixty-eight (923,768) square kilometres and is currently estimated to be home to over two hundred million people majority of which are youth.[224] Nigeria is a multi-ethnic and culturally diverse country. The country has an abundance of natural resources in the form of oil. It is Africa's biggest oil exporter and has the largest natural gas reserve on the continent.[225]

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[224] World Population Review, 'Nigeria population 2019', http://worldpopulationreview.com/countries/nigeria-population/ on 25 November 2021.

[225] Word Bank Overview of Nigeria, <https://www.worldbank.org/en/country/nigeria/overview> on 25 November 2021.

<u>Fig 4.1. Map of Nigeria</u> **"Source CNN"'**

Nigeria broke into the oil production industry in 1907 when the Nigerian Bitumen Corporation (NBC) began exploration activities.[226] Oil exploration activities however, ceased after the first World War (1914-1918). Small oil companies lacked the financial and technological resources required for exploration of commercial oil thus larger oil companies took this over. Licenses were given to D'Arcy Exploration Company and Whitehall Petroleum; however, they were not successful in their pursuit for commercially viable oil and returned their licenses in 1923.[227]

In 1937 Shell D'Arcy Petroleum Development Company of Nigeria began exploration activities once again. However, it was not until before the independence of the State of Nigeria that commercially viable oil was found in Oloibiri in 1956. [228]The first oil field began production in 1958. Between 1957 and 1960 approximately eight hundred and forty-seven thousand (847,000) tons of crude oil was exported. Towards the end of the 1950s and early 1960s non-British firms were being granted licenses such as Mobil (1955), Tenneco (1960), Gulf oil and Chevron (1961) and Agip (1962). It is important to note that like many other African countries prior to the discovery of oil, Nigeria predominantly relied on the agricultural exports to other countries.[229]

[226] Ukiwo U, 'Governance Regimes of Oil in Nigeria: Issues ns Challenges', *Center for Research on Peace and Development Working Paper no.69,* (2018), at 2.
[227] Akpotor E, Crude Oil Exploration and Exploitation in Niger Delta: A Christian Concern', *International Journal of Innovative Development and Policy Studies,* (2019), at 40.
[228] Ukiwo U, 'Governance Regimes of Oil in Nigeria: Issues ns Challenges',2.
[229] Akpotor E, Crude Oil Exploration and Exploitation in Niger Delta: A Christian Concern', 40.

The oil in Nigeria is predominantly found in the Niger Delta in the south-east coastal region of the country. Original discoveries in these region by Shell were onshore in swamp areas, but later discoveries in early 1960's by Mobil and Gulf were mostly offshore. Ever since the discovery of oil in this region it has been in turmoil over the control and sharing of the oil and gas resources, thus dominating the country's politics and development. This turmoil has led to a lot of conflict in the area causing disruption for the international oil companies (IOC's), which has in turn led to daily oil production being halved.[230] Indeed, the Nigerian Civil War, also referred to as the Biafran conflict, was about control and benefit from the oil resources.[231]

Nigeria has a few similarities to Kenya, such as the fact that the two countries share a colonial past, both having been under British rule. They both boast of a vibrant population, with Nigeria's ethnic, regional and religious diversity mirroring Kenya's own along with resultant major conflicts that mar each country's history. While Nigeria has over two hundred and fifty ethnic groups,[232] three the Igbo, the Yoruba and the Hausa are the most dominant.[233] Whereas in Kenya the big homogenous communities are the Kamba, the Kikuyu and the Luo.[234] As fate would have it, the communities living in the Niger Delta are 'minor' communities, and this has brought about tensions that shall be discussed herein.

Nigeria is a federation comprising thirty-six states[235] while Kenya has a devolved system of governance and forty-seven counties.[236] Nigeria is regarded a world leader in oil and gas production. A quarter of its states, located in the famous Niger Delta, are oil and gas producers. Nigeria has a crude oil production capacity of two point five million (2.5.million)barrels of oil per day, and has reserves of twenty-eight point two billion (28.2 billion) barrels of crude oil and one hundred and sixty-five trillion (165 trillion) standard cubic feet (scf) of natural gas

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230 Ogun D, 'Nigeria Oil and Gas: An Introduction and Outlook- Is the Nigerian Oil & Gas sector on the Road to Recovery? After a decade of instability, there are convincing signs that growth is imminent' Oil and Gas IQ, 16 October 2018 <https://www.oilandgasiq.com/market-outlook/news/nigeria-oil-and-gas-an-introduction-and-outlook> on 17 November 2021.
231 Achebe C, *There was a Country: A Personal History of the Biafr*a, Penguin Books (2003).
232 United States Embassy in Nigeria, 'Nigeria fact sheet', January 2012.
233 Adeniji AS, and Ofiwe ME, 'The impact of ethnicity in Nigeria's political development: An assessment 1999-2011', *International Journal of Research & Development Organization*, 2(2015), 12, 96.
234 Minority Rights Group International, *Kenya: Minorities, Indigenous Peoples and Ethnic Diversity,* (2005), at 9.
235 Article 3, Constitution of the Federal Republic of Nigeria.
236 Ngigi S, and Busolo D, 'Devolution in Kenya: The Good, the Bad and the Ugly', *Public Policy Administration Research* Volume 9 no.6, (2019), at 9.

which included seventy-five point four trillion(75.4 trillion) scf of non-associated gas.[237] Nigeria's oil and gas sector has been in operation for decades, while Kenya has only recently begun operations in the Turkana area in Northern Kenya.

This contradistinction makes Nigeria a worthwhile subject for comparative study as it is possible to borrow from the Nigerian experience while learning from shortfalls that have been encountered as well. Considering Nigeria is a prominent African country it would be of great help for a country such as Kenya to learn a few lessons from a country that may face similar challenges. However, it is important to also note that the oil in Nigeria is mostly located in Off-shore fields.

For the distribution of funds derived from oil and gas, Nigeria offers a principle novel to Kenya; the principle of derivation, which has been evolving over time. This principle will be discussed in more detail below. The next section of the study will dig into the legal framework for the upstream oil and gas sector in Nigeria, together with the allocation of funds in a bid to identify the strengths and challenges therein.

4.3. The Legal Framework for Upstream Operations in Nigeria

The Constitution of the Federal Republic of Nigeria vests the property and control of minerals, mineral oils and natural gas in the federal government. Their governance is to be legislated by the National Assembly.[238] The Acts of Parliament providing this guidance include: The Petroleum Act 1969, The Petroleum Profits Tax Act 1958 and the Land Use Act. The Minister has powers under the Petroleum Act 1969 to issue regulations for the regulation of various activities within this sector, these include; the Petroleum Regulations 1967, the Petroleum (Drilling and Production) Regulations 1969 (as amended by the Petroleum (Drilling and Production) (Amendment) Regulations 2006), the Petroleum Refining Regulation 1974, the Oil Prospecting licences (Conversion to Oil Mining Leases, etc.) Regulations 2003 and the Natural Gas Supply and Pricing Regulation 2008.The constitution also provides for compulsory acquisition, entrenching principles of prompt compensation and right to legal redress[239]. Section 162 provides guidelines on public finance including the maintenance of a

[237] Nigerian National Petroleum Corporation, '*Oil Production'*, https://nnpcgroup.com/NNPC-Business/Upstream-Ventures/Pages/Oil-Production.aspx on 17 November 2021.
[238] Article 44(3), Constitution of the Federal Republic of Nigeria.
[239] Article 44(1)(b), Constitution of the Federal Republic of Nigeria.

special account known as "the Federation Account" where revenues collected by the government shall be paid[240].

The table below presents the laws that govern petroleum operations in Nigeria.

Petroleum laws in Nigeria
The Constitution of the Federal Republic of Nigeria
The Petroleum Act 1969
The Petroleum Profits Tax Act 1958
Land Use Act
Petroleum Regulations 1967
The Petroleum (Drilling and Production) Regulations 1969 (as amended by the Petroleum (Drilling and Production) (Amendment) Regulations 2006),
The Petroleum Refining Regulation 1974, the Oil Prospecting licences (Conversion to Oil Mining Leases, etc.) Regulations 2003
Natural Gas Supply and Pricing Regulation 2008

Table 4.1. Laws that govern Petroleum operations in Nigeria

Nigeria appears to face similar pre-division challenges as is similar to those found in Kenya, as the Land Use Act which governs administration of communal land and compulsory acquisition has come under serious criticism.[241] Presumably to curb speculative purchase of land,[242] the Act vests all land within each state in the governor of that state who is to hold the land in trust for the people.[243] What the citizens have, therefore, is a right to occupancy.[244] The governor is empowered to revoke this right under prescribed conditions, and provides for compulsory acquisition mechanisms similar to those found in Kenya.

In Nigeria, when acquiring land for the development of oil fields and oil and gas facilities, survey plans, also known as Full preparation plan are prepared. These plans are the main

[240] Article 162 (1), Constitution of the Federal Republic of Nigeria.
[241] Iyanda AS, 'Communal Land Acquisition and Valuation for Compensation in Nigeria' *International Journal of Scientific and Research Publications*, 11 (2014), 4; Land Use Act, Nigeria (No. 6 of 1978).
[242] Otubu A, 'The Land Use Act and land administration in 21st century Nigeria: need for reforms' *Journal of Sustainable Development Law and Policy*, (2018), 81.
[243] Section 1, Land Use Act, Nigeria (No. 6 of 1978).
[244] Section 5, *Land Use Act, Nigeria (No. 6 of 1978)*.

documents used for the acquisition of lands for; access roads, blue peg locations, oil and gas pipeline right of way, flow lines among other things. Land holding inventory and the improvement of land by anyone is handled by the estate surveyors and valuers using the full preparation plan as the base map.

This inventory is used to enumerate the compensation that is payable to the landowners. Therefore because of the Land Use Act, little compensation is paid to these land owners, which in turn leads to their livelihoods being destroyed and they are left distraught once the small compensation is for the cash crops and other improvement in the land is exhausted. [245]

4.4. Resource Distribution: The Principle of Derivation

Nigeria has long grappled with the issue of distribution of revenue accrued from oil and gas. Feelings of injustice arising from this issue have often heightened to the extent of local communities sabotaging oil and gas projects in their areas. In 1939, Southern Nigeria was divided into two with the Niger as the dividing line. The country was therefore, split into three parts; the East where the Ibos were prominent, the West where the Yoruba lived and the North where the Hausas or the Fulani lived. To some extent the struggle over the control of the country's natural resources has stemmed from this regional division. This, taken in hand with political conflict has often led to political manipulation and delineation with the aim of influencing wealth allocation.[246]

The principle of derivation is a constitutionally prescribed criteria for distributing federally-collected revenue between the federal and the state governments which prescribed that the pre-determined percentage of federally collected revenue derived from a state of the federation shall be returned to the state as a form of compensation for its contribution to federal finance.[247] The principle simply seeks to create a balance between the contributions made by the states of

[245] Odeh J and Audu H,'Technical and Legal Issues in Land Acquisition for development of Crude Oil and Natural Gas Facilities withing the Niger Delta Religion of Nigeria', FIG Congress-Land Tenure and Land Management Projects in developing Countries, Sydney, 2010.
[246] Uche C and Uche O, 'Oil and the Politics of Revenue Allocation in Nigeria' African Studies Centre Working Paper 54, (2004), at 6-7.
[247] Adangor Z, 'The Principle of Derivation and the Search for Distributive Justice in the Niger Delta Region of Nigeria: The Journey so far', Journal of Law, Policy and Globalization Volume 41, 2015, at 124.

the federation to federally-collected revenue and their share of revenue from the total federal receipts.[248]

The principle of derivation was first introduced in Nigeria via the Philips Commission in 1946 and was meant to ensure that resource-producing states adequately benefitted from the economic gains brought about as a result of their natural resources. It is founded on the understanding that the people of oil producing areas bear the externalities that enable this production such as: environmental pollution and disruption of day-to-day activities.[249]

Some commentators argue that before the discovery of oil, solid minerals were the major natural resource operating based on the principle and it went unchallenged- presumably, because it benefitted the three dominant tribes. Upon the discovery of oil in the Niger Delta; which mostly has minority tribes, the principle apparently, became inconceivable in its original form to the dominant tribes and moves were made to reduce the percentage attributable to producing states. This sentiment is plausible, given the numerous times that the allocation formula was changed after 1958. At one point, the formula provided for a low of one percent (1%) to local communities. The current percentage due to local communities is thirteen percent (13%) and it is derived from the government revenue from production in their territory.[250]

The parameters that guide parliament on the formula for revenue sharing is provided for in the Constitution under article 162(2) and the formula is reviewed every five years.[251] Nigeria has a Federation Account that is financed by oil revenues (comprising proceeds of company income tax, custom duties, and excise taxes). The sharable percentages referred to above are derived from this account. Although 13% is meant to benefit host communities, the same is remitted through the federal states which are expected to manage and administer them for the benefit of host communities. The federal states have been blamed for failing to ensure host communities actually benefit.[252]

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248 Adangor Z, 'The Principle of Derivation and the Search for Distributive Justice in the Niger Delta Region of Nigeria: The Journey so far', 125.

249 Akinola SR, 'Derivation Principle Dilemma and National (Dis)Unity in Nigeria: A Polycentric Planning Perspective on the Niger Delta',

250 Okafor C, Nigeria: 'Oil Producing Communities Want Derivation Fund Raised to 50%' https://allafrica.com/stories/201807240262.html on 14 November 2021.

251 Article 162(2), Constitution of the Federal Republic of Nigeria.

252 AllAfrica, "Nigeria: 13% Derivation - Host Communities Fume Over States Refusal to Set Up Oil Commissions," <https://allafrica.com/stories/202011030541.html> 9 January 2021.

The 13% referred to above is only applied to royalties which are a fraction of the total share received by the government in Nigeria. They do not include profit oil which the Nigerian government shares with the IOCs under relevant PSCs as provided for in the Deep Offshore and Inland Basin Production Sharing Contracts Act, 2004.[253]

It is important to note that the principle of derivation as discussed in the Nigerian Constitution is applicable to all revenue received by the state from natural resources. These revenues include those received from oil and gas producing as well as solid mineral producing states. Derivation is therefore not limited to the oil producing states in the Niger Delta. Although the association of the principle with the Niger Delta originates from the fact that the main source of revenue received by the state is derived from oil and gas while the states from which solid minerals come from provide for an insignificant proportion of federal revenue[254]. The most prominent critique against the principle of Derivations as it applies in Nigeria is that while it is a good attempt to address inequality, It is still insufficient because in spite of the stupendous wealth created in the region, it still has a disproportionately high amount of oppressed and marginalised ethnic minorities who remain amongst the poorest in the nation.[255]

The principle of derivation in Nigeria is different from that of revenue allocation in Kenya. In Kenya the revenue allocation is only shared between the national government and the county government where the resources are located who in turn shares it with the local communities of the area. In Kenya resource revenue is only allocated to the county government of the area where the resources are located not to all county governments. The application of this principle in Kenya may be viewed as unfair as pre-discovery resource revenue was not allocated this way and a sudden change would be a cause for concern.

4.5. Papua New Guinea

Papua New Guinea (PNG) is located in the eastern half of the West Pacific Island of New Guinea, it is knotted together with the smaller islands of New Britain, New Ireland and Bougainville and another six hundred or so smaller and mostly uninhabited islands. Papua New

[253] Section 10.
[254] Adangor Z, *'The Principle of Derivation and the Search for Distributive Justice in the Niger Delta Region of Nigeria: The Journey so far'*, at 126.
[255] Adangor Z, *'The Principle of Derivation and the Search for Distributive Justice in the Niger Delta Region of Nigeria: The Journey so far'*, 15.

Guinea is a very diverse society. The country has more than 800 different languages spoken amongst its peoples and a population of over eight million people that come from more than one thousand ethnic clans.[256] The country may be small, but it is equipped with a vast amount of natural resources in both the oil and the gas sector.

Fig 4.2. Map of Papua New Guinea **"Source Google Maps"**

PNG gained independence from Australia in 1975 and their system of government is democratic as is Kenya. Their national constitution calls for the collective sharing of benefits of the country's vast natural resources which include oil, gas, fisheries, forestry and mineral deposits.[257]

Similar to Nigeria, PNG began oil exploration prior to the First World War. The first oil discovery however, was made in 1986 and oil production began in 1992. Oil production was at its highest from 1993 at over one hundred and fifty thousand (150,000) barrels a day(bopd). The country's first petroleum development was the Hides Gas project after which came the Kutubu field complex, SE Gobe, Gobe Main, Moran, NW Moran and SE Mananda.[258]

PNG's economy is dependent on two main sectors; the first being the extractives sector consisting of mining, petroleum and natural gas and the second is the agriculture and, forestry and fisheries sectors. The former accounting for approximately twenty six percent (26%) of the

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[256] World Bank Group, *'Papua New Guinea Country Partnership Framework '*,2019, at 1.
[257] Anoser K, 'The evolution of Benefit Sharing Agreements in Papua New Guinea: What are the lessons learnt and what are the prospects for the future?' Published MSc Thesis, Massey University, March 2013, 2.
[258] Kawagle S, 'Petroleum Resources of Papua New Guinea', Resource Geology vol.57. 2007, at 348.

Gross Domestic Product (GDP) (2016) while the latter is about twenty percent (20%) of the GDP (2016).[259] This study will focus on the oil and gas sector.

PNG has faced a few challenges from the volatility in the resource sector amongst other things combined with limited revenue mobilization and a monetary framework that is not very effective. There are a few reasons behind these challenges; the difficult economic geography, high dependency on natural resource extraction, limited data availability and low public sector capacity. The deficiencies in policy making have contributed to many of these reasons.

4.5.1. Benefit Sharing in Papua New Guinea

Local Communities such as those in PNG are gradually becoming more aware of the need for more equitable benefit sharing by the extractive industry in their country. International law has also gradually begun to accept the concept of 'fair and equitable benefit sharing' as the norm in various sectors including the extractives sector[260]. The PNG Constitution preamble contains five goals and directing principles that call for the equitable sharing of benefits, specifically goals 2 and 4 which states as follows;

'Goal 2- we declared our second goal to be for all citizens to have equal opportunity to participate in, and benefit from, the development of our country.

Goal 4- we declare our fourth goal to be for all Papua New Guinea's natural Resources and environment to be conserved and used for the collective benefit of us all, and be replenished for our benefit and future generations'.[261]

The above goals found in the constitution clearly demonstrate that benefit sharing is an integral part of the PNG community as a whole as both goals must be read collectively so as to really be clear in its explanation that all citizens should be able to benefit from the development of the country as well as all the country's natural resources being used for the benefit of all citizens.

Under International law the Convention of Biological Diversity provides under Article 15(7) as follows;

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[259] World Bank Group, *'Papua New Guinea Country Partnership Framework ',* 2019, at 4.

[260] Wilson E, 'What is Benefit Sharing? Respecting Indigenous Rights and Addressing Inequities in Artic Resource Project', *Multidisciplinary Digital Publishing Institute*, 2019, at 1.

[261] Constitution of the Independent State of Papua New Guinea, *Preamble.*

'Each contracting party shall take legislative, administrative or policy measures, as appropriate, and in accordance with Article 16 and 19 and where necessary, through the financial mechanism established by Article 20 and 21 with the aim of sharing in a ***fair and equitable*** *way the results of research and development and the benefits arising from the commercial and other utilization of genetic resources with the contracting party providing such resource. Such sharing shall be upon mutually agreed terms'*[262]

This provision highlights the fact that the monetary benefits from benefit sharing arrangements (BSA) must be adhered to as required under Article 20 and 21 of the Convention. Under this article, the terms of a benefit sharing agreement must be mutually agreed on by the parties involved and must also be on a fair and equitable basis.

As this paper's main focus is on sharing of oil and gas profits with local communities, we shall focus on the monetary benefits that the Convention provides under article 20 and 21. These articles provide the framework for access and utilization of financial resources in the development of genetic resources to assist and encourage developed and less developed countries to implement the convention. Monetary benefits come in the form of access fees, one-off compensation payment and licensing rights over patents.[263]

In PNG the state negotiates with provinces, local government and landowners regarding the sharing of benefits on a project-by project basis as is required under the Mining Act 1992 and the Oil and Gas Act 1998 as well as government policies and other established practices. When states negotiate for BSAs it may entail the following; social mapping studies, land owner identification processes to identify relevant beneficiaries, provincial, local and state government negotiations on formulas for benefit sharing, approval from either the Mineral Resource Authority (MRA) and the Department of Petroleum and Energy (DPE) and approval from the National Executive Council. It is important to note that because these agreements are signed on a project-by -project basis the negotiating efforts, processes and outcomes differ depending on the negotiating parties.[264]

[262] Article 15(7), *Convention of Biological Diversity*, 1993 Treaty Series, vol 1760.
[263] Papua New Guinea Institute of Biodiversity, *Access and Benefit Sharing: Policy and Legal Implications for Papua New Guinea*, 2006, at 14.
[264] Deloitte and Extractive Industries Transparency Initiative, *Papua New Guinea (PNG) Extractive Industries Transparency Initiative (EITI) Scoping Study for first EITI Report*, 2015, at 40.

In 2009 PNG signed an Umbrella Benefits Sharing Agreement (UBSA) for Liquified Natural Gas (LNG). The UBSA delineated how various states project their revenue streams, which include royalties, development levy and equity dividends and how these will be shared with project landowners, local level governments and provincial governments. Table 4.2 below demonstrates the various provisions under the 2009 UBSA provided for revenue division for benefit sharing.

The table below summarises the provisions for benefits sharing under UBSA.

Umbrella Benefit Sharing Agreement Provisions	
Royalty	The royalty benefit provided is two percent (2%) given by the State to the land owners, provincial governments and local level governments affected.
Equity	Equity under the UBSA is a total of two-point seven eight percent (2.78%) free equity participating interest in PNG LNG in the project area given to landowners and local governments in the greenfield areas. It further provides the landowners and provincial governments with a chance to buy-into indirect PNG LNG equity up to a collective maximum of 4.22% between 1 January to 30 June 2016.
Development Levy	This is provided at 2% of the wellhead value[265] calculated per the provision of the PNG oil and gas act and the LNG agreement is available to the provincial governments and the local level governments.
Infrastructure Development Grants (IDG)	The amount of K1.2billion has been allocated by the state equally over two five-year periods beginning from 2010 for infrastructure development and maintenance in the affected project areas.

[265] Wellhead value is determined by taking the gross value of petroleum recovered, and deducting all costs incurred between a defined valve on pipes and valves fitted to a production well-head to control flow of oil or gas (the Christmas tree) and the point of sale. Deductible costs are normally confined to processing, storage and transport of the petroleum recovered by the producer to the point of sale. All other costs, including those associated with exploration, drilling, recovery and abandonment are not deductible.

Business Development Grants (BDG)	The state has provided an additional K 120 million to assist landowner companies in business development activities under this project.

Table 4.2. Umbrella Benefitt Sharing Agreement 2009 provisions for benefit sharing[266]

The concept of benefit sharing is one Kenya might benefit from learning from a country like PNG. It would be of great benefit to see the Government of Kenya (GOK) applying some of the principles found in the PNG benefit framework. This is something that would be beneficial for the GOK to propose to the local community of Turkana. As Turkana country is considered a marginalised county applying the benefit sharing concept would assist in decreasing any conflict that may arise from the community as they would be receiving useful developmental structures to boost the local economy.

4.6. Venezuela

Venezuela's oil industry was nationalized in the 1970s when Petroleos de Venezuela S.A (PdVSA) was created. PdVSA is the country's national oil company. The oil reserves found in Venezuela is mostly heavy crude oil which is located along the Orinoco Oil belt (OOB) in central Venezuela as is illustrated below. It contains four exploration areas; Ayacucho, Boyaca, Junin and Carabobo. Venezuela also has reserves in the western part of the country known as Lake Maracaibo[267].

Fig 4.3. Venezuela's Orinoco Belt **"Source EIA"[268]**

[266] Deloitte and Extractive Industries Transparency Initiative, *Papua New Guinea (PNG) Extractive Industries Transparency Initiative (EITI) Scoping Study for first EITI Report,* 2015, at 41-42.
[267] U.S. Energy Information Administration, '*Background Reference: Venezuela',* January 7 2019 at 2-3.
[268] U.S. Energy Information Administration, '*Background Reference: Venezuela', at 3.*

Venezuela has been said to have the largest oil reserves in the world and has also been the recipient of the largest oil boom in history which began in 2004. However, this left their domestic oil industry and its national oil company crippled through political capture, hampered with social and political mandates, non-oil investment-related debt, firing most of its best-trained professionals and destroying its credibility in the oil industry and in the financial markets[269]. These effects have been suggested to stem from the effects attributed to the resource curse which shall be discussed further in the next section.

The country has been highly dependent on oil since its discovery almost one hundred years ago. According to the Organization of Petroleum Exporting Countries (OPEC) Annual Statistical bulletin 2019 Venezuela has proven oil reserves amounting to approximately three hundred and two point nine million (302.9 million) barrels and has crude oil production of approximately one thousand five hundred and ten point two (1,510.2) BOPD.[270]

The oil in Venezuela can be divided into two categories; conventional oil and heavy oil. The heavy oil is difficult to transport and refine and this will raise the cost of production. The wealth of oil found in the country has made Venezuela extremely dependent on oil revenues which in turn has brought about many policy challenges in the country. Similar to many other oil producing countries, the management of revenues from petroleum in the country has proved to be inefficient.[271]

4.6.1 Management of Oil revenues in Venezuela

According to a report published by the Inter-American Dialogue (2020) Venezuela has one of the highest government takes in the world from oil extraction amounting to over ninety per cent (90%). Some of the salient features of the fiscal regime in place in the country include; fifty percent (50%) on net profits, royalties of thirty-three percent (33%) of the value of extracted crude oil and a windfall tax[272] that raises taxes on oil income when prices are high above eighty percent (80%) for prices between eighty dollars ($80) to one hundred dollars

[269] Villasmil R, 'Venezuela*: Public Debate and the Management of Oil Resources and Revenues',* Center for International Development, Harvard University Cambridge, 2018, Massachusetts, at 347.
[270] Organization of Petroleum Exporting Countries (OPEC), *'Annual Statistical Bulletin'* 2019, at 8.
[271] Manzano O, and Scrofina J, *'Resource Revenue Management in Venezuela: A Consumption-based poverty reduction strategy',* 2013, Universidad Catolica Andres Bello and Instituto de Estudioes Superiores de Administracion (IESA), at 3.
[272] This is tax levied on unforeseen or unexpectedly large profit, especially one regarded to be excessive or unfairly obtained.

($100) and can go up to ninety percent (90%) if prices go higher than one hundred and ten dollars ($110).[273]

In the 1940s under Isaias Medina Agarita's government new laws were passed to unify the existing concessions under a new tax and regulatory frameworks which would see to the increase in royalties and the extension of existing concessions for the next forty years. Earlier, the Agarita government had passed the Income Tax Law. These two laws were used to guide for future governments by ratifying the states part in maximizing oil revenues.[274]

In 1999 when Hugo Chavez came into power one of his main goals was to change the management of oil resources and revenues in the country. Under Chavez's regime the new Liquid Hydrocarbons Law (LHL) 2001 and the Central Bank Reform Law of 2005 were passed in hopes to provide assistance for the governance of taxes on oil revenues. The LHL increased royalty rates from sixteen percent (16%) to thirty percent (30%) and lowered the income tax on conventional oil activities from sixty-seven-point seven (67.7%) percent to fifty percent (50%).[275]

Venezuela has attempted to manage its revenue from the oil and gas industry in different ways through various saving mechanisms whose main purpose was to assist the country in the management of its resource revenue. In the 1970s the Venezuelan Investment Fund (VIF) was created. The VIF aided in the creation of a set of energy-intensive industries in the hopes to diversify from oil.[276]

Then in the 1990s the Investment Fund for Macroeconomic Stabilization (FIEM) was created during a time when the prices of oil were relatively low. The FIEM original design was quite straight forward and clear on the saving and spending rules, however this was modified under Chavez's government making it more discretionary. The FIEM was meant to change fiscal expenditures in the central and the lower government levels, but appeared to have created more

[273] Inter- American Dialogue,*' Reviving Venezuela's Oil Sector the Role of Western Oil Majors',* 2020, at 7.
[274] Rodriguez P, Morales J and Monaldi F, *'Direct Distribution of Oil Revenues in Venezuela: A Viable Alternative?',* Center for Global Development Working Paper 306 of 2012, 4-5.
[275] Villasmil R, 'Venezuela*: Public Debate and the Management of Oil Resources and Revenues',* at 350.
[276] Manzano O and Scrofina J, *'Resource Revenue Management in Venezuela: A Consumption-based poverty reduction strategy',* at 9-10.

macroeconomic volatility. The FIEM eventually became inoperative due to the endless modification of its rules.[277]

Venezuela's final attempt at savings was in 2005 when the National Development Fund (FONDEN) was created. Its main purpose is to leverage economic growth and sustainable development. FONDEN's funds are derived from two sources; firstly, the PdVSA, where the fund receives all oil windfall taxes paid by the PdVSA and private partners in joint ventures as well as any resources demanded directly by the president. Secondly, the Central Bank which transfers a portion of the international reserves when they are in excess the level that is considered to be sufficient.[278]

There is no specific law providing for the manner in which profits from the oil and gas sector are shared with local communities in Venezuela. Venezuela only has a revenue sharing arrangement with lower levels of government under the Constitution, the Special Allocations Law, and the Inter-Territorial Compensation Fund.[279] Under the Constitution revenue sharing regime, 20% of the ordinary fiscal income is distributed to subnational levels of government.[280] In the Special Allocations Law, a minimum 25% of the Collected Fiscal Income was distributed to sub-national levels of government. From the 25%, 42% went to state governments, 28% to municipalities and 30% to communal councils.[281]

The Inter-Territorial Compensation Fund is controlled by the executive and it does not have specific rules of allocations. The amount distributed to subnational levels is decided by the executive and it has been criticised for being opaque and lacking accountability.[282] That notwithstanding, it is imperative to note that Venezuela has undergone a recent political and

[277] Manzano O and Scrofina J, *'Resource Revenue Management in Venezuela: A Consumption-based poverty reduction strategy',* at 10.
[278] Manzano O and Scrofina J, *'Resource Revenue Management in Venezuela: A Consumption-based poverty reduction strategy',* at 10-11.
[279] Osmel Manzano and Jose S. Scrofina, "Resource Revenue Management in Venezuela: A consumption-based poverty reduction strategy," at https://www.resourcegovernance.org/sites/default/files/Venezuela_Final.pdf (accessed 19/12/2021).
[280] Article 167 of the Venezuela (Bolivarian Republic of)'s Constitution of 1999 with Amendments through 2009.
[281] Manzano O, and Scrofina J, "Resource Revenue Management in Venezuela: A consumption-based poverty reduction strategy.
[282] *Ibid*.

economic crisis in recent years that it is now only beginning to recover from. Thus, the same would affect the returns of its oil and gas industry.[283]

Kenya has enacted the Petroleum Act, 2019 that is more elaborate on profit sharing between the national government, county governments and local communities, as well as other entitlements to the stakeholders. Venezuela's various fiscal management mechanisms could prove to be a learning curve for Kenya. Kenya can consider adopting Venzuela's mechanisms when it comes to saving the revenues received from oil. Although the initial mechanisms in Venezuela failed, Kenya can learn from these failures and implement stronger guidelines and policies that would ensure the savings programs are successful.

Although, Kenya has enacted the Petroleum Development Fund Act no.4 of 1991, which is supposed to be used to develop the petroleum sector.[284] However recently there have been talks of revoking the act stating that there has been a lack of accountability in the implementation of the levy fund for many years.[285] This study would suggest that the fund be modified to become a fund that collects revenues from oil operations in the country in order to develop the country in a sustainable manner. This may assist the country in avoiding the well-renowned resource curse that country's such a Venezuela face. The study will delve further into the phenomenon that is the resource curse below.

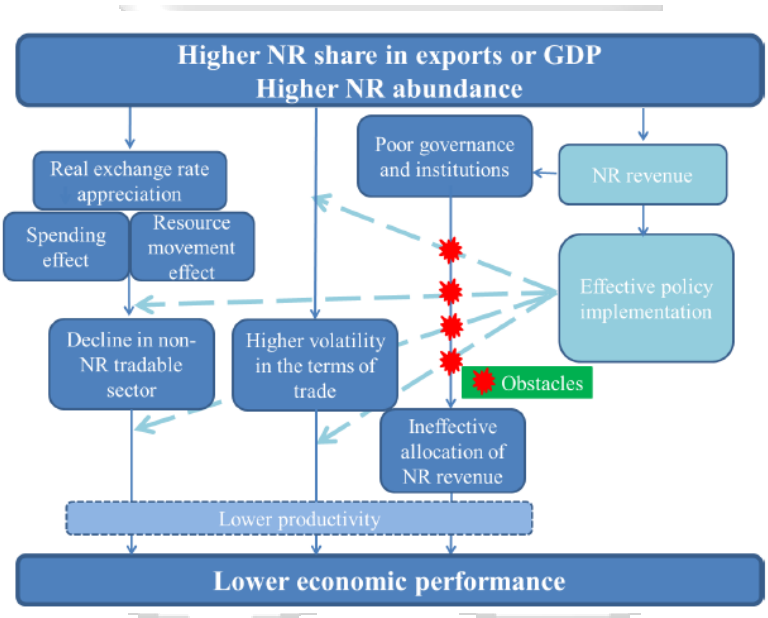
4.7. The Resource Curse

For the purposes of this paper, it is crucial that we mention a few points about the resource curse and its implications in the above-mentioned countries (Nigeria, PNG and Venezuela). This is because the theme of this study on the adequacy of the laws on the share of local communities in oil and gas is a key determinant of stability in the sector. As seen below, conflict arises out of non-involvement of affected citizens in the decision-making process with regard to natural resources.

[283] United states Institute of Peace, 'The Current Situation in Venezuela: A USIP Fact Sheet' on February 18 2022. See https://www.usip.org/publications/2022/02/current-situation-venezuela.
[284] Section 4, *Petroleum Development Fund Act* (Act No.4 1991)
[285] Mwangi I, 'Kenya: MPs mull revoking petroleum development fund citing opaque operations', *All Africa*, 29 September 2021, https://allafrica.com/stories/202109300202.html on 25 November 2021.

The phenomenon of the resource curse also known as the paradox of plenty, refers to the failure of many resource-rich countries in benefitting fully from their natural resource wealth, and for governments in these countries to respond successfully to public welfare needs. In countries where there is an abundance of resources, it would be expected that they would be more developed and in fact greatly reaping the benefits of their resource abundance. Yet, this is not the case for many of these countries.

Research has found that countries that suffer from the resource curse have many similarities among which are that they tend to have higher rates of conflict and authoritarianism[286], lower rates of economic stability and economic growth[287].



<u>Fig 4.4. Relationship between Natural Resources and Economic Growth[288]</u>

Studies have observed that there are three main elements that may lead to the undesirable relationship between the wealth of natural resources and lower economic growth namely; the Dutch disease, high volatility in the terms of trade and the governance weakness induced by competition over control of resources and leading to sub-optimal policies[289].

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[286] The enforcement or advocacy of strict obedience to authority at the expense of personal freedom.
[287] Natural Resource Governance Institute, *'The Resource Curse the Political and Economic Challenges of Natural Resource Wealth',* 2015, at 1.
[288] Avalos N, Stuva V, Heal A, Lida K and Okazoe N, 'Papua New Guinea and the Natural Resource Curse', Asia-Pacific Research and Training Network on Trade,' Working Paper No. 128 of 2013, at 10.
[289] Avalos N, Stuva V, Heal A, Lida K and Okazoe N, *'Papua New Guinea and the Natural Resource Curse', 2013, at 1.*

The Dutch disease was a term that referred to the fears of decentralization that took over the Netherlands as a result of the appreciation of the Dutch guilder[290] that followed the discovery of natural gas deposits within the country's jurisdiction in the North Sea in the late 1950s and early 1960s[291]. Simply put it refers to an increase in the economic development of a certain sector (such as the oil and gas sector) which causes a decline in other sectors (such as agriculture).[292]

Characteristics of the Resource Curse
Extreme dependence on resource wealth for fiscal revenues, export sales or both
Low saving rates
Poor Growth Performance
Highly Volatile Resource Revenues

Table 4.3. Common Characteristics of the Resource Curse

Nigeria, PNG and Venezuela can be described as countries that have fallen victim to the much-dreaded resource curse as these countries are abundant in oil resources yet they are still severely underdeveloped in many ways.

Although Nigeria has a vast abundance of natural resources the country is severely underdeveloped and this can be argued to have stemmed from the so-called resource curse. From their independence Nigeria has struggled with social and economic hardship in conjunction with bad governance, poor fiscal social contract, failed policies a corrupt political class and a serious over reliance on oil[293]. Nigeria is one of the poorest and most unequal countries in the world regardless of the profuse amount of money earned from oil revenue annually.[294]

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[290] The guilder was the currency of the Netherlands from the 17th Century until 2002 when it was replaced by the Euro.

[291] Gylfason T, *'Lessons from the Dutch Disease: Causes, Treatment and Cures'*, Institute of Economic Studies, 2001 at 1.

[292] Borysiak K, 'Model of State Management of Petroleum Sector- Case of Norway', 20(1), *Interdisciplinary Political and Cultural Journal*, 2017, 101.

[293] Chukwuma I, *'The Resource Curse in Nigeria: Lessons and Policy Option'* International Journal of Research in Humanities and Social Sciences Volume 2 Issue 8, (2015), at 38.

[294] Gbahabo P, and Oduro- Afriyie E, *'On the Dynamics of the Oil Resource Curse in Nigeria: Theory and Implications*, Unpublished Masters in Finance, Stellenbosch University,2017, at 2.

PNG is well known for having a substantial natural resources and mineral wealth. The social fragmentation in PNG has often led to conflict. The unequal distribution of the benefits of growth and the undemocratic decision-making processes in conjunction with the citizens' concerns with power and politics of the control and use of resources are just some of the reasons behind the conflict the country faces in the extractives sector[295]

Venezuela from 1922- 1973 was actually one of the top performing economies at the time making noteworthy advances in public health, literacy, education, basic infrastructure and democracy. Between 1922 and 1957 the country was even ranked first in the world in terms of cumulative GDP per capita. However, shortly after this success from 1978-2014 it was ranked one of the worst performing economies in Latin America and one of the worst performing economies in the world[296].

Venezuela can be said to be a victim of the unpredictable 'boom and bust cycle'. This refers to the over reliance of countries on a capricious global commodity market that regularly cycles through booms and busts. Capital labour shifts toward one product may have short-term benefit but likewise creates economic monoculture. This means that a country such as Venezuela will experience considerable economic hardships when the price of the commodity goes down[297] because of their over reliance on said commodity. Villasmil), notes that Venezuela's long-standing decline from the 1980s may have been as result of the oil price volatility, the misinterpretation of temporary price shocks as permanent ones and the incapacity to change course once this problem was identified.

It is of great importance to note that the above-mentioned countries (Nigeria, PNG and Venezuela) are oil dependent countries. Which is one of the characteristics mentioned in table 4.3. This simply means that their economies are highly dependent on the exports of oil. This in turn results in most of the government's revenue source stemming from oil revenues and not much is coming from other non-oil related sectors such as agriculture. This seems to be the common cause of these countries suffering from the resource curse.

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[295] Avalos N, Stuva V, Heal A, Lida K and Okazoe N, *'Papua New Guinea and the Natural Resource Curse', at 11*.

[296] Villasmil R, 'Venezuela*: Public Debate and the Management of Oil Resources and Revenues',* at 358.

[297] Kott A, *'Assessing whether Oil Dependency in Venezuela contribute to National Instability;* Journal of Strategic Security Volume 5 no 3, (2012), at 70.

In PNG a lot of conflict arises out of non-involvement of affected citizens in the decision-making process with regard to natural resources another characteristic found in table 4.3. Venezuela also suffers from the mismanagement of oil revenues by their government which boils down to poor governance of oil revenues and the oil and gas sector once again leading to the resource curse. The question then arises, will Kenya also fall victim to this so-called curse? The Kenyan economy is not an oil-dependent economy in fact the agricultural sector has been suggested to be the backbone of the economy contributing approximately thirty-three percent (33%) of the country's GDP[298]. This is a big factor as suggested above in countries falling into the resource curse as majority of their economy relies on oil revenues and how they are managed for the country's benefit.

However, not all countries fall victim to the much-discussed resource curse and we shall delve deeper into the case of Norway in the below section. One of the few countries that is significantly benefitting from its abundance of natural resources. A country Kenya stands to learn a lot from when it comes to successful management of oil revenues.

4.8 Norway

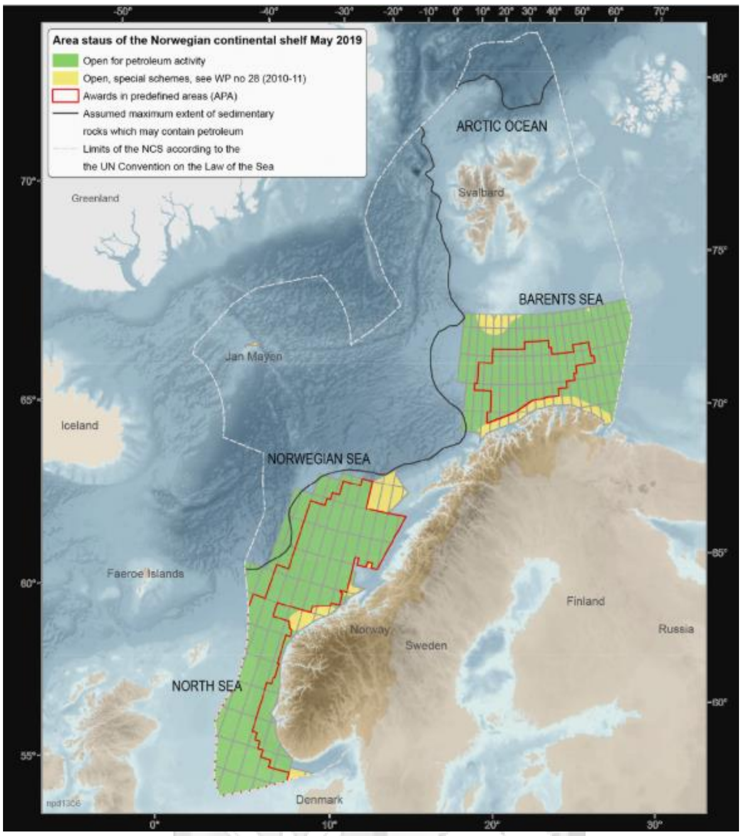
Our final discussion will be on a country that has been greatly successful in the management of oil revenues where others have been unsuccessful. In oil and gas, Norway's success is almost unparalleled. The total net cash flow for the government from the petroleum industry was estimated to be Norwegian Krone (NOK) one hundred and eighty-four billion (NOK 184 billion) in 2021and is estimated to be NOK two hundred and seventy-seven billion (NOK 277billion) in 2022.[299]

The Petroleum sector in Norway is one of the largest and most important sectors of the Norwegian economy. This is measured in terms of value added, government revenues, investments and export value. The petroleum resources on the country's continental shelf have been estimated to approximately fifteen point six seven billion (15.67 billion) standard cubic

[298] 'USAID, Economic growth and Trade, 20 September 2021, https://www.usaid.gov/kenya/economic-growth-and-trade, on 25 November 2021.

[299] Norwegian Petroleum, *'The Governments Revenues'* https://www.norskpetroleum.no/en/economy/governments-revenues/ on 14 November 2021.

meters of oil equivalents. However, only forty-eight percent (48%) of the total discovered and undiscovered resources on the shelf have so far been produced and sold.[300]



<u>Fig 4.5. The Norwegian Continental Shelf</u> **"Source NORSK"**

However, a more significant facet of this success, which is even more celebrated, has been Norway's ability to maintain a significantly equal state while accumulating impressive wealth.[301] Given that this study is about distribution of resources, Kenya stands to learn much from the Norwegian experience.

The administration of the Norwegian petroleum sector has been in operation since 1972. The model of governance has been based on a separation of policy, commercial and regulatory functions. In each of these areas there are state-controlled institutions that have their own distinct roles. We must note that the model of separation of duties combined with other unique elements cannot simply be mirrored by other countries. These include: a long tradition and high level of democratic competition, inter-governmental checks and balances, socio-democratic

[300] Norwegian Petroleum, *'The Petroleum Resources'*, https://www.norskpetroleum.no/en/petroleum-resources/ on 17 November2021.
[301] 77. Organization for Economic Co-operation and Development (OECD), 'Economic surveys: Norway', 2018.

traditions of strong public involvement in sectors consider to be of strategic importance to the country, mature institutional capacity and a highly developed model of co-operation between government, business and research institutions.[302]

Norway has been said to have the largest investment fund in the world commonly known as the 'oil fund' it holds 1.3% of the value of the world's listed companies.[303] On the 25th of October 2019 the fund reached ten billion kroner[304]. Norway derives funds from its oil and gas sector through different methods. Norway has put in place a specialised tax regime for petroleum given its significance, amounting to seventy-eight per cent (78%) charged on profit. This amount, may appear to be ostensibly high and may be seen as discouraging for investors due to possible low returns. However, the good standing the country has on transparency and ease of business has made up for the high tax rate as it has boosted investor confidence. The state also derives funds through its own oil exploration company, *Equinor*, which participates competitively in the market.[305] Equinor is established under the Chapter 11 of the Petroleum Act (Act 29 November 1996 No. 72 relating to Petroleum Activities).

Norway unlike Kenya and Nigeria, is a civil law jurisdiction. Majority of its laws are therefore found in legislation and regulation. The main relevant Act is the Petroleum Act (Act 29 November 1996 No. 72 relating to Petroleum Activities). As in the other two jurisdictions, the Act vests the property to petroleum deposits in the state.[306] Resources accruing from petroleum are to be utilised for the benefit of the whole society.[307] The Act uses the phrase 'long-term' indicating mindfulness for the future generations; a principle that motivated the establishment of the Sovereign Fund.[308] A Sovereign (Wealth) Fund shall be discussed in more detail below. The revenues accruing to the state are to be invested so as to benefit the entire nation for generations to come.[309] To further elucidate what is meant by using revenues 'to benefit the people' Norway has established principles on how to spend and invest funds accrued from petroleum, christened the *'Ten Oil Commandments'* as are listed below in Table 4.4.

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302 Borysiak K, *'Model of State Management of Petroleum Sector- Case of Norway'*, at 97-98.
303 Extractives Industries Transparency Initiative (EITI), *'Norway: Revenues from oil fund now exceeds Revenue from oil'* https://eiti.org/news/norway-revenue-from-oil-fund-now-exceeds-revenue-from-oil on 4 June 2020.
304 Norges Bank Investment Management, *'The Fund's Development'*, https://www.nbim.no/en/ on 4 June 2020.
305 Formerly known as Statoil. See official website: https://www.equinor.com/en.html on 19 April 2019.
306 Section 1-1, Petroleum Act 29 November 1996 no. 72 relating to Petroleum Activities.
307 Section 1-2, Petroleum Act 29 November 1996 no. 72 relating to Petroleum Activities.
308 The fund is intended to facilitate lasting investments and good governance. See Clark B and Monk A, 'The Legitimacy and Governance of Norway's Sovereign Wealth Fund: The Ethics of Global Investment',
309 Bustnesli Y, 'Norway', *The Oil and Gas Law Review*, (2018), 6.

The Principle of the Ten Oil Commandments
1. That national supervision and control of all activity on the Norwegian continental shelf must be ensured.
2. That the petroleum discoveries must be exploited in a manner designed to ensure maximum independence for Norway in terms of reliance on others for supply of crude oil.
3. That new business activity must be developed, based on petroleum.
4. That the development of an oil industry must take place with necessary consideration for existing commercial activity, as well as protection of nature and the environment.
5. That flaring of exploitable gas on the Norwegian continental shelf must only be allowed in limited test periods.
6. That petroleum from the Norwegian continental shelf must, as a main rule, be landed in Norway, with the exception of special cases in which socio-political considerations warrant a different solution.
7. That the State involves itself at all reasonable levels, contributes to coordinating Norwegian interests within the Norwegian petroleum industry, and to developing an integrated Norwegian oil community with both national and international objectives.
8. That a state-owned oil company be established to safeguard the State's commercial interests, and to pursue expedient cooperation with domestic and foreign oil stakeholders.
9. That an activity plan must be adopted for the area north of the 62nd parallel which satisfies the unique socio-political factors associated with that part of the country.
10. That Norwegian petroleum discoveries could present new tasks to Norway's foreign policy.

Table 4.4. The Norwegian Ten Oil Commandments **"Source Petroleum Act of Norway"**

The deliberate agenda of driving the nation's policy's is clear in the commandments, which require that Norway be self-sufficient in satisfying internal demand for crude oil; and that the market be diversified. Placing such rules in policy and law, and acting on them, has brought about tremendous success. There is no reference to or mention of local communities in the

Norwegian ten oil commandments. This is partly explained by the fact that Oil and gas production in Norway is only offshore[310] hence there is no community that can exclusively claim a share of the petroleum profit.

In matters of shareholder compensation, Chapter 8 focuses on the compensation of fisherman in the petroleum area. Section 8-2 provides for compensation of fishermen whose livelihood is impaired by petroleum activities within a fishing field.[311] The onus to pay compensation is placed upon the State, which may claim from the licensee. This compensation may be paid in form of a fixed sum or in annual installations.

Kenya should take these principles in account and tailor them accordingly when implementing or creating their own laws and policies and ensure that they are adhered to in practice so as to propel the economy to success. These principles can act as a guideline on how to spend and invest funds derived from the projected oil revenues. If Kenya chooses to use them then the country would have to modify them to suit the Kenyan social and economic needs which of course are different from those of the Norwegian citizens.

4.9 Conclusion

This chapter has given a brief background on the different methods used in the management of resources in countries with onshore (PNG and Venezuela) and offshore oil (Nigeria and Norway) and gas reserves demonstrating whether each country has been successful in its use of oil revenues funds. We have discussed the legal framework provided for in each of these countries and whether the laws provide progressive avenues for countries to successfully use their revenues appropriately.

We have discussed the resource curse, in hopes to shed some light on some of the reasons as to why this is a challenge for some countries. We have noted that the resource curse is prevalent in countries that have oil-dependent economies as this is their most prevalent resource and they do not focus on the other non-oil related sectors to provide revenues.

[310] https://www.trade.gov/knowledge-product/norway-offshore-oil-and-gas
[311] Section 8-2 Petroleum Act 29 November 1996 no. 72 relating to Petroleum Activities.

Much can be gleaned from the brief exposition of the practices employed in these countries. Norway not only states in its laws that natural resources must be held in trust for the people and utilised accordingly, but has actually gone a step ahead and implemented this mantra exhaustively. Nigeria on the other hand has struggled in achieving equity, the ethnic tensions and unfavourable legal provisions causing it to lag behind. PNG has been faced with conflict due to lack of involvement of the citizens in the decision-making process and considering how multi-ethnic the country is these are issues that should be addressed. Venezuela has been faced with poor governance when it comes to natural resources and the multiple mechanisms they have tried to enforce have not been as successful as the country would like.

There exist many similarities in the legal framework and socio-economic realities between Nigeria, PNG, Venezuela and Kenya. Given the amount of time Nigeria has had and consequently, experience in the sector, it is possible for Kenya to learn from this and in turn try to not make the same mistakes. Kenya's constitutional framework is undoubtedly stronger, considering the democratic principles entrenched and the fact that though public land is vested in the State, this is done in trust for the people- the ultimate owners. It is therefore imperative that Kenya puts these principles into practice.

Kenya should also take a few notes from PNG and Venezuela. From PNG we find that the locals face a lot of conflict when it comes to dealing with its natural resources. This is therefore something Kenya should consider by involving the local communities in the decision-making process so as to avoid stalemates with investor companies. Venezuela also has some lessons to teach in that it faces incredible mismanagement of oil revenues due to poor governance which is another problem Kenya faces as well. As there is the fear that the government will not be able to handle the oil revenues adequately and thus lead the country to despair. In this area Norway has set a good example through the NPFG, as this demonstrates how good governance can lead to success.

In the next chapter the study will discuss the finds and recommendations that have been found in the vast research that has been carried out. It will summarize and analyse the entire study and the various hypotheses set out in the first chapter and whether or not they have been met.

Chapter Five:

Findings, Conclusions and Recommendations

5.1. Introduction

This chapter discusses in summary what has been found and concluded from the extensive research. The study sought to analyse the framework guiding the distribution of funds derived by the government from oil and gas ventures. It hypothesised that such distribution does not take into account existing challenges at the upstream level, and that there is need to reconcile distribution with pre-existing factors. The research questioned the equitability of the division of funds that did not take these pre-division conditions into account. To achieve this, a conceptual framework for identifying stakeholders, determining pre-existing distributional challenges and ensuring profitability was necessary.

Furthermore, the study sought to analyse the various provisions and uses of petroleum revenue appropriation in Norway, Nigeria, Papua New Guinea and Venezuela so as to seek an avenue in which Kenya might be able to follow in their own distribution of revenue allocation in the future. Below are the findings, conclusions and recommendations of the study.

5.2.Findings

The study sought to review and challenge the legal and policy framework governing profit-sharing and the overall share and interests of local communities in the oil and gas industry in Kenya.

The study used the review of literature, policy, law and statistics from d secondary sources to analyse this problem and seek some answers as to whether Kenyan policies can be adequately and appropriately implemented. In order to further understand this issue the study briefly analysed the regional framework of the petroleum industry by looking at the EAC. It discovered that in the EAC the discovery of oil deposits is relatively new as they have been discovered in the region in less than a decade and a half. The policies found in the region are all rather similar in their mandate particularly when referring to the need that resources must be utilized in a manner that is beneficial to their respective societies.

The study looked at the Kenyan MPSC and found that there are clear provisions as to what is referred to in the agreement as profit petroleum. We found that the MPSC has set the profit sharing to be done on a quarterly basis once production begins, but the contract does not provide for any additional access to a share of the profit oil by the stakeholders involved with any interested relation to the profit oil.

The study found that stakeholders for the purposes of this research referred to the national government, county government, local communities, individual proprietors of the relevant land and the general public, who have an equitable interest as is found under Article 62(1)(f) of the Kenyan Constitution. Furthermore researchers, defined local communities to refer to those individuals that are located within the extractive area and those affected directly by explorations and production operations. Additionally, the local communities are those whose livelihoods are centred around the exploration region.

Research also delved into the concept of the stakeholder theory to further analyse and identify who a stakeholder is in the petroleum industry. From Mitchel *et al*, it was discovered that when applied to the Kenyan context the local communities can be described as having legitimacy in being a stakeholder in the industry but they are unable to exercise power to implement these moral rights.

5.3 Legal Framework in oil and gas Operations in Kenya

Kenya is not oil-dependent and therefore this could mean that there are vast possibilities of the petroleum resources adding a positive impact to the economy if revenues are divided appropriately.

In chapter one of the study, we set out two hypotheses namely;

a) The legal and policy framework governing the Kenyan oil and gas sector does not adequately take into consideration the interests of the local communities
b) Rules on restriction of the application of the government's take of profit oil are essential to addressing pre-division problems tied to oil and gas ventures.

The question then arises as to whether or not the study was able to find answers to the above statements by the end of extensive research that was carried out. For the first hypothesis regarding the Kenyan oil gas legal framework the study broadly discussed in chapter three the legal and regulatory framework set forth in Kenya. In the findings the various laws and regulations that govern the oil and gas industry in Kenya were outlined. These included; the Petroleum act 2019, the Energy Act 2019, the land act 2012 and the Community Land Act 2016. The study found that contracts entered into before the enactment of the new petroleum act will still prevail accordingly.

The study analysed the provisions of the constitution and discovered that the constitution states that any contracts in oil and gas operations that appear to be in contradiction with the constitution will be considered void including those that infringe on the people's rights. The constitution also brings to light the fact that in the implementation of policy legislators must consider Article 10 of the constitution specifically; equity, social justice, equality and the protection of the marginalized communities. The study deduced that public land as is described under the constitution includes all minerals and mineral oils and these are placed in the care of the government in trust for the people. Community land is that which is held by certain communities, registered in the name of group representatives and has been legally transferred to a specific community by an act of parliament.

The chapter further analysed the concept of compulsory acquisition in Kenya. It vocalizes that compulsory acquisition should be conducted within the parameters of chapter five of the constitution and prompt compensation should be provided for those who are affected. Chapter three also observed that as a result of the marginalization experienced by local communities such as Turkana locals were sceptical towards the government and ensuing oil and gas ventures that they are involved in. The study found that marginalization may have led to some of the more serious problems faced by local communities including; poor or non-existent community consultation and problems with information sharing and poor quality of engagement agreements.

Furthermore, chapter three looked at the legal framework surrounding acquisition of land governed by the land act and the Community Land Act. It was found that the guidelines set out for the governance of compulsory acquisition of land are found under Part VIII of the Land

Act. The process of compulsory acquisition was discussed in great detail and it is clearly stated that when land is compulsorily acquired full and just compensation must be paid.

Under the Land (Assessment of Just Compensation) Rules 2017 there are five factors to be considered in assessing the compensation required under rule 3, while rule 5 also outlines the factors to be considered in the determination of a compensation award. This clearly suggests that there is in fact legal framework that has been created to provide a guide as to how to compensate stakeholders in land transactions.

The previous PEPA 1984, was found to be a very shallow act and did not consider many factors pertaining to petroleum activities and grossly favoured the contractor. The act was also very limited in terms of description of compensation to enter privately owned land. Compensation for this is grossly inadequate and only pertains to disturbance and damaged incurred in the process of entry with no mention of interest granted if resources were discovered.

The act therefore did not provide a guideline relating to the matters of pre-division of oil or local communities and communal land. It is safe to say that the repealed law did not adequately address the issue of compensation faced by stakeholders affected by oil and gas ventures.

The study highlighted that the newly enacted Petroleum Act 2019, provided for a number of considerations that were not present in the repealed PEPA 1984 Act and this included a clear outline of the division of oil between the National government, the county government and the local communities into the ratio of seventy-five percent, twenty percent and five percent respectively among themselves. This new Act provides for an elaborate and extensive consideration of upstream operations covering important areas including; licensing and permits, unitization, petroleum production and decommissioning guidelines. The Act also provides for revenue sharing, reporting, transparency and accountability of the government regarding oil and gas operations. The act attempts to apply the concept of intergenerational equity to the utilization of the funds.

With reference to unregistered community land as defined by the Community Land Act, the provisions for compensation of local communities under the Petroleum Act, 2019 were found to be inadequate as there is no clear elaboration on how the community directly gets compensation. Therefore, with regard to the first hypothesis of the study the legal framework as it relates to oil and gas in Kenya can be said to provide for the pre-division challenges faced by the various stakeholders through the Land (Assessment of Just Compensation) Rules 2017. However, these rules are not specific to the oil and gas industry which suggests that it may not be explicit enough in their address of these compensation issues faced by local communities affected by this sector. Perhaps legislators should consider creating a more specific and exact framework to address this issue head on. Thus the legal and policy framework governing the Kenyan oil and gas sector does not adequately take into consideration the interests of the local communities.

This study also finds that rules on restriction of the application of the government's take of profit oil are essential to addressing pre-division problems tied to oil and gas ventures. In regard to the second hypothesis there is no direct guideline that references this in Kenyan law. There are no specific rules set out under Kenyan law restricting the government take of profit oil. The legal framework as discussed above does provide for the various divisions of profits and shows that the national government is to take the highest portion of the profits from production operations. However, there is no clear indication as to whether this affects the pre-division challenges faced in oil and gas ventures thus far and how this government take is calculated.

5.4 Comparison with other Countries

The study looked at different countries and their policies to see whether or not Kenya would be able to apply some of these policies to ensure the success of the upcoming oil industry. In chapter four the study discussed four different countries and their various oil and gas industries. In Nigeria it was discovered that although the country has been in the oil industry for many years they have not developed adequately and have not been able to utilize funds received from the oil industry accordingly. The country faces many issues with feelings of injustice from local communities who reside in the areas where oil and gas ventures are pursued. The local communities have even sabotaged some of projects undertaken in their areas.

The study noted that the principle of derivation used in Nigeria is when the revenue collected for oil and gas operations carried out in any state under the Nigerian federal government is returned to that state at a set percentage as compensation for the state's contribution to federal finance. This principle's main attraction is that the state collecting the most revenues receive the most share of petroleum profit. This has proven difficult to deal with as certain states don't receive enough and feel that they are 'missing out' on the benefits they believe they should receive. Thus, it has proved difficult to achieve its full potential as it has been met by so much uproar.

In PNG the country has used the concept of benefit sharing to ensure fair and equitable of revenue distributions in the country. Benefit sharing has been proven to be an important part of the whole country's objectives in the area of natural resources. In Venezuela the study found that the country has the highest government takes in the world amounting to over ninety percent (90%). It was also found that the price of oil can affect the tax on oil income when prices are above eighty percent (80%) which is a unique feature of the fiscal regime in that country. The country has attempted to save oil revenues through various fiscal management mechanisms which have proved to be difficult to manage.

The final country the study observed at was Norway. Norway has been one of the most successful in its management of oil revenues and the most beneficial to its citizens. It has managed to implement the concept of intergenerational successfully for the NPFG and has created one the most successful sovereign wealth funds globally reaching the massive amount of ten billion kroner (NOK 10 billion) in 2019. The study found that although the country's tax regime is significantly higher than other countries the level of transparency and ease of business in the country is what attracts investors and even allows them a form of safety when pursuing oil ventures in the country.

5.5 Outline of Legal Framework

The conceptual framework revealed that only relevant stakeholders may lay claim upon an entity. The definition and recognition of stakeholders in different ventures therefore has a significant impact on who benefits and who is locked out from such. For the state, identifying relevant stakeholders at the division stage will determine who has claim to funds derived from profit oil.

This study found that local communities in oil producing areas are relevant stakeholders at all levels, not just at the pre-division stages. This is due to their proprietary claim in community land, which is constitutionally protected. Their inclusion into the new resource allocation regime, where local communities are to be allocated five percent (5%) of the government's take, indicates that the state recognises this.

However, determining the percentage of funds to allocate was found to be problematic. It was shown that communities face challenges from the onset that need to be taken into account at all times. Resource allocation has therefore been detected to be a slippery slope upon which the country could tumble back into patterns of discrimination, land alienation and marginalization of communities. The allocation of percentages of the government's take to the national government, county government and communities was found to be arbitrary and non-scientific.

In the comparative analysis carried out in chapter four, the study found that it is a common practice to vest land and natural resources in the state for the benefit of the entire nation. However, realising such benefit is not easily achievable, as seen in Nigeria where there is a huge wealth gap despite the economic benefits derived from the oil and gas sector. Norway on the other hand was found to have made great strides in achieving this practice legally, policy-wise and through financial mechanisms. Legally, the practice is entrenched in the law. There is then clear policy in the form of guiding principles on how to achieve these legal provisions. Finally, the country has put in place requisite mechanisms to achieve the policy; establishing a significantly successful national oil corporation and an international fund for set up for future generations.

The Nigerian, PNG and Venezuelan experience additionally serves as a warning as to how a country endowed with vast natural resources can place their communities at a disadvantage. The discussion of the resource curse shed some light on the various features that countries that suffer from this phenomenon tend to have such as is demonstrated in Table 4.3. The main finding was that countries who have a highly oil dependent economy are the most likely to victims to the well-renowned resource curse.

Kenya's laws are strikingly similar to Nigeria due to the shared colonization experiences of the two countries. There is therefore a need to have structures in place to avoid making similar mistakes. The appropriation principle employed in Nigeria currently provides that 13% of funds derived from natural resources should go to local communities, yet this is still said to be insufficient. The most persuasive criticism has been that this figure is arbitrary, and therefore it may not represent the needs on the ground. Compared to Kenya's five percent (5%), perhaps there is need to rethink how this figure is determined.

5.6 Conclusions

The study seeks to understand the various problems faced by the local communities as stakeholders and their challenges with their proprietary entitlements that they face from oil and gas operations in their area. The study discussed extensively what a stakeholder is and discovered that throughout the oil and gas process local communities are important stakeholders.

The study also expounded on the meaning and implications of community land in the Kenyan experience in general; and especially in the specific case of the Turkana community as it is a marginalised one in which a majority of the land is unregistered community land. Furthermore, this study elaborates on the need to especially advocate for the Turkana community in the distribution of revenue from profits oil; due to the relatively lower levels of independence it has experienced since colonization. This foundation laid the basis for addressing the legal gaps that exist in protecting the economic interests of the community.

The study hypothesized that the Kenyan oil and gas legal framework of no division of profit oil does not take significant pre-division problems facing local communities, private land owners and the general public into consideration and is inequitable as a result. Chapter two discussed the conceptual framework set out in Kenya that should be able to govern this problem. The criterion for what determines the local community was concluded to mean those individuals or communities that reside in the natural resource are and that are affected directly by extractive ventures. As discussed above the study looked at the land laws in place and found that there are compensation measures in place for general compulsory acquisition, however seeing as the petroleum industry is only upcoming in Kenya, in situations where the land is oil related there is no framework per se in place for such operations.

Although this may be true, Kenya has come a long way in reforming its laws on oil and gas and incorporating communities into the framework. This has been demonstrated in the enactment of the new petroleum act of 2019 which has extensively covered various missing aspects of oil industry operations that were not indicated in the previous act. It was therefore concluded that the new act incorporates all areas involved in the industry including upstream, mid-stream and downstream. This shows that although the process is slow Kenya is actually making strides towards creating a better legal framework for the oil and gas industry in the country. The Act further addresses the local communities which are now recognised at the profit division stage with five percent (5%) of the government's take being due to them. This being said, however, there are still no guidelines as to how to arrive at this ratio of division.

Further, there is no legal recognition of the challenges faced before profit-division. There is therefore need for reform to address these concerns and achieve equity in the appropriation of natural resources and division of funds derived from them. However, the MPSC does outline the various ways that profit petroleum is calculated clearly as is shown in chapter three. Although this is between the government and the contractor.

In discussing the other oil producing countries it is clear that the resource curse is a factor that affects many oil producing states. However, the various factors that contribute to the occurrence of the resource curse as are found in Table 4.3. must be present the most significant being an oil dependent economy However, Kenya is not an oil dependant country as there are many other sources of national revenue for the country thus, the country falling prey to this phenomenon is highly unlikely.

5.7 Recommendations

The study set out to understand specific areas in the upstream oil and gas sector in Kenya and other countries as well. The study found that the legal and policy framework for sharing of petroleum profits does not adequately address the interests of local communities. The study has also found that there are indeed various distributional challenges faced at the profit oil pre-division stage especially in regards to compensation of local communities at the epicentre of the oil and gas operations within a country.

a. The Petroleum Act's provision on the division of profit oil should be reviewed. The ratio provided (75%-20%-5%) is an arbitrary one, arrived at by bargaining between the county and national government. A policy-led ratio is needed that will take into consideration the needs of the local communities, as opposed to political negotiations.

b. There needs to be a legal and policy framework specifically implemented on the compensation of communities for land compulsorily acquired for oil and gas ventures. Such a policy should take into account the unique historic, economic and social position of the local communities. Additionally, the said framework should borrow from Section

110 of the Mining Act which legally obliges private investors to enter into Community Development Agreements similar to the one between Base Titanium and the County Governments of Mombasa and Kwale in which they commit to remitting a certain percentage of their profits to the local community as royalties outside of the share that is legally obliged as profits law for the sake of developing the communities in which mining is taking place.

c. There is need for a detailed framework as to how funds derived are used by the national government, county government and local communities. Borrowing from Norway, Kenya needs to breathe life into principle of intergenerational equity by enacting laws and putting strong institutional and regulatory frameworks in place to enable a wholesome realisation of the benefits to the country.

d. The country needs to establish a transparent manner in which revenues are divided and demonstrate how they are spent to ensure that local communities and other relevant stakeholders such as the contractors and investors can benefit from the country's natural resources.

e. From the comparative analysis Kenya can borrow from the Norwegian Sovereign wealth fund and use the revenues received from the oil resources to better develop the local communities that are considered to be marginalised as well as the country as a whole. Reeling in intergenerational aspect as well.

f. If the revenues from the oil sector are used appropriately this may propel the country's economy into greater depths. Strategic measures need to be in place to allow for legislation to be implemented efficiently and correctly.

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Appendices

Appendix A: Similarity Report

BACK TO ANALYSIS OVERVIEW

PROFILE

SUBMITTER
faith.waigwa@strathmore.edu

FILE
FAITH WAIGWA LLM THESIS.docx

SIMILARITY
5 %

FINDINGS | SOURCES | ENTIRE DOCUMENT

SHOW IN TEXT

Quotes | Brackets | Detailed text differences

Adequacy of the Legal and Policy Framework Governing Profit-Sharing and the Related Local Community Interests in the Oil and Gas Sector in Kenya

VT OMNES VNVM SINT

Appendix B: Ethical Clearance Confirmation

Strathmore
UNIVERSITY

22nd July 2022

Ms Waigwa, Faith
faith.waigwa@strathmore.edu

Dear Ms Waigwa,

REF: SU-IERC1419/22 (*AMENDMENT*) PROPOSAL "Adequacy of the Legal and Policy Framework Governing Profit-Sharing and the Related Local Community Interests in the Oil and Gas Sector in Kenya"

I refer to your application for the approval of a proposed amendment submitted on 22nd June 2022.

We acknowledge receipt of the following submitted documents for amendment.

a) Amendment Cover letter dated 22nd June 2022.
b) Amended Study Proposal dated 28th March 2022.
c) CV of Investigator

The committee noted the following amendment(s):

1. Research Project Title changes from 'Establishing the Linkage between Pre-Division Problems and State Profit Oil' to 'Adequacy of the Legal and Policy Framework Governing Profit-Sharing and the Related Local Community Interests in the Oil and Gas Sector in Kenya'

The Committee concluded that the suggested amendments are justified and will not result in increased risk to the participants. The proposed changes have therefore been granted **approval** for implementation. You may continue with your study.

You are required to submit any further changes to this version of the protocol to SU-IERC for review and approval prior to implementing any additional changes.

Yours sincerely,

for: **Dr Ben Ngoye,**
Secretary; SU-IERC

Cc: Prof Fred Were,
Chairperson; SU-IERC

STRATHMORE UNIVERSITY INSTITUTIONAL
SCIENTIFIC AND ETHICAL REVIEW COMMITTEE
(SU-ISERC)
22 Jul 2022
Email:ethicsreview@strathmore.edu
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