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# Investing in the Tanzania electricity sector

Ten things to know



## Why consider Tanzania?

Tanzania has approximately 1,700MW of installed generating capacity and less than 25 per cent of the population have access to electricity. Tanzania's power sector suffers heavily from inefficiencies (across installed generating capacity, transmission and distribution) and The World Economic Forum's Global Competitiveness Report 2015/6 ranked Tanzania as 122 out of 140 countries for reliability of electricity supply – above Burundi but otherwise below neighbours Kenya, Rwanda and Uganda. It is well recognised that the state of Tanzania's power sector is adversely affecting GDP. Indeed the OECD in its recent Investment Policy Review cited energy in Tanzania as a “critical bottleneck” and highlighted that the problem of reliable energy was the top barrier to doing business in Tanzania.

Tanzania's low level of development is reflected in the fact that solid biomass fuel (mainly firewood) accounts for 90 per cent of total energy consumption. In Sub-Saharan Africa, after Nigeria, Ethiopia and DRC, Tanzania has the largest population relying on solid biomass for energy consumption. Within the power sector, Tanzania's generation mix is predominantly based on gas, emergency power producers (EPPs) using heavy fuel oil and jet fuel, and hydropower (around 30–40 per cent). Tanzania currently has a few independent power production (IPP) projects (approximately 300MW of capacity in aggregate), including 180MW of gas-fired capacity at Ubungo in Dar es Salaam which is owned and operated by Songas.

The energy demand growth in Tanzania is one of the highest in Africa. Given the current state of the energy sector, there is much room for development, and accordingly opportunities for the private sector. The Ministry of Energy and Minerals (MEM) is taking steps to respond to the private sector's requirements and in 2014 followed up its 25 year Power Sector Master Plan with an Electricity Supply Industry Reform Strategy and Roadmap for 2014 to 2025 (the Roadmap). The Roadmap seeks to respond to private sector concerns with its key focal points being transformation of the state utility, TANESCO's, operations and finances, strengthening of the governance and performance of the energy sector and attracting private investment. The Roadmap has attracted headlines due to its statement that the proposed reform would involve investment of US\$11.4 billion (US\$1.9 billion per annum) of which 73.5 per cent is for generation. Further, the Roadmap acknowledges that such funds cannot be raised by Government of Tanzania (GoT) and development funds alone, and therefore that private sector involvement is required, particularly in respect of generation. The announcement has been accompanied by clear statements of recognition across the GoT energy sector that private sector involvement is required and that such involvement entails credible financial and institutional reform. Since the Roadmap, the election of the new president in 2015 and the consequent political push for results has seen further increased activity levels within MEM and TANESCO during 2016.

## Gas, oil and coal

The availability of secure and reliable fuel is a key ingredient in the successful development of a country's power sector. In this regard, exploratory gas drilling in Tanzania has been highly successful, prompting headlines that gas discoveries on Tanzania's east coast are on an Emirati scale. Tanzania's proven reserves currently stand at 53 trillion cubic feet. Tanzania is now looking to gain traction in its bid to become the first exporter of East African natural gas.

BG Group, Statoil, Exxon Mobil and Ophir are, in conjunction with GoT, developing plans for a minimum two train LNG terminal to be situated at Lindi, near the gas logistics hub of Mtwara, however uncertainty now surrounds the timing of the FID which was originally anticipated in 2016. Furthermore, there is a potential of significant gas-fired power projects to fix Tanzania's power deficit, and GoT is eyeing up the prospect of significantly reduced costs of power generation as a consequence.

Following the introduction of the new Petroleum Act in late 2015, the Government is in the process of restructuring the sector by the creation of a new upstream regulator for mainland Tanzania, the Petroleum Upstream Regulatory Authority (PURA) and the state-run Tanzanian Petroleum Development Corporation (TPDC) has been stripped of its regulatory responsibilities and re-

designated as the national oil company. In its new role as the national oil company TPDC is empowered to become involved in reconnaissance and the development of projects, and is charged with handling the Government's participating interest in the petroleum sector. In particular, the TPDC is granted an exclusive right over all petroleum rights including licences. The private sector must partner with the TPDC, and the TPDC is required to maintain at least a 25 per cent participating interest in all petroleum operations unless the TPDC determines otherwise.

The TPDC is also granted exclusive rights to aggregate and sell natural gas (with a carve out for natural gas that is preserved for export purposes as LNG), and to own and operate major gas infrastructure in the upstream sector. In line with the Natural Gas Policy that was published in 2013 the Petroleum Act gives priority to domestic supply and imposes upon licence holders the obligation to "satisfy domestic market in Tanzania" but provides no detail as to how this obligation will be discharged. The Petroleum Act also paves the way for the creation of dedicated unit, the Oil and Gas Bureau, within the office of the President, to advise on strategic matters relating to the oil and gas economy.

Activities taking place within Tanzania-Zanzibar are to be governed and administered by parallel institutions in Zanzibar.

GoT and the private sector have explored ways to expand the domestic infrastructure to increase the amount of available processed gas. In July 2012 the GoT entered into a US\$1.2 billion credit facility with Exim Bank of China for the construction of a second natural gas pipeline (in addition to the Songo Songo pipeline which feeds the Songas plant). The pipeline extends for 532km and connects the nearshore gas fields at Mnazi Bay in the south to Dar es Salaam. TPDC signed an agreement with Maurel & Prom and Wentworth Resources for gas supply from these concessions. The Mtwara gas pipeline has large capacity and is used to supply the first phase of the 150MW Kinyerezi I, a GoT owned plant in Dar es Salaam which became operational in early in 2016, and also the Symbion and Ubungu II plants that previously ran on A1 jet fuel. There are also several gas IPPs in various stages of development, such as the 400MW gas power project in southern Tanzania that Symbion Power is developing and the circa 340MW gas power project in Kilwa that Kilwa Energy is developing.

The East African Rift System also contains oil, and has yielded results in Uganda's Lake Albert area and Kenya's Lokichar Basin. The rift system extends into Tanzania and is being explored by Swala Oil and Gas (Tanzania) plc (which is listed on the Dar es Salaam stock exchange) in its Pangani and Kilosa-Kilombero licence areas with a drilling program expected to start during 2016. The sector received a further boost in April 2016 when the Ugandan and Tanzanian governments announced that a 1,403km crude oil pipeline will be constructed, with the support of Total SA, from the Uganda oil fields to the Tanzanian port of Tanga (in preference to the previously publicised route through Kenya).

Tanzania also has significant coal resources, and GoT has made it clear in investor briefings that it is keen to include coal in its proposed energy mix. Kibo Mining and Korean government-owned Korea East West Power have completed pre-feasibility studies for the Rukwa coal-fired power project (a proposed up to 300 MW plant in western Tanzania). The project has a target operational date of 2019. The larger 600MW Mchuchuma coal-fired power plant has been subject to further funding delays and work on the mine development, which was originally anticipated in 2013, has been pushed back to 2017.

A large scale competitive bidding procurement programme is anticipated during 2016 which will include gas and coal-fired generation.

### What is the renewable energy potential in Tanzania?

Tanzania has high resources for each of wind, solar, hydropower, biomass and geothermal:

- Geothermal: as a result of the East African Rift System, Tanzania has a potential of 650MW of geothermal and around 50 potential sites have been identified as suitable for development. The GoT established the Tanzania Geothermal Development Company Limited as a dedicated

public entity to oversee geothermal development in the country and is assisted in this by the African Development Bank (in its capacity as implementation agency under the World Bank's Climate Investment Fund Scaling Up Renewable Energy in Low-Income Countries Program). Ongoing exploration work is being carried out by Geothermal Power Limited, a joint venture between German, Australian and Singaporean partners.

- Wind: there are a cluster of wind project sites around Singida (as a result of average wind speeds of eight metres per second) and elsewhere in the country. One of these sites is being developed by East Africa Wind Energy (which is backed by Aldwych International, the IFC, Singida Municipality and the National Development Corporation). It is expected to start operating by the end of 2017 with a capacity of 100MW.
- Hydropower: Tanzania has a potential hydropower capacity of 4700MW, only 561MW of which has been developed so far, so there is much room for further development. There are several major hydropower projects in the pipeline in Tanzania, such as the 358MW Ruhudji hydropower project which has been under development for some time, involving a consortium of investors led by Aldwych International. However, changing weather patterns and their impact on the existing hydropower plants (which saw generation drop to as low as 110MW in late 2015) has given fresh impetus to broadening the power mix away from what is viewed as the country's traditional over-reliance on large-scale hydropower.
- Biomass: various small scale biomass projects are being developed, particularly as part of agro-energy projects, and we see biomass as having significant potential in Tanzania.
- Solar: the mean solar energy density in Tanzania is about 4.5kW per square metre per day, which indicates its potential use as an energy source. Various solar developers are setting up small solar photovoltaic (PV) projects (with the largest being a 60MW project in Shinyanga for which feasibility studies are being carried out), but none as yet are operational.

The introduction in February 2016 of the Electricity (Competitive Power Procurement Framework) Regulations, 2015 pave the way for the introduction of two new sets of rules that will create a competitive bidding framework for small power projects (projects with a capacity of between 1MW and 10 MW) that utilise a renewable energy source, and for all large scale power projects (projects with an electricity generation capacity of above 10MW).

The first of these sets of rules, for the development of small power projects (SPPs), came into effect earlier this year. The new rules set out a simplified, non-competitive process that applies to the development of all hydro and biomass SPPs, and wind and solar SPPs of less than 1MW in size. Wind and solar SPPs of between 1MW and 10MW are subject to a competitive process that will be tendered in bid rounds, with the successful bidders being invited to enter into a 25 year standardised power purchase agreement. We anticipate a request for proposals for these wind and solar SPPs to be issued in the third quarter of 2016, and there is a potential for a large scale renewable procurement round to take place simultaneously.

The GoT, acting through the Rural Electrification Agency, has promoted solar PV, hybrid diesel-PV and mini-hydro projects in rural areas, particularly focussing on schools, health centres and public buildings. Furthermore, Tanzania is seen as an attractive environment for mini-grid projects, and we have seen the initial work for several of these being developed in recent months.

Tanzania submitted an Intended Nationally Determined Contribution (INDC) to the United Nations Framework Convention on Climate Change Secretariat (UNFCCC Secretariat) before COP21 in December 2015. In its INDC Tanzania set out its plan to cut emissions by 10 per cent to 20 per cent by 2030.

### What is the structure of Tanzania's power sector?

MEM oversees the power sector as a whole and has the power to develop and review government policies in the power and gas sector, and to take all measures necessary for the structure and organisation of the power sector. MEM generally acts as the principal negotiator for the GoT on IPPs, and ensures that any transaction is beneficial for Tanzania as a whole.

TANESCO is the single vertically integrated national utility in Tanzania, and fully owns transmission and distribution systems. TANESCO is wholly owned by the GoT and its operations are regulated by MEM.

The power sector is regulated by the Energy and Water Utility Regulatory Authority (EWURA). EWURA was established by the Electricity and Water Utilities Regulatory Authority Act 2001 and is relatively new, having only become operational in 2006. It is an autonomous regulatory authority which, as well as power, also regulates the water, and the mid- and downstream petroleum and natural gas sectors.

EWURA awards licences to entities seeking to undertake a licensed electricity activity under the Electricity Act 2008, approves and enforces tariffs and fees of licensees, and approves terms and conditions of electricity supply (including PPAs). EWURA is generally required to consult with the MEM minister who has wide powers in relation to the overall supervision of the power sector.

Lastly, the Rural Energy Authority is responsible for boosting energy services in rural areas (through mini-grid and off-grid solutions) and finances eligible rural energy projects through a Rural Energy Fund. This includes providing grants towards capital costs incurred on energy projects by private and public entities, co-operatives and local communities, but does not extend to cover operating costs or debt service.

### Electricity tariffs

In comparison to other parts of East Africa, Tanzania has low electricity retail tariffs, and TANESCO has been consistently operating at a loss as a result of this combined with the high cost of generation of EPPs and poor hydrological conditions. Motivated by the need to cover its cost of operations and assist it in demonstrating its bankability to its various donors, TANESCO requested an increase in electricity tariffs by an aggregate of 90 per cent through to 2015. This led to EWURA approving a tariff increase of 40 per cent in January 2012 and a further 40 per cent increase in January 2014. However, effective from 2016 EWURA approved a tariff decrease of 1.1 per cent based on the reduced costs of generation as a result of new gas powered facilities coming on line.

Low retail tariffs create a problem in Tanzania for potential IPPs, as tariffs must be sufficiently high to enable developers to cover their costs, meet debt service and achieve a reasonable return on equity. That said, increasing consumer tariffs abruptly at a time when IPP procurement is envisaged is politically sensitive, especially with a nation enduring power blackouts.

### Are government guarantees available?

Owing to the poor creditworthiness of TANESCO and the small number of operational IPPs in Tanzania, potential investors in power projects in Tanzania and their funders will inevitably seek a GoT guarantee in support of TANESCO's PPA payment obligations.

Under the Government Loans, Guarantees and Grants Act 1974, as amended by the Government Loans, Guarantees and Grants (Amendment) Act 2003, the GoT is only permitted to grant loans in certain circumstances – where the Minister of Finance is satisfied that it is in the public interest that the repayment of principal money, interest and other charges on any loan raised by an organisation of which the GoT owns the majority of shares requires a GoT guarantee. There are also further qualifications in respect of such a loan in the legislation, including that the amount guaranteed must be ascertainable.

TANESCO's payment obligations under a PPA are therefore not specifically covered by the current legislation. As a result of this prohibiting legislation, in order to ensure a robust guarantee from the GoT of TANESCO's PPA payment obligations, parliamentary approval for the guarantee will be required. Developers had been looking towards the Public Private Partnership Act and related regulations introduced in late 2015 to include such enabling provisions, however the issue was not resolved. Further legislative changes are expected to be made during the course of 2016 and we understand that preparatory work is taking place on an implementation agreement to be provided by GoT to power projects. A successful bankable IPP structure in Tanzania will require a level of GoT support, regardless of any partial risk guarantee that is available, and so this remains a key

investment issue in the Tanzania energy sector.

### What foreign investment incentives exist?

Recognising the need to welcome business into Tanzania, the GoT has implemented a series of legal reforms to clarify and ease the process of investing in Tanzania.

GoT offers special incentives to investors through the Tanzania Investment Centre (TIC), which was established under the Tanzania Investment Act 1997. TIC's mandate includes investment facilitation and promotion, and it is authorised to assist investors to obtain necessary permits, licences, approvals, registration and other matters required. TIC has the authority to grant a project company Strategic Investor Status, where the project company offers specific/great impact to the society or economy. Such incentives include a range of tax benefits, an unrestricted right to repatriate profits and dividends attributable to the investment, protection against nationalization or expropriation by the Government (unless such expropriation occurs under due process of law which makes provision for the payment of fair, adequate and prompt compensation), and a right of access to court or arbitration for the determination of the investor's interests and the amount of compensation to which it is entitled.

### What is the scope of a typical Tanzanian security package?

In our experience, a typical security package on a project financed power project in Tanzania would include:

- A mortgage over land – prior to its creation, consent must be obtained from the Commissioner of Lands, and the mortgagor must obtain an official valuation report from the Chief Valuer from Land Office, clearance from the Land Registry for payment of land tax for the previous ten years, and obtain property tax clearance for the previous ten years. Once created, the mortgage must be registered in the Land Registry for the local district. If a mortgage is granted by a company, it must also be registered in the Companies Registry within 42 days, and failure to do so will render it void against any creditor. Lastly, the mortgage must be stamped for a nominal amount.
- A debenture over all the company's assets – the Companies Act expressly refers to debentures as creating a charge over uncalled share capital, land, book debts, floating charge on the undertaking or property of a company, goodwill and intellectual property. A debenture must be stamped with nominal stamp duty payable, and must be registered against the company in the Companies Registry within 42 days.
- Share pledge – this must be stamped with the nominal stamp duty amount and notification of the charge must be sent to the company, and its confirmation obtained that no dealings will be undertaken in respect of the shares without its consent.
- Guarantee – there is no formal requirement to register a guarantee, but it is thought prudent to do so under the Registration of Documents Act.

In terms of enforcement, generally a lender is entitled to take action under a security document in case of default by a borrower, and no judgement from a local court or issuance of an additional document is required. However, certain regulatory procedures do need to be followed.

An assignment of receivables is enforceable on an event of default or insolvency, provided that the payer party has acknowledged the assignment.

Security over project documents is provided by way of an assignment, and Tanzanian law recognises lenders' step in rights under direct agreements. However generation licences cannot be transferred without the consent of EWURA.

### Foreign law of contracts

Generally, Tanzanian courts recognise parties' express choice for a contract to be governed by a foreign law, provided that the choice of law is not made by the parties with the intention of evading a more appropriate legal system, or if the foreign law that is chosen contravenes Tanzanian public policy.

## Reciprocal enforcement of foreign judgements and arbitration awards

Tanzania is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 and therefore recognises and enforces arbitration awards made in other contracting states, subject to certain limitations, including public policy grounds. Enforcement of a foreign arbitration award in Tanzania is achieved by applying to the High Court for an enforcement order, which has the effect of rendering the award binding between the parties.

The Reciprocal Enforcement of Foreign Judgements Act Revised Edition 2002 provides for the recognition of judgements obtained in certain foreign courts, notably including the High Court of England. Persons wishing to enforce foreign judgements in Tanzania must apply to the High Court within six years after the date of the judgement or, where there have been appeals against the judgement, within six years after the date of the last judgement given in those proceedings, to have the judgement recognised by the High Court in Tanzania. In certain circumstances the High Court may set aside a foreign judgement.

Whilst parties to a contract are free to choose the law which governs the contract, the freedom to submit to the jurisdiction of courts outside Tanzania is subject to certain limitations. Essentially, an agreement that purports to restrict absolutely the parties from enforcing their rights by usual legal proceedings in ordinary Tanzanian courts is void. Therefore, where jurisdiction is granted to a foreign court, this should be done on a non-exclusive basis.

### Total package

We have had an office in Dar es Salaam since 2012, which is headed by Adam Lovett, assisted by Angela Mndolwa on local law issues and Laura Kiwelu on energy, projects and banking issues. We are currently advising sponsors, governments and lenders on renewable and thermal power projects in Tanzania and the East and Southern Africa region.

More widely we have been active throughout Africa as legal advisers on transactions in the power sector for many years. Power generation and transmission projects are a core part of our business. We have extensive experience working with and advising sponsors, lenders, developers, bilateral and multilateral organisations and governments in Africa. We also advise on the regulatory changes which are being introduced in the energy sector of many African countries.

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