

Mkono & Co Advocates...

In association with Denton Wilde Sapte

Areas of practice:

Arbitration, Aviation, Banking & Finance, Capital Markets, Construction, Debt Collection, Energy, Environment, Employment and Industrial Relations, Intellectual Property and IT, Immigration, Insurance, Insolvency-receivership and Liquidation, Litigation, Mining, Privatization Company/Commercial Corporate, Projects / PFI, Real Property Shipping, Telecommunications, Tax and Pensions.

Firm profile:

This firm is one of the leading law firms in Tanzania. It was founded in the city of Dar es Salaam by Honourable Nimrod E. Mkono, MP as an international commercial and financial practice. On the 1st May 2000, Mkono & Co set up an alliance with Denton Wilde Sapte, a London based international Law firm. The association stops short of a merger but the expectation is that in due course the relations will come even closer. The move will build on the two law firms' existing strengths in corporate and trade finance. As a result Mkono & Co can provide a range of legal services to major commercial clients from within and outside Tanzania. The client base is Europe, North America, Far East and Africa.

Mkono & Co has ranked in the Chambers and Partners: The World's Leading lawyers for five consecutive years since 2000.

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Tanzania faces reality of private participation

Nimrod E Mkono, Steven De Backer and Joy Alliy of Mkono & Co say that changes to the country's energy policies and legal framework are a step in the right direction, but that more must be done to encourage private investment in the sector

The energy sector is a crucial focus point in Tanzania's transformation process; energy demand has grown rapidly due to population growth and the increase in economic activities in the last decade.

The energy balance is still dominated by biomass-based fuels, particularly fuelwood (charcoal and firewood), which are the main source of energy both to urban and rural areas. Commercial energy sources, that is, petroleum and electricity, account for less than 10% of the country's energy supply. Other energy sources that have been harnessed to meet growing energy requirements include natural gas, hydropower, coal, solar, wind, and geothermal energy.

The first National Energy Policy for Tanzania was formulated in April 1992. Since then, energy sub-sectors, as well as the overall economy, have gone through structural changes: the role of the government has changed, markets have been liberalized and private sector initiatives encouraged. So the policy document was revised in 2000, taking into account structural changes in the economy and political transformations at national and international levels. The national policy objective for the development of the energy sector remains *to provide an input into the development process by establishing efficient energy production, procurement, transportation, distribution, and end-user systems in an environmentally sound manner and with due regard to gender issues*. However, the 2000 revision of the National Energy Policy has focused on the market mechanisms and means to reach the objective, and achieve an efficient energy sector with a balance between national and commercial interests.

Based on the National Energy Policy's vision and mission, the main challenges in the country's energy sector are:

- development and use of indigenous resources, mainly coal and natural gas;
- availability of affordable grid and off-grid electricity;
- cross-border and interregional grid connections;
- development and use of renewable energy resources for various applications;
- promotion and adoption of energy conservation and efficiency practices; and
- improvement and strengthening of institutional infrastructure.

The National Policy further calls for the development of an appropriate regulatory framework to attract suitable investors and operators. In an attempt to create a clearer separation of the roles in the energy sector, an Act to establish an Energy and Water Utilities Regulatory Authority (Ewura) was passed by the parliament in April 2001. This Act makes provision for the establishment of Ewura as the authority in the regulated sectors such as the energy sector – and an Ewura Consumer Consultative Council, and lays down rules with regard to powers and functioning of the Authority and the Council, and provides for the resolution of disputes in relation to regulated services and goods. Under the new legislation, Ewura will be responsible for the licensing, tariff regulation and quality of service regulation and monitoring of the electricity, water, petroleum and natural gas sector and the Council should be instrumental in protecting interests of users with regard to the supply of regulated goods and services. The Ministry of Energy and Minerals' role in the energy sector will be restricted to the development of a policy, legislative and regulatory framework and of an institutional setting. Although Ewura has not yet started its activities as regulatory authority, the government is committed to have Ewura fully established soon.

Electricity

The Tanzania Electric Supply Company (Tanesco), which is 100% government owned, has so far been the sole vertically integrated electricity supplier on the mainland and also supplies bulk electricity to Zanzibar.

Electricity supply consists both of interconnected and isolated systems. Installed generation capacity on the connected transmission grid amounts to 771 MW. Out of the total installed capacity, 554 MW is supplied by hydro and the balance by thermal systems. It is reported that Tanzania has an estimated 3800 MW of economic hydro potential capacity. However, droughts over the east Africa region have had severe effects on the electrical power supply. Blackouts and power rationing as a result of low water levels in the hydro dams have forced Tanesco to rely on gas-powered generators and to look increasingly at thermal projects for future capacity increases.

The main legislation on electricity in Tanzania is the Electricity Ordinance, Chapter 131 of 1931 and its 1957 amendment, which regulates the generation, transmission, transformation, distribution and supply of electricity within the country. A new Electricity Act to replace the Electricity Ordinance has been drafted and is awaiting approval.

Under the Electricity Ordinance, the Minister of Energy and Minerals has the power to grant exclusive licences to supply electricity within any area in Tanzania, for no longer than 55 years. The licence may include provisions relating to any matter, such as: (i) the period for and the terms upon which the licence is granted, including the terms and conditions upon which the undertaking will be surrendered to the government when the licensing period expires; (ii) the exercise by the Authority of financial and technical supervision over the operations of the licensee; and (iii) the maximum rates to be charged for the supply of electricity to consumers as well as the system and mode of supply and penalties for failure to supply.

Although the Electricity Ordinance restricts the distribution, supply or sale of electricity except in accordance with the conditions of a licence, it also provides that the Authority may authorize any public institution or local authority whether within or outside any area of supply, to generate or transmit a supply of electricity for its own use.



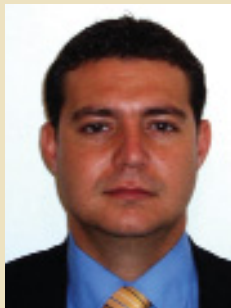
Nimrod E Mkono

Mkono & Co

Nimrod E Mkono is the founder and managing partner of Mkono & Co, Advocates. Having started his own practice in 1977, Mkono succeeded in developing it to become Tanzania's leading and largest law firm with far more experience in corporate, privatization, intellectual property, banking and energy experience than any other Tanzanian law firm. Today, Mkono is recognized as one of the country's leading corporate, finance and energy lawyers, although he also has extensive experience in all aspects of commercial practice and litigation. Mkono has represented and advised major Tanzanian and international companies as well as the Government of the United Republic of Tanzania in numerous transactions. He has also been instrumental in drafting different Tanzanian laws and regulations. Mkono's regulatory and transactional work and experience go hand in hand with his long, outstanding career in law.

Mkono is an elected member of parliament for the Musoma Rural Constituency and a trustee of the Mwalimu J K Nyerere Foundation.

He holds an LLB of the University of East-Africa, College of Dar es Salaam, an MA (Bus Law) and is a chartered secretary.



Steven De Backer

Mkono & Co

Steven De Backer obtained his master of laws degree at the University of Gent in Belgium. He further holds a business management degree and a postgraduate degree in international tax law. Before joining Mkono & Co as a global development partner, De Backer spent several years as a legal adviser in a leading European investment and brokerage firm and he worked in private practice with the international law firm Freshfields Bruckhaus Deringer. De

Backer has a broad corporate and finance practice, with particular expertise in mergers and acquisitions and capital markets transactions. His experience further covers a broad range of projects, including electric generating facilities, toll roads, airports, water and sewer facilities, chemical and other industrial facilities, telecommunications equipment and facilities. De Backer has been involved in a number of capital transactions, including private placements (equity), stock listings and public offerings and securitizations. He speaks English, French, Dutch and German.



Joy H Alliy

Mkono & Co

Joy H Alliy has been an associate with Mkono & Co since 2004. Her specialization includes corporate and finance, aircraft finance and mining law. She has experience in drafting and reviewing corporate and finance documents such as facility agreements, security agreements and shareholders agreements, aircraft finance transactions involving the drafting of aircraft leases and security documents, advising on mining laws and the procurement of mining licences, and advising on general corporate matters.

Recent projects include advising Kenya Airways Limited on share sales and purchase agreements and shareholders agreements in relation to the acquisition of shares in Precision Air Services Limited by Kenya Airways, drafting the transaction documents for Stanbic Bank Tanzania Limited in connection with the syndicated facility for Kagera Sugar Project refinancing, providing advisory services to PricewaterhouseCoopers on the legal and regulatory framework of Tanzania Zambia Railways Authority (Tazara) as part of the Tazara private sector partnership study and carrying out due diligence for the privatization of the several government-owned banks.

Any licensee who fails to comply with any of the conditions of the licence, and continues to do so after receiving a notice of non-compliance from the Authority,

will have its licence immediately revoked by the Authority. Revocation of the licence under the Electricity Ordinance will result in the licensee's property in the

area of supply, including the whole of the licensee's undertaking, becoming the property of the Authority on such terms as it deems fit.

Since the policy changes in 1992, when the government decided to allow private participation in electricity generation, two independent power producers (IPPs) have been licensed: Independent Power Tanzania Limited (IPTL) and Songas Limited. Songas Limited uses natural gas from Kilwa District, Lindi Region to generate 112 MW, while IPTL uses diesel to generate 100 MW.

However, the high cost of electricity and its low reliability still constitute a big challenge for the country's economy, especially for the manufacturing and mining sectors. To address this issue, further reforms including commercialization, further introduction of IPPs, contract management and privatization of non-core assets are being pursued.

Oil and gas

Petroleum exploration in Tanzania started in 1952 and has been cyclic due to world oil price changes, geopolitics, fiscal and legal frameworks, and knowledge evolution. Despite efforts to undertake exploration, Tanzania has not yet found oil and is, therefore, completely dependent on imported petroleum products. Gas discoveries, on the other hand, were made in the Songo Songo and Mnazi Bay gas fields. The reserves are estimated to be about 30 billion cubic metres and 15 billion cubic metres, respectively.

The legal framework for petroleum is the (Exploration and Production) Act 1980 (the Petroleum Act). The Petroleum Act, which applies to any naturally occurring hydrocarbon, whether in gaseous, liquid or solid state, or any mixtures thereof, vests title and control over petroleum in any land to which the Petroleum Act applies in the state. However the Act makes provisions for licensing by the Minister of Energy and Minerals. Section 13 (a) of the Petroleum Act provides that "a licence will be granted to an individual who is a citizen of Tanzania". On the face of it, this provision appears to exclude foreigners from the petroleum industry. However, the correct interpretation seems to be that it only excludes purely foreign businesses that have not been incorporated or registered under Tanzanian company law. The Act distinguishes two types of licences: an exploration licence and a development licence.

Any application including application for licence must be made to the Minister. If an application has been made, the Minister may require an applicant to furnish in writing any information that can be reasonably required. The Minister may also cause investigations, negotiations or consultations to be made or carried out as considered necessary and is empowered by the Petroleum Act to grant the application on the conditions the Minister determines, or refuse to grant an exploration licence in respect of any land blocks.

While in force, an exploration licence confers on its registered holder the exclusive right to explore in the licensed area for petroleum and to carry out any operations and execute any works necessary for that purpose. The exclusive right is, of course, subject to conditions specified in the licence or to which the licence is otherwise subject.

An exploration licence remains in force for four years, starting on and including the date on which it was granted, but the Minister can extend it.

The Minister is further required by the Petroleum Act to direct the holder of an area declared to be a petroleum location to carry out investigations and

studies to assess the feasibility of the construction, establishment and operation of an industry for the recovery of petroleum in that location. Among the matters to investigate and study is the physical impact of that industry on the environment.

The Petroleum Act enjoins the Minister to make regulations prescribing all matters that are required or permitted to be prescribed for carrying out or giving effect to it, including regulations on conserving and preventing the waste of the natural resources, whether petroleum or otherwise, of the land to which the Act applies.

The Petroleum (Conservation) Act 1987 empowers the Minister to make regulations restricting and regulating the import, landing, loading, shipping, transport and storage of petroleum. It also contains provisions regarding a system of licensing for those purposes, the manner in which the application for any such

licence should be made, the authorities that may grant the licence and the fees that may be charged for it and any other connected matters.

Production sharing

Notwithstanding the above, under the production-sharing practice in Tanzania, exploration licences are granted to the Tanzania Petroleum Development Corporation (TPDC), which is a wholly owned government entity, established under the Public Corporations Act 1969, which in turn enters into production-sharing agreements (PSAs) with private companies.

The TPDC has developed a model production-sharing agreement, which serves as the basic document for negotiations between private companies, the government and TPDC.

The general features of the model agreement are that TPDC is responsible under the PSA for applying for the exploration licence and, if any petroleum is discovered

during the exploration period, TPDC is responsible for applying for the development licence. The investor however has the exclusive right to conduct, on behalf of TPDC as licence holder, petroleum operations in the

designated area.

The PSA specifies how the oil and/or gas will be divided into *cost petroleum* and *profit petroleum*. As the investor bears all the costs for appraisal, development and operation, it is remunerated for these costs from a volume of petroleum, not exceeding, in any calendar year, 60% of the total petroleum production of the area.

Regarding the issue of taxes, the PSA makes provision for additional profits tax, which varies with the real rate of return earned by the company on the net cash flow from the development area. The threshold for the first and second accumulated net cash position is 20% and 30%, respectively. Apart from taxes of a minor nature, the investor is exempted from all other taxes. The model PSA also provides an option for TPDC to pay income tax on behalf of the investor if the foreign company desires such arrangement, or for the oil company to be exempted from income tax.

Other tax privileges granted to the investor are an import duty exemption on all equipment and material imported for the use in petroleum operations, which can also be re-exported free of any export duty and tax, and the right to export (subject to the requirements to help meet domestic crude oil demand) the investor's share in petroleum free of all export duties and taxes.

One central point about the model PSA, which also applies to other forms of petroleum fiscal regime, is that the investor undertakes its investment at its own risk. If the exploration operations do not find gas, the investor loses the money it has invested in its exploration operations. Similarly, if the quantities of gas turn out to be less than expected, or if the investment required to extract it proves much larger than expected, or if the gas price falls substantially, then the investor is probably not going to make the rate of return on capital, which it originally anticipated.

A step in the right direction

The energy sector regulation in Tanzania is still in its formative stages. The needed regulatory reforms are lagging behind the ongoing structural reforms. For example, while the monopoly of Tanesco was lifted in 1992, after which IPPs generated power intended for sale to Tanesco consumers, no corresponding changes have been effected in the regulatory regime to prepare the sector for the realities of private participation. In addition, the framework of the current legislation is so outdated that it is difficult to carry out legislative changes. New legislation is needed to encourage mobilization of financial resources for future expansion of the sector. More transparency and certainty is needed in licensing procedures - in the electricity sector as well as in the petroleum sector. And policy formation needs to be separated from policy implementation.

Nevertheless, compared with the pre-1990 state control, there can be no doubt that steps in the right direction have been taken. Good examples in this respect are the creation of Ewura as an independent multi-sector regulator and the establishment of a Rural Energy Agency with the responsibilities of increasing availability of energy services in rural areas, supporting research and development in rural areas, creating an institutional and legal framework to promote the application of renewable energy and to promote entrepreneurship and private involvement in marketing renewable energy in the rural sector. ■

One central point about the model product-sharing agreement is that the investor undertakes its investment at its own risk