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TANZANIA: A WELLSPRING OF OPPORTUNITY

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NEW NATURAL GAS FRONTIERS

The first commercialisation of natural gas discoveries in the 1970's and 80's enabled further on and off-shore exploration in Tanzania. As of June 2013, ensuing discoveries amount to 42.7 trillion cubic feet (7.5 billion barrels of oil equivalent). The deep sea discoveries have brought about new exploration targets for hydrocarbons in Tanzania, and the whole of the West Indian Ocean region.

The fourth licensing round for natural gas blocks off-shore Tanzania, which launched on 25 October this year, was met with considerable interest by companies that have an established presence in Tanzania as well as interested new IOCs and NOCs. During the opening ceremony of the licensing round a new Model Production Sharing Agreement ("MPSA") was introduced which toughens the terms on which international oil and gas players will be subject to when seeking to explore and develop in the country. This month then saw the Cabinet approving a National Natural Gas Policy for Tanzania, a policy limited to mid- and upstream issues but nonetheless showing the Tanzanian Government's resolve to integrate the infant gas industry with other economic sectors and achieve socio-economic transformation.

This client alert provides an overview of some of the key developments in the natural gas sector in Tanzania, all of which in combination have the potential to shape the future of the country and the region.

TANZANIA – THE COUNTRY

Tanzania, with Dodoma as its capital and Dar es Salaam as the commercial centre, is rich in natural resources and is emerging as an attractive destination for foreign investment partly due to its political stability. Foreign investment is expected to increase if the country enacts more comprehensive regulatory reforms and addresses infrastructure bottlenecks. As a member the East African Community (EAC) and the South African Development Community (SADC), Tanzania is party to plans to merge 26 countries in eastern and southern Africa into a single trading bloc under the COMESA-EAC-SADC tripartite arrangement which will have a combined gross domestic product of US$625 billion.

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Tanzania is the largest country in the EAC, and itself has a GDP of US$23.87 billion (2011). Although transport infrastructure suffers from poor maintenance, Tanzania has the capability to be a major import/export gateway for its landlocked neighbours. With one major and two supporting port facilities along its 800 km Indian Ocean coastline, its vantage location is ripe for further development.

TRANSFORMING TANZANIA

Leading global IOCs have confirmed their interest in building and operating LNG facilities in Tanzania in order to be able to export natural gas. In recent years, the Tanzanian Government has requested that the major investors in a LNG plant are to work together and preferably build one single facility together. The anticipated investments in the industry range from a minimum of US$20 to 40 billion over the next seven-ten years in the offshore and LNG components. The expected volumes also allow for the transformation of Tanzania's natural gas resources into higher value and exportable products. In aggregate, the developments could enable the country to shape its own future and become a stronger, more broad-based and private sector-driven economy.

2013 AS THE YEAR THAT SHAPED THE NATURAL GAS INFRASTRUCTURE IN TANZANIA

2013 have seen three significant events shape the gas infrastructure in Tanzania: the kick-off to the licensing round, the new MPSA and the 2013 National Natural Gas Policy in respect of mid- and upstream activities. These, together with the current regulatory framework, all play a part in the development of natural gas and these will ultimately have to be supported by the Government and the people of Tanzania in order for the transformation to succeed.

CURRENT REGULATORY REGIME

Pursuant to the Petroleum (Exploration and Production) Act, 1980 (PEP), the Ministry of Energy and Minerals (MEM), sets policy on exploration, exploitation and licensing. MEM coordinates:

- upstream activities through the Tanzania Petroleum Development Corporation (TPDC), which directly regulates gas exploration and development; and
- downstream activities, through the Energy and Water Utilities Regulatory Authority (EWURA).

Rights to explore for and produce petroleum are obtained by entering into a production sharing agreement with the Tanzanian Government and the TPDC. Standard terms for PSAs are set out in the new MPSA, launched by the Tanzanian Government as a part of its fourth Licensing Round at the end of October 2013, and the PEP.

1. THE FOURTH TANZANIA DEEP OFFSHORE AND NORTH LAKE TANGANYIKA LICENSING ROUND

The Tanzanian Government launched the Fourth Tanzania Deep Offshore and North Lake Tanganyika Licensing Round on 25 October 2013. As well as the North Lake Tanganyika block onshore, this round offers the following seven offshore blocks, which are in water depths of between 2,000 and 3,000 m and each of an average size of 3,000 sq.km:

Block
4/2A
4/3A
4/3B
4/4A
4/4B
4/5A
4/5 B

Blocks 1B and 1C are excluded; these are reserved for the Government and TPDC, who will be looking for a strategic partner for exploration through a competitive process. The fourth round is due to conclude on 15 May 2014.

2. THE NEW MPSA

The new MPSA replaces the 2008 Model Production Sharing Agreement and the standard terms therein. Overall, the new MPSA introduces tougher conditions for oil and gas companies exploring and producing in Tanzania, particularly on fiscal terms. We have outlined some of the key contractual terms below and commented on their potential impact.

Parties

The MPSA is tripartite between the Government of Tanzania, TPDC and the oil company ("Contractor") in question.

Term

A total exploration period of up to 11 years is possible (an initial period of four years and two renewal periods of three and four years respectively). Exploration and Production licences continue to be issued for 25 years, renewable for a further 20 years. We understand that there is an expectation that significant exploration expenditure is undertaken in initial exploration periods.

Participation

TPDC may at any time elect to have a participating interest of no less than 25% in the PSA expenses other than exploration expenses (including appraisal expenses). Failure by TPDC to meet calls for funds within agreed time limits results in liability interest of 1% over LIBOR.

Production sharing of profit oil is provided for in reference to tranches of daily total production for offshore gas. TPDC receives a share of up to 85% for onshore gas and up to 80% for offshore.

Fiscal terms

The fiscal terms of the new MPSA are particularly toughened in comparison to previous MPSAs.

Taxation: the MPSA now explicitly refers to assignments of participating interests under the MPSA being subject to "relevant tax law including capital gains tax". This is the first time a MPSA has referred to such taxes explicitly and this will be relevant wherever farm-ins are being considered. An "Additional Profits Tax" is also provided for in the MPSA which will vary based on the real rate of return earned by the Contractor on the net cash flow from their operations. There is, however, an import duty exemption for equipment and material imported in connection with petroleum operations.

Bonuses: a signature bonus of US$2.5 million is now in place, alongside a production bonus of US$5 million; and

Royalties: prior to cost recovery, there is an increased royalty of 12.5% on onshore areas and 7.5% for off shore areas on the gross production from operations, payable to the Government. This royalty is a "first charge" and will reduce overall the amounts available to contractors in their operations.

Fees

To develop skills in the oil and gas industry in Tanzania, the Contractor is liable to a non-negotiable training fee of US$500,000, payable annually, This is in addition to the annual charge levied in respect of any exploration licences issued at the following rates:

- Initial exploration period: US$50/sq.km
- First extension of exploration period: US$100/sq.km
- Second extension of exploration period: US$200/sq.km

Local Content and Domestic Market

Contractors must now comply with the Government's local content policy as modified from time to time. We understand that further details on this policy and its impact on the oil and gas industry are expected from the Government.

Contractors are subject to a slightly amended mechanism in respect of supplying the domestic market. Contractors must "satisfy the domestic market in Tanzania from their proportional share of production" with volumes to be agreed with TPDC on a pro rata basis with other suppliers.

3. THE NATIONAL NATURAL GAS POLICY 2013 – ADDRESSING HOPES AND EXPECTATIONS

The foreword to the policy makes it clear that the Tanzanian Government will use natural gas exploitation as an opportunity to boost local employment and infrastructure development –

"*Natural gas resource found in Tanzania belongs to the people of the United Republic of Tanzania and must be managed in a way that benefits the entire Tanzanian society.*"

The policy will build on existing legislation and regulation through a:

- Natural Gas Act and further regulations;
- Natural Gas Implementation Strategy;
- Utilisation Master Plan;
- National Gas Company and associated subsidiaries;
- Natural Gas Revenue Fund; and
- Communication Strategy to facilitate feedback from Stakeholders.

A National Oil and Gas Company

A "National Oil and Gas Company" will manage upstream activities (it is not clear whether this will be alongside, or in place of TPDC), as well as mid and downstream activities. Whilst the strategy recognises that the export market is the key incentive for international oil and gas companies, the Government envisages coordinating utilisation of gas on the basis of a National Gas Utilization Master Plan.

A More Robust Regulator Model

In response to the expected rapid growth of the natural gas industry, the strategy recognises that the fiscal, legal and regulatory framework of the country needs to be strengthened. The strategy also recognises that a strong institutional framework needs to be in place to successfully implement the Natural Gas Policy, and due to the potential size of natural gas resources, a robust regulatory authority will be required, whether this is through EWURA and MEM, or a new natural gas regulator.

Promoting a Domestic Gas Industry

Domestic utilisation of gas will minimise reliance on imported supplies, and optimise development of the broader economy. The policy seeks to ensure security of supply by requiring all natural gas processing activities to be undertaken in common facilities onshore. The new infrastructure will also include "industry parks" for the production of LNG, LPG and natural gas liquids.

National Participation in PPPs

Balancing a domestic and export oriented natural gas industry will be achieved through the National Oil and Gas Company (in which the Government owns at least 51% of the shares) participating in upstream issues through PPP structures.

The National Oil and Gas Company is also intended to ensure the development of local capacity to service the gas industry by working together with international oil and gas companies in providing opportunities for local companies to supply of goods and services, promoting employment of locals and creating investment opportunities for Tanzanians.

4. CONSTRUCTION OF PIPELINE INFRASTRUCTURE

The construction of a natural gas pipeline from the current on-shore and prospective off-shore areas in the south of Tanzania to Dar es Salaam is well on its way. The gas is already available from smaller onshore discoveries and has been triggering already big plans for gas-fired power stations in and around the commercial centre of Tanzania, Dar es Salaam, and the rest of the country. This immediately available route to commercialise existing gas drives the Government's ability to reform the power sector and provide much needed power to fuel the economic and infrastructure developments necessary to transform the country and attract foreign investors.

5. LNG SITE

The abundance of expected off-shore gas resources that are discovered and are expected to be discovered at a fast pace as more wells are being drilled by investors can only be commercialised through the export of LNG to the markets on the other side of the Indian Ocean (India, South East Asia, and China) as well as Europe. In the past the Government requested from the main investing IOCs to develop a LNG facility jointly rather than investing into competing facilities in Tanzania. This led to a joint proposal of BG Group, Exxon, Ophir and Statoil to build a single joint LNG facility. The negotiations related to this facility are on-going but as a major step, it is expected that the actual project site will be agreed upon and published in December 2013. Final investment decisions for the site are expected to be taken in 2015 or 2016.

OUTLOOK

The policy obtained Cabinet approval on 19 November 2013. The licensing round will close in May 2014. In addition, the Government aims to have natural gas legislation in place next year. Although it is not certain which further legislative changes will be formally adopted, or precisely when any such changes may be made, the natural gas sector is not standing still. The expectation of future change does not appear to be affecting investors' decisions, but interested parties will be well advised to prepare accordingly, and ensure that current agreements will be able to accommodate changes as and when they are implemented.

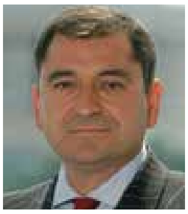
OUR PRESENCE

In Tanzania, DLA Piper works successfully with its DLA Piper Africa Group firm IMMMA Advocates, a leading business law firm in the country. Charles Morrison, International Group Head of the Finance and Projects team of DLA Piper has been working in Tanzania since 1995 and has significant experience of working in the energy, oil, and gas sector and the region. IMMMA Advocates has a designated Energy, Oil and Gas team headed by Protase Ishengoma who has substantial experience in advising IOCs, the government, foreign and international investors in relation to energy, oil and gas transactions and matters (including PSA negotiations, Farming agreements, joint-operating agreements and all regulatory aspects). Our joint ability to advise clients has further strengthened since Alexander Sarac, a senior energy, oil and gas lawyer from the London office relocated in 2013 to Dar es Salaam to work as part of the DLA Piper international energy team and locally with Protase Ishengoma and the IMMMA Advocates team.

IMMMA Advocates and DLA Piper are advising clients in the upstream, midstream and downstream business in the Tanzania. We are monitoring all future developments in the oil and gas sector for our clients. If you have any questions related to the sector and our experience and capability in Tanzania please contact any of our experts.

Doing business in Africa offers unique opportunities and challenges, and with this comes a need to understand the cultural, economic and political nuances that exist across the vast continent. DLA Piper understands this need and is one of the most active law firms on the continent of Africa, with a multi-disciplinary team of lawyers working across numerous sectors and a substantial and established alliance with African firms. Through our extensive global reach and strong local market knowledge, we deliver legal services to a broad range of clients, including project sponsors, governments, parastatals and banking and financial institutions.

CONTACTS



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