TANZANIAN ENERGY MINISTRY REPRESENTATIVES EXAMINE CONTRACT NEGOTIATIONS, FISCAL REGIMES

INTERNATIONAL ENERGY ATTORNEYS SHARE BEST PRACTICES ON NATURAL GAS CONTRACTS

ARUSHA, TANZANIA – Supported by the U.S. Agency for International Development (USAID), participants representing the various Tanzanian agencies and companies charged with implementing and regulating natural gas exploration, production, transmission, and distribution took part in a three-day workshop. They discussed drafting and negotiating natural gas contracts, in addition to gas taxation. Participants included lawyers, economists, geologists, and engineers from Tanzania's Office of the Attorney General, Ministry of Energy and Minerals (MEM), Tanzania Petroleum Development Corporation (TPDC), and Petroleum Upstream Regulatory Authority (PURA). The workshop was conducted by the U.S. Energy Association (USEA) as part of the Power Africa initiative.

Participants gathered in Arusha, Tanzania for a three-day workshop aimed at propelling Tanzania's presence on the natural gas market forward.

BACKGROUND: THE U.S. – TANZANIA PARTNERSHIP PROGRAM

Tanzania is one of the six initial focus countries of Power Africa, an initiative U.S. President Barack Obama launched in the summer of 2013, which aims at doubling electricity access in sub-Saharan Africa by 2018. Two important factors that currently influence the direction of electricity policy development in Tanzania include: a) recent natural gas discoveries in Tanzania and initial investments in transmission infrastructure have made natural gas one of the main anchors of electricity generation in Tanzania, and b) the country is aiming to double electricity access from 15% in 2010 to 30% by 2015.

Participant Raymond Baravuga of the Tanzania Petroleum Development Corporation speaks on government accountability.

TANZANIA'S NATURAL GAS INFRASTRUCTURE

Tanzania's recently-discovered on-shore and off-shore natural gas reserves are known as the newest frontier in global natural gas. The country is eager to break into the Liquefied Natural Gas (LNG) export market and is currently working on developing plans with international investors for LNG terminals that have the potential to be the largest investment projects in Tanzania. The Tanzanian government thus released the National Natural Gas Policy in late 2013. The policy is the base for the future National Natural Gas Act, which is expected to give the Energy and Water Utilities Regulatory Authority (EWURA) increased regulatory power to regulate the natural gas sector and develop the appropriate standards, codes and methodologies. Additionally, the government of Tanzania is developing a National Gas Utilization Master Plan, which will outline the priorities for natural gas usage, as well as a Local Content Policy for the Tanzanian oil and gas industry.

In terms of new natural gas infrastructure, Tanzania just completed a 532 kilometer pipeline of 36 inch diameter from Mtwara to Dar es Salaam. In conjunction with the pipeline, the Tanzania Electric Supply Company Limited (TANESCO) is also building a gas-fired power plant in Kinyerezi in Dar es Salaam - Kinyerezi I, with a capacity of 150MW, is expected to be completed early 2015. Kinyerezi II, III and IV (all preliminary phases) are slated to add 240MW (in 2015), 300MW (in 2016) and 450MW (2015) respectively. Having completed the technical infrastructure, Tanzania and EWURA now face the challenge of developing a new natural gas regulatory framework.

PRIMARY EXCHANGE OBJECTIVES

Within this energy context, USAID's Tanzania office requested a workshop addressing the drafting and negotiation of natural gas contracts. This was held June 2016, in Arusha, Tanzania. Three international energy attorneys served as the workshop speakers and representatives of the international upstream and downstream natural gas trade regarding transactions, regulations, compliance, shipping insurance, and oil and gas law. The workshop was part of a series of capacity-building exchanges intended to support the various agencies and companies in Tanzania charged with implementing, regulating, and/or oversight of gas exploration, production, transmission, and distribution. Topics discussed included:

Natural gas contracts: How to draft, review, and negotiate
- Current agreements under TPDC, MEM, and EWURA
- Host government agreements (HGAs)
- Gas sales agreements

Fiscal regimes: How to draft, review, and negotiate fiscal terms
- Taxation of gas

- Royalties: Concessions and profit-sharing

Production-sharing agreements: How to negotiate, monitor, and evaluate production-sharing agreements

SUMMARY OF KEY ISSUES/DISCUSSIONS

The following are the key topics addressed in the three-day workshop:

1. **Introduction to Fiscal Regimes**

   Speaker Buford Pollett explored ownership benefits and interests within fiscal regimes, including royalty tax, which defines title transfer at the wellhead. Production-Sharing Agreements (PSAs) were also discussed, in which the title is transferred at the export point. The benefits and drawbacks pertaining to the two different title transfers regarding natural gas as Tanzania defines itself on the world market were deliberated. Leases and the ownership rights and obligations for operating property and setting lease terms were defined, including duration and outlining specific activities and potential extension of terms.

USAID's Rogness Swai provides closing remarks.

   It was important for a clear definition of the responsibilities of the contractor throughout the duration of the contract, as well as the owner, to be outlined, in addition to elements of the contract which can be negotiated, and which are non-negotiable. The different types of natural gas contracts were defined, including service contracts and risk service contracts and the specific requirements for each. The Government of Tanzania's role within natural gas contracts regarding ownership of minerals was also outlined, including its balance of interest v. those of International Oil Companies (IOCs).

2. **Money in Natural Gas Contracts**

   Speaker Harry Sullivan explained each step in the process of writing natural gas contracts, from the first step of defining the project, to marketing, funding, construction, and operation. He emphasized how critical it was to know how the price for gas is set in the market, as this will define Tanzania's role and presence in the international natural gas trade. Because deriving natural gas for energy remains a very new aspect of the economy in Sub-Saharan Africa, despite the wealth of reserves several countries hold in it, Tanzania will be working to develop not only its presence on the international gas market, but the infrastructure to make acquiring its resources feasible and efficiently done. As of today, there is only one cross-border gas pipeline on the continent of Africa, which means initiating Tanzania's gas trade is initially costly to establish the infrastructure for it. Due to these factors, long-term contracts are necessary for sustainable development of the Tanzanian natural gas market.

   The cost of exporting Liquefied Natural Gas (LNG) was broken down, including the cost of service + liquefaction + shipment + re-gasification. Mr. Sullivan emphasized a consideration of the commerciality of the entire project, from its inception to the delivery of LNG, as commerciality. The key to pricing for natural gas, he said, is to provide an incentive for development of a project, especially when some gas reservoirs can provide up to 30 years of gas reserves.

3. **The Tanzanian Cause**

   Participant Priva Clemence of Tanzania's Petroleum Upstream Regulatory Committee explained the significance of Tanzania's natural gas reserves held inside inland rift basins, coastal and continental rift basins. He emphasized the vital need for timely, competent dialogue at two crucial points: during the licensing of awards, and in the approval of field development plans. He recognized some of the challenges to the development of Tanzania's gas reserves on the international market, including low worldwide oil prices, lack of availability of human resources, trusted and transparent mechanisms, and the process of creating environmental infrastructures to ensure availability and reliability.

4. Gas Sales Agreements

Harry Sullivan discussed how the gas industry is fundamentally different than the oil business, as oil is a commodity. Gas agreements tend to be tied to long-term buyers in long-term relationships with sellers through a high-cost infrastructure. For gas producers, finding a credit-worthy buyer is crucial. He explained that in the negotiations process, there are preliminary agreements, which include a term sheet, letter of intent, and memorandum of understanding. There is also an outline of the heads of agreement, the gas agreement, and the sale of purchase agreement.

There are two early gas sales decisions, says Sullivan: the type of contract and determining which party holds the responsibility for transport of gas, including the delivery point. Governing law of each country determines the type of LNG contract. In the price review process, the timing and frequency of gas delivery must be determined. Payment security must also be determined, including a standby letter of credit, guarantee, or an exchange of crude oil for gas. Penalties for late payments would also be decided at this time in the contract negotiation process, such as interest payments or suspension of gas delivery. The delivery point must also be set in the contract. It could be at the pipeline entrance, at the buyer's facilities, or the national border.

5. Natural Gas Pipelines

Speaker Nick Prowse talked about how pipelines should be low-risk with a low rate of return; pipelines are built today for the profit earned tomorrow. It is important, he stressed, to not underestimate environmental and social issues that may result from pipeline construction. A pipeline, he emphasized, must be viable on a stand-alone financial basis.

6. Responding to Litigation Over Disputed Gas Agreements

Speaker Buford Pollett emphasized that in the natural gas market, there is a desire to maintain market share over the long-term. Setting a ceiling and floor price to account for "freak" occurrences helps maintain the market share. Long-term natural gas contracts usually have clauses, he explained, with price review because natural gas contracts are long-term, markets are volatile, and there is an absence of clear market-wide price indicators. Each party must provide necessary information to substantiate its claim. It could also be relevant, depending on the location, to include a weather clause in order to account for unanticipated weather-related events. Hardship clauses could also be important.

It is important, stressed Pollett, to identify key areas of focus in supply contracts in order to help prevent disputes. Contracts must be drafted in a clear, enforceable manner. They should provide a clear understanding of each party's responsibility for events that arise after execution begins.

7. LNG and a Glimpse of the Future

LNG, said speaker Harry Sullivan, is soon to be a commodity in the international energy market. They are capital-intensive markets, and each link in the LNG chain must fully perform its contractual obligations. Contracts must set forth integrated responsibilities, as well as include joint planning and flexibility.

UTILITY EXCHANGE PROGRAM SPEAKERS AND PARTICIPANTS

1. SPEAKERS

BUFORD BOYD POLLETT	PROFESSOR OF ENERGY LAW, UNIVERSITY OF TULSA
NICK PROWSE	ENERGY LAWYER, NORTON ROSE FULBRIGHT
HARRY SULLIVAN	INTERNATIONAL ENERGY LAWYER & ENERGY PROFESSOR

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3. PETROLEUM UPSTREAM REGULATORY AUTHORITY (PURA)

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4. TANZANIA PETROLEUM DEVELOPMENT CORPORATION

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VICTORIA MUNISI	RESEARCH OFFICER, NATURAL GAS DISTRIBUTION
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BALTAZAR THOMAS	MANAGER, PIPELINE OPERATIONS

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