

# Tanzania's Upstream Oil and Gas Sector - Overview

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## Overview

Tanzania is endowed with diverse energy sources including biomass, natural gas, hydropower, coal, geothermal, solar and wind power, much of which is untapped. Wood-fuel accounts for up to 92% of total energy supply with about 2% from hydro-electricity and 7% from oil-derived products.

Nonetheless the downstream oil industry is an important sector of the country's economy absorbing on average 55% of the country's earnings. Government policies are directed at petroleum product substitution by exploiting indigenous resources.

In the upstream oil industry, oil and gas exploration and production is also being encouraged. Extensive gas fields have been identified off the coast at Songo Songo and Mnazi Bay and these are in the process of being developed.

The hydrocarbon industry is regulated by the Ministry for Energy and Minerals, with upstream activities governed by the Petroleum (Exploration and Production) Act 1980 and the downstream activities by the National Investment (Promotion and Protection) Act 1990.

Tanzania, with its oil seeps, seismic and other data, shows strong hydrocarbon potential in its upstream oil industry sector. However, only 20 wildcat exploration and 8 development wells have been drilled in a 222,000 sq km area, and therefore Tanzania can be classified as underexplored.

Current natural gas reserves are estimated to be 2 trillion cubic feet (tcf). The government is working closely with the World Bank to develop the Songo Songo gas fields off the Southern Tanzanian coast and in the Mnazi Bay area, with a view to substituting expensive imported petroleum fuels. The Songo Songo gas-to-electricity project will have a ready market of 17 potential industrial users of natural gas in the Dar es Salaam area.

Companies currently conducting oil exploration in Tanzania include: PanOcean Energy, Aminex plc and EnerGulf.

## Introduction

Tanzania's upstream oil and gas sector is currently enjoying a boom experienced elsewhere in East Africa following major discoveries of natural gas by Statoil, Ophir Energy

and BG Group. These discoveries mean that in 2012 Tanzania's total estimated natural gas reserves quadrupled from 10 trillion to 40 trillion cubic feet. Offshore gas fields at Songo Songo and Mnazi Bay are currently in the process of being developed by Pan African Energy and Maurel and Prom in conjunction with the Tanzania Petroleum Development Corporation (TPDC). However, despite 50 years of exploration activity, Tanzania still has no proven oil reserves and remains dependent on imported petroleum products.

## **Key legislation and regulatory structure**

The key legislation regulating the Tanzanian upstream oil and gas sector is the Petroleum (Exploration and Production) Act 1980 (the Petroleum Act 1980), which vests title to all petroleum within Tanzania and its territorial waters to the United Republic of Tanzania.

The large discoveries of natural gas have prompted the Tanzanian government to develop a Natural Gas Policy and Natural Gas Utilization Master Plan. In late 2012, drafts of both documents were in circulation for comments from stakeholders. These will supplement Tanzania's existing 2003 national energy policy. A Natural Gas Act is also due to be enacted during the course of 2013. In relation to oil and gas, the 2003 Energy Policy states that petroleum operations should be undertaken in accordance with high standards for environment, safety, health and product quality; that environmental impact assessments and environmental management plans should be made; and that regional and international co-operation in exploration, development of infrastructure, trade, database and capacity building should be promoted.

Under the Petroleum Act 1980, the oil and gas industry in Tanzania is regulated by the Ministry for Energy and Minerals (MEM), which sets industry-specific policies, strategies and laws. The MEM co-ordinates the TPDC, which regulates upstream activities, and the Energy and Water Utilities Regulatory Authority (EWURA), which regulates downstream activities.

The TPDC was established in 1969 by the Tanzanian government under the Tanzania Petroleum Corporation (Establishment) Order (GN No. 140 of 1969). It is the TPDC through which the MEM implements its petroleum exploration and development policies.

The role of the TPDC is set out in the Tanzania Petroleum Corporation (Establishment) Order as being:

- to promote and monitor exploration for oil and gas;
- to develop and produce oil and gas;
- to conduct research relating to and develop the oil and gas industry in Tanzania;
- to manage the exploration for oil and gas;
- to advise the government on petroleum production data;
- to undertake the management of strategic fuel reserves; and
- to undertake trading in petroleum products.

The TPDC is also a signatory to all production sharing agreements (PSAs) entered into in Tanzania. The TPDC monitors the implementation of PSAs and advises the Tanzanian government on various compliance issues.

## **Licensing regime**

Rights to explore for and produce petroleum in Tanzania are obtained by entering into a PSA with the Tanzanian government and the TPDC. Under the agreement, the Tanzanian government grants petroleum exploration and development licenses to the TPDC, which in turn engages the oil company to carry out petroleum exploration and production operations on its behalf. Standard terms for the PSA, which are negotiable, are set out in Tanzania's 2008 Model PSA (MPSA) and the Petroleum Act 1980. Applications for licenses and for entry into PSAs are done both through licensing rounds and by application.

The initial period of an exploration license is four years, which can be extended twice for a four and three year period. An exploration license normally consists of 60 blocks, although the Petroleum Act 1980 allows for the license to comprise up to 200 blocks in special circumstances. Moreover, more than one exploration license can be granted under each PSA in respect of different areas.

If there is a commercial discovery, the TPDC, as the registered holder of the exploration license, applies for a development license on the contractor's behalf. The application for a development license must be made (subject to certain permitted extensions) within two years of the date that the relevant blocks are declared to be a 'location', that is, an area (as prescribed by the Petroleum Act 1980) within which a discovery has been made. A development license is granted for 25 years, with the possibility of an extension for a further 20 years. A development license confers on the holder the exclusive rights to carry on exploration and development operations in the development area and to sell or otherwise dispose of the petroleum recovered.

Applications for exploration and development licenses must contain, among other things, details of the applicant's technical and financial capability and its proposal for the employment and training of citizens of Tanzania.

Only an entity incorporated in Tanzania can hold an interest in a petroleum license. In September 2012, the Energy Minister announced a review of all the then current PSAs to ensure that they are in the country's best interests. Additionally, the TPDC delayed a licensing round for nine deep-sea oil and gas blocks, originally set for September 2012, until a parliamentary vote on the new gas policy takes place. These measures have created some uncertainty as to the future direction of Tanzania's licensing regime.

## **National oil company/state participation**

Under the MPSA, the TPDC may elect at any time by notice in writing to the contractor to acquire up to a 25 per cent participating interest in any development area by contributing its share of contract expenses, excluding exploration and appraisal expenses. If the TPDC fails to pay its share of contract expenses, the contractor shall bear the TPDC's share of expenses by way of a loan, bearing interest at LIBOR plus 2 per cent and reimbursable on a preferential basis from the TPDC's share of profit oil or gas. The TPDC's profit oil and/or gas share is increased by the rate of the participating interest and the contractor's share is reduced accordingly.

## **Fiscal regime**

The fiscal terms applicable to upstream petroleum activities in Tanzania are governed primarily by terms of the Petroleum Act 1980, the Income Tax Act, No. 11 of 2004 (the Income Tax Act) and any PSA entered into as set out below.

- **Royalty** – under Section 81 of the Petroleum Act, a registered holder of a development license must pay a royalty to the government in respect of the petroleum obtained from the development area. Under Article 14(c) of the MPSA, the TPDC agrees to discharge this obligation to pay a royalty by delivering to the government 12.5 per cent of total crude oil or gas production before any cost recovery.

- **Cost recovery** – under the MPSA, the contractor is entitled to recover contract expenses out of up to 50 per cent of the volumes of crude oil or natural gas (after deduction of the royalty) produced and saved from the contract area in any calendar year. Any unrecovered contract expenses are carried forward. Operating expenses are recovered first, then exploration expenses and finally development expenses. Contract expenses incurred in any one license area within a contract area may be recovered from production from a development area within the same contract area to the extent incurred before first production from that development area.

- **Profit oil** – the remainder of the crude oil and natural gas produced is shared between the contractor and the TPDC on a sliding scale that depends on daily production rates for the prior calendar quarter. Under the MPSA, for crude oil the contractor's take ranges from 30 per cent when production is from 0–12,499bpd to 10 per cent when production is above 100,000bpd. Crude oil is valued based on the average price for sales of the relevant type of crude from the development area in the prior quarter. The valuation of natural gas for production sharing purposes is to be agreed between contractor and the government so as to give the contractor 'a fair return on its investment'.

- **Taxation** – the contractor is subject to income tax under the Income Tax Act at the standard corporate income tax rate of 30 per cent. Deductions are not permitted in respect of expenditure of a capital nature that secures benefits lasting longer than 12 months or is incurred in respect of natural resources prospecting, exploration or development. The Act provides for a 20 per cent depreciation rate for assets used in natural resources activities. Under the MPSA, the contractor is also required to pay an Additional Profits Tax calculated on positive cumulative net cash flow on a development area basis.

- **Customs duties** – under the MPSA, all machinery, equipment, vehicles, materials, supplies, consumable items and moveable property imported for use in petroleum activities can be imported and exported free of all duties and taxes. Subject to requirements to meet Tanzanian crude oil demand, the contractor can freely dispose of its share of petroleum and export it free of export duties and taxes.

- **Other** – the contractor must pay the TPDC an annual charge in respect of any exploration license ranging from \$4–16/sq km (indexed to dollar inflation rates) depending on the period of exploration. The annual charge for a development license is \$2,000/sq km and each year of the exploration license the oil company must spend a minimum of \$150,000 on the training of Tanzanian personnel.

• **Repatriation of profits** – the payment of dividends is subject to a withholding tax of 10 per cent save that payment of a dividend by a company to a local company shareholder with at least a 25 per cent ownership interest is only subject to a 5 per cent withholding.

## **Local content requirements**

Under the Petroleum Act 1980, applications for exploration or development licences must be accompanied by proposals with respect to the training and employment of Tanzanian citizens. Under the MPSA, the contractor must implement such proposals within six months of the grant of a development license. The contractor must also ensure that the transfer of management and operation functions to Tanzanian nationals occurs within five years of the start of commercial operations. Additionally, under the MPSA the contractor is required to:

- give preference to the purchase of Tanzanian goods, services and materials;
- make maximum use of Tanzanian service companies;
- establish appropriate tender procedures to give effect to local content requirements;
- maximize the level of usage of local goods and services, businesses, financing and employment of Tanzanian nationals;
- ensure that sub-contracts are scoped to match the capability of local enterprises and manage risk to allow their participation;
- give equal treatment to local enterprises by ensuring access to all tender invitations and by including high weighting on local value added in tender evaluation criteria; and
- employ Tanzanian citizens having appropriate qualifications to the maximum extent possible. In this connection, the oil company must propose and carry out an effective training and employment program for Tanzanian employees in each phase and level of operations.

## **Domestic supply obligation**

Under the MPSA, if domestic demand exceeds the TPDC's total entitlement to profit oil or gas, the contractor may be required to sell its share of profit oil or gas in Tanzania on a pro rata basis with other producers in Tanzania (except the TPDC). The Petroleum Act 1980 also states that a development license must include conditions with respect to the duty of the registered holder of a development license to supply petrol to meet the local needs of Tanzania.

## **Transfer of interests**

### **Consents**

Under the Petroleum Act 1980, a legal or equitable interest in or affecting an exploration or development license can only be transferred or assigned, directly or indirectly, by instrument in writing, and is subject to MEM's approval. This applies both on a transfer of an interest and on direct or indirect change of control of the party with an interest in the license. There are no reasonableness requirements regarding approval except that MEM shall give its approval for the transfer of an exploration licence when the transferee is a person controlling, controlled by or under common control with the transferor and is not disqualified from holding such license.

Under the MPSA, a contractor is permitted to assign or transfer its rights, privileges, duties or obligations under the MPSA to an affiliate company provided that the Tanzanian government and the TPDC are notified in writing in advance and that the assignment will not adversely affect the performance of obligations under the MPSA.

The written consent of the Tanzanian government is required if the contractor wishes to make such an assignment or transfer to a non-affiliated person, firm or corporation (in whole or in part). This consent must not be unreasonably withheld or delayed. Moreover, as a condition of the assignment, the oil company must provide an unconditional undertaking from the assignee to assume all the obligations of the oil company under the MPSA.

### **Taxation**

Under the Income Tax Act 2004, any gain on the disposal of an interest in a petroleum license will be chargeable income for the purposes of calculating the disposing party's liability to income tax.

### **Stabilization/equilibrium and dispute resolution**

The MPSA provides for disputes to be settled by arbitration in accordance with the International Chamber of Commerce Rules of Conciliation and Arbitration. The arbitration is to be held in Dar es Salaam and the applicable law is that of the United Republic of Tanzania. There are no stabilization or equilibrium provisions in the MPSA.