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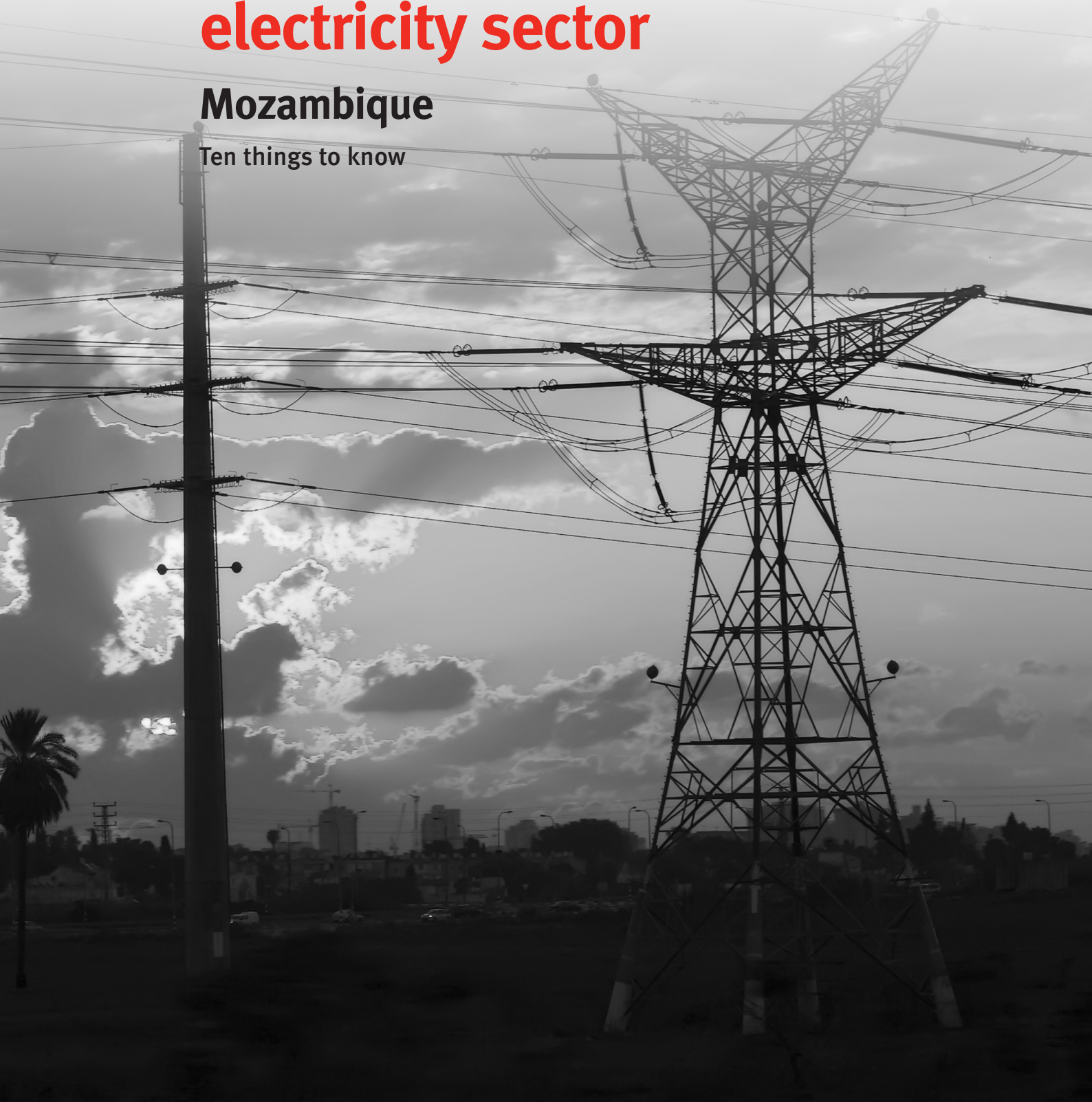
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Investing in the African electricity sector

Mozambique

Ten things to know



Investing in the African electricity sector – Mozambique

1 Why consider Mozambique?

Mozambique has experienced economic growth at the rate of 7 per cent per annum in recent years, which is projected to continue at similar or higher rates in the coming years as substantial coal and gas reserves are developed. Power projects worth an anticipated US\$12 billion are understood to be in the pipeline as the country's industry expands and new coal and gas reserves are exploited to fuel new capacity.

The electrification rate in Mozambique is approximately 12 per cent, which is well below the average for Sub-Saharan Africa, indicating that substantial growth in electrification is possible notwithstanding that Mozambique is a relatively rural country. The Government of Mozambique is targeting 20 per cent electrification by 2020, which will still fall well short of the regional average.

The features of Mozambique that stand out as making it a potentially rich environment for independent power projects are as follows: the significant discoveries of hydrocarbon resources in recent years, which are anticipated to fuel industrial growth; Mozambique is interconnected to South Africa and its other regional neighbours and is a member of the Southern African Power Pool (SAPP); and it is a net importer of power.

Mozambique's SAPP interconnections offer the opportunity to trade power regionally. Mozambique is interconnected to Zimbabwe to the west and South Africa and Swaziland to the south. Hidroelectrica de Cahora Bassa (HCB) jointly owns a HVDC transmission line with Eskom, which runs from Cahora Bassa to South Africa. Electricidade de Moçambique (EDM), the national power utility, owns and operates the balance of transmission in Mozambique and has been working to reinforce the back-bone transmission network in Mozambique since 2003, using funding from a number of international development agencies. The most significant transmission project is the Centre-South transmission backbone project (known as CESUL), which is designed to connect Tete province with Maputo and to facilitate the export of power generated in Tete province to South Africa. This involves the construction of nearly 2,600km of transmission line and eight new substations, at a cost of approximately US\$ 1.8 billion. Transmission network reinforcement projects are seen as crucial to facilitating private sector investment in Mozambique's power sector.

2 Natural resources lead the way

In 2012, four of the five largest oil and gas discoveries were made offshore Mozambique. Its estimated gas reserves of 160TCF mean that it has the fourth largest gas reserves in the world, behind only Russia, Iran and Qatar.

A consortium led by Anadarko and including Mitsui, Bharat Petro Resources Limited, Videocon, PTT and the Mozambican national oil company Empresa Nacional de Hidrocarbonetos (ENH), is developing Offshore Area 1 and a consortium led by Eni, including China's CNPC, GalpEnergia, KOGAS and ENH is developing Offshore Area 4. Anadarko and Eni are in the late stages of planning a joint onshore LNG liquefaction facility. It is understood that the final investment decisions by Anadarko and Eni will be made in 2013. Anadarko estimates that it will be in a position to export LNG by 2018. Bharat Petro Resources Limited of India has closed the debt financing for a new LNG liquefaction project, with a view to selling gas from the Romuva basin to Japan, Korea and Taiwan. All of these investments are likely to result in a significant expansion of the national economy, driving further increases in power demand in Mozambique.

The onshore Pande and Temane gas fields have been producing since 2004 and 2010 respectively. SASOL is the operator of these fields and a majority of the gas is exported to South Africa via the Mozambique-South Africa gas pipeline. However, three gas-to-power projects are currently under development, all using gas from the Pande and Temane fields.

In January 2013 it was announced that SASOL and EDM had formed a joint venture to develop a 175MW gas engine power plant in Ressano Garcia. Wärtsilä has been awarded a US\$184 million EPC contract for the project, which is scheduled for completion in 2014. All of the power produced by this new plant is reported to be sold to the domestic market, rather than being exported to South Africa. The plant will replace the existing 107MW Aggreko-Shanduka power plant, from which only 15MW is sold domestically.

Two further projects are also under development. A 200MW plant is reported to be under development by a Mozambican company, Gigawatt. The Kuvaninga Energia Project is reported to be a gas fired power project, also currently under development. It will be located in the Chokwé region and is being developed by a joint venture between a US company, Enventure Partners, and Investec Bank. Operations are expected to commence in the fourth quarter of 2013.

The prospects for coal-fired power are also strong. Mozambique has three large coal deposits at Moatize-Minjova, Senangoe and Mucanha-Vuzi in Tete province. The total reserves are estimated to be approximately three billion tons. A number of mining companies are planning mine-mouth projects as a means of monetising coal reserves. These are predominantly aimed at selling power to the South African market.

Ncondezi Coal intends to construct a 1,800MW coal-fired plant in the Tete province. The project will have a phased

completion, with the first phase of 300MW due to come on line in 2017. Jindal Steel and Power of India intends to construct a 2,640MW coal-fired plant in Tete province, to sell power domestically within Mozambique and for export to the Southern African markets. Vale and Rio Tinto are separately planning 2,000MW plants at Moatize and Benga respectively.

However, as noted above, the completion of the CESUL transmission project is essential to facilitate the movement of power from Tete to Maputo and South Africa.

3 Are incentives offered to renewable energy producers?

Mozambique has significant renewable energy resources. It is estimated that the potential exists for up to 190MW of small hydropower capacity to be installed in the Zambezi River basin. With an annual average irradiation level of approximately 5kWh per m² per day, there is also potential for solar power projects to be developed in Mozambique.

In 2011, the Government of Mozambique issued its Renewable Energy Policy. The 15-year Ministry of Energy plan is aimed at encouraging investment in solar, wind, small-scale hydro, biofuels and biomass power capacity. However, at present, there are no fiscal incentives offered to renewable energy developers and no specific legislative framework exists for renewable energy projects.

Fundo de Energia (FUNAE) is a governmental body established to fund the development, production and use of low cost power. It provides financial guarantees to projects that support its objectives of promoting the conservation and sustainable management of power resources. FUNAE has supported a number of solar, biomass and mini-hydropower projects in Mozambique to date.

4 What is the structure of Mozambique's power sector?

Mozambique currently has approximately 2,430 MW of installed capacity, which is significantly larger than Kenya and Tanzania. Its generation is dominated by the 2,075 MW Cahora Bassa hydroelectric power station, the largest dam on the Zambezi river, owned and operated by HCB. In 2012, the Government of Mozambique acquired most of the remaining interests in the plant from the Portuguese government, bringing it substantially within Mozambique state ownership. The Portuguese state transmission company, Redes Energéticas Nacionais, holds a 7.5 per cent interest in HCB.

The balance of installed capacity in Mozambique, which is a mixture of smaller hydroelectric and liquid fuelled power plants, is owned by EDM. EDM is wholly owned by the Government of Mozambique. Its installed capacity is

understood to be dated and in need of replacement. EDM is a vertically integrated electricity utility that is also responsible for transmission and distribution and operates the national dispatch centre. However, whilst EDM owns the national grid, it does not control all of the domestic transmission and distribution networks. Smaller regional grids are controlled by the Ministry of Energy, through district governmental bodies.

Mozambique Transmission Company (MoTraCo) imports power from South Africa to operate the Mozal aluminium smelter at Maputo. MoTraCo is jointly owned by EDM, Eskom and Swaziland Electricity Board. The construction of its transmission assets was financed using long term debt provided by the European Investment Bank and Japan Bank for International Cooperation.

The power sector in Mozambique is not currently regulated by an independent regulator. However, the Conselho Nacional de Electricidade (CNELEC) was established in 1997 by the Electricity Law to promote the establishment of relevant legislation for the electricity sector. CNELEC's remit also extends to advising the Government of Mozambique on the granting of concessions for power projects, the establishment of electricity tariffs and the mediation and resolution of disputes between concessionaires in the power sector, and between concessionaires and consumers in the supply of electricity. It is understood that, over time, CNELEC will expand its capacity and functions to become the fully independent regulator for the electricity sector in Mozambique.

Government policy in the electricity sector is established by the Direcção Nacional de Energia Eléctrica, a centralised directorate within the Ministry of Energy. Renewable energy policy is developed by the Direcção Nacional de Energias Novas e Renováveis.

5 How does the private sector participate in Mozambique's electricity sector?

The Electricity Law provides that the state will ensure the participation of the private sector in the electricity sector, guaranteeing the use of energy resources whilst protecting the interests of the state. The construction and operation of power plants and the production of electricity in Mozambique can only be done under a concession granted by the Government of Mozambique. The granting of concessions is subject to public procurement and for plants with a power output of more than 100 MVA, approval of the Council of Ministers is required.

The Procurement Regulations 2010 apply to procurement undertaken by all state entities, including companies in which any state entity owns 100 per cent of the equity, or where their financial activities are linked to state budgets

(including funds provided from foreign governments or multilateral agencies). The regulations are designed to ensure transparency, equality, competitiveness, impartiality and sound financial management by the government. Bids are evaluated by the procuring authority and CNELEC.

Among other requirements, potential investors seeking a concession for a power project must demonstrate that the economic and social benefits of the proposed project outweigh the environmental impact; that the tariff is fair and reasonable; and that the plant's capacity corresponds to the overall planning for the system to which it will be connected.

6 What are the key terms of the concession for a power project?

The Electricity Law, enacted in 1997, sets out the key provisions to be included in concession contracts that are awarded for the development of power projects. The initial term of a concession is limited to 50 years for hydroelectric power projects and 25 years in all other cases. Extensions are permitted in order to allow developers to recover additional investment in the project assets, provided that the concessionaire has complied with its obligations under the concession contract and has submitted an acceptable plan for the continued operation of the assets.

The concession contract will set out the standard of performance required by the project company, the rights of inspection to be granted to government bodies, the rights of the concessionaire to suspend performance where it is affected by force majeure and the circumstances in which the concession contract may be terminated. Termination of a concession contract may arise from the default by the concessionaire, if the default is not cured within the period stated in a notice of default. The Electricity Law also acknowledges that, where the authority granting the concession issues a termination notice, the concession contract may require that notice is also given to the concessionaire's lenders and that the lenders have the right to cure the default giving rise to termination within a period stated in the notice.

The concessionaire is also permitted to terminate the concession where the state has committed a material breach of its obligations which prevents the concessionaire from complying with the concession contract. Upon termination for a default by the state, the state is required to pay compensation covering the outstanding value of the unamortized investment made by the developers.

The concessionaire is required to pay annual concession fees based on its gross revenues.

In addition to entering into a concession contract, the project company will need to enter into a power purchase agreement (PPA) for the sale of its capacity and energy. There is no prescribed form of PPA.

7 How are tariffs established?

Essentially tariffs are set by contract, rather than being subject to regulatory approval. The Energy Law requires that tariffs are fair and reasonable. It also provides for tariffs to be set according to the following principles: (a) to ensure the least possible cost to consumers and which are compatible with the service being provided; (b) that amortize the capital costs of the project over time and provide for recovery of operating costs; and (c) that provide a fair return on the capital investment to the sponsors.

8 What protections do foreign investors receive?

Foreign sponsors intending to invest in Mozambique may apply for a range of tax incentives, customs incentives, incentives related to the repatriation of invested capital and profits, and guarantees provided by the state in respect of the protection of private property and investments. Incentives apply to investments in excess of approximately US\$ 80,000 and it is necessary to make the investment through a Mozambican company. Details of the proposed investment project must be submitted to the Investment Promotion Centre (investments within the Oil & Gas and the mineral resources sectors follow separate regimes).

The movement of funds into and out of Mozambique is subject to exchange controls. New exchange control regulations came into force in July 2011, which generally require that capital investments in Mozambique be registered with the Central Bank of Mozambique as a condition to the recognition of the right to remit earnings (the remittance of such earnings only being subject to registration with the Central Bank and the control of the commercial banks thereafter).

In relation to loans, prior approval of the loan agreement and loan conditions must be obtained from the Central Bank of Mozambique in respect of third party loans or shareholder loans entered into by resident entities with non-resident entities. Disbursements and payment of interest under the loans must also be registered with the Central Bank of Mozambique (the payment of interest is also subject to controls by the commercial banks). Finally, loan repayments require the prior approval of the Central Bank of Mozambique. If the procedures are not complied with, the resident entity will not be permitted to make loan repayments or to pay interest on the loan.

9 What is the scope of a typical Mozambican security package?

Land in Mozambique is the property of the state and cannot be sold, transferred, mortgaged or charged. Developers therefore need to acquire the right to use land from the state (a Direito de Uso e Aproveitamento da Terra or DUAT). Foreign investors are permitted to hold a DUAT only in respect of investment projects that have been approved under relevant

investment legislation and, if they do so, through a company incorporated and registered in Mozambique. A project company in which foreign investors hold more than 50 per cent of the share capital constitutes a foreign company incorporated in Mozambique for the purposes of DUAT.

DUAT is forfeited either by default by the project company, expiry of the term (an initial period of fifty years, but subject to renewals) or on public policy grounds. Immovable assets and fixtures revert to the state on termination of the DUAT. If a DUAT is terminated on public policy grounds, the grantor of the rights must pay just compensation to the DUAT holder.

Whilst a project company is not permitted to mortgage its DUAT, it may mortgage the immovable assets and improvements which it has been authorised to make on the land, or over which it has legally acquired a right of ownership.

Generally there are no other restrictions on granting or taking security over a company's assets in Mozambique. Tangible movable property that is subject to registration (such as vehicles, vessels and aircraft) is capable of being mortgaged, whilst other movables (tangible and intangible) such as bank accounts, are capable of being secured by way of pledge. There are no special formalities related to the creation of a pledge, save that it must be created in writing and documents of title must be handed over upon creation of the pledge. In certain cases, pledges granted in favour of banks do not require dispossession of the pledged assets to be fully valid and effective. There is no system of registration for pledges other than pledges of securities.

The granting of a security interest over the rights of the project company under a concession contract for a power project requires the prior consent of the Government of Mozambique.

Shares in a Mozambican company are also capable of being pledged. If the project company is incorporated as a Sociedade por Quotas, its share capital is divided into immaterial nominative participations (quotas). It is possible to pledge quotas in a Sociedade por Quotas provided that the company is given notice of the security interest and the pledge is registered with the Registry of Companies. If the project company is registered as a joint stock company, referred to as a Sociedade Anónima, its share capital will be represented either by nominative shares or bearer shares which, in turn, can be shares represented by certificates (ações tituladas) or book entry shares (ações escriturais), formalised through registry accounts held with a bank or the issuer.

Where its shares are nominative shares, the creation of a pledge requires the share certificates to be endorsed by the pledgor, whose signature must be certified by a Mozambican Notary Public. Thereafter, the share certificates are delivered to the pledgee/security trustee, who applies for registration of the pledge in the Company's share register. If the project company's share capital is represented by bearer shares, the delivery of share certificates to the pledgee is sufficient to create a pledge. In case the shares are book entry shares (irrespective of being nominative or bearer shares), the granting of a pledge requires registration of the pledge with either the company (in a special ledger) or with the bank with which the shares are registered.

If, in any event, the pledgee is non-resident, according to the foreign exchange regulation criteria, the pledge is subject to prior approval of the Central Bank of Mozambique.

10 Reciprocal enforcement of foreign judgements and arbitration awards

Mozambique acceded to the New York Convention on the Recognition of Foreign Arbitral Awards in 1998.

Foreign court judgements can also be recognised and enforced by a Mozambican court without a re-examination of the merits of the case but subject to the process of revision and confirmation of foreign judgements by the Superior Court. This applies if: the foreign judgement is final, non-appealable and conclusive in accordance with the laws of that jurisdiction; the Mozambican courts have no jurisdiction over the dispute in question and the foreign court in which the judgement was obtained does have jurisdiction; the foreign proceedings were conducted in accordance with the applicable procedures and the parties to the dispute had been duly notified and properly represented in the proceedings; no concurrent proceedings are pending in a Mozambican court; the foreign judgement does not conflict with a prior Mozambican or foreign judgement in the same matter; and the foreign judgement is not contrary to public policy in Mozambique or to the Mozambican conflict of laws rules.

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*associate office **effective June 3, 2013

Total package

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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