Public-private partnerships and the financial cost to governments: Case study on the power sector in Tanzania

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In the early 1990s, under the auspices of the World Bank and International Monetary Fund, Tanzania initiated a macro-economic structural adjustment programme, including electricity sector reforms. Resisting full privatisation of the wholly state-owned electricity generation, transmission and distribution company Tanesco,[1] Tanzania was nevertheless forced to 'liberalise' electricity generation in 1993, opening it up to independent power producers who sell electricity to Tanesco[2].

Access to the electricity grid in Tanzania is low, with around 20% of households connected, largely in urban areas. The government had (and still has) a target to raise this to 30% overall, and identified Public Private Partnerships as one way to achieve this. In addition, crippling power shortages mean that Tanzania has entered into a number of emergency Power Purchase Agreements (PPAs) with private producers.

But these 'partnerships' with private companies have left Tanesco, the Tanzanian state and its people mired in debt, litigation and government resignations against a backdrop of alleged corruption, whilst costs to the consumer and government have significantly increased.

In 1995 Tanesco entered into a 20-year Public Private Partnership with Independent Power Tanzania Limited (IPTL) for the purchase of 100mw of power from their diesel fuelled Tegeta plant in Dar-es-Salaam[3]. This deal was hotly contested on the grounds of cost, the environmentally damaging (diesel) fuel source and an unfounded assessment of the need for additional generating capacity, rather than extending access to grid connection for Ugandan people.

Even before the completed Tegeta plant had produced any electricity, in 1998 the deal with IPTL generated litigation at the International Centre for Settlement of Investment Disputes, part of the World Bank Group. Tanesco submitted a case for arbitration, asserting that it was entitled to terminate the contract or obtain a material reduction in the tariff rates it was due to pay on the grounds that these had been improperly entered into between IPTL and government officials outside of proper procedures and that charges were unjustifiably high. The claim for termination of the long-term contract obliging Tanesco to purchase electricity under the deal failed, but in the 2001 award of the tribunal Tanesco did achieve a material reduction of the power tariff to reflect actual costs of providing the plant,[4] allowing electricity production at the plant to finally commence in 2002.[5]

Despite this ruling, during the first year of operation Tanesco incurred $40m in capacity payments[6] alone, whilst the plant actually functioned at less than 10% capacity. Tanzanian consumers were paying seven to nine cents per unit for electricity generated by Tanesco, but the company was said to be paying IPTL over 12 cents per unit in addition to the 'statutory' monthly cost of $3m per month under the PPA[7]. Tanesco continued to dispute the level of tariff and in 2008, IPTL filed a claim in New York courts for unpaid charges totalling $70m.[8]

In 2004 another private power plant, Songas, majority owned by Globeleq, at that time wholly owned by the British Government through its CDC Group plc[9], became operational[10], selling electricity to state owned Tanesco under a similar Public Private Partnership arrangement.

Within a few years, payments to these two Independent Power Producers were costing the state electricity company, Tanesco, around 90% of its total revenue [11] despite their representing less than 30% of national generation[12] capacity[13]. As the Tanzanian Controller and Auditor General's annual report for the 2007/2008 financial year notes: "Tanesco is overburdened by the liabilities imposed by various power purchase agreements (PPA)[14], mostly entered without compliance with the requirements of the Public Procurement Act and its regulations"[15].

Despite these problems with Public Private Partnership arrangements, in 2006 Tanzania signed a further power purchase agreement with a company called Richmond Development Corporation to address emergency power shortages due to drought having reduced the country's hydro power production. Following the company's failure to supply the electricity contracted for and allegations of improper procurement a Parliamentary Select Committee was set up to investigate the contract.[16]

Reporting on the enquiry in February 2008, the Select Committee chair told Parliament that *"Richmond had neither the experience, nor the expertise, to deliver on the short-term agreement, and was in addition, financially and legally incapacitated".*[17] The enquiry also found evidence of political interference at a senior level in the government to make state-owned Tanesco sign the agreement with Richmond and grant it favourable credit terms in contravention of national regulations and those of the IMF Multilateral Debt Relief Initiative fund that it was using for this purpose.[18]

A few days after the release of the Select Committee report in February 2008, the Tanzanian Prime Minister, Edward Lowassa, who was said to have made the final selection of Richmond,[19] and two other ministers[20] resigned, prompting the Tanzanian President to dismiss his entire cabinet.[21]

Towards the end of 2008 the new government announced that Tanesco was cancelling the contract. As early as December 2006, following the issue of default notices for lack of performance, Richmond had passed the contract on to another company, Dowans Holdings, which now took Tanesco to the International Chamber of Commerce (ICC), alleging breach of contract.

Notwithstanding the findings of the Parliamentary Select Committee *that "the tender process and contract with Richmond for the emergency power production of MW 100, later being taken over by Dowans Holdings S.A on 23rd December 2006, was procedurally flawed and against national laws and hence resulting in favouritism, embezzlement and the possibility of corruption",*[22] in their 15 November 2010 ruling ICC co-arbitrators found in favour of Dowans Holdings and ordered Tanesco to pay $123.6 million to the company in settlement of its claim.[23]

In the following financial year, Tanesco made a loss of more than $100m, partly as a result of the high cost of bringing in short-term emergency power, and was forced to increase its tariff to consumers by over 40%[24] and seek to borrow over $200m from local banks to offset charges demanded by the private power producers when their plants were not running at full capacity and pay for diesel fuel.[25] In July 2012 this emergency tariff was extended for a further three months[26].

Tanesco has had to take out substantial loans, underwritten by the government, alongside large taxpayer subsidies to cover its losses, whilst tariffs have again risen by 40% in 2014.[27] For example to cover the losses for 2013/14 and to clear past arrears, Tanesco borrowed an amount equivalent to US$250 million commercially (with a sizable government guarantee) and received a direct budget transfer of about US$220 million (which was effectively paid for by loans from the World Bank and African Development Bank, directly adding to the Tanzanian government's debt).

In part this is a result of footing the bill for damages and legal costs awarded against Tanesco in litigation through the London law courts with IPTL and Dowans, for the costs of buying electricity from these independent power producers and emergency power producers at a shocking tariff of between 33 to 55 US cents per unit[28] and for the costs of onerous 'capacity payments' for electricity which was never actually produced or consumed under its Public Private Partnership contracts with them.

References

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[2] Kapika & Eberhart (2013), Power Sector Reforms and Regulation in Africa; Chapter 2, Tanzania: learning the hard way HSRC Press, South Africa. Accessed via http://www.gsb.uct.ac.za/files/Tanzania.pdf (27 January 2015)
[3] IPTL was a joint venture between the majority shareholder Mechmar, a Malaysian company (70%) and a Tanzanian firm VIP Engineering limited (30%).
[4] Kapika & Eberhart (2013), Power Sector Reforms and Regulation in Africa; Chapter 2, Tanzania: learning the hard way HSRC Press, South Africa. Accessed via http://www.gsb.uct.ac.za/files/Tanzania.pdf (27 January 2015)
[5] ICSID case no. ARB/10/12, Award in arbitration proceedings between Standard Chartered Bank and United Republic of Tanzania – III(B) Earlier Proceedings https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2754_En&caseId=C1080 (accessed 21 January 2015)
[6] Capacity payments refer to the payments that an electricity generator such as IPTL receives based on how much electricity they make available, whether it is actually used or not.
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[8] Kapika & Eberhart (2013), Power Sector Reforms and Regulation in Africa; Chapter 2, Tanzania: learning the hard way HSRC Press, South Africa. Accessed via http://www.gsb.uct.ac.za/files/Tanzania.pdf (27 January 2015)
[9] CDC Group plc was formerly the UK Government's Commonwealth Development Corporation, a statutory corporation converted into a plc in 1999; wholly owned by the Department for International Development but with an independent board of directors http://taxjustice.blogspot.co.uk/2009/06/can-cdc-assist-poorer-people-by-using.html.
[10] http://www.globeleq.com/about_us/history (accessed 21 January 2015)
[11] Controller and Auditor General Tanzania "Annual General Report : On the financial statements of the Public Authorities and Other Bodies for the financial year 2007/2008" pg. 108 http://www.parliament.go.tz/bunge/docs/reports/1251958326.pdf
[12] Kapika & Eberhart (2013), Power Sector Reforms and Regulation in Africa; Chapter 3, Tanzania: learning the hard way HSRC Press, South Africa. Accessed via http://www.gsb.uct.ac.za/files/Tanzania.pdf ((27 January 2015)
[13] Year on year the proportion of total electricity requirements generated by the IPPs, and the proportion of overall costs to Tanesco this represents, vary in response to the amount generated by hydro-electric power, which is determined by fluctuations in rainfall. In bad drought years (e.g. 2005/2006) IPPs represented over 50% of consumption, but by 2007 only 20% as 'normal' hydrological conditions returned, but costs remain high due to the nature of 'capacity payments'.
[14] The Power Purchase Agreement is one of the key contracts within the Public Private Partnership arrangement; this sets out the basis for calculation of the 'capacity payments' and other conditions over the term of the agreement.
[15] Controller and Auditor General Tanzania "Annual General Report : On the financial statements of the Public Authorities and Other Bodies for the financial year 2007/2008" pg. 66/67 http://www.parliament.go.tz/bunge/docs/reports/1251958326.pdf
[16] By now the contract had in fact been transferred from Richmond Development Corporation to Dowans Holdings SA/Dowans Tanzania (December 2006).
[17] Richmond Development Company LLC, was found not to be a legally incorporated company registered in Texas, USA as stated in contract documents and was described as a 'briefcase' or 'shell' company by the Parliamentary Committee, with no financial standing and requiring what amounted to an interest free loan from the Tanzanian Government to purchase the power plant it was contracted to install
[18] Tanzanian Affairs (2008), Report on Richmond Scandal http://www.tzaffairs.org/2008/05/report-on-richmond-scandal/ (accessed 22 January 2015)
[19] http://www.tzaffairs.org/2008/05/report-on-richmond-scandal (accessed 27 January 2015)
[20] Nazir Karamagi (Energy and Minerals Minister) and Dr Ibrahim Msabaha (East Africa Cooperation Minister, who was the Energy and Minerals Minister at the time when the contract was signed)
[21] Ronald Aminzade (2013) Race, Nation, and Citizenship in Post-Colonial Africa: The Case of Tanzania, Cambridge University Press, New York, USA
[22] Tanzanian Parliamentary Select Committee (2008), Report of the Select Committee formed to investigate the tendering process for emergency power supply to Richmond Development Company LLC of Houston, Texas, USA in 2006
[23] Sandra van Niekerk & David Hall (2013) Overview of Energy in Africa, PSIRU-PSI Africa http://www.psiru.org/reports/overview-energy-africa
[24] Tanesco had originally asked the energy regulator for a 155% increase in tariff rates[24].

[25] The Citizen (21 January 2012) Tanesco seeks Sh408 billion loan from local banks. http://allafrica.com/stories/201201231479.html

[26] Sandra van Niekerk & David Hall (2013) Overview of Energy in Africa, PSIRU-PSI Africa http://www.psiru.org/reports/overview-energy-africa

[27] IMF Country Report 14/120 (2014), United Republic of Tanzania, Staff Report on the 2014 Article IV Consultation, International Monetary Fund, Washington http://www.imf.org/external/pubs/ft/scr/2014/cr14120.pdf

[28] http://allafrica.com/stories/201308300602.html (accessed 27 January 2015)