

## STATUS OF THE MATTERS INVOLVING TANESCO AND IPTL IN THE AFTERMATH OF THE DECISION OF THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES (ICSID) IN ARBITRAL CASE NO. ARB/10/20 BETWEEN STANDAND CHARTERED BANK - HONG KONG AND TANESCO

### Purpose:

The Purpose of this paper is to appraise the Board of the status of matters involving Tanzania Electric Supply Company Limited (TANESCO) and Independent Power Tanzania Limited (IPTL) following the decision of the International Centre for Settlement of Investment Disputes (ICSID) Tribunal, which was delivered on 12<sup>th</sup> February, 2014 and circulated to the parties. The decision/award of the Tribunal (marked as "Decision on Jurisdiction and Liability") is annexed herewith as **Annexure I**.

After the issuance of the ICSID award, from 28<sup>th</sup> February, 2014, local newspapers have been reporting variously on the matter and painting a picture of a big "scandal" and or failure on the part of TANESCO and the Government. **Annexure II** is attached herewith to indicate some of the reports by some local newspapers of wide circulation.

The Chairman of the Board hence directed a report to be made addressing certain issues. This report addresses as far as possible the issues raised by the Chairman as well as giving a broader picture of the matter and implications.

### Background:

It is important to point out right from the outset the nature of this matter, as admitted and recorded by the ICSID Tribunal at paragraph 21 of its decision/award, thus:

*"The Tribunal finds it useful to provide first an overview of this case, which involves complex facts, multiple proceedings and multiple participants."*

Indeed, this is a matter involving very complex set of facts, transactions and legal issues, which have endured and continue for more than a decade so far. Therefore, any attempt by third parties to report or state some positions involving the IPTL matters goes with an obvious risk of distortion or misstatements or even sheer bias.

In any case, in a nutshell, TANESCO and IPTL executed a Power Purchase Agreement (PPA) way back in year 1995. The PPA was supported by Implementation Agreement (IA) between Government and IPTL. With the IA, the Government guaranteed the Investor that should TANESCO default in its contractual obligations, IPTL could claim against the Government.

The IA further provided for the establishment of an Escrow Account. Like any other ordinary Escrow Account, this is a type of payment services or coffer in which money is held by a neutral party before a transaction is fully and satisfactorily completed relative to some impending

issues. The Parties to this particular Escrow Account were the Government of Tanzania, IPTL and Bank of Tanzania (an Escrow Agent), the latter being neutral party.

During the implementation of the Project, a dispute arose between IPTL and TANESCO on the issue of tariff. As contemplated in the whole arrangement, tariff was to be calculated and arrived at based on a model which was supposed to take into account the debt/equity ratio. This first dispute was referred to ICSID in 1998 and was settled in July 2001 (hereinafter ICSID 1). Generally, the ICSID 1 Award incorporated a financial model of calculating tariff which was acceptable by both TANESCO and IPTL. The financial model recognized the Debt /Equity ratio of 70/30.

It is in record, as it actually happened, that following the ICSID 1 Award payments according to the PPA were made without any dispute until 2004, when TANESCO discovered that the Equity on the IPTL investment was only TShs. 50,000/-, for that reason, if that variable was to be applied to the model, the tariff would go down significantly, and was not reflecting the rightful tariff. Thereafter, TANESCO started disputing the charged invoices as from April 2004. In line with the underlying agreements, in disputing the invoices, TANESCO paid the undisputed sums of the invoices only, the disputed sums were put into the Escrow Account held at the Bank of Tanzania. Moreover, sometime in 2007, TANESCO stopped depositing into the Escrow Account the sums for the disputed invoices.

In the meanwhile, in year 2002, a dispute arose between the IPTL shareholders, namely; VIP Engineering and Marketing Limited (VIP) and Mechmar Corporation (Malaysia) Berhad (Mechmar). VIP had filed winding proceedings at the High Court of Tanzania. On a separate development, in 2009 Standard Chartered Bank Hong Kong (SCB HK) filed a petition at the High Court of Tanzania for administration of IPTL alleging to be creditors of IPTL (the Administration Petition). In a matter of fact this petition by SCB HK was filed to rescue IPTL from the winding up proceedings.

On 15<sup>th</sup> July, 2011, the High Court of Tanzania, Hon. Kaijage J. ordered the winding up of IPTL (Winding up Order) while the Administration Petition was still pending. **Annexure III** is a copy of the said Winding up order.

In September 2010 SCB HK instituted at ICSID two matters, one against the Government and the other against TANESCO. The matter against the Government was about an alleged Government expropriation of the IPTL plant, when the plant was being run by a Provisional Liquidator. This matter was dismissed. However, we are informed that SCB has applied for annulment of dismissal orders.

Subsequent to the issuance of the Winding up Order by the High of Tanzania (Hon. Kaijage, J.), SCB HK complained to the Chief Justice against the Winding Up Order, thus, the Court of Appeal opened revision proceedings, *suo moto*, in Civil Revision No. 1 of 2012. TANESCO for the first time was made a party to the matter and appeared before the Court of Appeal through its in-house lawyers.

On 17<sup>th</sup> December, 2012, the Court of Appeal did set aside the Winding Up Order and ordered revival and expeditious hearing of the Administration Petition along with all other related matters.

At that time, the ICSID arbitration proceedings against TANESCO were going on in London and, for obvious reasons; SCB HK had no interest in pursuing the Administration Petition, as this could have exposed their standing in the local courts and thus impairing their strategy at ICSID.

## **Proceedings at the High Court of Tanzania before Hon. Utamwa J:**

Upon realizing SCB HK's delaying and forum shopping strategy, VIP successfully moved the Principal Judge of the High Court for reviving the Administration Petition. The Administration Petition was revived and assigned to Hon. Utamwa Judge. Along with the Administration Petition, Hon. Utamwa, presided over the following Applications: (i) TANESCO application to join into the Administration Petition, (ii) VIP Winding Up Petition, (iii) Application by Mechmar (in Liquidation), for joining into the proceedings and (iv) Application by Martha Renju (allegedly the Receiver of Mechmar shares in IPTL). In which case therefore, before Hon. Utamwa, there were, again, multiple matters in the form of petitions and applications, all involving multiple participants with different interests.

In the midst of the above applications, it transpired that VIP had sold her 30% shares in IPTL to Pan African Power (PAP) and thereafter prayed to the Court (Hon. Utamwa J.) for the following Orders, among others: (i) withdrawal of Winding Petition, (ii) Provisional Liquidator be terminated and be ordered to hand over IPTL Plant to PAP who is committed to pay all legitimate creditors of IPTL and expand the IPTL's plant capacity to about 500MW and sell power to TANESCO between US \$ 6 cents and 8 cents.

On 5<sup>th</sup> September 2013, Hon. Utamwa granted all the prayers by VIP, as prayed (the Utamwa Order). Copy of the Utamwa Order is annexed as **Annexure IV**. SBC HK attempted to challenge the Utamwa Order at the Court of Appeal by way of Revision; this attempt failed, as it was out rightly dismissed by the Court of Appeal time limitation. Legally, therefore, the Utamwa Order rendered the Administration Petition by SCB HK and other petitions/applications before Hon. Utamwa redundant. Consequently, SCB and other applicants also applied to withdraw their matters.

Nevertheless, it appears that the withdrawal of the Administration Petition by SCB HK was still strategic and meant to enhance its standing at the ICSID proceedings against TANESCO.

Irrespective of its validity or correctness, thus, the Utamwa Order revived the legal life of IPTL in that it once again became a going concern company.

On different developments, around the same time, there were two unsuccessfully attempts by one Martha Renju (the alleged Receiver of Mechmar shares in IPTL) to restrain the handover of IPTL to PAP at the Commercial Division of the High Court of Tanzania (the Commercial Court). At the end, this Martha Renju withdrew the two matters from the Court.

### **Relationship between IPTL (as revived by the Utamwa Order) and TANESCO and the Release Escrow Account:**

In the aftermath of the Utamwa Order, IPTL approached TANESCO for the release of escrow funds and requested TANESCO not to dispute invoices any further. Besides, the Government also sought concurrence of the Board for the release of the funds. TANESCO internal legal team, knowing the implication of the release of escrow funds, insisted for indemnity from IPTL should ICSID case is decided against TANESCO.

It is in record that ultimately in October, 2013, the Government and IPTL instructed the Bank of Tanzania (the Escrow Agents) to release the escrow funds to IPTL. See **Annexure V**.

## **Revision 190/2013 between Mechmar (in Liquidation) and VIP and others on the Status of IPTL shareholding:**

Mechmar (in Liquidation) has applied to the Court of Appeal to challenge the Utamwa Order to the extent that (i) it transfers IPTL's affairs to PAP and (ii) it declares that Mechmar's 70% shares in IPTL have been transferred to Piperlink and further to PAP. The Application is annexed herewith as **Annexure VI**.

The Utamwa Order, much as it has not been reversed, it is legally binding. However, in our opinion, the Order is controversial and it is challengeable because it ordered matters which were not before the court. Besides, while it is clear factually that PAP bought the 30% stake of VIP in IPTL, it is not clear and disputable whether PAP or any other party in fact has acquired the 70% stake of Mechmar in IPTL. And, this is the essence of this Revision Proceedings by the Liquidators of Mechmar.

In a due diligence conducted in Malaysia, it was confirmed that indeed Mechmar is in liquidation. However, it is not certain who holds Mechmar's shares in IPTL because, both SCB and PAP assert holding Mechmar's share certificates, although none of them is ready to submit the original certificates for inspection when so inquired.

### **The ICSID Award dated 12<sup>th</sup> February, 2014:**

On 12<sup>th</sup> February, the ICSID Tribunal delivered its preliminary award in the dispute between SCB and TANESCO in Arbitral Case No. Arb/10/20. Two key issues were addressed and decided upon. These are:

- (i) Whether the Tribunal had jurisdiction to determine the dispute before it; and
- (ii) What is the liability of TANESCO on SCB HK's claims under the Power Purchase Agreement (PPA).

In respect to issue number (i), the ICSID Tribunal held that it has jurisdiction over the dispute between the parties. However, it categorically stated that its jurisdiction is confined to making declaratory order only. In respect to issue number (ii); TANESCO's argument on tariff overcharging due to lower equity ratio than the agreed in ICSID 1 financial model prevailed. Therefore, the Tribunal has ordered the parties to recalculate the tariff amicably within 90 days from the award date. Furthermore, the Tribunal ordered that bonus payments and capacity charges which were due during the period when the plant was being operated by the Provisional Liquidator under the Interim PPAs were recoverable and payable by TANESCO.

### **Implications of the ICSID Award and Way Forward:**

From the foregoing, it is incorrect to conclude that IPTL cases have come to an end. Obviously, immediately now, TANESCO should make a decision on how to approach the order of the Tribunal to recalculate the tariff with SCB. The 90 days time lapses in May 2014.

Secondly, but ancillary to the above issue, i.e. tariff recalculations, TANESCO external lawyers (Mkono & Co. Advocates in association with Hunton & Williams) are seeking instructions to represent TANESCO at this stage, as their instruction to handle the arbitration has now come to an end.

Additionally, these lawyers are proposing Castalia Strategic Advisors to be appointed consultants for tariff recalculations mainly on the reasons that they have been assisting TANESCO in the same arbitration, as expert witnesses.

It is our opinion that TANESCO should make a decision, in consultation with the Government on how to implement the directives of ICSID. On the other hand, at the same time, it should strategize on how to deal with IPTL because while SCB HK has successfully claimed in ICSID proceedings to have equitable rights over IPTL, the courts in Tanzania has pronounced IPTL as a going concern company.

Conversely, owing to previous controversies in the procurement of external lawyers in this matter, Management and the Board had decided that for domestic cases in-house lawyers will make representation in local courts. As for proceedings at ICSID, a decision should be made on who should represent TANESCO under supervision of internal counsel.

### **Issues raised by the Chairman:**

Relative to the issues raised by the Chairman of the Board below is the response:

- i. Whether the contract has defect; it is our opinion that the contract as it is has no defect. The source of the dispute between TANESCO and IPTL arises from the implementation of the contract but not the defect of the contract.
- ii. Whether the CAG did review the Contract: We are not aware whether the CAG did review the contract or not.
- iii. 2008 PAC directives if any and if the same are in line with the agreement: the scheme of agreement in the IPTL matter prohibits the Government or TANESCO from acquiring the plant.
- iv. Brief on decision in American Courts: this has been covered in the foregoing analysis.
- v. Whether Utamwa's Decision is legal regard being had that at the time of its delivery arbitral proceedings between TANESCO and SCB were pending: Utamwa's decision is lawful. Though related facts before ICSID are different from the facts before Utamwa J. As indicated above, facts before Utamwa were about winding up and administration of IPTL. Facts before ICSID are about tariff dispute and non-payment of capacity charges.
- vi. Legality of delivery of the ruling at 20:30 hours: nothing illegal in delivering a ruling at 20:30 hours; although as a matter of fact, the Utamwa Order was delivered at around 2.30 p.m.
- vii. Legality of Utamwa's order of increasing generation of electricity to 500MW: The order is not binding to TANESCO as TANESCO were not parties to the case or contract of sale/purchase of shares between VIP and PAP. This explains partly why the Utamwa Order is controversial and may be impeached.
- viii. Interpretation of ICSID award dated 12<sup>th</sup> February, 2014: the interpretation is covered above.

- ix. Who is the winner in the ICSID Award: ICSID decision is a preliminary award. So far each party has prevailed on some claims. Final winner will be known after the directives of tariff recalculations have been implemented.
- x. Why should TANESCO and SCB HK settle on tariff recalculations while the two have no contract relations and whether the settlement is lawful: This is because SCB HK arguments that they stepped into the shoes of IPTL by virtue of latter's assignment of PPA was accepted by the ICSID Tribunal. This is the law.
- xi. Whether the Settlement is lawful: Settlement is lawful to the extent that it has been ordered by ICSID. However, enforceability of the same might be difficult because IPTL was and is not a party to it. Besides, the ICSID decision will only be declaratory.
- xii. Who is a lawful owner of IPTL: to our understanding, as it stands now, PAP is the lawful owner of IPTL, unless and until that order is reversed.
- xiii. Lawfulness and comparison between High Court of Tanzania and ICSID: Both are lawful. The High Court is established under the laws of Tanzania while ICSID has been established under ICSID Convention to which Tanzania is signatory and it purely deals with investment disputes.

The Management submits the Paper for update, guidance and deliberations:

**SUBMITTED  
MARCH, 2014**

