

The Energy Transition: The View from Africa

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The energy transition is at the top of agendas around the world and the momentum behind this transformation will reshape the global energy sector. Africa is no exception to this, but local economic, political and social factors will mean a different kind of energy transition for the continent. At the same time, Africa is well placed to make a significant contribution to the global push towards sustainability.

In the run up to TICAD 8 in Tunisia at the end of August¹, we are currently discussing the following “Top 10” of African issues and opportunities with our clients.

1. Increasing access to energy and growing demand

Africa faces a major challenge to combat low levels of electricity access across much of the continent: the energy transition in Africa is as much about increasing electrification rates as it is about changing the way electricity is produced. High rates of urbanisation and population growth are also contributing to big increases in projected energy demand – the International Energy Agency predicts that energy demand in Africa will grow twice as fast as the global average². Energy supply will need to increase significantly to meet these challenges: it is estimated that to meet its development objectives, generation capacity will need to double by 2030 and increase five-fold by 2050³. With an abundance of renewable resources (particularly hydro and solar) and falling technology costs,

renewable energy will play a major role in this effort, although Africa will also continue to source electricity from coal, oil and gas.

2. COP26 and climate change

The costs of adapting to the effects of climate change will be significant for Africa (for example, droughts affect hydro plants across many countries on the continent). The costs of implementing the requirements of the Paris Agreement and Glasgow Pact are also significant for Least Developed Countries (LDCs), particularly in Africa. Mitigating the cost of climate change and implementing measures to combat climate change therefore remain a major challenge for Africa. Measures taken outside Africa to combat climate change may also indirectly have a significant effect on African economies. For example, the European Union Carbon Border Adjustments mechanism will require EU importers to buy carbon certificates corresponding to the carbon price that would have been paid had the goods been produced under the EU’s carbon pricing rules. This is likely to have a significant impact on more carbon-intensive economies in Africa. At the same time, these commitments will create opportunities in other areas (see points 3 and 4 below).

3. Continuing opportunities for off-grid and mini-grid (C&I) investments

The growing demand for electricity, coupled with poor grid infrastructure and other barriers (such as credit issues with state-owned electricity compa-

¹ Tokyo International Conference on Africa
https://www.mofa.go.jp/afr/af2/page24e_000325.html

² Africa Energy Outlook 2019.

³ PWC, Africa Energy Review 2021.

nies) have pushed forward the off-grid and mini-grid sector, from individual roof-top solar PV businesses to larger-scale commercial and industrial investments. Although East Africa has been at the forefront of this trend, investors are increasingly targeting West African markets as well. Industrial operations such as mine sites are also looking to decarbonise by using off-grid power solutions. In addition to hitting decarbonisation targets, these solutions in many cases also offer the prospect of reduced costs (compared to trucked diesel and HFO) and simplified logistics.

4. Part of the global move to sustainability: Africa forms an integral part of the energy transition for Europe, the US and Asia.

- Africa is an important source of “transitional” resources such as gas and uranium. For instance, the region will continue to supply significant quantities of piped gas to Europe and LNG around the world. In addition to large existing projects (such as those in Algeria, Nigeria, Equatorial Guinea, Egypt, and Angola), there are major new projects in the pipeline, in Senegal/Mauritania (expected to come online in 2023), as well as in Mozambique and Tanzania.
- The continent is rich in future-facing minerals such as cobalt, nickel, titanium, tantalum, manganese and copper. There is currently a significant increase in interest in countries such as the Democratic Republic of Congo and Zambia that hold major reserves of these ‘critical’ minerals.
- Although a more nascent trend, a number of countries are looking at producing lower-cost, greener energy (from hydro and solar in particular) to produce cost-effective green hydrogen, which can then be exported. For instance, Egypt has announced a planned investment of \$40bn to implement a hydrogen strategy for the country, targeting a production of 1.4 GW by 2030. Namibia has also taken concrete steps to promote a local hydrogen industry.

5. Challenges ahead for African oil and gas producers: The global momentum away from fossil fuels will put pressure on traditionally oil and gas focused African economies.

- Although offset by the impact of wider geopolitical factors on energy markets (see points 7 and 8 below), over the longer-term, countries that are heavily dependent on oil and gas revenues will need to focus on decarbonising their upstream projects and diversifying their energy sector.
- As oil majors come under pressure to deliver returns more sustainably, they are increasingly focused on lower cost, lower emission projects – in many cases, this means reducing their exposure to projects in Africa, which are generally more expensive and more carbon-intensive⁴. This trend is creating opportunities for new entrants in the upstream space, particularly smaller operators focused on improving operational efficiency.

6. Environmental, social and governance issues (ESG)

More broadly, ESG continues to be a key driver for clients in both their strategic investment decisions and day-to-day operations. In addition to reputational concerns, companies are faced with increasing regulatory pressure in areas such as supplychain transparency and diligence (see for example the European Commission’s Proposal for a Directive on Corporate Sustainability Due Diligence). The ESG credentials of products in the future are likely to have an increasing influence on where they can be sold and at what price.

ESG issues can be acute in African jurisdictions, particularly in the resources sector. In some cases these concerns have led to investors to avoid or divest from certain jurisdictions or sectors (such as cobalt in the DRC as a result of issues around working conditions and high incidence of child labour). However, we’re also seeing a growing awareness of the limitations of this approach and the recognition that engagement with the issues

4 See McKinsey & Company, “The future of African oil and gas: Positioning for the energy transition”

may ultimately lead to a better overall outcome. Navigating these questions in the face of an increasingly stringent regulatory environment will be a key challenge for investors.

7. Re-emergence of energy security

The invasion of Ukraine has put energy security back at the top of the agenda. As Europe looks to drastically reduce its reliance on Russian oil and gas, the prospect of accessible supplies of gas (either by pipeline or LNG) is likely to refocus attention on projects in Africa (in particular in North and West Africa). Similarly, demand for certain minerals, such as uranium from Niger and Namibia, will also increase as a result of geopolitical events in Europe.

8. Global geopolitics

Although the war in Ukraine is perhaps the starkest illustration of the trend, the emergence of a more polarised global political system is having a significant impact in Africa as the US, China, Russia and others vie for influence. For example, as an important source of strategically important minerals, the mining sector in the Democratic Republic of Congo is now a major focus of attention for global powers looking to secure long-term supplies of critical materials for their economies. For investors, this can have concrete effects on investment opportunities, how they are structured and how they fare over the life of the project.

9. Security issues and political instability in West Africa

The Sahel has been plagued by Islamist violence and resulting insecurity for many years. There have been a number of coups d'état and other unconstitutional changes of government over the past 18 months, in many cases as a result of the deteriorating security situation. The military has taken power most recently in Burkina Faso (in January 2022), as well as in the Republic of Guinea (September 2021) and Mali (May 2021 and before that in August 2020). Chad is currently under a Transitional Military Council following the death of President Idriss Déby Itno in April 2021. Frequent changes to the political order present existing investors with increased risks, in-

cluding contract reviews and renegotiations and tax re-assessments. New investors active in these jurisdictions need to ensure that engagements with transitional authorities are as legally robust as possible to protect against future challenge.

The deteriorating security situation continues to affect projects in the region, from higher security risks for personnel to increased costs for inputs such as fuel. In some cases, we are seeing projects changing hands in favour of operators that are better equipped to manage the security and political issues.

10. Need for clear, well adapted and stable policy environment

The energy sector is evolving rapidly. Although the energy transition is creating opportunities, investors are also taking greater risks on new technology and lower rates of return. Investors are also faced with an increasingly complex web of legal and regulatory constraints (from new laws to class actions) across a range of jurisdictions. A workable and stable regulatory framework for their investments is therefore a key consideration in deciding where to deploy capital.

Likewise, African policymakers are faced with significant challenges in the face of unprecedented changes in global energy markets to ensure that the energy transition also achieves critical development objectives. Governments will need to be proactive in leveraging the opportunities that the energy transition presents and meeting the specific challenges that it brings for African economies.

<Biography>

Rebecca Major is a corporate partner specialising in the energy and natural resources sectors and is the Head of Herbert Smith Freehills' Paris Energy, Mining and Infrastructure team. Rebecca is experienced in cross-border work, particularly in Europe and Africa (having advised on deals in most of Africa's 54 jurisdictions). She has also worked on a number of Government capacity building programmes in Africa with the ALSF, GIZ/Connex and the ISLP. Rebecca was a partner at Herbert Smith Freehills Tokyo for 5 years.

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