
THE ENERGY REGULATION AND MARKETS REVIEW

THIRD EDITION

EDITOR
DAVID L SCHWARTZ

LAW BUSINESS RESEARCH

THE ENERGY REGULATION AND MARKETS REVIEW

The Energy Regulation and Markets Review

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THE ENERGY
REGULATION
AND MARKETS
REVIEW

Third Edition

Editor
DAVID L SCHWARTZ

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EDITOR'S PREFACE

Our third year of writing and publishing *The Energy Regulation and Markets Review* has been marked by an increase in exploration and production of petroleum products and natural gas, investment in energy infrastructure, renewable resource development, competitive market developments in the electricity industry, privatisation of state-owned energy companies, and Chinese state-owned investment. We have also seen decreases in rate/tariff deficiencies and hydroelectric generation productivity in certain low-rainfall regions, as well as an effort to reduce reliance on nuclear generation.

From a supply perspective, upstream oil and natural gas exploration, development and production has continued to grow in North America. Canada continues to look for export opportunities, the United States is continuing to consider export authorisations, and Mexico is constructing natural gas pipelines to import low-cost natural gas from the United States. In the wake of the Fukushima disaster, some countries, including Germany, Switzerland, France, Japan and Korea, are seeking to reduce their current reliance on nuclear generation. Certain countries, such as the United States and Denmark, have also witnessed extensive retirements of coal-fired generation facilities, owing to greenhouse gas emissions targets and comparisons with the cost of natural gas. At the same time, other countries (including Malaysia, India and Indonesia) are continuing to develop coal generation resources due to significant electricity generation needs that require fuel source diversification. We have also seen increases in renewable generation development efforts (including in Sweden, Denmark, Romania, Kenya, Australia, India, Japan and Malaysia), while many other countries in Europe and North America have reduced subsidies for renewable resource development.

From a demand perspective, we are seeing noteworthy reductions in demand in some countries, owing to the residual effects of the global financial crisis, while we are witnessing significant demand growth in other countries, including Indonesia, Turkey and Angola.

From a market and rate perspective, we are observing substantial efforts to reduce rate/tariff deficiencies. Many countries have fully liberalised their generation markets, while others are heading towards a competitive market model. There are

continued efforts to develop competitive electricity markets for energy and capacity, and some countries have developed effective carbon pricing mechanisms. We have seen an increase in privatisations of state-owned energy companies, including in Turkey, Cyprus, New Zealand and Nigeria. Chinese state-owned companies have acquired interests in utilities in Australia (State Grid acquisition of significant shares of two Australian utility companies) and Mozambique (China National Petroleum acquired certain offshore gas rights).

Natural disasters and political strife continue to impair the ability to provide reliable energy services, as evidenced by the impacts of Typhoon Haiyan in the Philippines and the continued unrest in Ukraine. On the other hand, a lack of political strife has contributed to significant development of the energy industry in other countries, such as Angola, which has seen increased capital investment, including in oil exploration and production.

I would like to thank all the authors for their thoughtful consideration of these difficult challenges. We look forward to identifying possible mechanisms to resolve the many issues and concerns discussed in these chapters.

David L Schwartz

Latham & Watkins LLP

Washington, DC

June 2014

Chapter 26

NIGERIA

Ken Etim and Ayodele Oni¹

I OVERVIEW

The Nigerian oil and gas industry is made up of an upstream sector, comprising exploration and production of oil and natural gas, a midstream sector comprising transportation and refining of petroleum and natural gas,² as well as a downstream sector comprising the importation, storage, transportation and distribution of petroleum products – all aspects of which are still highly regulated by the federal government of Nigeria. The 1999 Constitution of the Federal Republic of Nigeria, which is the supreme legislation of the country, vests all petroleum *in situ* in the federal government. As one of the largest producers of petroleum in the world, the Nigerian petroleum industry is the major source of income for both the federal government and the governments of the component states of Nigeria ('the state governments'), with the federal government involved in the industry as both participant and regulator.

The rights to the exploration and production of petroleum are granted by the federal government through the issuance of oil exploration licences (OELs), oil prospecting licences (OPLs) and oil mining leases (OMLs).³ The federal government also awards rights to explore and extract petroleum through production-sharing contracts, which are awarded in respect of OPLs and OMLs held by the state-owned oil company, the Nigerian National Petroleum Company (NNPC). The NNPC is also a major stakeholder in several unincorporated joint ventures with international oil companies that act as

1 Ken Etim is a partner and Ayodele Oni is a senior associate at Banwo & Ighodalo.

2 Liquefied natural gas (LNG) is considered Nigeria's key midstream product.

3 It is pertinent to note that, although, there is provision for the grant of OELs under the law, OELs are no longer granted in practice as the current practice is the engagement of a seismic data gathering service company to provide seismic information which is made available for perusal by oil companies.

operators in respect of numerous OPLs and OMLs. Recently, government policy has focused on increasing indigenous participation in all segments of the Nigerian oil and gas industry. The Nigerian Oil and Gas Industry Content Development Act (NCA), enacted in 2010, establishes a framework for ensuring increased Nigerian participation in the petroleum industry. Of note is the fact that, the NCA provides for preferential treatment in the award of licences and contracts to be accorded Nigerian incorporated companies in which Nigerians hold at least 51 per cent of the equity shares. The NCA also makes it mandatory for certain services to be sourced from Nigerian oil and gas industry service companies.⁴

The Petroleum Act, Cap P10 Laws of the Federation 2004 (PA) is the principal legislation regulating the oil and gas industry. The federal government is currently proposing wide reforms in the oil and gas industry through the enactment of the Petroleum Industry Bill (PIB). The PIB seeks to consolidate all major Nigerian oil and gas laws, as well as introduce reforms to the rules, procedures and institutions regulating the industry. Although originally introduced in 2008, the PIB is yet to be passed by the National Assembly. Following the spate of nationwide strikes due to corruption in the oil and gas industry⁵ and the purported removal of the subsidy on the supply of premium motor spirit (PMS) by the government on 1 January 2012, the federal government established a committee to further review the PIB to address pertinent issues in the industry. The revised bill prepared by the committee was submitted to the National Assembly in June 2012.

The Nigerian electricity industry is also divided into three broad segments: generation, transmission and distribution. Until recently, the industry had been run almost exclusively by the federal government, through the federal government-owned vertically integrated monopoly (the National Electric Power Authority). Recognising the poor state of the industry, however, and the need for reform in order to attract the necessary investment to meet the electricity needs of the Nigerian economy, the federal government commenced a major reform of the industry in 1999.

These reforms are based on the Nigerian Electric Power Policy 2001/2002 (NEPP), and the Electric Power Sector Reform Act 2005 (EPSRA), which have opened up the electric power industry to participation by the private sector. The EPSRA provides for the licensing of private companies for the establishment of independent power projects. Also, the government, through the Bureau of Public Enterprises (BPE) is currently in the process of finalising the privatisation of the various generation and distribution successor companies established to hold assets formerly owned by the Power Holding Company of Nigeria (PHCN),⁶ while retaining the electric power transmission network for national security reasons. The government has also awarded a management contract to Manitoba Hydro International of Canada in this respect to ensure the effective running of, as well as

4 It is pertinent to note that the NCA does not preclude the 100 per cent foreign ownership of companies in the oil and gas industry in Nigeria.

5 Corruption is allegedly more widespread than formerly believed in the downstream segment of the Nigerian oil and gas industry.

6 The PHCN was the holding company (now unbundled) for the assets and employees of the former state-owned vertically integrated company NEPA.

increased investment in, the Nigerian electric power transmission network. The National Council on Privatisation (NCP)⁷ in April 2013 set up transition committees for successor companies to facilitate the smooth transition and eventual handover of the management and operational control of successor companies to their new owners.⁸ On 1 November 2013, the government handed over the ownership and control to new owners, of 15 out of the 17 power companies that were being privatised. It is expected that the handover to the new owners of the last two companies would take place no later than July 2014.⁹

II REGULATION

i The regulators

The Federal Ministry of Petroleum Resources (FMPR) has overall regulatory oversight of the Nigerian oil and gas industry. The FMPR acts primarily through the Department of Petroleum Resources (DPR), the regulatory agency of the FMPR. The DPR is responsible for the monitoring of the operation of petroleum companies and compliance with petroleum laws and regulations, as well as the collection of rents and royalties. Other regulatory bodies include the Petroleum Products Pricing Regulatory Agency (PPPRA), which regulates the rates for the transportation and distribution of petroleum products; the Federal Ministry of Environment, Housing and Urban Development, which is responsible for approving environmental impact assessment reports in respect of oil and gas projects; the Nigerian Content Development and Monitoring Board, which is responsible for ensuring compliance with the NCA; and the Joint Development Authority, which is responsible for the supervision of petroleum activities within the Nigeria–São Tomé and Príncipe Joint Development Authority.

The principal Nigerian law is the Constitution, while the primary piece of legislation regulating the exploration, production and distribution of petroleum and its derivative products is the PA. The Constitution and the PA vest in the federal government, the entire ownership and control of the petroleum resources in, under and upon any land in Nigeria. Pursuant to the PA, the prospecting, exploration, production and distribution of petroleum resources may only be undertaken with the consent of the Minister of Petroleum (the Minister) through the DPR's issuance of leases, licences and permits for the prospecting, exploration or distribution of petroleum and petroleum products.

The Petroleum (Drilling and Production) Regulations (the Petroleum Regulations) made pursuant to the PA regulates technical matters relating to petroleum production and the licensee or lessee's conduct of operations, including issues related to filing of monthly

7 The NCP is a think-tank sponsored by the Nigerian government charged with the responsibility of formulating and approving policies on privatisation.

8 Private-sector participation in the two hydrogeneration companies (Kainji and Shiroro) is expected to be through the granting of concessions as opposed to outright sale.

9 Comprehensive information can be found on the electric power sector in Nigeria in the *Nigerian Electric Power Sector: Policy. Law. Negotiation Strategy. Business*, written by Ayodele Oni. See www.nesi.com.ng.

progress reports of operations with the DPR, abandonment, assignments of participating interests, permits to carry out seismic data surveys and fees, rents and royalty rates.

The Oil Pipelines Act regulates the construction, operation and maintenance of gas pipelines and associated infrastructure. This legislation is also enforced by the DPR and provides for the grant of licences and permits for the construction and operation of oil or gas pipelines. It also confers the right to construct, maintain and operate installations that are ancillary to the construction, maintenance and operation of such pipelines. The Petroleum Regulations, also administered by the DPR, regulate the transportation of petroleum and natural gas derivatives in Nigeria.

The fiscal regime of the oil and gas industry primarily comprises the Petroleum Profits Tax Act (PPTA) and the Companies Income Tax Act (CITA), which regulate the taxation of profits made from the production and distribution of petroleum, the Deep Offshore and Inland Basin Production Sharing Contracts Act (DIPSA) and the Petroleum Regulations, which prescribe the rates for royalties and rents. The PPTA governs the taxation regime of upstream petroleum operations in Nigeria and provides for an applicable tax of 85 per cent of the company's chargeable profits, generally.¹⁰

The CITA governs the taxation regime of midstream and downstream petroleum operations in Nigeria and provides an applicable tax of 30 per cent of the company's chargeable profits. The DIPSA provides fiscal incentives for companies operating in the inland basin and deep offshore areas of Nigeria. Also the Education Tax Act provides an applicable tax of 2 per cent of the company's chargeable profit.

The National Environmental Standards and Regulations Enforcement Agency Act, the Environmental Impact Assessment Act and the Environmental Guidelines and Standards for the Petroleum Industry in Nigeria prescribe environmental and emission standards applicable to petroleum activities in Nigeria.

There are a number of laws, statutory instruments and policies that may also apply to companies engaged in natural gas operations, including the Companies and Allied Matters Act, Nigerian Investment Promotion Commission Act, Pension Reforms Act, the Immigration Act, the National Insurance Commission Policy Guidelines 2008, the Foreign Exchange (Miscellaneous and Monitoring) Provisions Act, the Pre-Shipment Inspection of Exports Act, the Customs and Excise Tariff, Etc (Consolidation) Act, the Customs and Excise Management Act, the Personal Income Tax Act and the Harmful Waste (Special Criminal Provision, Etc) Act.

In relation to the electric power industry, the primary regulator is the Nigerian Electricity Regulatory Commission (NERC) mandated to regulate and issue licences to participants in the industry. The Federal Ministry of Environment, Housing and Urban Development is responsible for approving environmental impact assessment reports in respect of power projects. The main regulatory framework for the electric power industry is provided by the EPSRA. By virtue of the EPSRA, the NERC is empowered to issue licences in connection with activities such as electricity generation, transmission, system operation, distribution or trading.

10 Profits from natural gas are taxed at the CITA rate of 30 per cent.

ii **Regulated activities**

As previously noted, the granting to investors of rights to develop natural gas reserves is done via the issuance of permits and licences. In respect of licensing, there is generally no distinction between oil and natural gas, and the relevant licences – OELs, OPLs and OMLs – apply to both. The installation of oil terminals cannot be undertaken unless by or under the authority of a licence or lease granted under the Minerals and Mining Act or the express written approval of the Minister. Other governmental authorisations required are a permit to survey a route for a proposed gas pipeline and an oil pipeline licence, both issued under the Oil Pipelines Act. Permits are also required to be obtained from the DPR to lift crude oil where it is to be exported for sale outside Nigeria.

The right to construct, maintain and operate a gas pipeline is granted via an oil pipeline licence as well as rights to construct and operate ancillary installations, such as pumping stations, storage tanks and loading terminals. A licence is also required for the construction and operation of refineries. This is the same licence required to construct and operate gas-processing facilities.

Nigerian law also requires the pre-shipment inspection of goods including petroleum before export. Additionally, pursuant to the guidelines for the importation of petroleum products into Nigeria (the Guidelines), any company wishing to engage in the business of importation of refined petroleum products is required to obtain an import permit from the DPR.¹¹ The Guidelines stipulate that all facilities for the storage of imported petroleum products must be inspected by both the Nigerian customs service and the DPR prior to the grant of a storage or sale licence. The DPR also issues licences for the transportation of petroleum derivatives pursuant to the Petroleum Regulations, which prohibits the transportation of many of such derivatives without an applicable licence. Where LNG is to be stored, a licence to store LNG must also be obtained from the Minister. The DPR further issues a permit to survey a route, which entitles the holder to construct, maintain and operate oil or gas pipelines, as well as other ancillary infrastructure (such as storage devices), that relate to the construction, maintenance and operation of the oil or gas pipeline.

Regarding the electric power industry, the EPSRA requires any person intending to engage in the business of electricity generation, transmission, system operation, distribution or trading to obtain the applicable licence from the NERC. The exceptions are in circumstances where the power plant has a capacity not exceeding 1MW or distribution activities of less than 100kW. Additionally, permits (which are much easier to obtain) are sought rather than licences where the power plant to be licensed is a captive plant.¹²

Applications for licences in relation to the aforementioned activities are to be submitted to the NERC. The issuance of licences under the EPSRA is at the discretion of the NERC. Applications are required to comply with the form prescribed in the relevant

11 As part of its efforts to ensure efficiency, viability and service, the PPPRA is finalising a review that will see the number of companies permitted to import refined petroleum products into Nigeria limited to about 20.

12 A captive plant is one for self-use and not to be sold to third parties.

regulations, and are required to be accompanied with the relevant application fees, as well as non-refundable processing fees. Relevant application forms are provided by the NERC. Within 30 days of NERC's acknowledgment of the application, the applicant is required to publish its intention to obtain a licence in one national newspaper and a newspaper in the area it intends to operate and invite any objections thereto to be submitted to the NERC for its consideration.

In granting a licence, the NERC is required to consider the interests of consumers and the development of the industry generally. Other key criteria in granting licences include that the applicant is suitably qualified to hold a licence, the applicant will comply with all relevant laws and regulations as well as the terms and conditions of the licence, and the grant of the application is in the public interest. There are also new 'fit and proper' rules, where directors and shareholders of the applicant for a licence would have criminal background checks conducted on them by independent experts, on behalf of the NERC.

Where the application relates to transmission and distribution licences, the NERC must be satisfied that the network has the relevant capacity to transmit or distribute electricity in a safe market, and that open access is provided to all users with transparent and non-discriminatory prices. It is also important to note that licences are not required in respect of the generation of electric power not exceeding 1MW (in aggregate at a site) or the distribution of not more than 100kW. Also, applicants that have acquired 10 per cent or more of a company that holds a licence are required to disclose same to the NERC.

iii Ownership and market access restrictions

There are generally no restrictions in relation to the ownership of energy assets, service providers or licence holders in the energy industry. The PA provides, however, that any sale of an interest in an OML, OPL or OEL will require the prior written consent of the Minister. The PA also provides that the Minister may revoke an OML or OPL if the licensee or lessee company becomes controlled directly or indirectly by a citizen of, or subject of, or a company incorporated in a country whose laws do not permit Nigeria citizens or Nigerian companies to acquire, hold or operate petroleum concessions on conditions which, in the opinion of the Minister, are reasonably comparable with those applicable to Nigerian citizens or companies. Further, the recent decision of the Federal High Court of Nigeria in the case of *Moni Pulo Limited v. Brass Exploration Unltd and 7 others* has set the precedent that any sale of a majority shares of a company that holds an OML, OPL or OEL will require the consent of the Minister.

Pursuant to the EPSRA, licensees are precluded from acquiring or otherwise affiliating with other licence companies without the prior approval of the NERC. It is also important to note that the NERC may issue licences upon such terms and conditions as it may deem fit, which may include restrictions in relation to assignments or change of control in the shareholding of the licence.

iv Transfers of control and assignments

The Securities and Exchange Commission (SEC), the regulatory body of the Nigerian capital market, has regulatory oversight in respect of mergers and acquisitions. Further to the Investment and Securities Act of 2007 (ISA), mergers and acquisitions are generally

subject to the prior review and approval of the SEC. The SEC has issued guidelines and rules in respect of these to guard against anti-competitive practices and they are applicable to all sectors, including the energy sector.

In considering whether a merger or acquisition is anti-competitive, the SEC will consider whether same will result in any technological or other pro-competitive gain that will be greater than, and offset, the effects of any prevention or lessening of competition, which may result or is likely to result from the merger, and whether all shareholders are fairly, equitably and similarly treated and given sufficient information regarding the merger. After making this initial determination, the SEC may grant an approval in principle to the merger. The timing for approval of such transaction varies based on the complexity of the transaction. Where approval is given, an application is required to be made to the Federal High Court to obtain approval for the merger.

Also, where a merger or change in control results in the direct or indirect assignment of an OPL or OML, ministerial consent may be required. While these licences may be transferred and even sometimes pledged as security, the enforcement of such security, which could typically translate to an assignment of the OML, the OPL or any right, power or interest arising therein, may only be done with the prior consent of the Minister. An application for consent to an assignment must be made in writing, accompanied by the prescribed fee. There may also be a requirement for the payment of other fees and or premium at the discretion of the Minister.

The consent requirement extends to the farm-out of marginal fields. Where interests in OMLs or OPLs are transferred without the requisite consent, such a licence or lease may be revoked. This is in addition to any pre-emption rights or rights of first refusal that may exist by virtue of contract. There is, however, no restriction on booking the rights for accounting purposes.

III TRANSMISSION/TRANSPORTATION AND DISTRIBUTION SERVICES

i Vertical integration and unbundling

A substantial part of the transportation pipelines, gas-processing facilities and other associated infrastructure is currently owned and utilised by individual gas producers. However, owners are required by law to provide third-party access to available capacity, if any, upon mutually agreed terms and under the supervision of the Minister.

In order to promote the utilisation of gas in the domestic and export markets, the FMPR has developed a gas master plan and an infrastructure blueprint. The infrastructure blueprint aims to optimise the development of gas facilities in line with government policy. It envisages the establishment of three central processing franchise areas, which are to be concessioned to preferred bidders. These facilities will form the major hubs for the processing of gas.

In the electric power industry, there are no vertically integrated players. While the federal government has retained control of the transmission infrastructure, the power generation and distribution infrastructure is now largely controlled by the private sector, following the unbundling and privatisation of the PHCN.

ii Transmission/transportation and distribution access

As regards the electric power industry, regulations that require holders of transmission and distribution licences to provide non-discriminatory open access to other licensees, provided there is available capacity to do so, have been recently issued. Notwithstanding third-party access rights, existing electricity distribution companies have exclusivity with respect to their areas of coverage, which typically is about three to five component states of Nigeria, except for two of the 11 distribution companies that cover only Lagos state.

Regarding oil and gas, the Oil Pipelines Act provides that any person who requires access to any pipeline may make an application to the Minister, who considers the application in consultation with the owner of the pipeline. The Minister will grant the application if he is satisfied that the pipeline can conveniently convey the substance the applicant wishes to convey. The terms and conditions of the access will be as negotiated and agreed upon between the parties; where the parties fail to reach an agreement, the Minister may impose such terms and conditions that he deems expedient to secure the access rights of the applicant and to regulate the access charge. Notwithstanding the foregoing, gas distribution companies typically have exclusive rights within their franchise areas.

iii Terminalling, processing and treatment

The storage, processing and treatment of oil and natural gas is generally regulated. The Petroleum Act and ancillary guidelines regulate the construction and actual operation of such facilities.

Also, the construction and operation of Liquefied Natural Gas facilities is generally regulated by the Petroleum Act and regulations made pursuant to the Act, including the Petroleum Refining Regulations, which cover from construction to the actual operation of such facilities. Further, the Oil Pipelines Act 1956 regulates the construction, operation and maintenance of gas pipelines and associated infrastructure wherein operators are expected to procure a permit for the route of a proposed gas pipeline and, subsequently, an oil pipeline licence. Licences are also required to construct and operate refineries and gas processing facilities.

The National Environmental Standards and Regulations Enforcement Agency Act (NESREA), the Environmental Impact Assessment Act and the Environmental Guidelines and Standards for the Petroleum Industry in Nigeria (EGASPIN) prescribe environmental and emission standards applicable to natural gas activities in Nigeria. Regarding operations, the Petroleum (Drilling and Production) Regulations stipulate that licensees/lessees must only use approved practices and methods acceptable to the DPR.

Furthermore, rates, siting and terms of service, including access to services, are on a willing-buyer and willing-seller basis, although the Minister in charge of Petroleum Resources may mediate where parties are unable to reach an agreement. The Department of Petroleum Resources, which is essentially the technical arm of the Ministry of Petroleum Resources in Nigeria, is primarily responsible for the implementation of the applicable regulations and guidelines for the oil and gas industry.

iv **Rates**

The NERC is mandated under the EPSRA to regulate prices in the industry with a view to ensuring fair pricing for consumers of electricity as well as ensuring sufficient returns for market participants. The EPSRA further empowers the NERC to establish one or more tariff methodologies for regulating electricity prices. The NERC, in consultation with market participants, established the Multi-Year Tariff Order (MYTO), a tariff structure for all levels of the industry, which incorporates all cost elements in order to arrive at electricity prices that are reasonable and guarantee a minimum return on investment for market participants.

The MYTO also provides incentives for participants who are able to achieve a higher efficiency in their operations. The structure is such that at the commencement of the MYTO all prices will be regulated; however, this will be reduced over time as competition increases in the market and electricity supply is sufficient to meet requirements of the market. In June 2012, an updated version of the MYTO, MYTO II, was issued, which now provides a tariff regime for renewable energy such as small hydro plants, solar, wind and biomass run plants. These tariffs are some of the most generous in the world and are attractive to investors.

The PPPRA, on the other hand, regulates the rates for the pricing and distribution of petroleum products. The pricing template is a pricing information sheet detailing the components used in deriving the PPPRA daily or monthly guiding products prices, which in turn affects the rates paid. Access charges to gas pipelines are negotiated and determined by the parties but are subject to the approval of the Minister.

v **Security and technology restrictions**

The National Office for Technology Acquisition and Promotion Act (the NOTAP Act) requires the registration of all contracts involving the transfer of technology between Nigerian and foreign companies. The NOTAP Act sets maximum limits for charges that may be imposed by foreign companies in connection with the provision of such technical, training, management and other such technology acquisition or transfer agreements. Failure to register such contracts with NOTAP will result in the Nigerian company not being able to access official foreign exchange markets and approved government channels for the purpose of making payments under such contracts.

With respect to security of critical information on the energy sector and the role of cybersecurity in this respect, concrete steps are being taken by the federal government, to ensure same, through a number of cybersecurity bills as well as critical infrastructure protection being considered by the Nigerian legislative houses.¹³ Further to the federal government's desire to, *inter alia*, protect such information, a committee was recently set up by the executive arm of the federal government to review the bills before the legislative houses with a view to assisting in fine-tuning same before enactment into law.

13 Nigeria's federal legislative houses are the House of Representatives and the Senate.

IV ENERGY MARKETS

i Development of energy markets

As previously noted, the electricity industry is currently undergoing significant changes with the introduction of private sector industry participation. Currently, there are several licensed active independent power projects (IPPs) operating in the industry. Many of these IPPs were established for the sole purpose of supplying electricity to particular areas, companies or cluster of industries or industrial areas, while others supply electricity directly to the national grid. As there is only one electric power transmission network in the country, dedicated IPPs are typically located around the areas or companies that they supply.

The federal government established the Nigerian Electricity Bulk Trading Company plc (the Bulk Trader) to act as an interface between the electric power generation segment and the electric power distribution segment of the electric power industry, because of concerns as to the creditworthiness of companies in the power distribution segment of the industry.¹⁴ The Bulk Trader's functions include negotiating and executing power purchase agreements (PPAs) with the privatised PHCN successor-generation companies, assuming the responsibilities under existing PPAs entered into by the PHCN, as well as negotiating PPAs with interested IPPs. It is understood that the World Bank will provide partial risk guarantees in respect of the payment obligations of the Bulk Trader.

The Bulk Trader currently has a capitalisation of \$750 million and this is expected to increase to \$1 billion in the coming weeks with grants and loans from the federal government.

Natural gas trading is mainly controlled by the Nigerian Gas Company (NGC), which, due to its ownership of the major transmission infrastructure, plays the role of gas merchant in Nigeria and grants franchises to private companies for the distribution of gas within established distribution zones.

ii Energy market rules and regulation

The government has issued the National Gas Supply and Pricing Regulations, which set out a pricing framework for gas supplied to different sectors of the domestic market. The Pricing Regulations also impose domestic supply obligations on natural gas producers, the fulfilment of which is a prerequisite for an export gas project. Outside the domestic supply obligations of gas producers, natural gas is sold on a willing-buyer, willing-seller basis, and the pricing is negotiated on a bilateral basis.

The pricing of grid electric power supply is, however, regulated by the MYTO. Where the electric supply is to be off-grid, parties may negotiate such terms and conditions, including pricing that would regulate their relationship under the electric power sale agreement.

There is at the moment, no exchange-traded energy derivatives market in Nigeria. Any such derivative arrangement would typically be over the counter.

¹⁴ Please note that this does not create a single-buyer model, such that a generation company is still allowed to sell to a distribution company of its choice.

iii Contracts for sale of energy

Market participants are free to enter individual contracts for the sale of power or natural gas. Where such natural gas sale is for sale of gas that falls within the purview of a company's domestic supply obligation, a standard template gas sale and aggregation agreement, already finalised by stakeholders, is required to be used with many of the terms, such as pricing formulae, force majeure definition, and such other predetermined terms. Only a few terms that are party, plant or location-specific are typically negotiated on bilateral basis.

With respect to power, there are also the template bulk PPAs and vesting contracts that are used for grid power sale and purchase pursuant to the ongoing electricity reform programme. Like the template gas agreement, many of its terms are fairly standard and fixed with only a few terms considered as bilateral terms subject to negotiations.

It is expected that the regulatory bodies for both the petroleum industry and power may mediate in negotiations. It is also the case that the prudence of utility purchases of power or natural gas is subject to regulatory scrutiny.

iv Market developments

The ongoing reform and power sector privatisation remain the primary developments in the electric power sector. The successor companies that emerged from the unbundled PHCN have been successfully privatised, except for two (the Afam Generation Company plc and the Kaduna Electricity Distribution plc – which are expected to be handed over to their new owners no later than July 2014). The process for the privatisation of those two companies was recommenced.

Also, following the reintroduction of the updated PIB to the National Assembly in June 2012, the PIB has passed its second reading and has been referred to the relevant committees of the House of Assembly and Senate. There is, however, no indication on when the bill will be passed into law.

Furthermore, preferred bidders for a set of 10 power generation companies owned jointly by the three levels of government of Nigeria¹⁵ have been selected. Additionally, a number of Nigerian indigenous exploration and production companies are expanding their assets portfolios by acquiring oil and gas assets from outside Nigeria. In addition, the Department of Petroleum Resources, in December, announced the commencement of a bid round for the award of marginal fields, a first since 2002. The bid round is slated for 2014, although the details of the marginal fields are yet to be communicated. Some of those same companies are also raising funds from international capital markets like the London Stock Exchange, the Toronto Stock Exchange and the Johannesburg Stock Exchange.

15 The federal government, component states and local government.

V RENEWABLE ENERGY AND CONSERVATION

i Development of renewable energy

A national energy policy was approved by the federal government in 2003 with the overall thrust of optimal utilisation of the nation's energy resources; both conventional and renewable, for sustainable development and with the active participation of the private sector. There is also the Renewable Energy Master Plan (the Renewable Energy Plan), which aims to upscale the use of renewable energy in Nigeria. The Renewable Energy Plan articulates Nigeria's vision for achieving sustainable development. The plan also aims at moving the economy from a monolithic fossil economy to one driven by an increasing share of renewable energy in the national energy mix. It involves the exploitation of renewable energy in quantities and at prices that will promote the achievement of equitable and sustainable growth.

In 2005, a Presidential Directive was issued to the NNPC to explore the development of renewable energy in Nigeria. The NNPC, through its Renewable Energy Division, has promoted the production and importation of biofuels such as biodiesel and fuel-ethanol to be blended with PMS with a view to reducing carbon emissions. The regulation of the production and importation of biofuels is carried out by the DPR.

As specified above, the new MYTO provides a generous tariff structure for renewables. This tariff structure is regarded as the renewable energy feed-in-tariffs (refits). The refits under Nigeria's electricity tariff system are among the most attractive in the world. There are also a number of renewable power projects under public-private partnerships. To encourage renewable energy investments, the government is promoting incentives. A template power purchase agreement for renewable energy is also currently being finalised.

ii Energy efficiency and conservation

Energy efficiency regulations are currently absent in Nigeria. The process of extraction, conversion and utilisation of energy is prone to wastage. Apart from direct losses, the inefficient use of energy has resulted in increased cost of energy products and services, faster depletion of energy resources and environmental degradation. The concept of sustainable development, therefore, dictates that deliberate efforts be made to promote efficiency in the production, conversion and utilisation of energy. The Energy Commission of Nigeria (ECN) has developed a draft national energy policy and the draft Energy Master Plan that contains basic policies and strategies for energy efficiency and conservation. Specifically, the policy provides for the promotion of energy efficiency and conservation in industrial, residential and transport sectors. The master plan also provides for the designing of a national programme on industrial energy efficiency and conservation in collaboration with the Manufacturers' Association of Nigeria and experts in higher institutions and research centres. The policy also aims at the introduction of fuel-efficiency labelling programme in the transportation sector for various vehicle types.

The policy also provides for establishing codes and standards for energy efficiency and conservation technologies. The Commission has also recently established an Energy Conservation Research Centre. There is also a pilot compact fluorescent lamps (CFLs) programme being anchored by the ECN in collaboration with the Economic

Community of West African States (ECOWAS) and the Cuban government to replace 1 million incandescent lamps with CFLs. In the power sector, the NERC has initiated some processes towards developing energy efficiency regulation. Specifically, the NERC is currently developing energy efficiency labelling standards for domestic appliances, energy efficiency standards for luminaries and other household appliances.

iii Technological developments

Smartgrid technologies are yet to be implemented in Nigeria, but the government of the federation has earmarked funds for the development of smartgrid technologies in Nigeria. With private sector participation in the electricity value chain, we expect that there will be a leap in technological developments in the sector.

VI THE YEAR IN REVIEW

The Shell Petroleum Development Company, which currently holds a large number of oil and gas concessions in Nigeria is currently negotiating agreements to exit some of its onshore oil and gas concession areas as a result of the conflicts it has been having with host communities in those areas. Its decision to exit those concessions has opened up the industry for participation by several indigenous Nigerian companies and other independents.

Additionally, as regards the power sector, the federal government handed over its majority stake in 15 power generation and distribution companies and has awarded a management contract for the transmission network. The three levels of government have also selected preferred bidders for the majority stake in 10 power plants. In the upstream petroleum sector, mini bid-rounds for marginal fields are expected to take place soon and new draft regulations are currently being finalised.

In the downstream petroleum segment, there are plans by the federal government to deregulate the sale and marketing of petroleum products, remove subsidies, encourage companies to build more refineries and, consequently, refine more crude oil in Nigeria.

VII CONCLUSIONS AND OUTLOOK

Although Nigeria has its fair share of challenges in the energy sector, it appears that the ongoing reforms in the entire energy supply chain have come at an auspicious time, and if the federal government forges ahead with its reforms, the energy sector generally would open up further for private sector participation, with improved energy security. For success to be recorded, however, issues such as corruption, nepotism and inconsistency in government policy must be adequately dealt with. Additionally, the federal government must act transparently while showing that it has the political will to conclude the reforms. The outlook therefore appears to be positive, largely because of the yawning gap in energy demand and supply, and the continuing reforms. Nigeria may well be particularly attractive to prospective investors if the reforms are successful.

The federal government is currently doing a great deal to encourage renewable energy. Some of the actions of government in this regard include the development of a

new tariff system that incentivises investments in renewable energy and the development of a bankable template power purchase agreement.

An issue currently being discussed is the electioneering process. Elections are to take place in Nigeria early 2015 and some investors fear an adverse change in policy where a government that has a different view about reforms and privatisation is elected. However, from a dispassionate point of view, many of the reforms have reached advanced stages making them difficult for any government to reverse. Many smart investors would also argue that, because of the apathy to invest, this is the best time to invest in Nigeria as the returns are currently higher than they have been in the past.

Appendix 1

ABOUT THE AUTHORS

KEN ETIM

Banwo & Ighodalo

Ken Etim is the managing partner and a partner in the energy practice at Banwo & Ighodalo. He has almost 20 years' experience of advising on, negotiating and closing intricate and highly challenging multimillion-dollar transactions. He specialises in Nigerian and international oil, gas and electricity work and is also experienced in corporate, commercial and project finance transactions and has been involved in almost all of the firm's energy and project finance transactions. He regularly acts for a cross-section of companies and governments and is recognised in international guides as one of the world's leading energy lawyers. He is a member of the Nigerian Bar Association, the Association of International Petroleum Negotiators (AIPN), the Nigerian Maritime Law Association and the Commercial Law & Taxation Committee of the Lagos Chamber of Commerce & Industry, among other associations.

AYODELE ONI

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Ayodele Oni, a Shell scholar and winner of the young lawyer of the year award at the inaugural Nigerian Legal Awards, is a senior associate in the energy and natural resources team of Banwo & Ighodalo. He has a broad range of experience in energy (oil, gas and power), corporate and commercial matters with particular focus on energy. Ayodele has acted for a broad range of clients in the energy sector assisting on various energy transactions. He also writes a column on energy in a Nigerian business newspaper and recently wrote the first complete text (and practice manual) on the Nigerian electric power sector.

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