Lessons from Shell

Ken Etim and Dipo Okuribido of Banwo & Ighodalo describe the challenges and achievements of a formerly struggling oil and gas industry

A few years ago, the Shell Petroleum Development Company Limited (SPDC) announced that it would be embarking on a strategy of refocusing its onshore interests in Nigeria, in line with the Federal Government of Nigeria's aim of assisting Nigerian companies to develop their capacity in the upstream oil and gas business. Accordingly, SPDC commenced the process for the assignment of participating interests in several onshore oil mining leases to exploration and production companies, most of which have majority Nigerian interests (the Divestment Programme). As of November 2012, six transactions have closed in what has been a revolution of sorts in Nigeria's typically change-resistant oil and gas industry.

Background

The Nigerian oil and gas industry has historically been criticised for its low contribution to GDP. Despite sometimes accounting for up to 95% of all government revenues, the industry has seldom contributed more than a meagre fifteen per cent 15% to the Nigerian GDP, consistently ranking no better than third behind agriculture, which contributes up to 40%, and wholesale and retail trade which contribute around 19%. This low contribution to national GDP is generally attributed to the fact that the bulk of oil and gas production is carried out by foreign oil companies which tend to rely mainly on foreign sources for finance and consumption of their production in Nigeria. Thus the defining sector of the Nigerian economy is left with little or no opportunity to benefit from the industry.

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To counteract this trend, various measures have been introduced by successive governments, including a marginal fields programme in 2003, according to which dormant fields within portfolios of international oil and gas companies were auctioned to indigenous Nigerian companies. More recently, in April 2010, the enactment of the Nigerian Oil and Gas Industry Content Development Act aims to compel greater consumption of Nigerian goods and services. Despite all of these measures, indigenous companies still generally account for only around 10% of oil and gas production, and contributions of the oil and gas industry to GDP have remained generally low. The SPDC divestments are significant because they are likely to serve as a major game changer to this situation.

The majority of onshore oil and gas production in Nigeria is undertaken by SPDC and a handful of other international oil companies (IOCs), with joint venture arrangements between the NNPC (Nigerian National Petroleum Corporation) and the IOCs. The Joint Operating Agreement (JOA) between the NNPC and SPDC also has Total E & P Nigeria (*Total*) and Nigerian Agip Oil Company (NAOC) as parties, with SPDC serving as operator of the fields covered by the JOA. The JOA accounts for the largest share of oil production in Nigeria. Participating interests under the JOA are shared as follows: (i) NNPC – 55%, (ii) SPDC – 30%; (iii) Total – 10%; and, (iv) NAOC – 5%.

Under the Divestment Programme, SPDC, Total and NAOC have thus far assigned their aggregate 45% participating interests in eight producing oil mining leases (OMLs). Participating interests in OMLs 4, 38 and 41, which have a combined production capacity of 91,000bpd of crude oil and 40MMscfd of natural gas and current production of 30,000bpd of crude oil, were sold to Seplat Petroleum Development Company (Seplat) which is majority owned by the Nigerian exploration and production companies, Shebah E&P and Platform Petroleum. Interests in OML 26, which currently has production of 5,000bpd of crude oil and capacity to increase to 40,000bpd, were sold to FHN 26, a wholly-owned subsidiary of First Hydrocarbon Nigeria. OML 42, which has a current production of 12,000bpd of crude oil, was sold to Neconde Energy, a special purpose vehicle (SPV) owned by a group of investors, including the Nestoil Group of Nigeria. OML 34, which has a current production of 15,000bpd of crude oil and 300 million cubic feet of gas, was acquired by ND Western, which is majority owned by Niger Delta Exploration and Production. OML 40 was acquired by Elcrest Exploration & Production Nigeria, a joint venture between two independent exploration companies, Starcrest Nigeria and Eland Oil & Gas. Finally, OML 30 which has a current production of 35,000bpd (the largest of the eight OMLs) with potential to achieve 55,000bpd in the short term (and 100,000bpd in the long term) was sold to a joint venture of Heritage Oil and its Nigerian partner, Shoreline Power. Banwo & Ighodalo was involved in 3 of these transactions.

Financing oil and gas acquisitions

The combined production of the eight OMLs which is in the region of 100,000bpd of crude oil is expected to significantly increase the proportion of Nigerian production under the control of indigenous companies. Other benefits of the divestments to the Nigerian economy are already becoming apparent. For instance, Nigerian commercial banks including Access Bank, First City Monument Bank, Guaranty Trust Bank, and Stanbic IBTC Bank, contributed a substantial amount of the over $2 billion required to fund the acquisitions and future operations of the various parties. More activity is still expected in this respect as foreign financing parties look to offload portions to Nigerian banks, and other indigenous companies look to acquire smaller roles in producing assets.

For financing oil and gas acquisitions in Nigeria generally, a wide variety of structures are typically adopted. Structures will usually be selected taking into consideration a number of factors, including the level of security required by lenders, the time available to close the acquisition, and the availability and quality of assets at the sponsor and shareholder level. Lenders will typically look to the asset itself and to its revenue streams to secure any funding. Challenges exist with these options.

The challenges

With respect to oil and gas assets in Nigeria, according to paragraph 14 of schedule 1 of the Petroleum Act (PA), the prior consent of the Minister of Petroleum is required for any assignment or transfer of a licence, lease or any associated right, power or interest. In practice, this provision is generally interpreted as requiring the consent of the Minister for the transfer of the legal title to an oil prospecting licence (OPL) and an OML to another party by way of security. Hence, ministerial consent will be required for the creation of a mortgage of an OPL or an OML. The process of obtaining ministerial consent under the PA is generally tedious and time consuming. Such mortgages of OPLs and OMLs are registered with the Department of Petroleum Resources (DPR).

On the other hand, the creation of a charge over an OPL or OML does not require prior ministerial consent. Unlike an assignment or a mortgage, a charge merely creates an equitable security interest over the OPL or OML in favour of the lender. This equitable interest is however not registrable with the DPR. This does not normally raise any concerns as the charge over the OML or other oil and gas assets will typically be part of an all assets debenture executed by the acquirer of the assets, creating a fixed and floating charge over all relevant assets of the acquirer. This all assets debenture will normally be registered in the company's records at the Nigerian companies' registry, the Corporate Affairs Commission, thus still affording public notice of the charge. The risk will however remain that at the point of perfection of the security, the Minister may refuse to enforce the transfer of the OML to the lenders or their assigns.

Previously, an option which was employed to avoid the requirement for ministerial consent for the assignment was for the lenders to require that the relevant assets be held by a SPV, whose shares could then be charged in favour of the lenders. By the strict language of the PA, the change of control of a licence or lease holder was not thought to require ministerial consent. However, in the recent case of *Moni Pulo* v *Brass Exploration*, relevant sections of the PA were conclusively interpreted as requiring ministerial consent for circumstances of change of control of licensees and lessees. The effect of this case is that whether the charge is directly on the asset or on the shares of the licence/lease holder, the risk remains that ministerial consent may ultimately not be granted in the event of perfection of the security.

Revenue streams from oil and gas assets are another popular choice for securing acquisition funding within the Nigerian oil and gas industry. This form of security is not without its challenges. Under the Pre-Shipment Inspection of Exports Act and the Foreign Exchange Manual, companies are required to repatriate all export proceeds to an export proceeds domiciliary account in Nigeria within 90 days from the date of shipment. In addition, according to section 52 of the Nigerian Oil and Gas Industry Content Development Act, all operators (including Nigerian oil and gas

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Author biographies

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Ken Etim is the managing partner of Banwo & Ighodalo. He has been involved in nearly all of the firm's energy and project finance transactions, and has immense skill and expertise in these areas of practice. An ardent negotiator, he is committed to ensuring that clients' needs and expectations are satisfied to the smallest detail and is untiring in achieving this goal. His continued quest to always exceed clients' expectations is a quality which endears him to both clients and peers.

Ken is the secretary of the energy and environment sub-committee of the business law department of the Nigerian Bar Association. He is also a member of the Association of International Petroleum Negotiators (AIPN) and the Nigerian Maritime Law Association (NMLA) and has authored numerous writings in leading publications worldwide.

Dipo Okuribido
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Dipo graduated in the fifth percentile of his class in the University of Lagos in 2006 and was called to the Nigerian Bar in late 2007. He is presently an associate with Banwo & Ighodalo, one of the foremost full service commercial law firms in Nigeria. He has been with the firm for the past five years with the exception of a three-month period in 2010 (September to November) when he was seconded to Berwin Leighton Paisner (London) as part of the International Lawyers for Africa Programme. He works primarily with B&I's energy and natural resources practice group, but is also one of the firm's leading tax experts.

A member of the October 2009 class of NLI associates, Dipo was nominated for professional of the year in the 2010 edition of the Future Awards. He is presently a member of the Association of International Petroleum Negotiators and the Chartered Institute of Taxation of Nigeria. He has published several articles on tax and other issues.

companies) in the oil and gas industry are required to maintain a bank account in Nigeria in which they are to retain a minimum 10% of their total revenue accruing from Nigerian operations. These requirements limit the options available for utilising revenue streams from oil and gas assets as security for acquisition finance, and generally require the design of complex waterfall mechanisms to ensure that operators remain in compliance with law but are still able to domicile funding with foreign lenders.

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Another aspect of oil and gas financing that continues to pose a challenge is the cost of stamping finance and security documents, and the registration of security documents at the relevant registries. Under Nigerian law, stamp duty is chargeable on a wide range of instruments with connection to Nigeria. Specifically, stamp duties are payable ad valorem, on virtually all security documentation. Duty rates range from 0.375% to 1.5% of the amount secured and vary with the specific type of security and the nature of the assets involved. Under the Stamp Duties Act 2004 (SDA), relevant instruments are required to be stamped within thirty days of execution, or where executed outside Nigeria, within 30 days of receipt of the instrument in Nigeria. The obligation to stamp is statutorily imposed on the obligee (the lenders); although in practice, the burden for the payment of the duty is usually transferred to the obligor (the borrower).

The payment of stamp duty is particularly relevant for the purpose of enforcing the security created by the security documents. This is because instruments that are required to be stamped under the SDA are precluded from being received in evidence by a Nigerian court without the required duty and applicable penalties first being paid. Further, late payment of stamp duty attracts a penalty of interest at the rate of 10% per annum from the due date up to the time when the amount of interest is equal to the unpaid duty. Thus, in order to enforce the security interests created by an offtake contracts assignment agreement and deed of charge over account in Nigeria, amongst others, it would be important to ensure that this is duly stamped.

Where stamp duty is chargeable at an ad valorem rate of the amount secured, most times, depending on the sum that was borrowed, the borrower may be unable to pay the full stamp duties payable. In practice, parties need not secure the entirety of the borrowing company's obligations in the first instance but may agree on a notional amount for stamping purposes and subsequently, where the need arises, upstamp the secured amount to the full obligation. This structure will ensure that the parties only incur the full stamp duty obligation where the need arises. In this regard, section 202 of the Companies and Allied Matters Act 2004 (CAMA), permits parties to a registrable charge to determine a figure as the maximum amount secured by the charge, particularly where the charge secures fluctuating or uncertain amounts. The proviso to section 202 of CAMA further states that the maximum sum deemed to be secured by a registrable charge can be increased at any time prior to the winding up of a company, provided additional stamp duty is subsequently paid on such increase. It is however pertinent to note that the instrument will only be enforceable in respect of the additional amount, from the date of the upstamping, and charges registered by third parties over the same asset during the intervening period may claim priority over the additional amount in respect of which the instrument is upstamped.

Bolder acquisitions to come

In spite of the security issues, within the relatively short period since the announcement of the Divestment Programme, eight transactions, with a combined value of more than $2 billion, and current production of around 100,000bpd, have been closed. Although some of the acquisitions will most likely have been financed by bridge facilities from sponsors and shareholders, which may subsequently be refinanced in the near future, it cannot be denied that such success is a testament to the coming-of-age of the Nigerian oil and gas industry. Based on this success, there is likely to be increased appetite from local and international lenders to finance new and bolder acquisitions and other transactions within the Nigerian oil and gas industry. This will especially be the case where the assets for acquisition are already in production. Things are about to get even more interesting.