# The Projects and Construction Review

Fifth Edition

Editor
Júlio César Bueno

Law Business Research

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*La meilleure façon d'être actuel, disait mon frère Daniel Villey, est de résister et de réagir contre les vices de son époque.* Michel Villey, *Critique de la pensée juridique modern* (Dalloz (Paris), 1976).

This book has been structured following years of debates and lectures promoted by the International Construction Law Committee of the International Bar Association (ICP), the Royal Institution of Chartered Surveyors (RICS), the Chartered Institute of Arbitrators (CIArb), the Society of Construction Law (SCL), the Dispute Resolution Board Foundation (DRBF) and the American Bar Association's Forum on the Construction Industry (ABA). Some important issues recently discussed during the annual meeting of the International Academy of Construction Lawyers (IACL) have also been included for a broader debate. All of these institutions and associations have dedicated themselves to promoting an in-depth analysis of the most important issues related to projects and construction law practice and I thank their leaders and members for their important support in the preparation of this book.

Project financing and construction law are relatively young, highly specialised areas of legal practice. They are intrinsically functional and pragmatic and require the combination of a multitasking group of professionals – owners, contractors, bankers, insurers, brokers, architects, engineers, geologists, surveyors, public authorities and lawyers – each bringing their own knowledge and perspective to the table.

I am glad to say that we have contributions from three new jurisdictions in this year's edition: East Timor, Nigeria and Saudi Arabia. Although there is an increased perception that project financing and construction law are global issues, the local flavour offered by leading experts in 30 countries has shown us that to understand the world we must first make sense of what happens locally; to further advance our understanding of the law we must resist the modern view (and vice?) that all that matters is global and what is regional is of no importance. Many thanks to all the authors and their law firms who graciously agreed to participate.

Finally, I dedicate this fifth edition of *The Projects and Construction Review* to a non-lawyer, a non-engineer, but yet a most noble man: Ozias Bueno, my dearest father, whose tenderness, dedication and wisdom has given me nothing less than the desire to also be a model father to my own little son.

**Júlio César Bueno**
Pinheiro Neto Advogados
São Paulo
July 2015

## Chapter 24

# NIGERIA

*Stella Duru*[1]

## I INTRODUCTION

In 2014, after years of using antiquated data, the Nigerian Bureau of Statistics finally recalibrated the prices used in its gross domestic product (GDP) calculations, expanding the sectors of the economy measured and switching from 1990 prices to 2010 prices. The rebasing officially confirmed Nigeria as the largest economy in Africa and perhaps further highlighted the poor state of its infrastructure. With a GDP of about $510 billion and a population of nearly 170 million, Nigeria's core stock of infrastructure is estimated at only about 20–25 per cent of GDP compared with the middle-income country average of about 70 per cent. The crippling infrastructure deficit, coupled with the enormous investment required to fix this deficit, has a direct impact on project financing structures in Nigeria. From the current estimates by the federal government of Nigeria, more than $3 trillion will be required over the next three decades to plug the gap.

Generally, it is accepted that government and its development partners cannot realistically be depended on to provide the requisite finance needed for overhauling infrastructure in Nigeria; and, possibly, public-private partnerships (PPP) and other private sector finance initiatives are required. In this regard, over the past few years, the government has focused on developing PPP structures and on privatising government utilities. While privatisations have largely been successful, PPP deals have tended to drag and there remain only a few examples of successful major projects.

In particular, following major power privatisations, which occurred in 2013, some attention shifted to development of gas-to-power projects expected to provide gas for various private and privatised power plants. However, deal development in this sector has been slow for various reasons including, in some cases, perceived absence of government support and restricted or regulated gas pricing for power projects.

1 Stella Duru is a partner at Banwo & Ighodalo.

## II THE YEAR IN REVIEW

In 2014, riding on the back of the momentum garnered from the 2013 power privatisations, the federal government's focus shifted to power transmission, the only aspect of the power industry that was not privatised. Up to six different high-voltage transmission projects were signed as PPP deals and are currently being developed on either a build-transfer basis or as build-operate-transfer projects. Aside from these projects, which are being developed on behalf of the Transmission Company of Nigeria, which is government owned, projects with combined value of about $2.76 billion, are also being developed as PPPs with either the federal government of Nigeria or various state governments. These projects include the rather interesting Lekki Deep Seaport project, expected to be the largest seaport in Nigeria and estimated to cost up to $1.5 billion, as well as the second Niger Bridge project, a 1.6-kilometre bridge and associated approach roads and bypasses, estimated to cost around $700 million. Contracts for these deals were signed in 2014. Also, it was estimated that the financial close for the $500 million Lagos cable car system would be achieved in 2014, with the construction of said system commencing in November 2014.

The pipeline of deals entered into in 2014, as highlighted above, only scratches the surface in detailing the infrastructure development situation in Nigeria. Specifically, the year 2014 witnessed the completion of the buy-back by the Lagos state government of the pioneer toll road project in Nigeria. The Lagos state government had in 2013, announced its intention to buy back the toll road ahead of the 2038 handover date in its bid to prevent the commencement of tolling at other toll plazas, which had proved unpopular with users of the roads. The buy-back, via a mutual settlement option provided for under a concession agreement, was ultimately completed in 2014. The total cost of the buy-back was estimated at 55 billion naira with 15 billion naira being paid to the Lekki Concession Company (the sponsor of the project), and 40 billion naira paid to senior lenders of the project. The buy-back effectively put an end to the project, which had hitherto been the main point of reference for PPP transactions in Nigeria.

## III DOCUMENTS AND TRANSACTIONAL STRUCTURES

### i Transactional structures

As in most developed markets, project finance structures in Nigeria take various forms depending on a wide range of factors including the relevant procuring entities (i.e., federal or state governments, ministries or departments or agencies, etc.), the value or size of the project, the revenue generation model and the applicable legal or regulatory framework. Common structures include developmental leases, concessions, build-operate-transfer, build-transfer and build-own-operate-transfer project models.

In virtually all of these structures the government or government agency will typically not provide any equity in the first instance but may sometimes be required to provide some express guarantees or other secondary commitments. In scenarios where the completed project may not generate sufficient revenue for the investor, the arrangement may sometimes be structured on a build-transfer model, whereby upon completion, government acquires the infrastructure and pays the investor based on an agreed schedule.

There is no particular structure that is generally favoured by the relevant authorities and procuring entities in Nigeria and, depending on the circumstances, the full bouquet of options tend to be employed. However, owing to regulatory restrictions, which require Federal Executive Council approval or House of Assembly approval in certain circumstances, projects may sometimes be structured as developmental leases rather than traditional PPP projects.

### ii Documentation

Although in some jurisdictions model contracts have been developed for use in PPP transactions, to date no such models have been developed in Nigeria. Documentation, however, tends to conform to international best practices, although in most cases the governing law for the agreement will normally be Nigerian law.

Projects will normally only be executed with limited liability companies incorporated in Nigeria and, thus, any investors or consortium of investors will usually need to incorporate a special purpose vehicle for the project. As is typically the case, requisite governance documentation will be required for this project vehicle. This documentation will normally extend beyond the basic company constitutional documents (which will be registered in the companies registry) and will include private shareholders' agreements executed between the parties. The government procuring entity will not normally be party to this governance documentation. Also, beyond incorporation in Nigeria, there are no specific local content requirements, such as Nigerian shareholders or company directors.

The main project document will be the concession agreement with the procuring entity. This will document the terms of the relationship between the government and the investor, clarifying rights granted to the investor and the manner in which these will be exploited. Under the concession agreement, the project company will accept responsibility for the implementation of the project and for the operation and maintenance of the constructed building or facility and the delivery of associated services during the concession period. The project company will look to pass down all construction-related risks to the construction contractor under a fixed-price design-build (DB) contract. A separate operation and maintenance (O&M) contract will be entered into for the concession period following completion of the works.

In the absence of any standard government models, there is no rule as to which party generates the first draft of the concession agreement and this can sometimes be provided by counsel to the concessionaire. The document will normally be extensively negotiated and, will typically be approved by the relevant PPP authority prior to execution by the appropriate procuring entity. As the investor is likely to rely on significant third-party funding, the agreement will normally clarify the extent of equity funding that the investor must provide as well as the extent to which security can be created over the concession agreement and assets developed or procured for the project.

Lenders step-in rights and direct agreements are fairly common in project finance transactions in Nigeria and will normally form part of the bouquet of documents. The capital funding for the project will generally be provided through non-recourse lending, secured against the income streams of the project company.

Offtake agreements will be required where the output of a project, such as oil, gas or power, is to be supplied to a particular customer. Minimum revenue generation through offtake agreements may be a key requirement of the project company for it to service its debt. Separate support agreements may be required where specific licensing or financial support is required.

### iii Delivery methods and standard forms

We reiterate that to date no model contracts have been developed in Nigeria.

Nonetheless, primarily, engineering-procurement-construction, DB and engineering-procurement-construction-installation contracts are primarily used for project finance-based transactions to deliver maximum risk transfer to construction contractors. Under such contracts, the contractor will be responsible for the entire design and construction of the works, usually on a lump-sum basis, with the contractor liable for liquidated damages in the event of delayed completion.

The specific form of construction contract utilised will depend upon the nature and location of the project. Where standard forms such as FIDIC (International Federation of Consulting Engineers) are used, these are often subject to substantial amendments to reflect the required risk profile. Many construction contracts used in transactions involving project finance are tailored to suit the specific characteristics of the project in question.

## IV RISK ALLOCATION AND MANAGEMENT

The approach to risk management and allocation in project finance transactions in Nigeria generally tends to mirror that in more advanced markets with parties aiming to allocate risks to the party best suited to bear them. As regards government projects, current policies of the Infrastructure Concession Regulatory Commission (the main federal PPP agency) provide that government will aim to optimise, rather than maximise, the transfer of project risks to the investor. In practice, this approach leads to the same outcome of risks being allocated to the party better suited to bear them.

In practice, the project company will normally look to limit its risks as much as possible, ensuring that where any deliverables are dependent on third parties then, as a minimum, a back-to-back commitment is obtained from the relevant third party to cover such risk. In addition, there will normally also be outright caps on liability (with the relevant acceptable exclusions, which may be extended beyond the norm, based primarily on the risk appetite and risk allocation mechanism of the parties), delay and performance liquidated damages and other compensatory payments. In this regard, the rule against the imposition of penalties is also applicable under Nigerian law with the recognised exception for genuine pre-estimate of losses such as liquidated damages. Although there is no significant recent case law on these points, Nigerian courts will generally be guided by current English law rules in determining whether or not a liquidated damages clause in a contract is enforceable. However, on the flip side, it is noteworthy that there are currently no limits to the instances in which liability could be excluded and or limited.

This means that in theory, an investor could still exclude liability in respect of fraud or gross misconduct, in a contract governed by Nigerian law, which in practice will involve counterparties to any such contract insisting on there being no cap in respect of liabilities of this nature.

Given its frontier market status and the limited number of thriving long term private infrastructure projects, political risk tends to be a major concern for private investors looking to invest in infrastructure projects in Nigeria. To hedge against such risks, in instances where contracts are being signed with government entities or agencies, investors will normally seek to execute some form of support or guarantee documentation with the relevant government itself to give additional comfort. The grant of such support or guarantees tends to be restricted under applicable PPP laws and will normally require some additional governmental approval.

## V SECURITY AND COLLATERAL

To a large extent, the applicable security structure and collateral accepted by lenders tends to vary with the nature of the project. To ensure complete protection in any project finance transaction, lenders will normally seek several levels of security including:

*a* direct security over the project assets – typically in the form of a mortgage, debenture or legal charge; and

*b* indirect security – in the form of a charge over shares of the sponsor in the project company.

In addition to the foregoing, and depending on the nature of the project, where there are offtake contracts, lenders will also typically seek to take a security assignment of the offtake contracts. There could also be charges over project accounts, assuming that these were not already covered under the debenture. Owing to the current stamp duty and filing fee rates applicable in Nigeria, a great deal of time is spent structuring security arrangements in Nigeria, not just to ensure that lenders are adequately secured, but also to minimise costs. Current perfection costs for any security created over securities of private limited liability companies will typically be in the region of 1.375 per cent (assuming there is no legal mortgage of real estate). Where, however, the security package includes a legal mortgage over real estate, costs could rise to as much as 2.5 per cent of the amount secured.

Aside from adjusting the amount of security required, an additional layer of efforts deployed by parties to minimise costs typically includes adopting an 'upstamping mechanism'. This entails the payment of reduced or nominal perfection fees in the first instance based on a limited secured amount with trigger events upon the occurrence of which the lenders could then quickly perfect the security for the full amount and proceed to realise their security. While the upstamping mechanism is not without its risk, it should be noted that it is an increasingly popular tool employed by financiers and project developers alike. It is currently featured in Nigerian financing model documentation and it would be rare to find a project finance transaction in which the mechanism was not at least considered.

Aside from the foregoing and as noted above, direct agreements giving lenders the right to step into a concession or other project document are generally commonplace in Nigeria.

## VI BONDS AND INSURANCE

Generally, the issuance of general infrastructure bonds or project bonds to finance projects is relatively rare. The corporate bond market is arguably still in its early stages of development and bonds tend to be for general corporate purposes. Federal and state governments have, however, issued infrastructure bonds in recent times. These tend to be for greenfield projects or for refinancing brownfield projects originally financed in more traditional ways.

Bonds are more familiar within the payment security context and, as in many other jurisdictions, contractors and subcontractors are frequently required to provide advance payment guarantees and performance bonds in project finance and construction transactions. Documentation for bonds and payment guarantees tend to vary with the financial institutions involved but will generally not require that a judgment or an arbitral award be in place before a demand can be made or complied with.

Typically, in addition to payment securities, project finance documents frequently prescribe requisite insurance, which the sponsor of the project is mandatorily required to take out to de-risk the project. The particular risks in respect of which such mandatory insurance is required will normally vary with the nature of the project, with a focus on both construction-related risks and operational risks. Lenders are usually noted as first loss payees on such insurance policies.

## VII ENFORCEMENT OF SECURITY AND BANKRUPTCY PROCEEDINGS

Security documentation for a project finance transaction will normally include detailed provisions regarding rights of financiers and project procurers in the event of a default by the project sponsor. Enforcement rights tend to be consistent with international project finance practices and include appointment of receivers, powers of sale and, depending on the nature of the security, foreclosure rights. Also, as noted previously, the inclusion of step-in provisions are also increasingly popular in project finance transactions and lenders will normally have entered into a direct agreement with the project procurers to provide for instances of default by the project sponsors.

Outside bankruptcy, the simplest means of enforcement tends to be taking over control of the special purpose vehicle and executing the project through the enforcement of share charge security.

Share charges are generally less expensive to create than other forms of security. Share charges are also relatively easier to enforce than other forms of security interests, as these charges require in the main, the registration of documents with the Companies Registry. More often than not, as part of the security package, requisite documents will have to been signed in advance to be held in escrow. As in other jurisdictions, many other forms of security interests including step-in rights are also enforceable outside bankruptcy scenarios.

In the event of bankruptcy, typical priority payments such as taxes, employee salaries and pensions will normally rank ahead of unsecured debts and floating debenture debts. In addition, as in many other common law jurisdictions, fraudulent preference rules are applicable in Nigeria such that any transactions within the three months immediately preceding bankruptcy that have the effect of giving a creditor preference over other creditors will be deemed fraudulent and void against the trustee in bankruptcy.

## VIII SOCIO-ENVIRONMENTAL ISSUES

### i Licensing and permits

***Environmental impact assessment***

Under Nigerian federal law, the public and private sectors are precluded from undertaking or authorising projects without prior consideration, at an early stage, of their environmental effects.

Typically, prior to commencement of construction, the project promoter will need to undertake an environmental impact assessment (EIA) of the project in conjunction with officials of the Federal Ministry of Environment (FME) and state government environmental board officials. Upon the conclusion of the EIA, the FME will normally issue a certificate confirming that the EIA has been concluded and the construction of the project may commence. Separate EIAs will normally be required for expansions of the project. The EIA report produced as part of the EIA process will normally identify likely adverse effects from the project and propose measures for mitigating such adverse effects.

Aside from the EIA, there are no specific rules or regulations regarding socio-environmental issues and any additional obligations will typically be driven by rules applicable to financiers and investors in the project.

### ii Equator Principles

There are no specific legal requirements for projects to be subject to the Equator Principles in Nigeria.

However, in practice, projects will typically still comply with these and similar requirements based on obligations and requirements of investors and financiers in projects. Virtually all foreign lenders, private equity firms and other investors that finance projects in Nigeria are either directly or indirectly required to comply with the Equator Principles and thus will usually flow this obligation down to project sponsors. Also, the International Finance Corporation, one of the main champions of the Equator Principles, has invested in several Nigerian banks and in this capacity requires, as part of the conditions of its investments, that these banks uphold Equator Principles standards in their operations. These institutions, therefore, also flow down Equator Principles compliance obligations to project promoters.

It is also noteworthy that aside from the Equator Principles, Nigerian banks are also obliged to comply with the nine Nigerian Sustainable Banking Principles, which include the following:

*a* avoidance, minimising and offsetting negative impacts of business operations on environmental and local communities;
*b* respect for human rights in business activities;
*c* promotion of women empowerment through a gender-inclusive workplace; and
*d* implementation of robust and transparent environmental and social governance practices and assessment of clients in this regard.

Where projects are being financed by Nigerian banks, these principles will also need to be complied with by the project promoters, and non-compliance will normally be an event of default in applicable documentation.

## IX PPP AND OTHER PUBLIC PROCUREMENT METHODS

### i Public procurement

At the federal level in Nigeria, public procurements are regulated by the Public Procurements Act (PPA), which applies to all procurements by government, government ministries and agencies and entities that derive at least 35 per cent of their funding from the consolidated revenue fund. The PPA generally requires all procurements to be by open competitive bidding save for certain exceptional circumstances recognised and provided for under the PPA. For procurements in excess of $5 million, the approval of the Bureau of Public Procurement (BPP) and the Federal Executive Council will be required.

The requirement for open competitive bidding can sometimes be the cause of tension in relation to project finance transactions where the project is initially developed on an unsolicited basis based on a cold approach of the procuring entity by the project sponsor. Even in such circumstances there are no general exceptions from the requirements for open competitive bidding and the procuring entity is still required to invite counterproposals from third parties.

Public procurement matters in Nigeria are regulated by the BPP. The BPP has a nine-step process for seeking redress in relation to public procurement matters. The process entails an initial complaint to the accounting officer within the relevant procuring entity, which will review the complaint and give a verdict within 15 working days. Where the complainant remains dissatisfied, further recourse may be had to the BPP. Once a report is made to the BPP, the procurement process will be suspended and the BPP will notify all bidders accordingly. Where a complainant remains dissatisfied with the decision of the BPP, further recourse may be had to the Nigerian courts.

## X FOREIGN INVESTMENT AND CROSS-BORDER ISSUES

While not offering any specific incentives to foreigners looking to invest in projects in Nigeria, Nigerian law does guarantee free repatriation of capital imported into Nigeria for such projects.

To ensure that invested capital can be freely repatriated, foreign investors will need to have imported such capital into Nigeria through commercial banks licensed by the Central Bank of Nigeria to deal in foreign exchange (authorised dealers). Within two days of importation of such capital into Nigeria and conversion into local currency, the authorised dealer will normally issue a Certificate of Capital Importation (CCI). So long as such a CCI is issued to the investor at the time capital is imported to Nigeria, there will not normally be any issues with repatriation of such capital together with any interest thereon, whether in the form of interest on loans or dividend in respect of equity. It is, however, pertinent to note that CCIs are generally not transferable, thus where a foreign investor seeks to divest itself of its interest in a project to another foreign investor, it may not always be possible for the deal to be consummated completely offshore. To avoid these issues, foreign investors may sometimes invest in projects through offshore special purpose vehicles incorporated specifically for the relevant project, which can be sold as part of the divestment process, ensuring that there is no need for a transfer of CCIs.

Apart from free repatriation of investments, Nigerian law also expressly guarantees foreign investors freedom from expropriation. This is consistent with the right to property guaranteed in the Nigerian Constitution and with provisions of bilateral investment treaties, which Nigeria has signed with a number of countries.

The foregoing aside, certain sectors and industries in Nigeria are subject to local content regulation, which either restricts the extent of foreign investor involvement or guarantees preferential treatment to Nigerian individuals and businesses in the relevant sector. For instance, the Nigerian Oil and Gas Industry Content Development Act, which regulates local content in the oil and gas industry, provides that local companies are to be given preferential treatment in the award of certain contracts and licences in the industry.

## XI DISPUTE RESOLUTION

There are no special courts or dispute resolution mechanisms for project finance or construction contracts. Typically, these contracts will provide for arbitration as the principal means of dispute resolution, with only limited recourse to the court for interim injunctive reliefs pending conclusion of the arbitral process. Pursuant to the Arbitration and Conciliation Act, Cap A18, Laws of the Federation of Nigeria 2004 (ACA), arbitral awards are to be recognised as binding and enforceable by Nigerian courts baring any vitiating circumstances such as fraud, which make such awards liable to be set aside. As regards applicable arbitration rules commonly adopted, the ACA contains default rules, which may be specifically adopted by parties or will be incorporated in the absence of any express adoption. Parties, however, frequently adopt International Chamber of Commerce Rules of the London Court of International Arbitration.

Nigeria is party to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) and thus Nigerian courts will generally recognise and enforce foreign arbitral awards.

## XII OUTLOOK AND CONCLUSIONS

As noted in the introduction, the sheer size of the infrastructure gap in Nigeria makes it clear that, even in the best of times, the government alone cannot be relied upon to finance infrastructure development and significant amounts of private investment are required to support any attempts to bridge the infrastructure gap. This situation implies that for years to come there is likely to be growing interest and activity in the project finance space in Nigeria.

Although not quite at the appropriate stage of sophistication, and with scope for further development, the legal, regulatory and business framework for project finance in Nigeria does display some level of maturity and progress. Undoubtedly as deals continue to be consummated, the framework will mature further and the different aspects of the system will be tested.

Given the current difficulties occasioned by the slump in oil price, it is likely that even less government funding will be available for infrastructure development. Balance this lack of government funding against the backdrop of Nigeria's recent entry into the club of middle-income countries (by GDP), and confirmation of its status as one of the top 30 economies in the world, and it becomes clear that there is likely to be even more interest and activity in the project finance space in Nigeria.

## Appendix 1

# ABOUT THE AUTHORS

**STELLA DURU**
*Banwo & Ighodalo*

Stella Duru is the only female partner in the energy practice group of the law firm of Banwo & Ighodalo.

Stella specialises in commercial, oil, gas, power, construction and engineering law. With her experience in project financing, Stella leads teams involved in the financing deals undertaken by oil, gas and power companies. She obtained a law degree from the University of Lagos, Nigeria and was admitted to the Nigerian Bar in January 2001.

Stella is a member of the Nigerian Bar Association, the International Bar Association (Section on Energy, Environment, Natural Resources and Infrastructure Law), and the Association of International Petroleum Negotiators. She has extensive experience in all of her core areas of practice.

Stella has authored many articles in leading law publications and has delivered presentations on diverse subjects, including 'Renewable Energy through the Ages – Legal and Regulatory', presented in 2014 at the second annual REFSA conference in Johannesburg, South Africa.

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