

ADDRESSING LOCAL CONTENT LAWS WHILST CAPITALISING ON BURGEONING DEEPWATER EXPLORATION OPPORTUNITIES IN NIGERIA

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INTRODUCTION

- Nigeria has 37 billion barrels of crude oil reserves
- Offshore accounts for at least 80% of its total production
- IOC's rebalancing their portfolios towards the offshore
- IOC divestments attracting junior players that can attract International equity to develop assets
- New oil and gas discoveries by UK listed companies - Afren and Lekoil
- Relative stability of offshore production remains attractive
- 99 billion will be spent on floating production systems in the next 5 Years
- Projected spend represents a 138% increase over preceding 5 years

NIGERIA'S GROWING ROLE IN DEEP WATER EXPLORATION ACTIVITIES

FPSO's/FSO's in use in Nigeria are the following:

- The AKPO FPSO - Total Upstream Nigeria: Capacity of 2 million barrels of oil.
- ERHA FPSO – ExxonMobil: Capacity of 2.2 million barrels of oil.
- The AGBAMI FPSO – Chevron: Capacity of 2.15 million barrels of oil.
- USAN FPSO is owned and operated by Total.
- CAMAC Energy recently signed a contract for the FPSO Armada Perdana for its production operations in Nigeria.
- FPSO Armada Perdana owned by Bumi Armada: Capacity of 40,000 barrels of oil per day and storage capacity of 1.1 million barrels.

NIGERIA'S GROWING ROLE IN DEEP WATER EXPLORATION ACTIVITIES

- FPSO Trinity Spirit ex Independence in use at Express Petroleum's Ukpokiti field OPL – 108 operated by Sheba E & P Co.;
- Texaco's FSO Oloibiri in use at the Pennington/Middleton terminals – OML 88 & 86;
- Shell's FPSO Bonga in use at its Bonga field - OPL 212;
- Exxon Mobil's FSO Falcon in use at its Yoho field - OML 104;
- Total's FSO Unity in use at its Amenam field - OML 99;
- Shell's FPSO Sea Eagle in use at its EA shallow waters field - OML 79;
- FPSO Grey Warrior owned by Prosafe, on lease to Agip Energy for its Abo field - OPL 316;

NIGERIA'S GROWING ROLE IN DEEP WATER EXPLORATION ACTIVITIES

- FPSO Mystras owned by SBM, on lease to NPDC/Agip for its Okpono field;
- FPSO Sendje Berge owned by Bergesen, on lease to Addax Petroleum for its Okwori field - OPL 90;
- FPSO Knock Taggart owned by Fred Olsen on lease to Addax Petroleum in use at OPL 98;
- FSO Ailsa Craig on lease to Amni Petroleum for its Ima field - OML 112;
- FPSO Jameston in use at Cavendish's Obe field - OML 110 operated by NNPC/Trafigura;
- LPG FSO Escravos owned by Chevron Texaco located offshore
- LPG FSO Berge Okoloba Toru owned by Bergesen on lease to GlobalGas & Refining Co. located at Bonny River.

LEGAL & FISCAL FRAMEWORK

LEGAL REGIME:

▪ Law/ Regulation

- Section 39, Companies Income Tax Act (CITA)
- The Nigerian Content Act
- The Cabotage Act

▪ Regulators

- Department of Petroleum Resources (DPR)
- National Petroleum Investment Management Services (NAPIMS)
- Nigerian Maritime Administration and Safety Agency(NIMASA)
- Nigerian Content Development and Monitoring Board(NCDMB)

LEGAL & FISCAL FRAMEWORK

FISCAL REGIME

- 2% surcharge payable to NIMASA on every contract executed in the cabotage area
- 1% of every contract sum awarded to be deducted at source and paid into the Nigerian content fund
- 10% of the revenue from all operations to be retained in Nigerian Banks
- 5% of the value of any contract to be paid as penalty for breach or non-compliance with the Local Content Act.

LEGAL FRAMEWORK AND INLAND SHIPPING (CABOTAGE) ACT 2003

- **PRINCIPAL OBJECTIVE** - To increase indigenous participation in the Nigerian maritime industry, empower Nigerians to acquire vessels and increase Nigerian tonnage.

- **CABOTAGE INCLUDES:**
 - The carriage of goods by a vessel, or any other mode of transport, from one place in Nigeria or above Nigerian waters to any other place in Nigeria or above Nigerian waters either directly or via a place outside Nigeria.
 - The carriage of goods in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources of Nigeria in or Nigerian waters.
 - The carriage of passengers by vessel from any place in Nigeria or under Nigerian waters in relation to the exploration, exploitation or transportation of the mineral or non-living natural resources in or under Nigerian waters.
 - The engaging by vessel in any other form of marine transportation activity of a commercial nature within Nigerian waters and the carriage of goods or any substance within Nigerian waters whether or not the same is of commercial value.

CABOTAGE ACT KEY PROVISIONS

- Only vessels built in Nigeria, wholly owned and manned by Nigerian citizens may engage in coastal trade or Cabotage within the coastal, territorial, inland waters, or any point within the waters of the exclusive economic zone of Nigeria.
- Section 2: "vessel" includes any description of vessel, ship, boat, hovercraft or craft....used or capable of being used solely or partly for marine navigation and used for carriage on through or under water of persons or property without regard to method or lack of propulsion.
- Floating Petroleum Storage/FPSO expressly listed as eligible for registration in the Cabotage special register.
- Minister can issue restricted license to foreign owned vessels

CABOTAGE ACT KEY PROVISIONS (CONT'D)

The Act provides for a system of waivers whereby some or all three requirements of the Act may be waived in the following circumstances:

- Where no wholly Nigerian owned vessel is suitable and available to provide the services or perform the activity
- Where no Nigerian ship building Company has the capacity to construct the particular type and size of vessel
- Where no qualified Nigerian officers or crew are available for the specific positions needed

CABOTAGE ACT KEY PROVISIONS (CONT'D)

- In granting waivers priority is given to vessels owned by joint venture companies; i.e companies where Nigerians hold at least 60% of the company's shares free from any trust or obligation in favour of non Nigerians
- Waivers may thereafter be granted to vessels registered in Nigeria and owned by any shipping company registered in Nigeria and last to foreign vessels
- All foreign qualified vessels (for Cabotage) require a licence from the Minister to operate within the Cabotage area
- Every vessel involved in Cabotage is required to be registered in the Special Cabotage Register
- Penalties for the violation of the Act include fines up to NGN15M and forfeiture of the vessel. NIMASA has a specialized unit for enforcement
- NB 2% on contract sums on contracts performed by vessel in Cabotage

BAREBOAT CHARTER REGIME

- To foster Nigerian tonnage and encourage indigenous acquisition of vessels
- Allows foreign vessel on bareboat charter to Nigerian citizens for a minimum period of 5 years, which is under the full control and management of Nigerian citizens or a company wholly and beneficially owned by Nigerian citizens
- Chartered vessel must be registered in the Nigerian Ship Registry and fly the Nigerian flag for the period of the charter.
- The vessel would have the status of a Nigerian ship, however all issues relating to proprietary interests in the vessel would have to be referred to the original underlying registry of the vessel.
- EG: a sale or mortgage of the vessel can only be conducted through the original registry.

NIGERIAN OIL AND GAS INDUSTRY CONTENT DEVELOPMENT ACT (NIGERIA CONTENT ACT) 2010

OBJECTIVES

- Designed to increase local capacity and participation in the oil and gas industry
- Provides the legal and operational framework for the development of local (“Nigerian”) content
- The Act regulates the activities and bidding processes of companies operating within the Nigerian oil and gas sector and prescribes minimum levels of “Nigerian Content” for specific work categories
- The Act creates the Nigerian Content Development Board (the “Board”)
- The Board is responsible for pre-qualifying companies bidding for contracts in the industry and monitoring compliance
- Promotion of Nigerian content - major criterion for the award of licenses, interests or other operations
- Pre-qualification is stipulated for contracts exceeding US\$ 1,000,000
- Nigerian independent operators to have first consideration in all projects for which a contract is to be awarded in the industry

HIGHLIGHTS NIGERIAN CONTENT ACT

- Nigerian Content is defined as the quantum of composite value added to or created in the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilization of Nigerian human, material resources and services in the Nigerian oil and gas industry
- *Nigerian Companies*- incorporation in Nigeria and 51% equity held by Nigerians. Partnership with Nigerians is therefore desirable to take benefit of preferential treatment accorded to Nigerian companies
- Bid with Highest Level of Nigerian Content to be selected where bids are within 1% of each other at commercial stage /Nigerian indigenous company with capacity to execute project not to be disqualified where its bid does not exceed lowest bid price by 10%
- Insurable risks related to oil and gas business, operations or contracts are required to be insured through insurance brokers registered in Nigeria. NAICOM may give written consent to the engagement of foreign insurers and reinsurers after ensuring that local capacity has been fully exhausted
- International/Multinational Companies Working Through Nigerian Subsidiaries To Demonstrate Nigerian Subsidiaries' Ownership of a Minimum of 50% of Equipment Deployed

HIGHLIGHTS NIGERIAN CONTENT ACT

- Contracts with budgets exceeding \$100M must contain a Labour Clause stipulating minimum percentage of Nigerian labour
- 1% of every contract sum to be paid to Nigerian Content Development fund
- Only services of Nigerian legal practitioners and Financial institutions to be retained

UPDATE ON LOCAL CONTENT POLICY – COMPLIANCE CHALLENGES

- Section 41(2) regarding the requirement for 50% asset ownership by Nigerian subsidiaries of international companies
- *“International or multinational companies working through their Nigerian subsidiaries shall demonstrate that a minimum of 50% of the equipment deployed for execution of work are owned by the Nigerian subsidiaries”*
- Finding the right Nigerian partners with financial capacity to take up 50% stake on commercial terms
- The Board’s subjective application of the Act has resulted in regulatory uncertainty
- The Board is suspicious of Cabotage bareboat arrangements

GUIDELINES AND POLICY STATEMENTS FROM THE BOARD ON COMPLIANCE WITH THE LOCAL CONTENT ACT

The Board has developed a model and approved a precedent for 50 % equipment ownership by a Nigerian Subsidiary based on the following minimum criteria:

- I. Existence of a Nigerian subsidiary (which is a Nigerian Company under the NCDMB Act).
- II. The Nigerian subsidiary must own at least 50% of the equipment, or a satisfactory plan for it to own 50 % of the equipment.
- III. Ownership or plan to transfer ownership must be in writing, legally binding, credible, and verifiable by the Board.
- IV. Ownership or agreement to transfer ownership shall not be predicated on impossible or dodgy conditionalities. All conditionalities or encumbrances based on 3rd party interest such as banks or financiers shall be submitted to Board for verification.
- V. A plan to transfer ownership shall take place during the life cycle of the contract for which the equipment is being imported.
- VI. Where the Board is giving approval based on a plan to transfer ownership, the approval will be provisional, normally for a period of one year, renewable upon satisfactory compliance with the terms of the agreement for the transfer of ownership.
- VII. The Board will not allow round tripping of ownership whereby agreement is entered with the foreign vendor or parent company to transfer ownership of asset/equipment after the life cycle of a contract. Except where the Nigerian shareholders (who shall have the first right of refusal to purchase the equipment) have declined interest in taking up the foreign equity interest, foreign shareholder(s) shall not be allowed to have the first option of buying back the equipment after the contract.

CORPORATE STRUCTURES FOR COLLABORATING WITH LOCAL PARTNERS IN THE AREA OF OWNERSHIP OF ASSETS DEPLOYED IN THE OIL AND GAS SECTOR

Asset Ownership

- The asset owning company incorporated offshore Nigeria
- A local non-asset owning company (operating company) incorporated in Nigeria with 51% Nigerian shareholding and 49% foreign interest
- Operating company holds an initial 10% equity in the asset owning company which is increased progressively to 50% over the life cycle of the contract
- Foreign partner loans Nigerians funds for acquisition of stake on commercial terms and at arms-length basis and secures loan with call and put options and preference shares arrangements

Capital Contribution Model

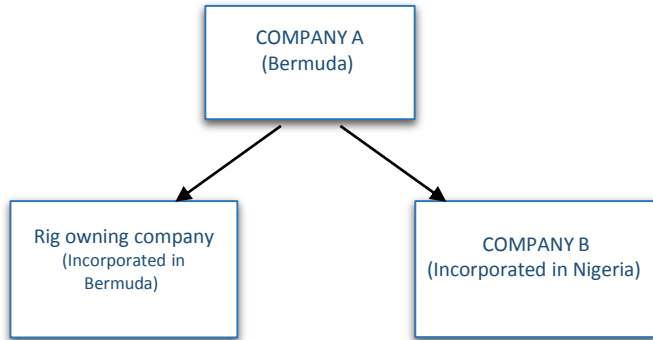
- A special purpose vehicle to carry out a project or projects registered in Nigeria
- Foreign partner contributes 50% of the asset (FPSO) to the SPV and provides a loan to Nigerian Partner(s) to acquire 50% shares of the SPV
- The loan is secured with call and put options and preference share arrangements

Joint Venture Company

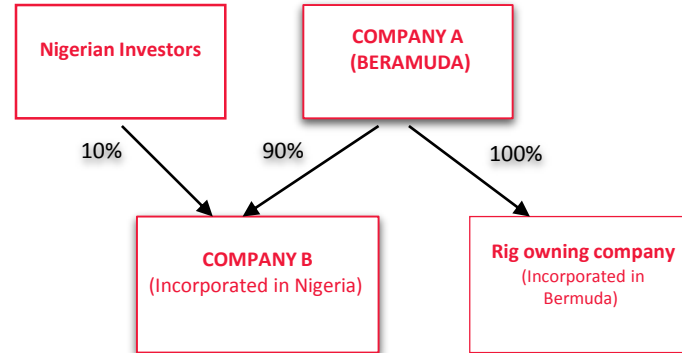
- A joint venture company is registered in Nigeria owned EG: 60% by Nigerians and 40% by foreign partner
- The relevant asset is owned by the joint venture company
- The foreign partner funds the local partner's acquisition and secures the loan through mechanisms that would not run foul of the local content legislations

POSSIBLE STRUCTURES – ASSET OWNERSHIP

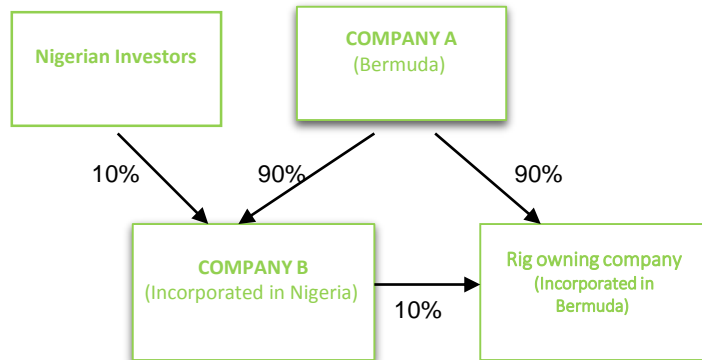
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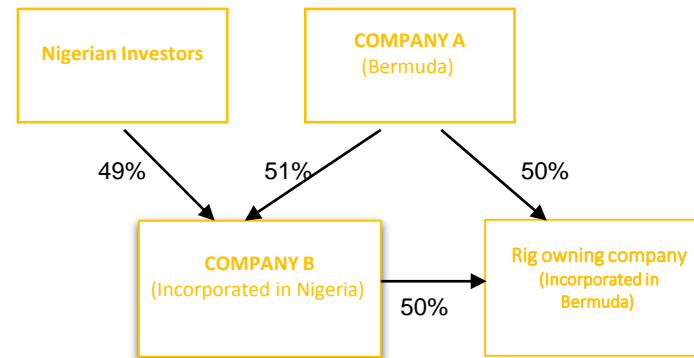
Step 1



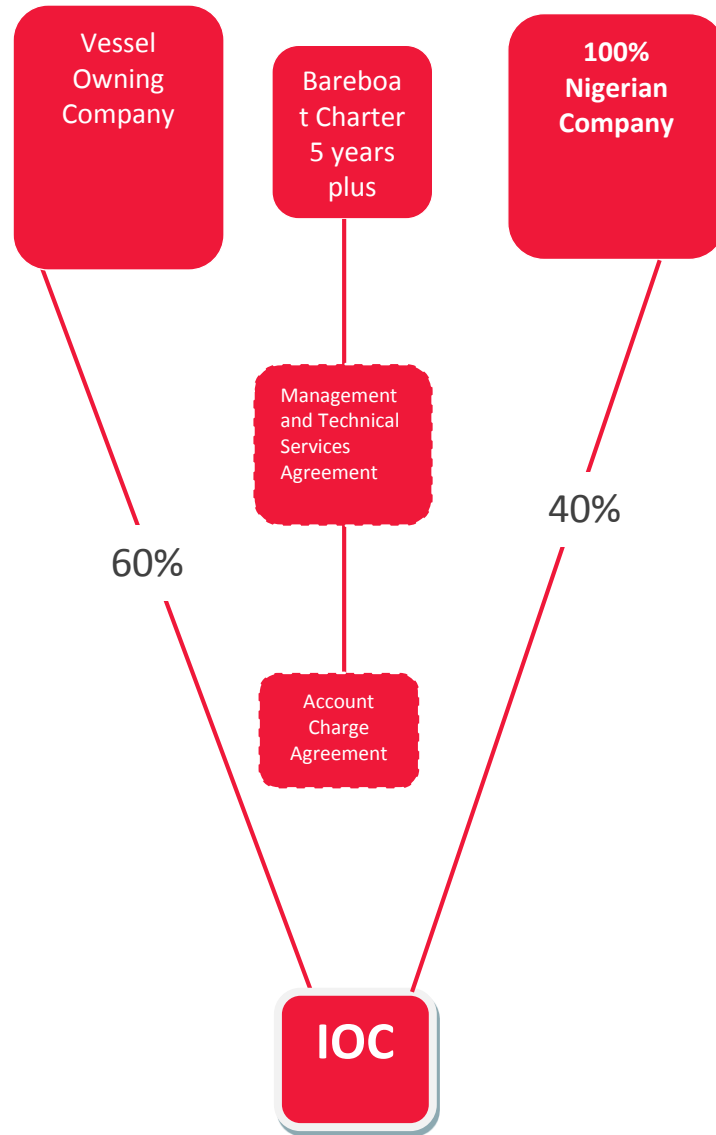
Step 2



Step 3



A TYPICAL BAREBOAT STRUCTURE



- The Contractual Framework Includes:
Bareboat Charter Agreement Including termination rights

Cooperation agreement envisaging a tri-partite contractual agreement regulating management, operational support cash flows etc

Tripartite arrangement gives IOC comfort and the vessel owner privity of contract and opportunity to cure any defaults of bareboat charterer

Payments in nigeria are subject to a currency split of 60:40 (USD ;Naira)

Bareboat charterer may direct IOC to pay USD portion directly offshore to vessel owner

Fees may be secured further by account charge

Other contractual measures including offshore dispute resolution

CONTENT REQUIREMENT FOR FPSOs & FSOs

Activities	Description	Minimum Requirement
Fabrication and Construction	Storage tanks	80% tonnage
	Umbilicals	60% tonnage
	Risers	100% tonnage
	Subsea systems	60% tonnage
Health Safety and Environment	Site clean-up services	100% man hour
	Pollution control	45% Spend
	Fire and gas protection system service	50% man hour
	Catering services	100% spend
	Cleaning and laundry	100% spend
	Security services	95% spend
	Medical services	60% spend
	Other supporting services	85% spend
Marine Operations/Logistics	Pollution control	90% man-hour/spend
	Hook-up, commissioning, marine installation services	75% man hour
	Floating storage units	45% man hour
Installation, hook-up and commissioning	Installation of subsea package	60% man hour
	Subsea construction services	45% man hour
	Installation of subsea services	45% man hour
	Diving/ROV/submersible operations	75% man hour
	Marine services	65% man hour
Project Management and Consulting Services	Subsea services	45% man hour
	Construction, management and supervision services	80% man hour
	Project administration and management	80% man hour
	Legal consultancy	50% man hour
	Marine consultancy	50% spend
	Sub-surface consultancy (geological, geophysical and reservoir)	90% spend
	Health, Safety and environment consultancy	45% man hour
	Design consultancy (industrial and web design)	85% man hour
	General management and business development consultancy	80% spend
	Other consultancy services	55% spend
Pollution and pollution control works and consultancy	65% spend	

A PRACTICAL GUIDE TO APPROACHING THE BOARD

- Identify prospective Nigerian partner (s)
- Settle memorandum of agreement outlining plan to comply with local content rules
- Parties meet with the Executive Secretary (“ES”) of the Board to discuss their plan and obtain an informal approval
- There is no specific model /arrangement which must be followed
- Parties may be referred to the legal unit of the Board for further discussions or ES may give his clearance to the IOC to prequalify a company for a tender
- Process of ensuring compliance is continuous. Parties are recommended to continually update Board of progress in growing Nigerian equity in the deployed assets

CURRENT TRENDS TOWARDS COMPLIANCE WITH THE ACT

WHAT YOU NEED TO KNOW

Since the enactment of the Act there has been a lot of fluidity and dynamism among stakeholders in their efforts at compliance. The key area in which the NCDMB is insistent on full compliance is the ownership of the assets deployed in the upstream sector .

ATTITUDE OF THE BOARD

- The NCDMB maintains that there must be demonstrable ownership or a road map towards attaining 50% Nigerian equity in the assets deployed during the life cycle of a contract
- For smaller valued assets such as old specification jack up drilling rigs and barges, there appears to be insistence on demonstration of 50% Nigerian ownership

CURRENT TRENDS TOWARDS COMPLIANCE WITH THE ACT

- With higher capital intensive assets like FPSOs where the Hull and Topsides costs could exceed \$700million, the Board is willing to consent to a grant of a minimal percentage shareholding of 5-10% to Nigerians
- The Board is also willing to allow a company, which has shown genuine commitment to acquiring an asset with significant Nigerian equity participation, to bareboat charter similar or other vessels without subjecting same to the ownership requirements.
- A key consideration then is how to demonstrate to the Board the genuineness of the structure or arrangement submitted for consideration

FREQUENTLY ASKED QUESTIONS ON NIGERIAN CONTENT ACT

- Is there a specific model that the Board has provided to ensure compliance with the asset ownership requirement?
- ANS: the Board has provided a plan in which it expects to see Nigerian equity in any asset deployed increased to 50% over the life cycle of the contract. It is however willing to consider individual plans and structures
- How compliant are stakeholders in the sector with this asset ownership requirement?
- ANS: Almost all stakeholders are struggling to comply
- Has the Board commenced enforcement actions against defaulters?
- ANS: the Board has not commenced large scale enforcement but has threatened to do so soon
- Would the Board allow for foreign partners to loan its local partners the funds for acquisition of its stake in the assets and if yes what security is it willing to allow the foreign partners?
- The ES has stated that it does not disapprove of a loan to the local partners so long as it is devoid of any dodgy conditionalities, grants first option of purchase in favour of the foreign partner and round tripping of ownership.
- Would the Board consider a call option on the shares of the local partner a dodgy conditionality?
- The Board is not likely to do so if there is an equivalent put option in favour of the local partner?
- What sort of penalty is the Board able to impose against a supposed defaulter?
- The Board can fine a defaulter up to 5% of the value of the contract and terminate a contract which has been awarded. It can also refuse to prequalify a company for a proposed tender

FREQUENTLY ASKED QUESTIONS ON NIGERIAN CONTENT ACT

- If a company is deemed compliant does the NCDMB usually issue a formal letter of compliance?
- ANS: The NCDMB is not obligated under the Act to issue any formal letter of compliance to subcontractors but usually reviews the operators submissions and signs off on same
- What documents would the NCDMB typically desire to peruse before formal signoff on a proposed plan?
- ANS: The NCDMB has stated it would require to see board resolutions, financing documents and title documents. However most plans are conditional upon a successful tender
- If an asset has Nigerian ownership is the NCDMB able to seize it in war time and if so what remedies would a foreign partner have?
- ANS: Nigeria has extant regulations prohibiting the expropriation of foreign assets, although the NCDMB as well as other Government Agencies can seize detain or confiscate assets if in breach of certain regulations

EVALUATING PARTNERSHIP GAINS FOR INTERNATIONAL INVESTORS AND LOCALS

- Successful projects will require partnerships with Nigerians:
 - E.G. the Abang & Itut Satellite Field Development Project Platforms-designed and fabricated at Nigerdock Island Integrated Free Zone for Mobil Producing Nigeria.
- Structures like FPSO topsides, offshore platforms, buoys, subsea trees and pressure vessels are fabricated at Nigerdock and other Nigerian yards.

PARTNERSHIP - INTERNATIONAL INVESTORS AND LOCALS

INTERNATIONAL PARTNER'S PERSPECTIVE

- Partners to conduct due diligence on each other
- Identify exits before you enter
 - Consider pre-emption/transfer consents/call option/put option
- Ability to fund – Agree how to deal with a party's failure or inability to pay
 - Default transfer
 - Forced sale (to another Nigerian)
 - Dilution
 - Guarantees
- Governance:;clarify roles of respective partners especially for decision making
- Aligned profit objectives is helpful (long term vs. short term)
- Beware of building a JV around one person
- Disputes resolution: International arbitration in a neutral forum
- Fair agreements have the best chance of success

PARTNERSHIP - INTERNATIONAL INVESTORS AND LOCALS

- Local partner/risk sharing
- Local law requires Nigerian beneficial ownership
- Strategic alliance to gain an advantage
- Local expertise & influence
- Local partner contributes contacts

CONCLUSION

- Partnerships with Nigerians are key to exploiting opportunities
- There are commercial arrangements that can meet the local content rules and provide investor comfort in relation to the asset deployed
- Offshore oil and gas operations is the main focus for investment by the IOC's

THANK YOU

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