Securing Regulatory Stability for International Gas Commercialisation and LNG Projects: the Nigerian Experience

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To secure project viability, what are the main forms of investment and regulatory stability mechanisms adopted by host governments? What are the implications?

What are the constitutional, public interest or socio-economic limits to such ‘stabilisation’ framework?

To what extent can applicable international and domestic law and policy support such arrangements and at what costs? e.g. political, reputational, economic or peace and security
The $14bn Prelude project, led by Royal Dutch Shell, is the latest in a surge of new LNG capacity (FT.com)

2013 blockade of NLNG loading terminals at Bonny Island – after repeated demands to pay levies and charges
1. Introduction

**Fiscal and Material Risks/Changes**
- Political risks
- Regulatory uncertainties
- New laws and regulations
- Socio-political factors
- Force majeure and conflict resolution

**Gas Commercialisation Arrangements**
- Pipelines and LNG
- Capital Intensive
- Third Party Financing
- Host Government support
- Long-term duration and payback
- New markets emerging
- Special legislation and stabilization arrangements
- GTAs, EPCs, SPAs, etc.

**Upstream Petroleum licensing and Contracts**
- State ownership & control
- Concessions/Licenses/leases e.g. OML/OPL in Nigeria
- Production Sharing Contracts
- Risk Service Contract
- Pure Service Contract

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- Risk of host government expropriation (lawful or unlawful)

- International Petroleum Stabilisation Provisions
  - Freezing clause; Equilibrium and re-examination, hybrids

- Enacting contractual stability as *a special law*
  - Granting supremacy to the contract over current or subsequent legislative enactments
    - The Western Australian state government enacted the North West Gas Development (Woodside) Agreement Act in 1979
    - The Israel's Leviathan Project and ‘Gas Framework’
    - The Nigeria LNG (Fiscal Incentives, Guarantees and Assurances) Decree No 39 of 1990 as amended (NLNG Act)

- Safeguards against:
  - Infringement against property and investment interests
  - Inconsistent subsequent legislation enacted by the Host State
  - Any material adverse effect (MAE) or material adverse change (MAC)-
    - *Fiscal stability and protection of economic incentives*
2. The International Gas Industry and LNG Supplies

Global Gas Trade Movements 2016 (BP 2017)

- LNG trade to grow 7 times faster than pipeline gas trade, accounting for about half of all globally traded gas by 2035 (BP, 2017)
- Flexible LNG supplies can now be met by LNG volumes (i) that are uncontracted; (ii) redirected; or (iii) open to multiple destinations (IEA, 2016)
- Growing race for market share and limited capital investments
- 4th main supplier - Nigerian LNG market share at 7.2% (IGU 2017).
  - Produced 1.8MT less compared to 2015 due to feed-gas supply sabotage & maintenance
  - Remained resilient despite controversies and 2013 blockade
To remain competitive, resilient and sustain export revenue stream, Nigeria should efficiently address:

✓ Relevant trade-offs – administrative, economic, socio-political - cost and benefits of mitigating events
✓ Risks arising from demand-side shocks and trends in the global markets
✓ Rent-seeking and opportunism by both private, corporate and public stakeholders
Typical Gas Production and Supply Value Chain

**Upstream Petroleum (Gas)**
- Domestic Licensing and Contracts
- or
- External Suppliers

**Midstream Gas**
- Gas Processing - NGLs, LPG, LNG etc.

**Exploration and Production**

**Midstream Gas**
- Imports/ Domestic Wellhead Sales

**Energy Distribution and Consumers**
- Domestic Gas Transmission
- Gas-fueled Power Generation
- International Markets
- Local Distribution
- Industrial Users

- Export- LNG, FLNGs, NGLs etc.
- Wellhead Sales
- International Markets
- Local Distribution
- Industrial Users

- Upstream Petroleum
- Gas Processing - NGLs, LPG, LNG etc.
- Midstream Gas
- Exploration and Production
- Midstream Gas
- Energy Distribution and Consumers
Three main models for LNG export projects:
(i) Project Company; (ii) Tolling Company; (iii) Unincorporated Joint Venture; (iv) integrated project model

**The Project Company Model:**

- LNG project assets and liabilities confined to a separate company. The shareholders contribute significant equity.
- NLNG’s Project Company model—
  - Nigerian National Petroleum Corporation (NNPC) (49%); Shell (25.6%); Total (15%) and Eni (10.4%).
A supply chain held together by law, regulation, contractual obligations and investments.
INTEGRATED (IJV) PROJECT STRUCTURE (No Project Financing)

1. Joint Venturers form PROJECTCO
2. PROJECTCO owns and finances LNG Plant (together with or separate from Concession)
3. PROJECTCO liquefies its gas
4. PROJECTCO sells LNG to Buyer(s)
5. Absent project financing, Buyer(s) pays PROJECTCO

Joint Venture Agreement
Shareholders Agreement

Concession and Liquefaction

Joint Venture Company ("PROJECTCO")

LNG Ship-owners (DAP/DAT)

LNG BUYER

LNG SALES

LNG BUYER

LNG Ship-owners (FOB)
INTEGRATED (IJV) PROJECT STRUCTURE (with Project Financing)

1. Joint Venturers form PROJECTCO
2. PROJECTCO owns and operates LNG Plant (together with or separate from Concession)
3. 3rd Party loan(s) to PROJECTCO to finance LNG Plant
4. PROJECTCO liquefies its LNG
5. PROJECTCO sells LNG to Buyer(s)
6. Buyer(s) pays Trustee
7. Trustee makes loan payments, pays other costs and distributes residual to PROJECTCO
MERCHAND "Buy-Sell" Structure

1. LNGCO owns & finances LNG Plant (separate from concession)
2. 3rd Party loans provided to LNGCO via Trustee
3. Gas producers sell gas to LNGCO
4. LNGCO sells LNG to Buyers
5. Buyers pay Trustee
6. Trustee makes loan payments, pays all other invoices & pays residual profit/loss to LNGCO
3. The NLNG Project and the Nigerian Scenario

The Minister of Petroleum grants an Oil Exploration License (OEL); Oil Prospecting License (OPL) and Oil Mining Lease (OML)

- OEL - non-exclusive exploration rights - geological/ geophysical or aerial surveys
- OPL – exclusive right to explore and prospect for petroleum;
- OML - exclusive right to search for, win, work, carry away and dispose of petroleum for a renewable duration of 20 years.
  - Granted to an OPL holder who- (i) satisfied required OPL conditions; and (ii) finds oil in commercial quantities

NNPC/IOC JVs and JOAs

- NNPC (55%), Shell (30%), Elf (10%) and Agip (5%)
- NNPC (60%) and Chevron (40%)
- NNPC (60%) and Mobil (40%)
- NNPC (60%) Agip (20%) and Oando (20%)
- NNPC (60%) and Elf (40%) etc.

- PSCs e.g. NNPC/Mobil PSC
- Marginal Field Concessions/ Sole Risk Concessions

Other JVs between NNPC and indigenous E&P Companies include:

- NNPC/NPDC (55%) and SEPLAT (45%)
- NNPC/NPDC (55%) and Neconde (45%)
Existing and planned LNG and pipeline systems
The NLNG Project - total est. investment/costs US$9.348 billion

- 6 trains- 22 Million Tonnes Per Annum (MTPA). A proposed 7th train.
- 5 MTPA of NGLs (LPG and Condensate) from 3.5 Bcf/d of natural gas intake
  - FID reached in 1995, first shipment to Spain etc. in 1999
- First set of contracts completed on DES basis
- 23 ships on long-term charter for its six-train operation.
- Loading at NLNG Terminal in Bonny on for ex-ship deliveries to offtakers.
- Backed-up by the military government decrees 1990/93 (now NLNG Act)
- Pays Companies Income Tax applicable to all registered companies
- Financing closure in 2002
  - Shareholder balance sheets and equity interests.
  - Last 3 trains- lenders giving security for the loan over the whole liquefaction project.
- Volumes contracted to offtakers e.g. project sponsors not linked to any specific destination
- Democratic governance began 1999.
- Location – Niger Delta, Bonny Island – volatility and socio-political risks
- Nigeria signatory to 30 BITs including Italy, France and Netherlands
NLNG Investment and Regulatory Stability Provisions

The NLNG Act Guarantees-

- Pioneer Status under the *Industrial Development Income Tax Relief Act*
- Tax holidays for three to five years
- Dividends distributed during the tax relief period are exempt from withholding tax; capital expenditures incurred during the pioneer period are tax deductible

- Fully deductible Interest on loans for tax purposes
- *Exemptions from all customs duties, levies, charges and imposts of a similar nature; pre shipment inspection of imports waivers*
- No export duties, taxes or other duties, levies, charges or impost of a similar nature shall be payable or imposed
- Guarantees, Assurances and Undertakings shall be in effect throughout the lifespan of the venture
- The company and its shareholders shall not be subject to new laws, regulations, taxes, unless those generally applicable to companies incorporated in Nigeria
- The Government ‘*binds itself not to amend the fiscal regime except with the prior written agreement of the shareholders*’
NLNG Investment and Regulatory Stability contd.

- The Government ‘agrees to ensure that these Guarantees shall not be suspended, modified or revoked during the life of the Venture, except with the mutual consent of the Government and shareholders’

- The National Shipping Policy Act (NPA) 1987 made inapplicable to the NLNG and its contractors, subcontractors, customers, or any shipping concern involved with the company's trade in LNG
  - NPA provides for payment of 2% of earnings from “every shipping company”
  - The Nigerian Maritime Administration and Safety Agency (NIMASA) Act 2007 repeals NPA and adopts similar provisions
  - NIMASA Act applies to both Nigerian ships and Ships with foreign flags
  - exemptions from levies to only “…warships and military patrol ships”.

NIMASA’s maritime, cabotage and coastal administrative role

- NIMASA Act 2007
  - Agency entitled to 3% of gross freight, earnings on all international inbound and outbound cargo from ships or shipping companies operating in Nigeria

- Merchant Shipping Act 2007

- Coastal and Inland Shipping (Cabotage) Act 2003.
The NIMASA-NLNG controversy:

✓ 2007- NIMASA demands statutory levies and charges from NLNG- 3% of the gross freight on international in-bound and out-bound cargo ships. – Cabotage Surcharge of 2% on the amount on any contract performed by NLNG vessels.

✓ NLNG declines, citing the NLNG Act guarantees and protection.

✓ Mediation attempts by the National Assembly and Minister of Transportation unfruitful.

✓ 2010- NIMASA seeks Federal High Court (FHC) determination on applicability of the NIMASA Act and Cabotage Act on NLNG; liability to pay the demanded freights and charges, and constitutionality of the NLNG Act to the extent of its exempting NLNG Ltd. from paying new statutory taxes and charges.

✓ 2013- case withdrawn and NIMASA’s agents executed a blockade of 3 NLNG chattered vessels, in-bound towards the Bonny Channel.

✓ a 21-day ultimatum issued by local maritime workers to the Federal Government of Nigeria to compel NLNG’s compliance.

✓ NLNG **pays US$20 Million “under protest” and NIMASA ends the blockade**

✓ NLNG sought the FHC’s decision on the applicability the NIMASA levies and legality of the blockade.

✓ 2017- FHC held NIMASA’s blockade for the purpose of enforcing compliance against NLNG was wrong - the NLNG is not subject to pay NIMASA the levies, since **the vessels “are not involved in coastal trade or cabotage.”**
Niger Delta Development Commission (NDDC) v NLNG (2007)-

- the NDDC Act 2002
  ✓ NLNG a gas processing company in the Delta Area
  ✓ 3% of the NLNG’s total annual budget to NDDC

- The NLNG Act unconstitutional to the extent that it fetters the government’s legislative powers to make new laws.

- On Appeal, the Court of Appeal and Supreme Court upheld the validity of the NLNG Act and refused the NDDC’s claim

- Stakeholders and local groups called for an amendment of the NLNG Acts
  ✓ It is being considered by the National Assembly.
Section 44. (1) 1999 Constitution of the Federal Republic of Nigeria:

“...No moveable property or any interest in an immovable property shall be taken possession of compulsorily and no right over or interest in any such property shall be acquired compulsorily in any part of Nigeria except in the manner and for the purposes prescribed by a law that, among other things –

(a) requires the prompt payment of compensation therefore and

(b) gives to any person claiming such compensation a right of access for the determination of his interest in the property and the amount of compensation to a court of law or tribunal or body having jurisdiction in that part of Nigeria…”
4. Ensuring regulatory and investment climate stability

Protecting private (foreign) investments & property rights

- State sovereignty - sanctity of contracts and changed circumstances factor – relational contracts
- State’s can act in public, security and national interests
- BITs + Fair & Equitable Treatment rule
- Good faith, non-discrimination, adequate and just compensation
- Determining direct and indirect expropriation and damages when applicable
- Calculating appropriate compensation - (i) market value; (ii) book value (iii) discounted cash flow value and (iv) replacement value.

Local obligations and factors

- Constitutionality and rule of law
- Force majeure and dispute resolution mechanisms
- Politics – socio-economic and environmental factors
- Good faith, transparency and conciliatory approaches
The Israel Example

Israel’s $6.5bn Leviathan offshore gas project:
- Led by Noble Energy (US) and Delek (Israel)
- One of the largest gas discoveries in the eastern Mediterranean region.
- Project to serve local and regional demands
- Project delays:
  - regulatory red tape
  - challenge in 2014 from Israel’s antitrust commissioner
  - political backlash from Israelis, accusing the government of giving investors too generous a deal at a time when gas prices are low

- Noble Energy and Israeli companies in the Leviathan consortium threatened to pursue claims in international arbitration if the country backs out of it.
- 2016- Supreme Court rules “stability” clause in Gas Framework unconstitutional. It promised pricing and regulatory stability for 10 years. The court inter alia suggested that any such guarantee should be the subject of a new law.
- The Israeli cabinet later approved a revised outline for gas regulation needed for development of Leviathan
- Noble Energy subsequently announced the eventual approval for the development of the Leviathan gas field.
Article 2 Nigeria-Netherlands BIT
Either Contracting Party shall, within the framework of its laws and regulations, promote economic cooperation through the protection in its territory of investments of nationals of the other Contracting Party. Subject to its right to exercise powers conferred by its laws or regulations, each Contracting Party shall admit such investments.

Article 3(1) & (4) Nigeria-Netherlands BIT
Each Contracting Party shall ensure fair and equitable treatment of the investments of nationals of the other Contracting Party and shall not impair by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals.

Notwithstanding the provisions of this Agreement, each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals of the other Contracting Party.
- **International Arbitration as a ‘safety-net’**
  - Liamco vs Libya - Kuwait vs Aminoil – CMS Gas Transmission Company vs Argentina - Sempra v. Argentina - Burlington Resources, Inc. vs Ecuador etc.
- **Determining expropriation by regulation**
  - "substantial deprivation“ affecting "fundamental rights of ownership" by investor
  - Indirect expropriation requires adverse effects plus proof of lost control of business operation or value of the business is "virtually annihilated".
- the stabilization clause doesn’t exclude **lawful sovereign powers**.
  - **Prohibits arbitrary alteration or abrogation by the State of its contractual obligation.**
- Nationalization in line with the public policy is non-discriminatory.
  - Requires payment of adequate compensation
  - Not a wrongful breach of the stabilization clause.
  - A ‘source of ‘liability to compensate’ the foreign investor

**Stabilization clauses implicitly require that nationalization should not have a ‘confiscatory’ character**

**Obligation to act in good faith and to compensate in case of breach**
- Permanent sovereignty over natural resources
  - *Foreign investors legitimate expectation counterbalanced by the State’s bona fide exercise of sovereign regulatory powers.*

- General international principles on the stability of contractual relationship between the Host State and a foreign investors:
  - The fair and equitable treatment (FET) rule;
  - The legitimate expectation rule; and
  - The umbrella clause provisions in BITs

- **Occidental vs Ecuador, LCIA Case No UN3467, Final Award of 1 July 2004**-
  - the tribunal held that “[t]he stability of the legal and business framework is an essential element of fair and equitable treatment”.
Legislating stability vs Contractual Pragmatism

- The Nigerian scenario
  - Some resolved and lingering legal and investment protection issues
  - NIMASA & NDDC laws are general application, public policy related and not *mala fide*
  - *NIMASA blockade seems irresponsible and an act of desperation*
  - *Should the NLNG investment incentives continue perpetually? NNPC owes JV cash calls upstream, investors withdrawing from proposed projects like OK LNG and Brass LNG*
  - *Securing investments without providing the needed stability tools??*
  - *Nigerian Constitution guarantees adequate compensation in cases of expropriation*

- For legitimacy and validity, stabilization provisions and arrangements:
  - *should not be in conflict with any constitutional and legislative powers*
  - *Unconstitutional and unjustifiable stabilisations should not receive the protection of international law*

- Stabilisation and re-examination provisions are rational tools for investment protection
  - *should explicitly recognise the rule of law, fair and equitable treatment of investors*
5. Conclusion

- Stabilisation and renegotiation provisions are integral to international petroleum arrangements.

- The peculiarities and dynamics of Gas production and supply requires firm commitments from resource owners and state control in the public interests.

- Generally, States have the inherent power(s) to take necessary regulatory measures.
  - Such measures must not be arbitrary or discriminatory.
    - Even where these measures diminish the value and proprietary interests of petroleum concessions and agreements, subject to the payment of just and adequate compensation and damages.

- Foreign investors must carry-out necessary due-diligence before committing to investments, while the state parties must remain ‘responsible’ and respect the rule of law.

- Parties should adopt an efficient conciliatory approach to resolving disputes and mitigating risks to stability.
THANK YOU FOR LISTENING!

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