AO2 LAW | Anaje Olumide Oke

2018 ENERGY OUTLOOK

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As we commence 2018, we thought to examine landmark events in the Energy space (i.e. oil, gas and power) that occurred in 2017 and offer some insight on what we expect in these sectors in 2018.

Highlights:

Upstream:

- Commencement of renegotiations of Production Sharing Contracts
- More investments in LNG projects
- Completion of another round of IOC divestments
- More compliance audits by the Nigerian Content Development and Monitoring Board.
- Implementation of Gas Flare Commercialisation Programme
- Completion of OB3 Pipeline and possibly the Egina project.

Downstream:

- Parallel pricing of Petroleum Products: Due to the continued increased cost of importation, the government in order to reduce subsidy payments to petroleum importers, would most likely adopt a parallel pricing regime for petroleum products. The parallel regime would enable the government owned stations to sell petroleum products at prices fixed by government while the petroleum importers may be allowed to sell petroleum products at prices profitable to them.

- More investments into LPG: The Nigerian Gas Policy has identified the huge potential of LPG in the following areas: Domestic, Power Generation, Autogas, Industrial, Agriculture, Industry and commercial. We believe with this opportunity, there will be significant investment drive towards the LPG market.

- Financing of Modular Refineries: We expect that the licensees of the modular refineries will be engaged in raising finance for their respective projects.

Power:

- Cautious investment in the sector due to proposed review of the privatisation of the sector.
- Potential Dispute between the Federal Government and the DISCOs as a result of the declaration of the eligible customer regime by the Minister of Power.
- Addition of 495MW to the national grid by Azura Edo-IPP. It is expected that full commercial operations of the plant shall commence on in Q2, 2018.
- Financial close for the construction of some solar plants.
- Commissioning of the Lagos Embedded Power Generation Project.

Oil and Gas

2017 was a year of reforms in the oil and gas industry. In what can be described a "Policy and Reforms Year", the government introduced a number of policy documents in the early part of the year. The government began with the release of the "7 Big Wins", a policy document which highlights the government's short and medium-term priorities to grow Nigeria's oil and gas industry between 2015 and 2019. The 7 Big Wins which had key focus areas such as: Policy and Regulation, Business Environment and Investment Drive, Gas Revolution, Refineries and Local Production to mention a few, set the tone for other policies such as the National Petroleum Policy and the National Gas Policy. With the approval of these policies, the Nigerian government has moved into the implementation phase. Also, the government embarked on reforms within the Nigerian National Petroleum Corporation ("NNPC").

Again, from the regulatory angle, in Q2 of 2017, the Nigerian Senate passed the Petroleum Industry Governance Bill ("PIGB"). The PIGB seeks to provide the governance and institutional framework for the petroleum industry is one of the 3 bills to be passed in Government's efforts to reform the industry. The other two bills are the Petroleum Industry Fiscal Reform Bill and the Petroleum Host Community Fund Bill which are currently before the National Assembly. The PIGB is yet to be passed by second arm of parliament – the House of Representative.

In the early part of 2017, the Nigerian Content Development and Monitoring Board ("NCDMB") also commenced audits on the compliance with remittance of the mandatory 1% deductions on contracts awarded in the industry. Also, the NCDMB launched a $200million intervention fund as a source of cheap loan to Nigerian oil and gas service providers that are contributors to the Nigerian Content Development Fund (NCDF).

In Q3 of 2017, the government introduced the Nigeria Gas Flare Commercialisation Programme (NGFCP),aimed at providing a commercial approach to the elimination of routine gas flareby mobilising private sector capital towards gas flare capture projects for the purpose of power generation amongst others. However, the NGFCP has slowed down on the basis that some of the NNPC JV Partners are yet to provide their gas commercialisation plan and there are also arguments as to whether the JV partners can be deprived of their rights to gas flared.

On the investment side, as a result of the decision to phase out the cash call JV funding mechanism, there was significant investment in the industry through the NNPC Alternative Funding Programme ("AFA"). About $2.4billion was raised through 3 major financing arrangements, the NNPC/SPDC JV financing of about $1billion termed "Project Santolina", NNPC/Chevron JV financing with transaction valued at $780 million termed "Project Falcon" as well as the NNPC/First E&P JV and Schlumberger funding arrangement of about $700 million.

There were a few investments in the gas sub sector in 2017. In Q3, Greenville signed a Gas Sale and Aggregation Agreement with the NNPC Total Exploration and Production JV which will see Greenville invest in about $850million in the construction of a mini-Liquefied Natural Gas Plant. Also in the latter part of 2017, Gas Company, Seven Energy announced the terms of its Capital Restructuring which will see listed company, Savannah Petroleum Plc, significantly investing into Seven Energy.

Unfortunately, the much talked about Marginal field bid rounds did not hold in 2017. However, in Q4, Shell Development Petroleum Company and its JV partners initiated another round of divestments of their on-shore assets.

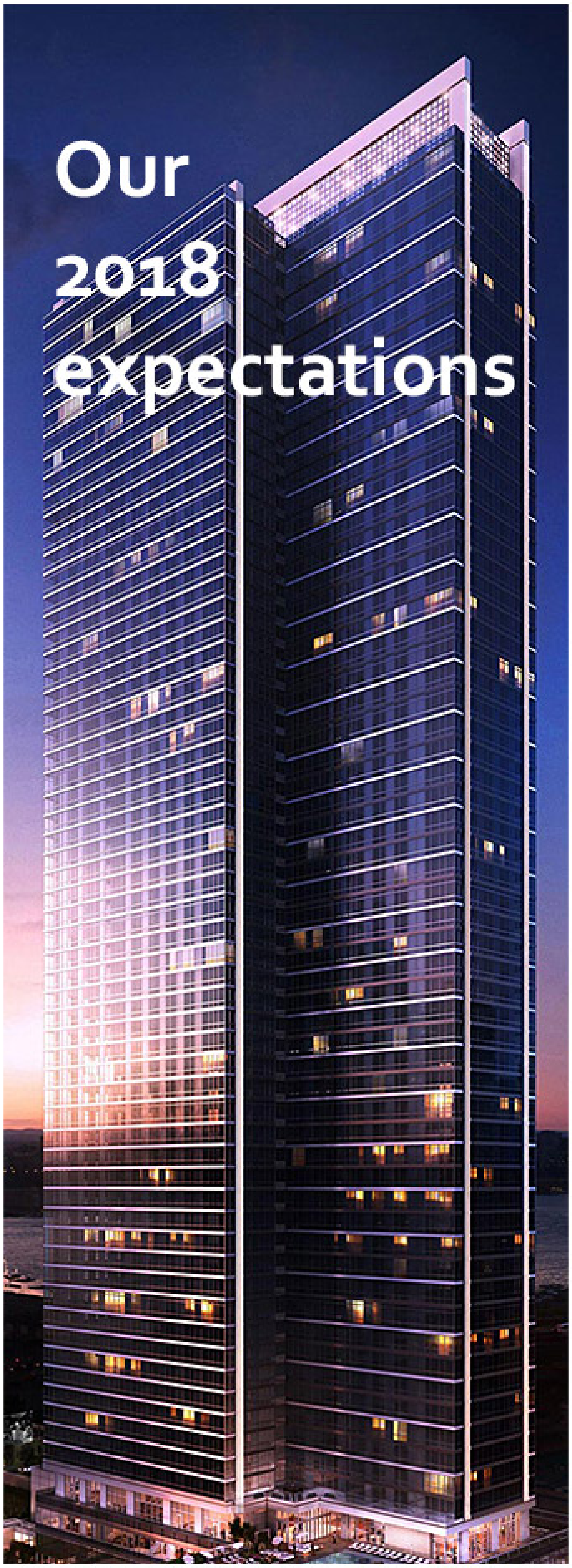
Downstream Sector

Investments:
The downstream sector of the petroleum industry witnessed investments by local and international companies alike through direct investments and portfolio investments. 2017 saw the N90billion acquisition of ExxonMobil Oil Corporation's stake in Mobil Oil Nigeria Plc by NIPCO Investments Limited. Also, Petrolex recently commissioned a 300 million litres capacity tank farm with capital outlay of about $330million. Furthermore, a few other international oil traders with local partners acquired some tank farms in the country. In order to boost refining capacity, the Nigerian government granted operating to 56 operators.

Pricing of Petroleum Products:

Further to the introduction of the Price Modulation system in 2016, the downstream sector of the petroleum industry was relatively stable in 2017. However, the partial liberalisation of the downstream sector with regards to price modulation has recently been facing challenges considering the fluctuations in the international market of the price of crude oil and the expensive cost of foreign exchange, the capped retail price of N145 per litre has continued to be less profitable for importers.

Our 2018 expectations



> ***Our expectation is that the government will adopt the revenue share renegotiation on the basis of the PSC Act.***

A

Renegotiation of Production Sharing Contracts (PSCs):

At the beginning of 2017, the Nigerian government announced its intention to revisit the fiscal terms of existing Production Sharing Contracts with International Oil Companies. The Nigerian government is of the view that the 1993 PSCs no longer reflect current realities and are no longer beneficial for government. In Q4 of 2017, the Federal Executive Council approved the proposed renegotiation of the 1993 PSCs. We expect that the renegotiation process will commence immediately therefore, there is the possibility that the Nigerian government will commence active engagement with its PSC counterparties in Q1 2018. The length of the negotiation will depend on the scope of the renegotiation. In the event the renegotiation is to be done on the basis of the Deep Offshore and Inland Basin Production Sharing Contracts Act ("PSC Act") which allows the Nigerian Government to adjust the revenue sharing formula in the PSCs whenever the price of crude oil exceeds $20 per barrel; the renegotiation period on this basis will no doubt be shorter when compared with a scenario where the basis of renegotiation is fiscal i.e. where there is change in the applicable royalty and tax rates. To renegotiate on a fiscal basis will entail amendment of the current laws such as the Petroleum Profit Tax Act and negotiation with the IOCs on the basis of stabilisation clauses under the PSCs which are designed to protect PSC counterparties from any material adverse effects of any changes in law, policy, directives, procedures etc.

Considering the length of time, a fiscal renegotiation may take, we do not expect that the Nigerian government will embark on this journey bearing in mind that the government is past its mid-term. Our expectation is that the government will adopt the revenue share renegotiation on the basis of the PSC Act.

B

Acquisitions:

We expect that the new round of the Shell Divestments should be completed in Q1 of next year subject to any regulatory approvals. Another major acquisition to look out for next year is the Petrobras divestments of its interests in OML 127 and 130. Petrobras in Q4 of 2017 has indicated its interests to divest its interests from the companies holding interests in the said assets. We expect Petrobras to commence engagement with interested bidders early 2018.

C

More NNPC Alternative Funding Arrangement ("AFA")?

Our expectation is yes however this may not be in the immediate term; We say this on the basis that some of the current AFAs are based on Short Term Oil and Gas Generation strategies as such are project/field specific. Therefore, identification of new projects by the NNPC and its JV partners will no doubt trigger the need for more funding. In addition to the AFA, the NNPC is also considering the contractor financing model for the construction of gas pipelines.

D

Forensic Audits by the NCDMB:

Following the general compliance audits by the NCDMB in 2017, it is expected that the NCDMB may conduct forensic audit on certain entities (operators and service companies) to determine the extent of compliance with regards to remittance of the 1% deductions on contracts to the Nigerian Content Fund.

E

Nigeria Gas Flare Commercialisation Programme (NGFCP):

It is expected that other IOCs apart from the Nigerian Agip Oil Company and Shell Development Company (who have already presented theirs) will present to the Ministry of Petroleum Resources, their Gas Flare Commercialisation Programme in order to move into the next phase of implementation of the plan. Also, issues around whether the government can allow non-JV partners to commercialise gas flared in view of the existing rights of the JV partners need to be resolved.

F

A few Mini-LNG Projects:

In 2018, we expect a few other agreements such as the Greenville/ NNPC Gas Sale and Aggregation agreement for mini LNGs. There are indications in the market that some indigenous companies will commence engagements in 2018 on the development of Mini-LNG Projects.

G

Marginal Fields Bid Round:

There seems to be great uncertainty regarding the bid rounds as the DPR has not given any definite position on when the bid round will hold. In our view, where the bid rounds are not held by Q1 2018, government may not be able to hold bid rounds in 2018 considering the fact that election preparations are due to begin in Q2 2018. All things considered, this may pose significant distraction for the government in the coming months.

H

Project Completion:

The following major projects have 2018 as their target completion dates:

- The Obiafu – Obrikom – Oben ("OB3") pipeline with a capacity of 2bcf/d;
- The Egina Project which will see the addition of 200,000bpd;

Power

The Nigerian Power Sector started out 2017 with severe liquidity challenges largely as a result of deficiency of revenue in the Nigerian Electricity Supply Industry to the tune of about N1 trillion because of debt across the power sector value chain. In order to boost liquidity, the Federal Government through the Central Bank of Nigeria provided a facility of up to N701bn to the Nigeria Bulk Electricity Trading Plc (NBET) to be disbursed over a 2-year period and repayable over a 10-year period. The purpose of the facility is to implement the payment assurance programme that guarantees energy payments for all electricity generation and gas supply companies to the national grid. In addition, to improve liquidity, the NBET decided to collect only 25% of its invoice from Electricity Distribution Companies ("Discos") through out 2017, and thereafter increase it over the course of 2018 to about 80%.

The liquidity challenges led to the introduction of the Power Sector Recovery Programme ("PRSP") in Q2 of 2017. The PRSP is a policy document on operational, governance and financial interventions to be implemented by the Federal Government of Nigeria ("FGN") over the next five years to restore the financial viability of Nigeria's power sector, improve transparency and service delivery and "reset" the NESI for future growth.

From a regulatory perspective, a major highlight of 2017 is the Eligible Customer Declaration pursuant to section 27 of the Electric Power Sector Reform Act ("EPSRA") by the Minister of Power. Further to this declaration, the Nigerian Electricity Regulatory Commission ("NERC") approved the Eligible Customers Regulations ("ECR") with effective date of 1 November 2017. Pursuant to the declaration by the Minister of Power, 4 categories of customers were declared eligible to purchase power directly from the generation companies other than the Discos.

On the investment side, the flagship power project the Azura Edo-IPP was completed with test synchronisation to the national grid commencing on the 20th of December 2017 of the first turbine with capacity of 159MW. Also, the Gas Sale Agreement between Seven Energy and the Calabar – IPP received the World Bank Parent Company Guarantee in the Q4 of 2017. Furthermore, the Federal Government signed Indemnity Agreements with the sponsors of a few solar power projects. In addition, we saw the US$115.8m acquisition of 75% equity stake in Oando Gas and Power Limited ("OGP") by Helios Investment Partners LLP and the subsequent change of name of OGP to Axxela Limited.

Power and 2018:

- Uncertainty regarding the proposed review of the privatisation of the power sector may be a dark cloud over the sector in 2018 as investors in the sector will be cautious.
- Potential Dispute between the Federal Government and the DISCOs as a result of the declaration of the eligible customer regime by the Minister of Power. Pursuant to this declaration, the Discos have declared Force Majeure pursuant to the Performance Agreement between them and the Federal Government. This issue if not resolved amicably has the potential of snowballing into a full-scale dispute between the Nigerian government and the DISCOs.
- Addition of 495MW to the national grid by Azura Edo-IPP. It is expected that full commercial operations of the plant shall commence on in Q2, 2018.
- Likelihood of the Solar IPPs that signed PPA with NBET in mid-2016, reaching financial close for the construction of solar plants.
- It is expected that the first phase of the Lagos Embedded Power Generation Project will be commissioned before the end of the first quarter of 2018.

The Energy Outlook is a publication of AO2 Law and does not in any way constitute legal advice. For further information on the foregoing, please contact Oyeyemi Oke (oyeyemi.oke@ao2law.com) with the subject: "2018 Energy Outlook"

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