ALONGE FUNMILAYO RONKE

ALNFUN001

MASTER'S COMMERCIAL LAW LLM

FINANCING OIL AND GAS PROJECTS IN NIGERIA

SUPERVISOR: TRACY GUTUZA

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I hereby declare that I have read and understood the regulations governing the submission of dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and this dissertation conforms to those regulations.

Signed by candidate

Signature: Signature Removed

Date: 14 February 2014

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LIST OF ABBREVIATIONS

AfDB- African Development Bank

AFC- African Finance Corporation

AIM- Alternative Investment Market

BPD- Barrel per Day

CBN- Central Bank of Nigeria

CCI- Certificate of Capital Importation

E & P- Exploration and Production

ECA- Export Credit Agency

ETAP- Enterprise Tunisienne d'Activités Pétrolières

GDP- Gross Domestic Product

HC- Host Country

IBRD- International Bank for Reconstruction and Development

IDA- International Development Agency

IFC- International Finance Corporation

IOC- International Oil Company

IIOC- Independent Indigenous Oil Company

IOPC- Indigenous Oil Producing Company

LSE- London Stock Exchange

MDB- Multilateral Development Bank

MIGA- Multilateral Investment and Guarantee Agency

NAPIMS- National Petroleum Investment Management Services

NIPC- Nigerian Investment Promotion Commission

NLNG- Nigerian Liquefied Natural Gas

NNDC- Niger Delta Development Commission

NNOC- Nigerian National Oil Corporation

NNPC- Nigerian National Petroleum Corporation

NOC- National Oil Company

NSE- Nigerian Stock Exchange

OEL- Oil Exploration Licence

OML- Oil Mining Lease

OPL- Oil Prospecting Licence

OPEC-Organisation of Petroleum Exporting Countries

PIB- Petroleum Industry Bill

PSC- Petroleum Sharing Contract

SPV- Special Purpose Vehicle

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ABSTRACT

Oil and gas is a major source of energy worldwide. Therefore its significance for Nigeria as a major producer cannot be understated. Notwithstanding the huge revenue derived from oil and gas, its contribution to the Gross Domestic Product (GDP) is minimal. This can be ascribed to the fact that there has been minimal indigenous participation in oil and gas projects as this has often been undertaken by the International Oil Companies (IOCs). To address this, the Federal Government awarded marginal fields and oil blocks to independent indigenous oil companies and enacted the Nigerian Oil and Gas Industry Content Development Act in 2010. This has been of great benefit to indigenous participation. However, these indigenous companies often encounter a major problem in accessing finance for their projects.

This dissertation examines the challenges to financing faced by the independent indigenous oil companies and how project financing will be the best means of financing a project by these companies.

1. INTRODUCTION

1.1 Introduction

Petroleum is a major source of energy worldwide and the foremost revenue earner for the Nigerian economy.[1] Oil and gas projects in Nigeria are usually undertaken by the Nigerian government through the Nigerian National Petroleum Corporation (NNPC), the International Oil Companies (IOCs) and the Independent Indigenous Oil Companies (IIOCs). The role of the IIOCs in Nigeria is very crucial because although it is arguable that the NNPC as the state-owned indigenous oil company can undertake the projects, it is necessary to have privately-owned indigenous oil companies performing similar roles as the NNPC as this increases the revenue accruing to Nigeria, encourages the local content capacity and further strengthens the oil and gas sector.

Financing of oil and gas projects has been a major challenge in Nigeria for the IIOCs. This can be attributed to inadequate legal and regulatory framework to effectively regulate and monitor the oil and gas sector. Other relevant factors include inability of local banks to finance long-term capital intensive projects, the difficult operating environment, inadequate technological expertise, perceived high risk of IIOCs by financial institutions, opacity and insufficient information on the petroleum sector and lack of credible institutions.[2] All these factors tend to deter indigenous participation, investment and the repatriation of profits from the sector in Nigeria.

In recent times however, there have been concerted efforts by the Nigerian government to encourage indigenous participation and consequently, the financing of oil and gas projects by the IIOCs. This can be seen in various measures undertaken comprising steps to support indigenous participation through the licensing of marginal fields to Nigerians, the enactment of the Nigerian Oil and Gas Industry Local Content Development Act in 2010, leasing of oil blocks to IIOCs and the

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[1] Y Omorogbe *Oil and Gas Law in Nigeria* (2001) 3.
Petroleum and oil and gas are used interchangeably.

[2] Joseph E. Aigboduwa and Michael D. Oisamoje *'Promoting Small and Medium Enterprises in the Nigerian Oil and Gas Industry'* European Scientific Journal January 2013 edition Vol 9, No.1.

drafting of the Petroleum Industry Bill (PIB).[3] However, these efforts have not resulted in the expected considerable progress. To an extent, indigenous participation has improved but the challenge of financing of IIOCs still persists.

Financing of oil and gas projects often poses a challenge because these projects are generally capital intensive, long-term and risky in nature. The cost of a project can be as much as $9 000 000 000.[4] The duration of most projects particularly in the upstream sector can range from about five to 50 years.[5] The Nigerian government can solely finance oil and gas projects without recourse to funders. The International Oil Companies (IOCs) are also capable of exclusively funding projects as done in production sharing contracts and risk service contracts or are in a much robust position than the IIOCs in getting funders. On the contrary, the IIOCs are often severely hindered by the lack of financing for the projects. Unlike the government and the IOCs, they often do not possess the huge financial resources required for oil and gas projects. They also face challenges in accessing funds from local financial institutions which are only capable of providing short to medium term funds as opposed to the long term funds required for the projects. Furthermore, their limited technical expertise and the level of risk involved in these projects puts them at a disadvantage in accessing funds from foreign financial institutions.

1.2 Project Finance

Financing of oil and gas projects can be achieved through project financing. Project financing according to the Black's law dictionary can be defined a method of

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[3] NEITI 'NEITI and the Petroleum Industry Bill' available at *http://www.neiti.org.ng/index.php?q=publications/neiti-and-petroleum-industry-bill*, accessed on 2 December 2013.
The PIB is envisaged to encourage financing when passed into law.

[4] The Dangote Industries Limited estimate the cost of constructing a Petroleum Oil Refinery & Petrochemical/ Fertiliser Plant at $9 000 000 000. $3 000 000 000 is to be by way of equity funding while the balance of $6 000 000 000 is financed by debt. Thisday Newspaper 'Bridging Nigeria's Infrastructural Deficit via Project Financing' Thisday Newspaper 25 September 2013, available at http://www.thisdaylive.com/articles/bridging-nigerias-infrastructural-deficit-via-project-financing/159827/, accessed on 8 February 2014.
About $2 200 000 000 was used in the NLNGPlus project for constructing 2 trains in 2002. NLNG 'Facts & Figures on LNG 2013', available at *http://www.nlng.com/publications/Facts_Figures_on_NLNG_2013.pdf*, accessed on 14 November 2013.

[5] Nigerian Eye 'Nigerian banks unable to fund large oil, gas deals' Nigerian Eye 23 May 2013, available at http://www.nigerianeye.com/2013/05/nigerian-banks-unable-to-fund-large-oil.html, accessed on 8 February 2014.

financing in which the lender looks primarily to the money generated by a single project as security for the loan.[6]

A comprehensive definition of project finance states that:

> *"The term "project finance" is generally used to refer to a nonrecourse or limited recourse financing structure in which debt, equity and credit enhancement are combined for the construction and operation, or the refinancing, of a particular facility in a capital-intensive industry, in which lenders base credit appraisals on the projected revenues from the operations of the facility, rather than the general assets or the credit of the sponsor of the facility, and rely on the assets of the facility, including any revenue-producing contracts and other cash flow generated by the facility, as collateral for the debt."*[7]

In other words, nonrecourse means that the debt granted is repaid mainly from the project rather than relying solely on its assets or the credit of the sponsor while limited recourse means the lenders can rely on the assets of a parent company sponsoring a project in special situations. [8] The level of risk involved may determine how much recourse will be made to the sponsors.[9]

Project financing is frequently used for long-term, capital-intensive and risky projects.

It is particularly used in developing countries to finance infrastructure projects, projects in the oil & gas sector and independent power projects in the energy sector among others.[10]

Project financing evolved through the centuries into a vehicle for assembling

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[6] Bryan Garner *Black's Law Dictionary* 9ed (2009) 707.
[7] Scott L. Hoffman *International Project Finance A Resource for Governments Sponsors Lenders Lawyers and Project Participants* (1998) 4-5.
[8] Hoffman op cit (n31) 6.
[9] Hoffman op cit (n31) 8.
[10] Hoffman op cit (n31) 24.

a consortium of investors, lenders and other participants to undertake projects that would be too large for individual investors due to the huge capital required for a long-term duration and the level of risk involved. Modern day project finance commenced in the 1970's due to the inability of governments particularly developing countries to continue financing infrastructural projects.[11]

A project comprises the sponsor(s) who coordinates the development of the project.[12] The sponsors create a Special Purpose Vehicle (SPV) otherwise known as the project company using equity or mezzanine debt. Basically, the cash flow of the project company is used to repay the loan while the assets act as guarantee to the lenders.[13] The project company has a separate legal personality which is distinct from its sponsors.[14] The project company ceases to exist after the completion of the project and its assets may be transferred to the parent company.

There are different participants involved in financing a project. They include: sponsors, project-company (borrower), contractor, financial Institutions, experts, advisors, lawyers, lenders, government, lessors, Insurers, suppliers, buyers, export credit agencies. The diverse participants in a project enable the project risks to be allocated to the parties who are in the best position to manage them.[15]

Although there are other means of financing a project such as corporate finance, project financing appears to be the preferred option.

Corporate financing can simply be defined as the planning, raising, investing and monitoring of finance in order to achieve the financial objectives of the company. It can also be defined as:

> *'That part of the theory of finance that is concerned with explaining the behaviour of companies in the following policy areas: capital structure, capital budgeting, dividends, taxation; and mergers and*

[11] Hoffman op cit (n31) 26.
[12] Hoffman op cit (n31) 42.
[13] Stefano Gatti *Project Finance in Theory and Practice: Designing, Structuring and Financing Private and Public Projects* (2013) 2.
[14] Ibid.
[15] Ibid.

acquisitions'. [16]

Usually, the board of directors, shareholders and senior management play an important role in corporate finance. They decide and plan how the funds should be raised. This can be through equity finance or debt finance or the utilization of both methods. Equity finance involves the offering of additional shares to existing shareholders in the company or offering of shares to new subscribers. Debt finance on the other hand encompasses the raising of funds by way of loans, bonds, notes, bills and debenture. Before a company can obtain debt financing, a financial institution usually assesses the ability of the company to repay the debt and any interest payable. This is usually done by examining the balance-sheet of the company.[17] The funds obtained are then used to achieve to achieve the project or set objective(s) of the company.

Despite the advantages of corporate financing, project financing is more suitable in financing oil and gas projects. It is often preferred by sponsors because of the effective allocation of the high level of risk involved and the access to the high capital required for a long period. In comparison, corporate finance is more appropriate for short-term projects with limited risks

Project finance is used to fund projects which are capital-intensive and large-scale in nature which may not be accomplished with corporate finance. Repayment is not based on the credit-worthiness of the sponsors but on the anticipated cash-flow of the project while the assets are held as collateral.[18] Therefore, important consideration is placed on the feasibility of the project and the risks involved. The cash-flow generated from the project is used to offset the debts and cover the operating costs or expenses. There is limited or no recourse to the project-sponsors in the repayment of the debt. The means of repayment in corporate financing on the other hand is based mainly on the balance sheet and good-will of the company although the feasibility of the project may also be taken into account.

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[16] Peter Moles and Nicholas Terry *The Handbook of International Financial Terms* (1997) 114.
[17] Hoffman op cit (n31) 11.
[18] Hoffman op cit (n31) 14.
Gatti op cit (n39*)* 2.

It should also be noted that risk allocation plays an important role in the choice of project financing. Risks are assigned to parties who are best-suited in dealing with and minimizing these risks.[19] Furthermore, project financing is in a better position to access foreign direct investment than corporate financing. It also provides better interest rates than would have been obtained under corporate finance.[20] Corporate financing often involves equity and debt financing required for the company's operations while project financing mostly comprises debt financing rather than equity financing.

The use of corporate financing for a project may also result in complications in decision making between the board of directors of a corporation and the investors of a project because usually the board of directors normally make most of the vital decisions. However in a project, the investors of a project would also want to make decisions concerning the project.

On the other hand, corporate finance may be advantageous in terms of reduced transaction costs. This arises because in corporate financing, the financing structures can be used for a variety of projects while financing structures in project finance are often tailored for a specific project which require monitoring and may not be suitable for subsequent projects and therefore likely to incur high transaction costs and require more time to conclude.[21]

Project finance is therefore appropriate for oil and gas projects undertaken by the IIOCs not only because of the risks, huge capital outlay and long-term nature of the projects but furthermore because it is unnecessary to examine the balance sheet of the IIOCs which are relatively new companies and may not be credit-worthy.

1.3 **A General Overview of the Nigerian oil and gas Sector**

Nigeria is located in West Africa. It has a population of about 170,000,000

[19] Gatti op cit (n39*)* 23.
[20] Hoffman op cit (n31) 18.
[21] Gatti op cit (n39*)* 22.

people.[22] Petroleum is a natural resource which Nigeria possesses in abundance and by virtue of it being an important source of energy required worldwide for different purposes, it occupies an important position in the world.[23]

Nigeria ranks among the ten largest producers of oil and gas in the world and is the largest producer of oil in Africa.[24] It has proven reserves of crude oil estimated at 38,500,000,000 barrels as at the 1st of January 2012.[25] It also has the largest natural gas reserves in Africa.[26] Based on the foregoing, it is not surprising that the main source of revenue for Nigeria is oil and gas.[27] By virtue of the Constitution of Nigeria and the Petroleum Act, the control and ownership of petroleum resources is vested in the state.[28]

The Nigerian petroleum sector is divided into the upstream, midstream and downstream sector.[29] The upstream sector is involved with the exploration, prospecting and production of petroleum. The midstream sector is concerned with the transportation of petroleum. This can be done by means of pipe-lines, tankers, vessels and rail. The downstream sector deals with the refining, sales and distribution of petroleum and is the sector that directly affects people.[30] The upstream oil sector is highly relevant due to its role as the first step in the process upon which the downstream process of refining and distribution are dependent. The Petroleum

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[22] Index Mundi 'Nigeria Demographics Profile 2013', available at *http://www.indexmundi.com/nigeria/demographics_profile.html*, accessed on 29 July 2013.
[23] Omorogbe op cit (n1) 3.
[24] Index Mundi 'Country Comparison Oil Production', available at *http://www.indexmundi.com/g/r.aspx?v=88*, accessed on 22 August 2013.
U.S. Energy Information Administration 'Overview data for Nigeria', available at *http://www.eia.gov/countries/country-data.cfm?fips=NI*, accessed on 2 December 2013.
U.S. Energy Information Administration 'Nigeria, the largest crude oil producer in Africa is a major source of U.S. imports', available at *http://www.eia.gov/todayinenergy/detail.cfm?id=3050*, accessed on 22 August 2013.
[25] The World Factbook 'Country Comparison :: Crude Oil-Proved Reserves', available at *https://www.cia.gov/library/publications/the-world-factbook/rankorder/2244rank.html*, accessed on 6 November 2013.
[26] KPMG 'Oil and Gas in Africa Africa's Reserves, Potentials and Prospects' available at *http://www.kpmg.com/Africa/en/IssuesAndInsights/Articles-Publications/Documents/Oil%20and%20Gas%20in%20Africa.pdf*, accessed on 2 December 2013.
[27] Organisation of the Petroleum Exporting 'Nigeria facts and figures' available at *http://www.opec.org/opec_web/en/about_us/167.htm*, accessed on 22 August 2013.
[28] Section 44(3) of the Constitution of the Federal Republic of Nigeria.
Section 1 of the Petroleum Act.
[29] NNPC Home, available at *http://www.nnpcgroup.com/Home.aspx*, accessed on 2 December 2013.
[30] NNPC FAQ, available at *http://www.nnpcgroup.com/PublicRelations/FAQs.aspx*, accessed on 2 December 2013.

Profits Tax Act (PPTA) is the applicable tax act for companies in the upstream sector while the downstream sector is regulated by the Companies Income Tax Act (CITA).

The exploration of oil in Nigeria commenced in the early 20th century.[31] The earliest legislation on Oil and gas was the Petroleum Ordinance of 1889. Subsequently, the Mineral Regulation (Oil) Ordinance 1907 was enacted. The latter legislation and the Nigeria Mineral Oil Ordinance (Colonial Mineral Ordinance No. 17) of 1914 provided that only British subjects and companies were to be granted licences and leases to explore for oil.[32] In 1956, oil was discovered in commercial quantity in Oloibiri, Bayelsa state by Shell BP (Shell D'Arcy) which was the sole concessionaire in Nigeria at the time.[33]

From the 20th century to the 1970s, the IOCs were the sole financers of oil exploration and production projects in developing countries including Nigeria.[34] They had concessions over large expanse of land with a long-term duration. In return, the concessionaire(s) paid a minimal sum of money as royalty to the Nigerian government. By the late 1960s and early 1970s, Nigeria had attained production levels in excess of 2 000 000 barrels of crude oil per day. During this period, Nigeria did not exercise any significant control and ownership over her oil resources.

However since the 1970s, Nigeria became an active participant in her oil resources and subsequently entered into joint venture agreements and production

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[31] Nigerian National Petroleum Corporation History 'International Directory of Company Histories', Vol.72. St. James Press, 2005 *Funding Universe*, available at http://www.fundinguniverse.com/company-histories/nigerian-national-petroleum-corporation-history/, accessed on 30 July 2013.

[32] Section 6 (1) (a) of the Nigeria Mineral Oil Ordinance (Colonial Mineral Ordinance No. 17) of 1914 provided thus:

> *"No lease or licence shall be granted except to a British subject or to a British company and its principal place of business within Her Majesty's dominions: The chairman and the managing director (in any) and the majority of the directors of which are British subjects."*

(Despite this provision, a German company was allowed to explore for oil in 1908).
A similar provision also existed under the Section 7 of the Mining Regulation (Oil) Ordinance 1907.

[33] NNPC History of the Nigerian Petroleum, Industry, available at http://www.nnpcgroup.com/NNPCBusiness/BusinessInformation/OilGasinNigeria/IndustryHistory.aspx, accessed on 30 October 2013.
Discovery of oil in commercial quantities occurs when at least 10,000 barrels of crude oil is produced per day.

[34] Hossein Razavi Financing 'Oil and Gas Projects in Developing Countries' Finance & Development June 1996, Volume 33, Number 2 at 2, available at http://www.imf.org/external/pubs/ft/fandd/1996/06/pdf/razavi.pdf, accessed on 24 June 2013.

sharing contracts with IOCs. Thus, Nigeria became a financer in her oil and gas projects.[35]

Nigeria was compelled to actively participate in her oil resources as a result of several reasons. These reasons comprised the United Nations (UN) General Assembly's Resolution No. 626 (VII) on the Right to Exploit Freely Natural Wealth and Resources adopted on 21 December 1952 and Resolution 1803 (XXII) on Permanent Sovereignty over natural resources adopted on 14 December 1962.[36] Her intention to become a member of the Organisation of Petroleum Exporting Countries (OPEC) in July 1971 was also a key reason.

The OPEC is an organization established for petroleum exporting countries with the principal aim of unifying the petroleum policies of its members.[37] In 1968, it adopted a Declaratory Statement of Petroleum Policy in Member Countries which recommended that member countries should where possible establish National oil companies (NOCs) in their respective countries in order to exercise sovereignty over petroleum resources, and to enable them directly undertake the exploitation of their oil resources for the benefit of their national development.[38] Therefore before Nigeria joined OPEC, it established a NOC called the Nigerian National Oil Corporation (NNOC) for increased participation in the Nigerian oil and gas sector. In July 1977, the NNOC was merged with the Federal Ministry of Mines and Power and metamorphosed into the Nigerian National Petroleum Corporation (NNPC).

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[35] Nigerian National Petroleum Corporation History *International Directory of Company Histories*, Vol.72 St. James Press, 2005, available at http://www.fundinguniverse.com/company-histories/nigerian-national-petroleum-corporation-history/, accessed on 30 July 2013.

[36] An excerpt of General Assembly Resolution 626 on the Right to Exploit Freely Natural Wealth and Resources provides thus:

> *"The right of peoples to freely use and exploit their natural wealth and resources is inherent in their sovereignty and is in accordance with the Purpose and Principles of the Charter of the United Nations.*
> *All member states to refrain from acts, direct or indirect designed to impede the exercise of the sovereignty of any state over its natural resources."*

An excerpt of General Assembly Resolution 1803 of 1962 on Permanent Sovereignty over Natural Resources (GAR 1803) states that:

> *"The right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interests of their natural development and of the well-being of the people of the state concerned."*

[37] OPEC 'Brief history', available at http://www.opec.org/opec_web/en/about_us/24.htm, accessed on 22 August 2013.

[38] Resolution XVI.90 Declaratory Statement of Petroleum Policy in Member Countries, available at http://www.jstor.org/stable/20690408, accessed on 24 August 2013.

From that period, the NNPC on behalf of Nigeria, entered into several joint venture arrangements and production sharing contracts with several oil companies. In 2011, its production rate was about 253 000 000 000 barrels per day (BPD).[39]

However since the discovery of oil in Nigeria and in spite of the huge proceeds generated from oil and gas, Nigeria has often been unable to fund its own share in joint-ventures. There have been allegations of mismanagement, corruption and lack of transparency in the conduct of NNPC's affairs which may be due to its exercise of commercial and regulatory roles.[40]

In the same vein, despite Nigeria's huge reserves of natural gas and its numerous advantages over oil including its being a cleaner source of energy and environmental friendly quality, usefulness in the generation of electricity and the possibility of its being the preferred energy resource of the future; little effort has been made to develop the production of natural gas commercially. The reverse is the case as natural gas is often wasted through the flaring of associated gas and thus, results in a loss of revenue for Nigeria.[41] Gas flaring is due to the inability to finance the production in this sector and further ensure the compliance of regulations prohibiting the flaring of associated gas.

Oil and gas projects in Nigeria have been mainly undertaken by the IOCs and the NNPC. The IIOCs have until recently, played a minimal role. There have been contractual arrangements such as concessions, joint ventures, production sharing contracts, and service contracts with IOCs including Shell, Chevron, Total, ExxonMobil, Eni, Addax Petroleum (Sinopec), ConocoPhillips, Petrobras, Statoil, Hydro, etc. There has been participation by the IIOCs including Seplat oil, Heritage oil, Famfa oil, Afren oil etc. They have been involved in joint ventures, production sharing contracts, marginal fields and concessions.

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[39] U.S. Energy Information Administration 'Analysis of Nigeria', available at *http://www.eia.gov/countries/analysisbriefs/Nigeria/nigeria.pdf*, accessed on 1 July 2013.

[40]. Charles McPherson & Stephen MacSearraigh 'Corruption in the Petroleum Sector' in J Campos & S Pradhan (ed) *The Many Faces of Corruption, Tackling Vulnerabilities at the Sector Level* (eds) (2007) 200–201, available at *http://sate.gr/nea/The%20Many%20Faces%20of%20Corruption.pdf#page=225*, accessed on 2 December 2013.

[41] Associated gas is natural gas which is normally found with crude oil in oil wells and may be flared when extracting the oil.

The advent of the IIOCs participation was commenced during the President Ibrahim Babangida's regime in which awarded licences to several IIOCS. This award was due to a policy shift to encourage indigenous participation and increase the reserve base of petroleum in Nigeria.[42] The IIOCs included Summit oil, Consolidated oil (Conoil), Yinka Folawiyo Petroleum Company Ltd, and Famfa oil. They were required to hold a maximum of 60 per cent interest in the concessions which were to be operated under sole risk.[43]

However, most of the awards resulted in failures because the allocations were not made based on the technical expertise and capacity of the IIOCs but were discretionary in nature.[44] Oil blocks were also awarded to 77 IIOCs through bidding rounds in 2005, 2006 and 2007.[45] Presently, only an oil block of the 77 awarded has commenced production.[46] The lack of access to finance has been portrayed as the major challenge of the IIOCs holding the oil blocks.[47] There are presently 173 oil blocks awarded, 90 are owned by the IIOCs while the IOCs own 80.[48] Nevertheless, it is discouraging to note that the IIOCs only produce six per cent of the total crude oil production and the IOCs produce 94 per cent.[49]

Due to inadequate technological resources, they may enter into agreements with IOCs who are the technical partners for exploration and production. Furthermore, they also have joint operating agreements with IOCs who undertake PSCs and JVs. For example, Famfa oil was allocated OPL 216 where it held 60 per cent participating interest and its technical partners Star Deep Water Petroleum (a subsidiary of Chevron Nigeria Limited) and Petrobras held 32 per cent and eight per cent participating interest respectively. It was a joint venture in which the IOCs acted as the technical partners for exploration and production.

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[42] Omorogbe op cit (n1) 167.
[43] Omorogbe op cit (n1) 164-170.
[44] Omorogbe op cit (n1) 167-169.
[45] Dayo Oketola 'Raising production level among indigenous oil operators' Punch Newspapers 31 October 2013, available at *http://www.punchng.com/business/energy/raising-production-level-among-indigenous-oil-operators/*, accessed on 8 February 2014.
[46] Ibid.
[47] Ibid.
[48] Vanguard Newspapers 'How we award oil Blocks - FG' Vanguard Newspapers 19 March 2013, available at *http://www.vanguardngr.com/2013/03/how-we-award-oil-blocks-fg/*, accessed on 8 February 2014.
[49] Ibid.

Recently there have also been divestments of onshore acreages by IOCs to IIOCs.[50] This has further promoted indigenous participation.

1.4 Objectives of the Dissertation

This dissertation seeks to discuss the challenges in financing oil and gas projects by the IIOCs in Nigeria and how project financing is the most preferable means of financing in view of the peculiar challenges faced by the IIOCS in Nigeria. This will be resolved in the light of existing legal, regulatory and contractual framework in the oil and gas sector and other related legislations.

This dissertation will examine the following issues:

- The role of the present Nigerian legislations and the legal environment in the financing of oil and gas projects especially for the IIOCs.
- The role of the financial Institutions, multilateral development banks, export credit agencies and the capital market in financing oil and gas projects.
- Legal and regulatory framework in Norway.
- Recommendations and proposals for IIOCs on financing oil and gas projects.

The focus of this dissertation is to examine the financing of oil and gas projects by the IIOCs. It considers the benefits of project finance for the IIOCs.

1.5 Structure

This dissertation has six chapters. Chapter one gives an overview of the Nigerian oil and gas industry. It also states the reason for the preference of project finance as

[50] Thisday Newspaper 'A New Vista for Nigerian Oil and Gas Independents', Thisday 29 October 2013 available at *http://www.thisdaylive.com/articles/a-new-vista-for-nigerian-oil-and-gas-independents/162873/*, accessed on 27 January 2014 .

the mode for financing oil and gas projects. Chapter two examines the legal and regulatory framework, contractual agreements and marginal fields in the Nigerian oil and gas industry. Chapter three discusses the risks involved in oil and gas projects. Chapter four addresses the ways of financing oil and gas projects. Chapter five examines the Norwegian legal framework for its upstream oil and gas sector. Chapter six which is the final chapter proposes possible recommendations and solutions for the financing of oil and gas projects by the IIOCs in Nigeria.

2. LEGAL, REGULATORY AND CONTRACTUAL FRAMEWORK FOR OIL AND GAS IN NIGERIA

2.1 Introduction

This chapter will examine the role of legislations and regulatory bodies governing oil and gas in Nigeria and the different contractual agreements for the exploration and production of oil and gas in Nigeria particularly with respect to IIOCs will be discussed. The importance of marginal fields and its role in increasing indigenous participation and revenue of the government will also be analysed. It will propose the challenges faced and the possible solutions to these issues.

The legal and regulatory framework for oil and gas in a country is made up of its national laws, regulatory bodies and International law. It goes a long way in determining the growth and monitoring the performance or effectiveness of the sector. The importance of the legal and regulatory framework cannot be underestimated as it greatly influences the level of investment to be attracted to the sector.

In Nigeria, there are several laws and regulatory bodies operative for the sector. Nonetheless, the sector performs below the standard expected compared with its contemporaries in other nations. This can be due to the fact that the laws are not in line with global trends in the oil and gas industry and the regulatory bodies are sometimes inefficient.

The contractual agreements for the exploration and production of oil in Nigeria are determined by different factors which are inclusive of the level of technology and financial resources.

2.2 Legal Framework

2.2.1 The Constitution

Section 44(3) of the Constitution vests ownership of oil and gas in the

government of Nigeria. It states thus:

> *'Notwithstanding the foregoing provisions of this section, the entire property in and control of all minerals, mineral oils and natural gas in under or upon any land in Nigeria or in, under or upon the territorial waters and the Exclusive Economic Zone of Nigeria shall vest in the Government of the Federation and shall be managed in such manner as may be prescribed by the National Assembly'.*

2.2.2 Petroleum Act and Petroleum (Drilling and Production) Regulations

The Petroleum Act 1969 and its attendant Petroleum (Drilling and Production) Regulations 1969 are the primary legislations governing oil and gas in Nigeria. It confers ownership and control of Petroleum in Nigeria on the State.[51]

They provide the basis for production and development of petroleum through exploration, prospecting and production. This includes providing rules for the issuance of oil exploration licences, oil prospecting licenses and oil mining leases which will be discussed subsequently.[52] The Petroleum Act also allows for marginal fields.[53] Its provisions are implemented or supervised by the Ministry of Petroleum Resources, NNPC and Department of Petroleum Resources.

2.2.3 Petroleum Profits Tax Act (PPTA)

The Petroleum Profits Tax Act imposes tax on income from petroleum operations on upstream companies in Nigeria. The charges are based on the profits made during an accounting period. The PPTA provides that the tax income on upstream operations is payable at the rate of 85 per cent of its chargeable profits for that period, or 65.75 per cent in the first five years of the company's operations in cases where the capital expenditure of the company is considered.[54] For Deep Offshore and Inland Basin PSCs, the tax rate is 50 per cent of the chargeable profits for the duration of the PSC.[55]

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[51] Section 1 of the Petroleum Act.
[52] Section 1 of the Petroleum Act.
[53] Paragraph 17 of the First Schedule of the Petroleum Act.
[54] Section 21(1) and (2) of the Petroleum Profits Tax Act.
[55] Section 3(1) of the Deep Offshore and Inland Basin Production Sharing Contract Act.

2.2.4 Deep Offshore and Inland Basin Production Sharing Contract Act

The Act regulates all production sharing contracts. It also governs the taxation of production sharing contracts. This Act gives incentives in the form of reduced fiscal rates to Deep Offshore and Inland Basin PSCs. The PPT rate is 50 per cent while royalty is payable by companies operating in the inland basin at the rate of 10 per cent while companies operating in deep offshore pay rates ranging from 0 per cent to 12 per cent.

2.2.5 Nigerian Oil and Gas Industry Content Development Act

This Act is otherwise known as the Local Content Act. It was enacted in 2010 to encourage indigenous participation in the oil and gas industry. It gives Indigenous companies in Nigeria priority in several areas including in the allotment of oil field licences and in projects where contracts may be granted in the oil and gas industry provided the companies possess the equipment, personnel and capacity to carry out the necessary work.[56]

Section 3 states that:

> *(1) Nigerian Independent Operators shall be given first consideration in the award of oil blocks, oil fields licences, oil lifting licences and in all projects for which the contract is to be awarded in the Nigerian oil and gas industry subject to the fulfilment of such conditions as may be specified by the Minister.*
>
> *(2) There shall be exclusive consideration to Nigerian indigenous service companies which demonstrate ownership of equipment, Nigerian personnel and capacity to execute such work to bid on swamp and land operating areas of the Nigerian oil and gas industry for contracts and services contained in the Schedule to this Act.*
>
> *(3) Compliance with the provisions of this Act and the promotion of the Nigerian Content shall be a major criterion for award of licences, permits and in any other*

[56] Section 3(1), (2) and 70 (c) of the Nigerian Oil and Gas Industry Content Development Act.

interest in bidding for oil exploration, production, transportation and development or any other operations in the Nigerian oil and gas industry.'

It aims to increase indigenous participation by encouraging the use of local materials and indigenous human resources. It also facilitates indigenous technological expertise through transfer of technology.

2.2.6 The Draft Petroleum Industry Bill

In order to correct some of the anomalies associated with petroleum laws and their regulatory bodies and ensure conformance with global practices on oil and gas, a Petroleum Industry Bill (PIB) was proposed. The Bill was drafted by the Oil and Gas Sector Reform Implementation Committee (OGIC) which was set up in 2007 because of the need to reform the oil and gas sector.[57] The PIB was drafted in 2008 and introduced to the National Assembly where it underwent several amendments and had several versions. To avoid confusion, a new draft bill was re-submitted to the National Assembly in 2012 for consideration prior to its passage and enactment as an Act.

The PIB provides a regulatory framework for the oil and gas sector. It seeks to stimulate the much-needed reform and enhance transparency and accountability. It proposes to harmonise the dispersed laws and address its numerous challenges. The objectives of the PIB include:

"(a) create a conducive business environment for petroleum operations,

(b) enhance exploration and exploitation of petroleum resources

[57] Omowumi Iledare 'An Appraisal of Oil and Gas Industry Reform and Institutional Restructuring in Nigeria', available on *http://www.iaee.org/documents/newsletterarticles/408wumi.pdf*, accessed on 3 December 2013.
The OGIC was originally set up in 2000 but was unable to complete its assignment.

in Nigeria and for the benefit of the Nigerian people,

(c) optimize domestic gas supplies, particularly for power generation and industrial development,

(d) establishing a progressively fiscal framework that encourages further investment in the petroleum industry while optimising revenues accruing to the Government,

(e) establishment of commercially oriented and profit driven oil and gas entities.

(g) create efficient and effective regulatory agencies.

(h) promote transparency and openness in the administration of the petroleum resources of Nigeria.

(i) promote the development of Nigerian content in the petroleum industry and

(k) attain such other objectives to promote a viable and sustainable petroleum industry in Nigeria." [58]

The Bill also proposes to repeal, review and harmonise 16 legislations regulating the oil and gas sector.[59]

Section 284 to 288 of the PIB seeks to promote indigenous

[58] Section 1 of the draft Petroleum Industry Bill.

[59] These include: the the Petroleum Act 1969 (PA), and all amendments, subsidiary legislation, regulations and instruments enacted under it; the Petroleum Technology Development Act 1973; the Associated Gas Re-injection Act 1979; the Petroleum Equalisation Fund Act 1989; the Oil Pipelines Act 1965;the Nigerian National Petroleum Corporation Act 1997, the Petroleum Products Pricing Regulatory Agency Act 2003; the Oil Terminal Dues Act, and the Oil in Navigable Waters Act 1968,The Nigerian Oil and Gas Industry Content Development Act 2010, the Deep Offshore and Inland Basin Production Sharing Contract Act, The Petroleum Profits Tax Act 1959.

participation.

The PIB also makes provision for the creation of Petroleum Host Community Fund to render financial assistance for the development of the petroleum producing communities. This will be useful in mitigating political risk. Risks will be addressed in chapter 3. The funds will be derived from all upstream companies which are to make a monthly payment of 10 per cent of its net profit.[60] This will assist in combating insecurity in the Niger-Delta region and inevitably lead to increased investment in the long-run.

Section 194 of the PIB provides for assignment, mergers and acquisitions. Section 194(1) deems the acquisition and exchange of shares of a licensee, lessee or production sharing or joint venture contractor as an assignment. Section 194(2) further requires that such assignments obtain the prior written consent of the minister for Petroleum. These provisions affirm the judgement held in *Moni Pulo v Brass Exploration Company Ltd.*[61] This case addressed the issue whether a share transfer amounted to an assignment in a company and if the minister's prior written consent was required for the share transfer. The facts of the case were that the Brass Exploration Unlimited (Brass Exploration) and Moni Pulo Limited (Moni Pulo) were counterparties to a joint operating agreement on Oil Mining Lease 114. In 2004, the Brass Exploration Unlimited assigned its 40 per cent interest to Petroleum Oil and Gas Group of South Africa Limited (PetroSA) with the consent of the minister. This assignment was by way of a share transfer to PetroSA. In 2011, PetroSA transferred the 40 per cent shares formerly held by Brass Exploration to the CAMAC Group without the prior consent of the minister as required under Paragraph14 of the First Schedule to the Petroleum Act and Regulation four of the Petroleum Drilling Regulations. On this basis, the Plaintiff filed an action that the prior consent of the minister was not obtained. The Court held for the Plaintiff that the assignment was invalid as the requirement of the Petroleum Act was not adhered to, despite compliance with the law governing the share transfer.

[60] Section 118 of the draft Petroleum Industry Bill.
[61] Moni Pulo v Brass Exploration Company Ltd (2012) 6 CLRN 153.

The Bill also supports indigenous participation. It gives preference to Indigenous Oil Producing Companies (IOPCs) with a low daily production rate. For example, there will no participation rights in such IOPCs. It equally favours IOPCs by granting OPLs which have been returned, revoked or cancelled.

The proposed PIB is also a source of concern to IOCs. The delay in its passage especially with respect to the proposed increase of the fiscal regime has caused a level of uncertainty among investors. This has led to a reduction in investments as there has been a wave of divestments of onshore assets by IOCs to mostly IIOCs or other IOCs. However, the IOCs have justified this move by stating that the divestments are to encourage indigenous participation and also enable them to move to deep offshore acreages which have attractive fiscal incentives and less prone to insecurity.[62]

2.3 Regulatory Bodies

2.3.1 Ministry of Petroleum Resources

The ministry is authorized by the Federal Government of Nigeria to introduce new policies for the oil and gas sector and administer the execution of approved policies.[63] It has several departments and agencies to which it delegates the execution of policies. Paramount among them is the Department of Petroleum Resources and the NNPC.

2.3.2 Nigerian National Petroleum Corporation

The NNPC is the NOC for Nigeria. It oversees the oil and gas industry and plays a vital role by representing the Nigerian government in

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[62] World Finance 'Oando's Nigeria oil and push', available on *http://www.worldfinance.com/markets/energy/oandas-nigerian-oil-and-gas-push,* accessed on 3 December 2013.
Joe Brock 'Analysis: Oil majors to stay onshore Nigeria despite grumbles', Reuters 8 August 2013 available on *http://www.reuters.com/article/2013/08/08/us-nigeria-oil-analysis-idUSBRE9770DN20130808,* accessed on 3 December 2013

[63] Federal Ministry of Petroleum Resources, available at *http://www.nigeria.gov.ng/2012-10-29-11-06-51/executive-branch/104-federal-ministry-of-petroleum-resources/184-ministry-of-petroleum-resources?showall=1&limitstart=,* accessed on 22 November 2013.

investments with IOCs. The preamble of the NNPC Act authorizes it to be involved in all commercial activities relating to the Petroleum industry.

It has 12 subsidiaries or strategic business units of which the National Petroleum Investment Management Services (NAPIMS) is in charge of managing Nigeria's investment and interests in the upstream sector of the oil and gas industry.[64] NAPIMS plays the role of partner in JV assets and is the concessionaire in PSC arrangements. However, the role of NAPIMS does not extend to being an operator neither can it be regarded as a regulatory body of the industry.[65]

2.3.3 Department of Petroleum Resources (DPR)

This is the regulatory arm of the Ministry of Petroleum Resources.[66] It has the legal duty to ensure that all laws, regulations and guidelines of the petroleum industry are adhered to including the monitoring of all activities performed under licences and leases. It is also responsible for the collection of royalties and taxes.[67] The DPR also executes the government's policies in the upstream oil and gas sector and grants the licences and leases for the exploration and production of petroleum.[68] In addition, it implements environmental laws.

2.3.4 Nigerian Content Development and Monitoring Board

The Nigerian Content Development and Monitoring Board implements the provisions of the Nigerian Oil and Gas Content Development

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[64] NAPIMS Profile, available at *http://www.napims.com/aboutus.html*, accessed on 22 November 2013.
NNPC FAQ, available at *http://www.nnpcgroup.com/PublicRelations/FAQs.aspx*, accessed on 22 November 2013.
[65] NAPIMS - Roles and Responsibilities, available at *http://www.napims.com/oversight.html*, accessed on 22 November 2013.
[66] Ibid.
[67] Department of Petroleum Resources 'Functions', available at *http://dprnigeria.org.ng/about-dpr/functions-of-dpr/*, accessed on 25 November 2013.
[68] Department of Petroleum Resources 'Roles of DPR – Upstream', available *at* *http://dprnigeria.org.ng/dpr-operations/upstream-regulation/roles-of-dpr-upstream/*, accessed on 25 November 2013.
Department of Petroleum Resources 'Licences and Permits', available at *http://dprnigeria.org.ng/license-permit/*, accessed on 25 November 2013.

Act.[69] It also has the duty of overseeing and organising the Nigerian content in the oil and gas sector. [70]

2.4 Contractual Agreements for Exploration and Production

Different contractual agreements exist in various countries for the exploration and production of petroleum. These agreements are usually made based on the owner of the petroleum resources. The needs of the parties, particularly the grantor are also taken into consideration.

By virtue of the Constitution of Nigeria and the Petroleum Act, the control and ownership of petroleum resources is vested in the state.[71]

In the Nigerian oil and gas industry, different contracts have been used for the exploration and production of oil and gas. These contracts usually take into account Nigeria's inability to provide sufficient funds, inadequate technical expertise and the need to promote indigenous participation.

The contracts include:

- Concession
- Joint venture
- Production sharing contract
- Service contracts

2.4.1 Concessions

A concession is an agreement between the government of the Host Country (HC) and an oil company whereby the HC grants rights to exploration, production and development of energy resources to the oil companies.[72] Concessions are further

[69] Section 5 of the Nigerian Oil and Gas Industry Content Development Act.
[70] Section 4 of theNigerian Oil and Gas Industry Content Development Act.
[71] Section 44(3) of the Constitution.
Section 1 of the Petroleum Act.
[72] Karen Makuch and Ricardo Pereira *Environmental and Energy Law* (2012) 209.

divided into two: traditional concessions and modern concessions.

- **Traditional Concessions**

Traditional concessions were the earliest forms of agreements between host countries and IOCs in respect of the exploration and exploitation of oil. They were popular in the first half of the 20th century. The parties to the concession were IOCs and the HC. The IOCs were usually given exclusive rights of ownership and exploration over all mineral resources discovered on the designated land.[73] Thereafter, the right to produce, market and transport the oil was also granted if petroleum was discovered. Consequently, the IOCs had the unlimited freedom to do whatsoever they wished in respect of the oil and gas discovered.[74]

The IOCs were required to pay certain costs and taxes for these rights. Usually, the rent for the concession was negligible and rarely was there any form of income taxation imposed until much later.[75] The quantity or weight of oil produced, rather than its value determined the royalties payable.[76] Often these concessions existed for a long period of time, for example 50 years and covered a large geographical area.[77] It has been stated that the rationale behind the use of this concession was the inadequate financial and technical resources of NOC's of most countries.[78]

This type of concession was also in existence in Nigeria. The first concession was granted to German Bitumen Company in 1908 for exploration in Ondo State but resulted in a failure. In November 1938, Shell D'Arcy Petroleum Development Company was granted the second exclusive concession for oil exploration.[79] This oil

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[73] Michael Likosky Contracting and regulatory issues in the oil and gas and metallic minerals industries Transnational Corporations Vol.18, No. 1 April 2009, available at *http:// http://unctad.org/en/docs/diaeiia20097a1_en.pdf*, accessed on 27 August 2013.
[74] Ernest E.Smith *'From Concessions to Service Contracts'* (1991) 27 Tulsa L. J. 493 – 515, available at *http://digitalcommons.law.utulsa.edu/tlr/vol27/iss4/3,* accessed on 24 August 2013.
[75] Omorogbe op cit (n1)39, where it was stated that payment in the Iraqi Agreement with the Khanaquin Oil Company in 1926 was four gold shillings per ton of crude oil produced and saved, and the agreement between Saudi Arabia and Getty Oil in 1949, the royalty payable was $00.55 per barrel.
[76] Ibid.
[77] Smith op cit (n70).
[78] Makuch and Pereira op cit (n53) 210.
[79] Shell 'History in Nigeria 1936-1979', available at *http://www.itll.com.ng/aboutitll/who-we-are/history/country/first-steps.html*, accessed on 27 August 2013.

exploration licence covered about 375,000 square miles but this was reduced in 1959.[80] After 1960, concessionary rights were also granted to other IOCs such as Chevron, Agip, Mobil, Texaco and Elf.[81]

The terms of these concessions were biased and benefitted the IOCs. Thus, they were phased out in the 1970s.[82] The nature of the concessions was also a major factor in the establishment of OPEC.

- **Modern concession**

The modern concession grants an oil company the right to explore, produce, market and transport the petroleum in a designated area for a fixed period of time.[83] The modern concession was analogous with the traditional concession in certain ways. For example, an oil company still retained the right to explore, produce, market and transport the petroleum. It mainly differed from the traditional concession in that the terms of the latter which were largely biased towards the IOCs, were removed or curbed. For example, the right granted was only over the oil produced ie it owned the oil only when it was extracted and had no right over the area of land where the oil was situate.[84] Also, the right was restricted to only a mineral resource in comparison with the old concession where the concessionaire had exclusive rights over all the mineral resources on the area of land.[85] The duration of the tenure and the size of the land area were also reduced.[86] The royalty, rent and tax paid were also greatly increased.

This type of concession can be categorized as licences and leases.[87]

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[80] Omorogbe op cit (n1) 17.
[81] NNPC 'History of the Nigerian Petroleum Industry', available at *http://www.nnpcgroup.com/NNPCBusiness/BusinessInformation/OilGasinNigeria/IndustryHistory.aspx*, accessed on 24 August 2013.
[82] Likosky op cit (n69).
[83] Jenik Radon The ABCs of Petroleum Contracts: License-Concession Agreements, Joint Ventures, and Production-sharing Agreements, available at *http://openoil.net/wp/wpcontent/uploads/2011/12/Chapter-3-reading-material1.pdf*, accessed on 15 August 2013.
[84] Omorogbe op cit (n1) 40.
[85] Ibid.
[86] Smith op cit (n69). .
[87] Francisco Parra *Oil Politics: a modern history of Petroleum* (2005) 9.

Similarly, Nigeria practised the system of modern concession. In the second half of the 20th century, there was a shift in Nigeria from the use of the traditional concession agreements to the modern concessions due to the minimal gains derived from the disproportionate terms of the former.

There was a vast difference between the terms of the old and modern concessions as the tenure of the latter is shorter, the designated area was smaller and a higher rate of tax and royalty was now paid.[88]

In Nigeria, the modern concession is applied through leases.

The Petroleum Act provides for licences and leases. Section 2 states that a license or lease may be granted by the minister of petroleum under the following conditions:[89]

- Oil Exploration Licence (OEL): OELs are usually granted for the exploration of oil.[90] The licence is for a year which can be renewed for another year. It covers an area not exceeding 5000 sq miles.[91] This licence is non-exclusive in nature and basically allows a number of companies to explore for oil in a specified area at the same time.[92] This can be done by way of preliminary surveys.[93] If a company discovers oil, it could then apply for an OPL.

- Oil Prospecting License (OPL): OPLs are for the exploration and prospecting of oil.[94] Unlike the OEL, it is a right granted exclusively for an initial and maximum duration of five years.[95] It usually covers an area not exceeding 1000sq miles.[96] If the licensee makes a

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Smith op cit (n70).
[88] Smith op cit (n70).
[89] Petroleum Act.
[90] Section 2(1) (a) of the Petroleum Act.
[91] Item 1 - 3, Schedule 1 of the Petroleum Act.
Regulation 2(2) (a) of the Petroleum (Drilling and Production) Regulations 1969.
[92] Ibid.
[93] Section 15 of the Petroleum Act.
[94] Section 2(1) (b) of the Petroleum Act.
[95] Item 5, 6 and 7, Schedule 1 of the Petroleum Act.
[96] Regulation 2(2) (b) of the Petroleum (Drilling and Production) Regulations 1969.

discovery of oil in commercial quantity, it may thereafter apply to the DPR for the OPL to be changed to an OML.[97] The licensee may be allowed to carry away and dispose of petroleum won during prospecting operations.[98]

- Oil Mining Lease (OML): This lease enables the holder to search for, win, work, carry away and dispose of petroleum over an area.[99] It is an exclusive right granted in respect of a maximum area of 500 sq miles and for a duration not exceeding 20 years.[100] A lease can only be granted when oil is found in commercial quantity and if other conditions of the OPL have been complied with.[101]

The modern concession in Nigeria can be compared with a lease.[102] By virtue of Section 2(2) of the Petroleum Act, a licence or a lease is granted to a company incorporated in Nigeria. Participation rights are usually granted in OMLs for joint ventures, production sharing contracts and service contracts.[103]

2.4.2 Joint Venture Contracts

A joint venture in the oil and gas project context is simply defined as when two parties or more come together to contribute funds and assets for a business transaction involving the exploration and production of oil for the purpose of making a profit. It has been described as a way of sharing risks as each party adds different and valuable skills to the project.[104] It allows the parties to share risks, expertise and funds.

Joint ventures allow the HC to have participatory interests and be a partner in

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[97] Joseph E. Aigboduwa and Michael D. Oisamoje *'Promoting Small and Medium Enterprises in the Nigerian Oil and Gas Industry*' European Scientific Journal January 2013 edition Vol.9, No.1.
[98] Item 5 - 7, Schedule 1 of the Petroleum Act.
[99] Section 2(1) (c) of the Petroleum Act.
[100] Regulation 2(2) (c) of the Petroleum (Drilling and Production) Regulations 1969. Item 10, Schedule 1 of the Petroleum Act.
[101] Items 8 - 11, Schedule 1 of the Petroleum Act.
[102] Omorogbe op cit (n1)40.
[103] Francisca Nlerum 'Reflections on Participation Regimes in Nigeria's Oil Sector', available at *http://nials-nigeria.org/pub/NCLR5.pdf,* accessed on 31 July 2013.
[104] Hoffman op cit (n31) 50.

the project with oil companies. Most importantly, it brought about an increase in revenue for the HC in comparison with concessions. The participants of a joint venture are required to make specified contributions to the project and also share in its risks, benefits and losses.

Paragraph 34(a) of the first schedule to the Petroleum Act provides for participation rights. It states that:

> *'If he considers it to be in the public interest, the Minister may impose on a licence or lease to which this Schedule applies special terms and conditions not inconsistent with this Act including (without prejudice to the generality of the foregoing) terms and conditions as to—*
>
> *(a) participation by the Federal Government in the venture to which the licence or lease relates, on terms to be negotiated between the Minister and the applicant for the licence or lease;'*

The NNPC Act also allows for joint venture agreements. Section 5(1) (g) provides that one of the duties of the NNPC includes:

> *"Doing anything required for the purpose of giving effect to agreements entered into by the Federal Government with a view to securing participation by the Federal Government of the Corporation in activities connected with petroleum".*

Section (6) (1) (c) further provides the NNPC with the power to:

> *"Enter into contracts or partnerships with any company, firm or person which in the opinion of the Corporation will facilitate the discharge of the said duties under this Act".*

The joint venture is the most popular form of contractual agreement in Nigeria. The unincorporated joint venture system is used in Nigeria. Ownership is

vested in the partners to the venture unlike the incorporated joint venture where ownership is vested in the company incorporated for the purpose of performing the exploration and production activities. Nigeria through the NNPC entered into several joint ventures through the modern concession - the OML. The NNPC is usually designated as the concessionaire while the IOCs are the operators.[105] The operator is responsible for planning a programme for the proposed work and expenses among other duties.

The joint venture is governed by two main agreements. These are:

1) The participation agreement, and
2) The operating agreement

The participation agreement states the interests of the parties.

The operating agreement which is usually with the NNPC is inclusive of the rules which govern the relationship between the parties in the joint venture, duties of the parties and each partner's contribution towards the venture including funding ie cash calls obligations. In addition, a Memorandum of Understanding with the Federal Government offers fiscal incentives to the oil company which in effect reduce the tax and royalty payable by the company.

There have been several joint ventures between IOCs and the NNPC. Nigeria owns a majority share of at least 55 per cent in the 6 joint ventures currently operating and which are operated by Shell, Chevron, Elf, Mobil, Texaco and Agip.[106] Joint ventures also exist between indigenous oil companies and the NNPC as a result of acquisition of onshore acreages divested by IOCs.[107] Most indigenous companies

[105] NNPC Joint Ventures Activities, available at *http://www.nnpcgroup.com/NNPCBusiness/UpstreamVentures/JointVentureActivities.aspx*, accessed on 2 September 2013.
[106] Ibid.
Revenue Watch Institute 'Resource Governance Index', available at *www.revenuewatch.org/rgi*, accessed on 30 July 2013.
[107] Thisday Newspaper 'A New Vista for Nigerian Oil and Gas Independents', Thisday 29 October 2013 available at *http://www.thisdaylive.com/articles/a-new-vista-for-nigerian-oil-and-gas-independents/162873/*, accessed on 27 January 2014 .
Ken Etim and Dipo Okuribido 'Nigeria: Lessons from Shell' available at *http://www.iflr.com/Article/3127624/Nigeria-Lessons-from-Shell.html*, accessed on 12 June 2013

had to merge to acquire these acreages due to inadequate financial resources. For example, Shebah E&P and Platform Petroleum merged to form Seplat Petroleum to acquire a 45 per cent participating interest in OML 4, 38 and 41 from Shell, Total (E&P) Nigeria and NAOC. Starcrest Nigeria and Eland Oil & Gas were merged into Elcrest Exploration & Production Nigeria to acquire OML 40.[108]

Joint ventures in Nigeria are currently been phased out because Nigeria is often unable to contribute its own share of the funding to the joint venture thereby leaving the other party(ies) to bear the entire financial burden .

2.4.3 Production Sharing Contracts (PSCs)

PSCs are also known as Production Sharing Agreements. PSCs are defined as:

> *"Legal arrangements in which the crude oil produced is shared by the parties in pre-determined proportions."*[109]

Indonesia is regarded as the first country that adapted the PSC for oil and gas contracts in the 1960s. It has subsequently been widely used.[110]

This type of contract is common in developing countries which lack the technical expertise and financial resources required for the exploration and production of oil.[111] Generally, in PSCs the HC has ownership and control of the oilfield while the contractor which is an oil company undertakes the exploration and production. If there is no discovery of oil, the contractor may not be paid. The contractor bears all of the risk and financial burden of oil exploration and production.

In Nigeria, PSCs are governed by the Deep Offshore and Inland Basin

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[108] Ibid.
Revenue Watch Institute 'Resource Governance Index', available at *www.revenuewatch.org/rgi*, accessed on 30 July 2013.
[109] Omorogbe op cit (n1) 41.
[110] Smith op cit (n70).
[111] Charles Onyekwere 'Structuring contractual arrangements in the upstream sector' *BusinessDay* 12 April 2012 available at *http://www.businessdayonline.com/NG/index.php/law/cover/35848-structuring-contractual-arrangements-in-the-upstream-sector-pt-1*, accessed on 29 August 2013.

Production Sharing Contracts Act.[112] PSCs are means of financing oil and gas projects.

The general practice in Nigerian PSCs is that if oil is discovered in commercial quantity, royalty oil is first allotted to the NNPC for payment on behalf of itself and the IOC. Section 5 of the Deep Offshore Act determines the royalty to be paid for deep offshore and inland basins PSCs. Thereafter, the contractor is remunerated for its operating costs with a percentage of oil which is referred to as cost recovery oil or cost oil.[113] Tax oil is then allotted to the NNPC to be paid on behalf of itself and the IOC. [114] The remaining oil is known as profit oil which is then shared in a pre-determined ratio between the parties to the contract ie the contractor and the NOC.

In Nigeria, PSCs are often used and preferred to the joint venture agreements and can be evidenced by the recent shift from the use of joint-ventures agreements to PSCs. This occurred because the Nigerian government is often unable to fund its own share of the financing of projects in joint ventures due to its financial obligations in other sectors of the economy and the PSCs do not require any financial contribution from the HC.[115] Furthermore, they are used in Deep water acreages which usually require a high level of expertise. Thus, this enabled Nigeria to reduce or eliminate her financial burden borne in joint venture agreements and also increase its rate of production. PSCs do not need to be funded directly by the NNPC as the risks are mainly borne by the oil companies who are rewarded by the allotment of cost oil, if oil is discovered.[116]

Section 3 of the Deep Offshore and Inland Basin Act grants a concession for companies in petroleum profits tax at the rate of 50 per cent of chargeable profits during the PSCs as opposed to 85per cent paid by companies in onshore or shallow waters. In addition, royalties for deep offshore PSCs range from 12 per cent to 0 per cent depending on the depth of the water, while inland-basin PSCs are charged a flat

[112] Section 1 of the Deep Offshore and Inland Basin Production Sharing Contracts Act. Section 17 defines Deep Offshore to mean as any water depth below 200 metres.
[113] Section 8 of the Deep Offshore and Inland Basin Production Sharing Contracts Act.
[114] Section 9 of the Deep Offshore and Inland Basin Production Sharing Contracts Act.
[115] Radon op cit (n79).
[116] Ibid.

rate royalty of 10 per cent.[117]

2.4.4 Service contracts

Service contracts are also commonly used in countries which want to retain total control over their oil resource and have sufficient financial means.[118] Service contracts are similar to PSCs in that the contractor also provides the requisite technical expertise for oil and gas projects. Ownership and control is vested in the NOC. The duration of this type of contract may be shorter than a PSC as it may be for the performance of a specific service. They are not commonly used in Nigeria.

Service contracts are divided into:

- Risk service contracts
- Pure service contracts.

Risk service contract

In a risk service contract, there are usually two parties: the NOC and the contractor. By the terms of the contract, the contractor usually incurs all the expenses and bears all the risks involved in the exploration and production except if oil is discovered in commercial quantity. If no oil is discovered, the contract is cancelled. However, if there is a commercial discovery, the contractor is reimbursed with a service fee in cash, although the contract can also provide that the contractor be compensated with a percentage of the crude oil. The contractor may also be allowed to buy back part of the oil at a discount.[119]

Pure Service Contract

In a pure service contract, the contractor usually undertakes the exploration

[117] Section 5 of the Deep Offshore and Inland Basin Production Sharing Contract Act
[118] Likosky op cit (n69).
[119] Muhammed Mazeel *Petroleum Fiscal Systems and Contracts* (2009) 9.

and production of oil on behalf of the NOC. In contrast with the risk service contract, the HC bears all the risks and costs of exploration as the contract states that the contractor is paid a flat fee for his service whether oil is discovered or not.[120] The contractor is also not entitled to any share in the oil discovered but there may a corresponding contract which allows the contractor to purchase part of the oil produced in the course of work. Service contracts are not as popular as other forms of petroleum contracts. They are mainly used in middle-eastern countries with proven reserves. These countries usually lack the necessary technical knowledge but have ample funds and want to retain total control over their oil resources eg Saudi-Arabia.

2.4.5 Technical Assistance Agreement

In this type of agreement, an IOC with requisite technical knowledge and experience is usually hired by a country as a contractor to perform a specific task in any upstream petroleum operation. The HC provides all the funds necessary for the project. The contractor is entitled to only a cash payment in return for services rendered as determined by the parties. The technical assistance agreement is distinct from the other forms of agreement because the contractor cannot have any interest in the oil. The contractor works under direction of the management of the NOC and therefore this contract encourages transfer of technology.[121]

Technical assistance agreements have not been used in Nigeria as it is likely to be expensive because it is the HC which solely provides the finances required for the project.

2.5 Marginal Fields

A marginal field has been defined to mean any field that the President may, from time to time, identify as a marginal field, while a farm-out means an agreement between the holder of an oil mining lease and a third party which permits the third party to explore, prospect, win, work and carry away any petroleum encountered in a

[120] Makuch and Pereira op cit (n53) 212-213.
[121] Omorogbe op cit (n1)44.

specified area during the validity of the lease.[122] The holder of the lease is regarded as the farmor while the third party or licensee is the farmee.

The Petroleum (Amendment) Act No. 23, 1996 and Guidelines for Farm out and Operation of Marginal Fields 2013 are the current relevant legislations for marginal fields in Nigeria.

Probably due to the insufficiency and ambiguity of the definition of a marginal field in the Petroleum Act, it was further defined as:

> *'A marginal field is any field that has (oil and gas) reserves booked and reported annually to the Department of Petroleum Resources (DPR) and has remained un-produced for a period of over 10 years.'*[123]

The objectives of issuing marginal fields are to expand production capacity, augment oil and gas reserves and encourage indigenous participation and technology transfer.

In 2002, Nigeria realised the necessity to boost her revenue by increasing her proven oil reserves whilst simultaneously encouraging indigenous participation and decided to award marginal fields to indigenous companies.[124] Consequently, in 2003

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[122] Paragraph 17 (1) (4) of Schedule1 to the Petroleum Act.

[123] Guidelines for the Farm out and Operations of Marginal Fields - 2013, issued by the Department of Petroleum Resources in November 2013.
Marginal fields may have some or all of the following characteristics:
"Fields not considered by license holders for development because of assumed volatile economics under prevailing fiscal and market conditions.
Fields with at least one exploration well drilled and reported as oil and or gas discovery for more than 10 years with no follow up appraisal or development effort.
Fields with crude oil characteristics different from current streams (such as crude with very high viscosity and low API gravity), which cannot be profitably produced through conventional methods or current technology.
Fields with high gas and low oil reserves.
Hitherto producing fields that have been abandoned by the leaseholders for upwards of three years for economic or operational reasons.
Fields that the present leaseholders may consider for farm-out as part of portfolio."

[124] Alexander's Oil and Gas Connections, 'Nigeria Pre-qualifies Indigenous Firms for Marginal Field Blocks', *Neftegaz.RU* available at http://www.gasandoil.com/goc/company/cna22854.htm, accessed on 5 November 2013.

the President issued 24 licences for marginal fields.[125] In 2013, another round of bidding for marginal field licences commenced and is presently on-going.[126]

Marginal fields in Nigeria may be regarded as sole risk contractual arrangements in situations where the indigenous producers solely bear the risk in developing the marginal fields and may also be operated as a joint venture.[127] The farmor receives royalty from the farmee.[128]

In this contractual arrangement, the holder of the OML may with the consent of the president assign oil fields which are not commercially viable to IIOCs or the president may assign fields which have been undeveloped for 10 years after its first day of discovery.[129] These are oil-fields which are often regarded as uneconomical to the IOCs for reasons such as its location, low reserves, high cost of production and consequently may have been neglected but yet remain attractive to IIOCs.

Ten years after the issuance of the first set of licences, the marginal fields

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[125] Nigeria: The Marginal Experiment at 10 africa oil+gas report 6 February 2010 available at *http://africaoilgasreport.com/2013/02/in-the-news/nigeria-the-marginal-field-experiment-at-10/*, accessed on 30 July 2013.

[126] DPR 'Press Briefing at the Flagging Off of the Second Marginal Field Licensing Round', available at *http://dprnigeria.org.ng/press-briefing-at-the-flagging-off-of-the-second-marginal-field-licensing-round/*, accessed on 25 December 2013. Alexander's Oil and Gas Connections, 'Nigeria Offers Marginal Oil Licences to Locals', available at *http://www.gasandoil.com/news/2013/11/nigeria-offers-marginal-oil-licences-to-locals*, accessed on 25 December 2013.

[127] ThisDay Newspaper: Nigeria Bond Market As Alternative Funding For Oil And Gas Projects (28 May 2013), available at *http://allafrica.com/stories/201305280707.html?viewall=1*, accessed on 13 November 2013.

[128] Paragraph 12.0 Guidelines for Farm Out and Operations of Marginal Fields.

[129] Paragraph 17(1) - (2) of the Petroleum Act further lists the conditions under which a marginal field may be granted. It states thus:

> *"(1) The holder of an oil mining lease may, with the consent of and on such terms and conditions as may be approved by the President, farm out any marginal field which lies within the leased area.*
> *(2) The President may cause the farm-out of a marginal field if the marginal field has been left unattended for a period of not less than ten years from the date of the first discovery of the marginal field.*
> *(3) The President shall not give his consent to a farm-out or cause the farm-out of a marginal field unless he is satisfied—*
> *(a) that it is in the public interest so to do, and, in addition, in the case of a non-producing marginal field, that the marginal field has been left unattended for an unreasonable time, not being less than ten years; and*
> *(b) that the parties to the farm-out are in all respects acceptable to the Federal Government."*

produce crude oil exceeding 100,000 BPD.[130] This can be said to be a success for the Nigerian indigenous oil and gas sector. However, only eight of the 24 holders of the marginal fields have commenced production.[131] There have also been several complaints from the present holders. These complaints include the lack of access to finance, litigation with technical partners, high taxes, high interest rates, oil theft and inadequate technical knowledge.[132] The licences of fields yet to be developed may be revoked and awarded to new holders during the 2013/2014 marginal fields' exercise. The unavailability of funds has been attributed to the fact that as at 2003 when the licences were awarded, local banks were poorly capitalized.[133] Moreover, banks are not willing to grant loans to marginal fields if the field is the only security because of the high risk of unproductivity.

2.6 Conclusion

The first part of this chapter addressed the legal framework for the upstream sector of oil and gas in Nigeria. Most of the laws are out-dated and not in conformity with the state of laws in other oil producing jurisdictions which are regularly amended or updated to suit changing realities. For example, the Nigerian Petroleum Act was enacted in 1969 and has not undergone any major amendments since then. Also, the laws regulating the oil and gas sector are also dispersed therefore making it difficult for them to be easily located. Furthermore, the laws do not also encourage accountability and transparency in the sector as the NNPC exercises both commercial and regulatory functions. On the other hand, the Local Content Act is a favourable development to indigenous participation and financing for indigenous companies. Since 2010 when the Act was enacted, several IIOCs have become holders of oil

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[130] DPR 'Press Briefing at the Flagging Off of the Second Marginal Field Licensing Round', available at, *http://dprnigeria.org.ng/press-briefing-at-the-flagging-off-of-the-second-marginal-field-licensing-round/*, accessed on 25 December 2013.

[131] DPR 'Press Briefing at the Flagging Off of the Second Marginal Field Licensing Round', available at, *http://dprnigeria.org.ng/press-briefing-at-the-flagging-off-of-the-second-marginal-field-licensing-round/*, accessed on 25 December 2013.

[132] Dayo Oketola 'Raising production level among indigenous oil operators' Punch Newspapers 31 October 2013, available at *http://www.punchng.com/business/energy/raising-production-level-among-indigenous-oil-operators/*, accessed on 8 February 2014.

[133] Vanguard Newspapers 'How we award oil Blocks - FG' Vanguard Newspapers 19 March 2013, available at *http://www.vanguardngr.com/2013/03/how-we-award-oil-blocks-fg/*, accessed on 8 February 2014.

blocks which have been divested by IOCs. This feat could not have been achieved without the enactment of the Act.

In relation to the regulatory authorities, their functions are commendable but they are not effectively implemented. For example, the DPR prescribes standards and guidelines for environmental issues in the oil and gas industry but it is doubtful if they are adhered to and enforced.

The contractual framework in Nigeria has evolved several times to suit her needs. From the traditional concession which was used during the colonial era, to the modern concession which was modified to grant participation rights to Nigeria to the adoption of joint ventures and PSCs. The service contracts have been used albeit to a minimal extent. The PSC and the service contracts vest ownership of the petroleum in the state, while the JV vests ownership in the state and its partners.

Presently, the PSC seems to be the most effective form of contract for Nigeria as the financing and risks involved in the exploration are borne by the contractor. This contract is preferred by the IOCs because of the high level of profit obtainable and the frequency of the NNPC's failure to honour her cash call obligation. It also seems ideal for Nigeria because of its financial challenges. However, the use of PSCs should be for a limited time as it is not in the best interest of Nigeria. A large percentage of the returns from the PSC by way of cost and profit oil is taken out of Nigeria as the contractors are mostly IOCs. This denies Nigeria the opportunity of re-investing the money in the economy or saving the money in local financial institutions where it can be accessed for oil and gas projects by IIOCs. The PSC does not encourage the transfer of technology which can aid indigenous participation and lead to increased revenue for Nigeria. There may also be inflation of the costs of exploration and production. Furthermore, there is the risk of the contractor being wasteful or slow in execution of duties based on the certainty of the payment of cost oil. Nevertheless, the use of PSCs should not be discouraged in its entirety as they are useful in encouraging deep-offshore explorations requiring technological expertise and financial resources which are presently not available in Nigeria.

The introduction of marginal fields and divestment of onshore assets by IOCs to IIOCs is a welcome development as this will impact positively on indigenous participation and consequently local financing.

Securing financing is difficult for indigenous companies. Lenders especially foreign commercial banks may be cautious of advancing funds due to the high risk of non-discovery of oil in commercial quantity especially in the case of marginal field holders. The political instability in Nigeria and unknown past performance of the companies will also inhibit them from lending money.

It is proposed that marginal field holders should also adopt project finance as a means of financing their projects. They should also consider having technical partners where they lack the requisite technical expertise. The government could also assist in granting a tax holiday to the marginal field holders. In addition, the government could parley with local banks to offer them reduced interest rates.

3 Risks

3.1 Introduction

The first chapter tackled the choice of project finance as the most appropriate way to finance oil and gas projects in view of several factors including the risks involved, while the previous chapter also addressed the different contractual agreements in Nigeria through which projects are financed by the designated parties.

Risk is an important component of project finance. It can be defined as:

> *"The uncertainty of a result, happening, or loss; the chance of injury, damage or loss; especially, the existence and extent of the possibility of harm"*[134]

Risk is a major factor which may occasion delay, increased costs, or even lead to the failure of a project. The main aim of the funders or lenders of a project is to make a profit. Consequently, risk constitutes a hindrance to making a profit. Before embarking on a project, the parties conduct a risk-assessment or analysis to identify potential risks, the probability of its occurrence, its impact, its management and how to structure the project in relation to the risks as this will to a large extent decide the project's viability and profitability.[135]

The level of risk involved and the extent to which it can be managed is an essential factor to the project sponsor and lenders in deciding if the project can be undertaken in view of its limited recourse.[136] The potential risks can be retained, shifted or allocated to the appropriate parties to be managed, or mitigated by insurance, thereby ensuring the success of the project.[137] The parties to whom the risks are transferred are also compensated in return for the risk taken.[138] Without the proper identification, allocation and management of risks, the lenders may be cautious of financing the project. The lenders may require that risks which are not

[134] Garner op cit (n30) 1442.
[135] Hoffman op cit (n31) 34.
[136] Akinrele, Adedolapo *Nigerian Oil and Gas Law* (2005) 180.
[137] Gatti op cit (n39) 43.
[138] Hoffman op cit (n31) 35.

allocated to any party be borne by the sponsor.[139] Risk may be managed by guarantees, contractual arrangements and insurance.

There are different types of risks in project finance. They include: country risks, legal risks and environmental risks.

In examining the Nigerian oil and gas sector, it can be seen that these risks are present and may discourage lenders from advancing funds to the IIOCs. In addition, due to the long-term and the capital-intensive characteristics of oil and gas projects coupled with the fact that most of the IIOCs have recently commenced Exploration and Production (E & P) activities with little or no equity, project finance is the preferred option for financing the project as there are several parties to manage the risks.

The risks are discussed below.

3.2 Country risks

The success and completion of a project is to a great extent reliant on the HC, particularly if it is a developing country. If the country is recognised as possessing high-risk, the lenders may not be willing to lend funds, or in the alternative curtail the funds allocated to the project. Country risks should be dealt with before the commencement of the project.[140] Usually credit ratings agencies such as Moody's Investors Service and Standard and Poor's ascribe credit ratings to countries that reflect their ability to repay debts and interest timeously and the chances of the countries default. Country risks may further be divided into political risks and investment risks.

3.2.1 Political risks

The political environment of a country can constitute a major source of risk to the project and its funders. Political risk is attributed to the political environment of a

[139] Hoffman op cit (n31) 10.
[140] Razavi op cit (n24) 3.

country and may be beyond the control of the funders and the government. It often constitutes the main impediment to lenders of oil and gas projects.[141] These risks may be in the form of expropriation; enactment of new laws or change of laws especially in relation with taxation & environment; force majeure eg the outbreak of violence or war delay; change of government; change in concession granted; quasi-political risks which include the failure of the government to grant necessary permits, disputes involving breach of contract arising from political, commercial and the regulatory authorities in the country.[142]

The state of insecurity in Nigeria can be categorized under political risk. Environmental issues and insecurity in the Niger-Delta area are somewhat interwoven as the insecurity can attributed to the socio-economic issues such as the neglect and low level of development of the area, poverty of the indigenes of the area, arising from environmental pollution.

Security issues have been a major challenge and source of concern for oil and gas projects in the Niger-delta. Recently, there have been numerous cases of vandalisations and sabotage of oil pipe-lines and installations. In addition, there have been attacks on vessels used for exploration and production, and oil thefts. This further degenerated to a high level of insecurity caused by the kidnapping of oil workers (especially expatriates) and members of their family who are only released after a heavy ransom has been paid.

This has resulted in a lower output of production of crude-oil and reduction in the revenue generated. In addition, the oil companies expend huge sums on securing their projects and workers. Some prospective foreign investors have been deterred from investing in Nigeria.

Due to the high level of insecurity experienced and to encourage investors, Nigeria declared an amnesty in 2009 for the militants who are a major cause of insecurity in the Niger-Delta region. This amnesty programme encompasses training and vocational training for the militants in return for their surrender. The programme

[141] Ibid.
[142] Hoffman op cit (n31) 10.
Gatti op cit (n39) 55.

seems to have been effective as the rate of kidnapping has decreased, however several cases of sabotage of pipelines and oil theft still exists.

Prior to this, the Niger Delta Development Commission (NDDC) was also established in 2000 to assist the development of the Niger Delta region. It also works hand in hand with the oil companies in dealing with various issues including environmental problems such as environmental pollution, its prevention and control.[143] In furtherance of its goal towards the development of the region, it has embarked on projects to provide infrastructure, quality health care facilities and equipment, youth empowerment programs.[144]

The oil companies are often directly affected by community issues and therefore usually manage the risks relating to community issues. The risk is often dealt with by the use of each oil company's Corporate Social Responsibility (CSR) programmes. This involves maintaining a good relationship with the community and trying to meet their needs. It can be by way of the provision of social infrastructure, for example pipe-borne water, provision of electricity, construction of roads etc., employment of the indigenes as workers in the project or on a contract basis in the company, construction of medical centres and supply of drugs and medical equipment, construction of schools and award of scholarships and economic empowerment of the indigenes. Insurance policies are often used by the oil companies to mitigate this risk. [145]

Section 44 (1) of the Nigerian Constitution provides an assurance against expropriation and the right of compensation and access to court in the event of its breach.[146] It states that:

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[143] NDDC 'About Us', available at *http://www.nddc.gov.ng/about%20us.html*, accessed on 22 November 2013.
[144] NDDC 'News and Events', available at *http://www.nddc.gov.ng/newsandevents.html*, accessed on 22 November 2013.
[145] Claims Management 'Heightened Insecurity, Terror Threats Inspires Renewed Interest in Kidnap for Ransom Insurance', available at *http://claims-management.theclm.org/home/article/Terror-threats-renewed-interest-in-kidnap-for-ransom-insurance*, accessed on 15 November 2013.
[146] See *Nigerian National Petroleum Corporation & Attorney General of the Federation vs. Famfa Oil Nigeria Limited* (2012) 17 NWLR Pt 148 where the Supreme Court confirmed the provisions of Section 44 (3) of the Constitution which states that the Federal Government cannot compulsorily acquire a person's property or interest without the prompt payment of compensation which may be

"(1) 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."

Section 25 of the NIPC Act also offers a guarantee against the expropriation or nationalisation of any enterprise by the government of Nigeria and in the event of its occurrence, it would be on the grounds of national interest or purpose for which the law would provide for the payment of fair and adequate consideration. It provides thus:

"(1) Subject to subsections (2) and (3) of this section:-

(a) no enterprise shall be nationalized or expropriated by any Government of the Federation;

(b) no person who owns, whether wholly or in part, the capital of any enterprise shall be compelled by law to surrender his interest in the capital to any other person.

(2) there shall not be any acquisition of an enterprise to which this Act applies by any Government of the Federation unless the acquisition is in the national interest or for a public purpose and under a law which makes provision for-

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determined by the court. The Federal Government had attempted to acquire a 50 per cent interest in the Oil Mining lease granted to Famfa Oil.

(a) payment of fair and adequate compensation; and

(b) right of access to the courts for the determination of the investor's interest or right and the amount of compensation to which he is entitled.

(3) Any compensation payable under this section shall be paid without undue delay, and authorisation for its repatriation in convertible currency shall, where applicable be issued."

Political risks can be mitigated by contracts known as government support agreements between the government and the parties to the project.[147] The contractual terms helps to create a conducive and enabling environment for the performance of the project. For example, the contract may grant certain tax exemptions or reliefs, exemption from customs duties on certain importations, easy repatriation of foreign exchange and the provision of guarantees on certain guarantees which may be to ensure that an important counterparty performs its obligations under the contract.

In addition, political risks can be managed by guarantees from the project sponsor, provision of Partial Risk Guarantees (PRGs) and Insurance from Multilateral Development Banks (MDBs) to attract investors to finance the project. Where the level of the country risk is quite high, the aid of multilateral development banks is often resorted to. Insurance can also be by export credit agencies (ECAs) and private insurance companies. These will be discussed subsequently.

3.2.2 Investment risks

These are economic or commercial risks in a country which may reduce or affect the anticipated return on a project. These include currency convertibility and repatriation of foreign exchange. Investment risk can be mitigated by establishment of special foreign deposit accounts, negotiating exchange agreements with the host government and obtaining monetary board or central bank approvals.[148] The parties

[147] Gatti op cit (n39) 56.
[148] Gatti op cit (n39) 57.

may also ensure that revenue obtainable for example from off-take contracts is the same currency as that of the loan agreement and of the operating cost.[149]

In Nigeria, repatriation of foreign exchange is regulated by the Foreign Exchange (Monitoring & Miscellaneous Provision Act No. 17 of 1995) which guarantees foreign investors an unconditionally transfer or repatriation of their profits and dividends (net of taxes) through an authorized dealer (which may be a bank) in freely convertible currency.[150] Investors are to obtain a Certificate of Capital Importation (CCI) from a Nigerian Bank which acts as an agent of the Central Bank of Nigeria (CBN) when foreign exchange is brought into the country.

The CCI also allows the investor to repatriate the capital at the end of the project. Investors may also operate a foreign currency domiciliary account with a Nigerian bank which permits the currency to be any internationally convertible currency.[151] Without the CCI, a foreign investor is likely to find it difficult to repatriate foreign currency.

Derivatives may also be used to manage investment risks involving increase in interest rates and currency rates. These involve the use of forward contracts, futures and options. Take or Pay contracts also assist in mitigating risks. Take or Pay Contracts are analogous to World Bank guarantees. It is explained as:

> *"A contract requiring the buyer to either purchase and receive a minimum amount of a product ("take") or pay for this minimum without taking immediate delivery("pay"). These contracts are often used in energy and oil-and-gas businesses).*[152]

They are often used in financing oil and gas projects and are particularly useful as security against most forms of risks and as well serve as an assurance of revenue for the sellers and lenders.

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[149]Hoffman op cit (n31) 56.
[150]Section 5, 13 and 15 of the Foreign Exchange (Monitoring & Miscellaneous Provision Act No. 17 of 1995).
[151] Section 17 of the Foreign Exchange (Monitoring & Miscellaneous Provision Act No. 17 of 1995).
[152] Garner op cit (n30) 374.

The above-mentioned contracts are often performed with the assistance of the government as it regulates or determines the price at which the petroleum products are sold.[153]

Corruption is another factor which comes into play in Nigeria as it may reduce the return on a project.[154] It often leads to unanticipated costs. The Nigerian government has tried to curb this menace by enacting the Corrupt Practices and other Related Offences Act, Money Laundering Act and the Economic and Financial Crimes Commission Act, however corruption still persists.[155]

3.3 Legal Risks

The enforceability of the contract under the laws of the HC during disputes is a key issue with the lenders and the project sponsor. To forestall this, the advice of local lawyers in analysing and managing the risk will be required at the initial stage of the project. The legal risk arising from the enforceability of a contract is influenced by the level of economic development, legal system and institutional conditions of the HC.[156]

The choice of the applicable law and the court to have jurisdiction is also relevant in dispute settlement, and should be chosen by the parties when drafting the various contracts for the project. This is necessary to avoid delay in deciding the applicable law and court as this may inevitably result in increased costs and in few cases, to the unsuccessful completion of the project.

Generally, parties to the project are amenable to submitting their disputes to an effective legal system for the fair interpretation and enforcement of obligations or claims arising from the contract. However, the law of the HC may not be chosen if the legal system of the country is not advanced to suit the specific needs of the project. For example, if the judges and lawyers in the HC do not have the expertise

[153] Razavi op cit (n24) 3.
[154] A Olaniwun *Legal Aspects of Finance in Emerging Markets* (2005) 47, 120 at 121.
[155] Ibid .
[156] Gatti op cit (n39) 56.

and experience in the project area. The law of a major financial centre may be preferred by the parties to that of a HC because of it is more advanced.

In the alternative, the parties may resort to arbitration. Arbitration is a popular choice because of it numerous advantages. It is neutral, fast and the arbitrators can deal with technical issues unlike litigation where the lawyers may lack the requisite expertise. Furthermore, it has the benefit of maintaining friendly relations between the parties necessary for the accomplishment of the project. The seat of arbitration also determines the procedure to be adhered to in the arbitration.

The choice of arbitration in Nigeria is advisable especially in light of the slow pace of litigation. Therefore arbitration is resorted to in oil and gas issues to prevent delays, issues of applicable law of different legal systems, problems of enforcement of laws and judgment, and avoid government interference.

The Nigeria courts have acknowledged that in a contract, parties can choose the applicable law and which court to have jurisdiction.[157] Nonetheless, it has been held by the Nigerian Supreme Court in *Sonnar Limited v Nordwind* to oust the constitutional jurisdiction of the court, the foreign law in question must be real, genuine, bona-fide, legal and reasonable. [158]

In order to mitigate legal risk, the contracts must be carefully drafted. The assistance of the HC may also be useful in reducing the bureaucracy that may delay or increase the cost of enforcing a contract.

3.4 Environmental Risks

These are risks which have an adverse effect on the environment. Environmental risks are frequent in the petroleum sector and difficult to determine at the onset of the project. In the context of oil and gas, these risks include oil spills, gas flaring. It is also necessary to consider the impact of the legislations regulating these environmental issues as they may be restrictive and frequently changed during the

[157] Olaniwun op cit (n147) 51.
[158] Sonar Limited v Nordwind (1987) 4 NWLR (Part 66) 520 at 543.

duration of the project and therefore have a negative effect on the project. Payment of fines, penalties, damages to parties affected by environmental harm and the cost of recovery for the damaged area may be expensive and thus, reduce the estimated profit due from the project.[159] Lenders in project finance may also be liable for environmental risks, for example in their exercise of step-in rights. Therefore, financial institutions such as the World Bank often require compliance with the environmental laws of the country and furthermore, have their environmental standards or policies to forestall any consequence which may reduce the return on their investment.[160]

The Niger-Delta region which produces 90 per cent of the oil produced in Nigeria has suffered immensely from environmental degradation arising from oil exploration and production activities.[161] These range from gas flaring to oil spills which results in the air, land and water pollution. Environmental degradation adversely affects farming and fishing activities which are the primary sources of income for the indigenes of these riverine communities and also impair health of the indigenes.[162]

Gas flaring is the burning off of the associated gas found with oil during extraction of oil. When drilling for oil, the associated gas may be flared if there is no arrangement to produce the gas. Nigeria flares about 40 per cent of its natural gas and re-injects 12 per cent to extract oil.[163] It has been reported that about 23 billion cubic metres of natural gas is flared yearly in Nigeria which constitutes 13 per cent

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[159] Hoffman op cit (n31) 10.
Gatti op cit (n39) 55.

[160] Jay Wagner and Kit Armstrong *Managing environmental and social risks in international oil and gas projects: Perspectives on compliance* Journal of World Energy Law & Business, 2010, Vol. 3, No. 2 Page 158.

[161] Legbosi Pyagbara 'The Ogoni of Nigeria: Oil and Exploitation', available at *http://www.refworld.org/pdfid/469cbfce0.pdf,* accessed on 20 November 2013.

[162] Professor Richard Steiner, '*Double Standard: Shell Practices in Nigeria Compared with International*
Standards to Prevent and Control Pipeline Oil Spills and the Deep-water Horizon Oil Spill', *https://www.milieudefensie.nl/publicaties/rapporten/double-standard,* accessed on 20 November 2013.

[163] NIPC 'Opportunities by Sector', available at *http://www.nipc.gov.ng/opportunities.html,* accessed on 20 November 2013.

of global flaring.[164] About half of the associated gas produced annually in Nigeria amounting to about $2 500 000 000 is flared.[165] There have also been several cases of oil spills in Nigeria which have been blamed on theft and pipeline sabotage. Gas flaring and oil pollution have a deleterious effect on the environment.

There are several legislations in Nigeria regulating pollution in the oil and gas sector.[166] The Environmental Impact Assessment Act stipulates that an environmental impact assessment (EIA) be conducted:

> *"where the extent, nature or location of a proposed project or activity is such that it is likely to significantly affect the environment."*[167]

An EIA is mandatory in developing oil and gas fields.

Nigeria still has one of the world's worst records of gas flaring despite several local and international laws prohibiting gas flaring including the Associated Gas Reinjection Act.[168] Several deadlines set for the prohibition of gas flaring have elapsed and have been postponed several times without the prohibitions being enforced.[169]

Environmental practices in the oil and gas sector is mainly regulated by the DPR, National Environmental Standards and Regulation Enforcement Agency (NESREA)

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[164] Friends of the Earth international, 'a valuable resource goes up in smoke'. available at *http://www.foei.org/en/get-involved/take-action/archived-cyberactions/stop-flaring/a-valuable-resource-goes-up-in-smoke*, accessed on 20 November 2013.

[165] NNPC 'Development of Nigeria's Oil Industry', available at *http://www.nnpcgroup.com/NNPCBusiness/BusinessInformation/OilGasinNigeria/DevelopmentoftheIndustry.aspx*, accessed on 25 December 2013.

[166] The Petroleum Act and Regulations.
The Oil in Navigable Waters Act, Cap 331, LFN 1990.
The Oil Terminal Dues Act, Cap 339, LFN 1990.
The Associated Gas Re-Injection Act, Cap 26, LFN 1990.
The National Oil Spill Detection and Response Agency, Cap 131, LFN 1990.
The Environmental Impact Assessment Act, Cap E12, LFN 1990.

[167] Section 2(2) of the Environmental Impact Assessment Act.

[168] Section 3 of the Associated Gas Reinjection Act states that:

> *"Subject to subsection (2) of this section, no company engaged in the production of oil or gas shall after 1 January, 1984 flare gas produced in association with oil without the permission in writing of the Minister".*

[169] The deadline for the prohibition of gas flaring has been postponed several times. The latest deadline was set for January 2005 by the Associated Gas Reinjection Act (Continued Flaring of Gas) Regulations 2005 (AGRA Regulations 2005).

and National Oil Spill Detection and Response Agency (NOSDRA). Environmental laws in Nigeria are not adequately enforced by the regulatory authorities. Moreover, the penalties are not severe enough to deter oil companies in Nigeria from flouting them as they prefer to breach the laws and thereafter pay the penalty.

Litigation is the most accessible option for redress for the members of the community when they have been impaired by the environmental degradation but this is of limited benefit to them because where compensation or damages are awarded, it is often insignificant in comparison with the loss suffered. Consequently, the issue of insecurity arises as the perceived injustice .[170]

Insurance policies can be used to mitigate environmental risks.[171]

3.5 Conclusion

This chapter dealt with the crucial issue of risk which must be carefully contemplated before embarking on a project. It addressed country, legal and environmental risks. These are risks which can be mitigated under project-finance. Although the risks are faced by both the IOCs and the IIOCs, the case of the IIOCs is peculiar as most of them are newly established companies and may not easily access funds.

Country risk which was the initial risk treated is further divided into political and investment risks. It constitutes the most important type of risk to indigenous companies in accessing funds from foreign financial institutions. Generally, lenders consider the country risk as a significant factor in the borrower's ability to repay a debt. Insecurity and oil bunkering which are prevalent issues in Nigeria are categorised under political risk. It has led to a frequent loss of revenue in oil and gas upstream projects and a major reason for the divestment of IOCs from onshore assets for deep offshore acreages. As a result, lenders may be wary of advancing funds to IIOCs who acquired the divested acreages due to the high risk involved.

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[170] .Judith Asuni '*Blood Oil in the Niger Delta',* available at *http://www.usip.org/sites/default/files/blood_oil_nigerdelta.pdf,* accessed on 20 November 2013.
[171] Gatti op cit (n39) 100.

As stated, Nigeria has endeavoured to manage the risk by offering amnesty to the militants involved. Oil companies also render CSR to Niger Delta communities. These steps have reduced but not completely eliminated the risk. A way forward is to address the main issue which is the grievances of the members of the Niger Delta communities who have suffered great losses rather than benefitting from the discovery of oil.

The government also ought to provide infrastructure for the community and jobs for the inhabitants whose main sources of livelihood of fishing and farming have been destroyed due to oil pollution. The prevention and elimination of oil pollution and gas flaring should be critical areas for the government to address through its regulatory bodies. These measures will be more effective than those previously adopted. The risk of expropriation and repatriation seems slim for now as Nigeria is eager to attract investors as it lacks the technical and financial resources to solely develop the petroleum sector.

Legal risk is the second type of risk. The judicial system in Nigeria is amenable to the enforcement of contracts. The major drawbacks of litigation in Nigeria include the judicial process being slow and the lack of expertise of most judges in oil and gas issues. Therefore parties often resort to arbitration or the law of another country for dispute settlement. Arbitral awards can be made a judgment of the court. In the same vein, foreign judgments can be enforceable when registered in Nigerian courts. It is submitted that the Nigerian legal system be reformed so as to allow for the speedy dispensation of cases. Judges and judicial personnel should also be trained on oil and gas matters.

The third type of risk is environmental risk. In most countries, environmental risk is very essential and given paramount consideration in the financing of most oil and gas projects as most projects are required to have complied with global environmental standards before lenders can agree to fund projects. Furthermore, remedying environmental damage and payment of their penalties are usually very costly. However in Nigeria, the reverse is the case as the regulatory bodies have often failed to enforce the environmental laws regulating oil and gas and the penalties are considerably minimal. Therefore, oil companies prefer to pay a penalty

for contravening environmental laws rather than adhere to environmental laws or remedy the environmental damage done because it is a cheaper.

The resultant effect is the state of insecurity in the Niger Delta region which in turn leads to a loss of revenue and a minimal level of uncertainty as to the future of oil and gas projects. This can be averted if environmental laws such as the EIA are complied with and the regulatory bodies perform their roles effectively. The sanction imposed on environmental damage should be heavier to deter offenders.

The draft Bill (PIB) attempts to redress this malady by imposing grave penalties for defaulters. The proposed creation of the Petroleum Host Community Fund for the development of the petroleum producing Communities will also be beneficial in mitigating political risk.

4. SOURCES OF FINANCE FOR OIL AND GAS PROJECTS

4.1 Introduction

Funding can be obtained from different sources for oil and gas projects. Formerly, financing of these projects were by HCs through budgetary allocation and by IOCs. However, due to most HC's financial obligations to other sectors of the economy and the IOCs reluctance to solely finance the projects, other local and foreign sources of funding had to be examined. Generally, financing occurs through debt and equity. As project finance has been stated to be the best means of financing for projects by IIOCs, debt finance which dominates project finance will mainly be considered. Financing need not be in monetary form only but can also be by way of assistance through guarantees by MDBs to the public and private sector.

One of the major challenges of the IIOCs has been the issue of funding. In financing an oil and gas upstream project, most financial institutions especially the foreign institutions put weighty consideration on factors such as the risks and the price of oil which determines the feasibility and rate of return on the investment. The ability of the borrower to repay is also taken into account, and the lender may require a form of security such as take or pay contracts for gas projects.

Although there are various sources for project finance, most of the funds obtained for projects in Nigeria have been sourced from foreign banks. Previously, the local banks were not capable of providing the amount of funds required for such projects but in recent times have seemed able to do so by means of loan syndication.[172] It will be preferable if the IIOCs utilize the services of local commercial banks as this ensures that the profits and interest remain in Nigeria.

4.2 Equity

[172] Michael Eboh Energy Financing: Nigerian banks come of age, Vanguard Newspaper 04 February 2014, available at *http://www.vanguardngr.com/2014/02/energy-financing-nigerian-banks-come-age/*, accessed on 5 February 2014.

4.2.1 Capital Markets

This involves raising funds for the project through the issuing of securities. This can be on the primary or secondary market by trading in equity or debt securities. Equity involves the selling of ordinary and preference shares in the capital market. It is regarded as an Initial Public Offer (IPO) it is the company's first time of selling shares. Subsequent sales are referred to as Public Offers. Listing on the Stock Exchange has several advantages for companies, in that it provides an easy access to funds from the public and also gives the company prominence and credibility

Nevertheless only ten oil companies are listed on the Nigerian Stock Exchange and the only IIOC among them is Oando, which is an indigenous integrated oil and gas company.[173] The capitalization of the oil and gas sector is N235 170 000 000 representing 1.49 per cent of the total market capitalization.[174] The listing requirements of the Nigerian Stock Exchange (NSE) can be daunting for new companies. It stipulates that in order for a company to be listed, it must submit its financial statements and business records for the past five years with audited accounts of not more than nine months.[175] Furthermore, the level of liquidity of the NSE is too low to finance oil and gas projects.[176]

Recently, IIOCs involved in exploration and production activities began listing their companies on foreign stock exchanges in order to fund their projects. These companies include Afren Oil, Heritage Oil, Eland Oil and Gas, Lekoil, Mart Resources and MP Nigeria which are listed on the London Stock Exchange (LSE) and the Alternative Investment Market (AIM). Lekoil in recent times raised the sum of £50 000 000 on the LSE to finance its oil exploration and production activities in Nigeria.[177]

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[173] Nigeria Oil and Gas Intelligence June 2013 available at *http://www.wimbiz.org/publication/nog.pdf*, accessed on 12 November 2013.
[174] Ibid.
[175] Akinrele (n137) 157.
[176] As at 7 February 2014, it was N3,181 428 533.95 ($19 million). The Nigerian Stock Exchange, available at *http://www.nse.com.ng/Pages/default.aspx*, accessed on 9 February 2014.
[177] Nigeria Oil and Gas Intelligence June 2013, available at *http://www.wimbiz.org/publication/nog.pdf*, accessed on 12 November 2013.

The raising of funds through the bond market in Nigeria is also being proposed by oil companies in resolving the issue of financing oil and gas projects.[178]

4.2.2 Private Equity

This involves when a group of investors usually institutional or private investors commit their funds to a private company or buy-out and delist a public company in order realise a profit at the exit point. Private equity is not a popular means of financing in Nigeria.

4.3 Debt

4.3.1 Financial Institutions / Commercial Banks

A financial institution can be defined as:

> *'A business, organization or other entity that manages money, credit, or capital, such as a bank, credit union, savings-and-loan association, securities broker or dealer, pawnbroker, or investment company.'*[179]

Commercial banks can therefore be categorised under financial institutions.

A commercial bank has been described thus:

> *'A bank authorized to receive both demand and time deposits, to make loans, to engage in trust services, to issue letters of credit, to rent time-deposit boxes, and to provide similar services."*[180]

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[178] ThisDay Newspaper: Nigeria Bond Market As Alternative Funding For Oil And Gas Projects (28 May 2013), available at *http://allafrica.com/stories/201305280707.html?viewall=1*, accessed on 13 November 2013.
[179] Garner op cit (n30) 706.
[180] Garner op cit (n30) 165.

Commercial banks offer loans to finance oil and gas projects. These loans can be senior loans, junior loans and mezzanine loans. Loans especially senior loans usually require some form of security.

- **Nigerian banks**

Commercial banks in the performance of its service of giving loans have a vital role to play in financing oil and gas projects particularly for IIOCs. Until recently in Nigeria, there was little or no information obtained on the funding of oil and gas projects by commercial banks in Nigeria. This can be due to the fact that the operations in the oil and gas sector were often shrouded in secrecy. In addition, local commercial banks had previously played a limited role in funding oil and gas projects due of its low level of liquidity and its inability to provide long-term loans for capital-projects.[181] As a result, funding was mainly sourced from foreign banks.

In 2004, there was a restructuring of the Nigerian banking sector that mandated commercial banks to increase their capital base from N2 billion to N25 billion. In 2009, there was another restructuring and intervention in the Nigerian banking system by the CBN which increased the capitalization of the banks.[182]

These changes seem to have improved the financial position of the Nigerian commercial banks as they are becoming active players in the oil and gas industry. In 2009, there was a $265 000 000 supplementary refinancing deal for ExxonMobil and the NNPC which was closed in London and arranged by eight Nigerian banks including United Bank of Africa, Oceanic Bank, Standard Chartered Bank, Skye Bank, Zenith Bank, Bank PHB, Access Bank and Union Bank.[183]

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[181] Michael Eboh Energy Financing: Nigerian banks come of age, Vanguard Newspaper 04 February 2014, available at *http://www.vanguardngr.com/2014/02/energy-financing-nigerian-banks-come-age/*, accessed on 5 February 2014.
[182] Ibid.
[183] Africa: 'Local Financing of oil and gas industry' available at, *http://groundreport.com/africa-local-financing-of-oil-and-gas-industry/*, accessed on 18 September 2013.
UBA Leads ExxonMobil/NNPC US$265 Million Upstream Financing. Available at *http://www.ubagroup.com/mc/newsandevents/newstopic?id=news187*, accessed on 18 November 2013.

Generally, a Nigerian bank cannot solely finance oil and gas projects because of the huge capital required for long term. It would also want to limit its exposure to the risks involved. Therefore, funding can be obtained by using a syndication of local banks or international banks.[184] Some Nigerian banks have set aside funds for oil and gas projects whilst concurrently creating special departments for oil and gas issues.[185]

- **Foreign banks**

On the other hand, foreign commercial banks when lending money to finance oil and gas projects require the following:

'A viable project;

Backing of a strong sponsor;

Sustainable macro-economy in the country;

Cash-flow from the project used for payment.'[186]

Furthermore, issues such the current level of insecurity, cash flow projections, environmental concerns and country risk are taken into account in

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[184] Nigeria: First Bank Assigns $3.2 Billion To Finance Oil, Gas Projects, available at *file:///C:/Users/Funmi/Downloads/Dissertation/Nigeria%20%20First%20Bank%20Assigns%20$3.2%20Billion%20To%20Finance%20Oil,%20Gas%20Projects%20-%20Ventures%20Africa.htm,* accessed on 14 July 2013. Punch Newspaper: Diamond Bank commits N150billion to oil, gas financing (September 1 2013). *http://www.punchng.com/business/diamond-bank-commits-n150bn-to-oil-gas-financing/* accessed on 15 November 2013.
Businessday Newspaper (7 March 2013) Nigerian financial institutions can support oil and gas projects - Aigboje Aig-Imoukhuede, available at *http://businessdayonline.com/NG/index.php/oil/52681-nigerian-financial-institutions-can-support-oil-and-gas-projects-aigboje-aig-imoukhuede*, accessed on 14 August 2013.

[185] Olusola Bello First Bank finances over N750bn oil and gas projects BusinessDay 16 May 2013 available at, *http://businessdayonline.com/2013/05/first-bank-finances-over-n750bn-oil-and-gas-projects/*, accessed on 3 December 2013.
National Oil and Gas Intelligence First Bank commits N500bn to petroleum projects finance NOGIntelligence Issue18, available at *http://www.nigeriaoilandgasintelligence.com/first-bank-commits-n500-billion-to-petroleum-projects-finance/*, accessed on 3 December 2013.

[186] Kevin Godier and Jon Marks *Financing Energy Projects in Africa* (2000) 58.

financing projects.[187] These factors may also increase the cost of funding.[188] Foreign commercial banks are cautious of lending money to countries with high political risk.

4.3.2 The African Finance Corporation (AFC)

The AFC is an African financial institution established in 2007 which provides financing for infrastructure, natural resources, power, transportation and telecommunication on the continent.[189] Presently its membership is drawn from West African countries. It has financed several projects in Nigeria, Ghana, Cape Verde, Cote d'Ivoire, Kenya, and South Africa among other countries.[190] It finances projects through debt, equity and guarantees.

The AFC contributed a sum of $20 000 000 as equity investment in Seven Energy, an indigenous oil and gas exploration and production firm. The investment constituted part of a $200 000 000 equity and debt raised by Seven Energy, earmarked for the development of gas reserves in the Niger-delta region of Nigeria.[191]

In 2011, the AFC was a Joint mandated lead arranger with Access Bank in $150 000 000 senior debt syndication where it invested $80 000 000. The loan facility was to assist Neconde Energy, an indigenous oil company in the upstream oil and gas sector fund its acquisition of Shell's Joint Venture interest in an OML.[192]

4.4 Multilateral Development Banks

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[187] Ibid.
[188] Olaniwun op cit (n147) 47.
[189]. AFC 'About Africa Finance Corporation', available at *www.africafc.org/*, accessed on 24 September 2013.
[190]. AFC 'FAQ', available at *www.africafc.org/?page_id=39*, accessed on 24 September 2013.
[191] AFC 'AFC invests US$ 20 Million in Oil and Gas Firm Seven Energy', available at *http://www.africafc.org/?p=833*, accessed on 24 September 2013.
[192] AFC 'AFC Finances Landmark Oil and Gas Acquisition by a Nigerian Company', available at *www.africafc.org/?p=1787*, accessed on 24 September 2013.

Multilateral Development Banks offer financial assistance and analogous professional advice for developing countries.[193] They are very essential in funding projects in developing countries as they are prominent participants in privatisation policies, provide financial assistance in countries with high political risk, and encourage financing in the private sector.[194]

Membership of MDBs is drawn from both developing and developed countries and is not restricted to a particular region despite the bank's location.

MDBs denote the World Bank Group and the following regional development banks:

- The African Development Bank (AfDB).
- The European Bank for Reconstruction and Development (EBRD).
- The Asian Development Bank.
- The Inter-American Development Bank.

For the purposes of this dissertation, it will suffice to discuss only the World Bank Group and the AfDB.

4.4.1 The World Bank Group

The World Bank Group is made up of five institutions: the International Bank for Reconstruction and Development (IBRD), the International Financial Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), the International Centre for the Settlement of Investment Disputes and the International Development Agency (IDA). The IBRD, IFC, MIGA are important institutions in project finance especially in financing oil and gas projects. The Bank's role is intended to be primarily that of a catalyst.

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[193] World Bank :Affiliates, available at *http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20040612~menuPK:8336267~pagePK:51123644~piPK:329829~theSitePK:29708,00.html*, accessed on 12 November 2013.

[194] Gatti op cit (n39) 190.

4.4.2 International Bank for Reconstruction and Development (IBRD)

The IBRD which is otherwise known as the World Bank was established in 1944 and caters for developing countries with average income and high credibility.[195] It provides long-term finance for infrastructural projects. The World Bank assists in creating a conducive environment to encourage financing by the private sector. This is done through provision of loans, guarantees, technical assistance and rendering of advice on diverse issues. Furthermore it assists in financing oil and gas projects by providing guarantees for the loans from the lenders against the country's political and economic risk. For the World Bank to lend money for a project, it must be considered successful ie have a ten per cent rate of economic return.[196]

The World Bank also ensures that adherence to best environmental practices and requires the HC to maintain transparency in the management of the oil revenue and protection of the public interest.[197] The World Bank is better suited to deal with political risk better than commercial banks.

Loans from the World Bank can occur in two forms. Firstly, it can be directly to the project company. It can also lend funds to the HC which re-lends it to the project company. The direct lending to a project company entails a loan agreement between the World Bank and the project company while the HC acts as a guarantor.[198]

The World Bank also offers PRGs to countries eligible for borrowing from the IBRD and IDA.[199] They are used in private sector investments to protect lenders against political risk. It guards against risks by government of the HC such as currency convertibility, expropriation, change of law and breach of contract. In return, the government of the HC covers risks such as political violence, war and

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[195] Hoffman op cit (n31) 192.
[196] Godier and Marks op cit (n118) 8.
[197] Oil and Gas Policy Issues, available at *http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTOGMC/0,,menuPK:463288~contentMDK:20219974~pagePK:148956~piPK:216618~theSitePK:336930,00.html*, accessed on 10 November 2013.
[198] Hoffman op cit (n31) 50.
[199] World Bank Guarantees: 'Countries and Project Eligibility', available at *http://web.worldbank.org/external/default/main?theSitePK=3985219&piPK=64143448&pagePK=64143534&menuPK=64143511&contentMDK=20191697*, accessed on 11 November 2013.

expropriation and indemnifies the IBRD for the repayment of any advances made to the lenders under the PRG.[200] This is set out in a government support agreement. This guarantee is not popular in project finance as it is mostly accessible to investors who are in financing agreements with the government or SPVs guaranteed by the government.[201]

4.4.3 International Finance Corporation (IFC)

The IFC is a member of the World Bank and was established in 1956. It is the largest global development organisation whose emphasis is on the private sector in developing countries.[202] It plays an important role in the financing of projects including oil and gas projects by providing long-term loans, guarantees and equity financing, and risk management and advice among other services.

The main aim of the IFC in relation to project finance is to encourage the development of the private sector and mitigate country risks in terms of breach of contract, convertibility and expropriation.[203] Its participation in a project is similar to a World Bank guarantee as its presence in the project enhances its success which is important to the lenders and investors.[204] Its major difference from the World Bank lies in the fact that the World Bank financing is geared towards the public sector while the IFC focuses on the private sector and does not necessitate the guarantee of the government of the HC to finance a project.[205] However, the IFC can also provide financing for a project that the public sector is involved in, if it has a private investor and the aim of the project is to make a profit.[206]

The IFC also expects that the project must be of benefit to the investors and economy of the HC and must comply with the required environmental standards.

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[200] Gatti op cit (n39) 193.
Hoffman op cit (n31) 478.
[201] Gatti op cit (n39) 193.
[202] About IFC: *http://www.ifc.org/wps/wcm/connect/CORP_EXT_Content/IFC_External_Corporate_Site/About+IFC/*, accessed on 11 November 2013.
[203] IFC Global Oil and Gas, available at *http://www.ifc.org/wps/wcm/connect/2e17440049a5ca20a138e3a8c6a8312a/IFC2012_Oil_andGasOverview.pdf?MOD=AJPERES*, accessed on 18 September 2013.
[204] Godier and Marks op cit (n118) 14.
[205] Hoffman op cit (n31) 471.
[206] Gatti op cit (n39) 194.

The IFC grants loans, equity, derivatives and partial credit guarantees.

The loans granted can be categorized into two:

- The A – loan program which are loans granted solely by the IFC to the borrower, and
- The B – loan program which is a loan is granted by the IFC to the borrower but syndicated by the IFC to commercial lenders. Repayment by the borrower is to the IFC and not the commercial lenders directly, as the IFC is the lender on record.

The IFC may also acquire equity of about five per cent to about 35 per cent in the SPV. It does not seek to have a controlling interest in the project. There may be a possible conflict of interest where the IFC occupies a dual position of a shareholder and a lender.

The IFC offers derivatives such as swaps, options, forward contracts to assist in mitigating risks. Derivatives are useful for developing countries as the IFC acts as an intermediary in providing assistance in gaining access to International capital markets.[207]

4.4.4 Multilateral Investment Guarantee Agency (MIGA)

MIGA is a member of the World Bank group. It was established in 1988 to encourage foreign direct investments in developing countries.[208] MIGA plays an important role in managing political risks and protecting investors in the World Bank member countries especially in countries where businesses are difficult to operate. This is achieved by the provision of political risk insurance guarantee which covers equity and debt. MIGA is the only agency that provides insurance against political risk.[209] It covers political risk in the oil and gas sector including transfer restriction & currency convertibility, expropriation, tariff, regulatory and credit risks arising from

[207] Gatti op cit (n39) 196.
[208] Multilateral Investment Guarantee Agency 'Overview', available at http://www.miga.org/whoweare/index.cfm, accessed on 18 September 2013.
[209] Gatti op cit (n39) 197.

breach of contract & failure to pay damages awarded by arbitration, and war & civil disturbance.[210]

4.5 Regional Development Banks

These are MDBs that have similar aims with the World Bank Group but cater for the needs of a specific geographical area in which they are located. They will be discussed briefly in connection with project financing particularly in oil and gas.

4.5.1 The African Development Bank (AfDB)

The AfDB was established in 1964 and commenced operations in 1966. It is made up of 77 member states comprising 53 African countries and 24 non- African countries and aims to promote the economic and social growth of its regional members.[211] Its operational priorities are inclusive of infrastructural development and private sector development.[212]

The AfDB provides financial assistance to both the public and private sector through loans, equity investments of either ordinary or preferred shares in a SPV and provision of PRGs to private investors to cover government risks. In addition, it also renders technical assistance and advisory services.[213]

The AfDB has provided financial support for few oil and gas projects in Africa. In 2010, the AfDB financed the Hasdrubal oil and gas field development project in Tunisia with a $150 000 000 corporate loan. The loan agreement was entered into and signed by the AfDB Group and the Enterprise Tunisienne d'Activités Pétrolières (ETAP) which is the Tunisia State oil corporation and the project includes the construction of a stand-alone gas, condensate and oil production

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[210] MIGA Extractive Industries, available at *http://www.miga.org/sectors/index.cfm?stid=1813*, accessed on 12 November 2013.
[211] African Development Bank (AfDB), available at *http://www.afdb.org/en/about-us/african-development-bank-afdb/*, accessed on 12 November 2013.
[212] Ibid.
[213] AfDB Signs USD 150 Million Loan Agreements with Tunisia' State Oil Corporation, available at *http://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic Documents/OPSM%20booklet%20ANG.pdf*, accessed on 13 November 2013.

system, an offshore gas pipeline, six offshore horizontal producing wells.[214] The project is a joint venture by British Gas Tunisia Limited and ETAP and is expected to be a source of revenue for the government.

The AfDB has been supportive towards some of its infrastructural and agricultural projects.[215] In 2002, the AfDB granted a 10 year term loan to NLNG expansion project.[216]

4.6 Export Credit Agencies (ECAs)

ECAs are used when the level of commercial and political risk in a project is considered high as they lower the risk of private lending and therefore, they have featured prominently in project finance.[217] They are often used when the SPV situate in a developing country needs to import plants or equipment required for the project.[218] They can be privately or state-owned, and are particularly useful in facilitating International trade. They serve as a guarantee for lending facilities.[219] They can cover political risk solely or with business and other risks.[220] They can also provide direct loans to exporting companies operating in their home country and loans to the importing SPV which may be in the form of direct lending, intermediary (or indirect) lending, and interest rate equalization.[221]

Direct lending to the SPV occurs when the ECA grants a loan to the SPV which may be at a subsidized interest rate to procure goods or services from the ECA's country. Intermediary or indirect lending arises when the specific ECA lends

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[214] AfDB 'African development Bank Private Sector Operations', available at *http://www.afdb.org/en/news-and-events/article/afdb-signs-usd-150-million-loan-agreements-with-tunisia-state-oil-corporation-7040/*, accessed on 13 November 2013.
[215] AfDB 'Nigeria Selected Projects', available at *http://www.afdb.org/en/countries/west-africa/nigeria/nigeria-selected-projects/*, accessed on 13 November 2013.
[216] AfDB 'African Development Bank, Law for Development Bulletin 2004', available *http://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/30724301-EN-LAW-FOR-DEVELOPMENT-BULLETIN-2004.PDF*, accessed on 14 November 2013.
[217] Export Credit Agencies, available at *http://www.fern.org/campaign/trade-and-investment/export-credit-agencies*, accessed on 14 November 2013.
[218] Gatti op cit (n39) 206.
[219]. Godier and Marks op cit (n118) 25.
[220] The Role of Export Credit Agencies in Project Financing, available at *http://whoswholegal.com/news/features/article/11811/the-role-export-credit-agencies-project-financing*, accessed on 14 November 2013.
[221] Gatti op cit (n39) 206-207.

the money to a financial institution (for instance, a commercial bank which acts as a liaison between the ECA and the SPV), which then lends to the SPV at a reduced interest rate. Interest rate equalization entails lending to SPVs by commercial banks at below market interest rates and is reimbursed by the agency for the difference between the below-market rate and the commercial rate.

Examples of ECAs include MIGA, Overseas Credit Investment Corporation (OPIC), US Export-Import bank (US Ex-Im bank) and the Exports Credit Guarantee Department (ECGD).

ECAs in some situations may not be relevant for project finance as most ECA's offer their services on a short-term basis.[222]

Major ECAs belong to the Berne Union (International Union of Credit and Investment Insurers), which promotes international coordination and exchange of information in this sector.[223]

The Organisation for Economic Co-operation and Development Consensus regulates the total financing activities of ECA's and is usually signed by its members. It seeks to organize the export credit market and prevent disagreements between different contending countries proposing more advantageous commercial terms for exports.[224]

An example of a Nigerian oil and gas project which had the support of ECAs was the Nigerian Liquefied Natural Gas (NLNG) expansion project of 2002 which involved the construction of two trains. It was known as the NLNGPlus project and at that time was considered as Nigeria's largest project financing and sub-Saharan Africa's largest private-sector financed project. It was also described by the Project Finance magazine as the "*African oil and gas deal of the year*" for 2002.[225]

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[222] Gatti op cit (n39) 206.
[223] Ibid.
[224] Ibid.
[225] Financing Strategies for LNG Export Products, available at http://www.arcticgas.gov/financing-strategies-lng-export-projects#NLNGPLUS, accessed on 14 November 2013.

The project involved NLNG, Shell, Total and AGIP as the sponsors and ECAs such as the US Ex-Im Bank, the ECGD, Istituto per i Servizi Assicurativi del Credito all'Esportazione (SACE) of Italy, and Netherland's private credit insurer Gerling NCM (currently Atradius) arranging loan guarantees of $620 million for a period exceeding eight years to the 19 international commercial banks that granted a loan towards the expansion. The AfDB and six Nigerian banks were also participants. The ECAs undertook to buy the debt from the banks if the borrower defaulted and were liable for collecting the loan. The facilities were fully repaid at 15 December 2010.[226]

4.7 Conclusion

This chapter focused on the sources of financing. It identifies the sources and their roles in the provision of funds, guarantees and insurance. The types of financing ie debt and equity were referred to. Debt financing however featured prominently due to the nature of the project. Commercial banks were first tackled as they are the principal sources of finance. Secondly, MDBs were also examined especially with regards to their different roles in providing finance, guarantees for political risks and insurance. ECAs on the other hand provide cover for political or commercial risk or both by providing insurance and guarantees for foreign borrowers or exporters.

The role of local commercial banks is very crucial. If they can provide sufficient funds to finance oil and gas projects in Nigeria with low interest rates, most of the failures of IIOCs in the production of oil in marginal fields and oil blocks would be reduced as obtaining financing for upstream projects would be much easier. IIOCs would not need to seek the assistance of MDBs or ECAs which are often expensive, impose stringent conditions and may take considerable time to conclude the loan transaction. In addition, it would encourage the participation of more indigenous companies in the exploration and production of oil. It is submitted that Nigeria should endeavour to strengthen the banking industry and consequently the banks through the reform of the sector and the enactment and implementation of

[226] Ibid.
NLNG 'Facts & Figures on LNG 2013', available at *http://www.nlng.com/publications/Facts_Figures_on_NLNG_2013.pdf*, accessed on 14 November 2013.

adequate banking laws. The Local Content Act should also be effectively monitored to ensure compliance.

Loan syndication by Nigerian banks should be embarked upon as an individual bank cannot solely fund a project. Furthermore, there should be genuine efforts to enhance political stability in Nigeria as this will motivate foreign commercial banks to increase lending to finance projects.

MDBs also serve a useful role in debt finance. They provide funds for the government and also encourage private sector participation. They provide guarantees and funds for projects in countries that may not be able to access funds from lenders because of their high political risk. An example is the World Bank which grants loans. The IFC will be beneficial in granting financial assistance to indigenous oil companies as it caters for the private sector. Therefore, it is recommended that these companies effectively utilize the services of the IFC.

Nonetheless, the use of MDBs is not without its drawbacks. For example, the interest on the loan granted is often higher than the market value. In addition, MDBs may refuse to be involved in a project if there are alternative sources of financing available as it is a lender of last resort. Also in practice, the World Bank has not rendered much assistance to oil and gas projects in comparison to infrastructural projects which seem to be its major focus and is more in line with its goals. The grant of financial assistance by the World Bank will probably have conditions attached to it which may be difficult for the country concerned to implement.

ECAs are also important in the financing of oil and gas projects as they provide guarantees and insurance cover for exporters and lenders. However, the use of ECAs often favours the economy of the exporting countries at the expense of the importing countries as they may encourage the use of expensive imports where cheaper and equally effective alternatives are available. ECAs are a cause of high debts for countries particularly developing countries which have increasing debt profiles. ECAs also tend to finance exports from their countries only.

It is recommended that indigenous companies should also examine raising equity funds from the capital market in Nigeria for oil and gas projects as this method of financing has not really been applied in Nigeria. Listing only on foreign capital markets without listing on Nigerian capital markets may not be convenient. If the company has a strong brand and a good track-record, it is expected that the Nigerian public will purchase the securities. However, the listing may be expensive and the requirements complicated for a new company.

In raising finance for projects, it should be noted that equity finance is very relevant. For example, oil exploration projects are often undertaken by means of equity finance as lenders rarely advance loans because of the high level of risk involved. Also, in other oil and gas projects, the lenders may not be willing to issue loans if there is no equity as the equity indicates commitment to the project.

In analysing the sources of finance listed above, each of the sources used individually for a project may not be appropriate for an IIOC in Nigeria in view of the risks involved, the low level of technological expertise of the IIOCs and the financial situation of the IIOCs. Though, the local banks are improved but it still remains to be seen if they have the capacity to solely fund capital intensive projects for a long duration even if they form a loan syndicate. Most projects which have been funded by Nigerian banks have had the larger part of the project financed by foreign banks. Furthermore, foreign banks may be reluctant to finance projects by the IIOCs because of their perceived inexperience, risks and uncertain security (in the case of marginal fields). The equity of the IIOCs will also be inadequate to finance the project. Therefore, the use of project finance is recommended as it takes into account these risks. Project finance will include the means of financing discussed above in the project company while the IIOC(s) will be the sponsor(s). The lenders will be repaid from the cash flow from the project with little or no recourse from the sponsor(s).

Generally, in lending money, lenders have to have some sort of security to guarantee that the loan will be repaid. In this case, the loan is to be repaid from the cash-flow and assets of the project. Therefore, a security in the form of a mortgage can be created over the lease. However, the Petroleum Act places a restriction on the

assignment in OPLs and OMLs. The Petroleum Act and Petroleum (Drilling and Production) Regulations state that prior to the assignment or transfer of a licence, lease or any associated right, power or interest, the consent of the minister for Petroleum must be obtained.

Paragraph 14 of the Petroleum Act provides that:

> *"Without the prior consent of the Minister, the holder of an oil prospecting licence or an oil mining lease shall not assign his licence or lease, or any right, power or interest therein or thereunder."*

Paragraph 4 of the Regulations states that:

> *(a) An application for the assignment of an oil prospecting licence or oil mining lease (or of an interest in the same) shall be made to the Minister in writing and accompanied by the prescribed fee; and the applicant shall furnish in respect of the assignee all such information as is required to be furnished in the case of an applicant for a new licence or lease.*
>
> *(b) Application for the assignment or takeover of an oil prospecting licence or oil mining lease (or of an interest in the same) shall be made to the Minister in writing and accompanied by the prescribed fees at the discretion of the Minister; and the applicant shall furnish in respect of the assignment, or takeover, all such information as is required to be furnished in the case of an applicant for a new licence or lease."*

This in effect means that the consent of the minister must be obtained before a mortgage can be created over the OML. Obtaining the ministerial consent and creating the mortgage is often an arduous and time-consuming process. Although the Petroleum Act and the Petroleum (Drilling and Production) Regulations stated that a

written ministerial consent is required prior to the assignment of a licence but it could not be determined whether a share transfer could be regarded as an assignment.[227] The purport of the above provision was uncertain until the decision in *Moni Pulo v Brass Exploratory Exploration Ltd supra* was given.

The DPR has the duty of registering mortgages over OPLs and OMLs. Alternatively, a charge can be created over the OML but this will be equitable in nature. This does not require the consent of the minister and registration with the DPR. The charge can be registered as a debenture by the Corporate Affairs Commission which is the companies' registry in Nigeria. However in the event of a default on the payment of the loan or perfection of the security, consent to the transfer of the OML may not be granted by the minister and may result in the lender's inability to enforce the security or recover the funds borrowed. The importance of the prior consent of the minister was highlighted in the case of *Moni Pulo v Brass Exploratory supra.*[228] This requirement is also contained in the draft PIB.

Although it is recognised that the prior consent of the minister is to discourage any abuse in the assignment of an interest, it is proposed that the conditions for creating a mortgage and obtaining the minister's consent be made conducive to encourage financing.

It is submitted that if the political and economic condition of a country is conducive and the country has a positive credit rating, it will be easier to access finance from local and foreign banks.

[227] Paragraph 14 and 16 of the First Schedule to Petroleum Act Cap P10 LFN 2004.
Paragraph 4 (a) and (b) of the Petroleum (Drilling and Production) Regulations as amended.
[228] Moni Pulo v Brass Exploratory supra.

5. THE NORWEGIAN INSTITUTIONAL AND REGULATORY FRAMEWORK

5.1 Introduction

There are several oil and gas producing countries in the world with distinctive regulatory and contractual frameworks for their upstream oil and gas sector and financing the projects. This chapter attempts to analyse the Norwegian oil and gas sector in comparison with that of Nigeria's. Norway has been selected because of its reputation as a country with an exemplary framework for other countries to emulate and also supports indigenous participation. Moreover, the Nigerian draft PIB is modelled after the legal framework of the Norwegian oil and gas upstream sector.

5.2 Brief Overview on Norway

Norway is a developed country in Europe which derives its revenue mainly from the oil and gas. Its oil and gas resources were discovered in 1969.[229] Norway possesses the largest reserves of oil and gas in Europe.[230] It is rated fourth in the production of natural gas in the world.[231] It is also the second largest exporter of natural gas and the seventh largest exporter of oil in the world.[232]

Although Norway is not rated on the 10 top oil and gas producing countries, it is regarded globally as a forerunner in upstream activity in offshore areas.[233] It has been described as setting a standard for other

[229] Ministry of Petroleum and Energy 'Norway's oil history in 5 minutes', available at *http://www.regjeringen.no/en/dep/oed/Subject/oil-and-gas/norways-oil-history-in-5-minutes.html?id=440538*, accessed on 12 January 2014.
[230] US Energy Information Agency Countries Norway, available at *http://www.eia.gov/countries/cab.cfm?fips=NO*, accessed on 8 January 2014.
[231] Ibid.
[232] Ibid.
[233] Studies of Regulatory, Corporate and Financial Alternatives for the Exploration and Production of Oil and Gas and the Industrial Development of the Oil and Gas Production Chain in Brazil, available

countries due to its exemplary and transparent management of its petroleum resources and revenue.[234] Norway also places importance on measures to enhance environmental sustainability.[235]

Norway has promoted indigenous participation in its oil and gas sector. In the 1970s, it ensured the transfer of technology by the IOCs through contractual provisions by making it a condition in issuing production licences.[236] Norway also fostered partnership between IIOCs and IOCs in research and development.[237] Contracts were awarded to IIOCs which offered competitive prices, quality and quality in comparison with their foreign counterparts.[238]

5.3 The Norwegian Legal, Regulatory and Contractual Framework

Norway's legal, regulatory and contractual framework is highly organised and transparent. The regulatory framework for its upstream oil and gas sector has also been consistent.[239] The main laws regulating the Norwegian petroleum sector are the Petroleum Act (Act 29 November 1996 No. 72 relating to petroleum activities) referred to as the Petroleum Activities Act and the regulations issued thereunder (Regulations of 27 June 1997 No. 653) referred to as the Petroleum Activities Regulations and the Petroleum Taxation Act (Act of 13 June 1975 No. 35). Similar to Nigeria, the oil resources in Norway are also vested in the state.[240] The Ministry of Petroleum and Energy supervises the petroleum sector and the Norwegian Petroleum Directorate regulates the petroleum sector.

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at *http://www.bain.com/bainweb/images/LocalOffices/BNDES_Consolidated_Report_BNDES_eng.pdf*, accessed on 25 December 2013.

[234] IEA Executive Summary and Recommendation, available at *http://www.iea.org/Textbase/npsum/norway2011sum.pdf*, accessed on 30 December 2013.

[235] Ibid.

[236] Ubong Michael 'Local Content In The Global Oil Industry: Driving Growth, Transforming Emerging Economies' Nigerian Orient News 11 October 2013 available at http://www.nigerianorientnews.com/?p=4700, accessed on 9 February 2014.

[237] Ibid.

[238] Ibid.

[239] Ibid.

[240] Section 1 (1) of the Petroleum Activities Act.

The Petroleum Activities Act and the Petroleum Activities Regulations contains the general legal basis for the contractual agreement of licensing which governs Norwegian petroleum activities. The Petroleum Act stipulates that Norway solely operates the contractual form of concessions. This is done through a license which grants IOCs rights of exploration and production.[241] The award of the license is usually through a bidding system and is granted based on the company's expertise, experience and work plans. This is also similar to the Nigerian system of bidding. There are two types of licences granted:

- The exploration licence
- The production licence

The exploration licence is for an initial duration of three years and allows the companies granted non-exclusive rights in the area designated solely for exploration.[242] The production license is for an initial period of 10 years which can be extended to 30 years or 50 years.[243] It permits the company to exclusively survey, drill and explore for petroleum and thereafter become the owner of the petroleum produced.

Norway imposes a company income tax and petroleum profits tax at a rate of 28 per cent and 50 per cent respectively.[244] The company income tax is paid by all companies operating businesses in Norway while the petroleum profits tax is imposed on upstream petroleum activities.

The petroleum sector operates through these companies which are monitored by the Ministry. These are:

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[241] Section 1(3) of the Petroleum Activities Act.
[242] Section 2 of the Petroleum Activities Act.
[243] Section 3(9) of the Petroleum Activities Act.
Facts 2013 The Norwegian Oil Sector, available *at* *http://npd.no/Global/Engelsk/3 Publications/Facts/Facts2013/FACTS_2013.pdf*, accessed on 10 January 2014.
[244] Norway's different approach to oil and gas development, available at *http://www.arcticgas.gov/norway%E2%80%99s-different-approach-to-oil-and-gas-development*, accessed on 10 January 2014.

- Statoil
- Petoro
- Gassco

Statoil

Statoil is an international energy company which was established in 1972. It is the Norwegian NOC which has 70 per cent of its shares held by the Norwegian government.[245] Statoil does not solely operate in Norway but also has a presence in about 33 countries including Nigeria.[246] It is the largest operator in Norway and manages about 80 per cent of the oil and gas production in Norway.

Previously, oil and gas exploration projects were financed by the state through Statoil and by the IOCs. In 1985, the State's Direct Financial Interest (SDFI) was established and was administered by Statoil. Through the SDFI, the government acquired interests in several oil and gas activities. It involved the use of government funds to invest in the oil and gas upstream sector particularly in financing production licences.[247] The creation of the SDFI meant that revenue from the state investments formerly accruing to Statoil was transferred to the SDFI. Consequently, Statoil had to finance projects with her funds or sourced for loans.[248] Thus the SDFI acting for the state together with the IOCs and Statoil financed projects. In 2001, Petoro was created to act as a licensee and oversee the SDFI assets, thus acquiring control of the SDFI from Statoil.[249]

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[245] Statoil 'The Norwegian State as a Shareholder', available at *http://www.statoil.com/en/about/corporategovernance/shareholder/pages/thenorwegianstateasshareholder.aspx*, accessed on 29 December 2013.
[246] Statoil 'Statoil in Brief', available at *http://www.statoil.com/en/About/InBrief/Pages/default.aspx*, accessed on 9 January 2014.
[247] Ministry of Petroleum and Energy 'Norway's oil history in 5 minutes', available at *http://www.regjeringen.no/en/dep/oed/Subject/oil-and-gas/norways-oil-history-in-5-minutes.html?id=440538*, accessed on 12 January 2014.
[248] Statoil 'Petoro SA', available at *http://www.statoil.com/annualreport2009/en/ouroperations/regulation/pages/petoroas.aspx*, accessed on 30 December 2013
[249] Ibid.

In 2001, Statoil was listed on the Oslo stock exchange. In addition, it is also listed on the New York Stock Exchange. This enabled it access funds from the public to finance projects.[250] Thus Statoil became ceased to exist as a wholly state-owned company and also established itself as an oil company in several countries where it also finances its operations by means of equity and debt.

Petoro

Petoro is a solely state-owned company which was created in 2001 to oversee the commercial operations and country's financial interest in several petroleum upstream activities thus transferring the supervisory role of the SDFI from Statoil to Petoro. This was as a consequence of the partial privatisation and listing of Statoil. It is the licensee for petroleum operations.[251] Unlike Statoil, its role is limited to Norway and does not perform the role of an operator. It can however, acquire equity interests in any lease in Norway ranging from 20 per cent to 60 per cent.[252] The marketing and sale of the petroleum products are also undertaken by Statoil whilst Petoro plays a supervisory role.

Gassco

Gassco which is the third company is a state-owned company and controls the shipping of natural gas by pipeline. It acts as an operator.

Unlike Nigeria, Norway does not make utilise project finance in financing its upstream projects. This is because it is a low risk and politically stable country and therefore has a high credit-rating for the country and companies operating in it. Consequently, Norway can obtain cheaper means

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[250] 'Statoil- a decade on the stock exchange', available at *http://www.statoil.com/en/about/history/tenyearsasalistedcompany/pages/default.aspx*, accessed on 30 December 2013.
[251] Petoro 'Key Duties', available at *http://www.petoro.no/what-we-do/key-duties*, accessed on 29 December 2013.
[252] Norway's different approach to oil and gas development, available at *http://www.arcticgas.gov/norway%E2%80%99s-different-approach-to-oil-and-gas-development*, accessed on 10 January 2014.

of finance than project finance and also easily access funds for its projects.

5.4 Conclusion

The Norwegian system involves the separation of commercial and regulatory roles. This encourages transparency and accountability while circumventing a conflict of interest.

As well as Nigeria, Norway's oil and gas sector was dominated by IOCs in its early stages of development. However, Norway realised the benefits of developing her petroleum sector and therefore ensured that the indigenous resources were adequately trained by way of technology transfer from its contracts with the IOCs and could effectively participate in the sector. This in turn led to the building of a formidable and independent NOC capable of operating in Norway and other countries. Nigeria can borrow a leaf from this and endeavour to develop the technical expertise of her NOC and invariably her oil and gas sector by adequate training and indigenous participation.

There should also be a separation of the commercial and regulatory roles currently being exercised by the NNPC. This will result in the neutrality and transparency much sought after in the Nigerian petroleum industry.

6. CONCLUSION

This dissertation has shown the various issues bordering on the financing of upstream oil and gas projects with emphasis on the challenges of raising funds by indigenous oil companies. Financing of petroleum projects by indigenous oil companies in Nigeria is preferably achieved through project finance mainly because of the high level of risk, huge capital and its long-term duration.

Closely linked with the issue of financing is that indigenous participation. An active indigenous participation in petroleum projects often indicates a corresponding high level of technical expertise and financial resources. In Nigeria, there has been a low level of indigenous participation which somewhat explains the challenge of minimal financing being faced. In a bid to resolve the issue, Nigeria introduced the licensing of marginal fields and award of oil blocks to indigenous oil companies.

The sources of finance for oil and gas projects are also diverse and take into account several risks which may deter the repayment of the investment. Financing can be by way of equity and debt obtained from the project sponsors, lenders, capital market etc. Debt finance is frequently utilized in comparison with equity finance and is also used in project finance. Financial assistance can also occur as money, guarantees and insurance.

The Norwegian legal framework for her upstream sector was also examined as a model framework to overhaul Nigeria's oil and gas sector. This is proposed to be achieved by the PIB which is adapted from the Norwegian legal framework.

The Nigerian government should adopt measures to develop and strengthen the oil and gas sector in the long-term rather than focus on short-term returns.

It is proposed that in line with the draft PIB and the Norwegian oil

and gas sector, there should be a separation of dual roles of commercial and regulatory roles by regulatory bodies in Nigeria. If accomplished, this will avoid conflict of interest and promote transparency and neutrality in the sector.

Indigenous participation should be promoted in Nigeria to assist in facilitating financing and investment in Nigeria. This will improve technological expertise which will in turn build and develop the NOC to operate in other countries as well as Nigeria and thus, increase the revenue accruing to Nigeria. Indigenous oil and gas companies should consider merging more often with other indigenous companies or IOCs for some projects particularly in cases where two or more companies possess the financial capacity and technological expertise to carry out a project. Although, there have been several cases of mergers, more mergers should be supported as this will accelerate technological advancement and increase financing by local commercial banks.

Indigenous participation will encourage financing as the revenue accruing to the indigenous sponsors of the project will be reinvested in Nigeria and subsequently can be utilized for future projects.

Loan syndication by Nigerian banks should be utilized more often in project finance for projects. This can be done in conjunction with foreign banks to ensure the interest is repatriated to Nigeria.

The Nigerian government also has a foremost role to play in enhancing the political stability in Nigeria so as make it easier to access funds from foreign and local commercial banks. Accessing of funds from the capital market through the issuing of debt and equity for financing oil and gas upstream projects as done in other countries should be encouraged in Nigeria. This can be made attractive to investors by providing sufficient information on the oil and gas industry and making the process transparent.

The government can further address environmental damage by

ensuring that adequate measures are taken to prevent environmental damage while its breach will concurrently attract a heavy penalty and remedy of the breach to deter offenders. This will serve the twin function of tackling political and environmental risks.

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