THE ENERGY MERGERS & ACQUISITIONS REVIEW

Editors
Sean T Wheeler, Kristin Mendoza, Roald Nashi
and Robert S Fleishman

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PREFACE

Energy underpins our economy and is central for economic growth globally. Energy makes possible the investments, innovations and new industries that are the engines of jobs, growth and shared prosperity for entire economies. Although fossil fuels remain critical energy resources across the globe, the energy landscape is transforming, and renewable energy is playing an increasingly important role in helping countries develop modern, reliable and resilient energy systems, and address environmental and climate change concerns.

As the pre-eminent energy guru Dan Yergin has stated, 'innovation in the energy space is quite important'; 'innovation doesn't end; technological progress doesn't end'. The history of the energy industry is 'really the story of one innovation after another, starting with Colonel Drake in oil and Thomas Edison with the light bulb, to shale gas today'. And since Yergin said these things, innovation has indeed continued, as we have seen significant technological progress in electrical storage and smart energy networks.

Energy M&A is important in the facilitation of innovation, technological change, growth and access to resources in the energy industry. Effective energy M&A practitioners must address a broad range of legal and other issues that arise in all M&A transactions, as well as issues unique to the energy space. This volume puts down a marker in describing many key energy-related M&A issues. That is why this volume is important.

Kirkland & Ellis is a global law firm with over 250 lawyers involved in energy and infrastructure matters. We thought it was time for the firm to take a leadership role in working with *The Law Reviews* to launch this inaugural volume and serve as global editors.

We would like to thank all the lawyers at Kirkland who developed the US chapter. We would also like to thank the contributing authors from Brazil, Hungary, Nigeria, Portugal and Singapore for their efforts in helping to put together this inaugural volume.

We hope our readers will find this to be a useful resource as they navigate the changing landscape of energy M&A.

Sean T Wheeler, Kristin Mendoza, Roald Nashi and Robert S Fleishman
Kirkland & Ellis LLP
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Chapter 3

NIGERIA

Gbolahan Elias, Okechukwu J Okoro and Yemisi Falade[1]

I OVERVIEW

There are two broad sub-markets in issue in Nigeria: the oil and gas sub-market and the electric power sub-market. Each sub-market has a separate regulator – the Department of Petroleum Resources (DPR) for oil and gas and the Nigerian Electricity Regulatory Commission (NERC) for electric power – and caters primarily to different major buyers: foreign traders for oil and gas, domestic consumers and business people for electric power.

Low international prices for oil and gas and for electric power domestically mean that acquisition financing has become harder to access than it was previously. The low prices for oil and gas are functions of foreign markets. The low price of domestic electric power is a function of Nigerian regulation. Uncertainty about the regulatory environment in the sectors does not appear to us to have been a factor in determining the level of M&A activity. For example, the failure to pass the much-needed Petroleum Industry Bill (PIB) does not appear to have had an adverse effect on M&A activity in the sectors. The PIB is concerned with the issues of:

a tax burdens;
b the division of power between bureaucrats and political appointees;
c the creation of government-controlled agencies; and
d the organisation of business.

While the M&A market for energy has been less busy lately than it has been at other times during the course of the past six years, it is far from being inactive. The oil and gas market has been especially active, because the largest international oil company (IOC) producer in this market has been carrying out a programme to divest a range of onshore acreage assets with a view to focusing on larger offshore acreage assets. The electric power market has also been unusually active because of a federal government programme to sell several generation and distribution companies.

The above-mentioned divestment and privatisation programmes have now largely run their course. However, there have still been owners selling and would-be buyers bidding to buy or trying to sell oil and gas assets upstream, midstream and downstream. The success of the divestment programme has prompted other IOCs to initiate their own acreage divestment programmes. Interest in buying and selling electric power companies remains strong, too, although few deals have actually been concluded.

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1 Gbolahan Elias is a partner and Okechukwu J Okoro and Yemisi Falade are senior associates at G Elias & Co.

II YEAR IN REVIEW

Major M&A deals have been concluded and announced in the downstream (e.g., Forte Oil), midstream (e.g., Seven Energy) and upstream (e.g., Seplat) oil and gas sector, and also in the thermal (e.g., Transcorp Afam) and solar power (e.g., NEOT) sector. Several deals are still being negotiated, albeit unannounced, in each one of the foregoing areas, as well as for electric power distribution companies.

Three legislative and regulatory developments are especially noteworthy.

First, the Deep Offshore and Inland Basin Production Sharing Contracts (Amendment) Act (2019) has been passed into law. This Act reviews the royalty rates for deep offshore production sharing contracts upwards, and calls for a review of the fiscal terms of such contracts every eight years. Unsurprisingly, many industry actors have taken a very dim view of the Act.

Industry actors have also taken a dim view of a new bill, still before the federal legislature, which proposes removing the exemption from withholding tax that currently applies to dividends paid out of the profits of upstream petroleum production operations.

Thirdly, Nigeria now has a dedicated, sector-neutral merger control regulator in the Federal Competition and Consumer Protection Act (2019) (FCCPA). Prior to that Act, the capital markets regulator doubled as the major control regulator, and changes of control that are either indirect or that occur at the level of foreign parent companies rather than within a Nigerian company were not regulated under Nigeria's general merger control law. This has now changed.

III LEGAL AND REGULATORY FRAMEWORK

Energy M&A deals need both sector regulator (DPR and NERC) and sector-neutral merger control approval to be concluded. The sector-neutral merger control authority is now the Federal Competition and Consumer Protection Commission (FCCPC). It used to be the Securities Exchange Commission until early 2019.

General merger control approval is needed for all energy sector mergers where the acquirer and the target combined are worth the equivalent of US$1.4 million in terms of either turnover or assets. This is the position under the FCCPA whether a merger is structured as an acquisition of shares or otherwise.

The approval of the stock exchange and the securities regulator is also needed where merging companies are either listed or simply public companies. The focus of these approvals is on making full disclosure to investors, while that of the general merger control regulator is on protecting competition and consumers.

A simple asset or shares acquisition may be effected purely by contract. Where liabilities (and not only assets) are to be transferred, the parties to the transaction may achieve their aims either under a contract with the consent of the creditors (novation) or by court order where the court is satisfied that the interests of the creditors will not be unfairly prejudiced.

The statute that sets out the mechanism for effecting a transfer of liabilities by court order is the Companies and Allied Matters Act (1990). It empowers the courts, following a meeting of the shareholders and the approval of a 75 per cent majority, to 'sanction an arrangement' whereby the assets and liabilities of two or more companies may become vested in only one company.

The approval of the sector regulators is also required both by statute and by regulation. The DPR, acting for the Minister for Petroleum Resources, must approve acquisition transfers, whether of acreage, assets, shares or operating licences, in petroleum companies. Where assets are marine vessels or the licences to operate them, disclosure to the shipping regulator is needed, but not its consent. Similarly, NERC's approval is required for acquisition transfers of shares, licences or assets of companies holding NERC licences. Every company operating assets generating more than 1 megawatt, or running a distribution network with more than 100 kilowatt capacity or a transmission network, must have a NERC licence.

Clearance from the tax authorities is also needed in respect of companies' income tax where there is to be a merger or an acquisition effected by a transfer of assets. This clearance is not needed in the case of upstream petroleum company M&A transactions (they pay petroleum profits tax, not general companies income tax) or share acquisitions by any kind of company.

IV CROSS-BORDER TRANSACTIONS AND FOREIGN INVESTMENT

Both foreign and domestic players have been active in the oil and gas and electric power sub-markets. For example, of the deals mentioned in Section II:

a the two parties in Forte Oil were Nigerian;
b Seplat, which is Nigerian but listed in London, acquired Eland, a UK company listed in the UK;
c the acreage-divesting IOCs were all foreign; and
d NEOT is European.

There are no prohibitions on foreign involvement in the energy market in Nigeria. Foreign nationals may fully own, invest and participate in Nigerian companies, except for enterprises producing arms and ammunition, narcotics and psychotropic substances, and military and paramilitary, police, customs, immigration and prison service uniforms and accoutrements. However, in practice, the DPR does not give more than a 40 per cent equity (as distinct from economic) interest in an oil field to a foreign-controlled company; and it will give that 40 per cent to the foreign controlled company only where that company has incorporated a subsidiary in Nigeria for that purpose.

Further, a foreign company can invest in assets in Nigeria, but it cannot operate assets in Nigeria directly and in its own right. It must incorporate a company in Nigeria to do so (except in very rare cases where it gets a special exemption from registration as an invitee to Nigeria by the federal government to execute any specified individual or loan project, or as an engineering expert engaged on an individual specialist project).

The Nigerian company must then be registered with the Nigeria Investment Promotion Commission (NIPC) before it starts operations. NIPC's prevailing practice is to decline to register businesses in which foreign nationals do not invest at least 10 million naira.

However, the Nigerian Oil and Gas Industry Content Development Act 2010 (LCA) provides for exclusive consideration to be given to Nigerian indigenous service companies for the award of certain contracts in the oil and gas sector.[2] The LCA also provides for preferential rights to be given to Nigerian independent operators in the award of oil blocks, oil field licences and oil lifting licences.[3] While the terms 'Nigerian indigenous service company' and 'Nigerian independent operator' are not defined, a Nigerian company is defined under the

2 Local Content Act, Section 3(2).

3 Local Content Act, Section 3(1).

LCA as 'a company formed and registered in Nigeria in accordance with the provisions of the Companies and Allied Matters Act with not less than 51 per cent equity shares held by Nigerians'. The LCA does not exclude companies registered in Nigeria with majority foreign participation from participating in the Nigerian oil and gas sector. The LCA only provides that companies that are majority-owned by Nigerians will have priority over companies with majority foreign participation regarding gaining rights to oil leases, oil lifting, oil trading, providing training services, and funding from the government and third parties.

Similarly, under the NERC Regulation on National Content Development for the Power Sector 2014 (Regulation), licensees under the Electric Power Sector Reform Act are to ensure that qualified Nigerian companies are given first consideration for the supply of goods and works and for the provision of services in the electric power sector. The term Nigerian company is not defined under the Regulation; however, a Nigerian operator is defined as 'a company incorporated in Nigeria with the object of providing goods and services for the Nigerian Electricity Supply Industry'.

Parties to M&A transactions are free to choose the governing law and dispute resolution clauses for their transaction documents. The parties' choice of law to govern their transaction documents would be upheld by Nigerian courts in proceedings regarding all matters relating to the construction, validity and performance of the transaction. Such choice of law will be upheld by Nigerian courts, provided the choice of law was not made in bad faith or contrary to mandatory Nigerian statutes or Nigerian public policy.

V FINANCING

Loans, bonds, equity offerings (whether private or public) and share exchange, cash holdings and sales have all been used extensively to pay for energy sector M&A transactions. This has been the case across the various areas of the sector. Existing cash holdings are an obvious way to pay for smaller acquisitions.

Some electric power privatisation acquisitions are paid for by the parent company of the acquirer issuing bonds and shares to put in place a war chest for the acquisition. It is also not unusual for acquirers to take out loans and issue bonds to pay off or pay down the creditors of target distressed companies as part of the process of acquiring them. Three points deserve further comment.

First, for now (some attempts to reform the law are ongoing) the old common law rules against a company financing the acquisition of its own shares continue to apply in Nigeria. This means that where an acquisition is to be financed with debt, there will typically be an acquisition vehicle that will be the borrower of record and hold shares in the target, and that the target's assets cannot be used as collateral. Most privatisation energy acquisitions are financed using this structure.

Second, the use of forward sale financing structures to pay for oil and gas sector acquisitions is emerging. These structures were originally developed in the context of project. Under the structure, the acquirer would sell future oil production forward, get a large payment at that time of much of the price and apply that payment to pay for the acquisition.

Third, careful tax planning is critical to optimal structuring. At some risk of oversimplification, it is broadly correct to say that acquisitions of shares and formal mergers are more tax-efficient than asset acquisitions with respect to capital gains tax and stamp duty rates. Further, the rules governing official clearance for the adjustments to be made to companies' income tax on the commencement and cessation of business apply to midstream and downstream oil and gas companies and electric power companies, but not to upstream petroleum companies.

On the face of the legislation, capital gains tax at a rate of 10 per cent and stamp duty on sale documents for assets at a rate of 1.5 per cent are chargeable on asset sales transactions. Both compliance with these rules and the enforcement of the rules have been patchy. Formal mergers are exempt from capital gains tax where one of the companies is dissolved as part of the merger process and the consideration is in kind rather than cash. Share sales are exempt from capital gains tax and attract only nominal stamp duty. These rules present obvious opportunities for tax planning.

VI DUE DILIGENCE

Undertaking a due diligence exercise is an essential aspect of entering into an energy M&A transaction. Legal, financial and environmental due diligence are commonly conducted for energy M&A transactions in Nigeria. There are no peculiarly Nigerian considerations on project and asset evaluations.

The pertinent aspects of the legal due diligence are usually in respect of the corporate structure, regulatory (including environmental) compliance, security arrangements over assets, and existing litigation or arbitration. Depending on the target company, a search may have to be conducted at the lands registry, the Corporate Affairs Commission (CAC) and other relevant registries. It is prudent to make inquiries at the offices of the sector regulators.

Other aspects of the legal due diligence in energy M&A transactions include:

a material contracts;
b assets;
c bank and pension liabilities;
d employment contracts;
e intellectual property and technology rights;
f pending and potential litigation and claims; and
g tax and other statutory and regulatory compliance (including environmental impact assessment approvals, and work programme approvals in the oil and gas sector).

It is crucial to conduct the above due diligence inquiries prior to consummation of M&A transactions as this will help the purchasing company to assess and provide possible solutions to mitigate legal risks and obligations identified.

It is advisable to ensure that the target company and its shareholders make representations and warranties in the transaction documentation to the effect that there are no existing liens and regarding the authority and title to, and tax of, critical assets. The target company and shareholders should also undertake to indemnify the acquirer in the event of a breach of any of the representations and warranties, and as to other commercial matters that the parties may agree.

However, an acquirer cannot completely eliminate the risk that there may be prior security interests, because there are security interests that are not required by law to be registered at the CAC (e.g., charges over shares, receivables (including book debts) and pledges of goods), and prior registered interests may not be disclosed in the course of a search owing to possible administrative lapses at the relevant registry.

This is not unusual under company charges registration regimes that, like Nigeria's, are descendents of the prevailing English law position in the 20th century. Similarly, there are no electronic, complete and publicly available docket disclosure sources for litigation, arbitration or administrative proceedings.

A financial due diligence exercise is usually undertaken by financial advisers to evaluate the financial prowess or position of a target company and to reveal, inter alia:

a the accounting and financial control systems of the company;
b the value of its assets and liabilities;
c its product development and competitors;
d the solvency or insolvency status of the company; and
e the capacity of the company to raise short and long-term loans, and to service its outstanding debts and loans.

VII PURCHASE AGREEMENTS AND DOCUMENTATION

The enactment of the FCCPA has resulted in purchase agreements being structured for completion to occur after the approval of the FCCPC has been obtained. Parties ensure that no action that may be interpreted as an implementation of a merger is undertaken until this approval has been sought and obtained. Even for purchases that are structured as asset sales, it is imperative to obtain this approval, as any uncertainty that hitherto existed as to whether merger control approval was required for asset sales no longer exists. The criteria for the determination of whether an asset sale requires prior merger control approval are now clearly stated in the FCCPA.

For a typical energy M&A, whether in the oil and gas sector or in the electric power sector, it is usual for the target company, and in some cases the shareholders, to give extensive representations and warranties around:

a the good standing of the target;
b ownership of the shares;
c the authority to consummate the transaction;
d ownership of assets; and
e the financial standing of the target company.

Others include representations and warranties in the purchase agreements around liabilities that may arise from environmental issues. Such representations and warranties are considered fundamental warranties; therefore, claims may be made therefrom for longer durations compared to other warranties. It is also advisable to ensure that the target company and the shareholders make representations and warranties in the transaction documentation to the effect that there are no existing liens. It is also usual to have the target company and shareholders undertake to indemnify the acquirer in the event of a breach of any of the representations and warranties, and in respect of unpaid taxes. Warranty insurance is not yet widely used in Nigeria.

VIII KEY REGULATORY ISSUES

As previously mentioned, the key regulatory issues are the need for sector-neutral merger control approval from the FCCPC and sector-specific approval from NERC (for holders of NERC licences) or the DPR (for oil and gas sector actors). There are also requirements relating to tax, getting environmental impact assessments, meeting environmental standards and holding the right permits.

To the extent that an employer of any employee is to change as a result of an M&A deal, the approval of the DPR is needed in the case of oil and gas targets; that of the Minister for Labour is needed for manual or clerical employees in both sectors; and that of the Minister for Interior is needed for foreign employees in both sectors.

IX INSURANCE

Representation and warranty insurance is still quite uncommon in Nigeria, and it is largely unused in energy M&A deals. It is usual for the parties under an M&A transaction to escrow a certain part of the consideration to mitigate transaction risks.

X DISPUTE RESOLUTION

For most M&A contracts, the dispute resolution clause contains one or more options to be adopted in resolving disputes that may arise in connection with a transaction. The agreement often provides for both informal and formal dispute resolution mechanisms. It is noteworthy that M&A resulting from insolvency are usually characterised by acrimonious litigations. However, the courts will enforce the parties choice of dispute resolution and governing law.

Parties may agree to subject eventual disputes to negotiation, mediation or arbitration, or a combination thereof. The formalities governing the chosen resolution mechanism will be spelled out under a dispute resolution clause. Parties may also choose to resolve their disputes by way of litigation.

In any case, the parties are at liberty to agree the governing law and the courts with jurisdiction with respect to claims arising from contracts. Nigerian courts will recognise and enforce choice of foreign law and foreign jurisdiction clauses subject to public policy-type considerations. In any event, tax, immigration and other matters asserting claims against governmental authorities and matters regarding the dissolution or corporate status of a Nigerian insolvent company are ultimately controlled by mandatory domestic legislation irrespective of any contractual agreements between the parties.

Arbitration is fast becoming popular and the preferred dispute resolution mechanism for most oil and gas contracts in Nigeria. It is also common for parties to agree to international arbitration with a foreign seat and venue for arbitration. Nigerian courts generally recognise international arbitration contractual provisions and awards. There are grounds for refusal of recognition or enforcement, including due to public policy issues and where the subject matter is not arbitrable under Nigerian law. Criminal matters are not arbitrable in Nigeria.

Nigeria is a party to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) and the ICSID Convention.

XI OUTLOOK

The pipeline of energy sector M&A deals is robust for four reasons:

a three IOCs have acreage divestment programmes;
b the federal government is expected to embark on its own divestment programme soon;
c a number of energy sector companies are distressed, and many of their creditors are keen to sell them; and
d the federal government is keen to sell off privatised power sector companies that are in breach of the targets agreed with them at the time of privatisation.

However, the closing of these deals may be delayed because:

a targets may have owners who are unwilling to sell even though they are under pressure from their creditors and the federal government to do so (pursuant to (c) and (d) above);
b financing is not easy to obtain in these times of widespread validity and low prices; and
c regulators may be their usual dilatory selves in giving the approvals needed.

Appendix 1

ABOUT THE AUTHORS

GBOLAHAN ELIAS

G Elias & Co

Professor Gbolahan Elias is a partner at G Elias & Co, one of Nigeria's leading business law firms. He is also a visiting professor of law at Babcock University, Ilishan where he teaches shipping, petroleum and arbitration law. He has published widely on a range of both historical and topical legal matters and served on numerous law reform committees, university administration boards and law journal editorial boards.

He read law at Magdalen and Merton Colleges, Oxford. He has DPhil, BCL (first-class honours), MA and BA (first-class honours) degrees from the University of Oxford. He was called to the New York Bar in 1990. Professor Elias was an associate at the Cravath firm in New York and has been a senior advocate of Nigeria since 2005. He is a member of the Chartered Institute of Arbitrators.

He has led our team on all of our electric power sector financings and on most of the firm's M&A deals. He has advised on numerous transactions in the Nigerian energy sector, including the largest acquisitions to date of electricity generation and distribution companies. He has also advised on the development and negotiation of the precedent-setting power purchase contracts and vesting contracts for the federal government-backed single buyer of grid electric power. He recently advised on a US$1.2 billion 'gas-to-power' project financing and a US$1.5 billion refinancing of Nigerian National Petroleum Corporation petroleum product import receivables.

OKECHUKWU J OKORO

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Okechukwu J Okoro is a senior associate at G Elias & Co. He holds a bachelor of laws degree from Ebonyi State University.

He is a core member of the firm's energy sector practice. He has been actively involved in the legal review of oil and gas and electric power sector transaction documentations. He has advised on at least 10 renewable energy deals in the past 12 months. Among others, he was on the team that advised NEoT Capital on its acquisition of majority shares in a Nigerian renewable energy company. He is currently advising All On Partnerships For Energy Access Limited by Guarantee, a Shell Petroleum entity (involved in interventions to address access to energy challenges in Nigeria) on sundry renewable energy issues including investments and funding of renewable energy companies.

He advised Africa Finance Corporation on its investment in and divestment from the acquirer of a 45 per cent participating interest in an oil mining lease. Okechukwu J Okoro was also on the team that advised on a US$1.2 billion 'gas-to-power' project financing and a US$1.5 billion refinancing of Nigerian National Petroleum Corporation petroleum product import receivables.

YEMISI FALADE

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Yemisi Falade is a senior associate at G Elias & Co. She holds a bachelor of laws degree from the University of Ibadan.

She is a core member of the firm's M&A and capital markets practice. She was a key member of the team that advised Multipro on its spin-off and divestment of its haulage, sales and distribution business to The Kellogg Company. She led the team that advised Cement Company of Northern Nigeria Plc on its merger with Kalambaina Cement Company Limited and the team that advised Tolaram on its joint venture with Colgate-Palmolive. She was also a key member of teams that have advised on some recent capital market debt and equity offerings.

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