THE PETROLEUM INDUSTRY ACT 2021: WHAT ARE THE REGULATORY CONSIDERATIONS FOR ENTRY AND DIVESTMENTS?

Recent developments in Nigeria's Oil and Gas Industry have set the stage for the entrance of new local and international players into the sector. A good example is the recently concluded 2020 Marginal Field Bid Rounds, which has seen the entry of over 50 new indigenous entrants into the sector, majority of whom will require substantial foreign investments from international financing partners to develop the fields that they have been awarded. The passage of the Petroleum Industry Act, 2021 (PIA) is also expected to stimulate entry into the upstream sector, by mandating competitive bidding as opposed to discretionary awards, the award of upstream assets and the introduction of more favourable fiscal terms.

On the divestment side, the trend of International Oil Companies exits is accelerating rapidly. The past year has witnessed the commencement of divestment processes by Chevron, ExxonMobil, and Shell of their onshore and shallow water assets. This trend is apparently driven by pressure from their stakeholders to pursue their energy transition strategies more aggressively or to focus on offshore portfolios are more lucrative and easier to manage. While this trend presents opportunities for buyers of these assets, the process of exiting these assets can be quite cumbersome for the exiting owners.

In this short piece, we spotlight the major regulatory considerations that parties intending to enter into or divest from, an oil and gas asset would need to be aware of under the PIA.

Regulated Entry/Exit

Acquiring and divesting ownership title in upstream oil and gas assets ("**M&A Transactions**") are regulated in Nigeria by the Petroleum Act, 1969 ("**Old Act**") and the recently passed PIA. It is important to note that the Old Act has not been entirely repealed by the PIA. The Old Act will continue to regulate Oil Mining Leases (OML) and Oil Prospecting Licences (OPL), which are not converted to Petroleum Mining Leases (PML) and Petroleum Prospecting Licences (PPL) under the PIA regime, until all their terms expire (refer to our publication ***"The Petroleum Industry Act, What is next for Upstream Players?",*** for more details). Therefore, the Old Act will continue to govern M&A Transactions in relation to OMLs or OPLs, while the PIA will govern M&A Transactions in relation to PMLs and PPLs.

M&A Transactions (Entry/Exit)

Under both the Old Act and the PIA regimes, a prospective assignor of a 'qualifying interest' (explained below) in an upstream asset is required to obtain the consent of the Minister of Petroleum Resources (**MPR**) before concluding the legal transfer of the asset to the prospective buyer.

Qualifying Interest

In M&A Transactions in respect of OMLs and OPLs, a qualifying interest under the Old Act means any interest in an upstream asset which can be broadly categorised into the following:

- ***ownership interests*** (participating interest, shareholding in companies),
- ***working interests*** (PSC contractor interests, other production sharing arrangements)
- ***security interests*** (mortgages, charges, liens)

The direct or indirect transfer of any of the above interests will require the prior consent of the MPR. The position is similar under the PIA regime, except that the creation of security interests will only require the consent of the Nigerian Upstream Petroleum Regulatory Commission (**NUPRC**). The lesser consent requirement as well as the introduction of a publicly accessible registry that will record existing interests in all upstream assets, which presumably will include security interests, creates a better structure for taking security interests in upstream assets and will hopefully attract more lenders to the sector.

Thresholds for Corporate Divestments

Like the regime under the Old Act, the PIA also treats corporate divestments of shares in petroleum asset holding companies as an indirect transfer of the interest in the asset; however, the requirement for Ministerial consent is only triggered where it is significant enough to constitute a change of control of the asset holding company ("**Change of Control**"). An exception however applies with respect to an incorporated joint venture company (**IJV**) involving the Nigerian National Petroleum Company Limited ("**NNPC Ltd**"). For such companies, the transfer of any shares, will require MPR Consent ("**IJV Share Divestment**").

It is noted that in the case of the IJV Share Divestments, Section 95(1)(3) and (14) of the PIA, which are relevant to corporate divestments, appear somewhat contradictory because the PIA misses the opportunity to define the term 'Incorporated Joint Venture', even though the term is used throughout the Act. This contradiction is less obvious when these provisions are read together with section 65 and Schedule 2(a) of the PIA, which clarify that IJVs are joint venture companies with NNPC Ltd and that MPR consent is required to divest any share in such IJVs. It is reasonable to infer that the mischief the PIA sought to cure is the absurd requirement which has pervaded for quite some time that share divestments in Companies holding participating interests in petroleum assets, which do not amount to Change of Control, must also secure MPR consent. This would suggest that the sale of a single share in such companies will require the lengthy and expensive process of obtaining MPR consent.

Timelines for Consent Applications

Another innovation of the PIA is the introduction of time limits for the NUPRC and the MPR to act on applications for consent. The PIA requires the NUPRC to complete its review of consent applications within sixty (60) days of receipt of an application, while the MPR is to make his decision within another sixty (60) days, failing which the consent will be deemed granted. Thus, the expectation is that the applicant will receive a definitive response to its application within one hundred and twenty (120) days of submitting the application. These fixed timelines and the deemed consent introduced by the PIA, should mitigate the uncertainties and delays that hitherto plagued M&A Transactions in the sector.

Merger Control

As part of the conditions for the grant of MPR consent, the PIA also introduces the explicit requirement that a transferee of an interest in a PPL or PML complies with the provisions of the Federal Competition & Consumer Protection Act (FCCPA) presumably in respect of merger controls. Section 92(4) of the FCCPA describes a merger as meaning "**when one or more undertakings directly or indirectly acquire or establish direct or indirect control over the whole or part of the business of another undertaking".** A merger might be executed through

i.) the purchase or lease of shares, an interest or assets of the other Company

ii.) the amalgamation or other combination with the other Company

iii.) a joint venture

Only large mergers are required to be notified under the FCCPA i.e., mergers where the combined annual turnover of the acquirer and the target exceeds ₦1 Billion or where the annual turnover of the target exceeds ₦500 Million.

Licensing Rounds (Entry)

Before the PIA was passed into law, the Government could award OMLs, OPLs and marginal field licences to companies on a discretionary basis, without providing equal opportunities for all intending companies to vie for such awards. Following the passage of the PIA, discretionary awards are no longer possible. Other than in very limited circumstances, companies may only secure the award of PPLs or PMLs from the Government by a successful bid in a competitive round. This new regime democratises access to upstream assets for technically competent investors in the sector as the successful bidder in any bid round would be recommended by the NUPRC to the MPR for the grant of the relevant PPL or PML and the MPR has ninety (90) days to respond, failing which, there will be a deemed grant of the PPL or PML to such bidder.

Unlike the OMLs and OPLs, which were standard concessions, PPLs or PMLs are to be awarded to a successful bidder ("**Awardee**") under any of the following contracting frameworks:

1. Concessions: traditional licencing model, which may include an incorporated or unincorporated joint venture with NNPC Ltd.

2. Production Sharing Contract (PSCs): the Awardee bears all the operating and financial risks and shares any resulting production with the government.

3. Profit Sharing Contract: similar to PSCs, except that the government receives cash instead of actual production.

4. Risk Service Contract: the Awardee bears the financial risk and recovers its costs and margin from the payment of a fixed fee in cash or kind.

Unregulated Entry/Exit

New models of participation in the oil and gas industry have emerged overtime, especially economic participation in fields on a short-term basis rather than in perpetuity. The Old Act and the PIA appear to only regulate the outright alienation of interests in a petroleum asset, i.e., assignments, novation and transfers. Thus, a petroleum asset holding company may temporarily share its economic interest in the production from an asset with a third party for a particular benefit, mostly financing, without altering its rights or interest in the underlying petroleum asset. In such a situation, MPR consent is not triggered, and upstream companies are able to enter and exit petroleum assets unregulated.

An example of such temporary economic interest in petroleum assets, is the Finance and Technical Service arrangements (FTSAs) where a third-party operator provides funding and technical support for the development of the petroleum asset in consideration of recovering the costs expended and a fair return over an agreed period, from the petroleum produced from the asset. This model has become quite popular with Nigerian Petroleum Development Company Limited for the development of most of its assets. A similar arrangement is the field management arrangement, where a third-party operator provides asset management and oil field support services to the asset owner on a deferred invoice basis, then subsequently recovers payment on its invoices in form of a portion of the petroleum eventually produced from the asset. These forms of participation allow for instant and cyclical investments in the sector, without the burden of regulatory scrutiny and bureaucracy.

Conclusion

In contrast with the previous M&A regime, the PIA has improved the framework for the collateralisation of petroleum upstream assets whilst also improving the transparency around the ownership of these assets.

With clearer rules to guide transactions for entry into and exit out of upstream petroleum assets, we expect an increase in M&A transactions going forward. M&A Transaction parties however need to be aware of the dual regime of the Old Act, which still applies to the OMLs and OPLs, as well as the emerging regime of the PIA, which will apply to PPLs and PMLs. This understanding and the innovations introduced by the PIA as described above may impact the choice of assets to acquire or a decision as to whether the target assets should be acquired or divested under the regime of the Old Act or the PIA.

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