

# THE GLOBAL OBSESSION FOR NATURAL GAS: POLICY AND TRANSACTIONAL ISSUES GERMANE TO NIGERIAN LENDERS

1. LNG is natural gas that has been cooled to -162oC (-260oF).
2. Sarah El Safty and Ari Rabinovitch, 'EU, Israel and Egypt Sign Deal to Boost East Med Gas Exports to Europe' (September, 2022). Available at <https://www.reuters.com/business/energy/eu-israel-egypt-sign-deal-boost-east-med-gas-exports-europe-2022-06-15/> (Accessed December 1, 2022).
3. Macdonald Dzirutwe, 'EU Looks to Replace Gas from Russia with Nigerian Supplies'. (July, 2022) Available at <https://www.reuters.com/world/africa/eu-looks-replace-gas-russia-with-nigerian-supplies-2022-07-23/> (Accessed December 1, 2022).
4. Andreas Rinke and Sarah Marsh, 'Germany is Keen to Pursue Gas Projects with Senegal, says Scholz on first African Tour'. (May, 2022). Available at <https://www.reuters.com/world/russia-looms-la-rge-scholz-first-africa-tour-chancellor-2022-05-22/> (Accessed December 1, 2022).
5. Africa Oil & Gas Report, "ENI Gets Two Algerian Gas Fields to the Market for Europe" (October, 2022). Available at <https://africoilgasreport.com/2022/10/gas-monetization/eni-gets-two-algerian-gas-fields-to-the-market-for-europe/#:~:text=Italian%20major%20ENI%20has%20taken,Sonatrach%2C%20in%20April%202022.> (Accessed December 1, 2022).
6. Rafiq Raji, 'Europe Goes Searching for Gas in Africa' (June, 2021). Available at <https://businessday.ng/columnist/article/europe-goes-searching-for-gas-in-africa/#:~:text=Italy's%20Eni%20is%20also%20aiming,bcm%20a%20year%20of%20LNG> (Accessed December 1, 2022).
7. BBC, 'Climate Change: EU to Cut CO2 Emissions by 55% by 2030' (April, 2021). Available at <https://www.bbc.com/news/world-europe-56828383> (Accessed December 1, 2022).
8. Nigeria, which has Africa's largest gas reserves, proven gas reserves of about 206.53 trillion cubic feet, which is valued at over \$803.4tn.

## Proem

Over the past two (2) decades, the global natural gas market has undergone immense changes which have allowed the market to be more dynamic and more competitive, making it the largest energy source, after crude oil. Amongst others, the electricity, agriculture, manufacturing, and transportation sectors are experiencing a growing use and reliance on gas, via more modern uses, such as gas-to-liquid and compressed natural gas ("CNG"), alongside evolutions in liquified natural gas ("LNG"),<sup>1</sup> leading to further gas demand and a growing proportion of gas projects being developed around the world.

## The Global Demand for Gas

With the Russian-Ukraine war, there have also been more recent disruptions in the global energy markets and fossil-fuel supplies have been reconfigured worldwide, thereby creating negative ripple effects on nations. On their part, European nations have increased efforts to secure non-Russian gas supplies, with African sources being targeted, despite already accounting for between eighteen per cent (18%) to twenty per cent (20%) of European gas imports.

This is due to existing gas pipelines connected to the European gas network and LNG exports originating, predominantly from the likes of Nigeria, Algeria, Egypt, and Angola. The European Union ("EU") previously signed a deal with Egypt and Israel to boost LNG shipments<sup>2</sup> and the Deputy Director General of the EU's energy department recently visited Nigeria to seek additional LNG supplies from Nigeria as the bloc prepared for Russian supply cuts.<sup>3</sup> Germany's Chancellor visited Senegal in a bid to invest in gas extraction and LNG,<sup>4</sup>

while Italy's ENI has signed an agreement with Algeria's Sonatrach to ramp up Algerian gas pipeline exports to Europe.<sup>5</sup> ENI is also planning the development of LNG production in Mozambique and the Republic of Congo.<sup>6</sup> There are also plans for long-distance pipelines, such as the offshore Nigeria-Morocco Gas Pipeline and the onshore Trans-Sahara Gas Pipeline, all of which will give Africa momentum to boost its economies and strengthen Euro-African energy co-operation.

Question is, why is there the sudden craze for natural gas? The reason is not far-fetched. The EU's long-term energy goal is to become carbon neutral by 2050 and reduce net greenhouse-gas emissions by at least fifty-five per cent (55%) by 2030, compared to 1990.<sup>7</sup> As things stand, Europe needs short and medium-term gas supplies, and with the recent categorization of natural gas as a green energy source, this would favourably impact countries like Nigeria, due to the nation's abundant natural gas reserves.<sup>8</sup>

## Nigeria's Gas Prospects and Policy

Nigeria's gas value chain cuts across the upstream, midstream and downstream segments of the oil and gas sector, with players that extract gas, strictly and during oil production, companies who process and transport, companies who provide infrastructure for trans-shipment and storage, up to the final users, including petrochemical firms, power generation companies, regulatory agencies, as well as industrial and household consumers. Unfortunately, like most African countries, Nigeria has always had the challenge of gas exploration and infrastructure constraints, which hinder the capacity to adequately fulfil domestic gas demand and export obligations.



9. Balarabe Alkassim, 'NLNG Earned \$108bn, Paid \$35bn Dividends In 21 Yrs' (February, 2021) Available at <https://dailytrust.com/nlng-earned-108bn-paid-35bn-dividends-in-21-yrs/> (Accessed December 1, 2022).

There was, however, hope that Nigeria's Gas Master Plan, which was aimed to reposition Nigeria as a regional gas supply hub, and establish its presence in the domestic, regional and export markets, will effectively curb the existing challenges. More recently the Federal Government of Nigeria declared January 2021 to December 2030 as Nigeria's Decade of Gas; a period the government aspires to leverage on Nigeria's huge gas potential and industrialize the country, using gas as an enabler. The Nigerian Gas Flare Commercialization Programme (NGFCP) is ongoing and provides a bankable commercial structure for the monetization of flare gas, by providing flare gas buyers with title and access to collect flare gas from the prescribed fields and for such purposes, as permitted by the government.

There is also the mandate of the National Gas Expansion Programme, which is to create a framework for Nigeria that recognises CNG and Liquefied Petroleum Gas ("LPG") as alternative fuels, with low carbon emissions sources of energy. Already, the Petroleum Industry Act 2021 ("PIA") has been passed and its Section 110 makes statutory, the domestic obligation for producers to deliver gas to the local market before exporting same. This is to accelerate the development of domestic gas as a focal, strategy for achieving aggressive gross domestic product (GDP) growth.

This is surely expected to signal a good omen for investors. Indeed, it is right to say that this is a good time to invest in the gas industry, with a plethora of options available, such as: production activities (processing, exportation, distribution and supplies), infrastructure (operation facilities, construction and engineering transportation, physical pipelines, virtual pipelines and storage) and services and utilities (power plants, gas flare commercialization, LPG, CNG and LNG uses).

Particularly with LNG, Nigeria LNG Limited ("NLNG") has been at the forefront of the development of LNG in Nigeria, with customers/offtakers in Europe, America and Asia, thereby making Nigeria a supplier of ten per cent (10%) of the world's LNG supply. So much so has the success of NLNG been, that its train seven (7) station is currently being developed from internally generated cashflows and Three Billion United States Dollars (US\$3,000,000,000) of debt. It has also declared, to date, over Thirty-Five Billion United States Dollars (US\$35,000,000,000) in dividends,<sup>9</sup> whilst remitting one of the highest tax returns in Africa. There have also been active gas utilization projects such as the successful Oso NGL Project by NNPC/Mobil JV, and the ongoing LPG – Escravos Gas Project by NNPC/Chevron JV, and Ajaokuta-Kaduna-Kano (AKK) gas pipeline, respectively, to mention a few.

### Major Lenders' Concerns in Financing Gas Projects

A key aim of the PIA is to make the oil and gas sector more attractive to investors. This is premised on the realization of the need to properly harness the potentials and opportunities that exist in a country like Nigeria.

Whilst this paper highlights the great strides being made, and the even more abundant opportunities for investment in the sector, it is also important that we highlight key issues that lenders, who may wish to finance gas projects, should concern themselves with, especially through the conduct of their own due diligence, as follows:

1. Cash flow certainty/decline in revenue, which would significantly determine the risk of default;
2. Volatility in market prices;
3. Effectiveness and enforceability of project contracts;

4. Regulatory stability;
5. Performance of project contractors;
6. Termination regime;
7. Project's reputational impact (environmental and social); and
8. Insurance coverage.

All of those concerns are typically addressed when the risk in the value chain is analysed and appropriately mitigated.

Below is an itemization of typical risks which exist in a typical gas project value chain and mitigating factors available for investors:

#### A. Upstream Risks

Risk	Mitigant
Reservoir risk	Reserves Report as a condition precedent.
Operational risk	Maintenance contracts, guarantees and warranties, reporting obligations, Lender's inspections.
Price risk	Commodity swaps, call options, put options, futures contracts, and forward contracts.
Joint Operating Agreement ("JOA") risk	Indemnities and warranties regarding JOA parties, rights and obligations.

#### B. Midstream Risks

Risk	Mitigant
Construction risk	Performance bonds, government guarantees, completion guarantees, damages for breach of performance, and fixed price for operation and maintenance contracts.
Storage and transportation risk	Expert determination and security.
Political risk	Freezing clauses, economic equilibrium clauses, waiver of sovereign immunity.
Environmental risk	Insurance, Indemnity clauses, employee training, and emergency response.



10. In Nigerian gas lingua, gas sale agreements are upstream contracts whilst gas sale and purchase agreements are mid/downstream gas contracts.
11. Bloomfield LP, 'Shipping Finance - The Emergence of Poseidon Principles: Pointers For Nigerian Financial Institutions' (July, 2019). Available at <https://www.bloomfield-law.com/gaze/through-leadership/shipping-finance-emergence-poseidon-principles-pointers-nigerian-financial> (Accessed December 1, 2022).
12. Currently over one hundred and fifteen (115) financial institutions, including some export credit agencies (ECAs), from over thirty-five (35) countries have adopted the Equator Principles and are designated as Equator Principles Financial Institutions (EPFIs).
13. *Sonner (Nig.) Ltd v. Partnereedn M.S. Nordwind* (1987) LPELR 3494 (SC).
14. Cap A18, Laws of the Federation of Nigeria, 2004.
15. Section 222 of the Companies and Allied Matters Act, 2020.

### C. Downstream Risks

Risk	Mitigant
Feedstock supply risk	Take or pay arrangements.
Construction and completion risk	Guarantees and warranties.
Pricing risk	Commodity swaps, call options, put options, futures contracts, and forward contracts.
Offtake risk	Offtake agreement with defined price variables, Take or pay, minimum annual contracted quantity.

Whilst there are trends in the gas industry regarding the structuring of projects, there is no 'one size fits all' approach. Thus, each gas project will benefit from a bespoke financing structure, arranged by the parties. Whatever the agreed structure, financiers will want all project documents to work together to allocate risks to contractual counterparties in a manner that makes them properly absorbed and managed. Financiers will also conduct due diligence on the key project documents, including the engineering, procurement and construction (EPC) contracts, the gas supply agreement(s) and the gas sale and purchase agreement(s).<sup>10</sup>

### Trending Transactional and Project Bankability Points for Lenders

The following key concepts are also being put on the front burner, for lenders' consideration:

**(a) Forward Sale Agreement:** This is used by parties for the sale of a product at an agreed price with a clear upfront payment arrangement which seller could, for example, use to develop the field(s) from where the gas will be produced. It serves to hedge against potential losses that may arise due to the volatile market and enables parties to lock in a price for the future, whilst delivery of the gas is made at a later date. It also helps seller raise financing. The lender who provided the requisite finance for the arrangement, also enters into a direct agreement with the seller who undertakes to transfer the title in the gas, to the lender or its designate, in the event of default by the borrower.

**(b) Negative Pledge:** This serves to limit a borrower's right to take security over gas asset or project, in favour of lenders. Thus, the borrower undertakes that, as long as any portion of the loan(s) remains outstanding, the borrower will not create and/or permit to subsist any pledge, lien, mortgage or other charge (whether fixed or floating) on the whole or any part of its existing and/or future undertaking, property, assets or revenues to secure any other indebtedness without the lender's prior written consent.

**(c) Sovereign Guarantee:** This serves as comfort to lenders with a guarantee by the government (usually the Federal Government of Nigeria) that all obligations will be satisfied when and if the borrower goes into default. It is mostly used in order to financially promote projects that are deemed to be of public interest and employed as an economic incentive for the capital market to finance the projects.

**(d) Environmental, Social and Governance ("ESG") Issues and Sustainable Finance:** In line with climate change and global push for the reduction of net greenhouse-gas emissions by 2050, ESG issues have become front line in the assessment of gas projects financing. As such, projects are required to have in place infrastructures to encourage climate change mitigation and adaptation, alongside biodiversity conservation; cause positive social impact on communities and societies; promotes proper governance processes and oversight.

**(e) The Poseidon Principles<sup>11</sup>:** These principles provide a common and global baseline to quantitatively assess and disclose whether the lending portfolios of financial institutions are in line with adopted climate goals of the International Maritime Organisation (IMO) to reduce greenhouse emissions from shipping by fifty per cent (50%) by 2050. The Poseidon Principles now cover about thirty (30) financial institutions (representing a loan portfolio of over One Hundred and Fifty Billion United States Dollars (US\$150,000,000,000), or about a third (3rd) of all maritime loans) and seventeen (17) marine insurance providers and brokers institutions. The principles speak to the requirement for assessment of climate alignment; accountability; enforcement; and transparency. Thus, lenders must factor this into decision-making especially in relation to the shipment of gas.

**(f) The Equator Principles:** The Equator Principles are a set of minimum standards for due diligence and monitoring, aimed at emphasizing the requirement to mitigate environmental and social risks of financing large scale resources projects such as gas projects, encourage responsible risk decision-making and ensure that projects are such that have positive impact on the natural environment and the affected communities.<sup>12</sup>

**(g) Governing Law and Dispute Resolution:** The interplay of the different nationalities, legal backgrounds, and complexities relating to the diverse interests of parties to gas development or finance agreements, showcases the need for the pre-determination of the mode and manner of resolving disputes that may arise from such contracts. Under Nigerian law, parties to a contract, are generally free to agree their dispute resolution mechanisms, and the attitude of Nigerian courts to the choice of dispute resolution mechanism by contracting parties is to generally enforce such mutual understanding, including local dispute resolution mechanisms and international commercial arbitration. However, such choice of law must be reasonable, not contrary to public policy, and must comply with the Nigeria's mandatory legal principles.<sup>13</sup> Thus, whilst lenders may be interested in choosing a neutral jurisdiction, it would be important to also consider jurisdictions that would afford the shortest timeframe and least associated cost for adjudication. Whatever the case, it is noted that Section 57(2) of the Nigerian Arbitration and Conciliation Act<sup>14</sup> okays international commercial arbitration between Nigerian entities, same of which may be enforced by local courts in Nigeria, upon registration.

**(h) Perfection of Security:** In order to perfect registrable security, lenders must register same promptly, at the Corporate Affairs Commission (CAC), within ninety (90) days of creation of the registrable security. In relation to the quantum of registration fees to be paid for the registrable security<sup>15</sup> lenders may adopt an up-stamping/registration regime that allows, initial, the stamping and registration of only a portion of the secured amount, with assurances from the borrower that subsequent stamp duty and registration fees will be paid on a future date or upon the occurrence of certain agreed events of default.





16. Oladeinde Olawoyin, 'Shell Acquires Lagos-based Daystar Power to Expand Renewable Energy Interests', (September, 2022). Available at <https://www.premiumtimesng.com/news/top-news/556627-shell-acquires-lagos-based-daystar-power-to-expand-renewable-energy-interests.html#:~:text=Daystar%20announced%20in%20a%20statement%20Wednesday%20that%20the%20takeover%20awaits%20regulatory%20approval.&text=Global%20oil%20giant%2C%20Royal%20Dutch,emission%20and%20focus%20on%20renewables.> (Accessed December 1, 2022).
17. The UK will ban imports of Russian gas from the start of 2023. The EU has not agreed a ban on Russian gas but has introduced policies aimed at moving away from dependence on it.

## Conclusion

In September 2022, British multinational oil and gas company, Royal Dutch Shell, acquired Nigerian-based solar power solutions company, Daystar Power, as part of the major's strategy to diversify its energy portfolio in line with the energy transition whilst expanding its footprint across Africa's expanding power industry.<sup>16</sup> This and many more, are proofs of the clean energy integration which is sweeping through the energy sector, with even more mergers and acquisitions expected in the future. However, Africa is expected to retain fossil fuel exploration due to energy poverty and the need for rapid development. Although, several high-profile financiers of emerging markets infrastructure, such as the EU and United Kingdom's (UK) government, have considered partial and full bans on fossil fuels that would preclude any new projects involving natural gas by the end of 2022,<sup>17</sup> blocking money for new gas pipelines, gas-fired power plants, or gas-consuming industries, will not be the answer because gas has a pivotal role to play in Africa's transition to clean energy and a ban now could slow the adoption of renewables and reinforce a global energy double standard. It is also the case that a number of European countries are re-considering their stand as they now look to 'dirtier' energy sources like coal.

On the other hand, African lenders must look inwards and not merely listen to European counterparts, but rather, be determined to finance Africa's peculiar energy needs, especially in view of the profitability that exists in doing so. Although, many countries and activists had proposed that governments should commit to a phase out of all fossil fuels as an overarching agreement of the recently concluded Conference of Parties (COP) 27, this did not materialize, with the only commitment made to being phasedown unabated coal power and phase-out of inefficient fossil fuel subsidies. The United States, China, and large parts of Asia and parts of Europe are all still betting heavily on gas as a core component of their energy futures, with important volumes sourced from Africa, while some wealthy countries have already increased their fossil fuel use and expanded exports in recent months following Russia's invasion of Ukraine and the ensuing turmoil in global energy markets.

Many governments are also eager to give their economies a boost with cheap fuel as they emerge from the Covid-19 pandemic. This invariably must be seen as a great opportunity for African countries who have gas, as gas will be an indispensable input for their economic survival.

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