Incorporated Joint Ventures in the Nigerian Petroleum Industry: Examining the Legal Implications & Regulatory Risks
by O.M. Oladunjoye

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INCORPORATED JOINT VENTURES IN THE NIGERIAN PETROLEUM INDUSTRY: EXAMINING THE LEGAL IMPLICATIONS & REGULATORY RISKS

By

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1 Introduction

Laws and regulations are often designed to isolate or guard stakeholders against plausible risks apart from outlining the framework in which State policies and objectives are to be effected in a given industry. In the petroleum industry, the stakeholders are often the State or custodians of State interests on one hand and private (local and multinational) corporations on the other. The process of changing or reforming the underlying legal regime within the industry also brings to life certain risk elements. Regulatory risks entail the threat to earnings, capital and business reputation associated with a failure or difficulty in complying with an increasing or dynamic array of regulatory requirements, including a change in underlying regulatory and contractual framework for investments. Furthermore, it is the effect of a change in law(s) or regulation(s) made by the government or a regulatory body, which consequently increases the costs of operating a business, reducing the attractiveness of investment and/or change the competitive landscape of an economic sector.

A critical policy thrust of the Federal Government of Nigeria as contained in the National Oil & Gas Policy 2004, is to convert existing Unincorporated Joint Ventures (UJVs) to Incorporated Joint Ventures (IJVs) which raises critical corporate governance, funding, financing and investment protection issues. A UJV is a strategic alliance between two or more companies, individuals or organizations that are otherwise unrelated, which is formed for the purpose of conducting a new profit-motivated business. An IJV on the other hand is

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6 This policy forms the basis of the Petroleum Industry Bill which was drafted by the Oil and Gas Sector Reform Implementation Committee (OGIC) and submitted by the Presidency in May, 2009. The passage of the Bill was however inconclusive in the last Legislative dispensation. It is currently in the process of being re-submitted to the National Assembly.

a joint venture arrangement in which the companies involved create or incorporate a separate corporation and divide its shares between themselves generally as an equitable way to distribute income from the joint business operations.

This article examines prevailing regulatory risks and legal implications of incorporating existing and future joint ventures in the Nigerian petroleum industry particularly, as a potential outcome of the ongoing legal reforms being carried out through the Petroleum Industry Bill (PIB).

2. **The Reform and Change of Law**

Since its inception, the main laws regulating the Nigerian Petroleum Industry have been the Petroleum Act 1969, the Petroleum Profits Tax Act 1959, and the Nigerian National Petroleum Corporation (NNPC) Act 1977. Another key regulation made pursuant to the Petroleum Act is the Petroleum (Drilling and Production) Regulations 1969. These, and practically every other law regulating the industry, are all outdated and inadequate to meet up with the dynamics of contracting and operations in the industry. Consequently the Federal Government of Nigeria commenced the reform process in 2000 by setting up the Oil and Gas Sector Reform Implementation Committee (OGIC). This process led to the approval of the National Oil & Gas Policy 2004 and the submission of the Nigerian Petroleum Industry Bill in 2009 to the National Assembly. The current administration is in the process of re-submitting the PIB.

The proposed law aims at sweeping reforms, by repealing extant laws like the 1969 Petroleum Act. Some of the main objectives include the creation of new institutions to govern the operations of the industry; incorporation and privatization of the Nigerian National Petroleum Corporation (NNPC); transforming the existing UJVs between the multinational oil companies (MOC) and the NNPC into IJVs etc. Notably, NNPC is presently engaged in six UJVs and a few others with local E&P companies through its subsidiary Nigerian Petroleum Development Company Limited.

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11 The interplay of converging and divergent public, state and business interests led to the stall in the legislative process and the PIB which was at the 3rd reading stage of the 6th National Assembly was never passed into law. Moreover, several versions also came into circulation.

12 The institutions are to take up the Government’s separated, regulatory and policy making functions, while NNPC will function as a privatized National Oil Company, to serve as the Government’s commercial arm.


3. The Joint Venture Arrangement
Operations in the international petroleum industry and indeed Nigeria are essentially regulated by law and contracts. For exploration and production operations, the contractual arrangements can be in the form of a Joint Venture/Joint Operating Agreement (JV/JOA), Production Sharing Contracts (PSC) or Risk Service Contract (RSC). The adoption of the JV/JOA as an unincorporated association in the petroleum industry was as a result of the perceived inequities faced by oil producing countries in the Middle East, South America and North Africa with respect to 'government take' based on the traditional concession arrangements with the MOCs. These host countries respectively decided to participate (as “co-venturers” while retaining sovereignty and legal title to the petroleum resources in situ) in the oil concessions by forming National Oil Corporations (NOC’s) and executing JV/JOAs with the MOCs. The foundation for these developments was often laid out in various enactments or regulations as in the case of the Nigerian National Oil Corporation (the predecessor national oil company to the NNPC) and NNPC.

In Nigeria, the Oil Mining Lease (OML) granted under the Petroleum Act essentially constitutes the concession. It authorizes the lessee to search for, win, work and carry away discovered petroleum and confers a non-possessory interest in the produced petroleum, while the land and all resources on and under belongs to the Federal Government. Through NNPC, the Federal Government acquires participatory interests in the concession, thus the ensuing relationship and interest are defined by a combination of the OML, the Participation Agreement (PA) and the Joint Operating Agreement (JOA). Sometimes, a Memorandum of Understanding (MOU) is entered between the Government (through NNPC, NPDC or the Ministry of Petroleum) and its co-venturers.

3.1. The Unincorporated Joint Venture
Without the participation of the Government or NNPC, the companies or lessees bear all the risks and costs of E&P operations. Where NNPC participates, it brings to the venture its perceived capacities, which includes Nigerian and Government content, socio-political and local economy awareness etc. However, being a public state-owned corporation and a custodian of public interests the NNPC is susceptible to inherent bottlenecks and

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16 Section 2(c), CAP P10, Laws of the Federation of Nigeria 2004

17 Section 44(3) of the Nigerian Constitution, 1999.

18 Prof. Yinka Omorogbe note 15 supra p. 8.

19 Due to the oil glut of the 1980s, the Federal Government signed an MOU with JVA parties (the MOCs) to secure the profit margin of the MOCs in 1986, 1991 and 2000.
bureaucracy which often runs contrary to core business and private interests of the multinational or local co-venturer. Furthermore, one will also note that the NNPC is currently a commercial entity as well as a regulator with some policy making role, which must rely on the Government funding for survival. Therefore, in a strict business and operational sense, the arguments in support of the institutional reforms, NNPC privatization and the conversion of the existing UJVs to IJVs seem justified.

3.1.1. Participatory Interests
The interests acquired in the JV/JOA confer on the JV co-venturers a right to participate in operationalizing the rights created under the OML, the fixed and moveable assets for the JV and the working capital for joint operations. It is important to note that technically the parties to a JV/JOA are co-venturers and not ‘partners’. Each co-venturer has an undivided ‘stake’ in the capital, risks and liabilities of the E&P activities with respect to one or more OMLs. The Association of International Petroleum Negotiators (AIPN) Model JOA (2012) defines Participating Interest as:

“…each Party’s undivided share (expressed as a percentage….of the total shares of all Parties) in the rights, interests, obligations, and liabilities of the Parties derived from the Contract and this Agreement…”

For example, the Shell Petroleum Development Company Limited (SPDC) joint venture arrangement with NNPC, Total E&P Nigeria Limited (TEPN) and Nigerian Agip Oil Company Limited (NAOC) regulates operations in several OMLs. The participating interests of parties are divided as follows: NNPC (55%), SPDC (30%), TEPN (10%) and NAOC (5%). In recent divestment transactions, SPDC/TEPN & NAOC, which jointly hold a total of 45% interests, transferred their interests to qualified Nigerian-owned independents with respect to some of the OMLs, including OMLs 26, 30, 34, 40 and 42 etc.  

3.1.2. Joint Operating Agreement
The JOA defines the legal relationship of parties: including the conditions of appointment and removal of the operator, default and exit, establishment of the joint operating committee, funding and cash call obligations, joint development of the acreage, work programme and budget, disposal of petroleum, taxation and dispute resolution. Under the JOA, one of the co-venturers is appointed as the operator and is given the day-to-day responsibility for the conduct of the exploration and development operations. The operator is subject to the overall supervision by the operating committee, upon which all of the co-venturers are represented. Other key provisions of the JOA are:

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• scope of the J.O.A.;
• percentage interests of the parties;
• appointment, powers and liability of the operator;
• provision of reports and information;
• role and procedures of the operating committee;
• programmes and budgets;
• authorizations for expenditure (AFEs);
• accounting procedures and right of audit;
• provision for abandonment costs.

Generally, the J.O.A. is structured to prevent any suggestion that a corporate partnership has been created between the co-venturers. For instance, in the disposal of petroleum, it is common to provide that each co-venturer has the right to take and dispose of separately its share of the petroleum obtained. Article 9.1 of the 2012 AIPN JOA provides that “...each Party shall have the right and obligation to own, take in kind and separately dispose of its Entitlement...” Therefore, the common enterprise of the JOA is limited to the exploration and/or the production of the oil or gas which the co-venturers hold in common.

3.2. **Incorporated Joint Venture Arrangement**
Under an IJV, the parties are more than just owners of an undivided share of the joint venture’s capital, risks and liabilities, but become shareholders in a new company incorporated at the Corporate Affairs commission (CAC)\(^{21}\) with the assets and liabilities belonging to the IJV company.

The issue of converting ‘participating stakes’ in an OML under a UJV to equity in an IJV may be difficult to implement, where the law mandates a conversion from UJVs to IJVs. In the writer’s view such considerations are best left to inter-party negotiations and evaluations. It is important that the law does not mandate an expropriation of the

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\(^{21}\) The Corporate Affairs Commission is set up under the Companies and Allied Matters Act (CAMA) for the regulation and supervision of the formation, incorporation, registration, management, and winding up of companies in Nigeria. See section 7 CAMA.
undivided share of each co-venturer’s proprietary interests as section 44(1) of the Nigerian Constitution provides that:

“...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…”

Another important issue is the transfer of the underlying core assets of the UJVs i.e. OMLs or other licenses to the IJV. Such assignments usually require the consent of the Minister of Petroleum. One may however take it as a given approval, since the process is at the instance of the State.

An example of an existing IJV company in the Nigerian oil and gas sector is Brass LNG Limited. The Shareholders are Nigerian National Petroleum Corporation (NNPC) (49%), Eni International (17%), Phillips (Brass) Limited (an affiliate of ConocoPhillips) (17%) and Brass Holdings Company Limited (an affiliate of Total) (17%). The Company was formed to construct and operate a Liquefied Natural Gas Plant to be sited on the Island of Brass, Bayelsa State. The most outstanding IJV in Nigeria remains the Nigerian Liquefied Natural Gas Limited, comprising of NNPC (49%), Shell (25.6%), Total (15%) and Eni (10.4%).

3.2.1. Contractual Documentation for an Incorporated Joint Venture

The most important document for the establishment of an IJV further to a mandatory conversion from a UJV is the JOA. Upon incorporation, the board of the new IJV company must ratify it as part of the company’s constitution. Other required documentation includes:

- Articles of Association

This is a public document registered at the CAC under the Companies and Allied Matters Act (CAMA) 2004. It contains among other things agreed rules about the procedures to be followed at general meetings, board meetings and composition, company secretaryship, the rights attached to the various types of shares and other procedural matters. It also specifies the role of the Chairman if any, vis-a-vis the Board of Directors.

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23 See Section 72(1) of CAMA.
* **Shareholders' Agreement**
This is a private document, which may therefore contain commercially sensitive or highly confidential information. For a UJV being converted to an IJV, the provisions of the participation agreement should automatically guide the parties in negotiating the new Shareholders Agreement. Typically, it would include provisions relating to board representation, voting rights, confidentiality, the transfer of shares and the procedure to be followed in instances of deadlock.

* **Management Agreement**
If required by the parties, they may appoint a "managing shareholder" who enters into a management agreement with the IJV company. The management agreement typically provides that one of the shareholders would be responsible for the management of the business. The agreement sets out the role of the managing shareholder and any limit on his power to conduct the business, his remuneration, provisions regarding his accountability, and the circumstances in which the agreement may be terminated. Occasionally, other shareholders may also be parties to the management agreement with specific roles.24

* **Contracts for the purchase of assets or business**
Generally, an IJV may be formed by the co-venturers in order to purchase the existing business or asset of a third party. Alternatively, the co-venturers may establish a jointly owned vehicle through which they intend to channel various businesses in order to carry them on as a combined operation. In either case, it is necessary to have agreements between the IJV company and the third party or co-venturers providing for the sale and transfer of the assets to be used in the joint venture (for example, geological surveys; oil rigs etc.). This agreement should be "at arm's length" and provide the IJV with all of the usual warranties and assurances that a normal business would require.25 Depending on the particular scenario and situation surrounding the formation of the IJV, the other documents that may be required are:

  ✓ Loan agreements;
  ✓ Contracts for the supply of goods and services;
  ✓ Intellectual Property Transfer Agreements;
  ✓ Distribution and marketing agreements (Crude Handling Agreements);
  ✓ Service and secondment agreements; and
  ✓ Agreements relating to real property.

24 See. Stephen Sayer, “Negotiating and Structuring International Joint Venture Agreements n7 supra

25 Ibid.
3.2.2 Risk Allocation under an IJV

The IJV company is a separate legal entity from the shareholders. Thus, it is the company that is, therefore, exposed to the financial and commercial risks involved in the joint venture. A board of directors will be established to manage and decide on the activities of the IJV. Theoretically, the parties are protected from losses arising from the company’s operations and their liabilities are either limited by the amount of unpaid shares they subscribed to or unlimited accordingly. In practice, the concept of limited liability of many joint venture companies is often undermined by financiers who require the parties or shareholders to put forward guarantees, if the joint venture company itself has no track record or has insufficient assets to cover huge investment risks as security for its proposed borrowings. This situation may arise where the newly created UJVs (i.e. those comprising of NPDC and local oil companies who recently acquired interests held by some MOCs in Nigeria) are incorporated as they have no sufficient track record as separate legal personalities.

Furthermore, undue political influence on the IJV may hamper its smooth functioning with the NNPC being the majority shareholder. Also, the capacity of the NNPC to function effectively as the operator remains another issue.

4. Legal and Business Implications

Whatever legal structure is adopted, IJVs inevitably require a degree of mutual trust and co-operation that goes beyond the usual arm's length commercial relationship between contracting parties. In an IJV, the relationship is contractual as between shareholders amongst themselves on one hand, and between the shareholders and the company. Section 41(1) of the CAMA, provides that the memorandum and articles of an incorporated company has the effect of a contract under seal between the company, its members and officers and between the members and officers themselves whereby they agree to observe and perform the provisions of the memorandum and articles, as altered from time to time in so far as they relate to the company, members, or officers as such. Unlike in the UJV where each co-venturer acts in the course of its own business when it comes to the disposal of the resulting petroleum, in an IJV, the ‘IJV company’ as opposed to respective shareholders, owns and disposes the petroleum.

4.1. Corporate Governance

In terms of corporate governance and decision making, without a uniform agreement on the companies objectives and work programmes, the IJV company’s business may suffer due to differences in the business customs and style of operations of individual corporate

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27 Under the CAMA, a private company can be limited by shares or unlimited. See section 21

shareholder. The corporate governance arrangements must therefore be pragmatically laid out in the articles of association and/or shareholders' agreement bearing in mind the legal and regulatory requirements that the IJV company will be subjected to inter alia under the CAMA and the Petroleum Industry Act (when passed). Importantly, the parties must agree on the extent to which authority should be delegated to the executive management of the IJV company and the main board of directors (which according to CAMA is responsible for the overall management of the Company). The parties may exercise control over key issues directly through the shareholders' agreement but in the interest of the IJV.

Importantly, the directors of an IJV appointed by the shareholders may be conflicted in deciding between the interests of the appointing shareholder and the interests of the IJV. This is because: apart from the obligations owed to his regular employer (i.e. the shareholder) the director is also under a fiduciary duty to act in the interests of the IJV. Therefore, the interests of the IJV and the appointing shareholder may conflict. Ultimately, the duty of the director to the IJV must supersede that which he owes to the appointing shareholder as Section 279 (2) of the CAMA provides that a director shall owe a fiduciary relationship to the company even where such a director is acting as an agent of a particular shareholder.

4.2. Funding and Financing

Obtaining finance or funding is crucial to the success of joint operations in the petroleum industry, whether through UJVs or IJVs. Parties must critically consider initial funding and future financial requirements. In the wake of new regulatory requirements, the relevant parties will be required to function not as co-venturers or partners but as equity holders in a limited liability company. The general perception is that a fully privatized IJV stands a better chance of securing finance for its operations. However, major transactions in the Nigerian oil and gas industry, particularly in the upstream sector have been consummated through reserves based lending and project finance. It is worthy of note that a key element of these types of financing is the emphasis by the lender on the cash flow rather than the credit base of the sponsor. Undoubtedly, these types of financing will still be the order of the day even for IJVs.

4.2.1. Budget approval

Under the UJV, this is carried out by the operating or steering committee on behalf of the co-venturers, followed by particular Authorities for Expenditure (AFEs) established in relation to specific items. However, in an IJV, the responsibility ordinarily will be for the board of directors to propose the budget and for the shareholders to approve.

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29Scott L. Hoffman, The Law and Business of International Project Finance (Cambridge University Press) p. 4
4.2.2. **Cash calls**

Cash calls would be made by the operator on all of the co-venturers to fund items for which AFEs have been issued under the UJVs. This has been a major challenge for existing UJVs as NNPC has often been in default in meeting its cash call obligations. In an IJV, the company will ordinarily be responsible for its own financial obligations and obtaining capital for its operations. The shareholders’ agreement may set out the initial capital contributions of the parties to the IJV company’s account which doesn’t necessarily have to be based on the shareholders shareholdings in the IJV company. Subsequent funding by the IJV may be by additional equity contributions, quasi-equity or debt.

As earlier stated, under an IJV, there is a distinction between the company (IJV) and the owners/shareholders, since the IJV has a distinct legal personality upon incorporation and any assets of the IJV are owned by the IJV. Thus, an IJV may be able to raise finance on the strength of its balance sheet and give security to lenders accordingly. It can be argued that since the IJV will be the entity raising finance (and not the individual shareholders), there will be an alignment of interest between the MOCs and their fellow shareholders to provide the necessary incentives and co-operation (for e.g. shareholder guarantees) to make the IJV attractive for raising the funds. This is unlike under an UJV where each party would have to source for their funds separately leading to a situation where one party may be disadvantaged.

Furthermore, being a separate legal entity, the IJV can access the capital market either by listing its shares on the capital market or issuing debt instruments. IJV companies may also be, financed by non-cash consideration contributions (e.g. when a co-venturer transfers assets to the company or may agree to provide know-how or other technical assistance in return for the initial issue of shares by the joint venture company).

4.3. **Return on Investment**

Under an IJV, the shareholders would typically get returns on their investment by way of dividend payouts declared by the Company. This is measured based on each shareholder’s shareholding in the Company. There are certain provisions governing the distribution of dividends under the Company and Allied matters Act. Section 379(5) of the CAMA provides that dividends shall be payable to the shareholders only out of the distributable profits of the company. Section 380 of the CAMA further specifies that profits out of which dividends may be paid as:

- (a) Profits arising from the use of the company’s property although it is a wasting asset;
- (b) Revenue reserves; and

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30 Although the IJVs will be initially set up as private limited liability companies, there appears to be no restrictions on their ability to convert to private companies for the purpose of listing in accordance with the CAMA, Nigerian Stock Exchange Listing Rules, Investment and Securities Act 2007 and the Securities and Exchange Commission Rules.
(c) Realized profit on a fixed asset sold, but where more than one asset is sold the net realized profit on the assets sold.

Under a UJV the mechanism effecting the returns on investments is usually less uniform. This depends on the participatory interests of parties and as mentioned earlier, each party usually has the right to its share of production.

4.4. Termination
Unlike in a UJV where the JOA provides for the process of termination and notices, in bringing the IJV to an end, the winding up process as stipulated under Part XV the CAMA must be adhered to. Thus, there is a significant difference in the transaction cost accruable in ending the business relationship in either case.

5. Conclusion
The ongoing and proposed regulatory reforms in Nigeria, naturally calls for answers to fundamental and essential questions bordering on the regulatory and risk implications of its identified objectives. Any model or form of regulation or policy that will affect the operations of existing and future JVs should be tailored towards the reduction and isolation of risks.

Thus, both the State and the private stakeholders must work in harmony during the transition period to guaranty and guard against the plausible and avoidable threats, especially in the incorporation of erstwhile UJVs. It is worthy of mention that the IJVs, being incorporated companies will be subject to the provisions of the CAMA which is hoped will engender more transparency and efficiency in their operations. Furthermore, having the NNPC (or its nominee) and the co-venturers operating through a single entity should reduce the risk of cash call defaults by the NNPC.

Nevertheless, in view of the uncertainty in the transitioning from the UJV model to the IJV model, it will be expedient for the proposed PIB or policy guidelines to permit the parties through their contractual mechanisms to determine if and when to carry out such incorporation or whether to create IJVs only for designated major projects like the NLNG.