

## INVESTMENT OPPORTUNITIES IN NIGERIA'S ENERGY SECTOR

### INTRODUCTION

The Nigerian energy sector presents a significant but largely untapped potential for investment. It has huge energy resources and a large domestic and regional market yearning to be served. However, to realise this potential, the Nigerian energy sector will require a total investment of about \$1 trillion within a 30-year period<sup>1</sup>. Annualised, this comes to about \$33.4 Billion only though the current total investment for the year is well under \$20 Billion. This funding gap creates investment opportunities for entities that wish to explore the potential of the Nigerian energy market.

This article is an overview of some of those investment opportunities, the legal and fiscal framework that underpins them and also contains some thoughts on investment protection.

### LEGAL AND FISCAL FRAMEWORK

The Nigerian Constitution vests ownership of mineral resources exclusively in the federal government (the **Government**) and further confers on the Government exclusive powers to make laws that govern the industry. Some of the key legislations regulating the energy sector are:

- i. Petroleum Act<sup>2</sup>
- ii. Petroleum Profits Tax Act (PPTA)
- iii. Deep Offshore and Inland Basin Production Sharing Contracts Act<sup>3</sup>
- iv. Oil Pipelines Act and the Oil Pipelines Regulations
- v. Associated Gas (Reinjection) Act<sup>4</sup>.
- vi. Industrial Development (Income Tax Relief) Act<sup>5</sup>
- vii. Nigeria LNG Act
- viii. Petroleum Production and Distribution (Anti-Sabotage) Act
- ix. Electric Power Sector Reform Act (EPSRA)<sup>6</sup>

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<sup>1</sup> See [http://www.niimp.gov.ng/?page\\_id=1190](http://www.niimp.gov.ng/?page_id=1190)

<sup>2</sup> Provides the framework for the licensing of oil and gas companies

<sup>3</sup> Accords tax relief incentives

<sup>4</sup> Promotes anti-gas flaring policies in Nigeria

<sup>5</sup> Geared at attracting foreign investment in Nigeria

<sup>6</sup> The National Electricity Power Policy (NEPP) and the EPSR provide for the development of Nigeria electricity market

- x. The Nigerian Extractive Industries Transparency Initiative Act
- xi. Federal Inland Revenue Service (FIRS) Establishment Act
- xii. National Environmental Standards and Regulations Enforcement Agency Act<sup>7</sup>

## **OPPORTUNITIES IN THE ENERGY SECTOR**

### **1. Oil and Gas**

#### **1.1 Upstream Oil and Gas**

##### *i. Licensing of Open Acreage*

Nigeria has not held a licensing round in several years although there are about 215 open acreages onshore, shallow offshore and deepwater. A licensing round is well overdue and it is widely anticipated that one is afoot. In order to directly participate in such rounds, local registration at the Corporate Affairs Commission and the Department of Petroleum Resources are mandatory minimum requirements. Otherwise, an investor can team up with exiting operators to take advantage of the licensing rounds.

##### *ii. Marginal Fields*

Presently, only about 9 of the 18 marginal oil fields awarded to indigenous companies have been producing in over 12 years of their award. The current legal regime empowers the President to compel a leasee to 'Farm Out' discovered hydrocarbon wells that have not been produced for over 10 years to an indigenous producer. Although the intention of the Government is to ensure that indigenous companies play a greater part in developing petroleum assets, these investors have encountered funding challenges over the years. This creates opportunities for investors to provide direct investment in the companies awarded the marginal fields.

##### *iii. Mergers and Acquisitions (M&A)*

Mergers and/or acquisitions present an ideal structure for investors that are desirous of operating on a shared responsibility/risk basis. The rise in divestment by International Oil Companies (IOCs) from onshore and shallow water fields has been the major driver of M&A

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<sup>7</sup> Prescribes environmental and emission standards applicable to natural gas activities in Nigeria.

in Nigeria's upstream sector. There is now a steadily growing list of small independents that may not have the capacity to survive a price constrained operating environment. Investors can find operators that have a core of excellence to back in a mutually beneficial joint venture. Noteworthy also, is the opportunity for acquisition of upstream assets through refinancing. Investors can therefore shop for such prospects and refinance them on terms.

## 1.2 Midstream Oil and Gas

### *i. Modular Refineries*

Modular refineries are gradually being embraced as the short-term and mid-term solution to meet domestic fuel demands. While a full conversion plant can cost anywhere from \$2 to \$9 billion, the same amount can be used to spread the risk potential and build various modular plants all over the country to cater to the needs of each geopolitical zone. Beyond the domestic market, there is the prospect for growth into the West African sub-region and other regional markets in Africa. A licensing round of operating license by the Regulator is anticipated.

### *ii. Mini LNGs*

Nigeria is in dire need of an efficient mechanism for gas transportation as most of the available gas reserves in the country are in the south south while a large portion of the growing market is in the south western and eastern parts of the country. Although investment in integrated gas pipeline networks can be considered the cheapest means to ensure a stable gas supply network, pipelines tend to be long term investments and susceptible to vandalism. The business case therefore for mini LNG is that the security risk is lower and these plants require minimal infrastructure development, thus substantially reducing design complexity, and the time attributable to gas pipeline development. Similar to modular refineries, the mini LNGs can also serve the Western African sub-region thus making it a viable investment opportunity.

### *iii. Flared Gas Gathering and Processing*

The Government's plan to locate power plants adjacent to gas flare sites would boost power supply while reducing the incidence of gas flaring in the country<sup>8</sup>. Essentially, the best

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<sup>8</sup> Referred to as the 'Gas flare-out through gas utilization projects'.

prospects for reducing gas flare sites across the country are through projects developed by investors and companies with experience in modest size projects in challenging environments and with strong local engagement plans. A licensing process is underway for potential investors in this regard.

### 1.3 Downstream Oil and Gas

#### *i. LDC (Local) Gas Distribution Companies*

Natural gas may generally be distributed using three broad methods: by tankers, bottling, and by pipelines. Of the three methods, pipeline distribution systems is less expensive, consumes less energy, produces less traffic and also minimizes resultant pollution due to spillage. The only problem (for the Government but an opportunity for investors) is that it involves huge capital outlay. Several local distribution projects are planned to facilitate distribution of natural gas. For instance, the proposed \$745 million Ajaokuta-Abuja-Kaduna pipeline will deliver gas to central and northern Nigeria, while the proposed \$552 million, Aba-Enugu-Gboko pipeline will deliver natural gas to portions of eastern Nigeria.

#### *ii. Liquefied Petroleum Gas (LPG)*

Although LPG is the least utilized of the major cooking fuels (firewood, kerosene and charcoal), forward thinking investors will sight the investment opportunity embedded in this product. Nigeria's current annual spend on kerosene subsidy is about \$1bn. The Country also faces increasing environmental challenges with continuous deforestation as over 50% of households still rely on firewood or charcoal as cooking fuel. Due to its environmental and cost effective nature, the Federal Government is considering a number of interventions in the LPG industry that would expand the domestic LPG framework. The target is to convert additional 4 million households to LPG use as cooking fuels within two years, progressing to 10 million households over five years and eventually converting additional 21 million households over 15 years. Reports indicate that a successful implementation of the intervention strategies developed would require an investment of up to \$25.2 billion over the next couple of years<sup>9</sup>. It is therefore safe to conclude that LPG will eventually replace the major cooking fuels in the country.

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<sup>9</sup> <http://www.vanguardngr.com/2016/11/fg-spent-1bn-kerosene-subsidy-2015-osinbajo/>

## **2. Power**

Investment in Nigeria's power sector is very attractive due to the fact that electricity demand currently exceeds supply. In order to attract investment into the sector, the Federal Government in 2005 enacted the EPSRA which liberalized and commercialized the power sector. The country also has a large amount of renewable energy resources including hydro-electricity, solar, wind and biomass energy. Utilization of the nation's renewable energy resources will reduce the country's dependence on fossil fuels and provide an economically stable source of energy to the power generation mix.

The major challenge with power is the non-cost reflective tariff mechanism, particularly power to the grid. In recognition of this issue, the Government has recently come up with a number of innovations; one of which is the embedded generation which enables power producers supply power to distribution companies on mutually agreed terms of tariff. Although the Nigerian power sector presents a viable investment opportunity, investors are advised to critically examine the pricing dynamics peculiar to this sector.

## **INVESTMENT PROTECTION**

### Stability of Policies and Laws and Sanctity of Contracts

Sporadic change in policies, unwillingness of successive governments to honour their commitments and the delay in the judicial process present a unique country risk to investors and have undermined the country's efforts to attract investments. These risks are not insurmountable as there are a variety of tools such as selection of appropriate dispute resolution mechanism, waivers, inclusion of stabilisation clauses in agreements and obtaining consent letters which can be used to manage them. Investors should therefore seek advice on the combination of tools to employ.

### Repatriation of Funds

Although typically Nigeria practices a liberal "free entry, free exit" approach to the movement of foreign investment funds, practical difficulties have been experienced in recent times due to the decline in the country's foreign reserves<sup>10</sup> arising from the global drop in oil prices. The government initially took a number of extreme capital control measures to reduce the rate of

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<sup>10</sup> From \$42.8 billion in January 2014, to about \$25.7 billion in 2016

foreign exchange outflow<sup>11</sup>. In recognition of the detrimental effect the measures have had on investment<sup>12</sup>, the CBN has in recent times aggressively injected US Dollars into the forex market to ensure stability across all segments of the market. Despite this intervention, investors need to be cautious and examine the sustainability of this intervention.

## **Conclusion**

Although the Nigerian energy sector has huge investment opportunities on all sides, the environment is fraught with risks that require careful navigation. Entities doing or desirous of doing business in Nigeria therefore need to seek legal and transactions advice on the peculiarities of investing in Nigeria's energy sector.

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<sup>11</sup> CBN provided a list of 41 items that are classified as ineligible for official forex allocation.

<sup>12</sup> about \$80 billion worth of investments reportedly exited the country