Reframing The Picture: Debt Restructuring Options For Local Players In The Nigerian Oil And Gas Industry

By DAMILOLA SALAWU *and* MARYAM OLAWUNMI OYEBODE

Partly in response to sustained low oil prices, global economic growth has slowed and different countries have adopted varying measures to deal with the crises they currently face as a result. Nigeria, for whom oil revenue earnings form up to 70% of government revenues, is now faced with the challenge of trying to stabilize its economy by diversifying its revenue sources. Compounding the situation, the unrest in the oil rich Niger-Delta region[1] and ensuing production shut-ins have further reduced earnings by the Nigerian government and this has in turn contributed to the continued pressure on the Nigerian Naira and created a tightened foreign exchange market in the country.

Between 2013 and 2014, the oil and gas industry in Nigeria experienced a flurry of activity, with the International Oil Companies ("IOCs") divesting their interests in onshore assets to independent local companies and the emergence of a new class of local players that were largely new to the upstream oil and gas space and without the benefit of balance sheets as robust as those of the IOCs. These local players (which are heavily leveraged after having approached the Nigerian banking community to finance the acquisition of onshore assets) are now faced with increasing uncertainty in relation to their production output and their revenue stream and are now forced to find innovative ways to stay afloat and to continue servicing their debt obligations to their lenders.

As a possible way out for some of these leveraged companies, debt restructuring options that are available in Nigeria can be explored by companies in the Nigerian oil and gas space as a means to continue meeting their debt obligations and to remain a going concern.

Some Methods of Debt Restructuring Available to Oil and Gas Companies Under Nigerian Law

The debt restructuring options open to any local oil and gas companies in any given circumstance will ultimately be determined by various considerations. These considerations for a company facing a restructuring may be further influenced and affected by the current economic climate, as well as the unique challenges facing the oil and gas industry. Several of these options, and the key issues that should be considered by Nigeria's local oil and gas players in exploring them, are discussed below.

Debt- Equity Swap

Debt equity swap is a method of restructuring which entails a reorganization of the capital of the debtor where its debt to a lender is converted into equity in the debtor. It is mostly employed where a lender looks beyond the present financial challenges and instead to the viability of the debtor's business and the potential long term value of the debtor company and elects to take a position in the debtor company. It may also entail the lender providing, where agreed by all parties, a change of management in the debtor. For the debtor, this option will free its balance sheet from the weight of the debt liability, free up its cash flow and enhance its financials. As may be expected, there will be a dilution of the existing shareholders, possibly resulting in a change of control. Given that most onshore petroleum assets are exploited under joint venture and production sharing arrangements with the government, an ensuing change of control could trigger certain default-type provisions under the relevant joint operating agreements and production sharing contracts between the debtor company (with funding obligations) and its co-venturer. Careful thought must therefore be given to these triggers in executing a debt- equity swap arrangement.

Debt-Asset Swap

This approach involves the transfer of identified assets in part or full satisfaction of the debt obligations of a debtor. This option is possible where the debtor has a portfolio of valuable assets which may not be significant or otherwise fundamental to its primary business but which are of sufficient value to offset part or the whole of its debt to a lender. Issues around an independent valuation of the asset will need to be considered here. The specific asset to be transferred to the lender will usually by agreed by both parties. It should be noted that this process is quite different from a scenario where a lender will be enforcing security over an asset which it holds a security interest over.

Between 2013 and 2014, the oil and gas industry in Nigeria experienced a flurry of activity, with the International Oil Companies ("IOCs") divesting their interests in onshore assets to independent local companies and the emergence of a new class of local players that were largely new to the upstream oil and gas space.

As a general point to note though, there is no widely documented instance where the Debt-Asset Swap has been employed by an oil and gas company in Nigeria. Although this has been utilized by Nigeria's asset management corporation, AMCON as a restructuring option in the pursuit of its statutory mandate to recover bad loans purchased from Nigerian banks. Similarly, the latter case of enforcement by a lender of a security interest over a petroleum asset remains largely unseen in Nigeria.

Standstill and Rescheduling Arrangements
Here, the objective is to delay the repayment obligations of the debtor whilst protecting the rights of the creditors and keeping the debtor as a going concern.

Standstill agreements generally predate the execution of rescheduling/restructuring agreements and the objective is to "*freeze*" the current position of all parties to allow for negotiations and discussions as to how best to address the challenges facing the debtor with respect to its debt obligations. This approach is usually employed in multiparty financings such as under a syndicated lending arrangement or where the debtor is indebted to several creditors under several bilateral loan arrangements which for example may hold security over varying assets of the debtor. It is used to prevent a scenario where different lenders exercise their enforcement rights which may trigger cross default provisions under their loan documents, which in turn, may cause the debtor to become insolvent.

Typically, the standstill agreement will articulate the standstill period, the obligations of the lender(s) and the debtor in the interim period during which negotiations of a path to repayment by the debtor will be held and concluded. Additionally, the standstill agreement may also include restrictions on the debtor from taking additional debt from any new lenders.

For its part, the debt rescheduling involves the renegotiation of the terms of an existing debt obligation, usually to extend the maturity or amortization provisions and sometimes as a result of a default or capital reconstruction. It involves the extension of the repayment period or a modification of the repayment plan with a view to making it easier for a debtor to repay and discharge its debt obligations by affording it more time and more flexible terms in paying off the debt. It is often used where the lender takes the view that the debtor is experiencing a short term liquidity squeeze and just requires some time to stabilize its cash flow.

Recently, a leading Nigerian marginal field operator with strong production volumes faced with difficulties in meeting its obligations (owing mostly to reasons prevailing in the industry issues i.e drop in oil prices and the production shut ins owing to the restiveness in the Nigeria Delta affected the production volumes and the revenue of this operator), occasioning default on its existing loan obligations with a Nigerian lender. Following discussions with the creditor, the parties entered into a debt rescheduling agreement. The agreement (a) extended the repayment tenure for an additional period of 6 years; (b) with an additional moratorium period of 6 months on principal repayments and (c) a grace period of 7 days for late payments.

Broadly however, some other agreements which may be necessary to implement this arrangement include a Standstill Agreement, Restructuring Agreement, Security Sharing Agreements, Equity Injection or Share Retention Agreements etc.

Corporate Restructurings
A corporate restructuring involves an arrangement where a creditor acquires equity and/or assumes management and control of the debtor, usually with a view to improving the efficiency of the debtor's management, governance and the conduct of its business.

Section 537 of Nigeria's Companies and Allied Matters Act ("CAMA") contemplates the restructuring of companies and defines an "arrangement" as any change in the rights or liabilities of members, debenture holders or creditors of the company, other than a change effected under any other provision of CAMA or by the unanimous agreement of all parties. This provision very clearly envisages an agreement between the company and its creditors.

Specifically related to an arrangement between creditors and the company, Section 539 of CAMA provides for three quarters of the creditors to vote and agree to a compromise or an arrangement, which may then be referred by the courts to the Nigerian Securities and Exchange Commission ("SEC") to investigate the fairness of the terms of the compromise or arrangement, following which a written report shall be provided by SEC to the courts. On the courts satisfaction of the fairness of the arrangement or compromise, the court sanctions the arrangement and it becomes binding on all parties.

Some Issues to Consider

— *The risk of shadow directorship:* Where the restructuring option employed is a debt for equity swap or even a corporate restructuring, there is often the concern that the creditor may be liable as a shadow director of the debtor company[2]. Given that Nigerian law effectively treats a shadow director as a director of a company, a creditor regarded as a shadow director will bear the full weight of the duties of care and skill as well as other statutory and fiduciary duties borne by directors to companies under CAMA. Consequently, a creditor must be careful to ensure that the right balance is struck and that its random acts and occasional interventions in the management of the debtor do not make it a shadow director of the debtor company.

— *Past Consideration Issues:* The terms of a restructuring may involve the grant of additional funding by a creditor to a debtor or the provision of additional security over an asset. As required, these if given must be for good and valuable consideration otherwise it may be regarded as being invalid as past consideration. Past consideration arises where an act has already been performed and as such cannot be induced by the other party's subsequent promise or act. In the strict sense, where new obligations are created by the restructuring agreement, new consideration must be provided. Where none is provided, the new obligation (promise) made by the debtor subsequent to the independent and underlying transaction fails as an enforceable contract. Careful attention must therefore be given to the terms of the restructuring especially where additional funding is passing from the lender or additional security from the debtor.

CASE STUDY 0N OANDO PLC. DEBT REFINANCING AND RESTRUCTURING

Oando Plc.

To illustrate how some of the restructuring options discussed have been applied recently, Oando Plc, a local integrated oil and gas company in Nigeria, recently concluded a fairly complex transaction which involved a refinancing and restructuring of a medium term loan with the objective to improve its overall debt portfolio and concentrate on its upstream activities. The transaction involved (a) the sale of its entire downstream business comprising of a number of key subsidiaries to strategic investors and the use of the sale proceeds to pay down some of its existing debt to the syndicate of lenders and (b) the release of security held by a couple of individual lenders and the accession by those individual lenders to the security held by the security trustee on behalf of the syndicate of lenders.

A condition for the sale of one of the key downstream subsidiaries was its sale without any debt liabilities. Accordingly, the purchase price from the sale of that particular subsidiary was used to pay down the intercompany loan of that subsidiary to the parent company.

In relation to another key subsidiary (in the downstream oil and gas petroleum distribution business) which itself was indebted to a small group of lenders, a corporate restructuring through a reorganization of its entire share capital was necessary as a condition for the sale of that subsidiary to a strategic investor.

Consequently, the security held by the lenders on the shares of the subsidiary had to be released. The share capital of the company was reorganized into different classes with varying economic rights, with those holding the most economic rights issued to the strategic investor, the security was recreated and most pertinently, the debt by the lenders to the subsidiary was restructured on terms which gave the company an additional moratorium period, and the rescheduling of the first repayment date.

Alternative Financing Options

Beyond considering debt restructuring options, local oil and gas companies may also consider other options as a means of meeting their funding requirements.

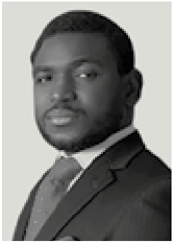
For example, the use of funding arrangements such as financial and technical service agreements (FTSAs) or strategic alliance agreements (SAAs) under which a local E&P company receives funding and/or the provision of technical services or assistance from another party in consideration for a predetermined portion of the debtor's entitlement of hydrocarbons produced from the asset. In this way, the debtor is able to meet its obligations to its creditor.

Other commonplace funding options include prepayment arrangements where the local E&P company receives advances of cash to fund operations and debt servicing in consideration of agreeing to sell crude volumes to the financier[3] up till the value of the advances received.

Conclusion

Whichever option is adopted, it is clear that the local players in the upstream oil and gas industry in Nigeria need to give careful consideration to their continued funding requirements and should not hesitate to approach their current creditors with a view to restructuring their debt positions to ensure they are able to weather the period of depressed prices. In so doing, the key issues identified above must be considered and borne in mind to prevent any liabilities on the part of the lenders. ■

1. Since the 1990's, there has persistent restiveness and unrest through violent militia activity by minority ethnic groups in the NIger Delta region where oil and gas assets are concentrated (Niger Delta).
2. Under CAMA a shadow director is a person on whose instructions and directions the directors of the company are accustomed to act.
3. Typically, an international trading company such as Mecuria, Vitol, Trafigura and the like.



▼ **Damilola Salawu** is is a Senior Associate with the Oil and Gas Practice of Olaniwun Ajayi LP, where he advises on upstream asset acquisitions, re-entry operations into field developments, financing the development of petroleum assets and advising on local content compliance issues, Damilola also advises on a wide range of finance matters including corporate finance, project finance and security arrangements. Recently, he advised on the USD 3.2 Billion Financing for the development of an integrated refinery and petrochemical complex by the Dangote Group. Mr. Salawu received an LL.B. from the University of Lagos in 2005, a BL. from the Nigerian Law School in 2006 and an LL.M. from the University College of London in 2008.

▼ **Maryam Olawunmi Oyebode** is a member of the Dispute Resolution Practice of Olaniwun Ajayi LP. She has a background in corporate commercial practice and litigation. Specifically, she has provided advice on compliance and regulatory issues pertaining to companies seeking to be established in Nigeria, she has assisted in the establishment of foreign entities within Nigeria and has advised on security arrangements. Ms. Olawunmi Oyebode received an LL.B. from the University of Reading in 2009, an LL.M. from Kings College London in 2010 and a B.L. from the Nigerian Law School in 2012. She was admitted to the New York Bar in 2014.