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Oil and violence

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Nigeria has witnessed an uptick in foreign direct investment through non-recourse and commodity-based financing structures in recent years, buoyed by low interest rates and the rising price of oil. Like the Middle Eastern economies of Qatar and Oman, project financings, once concentrated on upstream oil, have spread to include LNG facilities, power plants, downstream infrastructure and industrial operations. Similarly, local and regional banks have become increasingly active at booking assets.

But, although in mid-2005 Nigeria looked set to follow in the footsteps of the Middle Eastern economies, the repercussions of social inequality and years of corruption look set to knock Nigeria's project pipeline back again.

2005 almost a very good year

Before militants used dynamite to blow up a Shell pipeline at Opobo Channel, near Port Harcourt on 22 December 2005, the outlook for the reduced cost of, and increased innovation in, structured financings in Nigeria looked good.

The attack forced Shell – the largest foreign producer operating in Nigeria – to cut production by 180,000 barrels per day. Although pipelines have been attacked in the Niger Delta region before, the explosion signaled a new wave of intense violence (see 'A catalogue of violence', bottom of page).

It is now difficult to imagine how the two most notable financings in the latter half of 2005 – NNPC and Exxon's Satellite oil field project and the Obajana cement plant project – would have achieved the same terms had they closed six months later.

Obajana Cement, a subsidiary of Dangote Industries Limited of Nigeria, closed $479 million of multi-sourced project debt for a new cement complex on 17 August 2005. The deal was notable as the largest industrial project financing in Africa.

The project comprises three distinct assets – a power plant, a cement plant and pipeline infrastructure. The $479 million financing comprised $320 million of external debt and $160 million of local bank debt. Both Dangote Industries and its adviser African Merchant Bank spent time persuading local banks to take project debt onto their books at a reasonable margin. Across the board, the debt pays 410bp over Libor (or its equivalent in interest plus monetised upfront fees).

A $150 million EIB tranche was funded under the Cotonou agreement, with a $40 million direct loan and a $110 million covered loan. The guarantee is for commercial risks only and is provided by Eksport Kredit Fondsen (EKF) of Denmark, for $70 million, and by Fortis Bank and Barclays, for the remaining $40 million.

A banker familiar with Nigeria says "Had the deal been completed today it is highly unlikely that the sponsor would have achieved the same terms. Most commercial banks were already reluctant to lend into the region even on a covered basis. Now with greater instability and the likely reduction in affordable political and commercial risk cover, these banks will be put off even more. Sponsors of planned projects will now have to bear the inflated cost due to these risks and may have to reconsider the viability of their projects."

Just when non-recourse financing was spreading outside the oil and gas sector, this progress appears to be checked. This is particularly galling for sponsors of non-oil related projects, which have so far escaped any attacks. Following Obajana,

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Unichem Nigeria was thought to be considering a non-recourse facility for a new cement plant that is now less feasible.

Recent oil and gas projects

All oil and gas projects, even offshore, are now in the line of fire. Lenders to projects such as the West African Gas Pipeline (WAGP) and the Satellite Oil Field Project are unlikely to be directly affected, barring large assaults on facilities and personnel, but they will be feeling less comfortable, since the deals were structured and priced in more peaceful times.

The first disbursement to WAGP is due at the beginning of February. The equity portion for Benin and Togo's stake has been provided through loans from FMO – the Netherlands development finance company. FMO is providing $18 million each to Benin and Togo, repaid over 12 years. The remaining balance of the $560 million project is fully funded by Ghana and Nigeria, with the money held in an escrow account. The pipeline will enable Ghana, Benin, and Togo to access Nigeria's large resources of natural gas as fuel for power generation and industrial development and reduce gas flaring in the region.

The $600 million financing of the Satellite Oil Field Project closed 24 December 2005. The financing is the largest and longest-ever non-recourse facility with full Nigerian performance risk, without the benefits of the involvement of any multilateral agency or ECA. The deal is structured as a pre-pay on a forward oil sale agreement, with recourse only to the new project production and not to the existing oil production of the sponsors.

The financing represents the Nigerian government's desire to bring additional sources of financing to bear on upstream field development. The project's sponsors are the Nigerian National Petroleum Corporation and ExxonMobil, advised by Credit Suisse.

A $270 million international bank facility was lead arranged by RBS, SG, Standard Chartered and WestLB, with Calyon, Natexis Banques Populaires and CSFB coming in at co-arranger level. The three lead arrangers on the $90 million local facility are Standard Chartered Bank, Union Bank of Nigeria and United Bank for Africa joined by IBTC, Guaranty Trust Bank, Zenith, Access Bank and First Bank. ExxonMobil is also providing a $240 million sponsor loan. All facilities have a tenor of seven years. The debt pays sub 200bp over Libor.

As sole mitigant of completion risk, the drawdown of the international bank facility is subject to certain completion tests to be run on the rehabilitated fields. As a result, in addition to the reserve risk, the lenders are required to be satisfied with the nature and the extent of the completion tests to be run on the rehabilitated fields and also take a view on the portion of the development risk which may not be covered by those completion tests.

The deal seems to be as far upstream as oil and gas project financing is likely to get, with banks almost taking on diluted exploration and production risk. The deal requires banks to make an assessment on development risk that goes beyond what is required from banks in traditional upstream project finance, not only in Nigeria, but also in established markets like the North Sea or in North America. Despite these increased risk factors the deal was 250% oversubscribed.

The debt program has been designed to raise funding for multiple phases of the Satellite Oil Fields developments, subject to the sponsors' continuing requirements. It finances three out of the 22 undeveloped satellite oil fields within the concession area run by the joint venture. The facility could allow over $2 billion of debt to be raised.

Lenders can take comfort from the fact that Exxon has so far escaped the upsurge in violence relatively unscathed, and that the oil fields are some distance offshore and so should be relatively safe. The principal concern will be the onshore receiving terminal at Qua Iboe that is of key strategic importance and will handle up to 70,000 barrels of oil per day initially.

Risks over-egged?

Most bankers remain confident about the prospects for project financing in Nigeria – the attacks may be isolated incidents and the actual risks on the ground are far lower than portrayed by the media. And if history is a guide, current

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levels of violence will not prevent the financing of projects. The violence that erupted with the Ijaw uprising before the 2003 elections curbed some 40% of Nigeria's input, but did not stop Nigeria's run of closing at least one major project financing per year since 1999, although in 2003 the major deal was the Bonny Gas Transport III project, a vessel financing with little Nigerian risk.

A consequence of sustained militant attacks against facilities is that the cost of insurance, and therefore the cost of lending to future projects, as well as direct project costs such as EPC contracts and security, will increase. It is unlikely in the current climate that many projects, particularly onshore (where Nigeria, for one, desperately needs upstream investment in refineries), will go out to market.

"It's not really a question of price," says a director of an export credit agency active in Africa. "It's more a question of go-ahead. Projects in the pipeline could go slower or get stopped altogether. We make an assessment on a project-by-project basis: on a project's location, the strength of its sponsors – whether it has, say, international standing – and the sector in which it operates. Nigeria's central government has less to do with stability on the ground than the provincial governments – some of these regions are strong, some less so. Such is the revenue support to the country, central government will do all it can to keep the oil majors in Nigeria – the question is, is it enough?"

Oil and gas remains crucial to the Nigerian economy, accounting for 90% of foreign exchange revenues. Production is dominated by five joint ventures, all majority owned by NNPC. The largest, operated by Shell, produces nearly 50% of Nigeria's crude oil. The others are operated by ExxonMobil, Chevron Texaco, ENI/Agip and TotalFinaElf.

Banks may take a view on an uncovered asset, but even the most thick-skinned credit committee is likely to have shifted their view on Nigerian risk. That these once sporadic attacks have entered a different, more intense, era is shown by the attacks on offshore facilities by speed boat and a recent kidnapping. It was previously accepted that offshore infrastructure was almost immune to political risks, but this is now proven not to be the case.

Shell targeted, now others

As the largest and longest-serving oil producer in the country, Shell has been singled out for the brunt of militia attacks. The motives for many of the attacks are unclear, with raids carried out by tribes that use the proceeds to buy weapons. The chief perpetrator, Movement for the Emancipation of the Niger Delta (MEND), is fighting for the rights of the Ijaw tribe. MEND is demanding Shell pay $1.5 billion to the Ijaw communities, as ordered by the Nigerian House of Representatives in 2004, as reparation for pollution and damage to the environment since Shell first started production in 1956.

The militants also call for the release of Chief Diepreye Almieyeseigha and Alhaji Asari Dokubo. Alamieyeseigha was former governor of Bayelsa State, and was seemingly granted immunity by the government before his arrest.
MEND has said that all oil companies may be attacked, as it aims to reduce Nigerian export capacity by 30%. This was tragically demonstrated with the killing of nine men when the offices of Agip (subsidiary of Italian firm Eni) were attacked in January. But again, is this a bank robbery or part of a systemized campaign?

The violence could escalate as political tensions increase in the run up to the 2007 elections. A leaked Shell report on the conflict estimated that the conflict in the Niger Delta is responsible for about 1500 deaths a year, placing it on a par with conflicts in Chechnya or Colombia, with an ever-more concentrated number of guns among local people. The oil companies will be holding their breath as pre-election primaries get under way in five month's time. Shell has withdrawn about 500 personnel from four workflow stations, while Exxon denies reports that it has cancelled two shipments through its terminal located at Escravos, and has instead stepped up armed security. Oil unions have threatened to withdraw their staff if security is not improved – but the Delta is almost impossible to police.

Although central government will do all that it can to appease the oil majors, Nigerian security forces seem neither to have the capability nor integrity to protect the network of pipelines and wells spread across the maze of tributaries and swamps that makes up the delta. A political remedy is required that would involve greater social investment in the Delta region.

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Some commentators speculate that the oil companies are now seriously considering divesting themselves of onshore facilities, perhaps to a Chinese buyer, if an all-out tribal war erupts. Stakeholder Democracy Network, a campaign group active in the region, states in a recent report that 'The most pessimistic assessments suggest Shell and foreign oil operators may have to go offshore altogether by 2008 as security and public order deteriorates.'

Such predictions are likely premature. Nigeria's natural resources are of key strategic importance to the US market, which favours the light sweet crude abundant in the region. Although OPEC could step in, its heavier crude would be bottlenecked because of limited refinery capacity.

In terms of project financing, assessments on feasibility and risk will continue to be made on a project-by-project basis. Nigerian project bulls will take comfort from the fact that, outside Shell's production, there have been few interruptions in production during the increased period of violence. More likely than the rise in the cost of borrowing and insurance, some Nigerian oil and gas projects, particularly onshore Shell-sponsored facilities, are likely to be postponed in the foreseeable future and projects in other sectors in affected regions are likely to be delayed until the elections are over. As the old adage goes, you cannot price yourself out of bad risks.

A catalogue of violence

22 December 2005 – Militants use dynamite to blow up a Shell pipeline at Opobo Channel, near Port Harcourt, forcing Shell to cut production by 180,000 barrels per day.
11 January 2006 – Miltants from the Movement for the Emancipation of the Niger Delta (MEND) kidnap four expatriate oil workers and attacked Shell's Sea Eagle Vessel off the Atlantic Ocean in the EA (East Area) field. 120,000 bpd of output is shut. The kidnappers demand the release of two Ijaw leaders and $1.5 billion in pollution compensation to local villages from Shell, the largest producer in the delta.
11 January 2006 – Vandals hit Shell's Trans-Ramos pipeline in the Brass Creek area that feeds crude oil to the export terminal at Forcados, causing a large oil spill. Shell closes four flow stations at Benisede, Opukushi, Ogbotobo and Tunu. The closure results in a loss of 106,000 barrels of oil per day.
13 January 2006 – Shell declares force majeure on Forcados offtake
15 January 2006 – Four security soldiers killed when unknown gunmen attack a flow station Benisede operated by Shell. Shell starts evacuation of around 500 workers at the four flow stations.
18 January 2006 – MEND says it will target all oil producers in the country
25 January 2006 – Nine people killed when armed men storm the offices of Italian oil company Agip in Port Harcourt in southern Nigeria.
29 January 2006 – Attackers storm the headquarters of a South Korean oil services company, Daewoo Nigeria Limited, and steal more than $300,000. There are no casualties
30 January 2006 – MEND releases the four oil workers, ending a 19-day hostage crisis. MEND says it is targeting a 30% reduction in Nigeria's export capacity

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