MERGERS AND ACQUISITION AS TOOLS IN OIL AND GAS MARGINAL FIELD DEVELOPMENT IN NIGERIA

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ABSTRACT

In the 1990s, the Nigerian government mandated the transfer of fields by the International Oil Companies (IOCs) to indigenous companies interested in acquiring them. While this policy might have actualized the indigenization policy motive, the more significant objective of boosting production and reserve base through the fields has remained elusive, owing to the limitations of most of the indigenous farmees of these fields. Much of the existing literature on the problems of developing the marginal fields focus on the specific problems of the development agenda such as funding and technological needs, while glossing over issues of the corporate structures of the marginal field companies and their impact on the development of the fields. This paper examines mergers and acquisition as a tool of corporate restructuring, and their prospects for the marginal field companies. The study adopted the doctrinal research method, utilizing relevant publications for analysis of concepts, principles, legislations and policies. It finds that in spite of the rigorous procedural burden consisting mainly of consents and approvals from multiple regulatory organs, mergers and acquisitions are viable tools for rapid development of the marginal fields. To surmount the procedural burden therefore, the study recommends, among other things, a decentralized merger administration system as obtainable in other Jurisdictions.

Key words: merger, acquisition, marginal field, development, regulation.

JEL Classification: G34, K23, K29, H00

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1. INTRODUCTION

An oil and gas marginal field means any oil and gas field declared a marginal field by the President of the Federal Republic of Nigeria (Petroleum Act, 2004). It is more elaborately described in the Marginal Field Farm Out Guidelines, 2013 as any field which, by the annual records of the Department of Petroleum Resources, has a specific quantity of oil and gas deposit, and from which there has been no production for a period of more than 10 years.

Following amendment of the Petroleum Act in 1996 to provide for farm-out of the marginal fields, 24 of the fields were awarded to 31 indigenous companies as part of the marginal fields licensing round, 2003. Data from the Department of Petroleum Resources (2010) reveals that there are currently a total of 30 awarded marginal fields, of which only 12 have made the list of producing fields. This data indicates inactivity in the majority of the farmed out marginal fields, which implies marginal contribution of the fields to Nigeria's total daily oil and gas output.

A sound prospectof merger for Nigerian marginal field companies was indicated in the merger between Platform Petroleum Limited, and Shebah Petroleum Development Company Limited in 2009 which gave birth to Seplat Petroleum Development Company. Following this merger, production by Seplat has rapidly risen to surpass the combined production capacity of most of the producing marginal field companies.

This study adopted doctrinal research methodology as there are lots of legal, policy and theoretical facets of the work which called for proper analysis, as well as a much needed exposition of relevant developments in the oil and gas marginal field industry. This doctrinal research involved the use of Law and Economics textbooks, relevant articles and reports in journals, newspapers and periodicals. It also involved the use of sources from the internet as well as legislations, and decided cases in the Law reports. The critical and expository analysis achieved through this research methodology best suited a presentation of the role of mergers and acquisition in developing the Nigerian marginal fields, and the merits of and obstacles to mergers and acquisition in marginal field operations.

This paper aims at not only examining the benefits of mergers and acquisition to marginal fields but also addresses pertinent challenges and issues. It concludes with a set of recommendations.

2. THEORETICAL FRAMEWORK

Gupta (2012) referred to an earlier work ofFriedrich Trautwein to summarize seven theories of mergers and acquisition: Efficiency, Monopoly, Raider, Valuation, Empire-building, Process, and Disturbance.

The theories underscore the motives of mergers and acquisition to the various stakeholders and parties to the mergers. The first four of the seven theories hold out mergers and acquisition as reasonable choice or direction which benefits the shareholders of the joining entities. The fifth theory which also views merger as a rational direction, holds that merger benefits the managers of the merging entities. The Process theory views merger as the outcome of a process that may or may not yield the desired results. The Disturbance theory views merger as a macroeconomic phenomenon that leads to economies of scale for the benefit of all parties involved.

For the purpose of marginal fields, three of the seven theories appear to be the most relevant: efficiency, empire-building and disturbance theories. These three theories reflect the motives of mergers and acquisition in a less-competitive market like upstream oil and gas where each player grows and survives at its own pace and also increases operational scale with minimum obstacles from other players. The other theories, on the other hand, underscore the purposes of mergers and acquisition in a stiffly competitive market where the growth of a company depends to a large extent on the scale of market share in its possession.

The three relevant theories can be illustrated in table 1:

Table 1: Theories of Mergers and Acquisition

Theory	Principle	Target Beneficiary
Efficiency	The synergy from merger results in greater efficiency.	Shareholders
Empire-building	Mergers and acquisition would widen the ambit of companies	Managers of the merging entities
Disturbance	Merger is geared towards economics of scale	All entities involved in the merger

3. OVERVIEW OF MERGERS AND ACQUISITION IN NIGERIA

The Securities and Exchange Commission (SEC) Rule 227 defines a merger as the combination of the businesses or any part of the businesses of two or more companies, and one or more bodies corporate. By the same token, Section 119 (1) of the Investment and Securities Act, 2007 defines the term as "…any amalgamation of the undertakings or any part of the undertakings or interest of two or more companies or the undertakings or part of the undertakings of one or more companies and one or more bodies corporate".

Merger envisages the combination of companies whereby the transferor company may be wound-up or dissolved, or both companies may be merged into a new company. In effect, the assets of two or more companies are transferred to one

company which is either one of the original companies or a completely new one. (The Economist, 2000).

While the two words – mergers and acquisition – are often used interchangeably or as a single term, they are of different meanings, processes and effects in the business context. Acquisition has been defined as a transaction or a series of transactions where an entity acquires control over assets, either directly or indirectly (Tom, 2008). But unlike in mergers, the companies that are parties to the relevant transaction in an acquisition may not necessarily combine their respective businesses and operations, depending on the transaction structure adopted. Such companies may retain their distinct legal status, but experience only a variation in the management of the acquired company (Dimgba, 2015).

The broad categories of merger are: Horizontal merger, whereby two or more companies offering the same products or services are combined to form one entity; vertical merger, a combination of two or more distinct enterprises engaged in the same market but operating at different levels of the market; and conglomerate merger involving the coming together of two companies in different industries with no vertical or horizontal relationship.

Section 120, Investment and SecuritiesAct (ISA) also categorizes mergers into small, intermediate or large depending on the value of transactions involved. Section 122 of the ISA stipulates that parties to a small merger need not notify the SEC of the merger unless specifically required by the regulatory body to do so. On the other hand, intermediate or large merger parties are mandated by law to notify the SEC and get its formal endorsement to such merger pursuant to Section 123 (1) of ISA 2007. Similarly, section 120 of the ISA empowers the SEC to determine the threshold for each category from time to time. The threshold has been changing since 2007 following the SEC Rules of subsequent years as illustrated in the table below.

Class of Merger	**Threshold under ISA 2007**	**Threshold under SEC Rules 2010**	**Threshold under SEC Rules 2013**
Small merger	Below N500million	Below N250million	Below N1billion
Intermediate merger	N500million and N5billion	Between N250million and N5billion	Between N1billion and N5billion
Large merger	Above N5billion	Above N5billion	Above N5billion

3.1 Merger Regulation

The SEC is the main regulatory body on mergers for companies in all business sectors in Nigeria. Its operations are guided by ISA, 2007 and SEC Rules. The Corporate Affairs Commission (CAC) is involved in mergers to the extent that alterations in the

composition of directors and shareholders of the merged entities are registered or filed with the CAC.

The omnibus power of the Federal Inland Revenue Service (FIRS) to administer the various tax laws pursuant to Section 25(1) of the FIRS (Establishment) Act, 2007 has also vested the FIRS with a measure of merger regulatory powers. One of the tax laws, the Companies Income Tax Act (CITA) Cap C21, LFN, 2004 (as amended) in section 29(12) provides: "No merger, take-over, transfer or restructuring of the trade or business carried on by a company shall take place without having obtained the Board's direction under subsection (9) of this section and clearance with respect to any tax that may be due and payable under the Capital Gains Tax Act." In 2006, the FIRS released Circular No. 2006/04 on Tax Implications of Mergers and Acquisitions. The circular, in its Paragraph 2.0, re-emphasized the above statutory provision in CITA by expressly stating that FIRS must approve a merger or acquisition bid before its completion.

4. LEGAL FRAMEWORK FOR MERGERS AND ACQUSITIONS OF MARGINAL FIELDS

Mergers and acquisition for oil and gas companies in general and marginal field operators in particular are not expressly enabled by the law. What can be linked to mergers of oil and gas companies by necessary implications are provisions requiring consents and creating regulatory powers in processes of alienation of oil and gas rights and interests which can include mergers by interpretative stretch.

Examples of such implicit provisions being linked to mergers are Paragraphs 14 and 15 of the 1st Schedule to the Petroleum Act, 1996 which provide as follows:

> "14. Without the prior consent of the Minister, the holder of an oil prospecting licence or an oil mining lease shall not assign his licence or lease, or any right, power or interest therein or thereunder.
>
> 15. The prescribed fee shall be paid on an application for an assignment under paragraph 14 of this Schedule and the Minister's consent for the assignment may be given on payment of such other fee or such premium, or both, and upon such terms, as he may decide: Provided that the Minister may waive payment of that other fee or that premium, or both, if he is satisfied that the assignment is to be made to a company in a group of which the assignor is a member, and is to be made for the purpose of re-organization in order to achieve greater efficiency and to acquire resources for more effective petroleum operations."

From the above provisions, The Petroleum Minister's consent is prerequisite to any alienation of right or interest in an Oil Prospecting License or Oil Mining Lease. What lingered as knotty issues here are: what is the scope of assignment under this provision that calls for ministerial consent, the payment of prescribed fees, and

other requisite terms? Could the term "assign" in the context of the provisions connote the alienation of any right however minute or in whatever form by the licensee of an OPL or lessee of an OML? Assuming the alienation contemplated here includes merger of the OML holder, is a marginal field akin to an OML, such that the mergers of marginal field farmee companies must undergo the procedure stipulated in Paragraphs 14 and 15 of the 1st Schedule to the Petroleum Act stated above? The legislative silence on the above significant questions created room for assumptions which were capable of placing a merger of marginal field companies at the risk of judicial nullification for want of compliance with the Petroleum Act.

In a merger or an acquisition, the ownership and structure of the merging entities undergo significant changes which extend to the ownership of the OML involved. Hence, there is an assignment of a right, power or interest in the OML as contemplated by Paragraph 14 above. Again, a merger or acquisition of oil and gas entities is usually geared towards "*re-organization in order to achieve greater efficiency and to acquire resources for more effective petroleum operations*" as required in the proviso to Paragraph 15 above. This is however, an interpretative attempt open to judicial scrutiny, just like other presumptions on the scope of the above provisions.

All the presumptions were however brought under judicial test in*Moni Pulo Limited v. Brass Exploration Unlimited & 7 Others (*CLRN, 2012). In that case, PetroSA holding 100% share capital in Brass which had 40% participating interest in OML 114, sought to transfer the controlling shares and the 40% interest to Camac. PetroSA did not apply to the Minister for consent to the transfer. The key issue before the court was whether an oil concession can be transferred under the law without the prior consent of the Petroleum Minister. The court, pursuant to its findings, held *inter alia* that,

"*whoever buys, acquires and takes over the controlling shares of Brass ultimately buys, acquires and takes over the right, power and interest in the Brass' 40% participating interest in OML 114 and must obtain the approval of the Minister of Petroleum Resources before such an assignee can exercise such right, power and interest.*"

This judgment prompted the Department of Petroleum Resources (DPR) to produce and circulate the "Guidelines and Procedures for Obtaining Minister's Consent to the Assignment of Interest in Oil and Gas Assets". The Guidelines describe an "assignment" as "the transfer of a license, lease or marginal field or an interest, power or right therein by any company with equity, participating, contractual or working interest in the said OPL, OML or marginal field in Nigeria, through merger, acquisition, take-over, divestment or any such transaction that may alter the ownership, equity, rights or interest of the assigning company in question, not minding the nature of upstream arrangement that the assigning company may be

involved in, including but not limited to Joint Venture (JV), Production Sharing Contract (PSC), Service Contract, Sole Risk (SR) or Marginal Fields operation."

The express mention of marginal fields, merger and acquisition effectively resolves the issue of applicability of paragraphs 14 and 15, 1st Schedule of the Petroleum Act to the mergers of marginal fields. Furthermore, paragraph 20 of the Marginal Fields Farm-out Guidelines likens a marginal field to an OMLby providing that: "the Farmee has all the rights of the OML leaseholder in respect of the farm-out area." Paragraph 20 suggests that a marginal field is treated as separate and distinct from the OML from which it is farmed out.

5. ECONOMIC IMPORTANCE OF MERGERS FOR MARGINAL FIELDS

The importance of mergers and acquisition as a turnaround mechanism for marginal fields companies is identified from the following standpoints:

5.1 Funding Needs

Inadequate funding sources is the most glaring of the marginal field development challenges besides low level of support infrastructure. For these two, mergers and acquisition come in handy as a panacea. On the issue of bankability which is an obstacle to marginal field companies accessing credit facilities, the joinder of assets for credit collaterals enhances the credit-worthiness of the marginal field company seeking a loan.

5.2 Integrated Market for Gas and Electricity

The combination of gas marginal fields in a merger would enhance collaboration between the natural gas and electricity markets in Nigeria. Some of the fields are quite richer in gas reserves than others and some farmee companies have indeed keyed into gas production faster than others. For example, among the marginal field companies in Nigeria, Frontier Oil Limited and Platform Petroleum have built capacity in gas production from their fields, and even supplied gas for power generation. With this capacity and potential of gas production in the above examples, a merger with, or acquisition of, other companies with rich gas reserves but lacking in gas production equipment and experience would enhance gas production and further boost integration of natural gas and electricity market.

5.3 Expanding the Reserves Base

Most marginal field companies have single fields to exploit, and mostly on joint operation basis. To remain in business beyond the life of its particular field, a marginal field company must expand its reserves of oil and gas. Mergers entail field combination and a stronger financial and technological competence to bid for more fields.

5.4 Diversifying Operational Areas

Among the marginal fields awarded so far, some are offshore, others onshore,or in swampy terrain. An offshore company successful in producing from its field would have less limitations with an onshore field. So, for an onshore field holder who is stuck with his own field, a merger with the successful offshore producer could be the way forward. Relevant factors here include: the costs necessary to extract resources offshore, proximity to refineries, quality of pipeline and other infrastructure. Oil and gas prices are usually across the board, and never take all these factors into consideration. Thus operation in some geographical areas could place the marginal field operator in grave disadvantage. Consequently, a diversified portfolio can minimize risk by spreading it across multiple unrelated revenue streams. Merger is a sound means of achieving this.

5.5 Technology Acquisition

The various marginal field companies are of different core competencies. Some of the companies are quite new and are indeed taking off with the Nigerian marginal field programme, unlike others that had been in petroleum operations. The experience of the latter companies entails a higher technological base than in the case of the former. Likewise, some of the companies are better at deep-water drilling. Combination of desired know-how that would result from merger or acquisition can bring a non-producing field on-stream.

6. COMPATIBILITY OF THE MERGING ENTITIES

It is not unusual for the corporate motives of different entities, even in the same line of business, to differ. Thus incompatibility issues are bound to arise after the coming together of such entities. Some pertinent issues of compatibility are: why a company would choose another particular company to acquire or merge with, and how many common features are in the management systems of the merging companies.

6.1 Time Demand

Mergers and acquisitions transactions are usually time-consuming to the extent of taking months, even years, to complete; and that these timelines would typically vary depending on a number of factors including issues arising from due diligence, regulatory hurdles, tax and accounting issues, amongst others (Dimgba, 2015). Usually, a timeline is drawn to guide and expedite the activities in each merger transaction. However, it may not always be possible to strictly follow such timelines because delays in the pace of the merger may sometimes be from the end of the regulatory agencies. A welcome development in this respect is that the Nigerian Federal Government, on May 18, 2017 signed the Federal Government Executive Order on the Promotion of Transparency and Efficiency in the Business Environment.

By this Order, any application for approval not responded to within the stipulated time, shall be taken as granted.

6.2 Multiplicity of Regulatory Agencies and Rigorous Procedures

The regulatory authorities for mergers and acquisitions are many. All corporate mergers involve SEC, CAC and FIRS as regulators. The court also comes in at times for the purpose of incidental orders and directives. This, coupled with requirements of the regulars in some sector-specific mergers, all compound the merger procedure. In the case of oil and gas companies under which marginal fields fall, the requirement of ministerial consent with the requisite fee under paragraph 15, First Schedule to the Petroleum Act would constitute an extra burden for the marginal field companies that have scaled other hurdles in the merger procedure.

6.3 Protection of the Minority Interests

Mergers and Acquisitions almost always involve the meeting of a larger entity with a smaller entity with the result of an imbalance of decision powers and choices among the stakeholders of the resulting entity. This would be most pronounced in the case of the marginal fields because the clarion call for mergers of the marginal field companies is as a result of the low fortunes of most of the companies. Based on this, minority rights protection following a merger is very crucial.

6.4 Tax Issues

Marrying the tax records of the merging entities for continued tax compliance is highly intricate. FIRS Circular on mergers and acquisitions provides the procedural requirements for mergers, and the tax effects of a merger. It provides in its Paragraph 3.0 a requirement for, and the Procedure of obtaining, the approval of the Board of FIRS prior to the merger. It requires the merging companies to provide FIRS with all documents that would aid charging all taxes arising from the merger.

Most of the powers of FIRS under this Circular are anchored on Section 29(12) of CITA which provides that every corporate restructuring requires FIRS' direction, and confirmation that there is no outstanding liability on Capital Gains Tax.

7. RECOMMENDATIONS

To lessen the procedural burden for marginal field companies in terms of the monetary costs, waiver of payment which is also provided in Paragraph 15, First Schedule to the Petroleum Act should be made automatic in the mergers of marginal fields. The proviso to Paragraph 15 states: "Provided that the Minister may waive payment of that other fee or that premium, or both, if he is satisfied that the assignment is to be made to a company in a group of which the assignor is a member, and is to be made for the purpose of re-organization in order to achieve greater efficiency and to acquire resources for more effective petroleum operations."

The Nigerian merger laws are strictly Federal laws, for example CAMA and ISA. However,Nigeria has advanced to a commercial stage where merger regulation should be decentralized by law. In USA, administration of mergers and acquisitions is decentralized between the federal law and authorities on the one hand, and state laws and authorities on the other hand (Mergers and Acquisition Law,). The essence of two regimes of laws in USA is to allow each state within the federating unit to cater for its own peculiarities. It should be noted that some Nigerian states are more commercially active than others e.g. Lagos State.State laws should set the standards, procedures, and requirements for mergers in the various states of the country while federal laws should check on the size of the joint firm after a merger to avoid resultant monopolistic powers.

To alleviate the rigours of compliance, and ease due diligence in marginal field mergers, the disclosures captured in the records of the DPR in the course of the marginal field bidding process can be relied upon during mergers. For instance, Paragraph 6.5 of Marginal Fields Farm-out Guidelines mandates companies bidding for the marginal fields to provide: i. Information on their structure, composition, activities and experiences in the areas of oil and gas exploration and production; and ii. proof of the company's technical and managerial competence.

The Nigerian Senate on June 8, 2017, passed the Federal Competition and Consumer Protection Bill, 2017. The Bill, upon receiving Presidential assent, would establish the Nigerian Trade and Competition Commission, with the power to formulate measures to restrain, and where possible, eliminate all uncompetitive behaviour in trade activities in Nigeria. The power of this Commission is wide in scope as it relates to trade competition. The SEC, considering its roles in competition, has a prospect of liaison with this Commission for exchange of information to aid detection of mergers with anti-competition motives and control of post-merger competition.

An exclusive legal framework for marginal fields is recommended. The envisaged special law would create exceptions to procedural rules and monetary requirements for mergers and acquisitions in the case of marginal fields, as well as a special tax rate for marginal fields. An analogy can be drawn with deep offshore petroleum operations. With the huge financial and technological demands of deep offshore exploration and production, the Deep Offshore and Inland Basin Act was enacted. This law created special tax and royalty rates for deep offshore operations in Nigeria.

8. CONCLUSION

Mergers and acquisitions are sound turn-around mechanisms for the companies challenged with their marginal fields. The major benefits of mergers to marginal field development underscore the need to ease up merger costs and procedures as highlighted in the recommendations. The challenges of mergers peculiar to

marginal fields have been considered, most conspicuous of which is the proliferated procedural requirements occasioned by multiplicity of regulatory authorities and rules. Remedies to this have been recommended. Most importantly, favorable discretion and waivers must be applied by the regulatory authorities to ensure that the game of mergers would be worth the candle in the long run. The Federal Government Executive Order on ease of doing business is the most welcome development in respect of lessening the burden of regulatory compliance. SEC has also alleviated the procedural burden of mergers by its 2015 amendment of the SEC Rules which reduced the filing stages from 3 to 2. A liberalization policy that would give room for foreign companies and experienced viable Nigerian companies not yet holding any field to merge with or acquire marginal field companies would broaden the horizon of participation in marginal fields through mergers and acquisitions.

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