Nigeria’s oil industry transition: some governance considerations

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Introduction

Approved by the Federal Executive Council in July 2017, the National Petroleum (Oil) Policy[1] (the ‘Policy’) highlights the Nigerian government’s intention to move the Nigerian economy away from dependence on crude oil as its major source of income. An overhaul of the governance and industry structure is one of the main features of the Policy. In this manner, the government planned to exit from cash call arrangements by December 2017 and, among others, change its existing unincorporated joint venture (JV) arrangements to incorporated JV arrangements.

A JV is ‘a business undertaking by two or more persons engaged in a single defined project’.[2] Companies typically enter into JV agreements when a project is too large or costly to be managed by one company.

In Nigeria, the trend has been for petroleum companies to operate by means of unincorporated JVs rather than incorporated JVs. The relative flexibility offered by using unincorporated JVs has been a major attraction in this regard. With the publication of the Policy, however, certain questions become relevant: What steps need to be taken to transition an unincorporated JV to an incorporated JV? What are the corporate governance considerations?

To address these questions, this article provides some basic compliance requirements for transitioning from an unincorporated JV to an incorporated JV, then analyses and addresses corporate governance concerns that would be of relevance following the transition.

Unincorporated v incorporated: the considerations

Companies typically enter into JV agreements when a project is too large or costly to be managed by one company, as is often the case in oil and gas projects, which are highly capital-intensive in nature.

The basic choice in structuring a JV is between an unincorporated JV and an incorporated JV. An unincorporated JV is a JV set up by contract. An unincorporated JV is not a separate legal entity and does not own assets in its own name. An incorporated JV, on the other hand, is a separate legal entity formed to carry out the JV's business and owns assets in its own name. Incorporated JVs include limited liability companies whether private or public, and in the case of a public company, whether listed on the stock exchange or not.

Some of the factors that influence the choice of structure for a JV for the petroleum industry are:

- local regulatory requirements;
- anti-trust and competition concerns;
- tax considerations;
- capacity and limitation of liability;
- accounting;
- achievement of synergies with existing operations;
- operational simplicity;
- flexibility for future growth; and
- ease of exit.

Transitioning: compliance requirements

In Nigeria, the first step to transitioning from an unincorporated JV to an incorporated JV is to incorporate a company. Since JVs are commercial undertakings that are set up to make profit, the type of company to be incorporated would be a company limited by shares or even an unlimited company, as opposed to a company limited by guarantee. A company limited by shares is also a more common form of company structure than an unlimited company, since the former offers the apparent protection[3] of a limited liability,[4] which is not offered by the latter. A company of any of these types may be either a private company or a public company. Notable differences between a private company and a public company are the number of members (shareholders)[5] and the extent of restriction on the transfer of shares.[6] A public company limited by shares also may or may not be quoted on the stock exchange.

A JV may therefore opt to transition from an unincorporated JV to an incorporated JV, which is a private or a public company. It is also possible upon incorporation to change from one form of incorporated company to another, subject to compliance with the regulatory requirements.

Since 'transitioning' implies a change from one structure to another, it may be assumed that the sort of regulatory approvals that need to have been obtained by the transitioning JV to receive the initial oil prospecting or mining licence would not be required, since those approvals would have been in place prior to commencing the unincorporated JV.

Where foreign investors are desired for the incorporated JV pursuant to the transition, the incorporated JV would be required to register with the Nigerian Investment Promotion Commission (NIPC) under the NIPC Act and obtain a business permit (for the business) and expatriate quota (for its foreign personnel) from the Nigerian Ministry of Interior. Under the Local Content Act, Nigerian shareholding in the incorporated JV must be at least 51 per cent to sustain the licence and approval.

Transitioning: corporate governance concerns

The bedrock of corporate governance considerations following a transition from an unincorporated to an incorporated JV would be the procedures for ensuring optimal functioning of the JV in accordance with regulatory standards. In this regard, the following points should be borne in mind.

Management and control

The decision-making organs of an incorporated JV would be its shareholders in general meeting and the board of directors, as opposed to the operating committee under the unincorporated JV structure. Currently, every incorporated company in Nigeria must have at least two directors and two shareholders. The allocation of powers between the directors and shareholders of the incorporated JV is for the incorporators in the constitutional documents of the incorporated JV to decide, subject to any mandatory regulatory provisions. The practice would be to vest the management and control of the company in the directors and reserve for the shareholders only such powers as are mandated for shareholders' exercise. As a practical point, in any case where greater shareholder control is to be exercised, there may be advantage in electing for requiring shareholders' consent but leaving the executive decision to the directors. This would then effectively maintain the responsibility of the board of directors for all aspects of the company's operations.

Board composition

In an incorporated JV, it would be typical to provide for the right of each shareholder to nominate a given number of directors reflecting roughly the proportionate shareholding of each shareholder. This can be achieved by:

- constituting a different class of shares for each intended shareholder and conferring on each class of shares the right to appoint and remove in writing the number of directors appropriate to the shareholding;
- conferring the right to appoint and remove in writing a director by reference to the share capital held by each shareholder – for instance, one director for each 15 per cent of issued capital; and
- providing for the holder of a specified percentage of issued shares to nominate the appropriate number of directors but leaving the formal appointment to be made by the shareholders in general meeting.

The chairman of the board is usually drawn from the ranks of directors appointed by the largest single shareholder. Alternate directors ought to be provided for, wherever possible, in the interests of convenience and efficient management. Alternates are often – but need not be –

drawn from the substantive directors. Committees of the board may be established, either with such powers as the board may delegate from time to time, or with a 'standing brief' to deal with all matters not expressly reserved to the substantive board of directors or shareholders. Equally, the articles of association can contain a permissive provision allowing the board to establish committees as and when it pleases. The constitution of committees should be required by the articles of association to reflect the same 'balance of power' as the board itself.

Articles of association and shareholder agreement

Several of the special provisions sought by shareholders of the incorporated JV are capable of being documented in either the articles of association or the shareholder agreement. This would be a change from the joint operating agreement that governed the relationship of parties under the unincorporated JV. Generally, the incorporated JV would not be a party to the shareholder agreement but it is a party to the contract with the shareholders constituted by the articles of association.

Thus, the preferred approach should be to document as many shareholder matters as possible (such as general meetings, quorum, voting, directors and transfer of shares) in the articles of association so that both the incorporated JV as an entity and the shareholders are bound by them. Nevertheless, the use of a shareholder agreement may be preferred over the articles of association in circumstances where it is expedient to preserve confidentiality since the articles of association generally is a public document while the shareholder agreement is not.

Quorum and voting

Valid decisions can only be taken when the decision-making body is properly constituted. Thus, the issue of quorum is a relevant governance consideration for the incorporated JV.

In the unincorporated JV structure, parties are free to determine their quorum in the manner they decide. The voting mechanism for the unincorporated JV in Nigeria is typically unanimity of all parties. For an incorporated JV, unless the contrary is expressed in the articles of association, the quorum for a board of directors' meeting would be one-third of the directors. For a shareholders' meeting, the quorum would be one-third of the total shareholders in the incorporated JV or 25 members (whichever is smaller).

Decisions by the board of directors are reached by a simple majority and in the case of an equality of votes, the chairman has a second (casting) vote. Decisions are reached by the shareholders by a simple majority, unless the Companies and Allied Matters Act or articles of association mandate that a decision on a specific matter be reached by special resolution, in which case a three-quarters majority of votes will be required to validate such decision.

Since the minimum quorum stipulated by law (either for directors or shareholders) may be too small for JVs with many participants, it is therefore important to exclude from operation the default law provisions by providing expressly in the articles of association for a larger minimum number of participants for forming a quorum. In fixing quorum and voting, a balance should be achieved between safeguarding the interests of a shareholder and preventing possible abuse of the system by a shareholder who persistently fails to be represented at meetings, thus frustrating the execution of business of the incorporated JV.

Conclusion

In the final analysis, it is evident that addressing corporate governance concerns is the bedrock for the successful transition of Nigerian petroleum from an industry of unincorporated JVs to incorporated JVs to ensure continued optimal functioning of the JV.

Notes

[1] Paragraph 5.5 of the National Petroleum (Oil) Policy (July 2017).

[2] B A Garner (ed), Black's Law Dictionary (West Publishing Co, 1999), p 843.

[3] Reference is made to 'apparent protection' because, in practice, by means of appropriately worded agreements, creditors before advancing a loan require shareholders to commit to contributing funds beyond the limit of their unpaid shares.

[4] A company limited by shares has limited liability. This means that the liability of the members of the company is limited by its memorandum of association to the amount, if any, that remains unpaid on the shares respectively held by such members. Thus, in the event of insolvency, there is a restriction on the ability of creditors to reach into the personal assets of members (ie, shareholders) to settle outstanding debts.

[5] A private company is not permitted to have more than 50 members while a public company is permitted to have more than 50 members.

[6] Section 22(2) of the Nigerian Companies and Allied Matters Act mandates a private company limited by shares to restrict the transfer of its shares by its articles of association.

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