

# Practical legal issues in African oil & gas mergers and acquisitions

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Merger, acquisition and disposal activity in the African energy market continues to gather pace, specifically in the upstream oil and gas sector. This article explores how and why these deals have been taking place. Particular consideration is given to some key issues that future asset sellers should consider when they make their initial investments. We also focus on certain matters relating to the structuring of projects, by international oil companies and their lenders, to facilitate future monetisation by way of sell-down. We also identify some specific country-by-country considerations and some regional variations in transaction approval processes.

## Evolution of the African market

Many oil and gas companies have long-recognised that the most attractive growth opportunities are to be found outside their domestic markets. According to figures published by BP in the summer of 2007, more than 80% of the world's oil and gas lies in the Africa/Middle East/Europe region. Within that region Africa, and particularly West Africa (and increasingly East Africa), has become one of the most exciting markets for international energy explorers.

The sheer volume of oil and gas in the region has made it impossible for energy investors to ignore. By way of simple example, Africa as a continent contains almost exactly twice as much oil and gas as the whole of North America. As illustrated in Figure 1, proved oil and gas reserves in Nigeria alone are far greater than the total proved reserves of the UK. Likewise, within the last

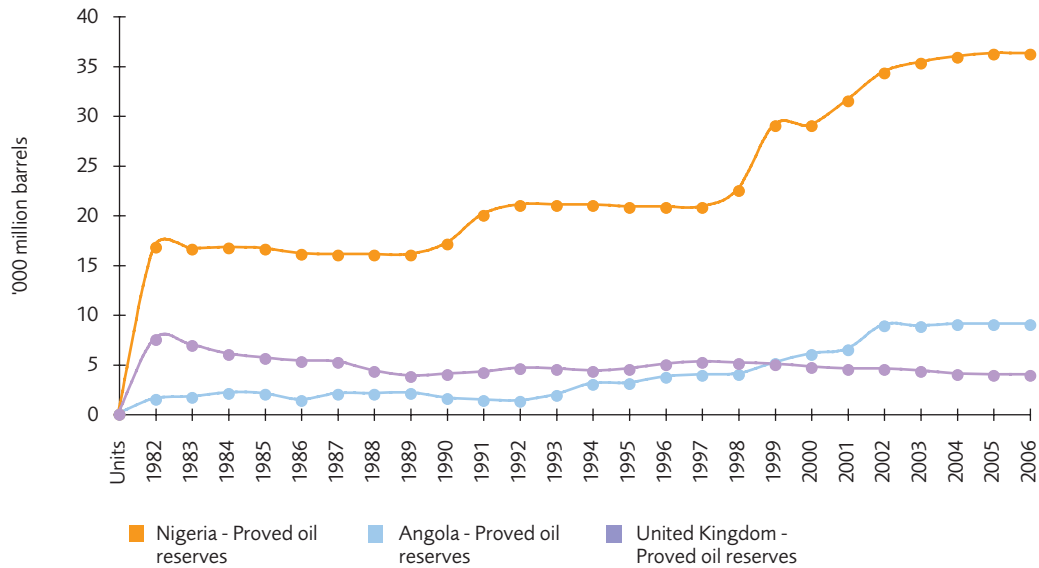
10 years reserves in Angola have overtaken those in the UK, and there has been a dramatic upward trend in both Nigeria and Angola (with a similar story across the rest of West Africa), while UK reserves have steadily declined.

All of this has triggered significant new investment in Africa from a diverse range of sources. First, the traditional majors remain highly active in the region. Second, a great many foreign players have entered the market to capture some of the new opportunities (and indeed many small US and UK oil companies have been created solely for this purpose). Third, local African companies have now started to find ways successfully to enter their domestic markets. At the same time, as ever, those companies who have succeeded in winning blocks now need to find partners and to realise some of their profits and gains.

A new feature of the African energy mergers and acquisitions market is the scale and scope of the deals now being done. The market has evolved beyond the simple, single-asset, cash payment farmouts that have traditionally been the staple diet of oil and gas dealmakers. Now, transactions in the region are commonly multi-asset portfolio deals. These deals are increasingly structured as corporate share deals rather than asset assignments, and the consideration can involve complex 'earn-in' work obligations or asset swaps. Even more notable is the fact that African energy deal values are no longer just in the tens or even hundreds of millions of dollars. Billion dollar African oil and gas deals are becoming less and less unusual and these deals are starting to grab the attention not just of the corporates, but also of the investment banks and commercial banks who now see real opportunity for themselves in the region.



**Figure 1: Comparison of proved oil & gas reserves in UK, Nigeria and Angola 1982-2006**



Source: BP Statistical Review of World Energy 2007

All of these factors are combining to create an active and exciting African energy M&A market, and all of these deals, at least in the oil and gas sector, face many of the issues described in the rest of this article.

### Preparing for M&A

Planning a successful sale, sell-down or farm-out can start even before the interest to be sold has been acquired. Numerous consents and approvals can be required to change the ownership structure of an upstream oil and gas interest, even within group, so it makes sense to use from the start a structure that will facilitate future sale.

At its simplest this can mean making sure that the asset is owned by a single purpose corporate vehicle, the shares in which can be sold in future to dispose of the asset. The question then arises as to where that entity should be incorporated. Local law requirements (such as the Nigerian Companies and Allied Matters Act) will frequently dictate that the company should be located in the jurisdiction in which the assets are located, but this is by no means always the case. Tax considerations will also be critical and may suggest that the immediate parent of the asset-holding company should be located in a low-tax jurisdiction to minimise any tax immediately payable on the gains resulting from a future sale.

Of course, all the usual project-structuring

considerations will also apply. These will include selection of corporate jurisdictions to gain protection from bilateral investment treaties; allocation and limitation of liability within the group; and structuring in the way required by any third party lenders providing finance for development of the block.

Potential sellers should also be mindful of the issues that any purchaser of African energy assets will want to place under the microscope from a due diligence perspective. Compliance with ethical corporate practices, and in particular with mandatory anti-corruption laws, is a critical issue for investors in the region. Regulatory authorities in the US and the UK have made it clear that they will not tolerate breaches of the Foreign Corrupt Practices Act and similar legislation. West Africa is an obvious focus for the attention of these regulators, and the current investigations into a number of West African energy projects prove that the regulators mean what they say.

Developers and sellers of African oil and gas projects need to be scrupulous from the start in complying with these laws. Even where no breach occurs, any suspicion of non-compliance can be extremely costly in terms of reputational damage and can be fatal to any proposed sale transaction. It is therefore important that thorough payment records are maintained and that compensation arrangements with local partners are transparent and

A photograph of several offshore oil rigs in the ocean at night. The rigs are illuminated with various lights, and one rig in the foreground has a large flare emitting a bright orange flame. The sky is dark blue, and the water is dark with some whitecaps.

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justifiable. By the same token, from a compliance perspective purchasers will need to examine with a critical eye the history of the asset, the activities of the seller and the identity and activities of any co-venturers. All parties should also remember that this is not only a matter of US law, and that the requirements of English law (which apply to transactions and projects located anywhere in the world) are just as onerous as, and in some respects more onerous than, the rules applicable to US companies.

Indeed local partner participation in general is an issue that complicates or delays many African M&A and financing transactions. As a rule energy companies should try to ensure that local partners will not be in a position to exert more influence over a future sell-down (for example through entrenched royalty rights or carried interest entitlements) than their role in the development of the project deserves.

## Regulatory issues

Local law consents and approvals should also be considered when structuring to allow for future sales. For example, it is common for local law (or the requirements of the applicable PSC) to prohibit assignments (i.e. asset deals) in favour of non-affiliates. However, at least for the time being, it is far less common in West African jurisdictions to find any statutory restriction on changes of control (i.e. share deals) in the upstream corporate chain of ownership. This is discussed in more detail later in this article, but the simple act of planning for a share deal rather than an asset deal can dramatically simplify the M&A process in the subsequent months and years.

However, there may ultimately be other compelling reasons to effect a sale by assigning assets rather than by transferring shares. For example, if asked to buy shares, buyers may find that their ability to book the hydrocarbon reserves attributable to their interest is impaired. Where the interest arises through a minority shareholding, the accounts of the company will not be consolidated with those of the buyer, whereas a direct interest in a PSC may allow the booking of the reserves attributable to such interest. Similarly, a minority shareholding may not give the same degree of voting power and control as a direct stake in the asset. There may also be tax advantages to buying the assets rather than the shares.

However, the option to effect a share sale rather than an asset sale can be a valuable one which can often be achieved through relatively simple initial structuring.

## Contractual issues

Careful consideration should also be given to possible future disposals when the contractual terms relating to the block are drafted and agreed. In negotiating a JOA it is easy to pay insufficient attention to the transfer restrictions and simply to agree to apparently 'standard' terms.

It is worth considering, for example, the dramatic differences in this regard between the terms of the 1995 model form JOA of the Association of International Petroleum Negotiators (AIPN) and the terms of the subsequent 2002 AIPN model form. Both of these JOAs are very widely used across Africa and are considered by many to be 'standard'. However, the 1995 form contains arguably no restriction which is legally effective (at least under English law) on the sale of shares in a company that is party to the JOA, or in any entity further up the corporate chain. The 2002 form, however, contains additional provisions, covering no less than three and a half pages, to address more comprehensively the possibility of a change in control (i.e. a share sale) of a JOA party. Detailed analysis, and careful drafting, of the terms of any JOA are required by parties who want to be sure they can achieve (or ensure they can avoid) approval rights and pre-emption rights in an oil and gas transaction which is structured as a share sale.

PSCs themselves will also contain restrictions on future M&A activity (as will any bank facility agreements signed for the purpose of developing the asset). As ever, the terms of African PSCs remain subject to only limited negotiation. However, there is no doubt that West African governments have not been quick to update their PSCs to address the variety of M&A structures that are likely to be used. Indeed it remains relatively rare to find African PSCs that expressly and adequately deal with future share sales as opposed to assignments. In addition, even where such PSCs do address the possibility of share sales, there is rarely express distinction between (i) a sale of the company that directly holds the asset, and (ii) a merger transaction conducted at ultimate parent company level, and such omission can be an unintended 'poison pill' to parent company corporate activity. In any event, clarity is often to be favoured over ambiguity, even if it means making clear that approval is required for a share sale. Oil companies should at least consider addressing with governments, head-on at the time of PSC award, the scope of the transfer restrictions and the procedures to

be followed for share sales and asset assignments.

Brief mention should be made of the sale and purchase agreements that need to be drafted and negotiated for African M&A transactions in the energy sector. In common with the documentation for any M&A deal, the parties should expect to expend significant time and energy on the negotiation of representations and warranties relating to the target company or asset. However, in the African energy context, sellers may be faced with, and buyers may demand, a number of additional measures that would be rare in the UK or the US. For example, buyers may seek more extensive rights to terminate SPAs for African energy deals, so they can walk away in the event of political changes or other adverse events in the region occurring before the deal closes. Even where buyers themselves are comfortable with the level of political risk, such conditions precedent may be necessary to reflect any conditions to drawdown imposed by lenders in the buyer's financing arrangements, at least if a buyer is to avoid inserting an overall financing condition in the SPA.

Similarly, attention may need to be devoted in the SPA to addressing, for example, any governmental reopening of past PSC cost-recovery amounts, and to allocating the risks associated with tax regimes that are not yet fully tested and even the perceived risk of possible post-signature PSC renegotiation by host African governments.

## Regional variations

The regulatory hurdles faced by the parties to energy M&A deals are not uniform across the West African region. For example, in Equatorial Guinea, typical PSC and local law provisions require government approval both for an asset assignment and for a change of control by way of share sale. However, in Angola it is common to find restrictions on a direct change of control (such as a sale of the company that signs the Angolan PSA), with indirect (or parent company) share sales left unregulated. By contrast Nigeria tends not to regulate the sale of shares at any level, leaving maximum flexibility to PSC contractors in their transaction structuring. Most jurisdictions will expressly restrict asset assignments, although affiliate transfers are commonly permitted. Typically no mention is then made of the consequences of a sale of the shares in that affiliate company, so a restructuring and sale by way of

affiliate hive-down is often, in theory, a possibility.

As usual, however, caution dictates that in order to avoid practical and political problems post-acquisition, the NOC should generally be afforded the rights that the NOC believes or intends it should have, regardless of the letter of the PSC.

There are other variations between African countries, not just in the necessary regulatory approvals but also in the tax considerations applicable to M&A transactions. In some jurisdictions the amount of tax payable on sale can be less than clear. This can be the case in relation to the taxes on capital gains as well as in relation to local stamp duties and transfer taxes. In Nigeria, for example, there is arguably a liability to stamp duty on an asset assignment (although in practice the tax is rarely paid), whereas it is unambiguous that no stamp duty arises on a sale of Nigerian shares.

In summary, there remain many obstacles and uncertainties associated with M&A transactions in the African energy markets. However, given growing transaction volumes, many of these ambiguities and uncertainties are starting to be resolved. Over time, transaction costs and timescales should start to reduce and documentation quality should improve. This should serve further to increase confidence in the region and to accelerate the evolution of one of the most exciting markets in the energy world.

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